REPORT OF THE PERSONAL REPRESENTATIVE OF THE SECRETARY-GENERAL OF THE UNITED NATIONS ON DEBT

The Honourable Bettino CRAXI

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The text set forth in this document was submitted by the Honourable Bettino Craxi, in his capacity as Personal Representative of the Secretary-General on Debt, to the Secretary-General, and is not an official document of the United Nations. The views contained herein were presented, in a shorter version, by the Secretary-General to the General Assembly in document A/45/380 of 8 October 1990.

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Part One

THE GREAT CHALLENGE

I. DEBT, RICH COUNTRIES AND POOR COUNTRIES

A. Why the debt problem concerns us all

1. It is often said that the debt problem of developing countries is by now their problem alone and no longer an economic problem involving the industrialized countries, since the crisis of the international banking system - thanks to the considerable provisions made for these debts - is no longer a real threat.

2. However, even if this were true (but, as can be seen later, it is not), the statement made above is quite erroneous, both as far as the interests of the industrialized countries are concerned and from the point of view of the equilibrium in international finance.

3. As was remarked by Mr. Mario Cuomo, Governor of New York State, for the United States of America, as for the industrialized countries in general, the third-world debt problem is a problem of international security. Drug-trafficking, migration from countries with a heavy debt burden that constrains their growth, the environmental challenge, trade imbalances, together with the adjustment problems they create, and political instability are exacerbated by pervasive debt paralysis.

4. The issue of uncontrollable poverty-induced emigration from Latin America and the Caribbean to Texas, California and the south-western region of the United States is clear to all: this migration is often an act of despair, and not of choice. 1/

5. A similar problem arises for the European countries vis-à-vis the African continent. The only alternative to such migration is development, but this is possible only if the debt problem is alleviated and new means are provided to sustain growth in developing countries and to reduce the North-South imbalances.

6. Even the drug problem is closely linked to the solution of the debt problem in the least developed countries: in heavily indebted countries such as Colombia and Bolivia, drug cultivation and trafficking are a sort of antidote to underdevelopment, which is difficult to eradicate given the increasing economic frustration these countries are facing. This situation can and must be combated, replacing undesirable forms of economic activity by more acceptable ones.

7. Statements made at meetings with the President and the Government of Egypt would suggest that in some African countries (and also in Latin America and Asia) a number of people are now illegally beginning to cultivate drugs, allegedly to cope with the economic difficulties that are in many cases connected with the unsolved problems of the debt burden. Furthermore, extremist religious beliefs are ostensibly spreading as a remedy to affliction and poverty. Their advocates claim that present society needs to be drastically replaced by a new one, based on fundamentalism. Such beliefs are rapidly spreading in Pakistan, Jordan and Egypt, as well as in other indebted countries.

8. At the same time, certain geographical areas, which are "natural" markets for the industrialized countries, such as the Mediterranean, Latin America, Asia and the Middle East, are unco-ordinated with the developed countries of the same region.

9. Some Latin American countries have changed from dictatorship to democracy, from the repression of civil and human rights to the respect for them. Africa, too, has started along the road from dictatorship and civil war among ethnic groups and States to democratic institutions, but the way is harder. Yet, it can be made easier with the understanding of the industrial countries in the framework of regional policies that are urgently needed, as in north-eastern Africa.

10. Democracy, respect for human rights and peace are indeed an indispensable heritage of mankind, but the path towards them is made more difficult by onerous external debt. New Governments are often faced with the burden of debt accumulated by previous corrupt, demagogic and military regimes. It is in the interest of all to promote the strengthening of Governments working for the expansion of democratic institutions, as well as for peace and progress, through debt relief.

11. The advent of democracy in Eastern European countries adds a new significance to this argument: for some of these countries, the weight of the external debt is as burdensome as for the developing countries. A precondition for strengthening democracy is the inflow, not the outflow, of financial resources in the delicate period of economic and political transition. It has been pointed out that these countries were excluded from the Marshall Plan. However, the era of the Marshall Plan is long over. Other institutions are now working for international co-operation - which must be guaranteed - and they are also tackling the obstacles raised by the external debt burden.

12. The issue of the environment is likewise tightly linked with the debt burden problem. In fact, the feverish quest for land to deforest, turn into pasture or use for growing poor-quality crops; the abuse of land in Latin America, Asia and Africa caused by urban sprawl; desertification due to the shortage of irrigated land and to the lack of any substitute for fuelwood: all these are the result of the low growth rate and the decrease in per capita income. The population is therefore exerting heavy pressure on natural resources; such pressure can be neither controlled nor confined unless the means are provided to develop the economy. Indeed, the very ecological problems connected with development can be solved only if the community has the financial means to bear the related cost. This is hardly possible when external public debt servicing drains away a considerable part of national income and too big a share of the scant fiscal resources available.

13. Finally, the debt burden is an obstacle to equilibrium in world trade. Too much emphasis has been laid on the fact that market outlets of developing countries account for a small part of trade in developing countries - which are oppressed by the external debt burden - and that, therefore, the contraction of their imports entails no significant loss for the industrialized countries. The attention paid to percentages of the aggregate grand total has detracted from the importance of some absolute figures.

14. In 1981, United States exports to Latin America registered a $2 billion surplus: Latin American imports from the United States amounted to $43 billion and exports to $41 billion. In 1988, the United States deficit vis-à-vis Latin America totalled $10 billion, while its exports did not reach their 1981 level. The forced

export flow from Latin America to the United States, necessitated by the need to find resources to pay for the debt, gave rise to serious distortions in some markets. Asian countries, too, had to force themselves to produce exports to pay their debt service, which fortunately they succeeded in reducing, but at the cost of disrupting North American and European markets and contributing considerably to the trade deficit. Hence, protectionist pressures have emerged, which have adversely affected the atmosphere of the difficult negotiations on the liberalization of world trade. Their slow progress is mostly due to the difficulties brought about in both debtor and creditor countries by the financial disruptions caused by debt servicing. Debtor countries are generally reluctant to eliminate or reduce quantitative restrictions and the other obstacles to imports that were introduced to tackle balance-of-payments problems, in that they need hard currency to pay interest and debt amortization. Within creditor countries calls are often heard again for the defence of "mature" sectors, since imports from countries with a debt burden are specially priced.

15. Finally, a common concern should be the delicate situation faced by the large multinational financial institutions - the World Bank and the International Monetary Fund (IMF) - as a result of the debt crisis in the developing countries and Eastern Europe. In fact, this problem affects the industrialized countries in particular since they are the most important shareholders and subscribers to international institutions and need to resort to them to avoid world-wide monetary and financial disorder.

16. World Bank funding comes from the securities it issues on the market, and whose amount is a multiple of its capital. It is subscribed by those countries that have World Bank shares, in proportion to those shares. The most important subscriber is the United States, followed by Japan, the United Kingdom of Great Britain and Northern Ireland, Germany, France and Italy. For the United States federal budget, however, World Bank subscription shares are not public expenditure and are not part of the federal deficit. They are not a budget item, in that they are considered money on call. An increasing part of World Bank loans is now lent to countries in debt. The loans are not allocated to investments, but are used instead by such countries to pay for their debt service, in the form of structural adjustment loans (SALs). At present, SALs account for 25 per cent of annual loans and for 10 per cent of the overall portfolio of World Bank loans. An increasing part of them is allocated to countries facing a difficult situation. While up to 1985 failure to pay the World Bank was an anathema, at present nine developing countries are one year or more in arrears vis-à-vis the World Bank. For this reason, the Bank is making special provision, as commercial banks have done. Of course, its liquidity has consequently decreased.

17. The Brady Plan is worsening the World Bank's situation, in that it is compelled along with the Fund to lend "new money" to the countries it is interested in, while the private sector is not following suit. As a consequence, liabilities are increasing, passing from the banking sector to the World Bank, without a global effort capable of reducing them.

18. The World Bank must therefore face the concern of the United States Congress that the sum of $30 billion, recently allocated to the World Bank, is not a deposit

in the form of demand money, but rather a hazardous investment, which should be recorded in the budget.

19. As a result, it is more difficult for the World Bank to raise its own capital according to the rules currently in force, and hence it must acquire funds from the contributions made by certain countries.

20. New loans to indebted countries can be a vicious circle, and the way out can be difficult to find. If the World Bank issues new loans, its global risks increase, but if it does not issue them the situation of its debtors worsens. Thus it is not fulfilling its role, and the risk that its outstanding debts will not be repaid increases.

21. To summarize, the policy towards the debt problem adopted up to now has been inadequate, and therefore the World Bank has entered a tunnel with no end in sight.

22. As far as IMF is concerned, most of its traditional functions with industrialized countries have become less important, as the latter are less in need of its funds to carry out their own adjustment programmes.

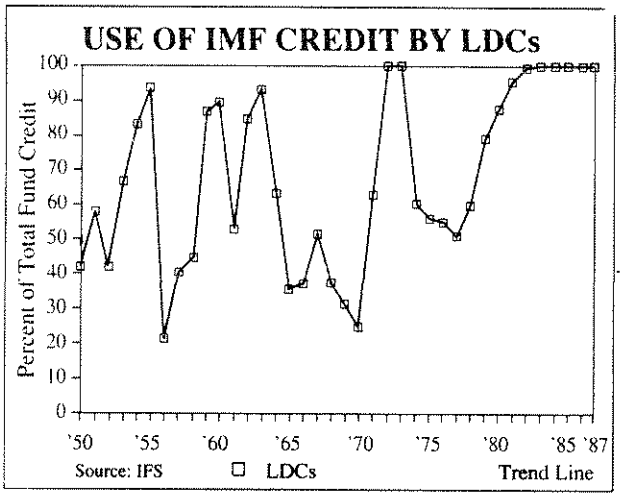
23. Figure I.1 shows that the share of IMF funds allocated to developing countries, to countries in the southern part of the globe and to Eastern Europe is now 100 per cent. Considering the debt magnitude in those countries, there are greater risks and few hopes that debts will be repaid. The Fund used to impose strict lending terms, which have often been criticized, and sometimes rightly so, aimed at safeguarding creditors. Now, it is claimed that the Fund is no longer in a position to do so, because its loans - like those of the World Bank - may often be required to bridge the inability to pay the loans previously incurred, i.e. as a form of rescheduling. This argument may be exaggerated, but it indicates how, once again, the failure to solve the debt problem affects creditors and therefore the community of industrialized countries as a whole.

24. In sub-Saharan Africa, IMF is in a "no-win" situation. Most of the countries are burdened by so large a debt that they can hardly survive, or risk collapse (in Somalia and the Sudan the collapse has already taken place). They cannot pay, nor can they meet the recovery requirements. Therefore, the Fund cannot complete their adjustment programmes. These countries are excluded from international financing mechanisms such as export credit insurance by different industrialized countries, private external debt, etc. and their situation is getting worse. 2/

25. The recent increase in the IMF quotas was justified by the Group of Seven as a means to make new funds available for developing countries and for the alleviation of their debt. Such initiatives should be followed by others but it most be borne in mind that the role of IMF in the debt crisis of the South and of the Eastern European countries will become very delicate in the absence of concessional lending, such as a special issue of special drawing rights (SDRs) to be credited to industrial countries - on account of the debts owed to them - in a fund for the strengthening of debt alleviation policies.

Figure I.1

Use of IMF credit by the developing countries



Source: Feinberg, R. E. and C. Gwin, "The IMF: dead in the water?". International Economy, September-October 1989, p. 50.

26. Lenders of last resort can play their role only if they have monetary power of last resort, namely greater seignorage.

27. Among all these interdependent factors relating to the debt of developing countries one fact clearly emerges: it is absolutely not a matter that concerns debtor countries only, their public and private financial institutions. It is an issue that concerns us all and that seriously threatens industrialized countries and multilateral institutions owing to a lack of will to bring about financial innovations and common action at a time when the "dividends of peace" can bear the best fruits.

B. The imbalance between the world's rich and poor

28. Within the framework of the problem of the developing countries' debt, four groups of countries can be identified, for which the external debt problem is particularly sensitive: middle-income, highly indebted countries; poor highly indebted countries and poor, moderately indebted countries; middle-low income countries with debt-related problems; and middle-income countries with considerable debt-related problems.

29. Obviously poverty, generally speaking, has not been caused by the external debt burden; it existed before and derives from several causes that are beyond the terms of reference of the present report. On the other hand, it is true that debt burden and the adjustment policies carried out in the framework of and as a condition for debt reduction have often aggravated poverty conditions, even in the so-called middle-income countries. It seems that as a consequence of the debt situation and of the adjustment efforts of the indebted countries the poverty area has increased by 10 per cent in Mexico and Guatemala and by 20 per cent in Argentina. 3/ It is therefore very important to include the issue of poverty in the strategy for reducing the debt burden and in the related strategy for providing resources to foster the growth of developing countries.

30. The problem is not merely one of relations between creditors and debtors, but rather of confrontation between "lucky" and "unlucky" human beings. On the one hand, there are 800 million "lucky" people, while on the other hand there are 4 billion "unlucky" people, nearly 1 billion of whom are oppressed by the debt problem.

31. Table I.1 shows that almost 73 per cent of world revenue is produced and enjoyed by 15 per cent of the population: fewer than 800 million people, out of about 5 billion human beings. Third world countries, whose population accounts for 76 per cent of the world's population, have only 16 per cent of world revenue. Among third world countries, poor countries, with more than half the world's population, have only 4.6 per cent of world revenue. Their debt burden, although not high compared to the third world's global debt, is impressive and unbearable, owing to their dramatic distribution imbalance, implying a state of misery and often hunger and starvation.

Table I.1 Population and gross world product
(1988 estimates)

	Populations (millions)	%	Gross product (billions $US)	%	Gross product per capita (US dollars)	Gross product per capita Poor countries = 100
Developed market economy countries a/	785	15.4	13 868	72.7	17 666	54.54
United States	286	5.61	4 847	25.4	19 703	64.17
Japan	123	2.41	2 844	14.9	23 146	75.39
EEC countries	325	6.37	4 628	24.2	14 240	46.38
Germany, Federal Republic of	61	1.20	1 202	6.3	19 705	64.18
France	56	1.11	949	5.0	16 946	55.19
Italy	57	1.12	829	4.3	14 543	47.37
United Kingdom	56	1.11	702	3.7	12 535	40.83
Others	91	1.78	1 549	8.1	17 022	55.44
Soviet Union and centrally planned Eastern European countries b/	426	8.4	2 128	13.0	4 995	16.27
Third-world countries c/	3 890	76.2	3 088	18.6	793	2.53
among which: poor countries d/	2 884	56.5	886	4.6	307	1.00
World	5 101	100.0	19 084	100.0	3 741	12.18

Source: World Bank. Poverty, World Development Report 1990, Oxford University Press. USSR and other data have been updated to 1988, by adding 1986 estimates to GDP for the area, as registered by the United Nations Economic Commission for Europe between 1986 and 1988.

a/ Including Canada, Australia, New Zealand, Austria, Finland, Norway, Sweden and other European countries beside the United States, Japan and EEC.

b/ Albania, Bulgaria, Czechoslovakia, Yugoslavia, Poland, German Democratic Republic, Hungary.

c/ All Asian, African, American and Oceania countries not included in the above groupings. Thus, some high-income countries and some oil-exporting countries are not included.

d/ Countries with per capita income lower than $US 400 in 1984.

Table I.2 Life expectancy and other health indicators

Countries	Life expectancy at birth F 1965	F 1987	M 1965	M 1987	Under-weight new-born babies % 1985	%	Calories per day 1965	1984	Population per physician 1965	1984	Maternal mortality a/ 1980	Infant mortality b/ 1965	1987
Developing countries	52	63	49	61			2 116	2 509	8 300	4 630		118	71
Low-income countries	49	62	47	60	25 c/	30 d/	1 993	2 384	9 790	5 410	1 500 d/ 500 c/	124	76
Middle-low income countries	55	66	53	61	7 e/	13 f/	2 394	2 777	5 370	3 330	1 000 e/ 303 f/	108	61
Middle-income countries	59	67	55	62	8 g/	9 h/	2 463	2 855	4 030	2 390	150 g/ 65 h/	99	56
Industrialized countries	74	79	67	73	5 i/	6 j/	3 083	3 375	940	470	15 i/ 4 j/	26	10
United States	74	79	67	72	7		3 224	3 645	670	470	9	25	10
Switzerland	75	80	69	74	5		3 412	3 437	710	700	5	18	7

Source: World Bank, World Development Report, World Economic Indicators, 1989.

a/ Per 100,000 live births.

b/ Per 1,000.

c/ Nigeria.

d/ India.

e/ Tunisia.

f/ Cameroon.

g/ Brazil.

h/ Venezuela.

i/ Japan.

j/ Denmark.

Table I.3 The main economic indicators of developing and developed countries
(Part A)

Countries	GDP per capita		Average annual growth rate / GDP (percentage)		Population	
	(US dollars) 1988	Average annual growth rate (%) 1965-1988	1965-1980	1980-1988	(Millions) Mid-1988	Growth rate 1980-1990
Developing countries	750	2.7	5.8	4.3	3 952.0	2.1
Low-income countries	320	3.1	5.4	6.4	2 884.0	2.0
Middle-low income countries	1 380	2.6	6.5	2.6	741.7	
Middle-income countries	1 930	2.3	6.1	2.9	1 068.0	2.1
Industrialized countries	17 080	2.3	3.7	2.8	784.2	0.7
United States	19 840	1.6	2.7	3.3	246.3	0.6
Switzerland	27 500	1.5	2.0	1.9	6.6	0.6

Source: World Bank, World Development Report, World Economic Indicators, 1990.

Main economic indicators of developing and developed countries
(Part B)

Countries	Growth rate per capita GDP				Average annual rate of inflation		Distribution of GDP						GDP (billions $)
							1965			1988			
	1980-86	87	88	89	1965-1980	1980-1988	AGR.	IND.	SER.	AGR.	IND.	SER.	1988
Developing countries	1.5	2.7	3.4	1.2	16.5	46.8	31	31	38	18	39	44	3 061
Low-income countries	4.0	3.9	6.8	1.8	8.8	8.9	44	28	28	33	36	32	887
Middle-low income countries	...	...	2.6 (65-88)		21.7	80.8	22	28	50	14	38	50	1 062
Middle-income countries	0.1	1.8	1.1	0.8	20.4	66.7	20	33	46	12	40	50	2 201
Industrialized countries	1.7	2.5	3.5	3.1	7.9	4.9	5	41	55	-	-	-	13 868
United States	...	...	1.6 (65-88)		6.5	4.0	3	59	59	2	33	65	4 847
Switzerland	...	...	1.4 (65-88)		5.3	3.8	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	185

Source: World Bank, World Development Report, World Development Indicators, 1990.

Main economic indicators of developing and developed countries
(Part C)

Countries	Household consumption as % of GDP		Household consumption percentages (1980-1985)						
	1965	1988	Food	Clothing	Rents	Energy	Medical	Education	Transport	Other
Developing countries	68	61								
Low-income countries	70	65	52 a/ 52 b/	7 a/ 11 b/	18 a/ 7 b/	2 a/ 3 b/	3 a/ 3 b/	4 a/ 4 b/	4 a/ 7 b/	20 a/ 13 b/
Middle-low income countries	71	68	37 c/ 24 d/	10 c/ 7 d/	9 c/ 14 d/	4 c/ 3 d/	6 c/ 11 d/	9 c/ 9 d/	7 c/ 12 d/	18 c/ 21 d/
Middle-income countries	67	62	35 e/ 38 f/	10 e/ 4 f/			6 e/ 8 f/	5 e/ 7 f/g/	8 e/ 10 f/	27 e/ 25 f/
Industrialized countries	63	61								
United States	63	66	13	6	14	4	14	8	14	27
Switzerland	60	59	17	4	9	6	15		9	38

Source: World Bank, World Development Report, World Economic Indicators, 1989.

a/ Nigeria.

b/ India.

c/ Tunisia.

d/ Cameroon.

e/ Brazil.

f/ Venezuela.

g/ Government consumption only.

Table I.4 Gross income allocation
(In percentages)

Countries	General government consumption		Private consumption		Gross domestic investments		Gross domestic savings	
	1965	1988	1965	1980	1965	1980	1965	1980
Developing countries a/	11	13	68	61	20	26	20	27
Low-income countries	11	12	70	74	19	18	12	14
Middle-low income countries	10	12	71	64	19	23	18	24
Middle-income countries	11	15	67	59	21	25	21	27
Industrialized countries	17	17	63	61	20	22	21	22
United States	19	20	63	67	17	15	18	13
Switzerland	11	12	60	58	30	31	30	31

Source: World Bank, World Development Report, World Economic Indicators, 1990.

a/ Excluding China and India.

Table I.5 Central government expenditure and current revenue
(As a percentage of GNP)

Countries	Total current revenue		Total expenditure		Overall surplus / deficit	
	1972	1988	1972	1988	1972	1988
Developing countries	13.5	16.5	15.9	20.9	n.a.	-4.7
Low-income countries	n.a.	15.4 a/	n.a.	20.8 a/	n.a.	5.2 a/
Middle-low income countries	11.9	11.7	14.9	15.4	-3.4	-3.7
Middle-income countries	16.0	15.7	18.5	19.9	-2.8	-3.9
Industrialized countries	22.0	25.5	22.7	28.9	-1.9	-3.3
United States	17.6	19.7	19.1	22.9	-1.5	-3.2
Switzerland	14.5	n.a.	13.3	n.a.	0.9	n.a.

Source: World Bank, World Development Report, World Economic Indicators, 1990.

a/ 1986 figures.

Table I.6 Education
(Percentage of age group enrolled in education)

Countries	Primary education				Secondary education				Education	
	Female		Total		Female		Total		Total	
	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
Developing countries	62	96	78	104	14	35	22	41	3	8
Low-income countries	n.a.	95	73	104	n.a.	29	20	37	2	n.a.
Middle-low income countries	86	101	92	104	20	50	23	49	6	16
Middle-income countries	86	101	93	104	22	54	26	54	6	17
Industrialized countries	105	103	104	102	59	96	62	93	21	39
United States	n.a.	100	100	100	n.a.	99	n.a.	98	40	60
Switzerland	87	n.a.	87	n.a.	37	n.a.	35	n.a.	8	24

Source: World Bank, World Development Report, World Development Indicators, 1990.

Table I.7 Urbanization

Countries	Urban population as a percentage of total population		Percentage of urban population in cities of over 500,000 persons		Number of cities of over 500,000 persons	
	1965	1988	1960	1980	1960	1980
Developing countries	24	41	31	44	110	278
Low-income countries	17	35	30	43	59	165
Middle-low income countries	40	56	32	47	31	70
Middle-income countries	42	58	34	47	51	113
Industrialized countries	71	78	47	55	107	157
United States	72	74	61	77	40	65
Switzerland	53	61	19	22	1	1

Source: World Bank, World Development Report, World Development Indicators, 1990.

32. In 1986, while the net per capita income of poor countries of the third world amounted to $320, the related figure in developed market economy countries was $17,000, that is, more than 50 times as much.

33. The gap increases if one compares the richest group among the industrialized countries and the poorest group among poor countries. In 1988, an Ethiopian had an average income of $120, people in Bhutan or Zaire had about $170, while a Swiss person had over $27,500, i.e. more than 200 times the Ethiopian's purchasing power. In 1988, a United States citizen had an average disposable income of $19,840, in other words 100 times more than somebody in Bangladesh and in sub-Saharan African countries, highly indebted with the banking system of the industrialized countries and also with bilateral and multilateral bodies.

34. In the 42 poorest countries in the world, i.e. those with less than $450 per capita income (excluding China and India), the average per capita income amounts to $280.

35. Life expectancy at birth in the 42 countries with a $280 average per capita income is only 54 years, decreases to 47 in Ethiopia and many other sub-Saharan African countries and drops to 41 to 42 years in Sierra Leone and Guinea. In rich Western countries life expectancy is 77 years. While in Switzerland only 5 new born babies out of 100 are under weight and in the United States only 1 out of 7, in Nigeria 1 baby out of 4 and in India 1 out of 3 are under weight.

36. While in poor countries in Africa, Asia and South America the average daily per capita calorie allowance is now 2,385 (in 1965 it was less than 2,000), in the industrialized countries it is 3,375 calories and in the United States reaches even 3,645 calories. People in Switzerland, more attentive to weight and health, have succeeded in stabilizing their daily caloric intake at an average of 3,440.

37. The maternal mortality rate per 100,000 inhabitants is 9 in the United States, 1,500 in Nigeria and 500 in India.

38. The infant mortality rate is 76 per 1,000 in low-income countries, 10 per 1,000 in the industrialized countries and 7 per 1,000 - i.e. one tenth - in Switzerland.

39. In low-income developing countries there is only 1 physician per 5,400 inhabitants, while in the industrialized countries there is 1 per 470 inhabitants.

40. Most of the poor live from subsistence agriculture. Their existence, though short and marked from the outset by undernourishment and physical handicaps, could at least benefit from a natural environment which, although very limited, need not be affected by the environmental pollution typical of towns in rich countries. In fact, this is not the case. Frequently, agricultural life is endured in areas of soil erosion and desert. Thirty per cent of the inhabitants of low-income developing countries and over 50 per cent of the inhabitants of middle-low income developing countries live in shanty towns, with no sanitation and often without electricity and water supplies. In middle-income countries, the urban population

accounts for 57 per cent, 50 per cent of whom are crowded in towns with over 500,000 inhabitants. This is an undernourished throng made up of badly housed and badly clothed unemployed and underemployed people striving to survive in urban areas.

41. The so-called developing countries, because of their low level of economic development, are dwarfed by the giants of world trade, i.e. the industrialized countries and their multinationals.

42. In 1987, world exports totalled $2,390 billion and imports $2,478 billion. 4/ In sub-Saharan African countries, with 400 million inhabitants, exports totalled only $28 billion and imports $32 billion, while in high-income countries with 777 million inhabitants exports amounted to $1,924 billion and imports to $2,007 billion. Foreign trade in sub-Saharan African countries accounts therefore for 1.5 per cent of the industrialized countries' foreign trade. Assuming that in 1980 the terms of trade were equal to 100, no wonder that, in 1987 after the world-wide restrictive monetary policy, they were equal to 84 per cent in sub-Saharan Africa and to 97 per cent in the industrialized countries.

43. In 1987, in Latin American and the Caribbean countries - a group of middle-income countries with a population of 400 million inhabitants - exports totalled $90 billion and imports $75 billion. Their global foreign trade accounted for about 4 per cent of the industrialized countries' foreign trade. The terms of trade even in this region stood at 76 per cent of the 1980 level: the region contributed $15 billion to the rich countries' surplus. For the latter countries, this is a low figure, whereas it is huge for Latin American and Caribbean States, whose overall gross investment in 1980 totalled $131 billion.

44. In 1987, exports from the group of highly indebted countries - with a $400 billion debt burden - amounted to $113 billion, and imports to $95 billion: the net transfer was equal to $18 billion, out of $178 billion worth of investments.

45. Their terms of trade decreased to 84 per cent as compared to those registered in 1980. In any case, their foreign trade accounted for only 5 per cent of the $3,932 billion imports and exports of the industrialized countries. Their population, totalling 580 million inhabitants, was 75 per cent of the population of industrialized countries.

46. In the light of these basic data, it cannot be denied that foreign trade, and thus the economies of developing countries - the poorest countries in Africa and Latin America in particular - depend on the industrialized countries. The dependence of highly indebted countries - belonging for the most part to these two areas - is equally evident.

47. The nature of such dependence emerges clearly from their imports and exports.

48. In sub-Saharan Africa, in 1987 exports of mineral fuels and metals accounted for 48 per cent of global exports in value terms; primary agricultural commodities accounted for 40 per cent. Thus, almost 90 per cent of exports consisted of basic raw materials. In the Latin American and Caribbean countries, with a reasonable

level of industrialization, exports of mineral fuels and metals account for 39 per cent, while exports of primary agricultural foodstuffs account for 28 per cent. Textiles and garments account for only 3 per cent, largely owing to protectionist measures. Export percentages of highly indebted countries show little variation.

49. The situation is altogether different in the case of imports. In sub-Saharan African countries, manufactures account for 74 per cent of imports and fuels account for 11 per cent, while food accounts for 12 per cent, since these countries have not attained self-sufficiency in food.

50. Imports in Latin American and the Caribbean countries show little variation: manufactures account for 73 per cent, fuels for 10 per cent and food for another 10 per cent.

51. As far as highly indebted countries are concerned, import percentages are similar to the above data.

52. The gap between global export data and global import data in rich countries is mostly the result of the following paradox: resources are transferred from poor countries to rich countries, and not vice versa.

53. Yet another important reason for such a gap is that, as a whole, world exports from rich countries and from developing countries - as well as from other countries not belonging to these two categories - are considerably lower than imports.

54. Besides complex, detailed technical explanations, 5/ two main reasons for this phenomenon should be mentioned: tax evasion and avoidance and unrecorded capital flight. Both frequently lead to underestimated exports and overestimated imports, thanks to the complicity of "tax havens" and of micro-States that do not even appear in the international trade figures. This phenomenon involves both the wealthy in developing countries and operators of multinational companies who are agents of legal and illegal world finance. It certainly has negative repercussions on both the balance of payments of indebted developing countries and on the availability of capital resources.

55. The huge income gap between the economies of the industrialized countries and the economies of underdeveloped countries is such that the decisions (or non-decisions) implemented in the former affect the latter, which are unable to exert any significant influence.

56. From the viewpoint of the developing countries' debt problem, an extremely important role is played by the real interest rate, which is determined within the industrialized countries and changed significantly in the 1980s as compared to previous decades. In the decades following World War II, the long-term real interest rate of the seven major industrialized countries had never exceeded 4 per cent and had often approached zero, or had even been negative. In the first half of the 1980s, real interest rates exceeded 5 per cent and, in the United States and the United Kingdom, even rocketed to over 10 per cent. This was due to the restrictive monetary policies adopted by the main industrialized countries in

order to compensate for the shortcomings of their previous policies. For some of them, it was also the result of a deliberate choice to deflate, which was aimed at halting, through unemployment, the upward trend in wages brought about by full employment or by the widespread use of wage indexation. Incomes policy was used as in Sweden and - over a certain period - in Italy to avoid resorting to unemployment to implement changes aimed at keeping at bay wage distortions in the industrialized countries. Yet, either on the basis of a deliberate decision or by lack of any decision, the monetary policy option prevailed.

57. According to the Organisation for Economic Co-operation and Development (OECD) 6/ the evolution of long-term real interest rates (as measured by the difference betwen long-range nominal interest and mean annual inflation for two consecutive years) seems to have gone through three distinct stages since the early 1960s: low but positive rates during the 1960s; low but generally negative rates during the 1970s, accompanied by high volatility for most countries; and high (but generally less volatile) rates during the 1980s. Not only did the real rates rise to high levels in the early 1980s, but they did so from the negative values of the late 1970s.

58. From this standpoint the 1970s are a good example. United States real interest rates ran on average at around 9 per cent between mid-1981 and mid-1984, having risen by 16 percentage points between the third quarter of 1978 and the last quarter of 1981. From the mid-1980s, the real interest rates showed a tendency to decline somewhat from the very high levels reached during the early 1980s.

59. From early 1987 to the first half of 1989, the long-term interest rates were on average 4.25 per cent for the United States, 3.5 per cent for Japan and 4.25 per cent for the Federal Republic of Germany. The current rates in many countries are still higher than those recorded in the 1960s and are obviously well above the low or negative values recorded in the 1970s.

60. According to OECD, in the period following the first half of the 1980s, the high level of real interest rates was due to the continued presence of budget deficits in some important industrialized countries. OECD expressed the hope that the efforts made to reduce such deficits would be strengthened. It also assumed that among the causes leading to an increase in interest rates were the reduction in savings in industrialized countries (which is a fact) and the increase in the return on capital, which is due to improved productivity and encourages investment, even if money is tight (see figure I.2).

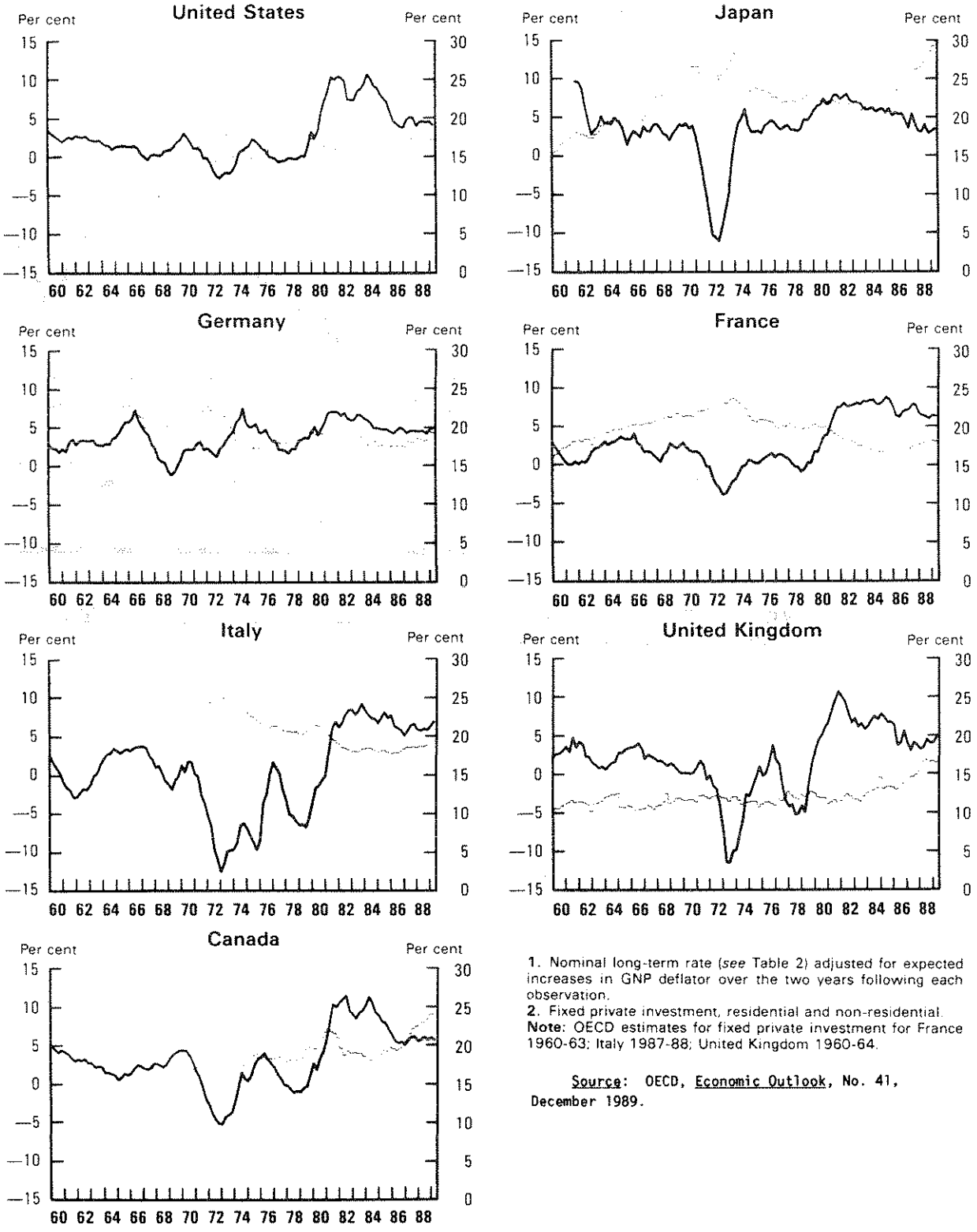
61. In any case, these events are taking place in industrialized countries and affect the scarce amount of capital, investments and production of developing countries, which can exert little influence.

62. The fact that on international markets indebted countries contracted variable-interest-rate loans from the banks, thus paying a 1 to 2 point differential as compared to the ordinary rate, bears witness to the above.

Figure I.2

REAL LONG-TERM INTEREST RATES AND PRIVATE INVESTMENT

Real long-term interest rate (1) *(left hand scale)*
Real investment as % of real GDP/GNP (2) *(right hand scale)*



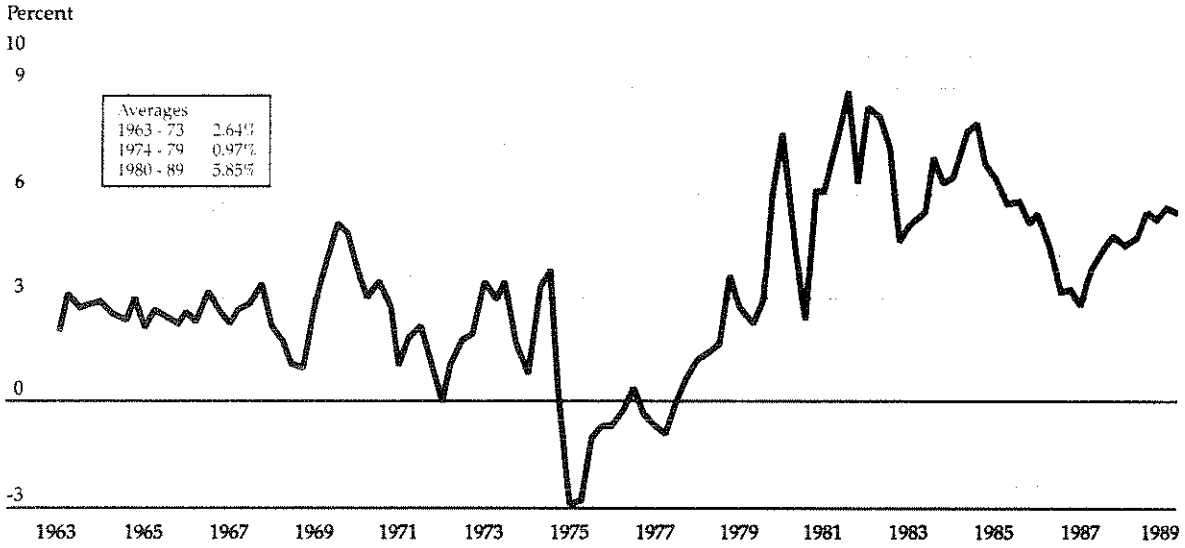
1. Nominal long-term rate (*see* Table 2) adjusted for expected increases in GNP deflator over the two years following each observation.
2. Fixed private investment, residential and non-residential.

Note: OECD estimates for fixed private investment for France 1960-63; Italy 1987-88; United Kingdom 1960-64.

Source: OECD, Economic Outlook, No. 41, December 1989.

Figure I.3

Real interest rates, 1963 to 1989



Note: The real interest rate is calculated as the London interbank offered rate (LIBOR) minus the U.S. GDP deflator.

Source: World Bank, Poverty, World Development Report 1990, World Development Indicators, 1990, p. 15.

63. From the difference between the 1980s world real interest rates and long-term interest rates, it can be seen that (even disregarding the abnormal, negative interest rates of the late 1970s) in the 1980s the real interest rate was about twice the long-term interest rate. Taking, then, the variable interest rates applied to least developed countries, it can be observed that their real interest rate was one third higher than the average market rate of the 1980s, hence possibly 60 per cent higher than the long-term interest rate. Expectations, however, could have been even more optimistic, in that most debts were incurred at a time when average real rates were equal to zero, or were negative.

64. An analysis of the indebtedness of developing countries produces a paradox. World Bank data show that the total debt figure of developing countries went from $752 billion in 1982 to $1,165 billion in 1989. Yet, starting from 1983 onward, loan reimbursements net of new loans exceeded $100 billion, with $600 billion for the former and $500 billion for the latter.

65. The flow of interest alone is around $460 billion. Owing to net reimbursements, the principal ought to have been cut by $100 billion, instead of rising by more than $400 billion due to burdensome debt restructuring. Arrears rose by another $100 billion.

66. Paradoxically, a 40 to 50 per cent reduction in bank debt interest to developing countries with a debt problem would mean changing their loans into long-term ordinary loans; 7/ in any case, they would be conceived as transactions whose return is comparable to the bulk of transactions carried out in the 1960s or, certainly, in the late 1970s.

Notes

1/ See M. Cuomo, "Has George Bush dropped the ball on debt?" The International Economy, October 1989.

2/ Feinberg, R. E. and C. Gwin, and contributors Jacques J. Polak et al., Pulling together; the International Monetary Fund in a multipolar world, Transaction Books, New Brunswick, N. J., 1989.

3/ See annex I, statement by Nora Lustig, Visiting Fellow, Brookings Institute, Washington, D.C.

4/ Theoretically the two totals should coincide, at least in the long run (thus allowing for different firming in accounting for the various items. A technical note in the IMF World Current Account examines the several factors of the discrepancy between current account trade and services balance. The suspicion that a large amount of the discrepancy may be explained by underassessment of exports and overassessment of imports to conceal capital outflows is not dispelled by the reading of this sophisticated technical note.

5/ See discussion in note 4.

Notes (continued)

6/ OECD, Economic Outlook, No. 41, December 1989, p. 14.

7/ A 9 per cent nominal interest rate minus a 1.5 per cent "plus" interest gives 7.5 per cent and, with a 2.5 per cent real long-term discount, 5 per cent. This entails a 45 per cent discount. Assuming a 10 per cent nominal interest rate, the above deductions lead to the figure of 6 per cent, implying a 40 per cent reduction.

II. ORIGINS AND FACTORS OF THE CRISIS

A. Causes of the enormous growth in debt: responsibilities and mistakes of industrialized countries

Responsibilities and mistakes in developing countries

67. The total debt figure of developing countries has now reached astonishing levels, with rapid growth between 1980 and 1990. IMF data show that the debt level in 1989 approached $1,200 billion, while according to the World Bank it stands at $1,165 billion and IMF projections for 1990 indicate $1,246 billion. The total amount was $600 billion in the early 1980s. Equally rapid was the rise in the level of debt servicing and principal payments: the figure went from about $90 billion in 1980 to more than $160 billion for the World Bank and to $175 billion for the IMF. When payments were not made, capitalizing arrears raised the total debt figure (see table II.1).

68. The causes of such enormous debt and of the related and abnormal transfer of resources are many and varied and with different implications from country to country. A frequently neglected but still fundamental element is the nature of the debt itself, that is, whether it is owed by Governments or by Government-backed enterprises, and thus not recorded in the Government's annual financial statement. This practice is questionable because part of such debts originated from the financing of investment projects for public bodies, which in theory are integrated in the national economy, but which in practice mainly produce public services free or almost free of charge. Such external debt has been used to finance balance-of-payments deficits, caused largely by public sector budget deficits.

69. In principle, it must be said that the problem of external debt confronting developing countries is mostly a problem of public debt and is related to the budget deficit of the overall public sector (i.e., including the financial results of public corporations). Public investments were not necessarily the reason for the deficit. The revenue from investments has in any case to be compared with the cost of the debt, which is not easy. This is because the agreed interest rate, in most cases, varied according to fluctuations in interest rates on international markets.

70. Contrary to domestic markets, the placement of public debt on the international market could and can still be done also by resorting to medium- and long-term bank loans. One of the main reasons for the abnormal growth of the external debt of developing countries has been the lack of international fiscal and monetary policy. No regulations have been established on the possibility of issuing international equities for the financing of public debts with bank loans or with the far more risky mechanism of funds given at an interest rate that varies according to fluctuations on the international market, in currencies with equally fluctuating exchange rates.

71. This became increasingly the general practice in the 1970s, essentially because banks operating on the Eurodollar and foreign exchange markets found themselves glutted with petrodollars, which they wanted to invest at any rate. 1/ The result was a hectic lending rush by the banks in industrialized countries, pushed to invest by their enormous liquidities, by the very good terms they could

Table II.1 Total debt and debt servicing, 1980-1990
(In billions of United States dollars)

	Total debt		Debt servicing	
	World Bank	IMF	World Bank	IMF
1980	572.1	n.a.	92.7	n.a.
1981	n.a.	731.5	n.a.	124.1
1982	752.9	826.6	117.6	135.8
1983	818.9	878.6	100.7	120.9
1984	854.8	918.3	119.1	136.1
1985	952.7	995.5	136.3	137.6
1986	1 046.7	1 086.7	141.1	144.8
1987	1 176.3	1 200.2	147.2	149.2
1988	1 155.9	1 197.2	160.3	170.2
1989	1 165.4 a/	1 193.7	163.0	175.8
1990	n.a.	1 246.3	n.a.	n.a.

Source: World Debt Tables 1989-90; External Debt of Developing Countries. World Bank, Washington, D.C., 1989 World Economic Outlook; a survey by the staff of IMF, Washington, D.C., 1989.

a/ Projected.

Table II.2 Gross domestic savings in sub-Saharan Africa
(As a percentage of GDP)

	1972	1981	1987
Gross domestic savings	17.8	15.3	12.6
Public savings a/	-3.3	-5.9	-7.2
Private savings b/	21.1	21.2	19.8

Source: World Bank, Sub-Saharan Africa: from crisis to sustainable growth, a long-term perspective study, Washington, D.C., 1989, table 8.1.

a/ Current account budget surplus or deficit.

b/ Residual.

get by granting loans at variable interest rates and by the absence of domestic supervisory bodies, which they regarded as last resort guarantors. In important industrial countries, bank managers do not operate with long-term policies since they are mainly concerned with presenting positive balance sheets in the short term, in order to be praised by the senior executives of the bank and by the shareholders, and then to gain a promotion to greater responsibilities. Future insolvencies or difficulties related to said loans will not undermine their reputation as they can always blame debtors on the one hand, together with Governments and international bodies on the other, for their reluctance to adopt effective measures.

72. A similar attitude can be found among those Governments running into debt and in search of immediate relief, enabling them to pass the problem on to those who will later replace them.

73. In Latin America and Africa, some of the high-debt countries in question are oil producers. The mid-1970s oil price rise led to a spate of international financial and insurance enterprises connected with such countries, with a creditors' attitude now to be qualified, in retrospect, as irrational, but then regarded by each of them as rational. Conversely for several other developing countries the oil price rise caused balance-of-payments and public finance difficulties, which led to external indebtedness.

74. For low-income countries in Africa and for some Latin American countries, an important cause of their external debt was the temporary rise in the price of exported raw materials (bauxite, cocoa, copper, groundnuts, uranium, tea, sugar) in the mid- and late-1970s. Those countries were deceived by the prospect of having permanently higher levels of foreign exchange and local earnings, which would have enabled them to borrow funds 2/ to build infrastructure and thus lay down the foundations of their State-backed industrialization. Raising the public debt level seemed feasible because of two converging trends: higher export earnings in order to improve the balance of payments and increased tax revenues derived from raw material exports then used to acquire foreign exchange from exporters. This, however, depended on the continuation of the favourable trend in the export prices of raw materials without increasing consumption at home and without having to increase the amount of imports in order to meet people's basic needs, and also on no rise in the modest level of public expenditure for education, health and public services as a result of increased earnings. When raw material prices dropped, the initial feeling was one of temporary setback. Governments borrowed abroad to maintain consumption and to be able to maintain imports. This made things worse, since such external borrowing did not lead to productive investment.

75. Many government debts originated from military spending and not productive investments, that is, they financed "unproductive" expenditure. However, this observation does not apply to all developing countries, for there are indeed cases in which the opposite is true. A considerable part of developing countries' military debts was caused by defensive actions carried out in the interest of the industrialized world and not only of those countries which, in order to foot such large and unavoidable bills for their independence and peace, were obliged to run into debt. The loans in question (often Government to Government) were generally

granted at an interest rate higher than the market one, and with strings attached in case of delayed payments. Therefore, debts to be honoured first are those with friendly Governments that stand to gain considerably from a defence alliance.

76. In this respect, the case of Egypt is particularly significant. Egypt performed the role of guardian of the oil routes to the industrialized world and played an important part in bringing stabilization and equilibrium back to the whole area, but it paid a high price. One fifth of the Egyptian debt, namely $10 billion (with a total gross domestic product (GDP) of $35 billion), is made up of military debts towards industrialized countries at an interest rate of 14 per cent. The debt figures do not however fully reflect the value of existing loans, as they are the result of the capitalization of arrears. That is how friendly help turned into a heavy burden. The Egyptian debt has now been largely forgiven in the context of the Gulf crisis.

77. Another factor to be mentioned is the utilization of a considerable part of the resources accumulated in periods of high oil and raw material prices for prestigious and typically unproductive purposes, such as monuments. But, monuments apart, public investments are often used for projects with very low profitability, which would not have happened, or at least not to the same extent, if they had been made not by a State with a bureaucratic and centralized economy, financed by State issues of debt, but were the result of financial operations carried out by private or public companies with budgetary and capital autonomy and accountability. The low productivity was partly due to inefficient economic systems, or highly centralized dirigiste models of nationalistic-totalitarian inspiration. Bureaucratic planning systems, through artificial ceilings and food subsidies, gave priority to the urban population and provided incentives for urbanization at the expense of rural dwellers and of private agriculture and frequently replaced the latter with misguided experiments of villagization and by assigning a leading role to co-operatives, which were in practice State companies.

78. A high level of public expenditure was and still is accompanied by low fiscal pressure because the public sector and even elements of the private sector that dominate the economy are strong enough to prevent the introduction of high taxes on estates and on the wide consumption of mainly imported goods; another reason is that collectivist economic planning and a system of restraints strongly reduce the total taxable incomes of industrialists and real estate owners, without generating a corresponding and generalized wealth increase for everyone, which would have led to an increased tax yield; and yet another explanation is that the superficial imitation of the tax systems of highly industrialized countries, compounded by corruption, produces tax evasion and fiscal inefficiency.

79. It is opportune to reiterate that large external debts have often mirrored high levels of public debt, caused by an imbalance between public expenditure and revenue. The comparison between gross private savings and national savings shows a dramatic picture in Africa.

80. It must be added that the population growth rate is extremely high, with figures showing an annual population increase of 2.7 per cent to 3.3 per cent. In Africa, the population growth rate problem, combined with the erosion of savings as

a result of public deficit, translates into dramatically poor results in terms of per capita income. There is no doubt that ad hoc policies involve delicate problems of a moral nature, but a State simply cannot erode savings and drain away almost all investment capital without reacting to the population growth rate problem, which can be dealt with to a large extent by education policies. It is an elementary issue of far sightedness and responsibility towards future generations and towards the environment which, under the growth rate pressure, is being increasingly and often irreparably debased.

81. If borrowing Governments made mistakes, more mistakes were made by lenders and guarantors.

82. In contrast to middle-income countries in Latin America and Asia, African countries' lenders and guarantors were not so much banks but Governments. To all the countries currently indebted, ample guarantees were given by public insurance bodies in lending countries, anxious as they were to get profitable orders and contracts for large- and medium-sized projects.

83. In the absence of international regulations governing monetary and fiscal policy, individual public or private operators simply lent funds without knowing the amounts already borrowed elsewhere or still under negotiation. Old debts could be paid with fresh loans as long as those countries could manage to find lenders on the basis of their natural resources, particularly oil. It was a kind of bubble similar to those in stock exchange booms around the world. At a certain point, big bubbles burst.

84. But, while strong financial buffers were set up to offset the consequences of the fall of the dollar in 1986 and of the 1988 stock exchange crash, the same did not occur with the excessive amount of loans granted to developing countries in the late 1970s; rather the opposite. No account was taken of the repercussions on these countries when, at the beginning of the 1980s, it was decided to adopt monetary policies to reduce global demand, together with policies of high interest rates that were required not only by such monetarist lines, but also by the policy of allowing a large budget deficit followed by the United States. The high United States budget deficit in the 1980s was matched by a current account deficit in the United States balance of payments which, given the constraints on money demand, implied a massive transfer of resources, pushed by higher and higher real interest rates.

85. In 1980-1983, long term nominal interest rates in the United States ranged between 13.9 per cent and 11 per cent (see table II.3), while real interest rates gradually rose over international levels in order to finance the enormous budget deficit with external borrowing.

86. After an increase in 1977 and 1978 of more than 3 per cent, real money supply in the industrialized countries went down by 0.4 per cent in 1979, and the fall continued in 1980 and 1981, leading to a cumulative squeeze of 5.5 per cent in three years (see table II.4).

Table II.3 United States interest rates: nominal and real, 1976-1983
(In percentages)

	1976	1977	1978	1979	1980	1981	1982	1983
Long-term								
Nominal	7.6	7.4	8.4	9.4	11.5	13.9	13.0	11.0
Real	2.3	1.5	0.9	0.7	2.1	4.2	6.6	6.7
Short-term								
Nominal	5.0	5.3	7.2	10.1	11.4	14.0	10.6	8.6
Real	-0.2	-0.5	-0.2	1.3	2.1	4.3	4.3	4.3

Source: Sub-Saharan Africa: from crisis to sustainable growth, a long-term perspective study, World Bank, Washington, D.C., 1989, table 8.1.

Table II.4 Percentages of money growth, inflation and interest rates in major industrial countries

	1976	1977	1978	1979	1980	1981	1982	1983
Nominal M1 growth a/	10.2	8.8	10.9	9.6	6.6	6.0	6.7	9.5
Real M1 growth	1.0	3.3	3.6	-0.4	-3.8	-1.2	3.0	3.7
Consumer prices	8.3	8.5	7.2	9.1	11.9	9.9	7.5	5.0
Real interest rates b/								
Short-term	0.0	-0.7	-0.2	1.4	2.4	4.3	4.0	4.3
Long-term	1.4	1.0	0.9	1.2	1.9	4.2	5.4	6.0

Source: Real money growth and interest rates: IMF, World Economic Outlook (1984), pp. 115 (table 1.7), pp. 120-121 (tables 2.2 and 2.6). Nominal M1 growth and consumer prices: IMF, International Financial Statistics. 1983 Yearbook, passim ("change in money" tables; "change in consumer prices" tables).

a/ M1 is the currency outside banks and private sector demand deposits.

b/ Excess nominal rate over GNP deflator. Elaboration by R.M. Kubarych, The Financial Vulnerability of LDCs: 'Six Factors' in W.N. Eskridge, A Dance Along the Precipice, The Political and Economic Dimension of the International Debt Problem, Lexington Books, Lexington Mass., 1984.

87. On account of this monetary policy, average rises in retail prices gradually fell to 5 per cent in 1983, while real interest rates - which in 1978 were negative for the short term and lower than 1 per cent for the medium and long term - slowly went up to 1.4 per cent and 1.2 per cent in 1979, 2.4 per cent and 1.9 per cent in 1980 and 4.3 per cent and 4.2 per cent in 1981, to reach 4.3 per cent and 6 per cent in 1983, with the second figure gradually overtaking the first. That was an indication of a steady trend towards high lending rates.

88. Unfortunately, bank loans to developing countries were granted at variable interest rates, denominated in dollars, yen and European currencies, with total anarchy in exchange rates.

89. The high London inter-bank offered rate (LIBOR) was usually applied to them, that is to say a variable rate equal to the interbank rate offered in London plus an additional 1 to 2 per cent, officially because those operations were not conducted between international banks, but between the international banking system and the financial systems of developing countries. This official explanation does not stand up, considering that the size of the loans in question made them similar to interbank loans. Furthermore, LIBOR is by its very nature more variable than the bank interest rate, because the interbank rate responds more promptly to changes in the money supply. In 1981 LIBOR reached 15 per cent, whereas the United States rate was 13.9 per cent. And those loans had a duration far shorter than that of normal bond certificates connected with investments.

90. Even when loans were directed at financing investment projects with good long-term profitability, the strong rise in real interest rates produced a gap between investment opportunities and the debt burden. Besides, investments undertaken were often profitable only in a long-term perspective, when economic growth takes full advantage of them and pays back in resources generated by the national economy. The profitability of such investments was frequently not private but collective, which in any case implied problems of how to capture the returns. Those problems are easier to solve in an economy with sustained growth than in a low growth economy.

B. The crisis

91. The international recession of the early 1980s raised in developing countries prospects of reduced growth and in many cases of negative growth in GDP per capita, with payment problems caused largely by imbalances in national budgets, which were financed through inflation. Payment difficulties were also linked to the inability to meet debt service obligations through exports, further hampered by the global fall-off in demand. All this led to a push towards policies of foreign exchange control, import quotas and price controls.

92. Financial and monetary instability, together with frequently inefficient control policies, led to a further downward economic spiral in several developing countries, reflected in a reduction of tax revenues and factors of political instability such as capital flight, often legal. Total capital exports frequently amounted to 50 per cent of the external debt and sometimes even 100 per cent, as in the case of Mexico.

93. Obviously this produces a further deterioration in the balance-of-payments problems in indebted countries, with increased reluctance by the international banking system to grant fresh loans.

94. Hyperinflation discouraged domestic savings. For the same reason, real interest rates became recurrently negative. The result was a disappearance of bank savings in certificates, a halt on savings and a rush to shelter goods, with the alternative of capital flight already mentioned, which was stimulated by the tax privileges granted to foreign investors by the United States and other countries.

95. The consequence has been a shortage in bank liquidity which, compounded by legislative uncertainty and by the excessive role played by public corporation monopolies (also owing to the spread of collectivist and centrally planned economies), frequently provided further disincentives to productive investment and the foundation of new industrial enterprises.

96. None the less, it has to be stressed that some Asian countries - particularly in the newly industrializing group - with a high external debt in the early 1980s were able to reduce their debt burden through reducing its ratio to exports and to GDP. This was done thanks to a high rate of savings, a high level of diversified productive investments, a business-oriented economic system and wise monetary and fiscal policies, which led to high exports and high domestic economic growth, mostly through reinvestment of domestic capital.

97. Even Chile and Uruguay managed to restructure and to find the way to growth and capital inflow once more, together with the development of democracy, although with difficulty and after mistakes due to "shock therapies" that produced much suffering. Therefore, there is a way out, even from the debt crisis, when the State and the market economy work well and when there is readiness to make sacrifices.

Table II.5 Flight capital assets of the Baker 15 a/
(In billions of United States dollars at year-end)

	1980	1982	1987
Baker 15	76	159	295
Argentina	11	35	46
Bolivia	1	1	2
Brazil	6	8	31
Chile	0	1	2
Columbia	0	0	7
Ecuador	3	4	7
Côte d'Ivoire	1	1	0
Mexico	19	44	84
Morocco	0	0	3
Nigeria	6	13	20
Peru	0	1	2
Philippines	11	19	23
Uruguay	0	2	4
Venezuela	15	33	58
Yugoslavia	3	3	6

Source: Morgan Guaranty Trust, World Financial Markets, 1988.

a/ Compounded values excluding assets built from capital flight prior to 1977. The compounded values assume a pretax return of six-month dollar LIBOR on the annual flight capital outflow estimates or, if greater, are taken to be the increase in the reported stock of each country's external non-bank, non-reserve assets since end-1976.

Table II.6 Flight capital outflows from the Baker 15 a/
(In billions of United States dollars, cumulative)

	1977-1987
Baker 15	76
Argentina	11
Brazil	1
Mexico	6
Venezuela	0
Nigeria	0
Philippines	3
Other	1

Source: Morgan Guaranty Trust, World Financial Markets, 1988.

a/ Estimated indirectly on a year-by-year reckoning as the current account balance plus net direct investment inflows, plus the valuation-adjusted increase in the stock of external debt, minus the increase in the volume of official gold holdings multiplied by the average London gold price. The methodology, advantages and shortcomings of this procedure were discussed in "LDC capital flight", World Financial Markets, March 1986.

98. This argument cannot, however, be stated in such a stark form as all too often is the case in the international banking community and in respectable official institutions, because in so doing one would commit an error of aggregation. What may hold true under certain circumstances and for single countries is not necessarily applicable to other countries or to all countries considered as a whole. Given global demand, an export boom in one country is detrimental to the export opportunities of another. There are strong factors of a "zero-sum game" here: somebody wins because others lose.

99. Unwelcome competition from some newly industrializing countries led to a fresh outbreak of protectionism in American and European markets and hampered exports by Latin American, African and even Asian countries, when those exports were not backed by powerful multinational trading and financial corporations.

100. Devaluations, carried out to push exports, produced domestic inflation and gave only temporary relief since competitor countries were devaluing even more to be competitive, with everyone ending up in the same position as before. Eventually, price elasticity operated pervasively because buying countries had reached the saturation level. 3/

101. There can be little doubt that productive diversification requires time and money, and when a country is hit by a crisis such requirements cannot be met. Additionally, it must be noted that part of the exports from indebted countries is controlled by multinationals that remit their profits abroad by means of transfers in order to avoid taxes and foreign exchange regulations. That is why their increased profits were not translated into beneficial effects for the balance of payments of those countries that devalued.

102. In other cases, failure to adjust national currencies to their real values in order to keep prices of primary goods down certainly discouraged agricultural exports and depressed farming activities. This was a route full of pitfalls, like the one followed by several industrialized countries that had to face adjustment problems after the various oil shocks.

103. International monetary authorities have not always been of help in such an adjustment process. They have suggested shock therapies that have often failed to produce good results, when they have not been outright failures, thus prompting a furious rejection of their proposals.

104. Income distribution imbalances reveal the existence of very large poverty traps, malnutrition and high mortality rates caused by poverty-related diseases. Conditions in those areas have been exacerbated by deflation and devaluation and by deregulation carried out in the framework of the above-mentioned adjustment processes connected with the debt crisis.

105. If the basic causes of the failure to solve the debt problem lie in the mistakes reviewed so far, the causes illustrated later are strongly linked to the reactions prompted by excessive deflation and devaluation, to the non-credibility of measures first adopted and then abandoned owing to political weakness, to inflation triggered by liberalization and to devaluation carried out too quickly and too severely.

106. At the same time, the debt burden produced insolvencies and subsequent reluctance on the part of banks to grant fresh loans, together with legal barriers and financial difficulties preventing multilateral organizations from providing fresh funds. It is obvious that they might be afraid that fresh loans can add up to old debts, and their legitimate concern has been exacerbated by two interconnected facts. First of all, there has been a slackening of secondary market bids for the external debts of highly indebted countries. Second, the high level of provision built up by the international banking system against such debts in keeping with fiscal and banking regulations, which on the whole provided incentives for said provision, made discounts on old debts as well as fresh loans unprofitable. It was a spiral, and secondary market bids for the external debt of indebted countries gradually fell, not only because of increasing repayment difficulties, reflected in arbitrary reductions of payments, sometimes declared unilaterally, but also because of the massive provision built up against such debts.

107. Massive provision by leading banks reflected the idea that certain countries were no longer creditworthy, with the effect of halting the flow of fresh loans to them and the result that they became even less creditworthy. What followed was a drop in secondary market bids and a further blow to their credibility for the granting of fresh funds. The next step was a stronger request on the part of the bank supervisory bodies to build up provisions against new loans granted to those countries; and that proved to be a big hurdle for obtaining conventional loans.

108. The picture of the highly indebted countries is a dramatic one. Export growth in those countries no longer affected by the debt crisis was possible thanks not only to the high level of investments and to wise economic policies that provided incentives for a capital inflow, but also to a favourable export trend and a lower debt service. Investment in indebted countries was much lower than in those countries that have now found their way out of the debt crisis. The investment/growth rate ratio (i.e., the outturn in GDP for every 100 units of invested capital) was 25 in the developing countries not affected by the debt crisis, about 7 for middle-income developing countries not in the debt crisis, and about 6 for poor developing countries hit by the debt crisis.

109. Clearly, there are differences in economic efficiency that are only in part attributable to different original conditions in terms of infrastructures and human resources. They often depend on different levels of functioning economic institutions and enterprises, in other words they depend on the good or bad health of private and public enterprises and on their equal or unequal share of the market.

110. The 1989 report of the Secretary-General to the United Nations General Assembly on the subject of the debt crisis and development (A/44/628) dramatically shows the strong relation between debt burden and economic growth capability of the indebted countries.

111. In the 1970s, low-income highly indebted countries experienced a fall in their per capita income of almost 1 per cent per annum, and the same happened in the 1980s, resulting in a gradual shift from an average of $340 per year in the 1970s to $316 at the beginning of the 1980s. And there are no prospects for a reversal

Table II.7 Differential performance of developing countries with and without debt crisis, 1982-1989

	Highly indebted countries with medium income	Poor countries	All other developing countries without debt crisis
Growth rate a/	1.4	0.8	6.4
Investment as a percentage of GDP	19.8	13.1	27.5
Export growth rate a/	4.9	1.1	8.3
Import growth rate a/	-0.2	-6.8	-5.5

Source: Review of the debt strategy and its impact on development prospects of highly indebted countries, IMF and World Bank, March 1990.

a/ Growth rates are in real terms.

Table II.8 Per capita output of capital-importing developing countries, 1970-2000

	Level of GDP per capita (1980 US dollars)				Average growth rate a/		
	1970	1980	1990	2000	1970s	1980s	1990s
Low-income countries							
High debt	342	316	292	281	-0.8	-0.8	-0.4
Others	172	243	404	711	3.5	5.2	5.8
Middle-income countries							
High debt	1 514	1 913	1 696	1 838	2.4	-1.2	0.8
Others	715	1 121	1 461	2 069	4.6	2.7	3.5

Source: United Nations Secretariat, Department of International Economic and Social Affairs.

a/ Annual percentage change.

of this trend with the debt burden remaining as it is. United Nations estimates indicate for those countries an annual per capita income falling to $280 by the year 2000, an intolerable level of poverty.

112. The per capita income of poor countries not oppressed by the debt burden may reach the figure of $711 by the year 2000, while they started off in the 1970s from an average $172, namely half the figure for those poor countries which at that time made the mistake of running into debts, or felt obliged to do so.

113. From the data, it is however clear that:

(a) Investment compression due to the debt service burden hampers growth in debt-ridden countries;

(b) In countries with difficulties, monetary devaluations carried out to meet debt service requirements have led to progressive deterioration of the terms of trade without stimulating differentiated exports and resulting in a curb on imports that could probably be brought about with better effect by means of indirect taxes;

(c) The inflation rate is strictly related to the debt crisis, partly because the latter in the first place calls for an increase in the public deficit, or reflects bad monetary policy and consequential difficulties in issuing certificates of domestic public debt; but also partly because devaluations carried out to solve balance-of-payments problems have triggered cost inflation, together with expectations of further devaluations and higher inflation.

114. For middle-income countries, the picture looks much the same. Those with a per capita income lower than $800 in the 1970s and that attracted fewer loans or those that were more successful in balancing their debts and incomes experienced high growth rates in the 1970s and 1980s. Their per capita income should accelerate in the 1990s. In contrast, heavily indebted countries with high-middle-income levels in the early 1980s experienced a negative per capita growth rate. Their growth rate in the 1990s will be insufficient to counteract the drop of the 1980s. By the year 2000 they will have a per capita income lower than that of the 1980s, again the result of an unbearable debt burden.

115. Table II.7 shows that in countries with debt service problems exports grew by less than 5 per cent during 1982-1989, that is to say half the amount recorded in the developing countries not affected by the debt crisis. While imports fell by approximately 2 per cent in the first group, they rose by more than 8 per cent in the second. Inflation (see table II.11) is rife at 107 per cent per annum in countries with debt service problems, while it stands at 11 per cent in those without and in Latin America alone inflation was 177 per cent.

116. The reasons for such diverging trends - simulated by econometric models based on available data for different countries - lie in different rates of accumulation. As already stated, external debt in highly indebted countries has a negative and double impact on accumulation rates: through the need to squeeze domestic demand and therefore domestic investment in order to generate a surplus in the balance of trade; and through the reluctance of banks and official bodies to provide new loans.

Table II.9 Growth in the world economy, 1969-1989
(Annual rates in percentages) a/

	1969-1973	1974-1982	1983-1989
Industrialized countries	4.3	2.1	3.6
Developing countries	7.2	4.3	3.6
Africa	7.5	2.8	1.8
Asia	5.2	5.9	7.4
Europe	5.9	3.9	2.6
Middle East	11.9	3.5	1.0
Western Hemisphere	6.9	3.8	1.7
Countries with recent debt-servicing difficulties	6.6	3.5	1.9
Countries without debt-servicing difficulties	5.7	5.4	6.6

Source: IMF, World Economic Outlook, October 1989.

a/ Weighted average of growth rates of real GDP, where weights are average United States dollar values of GDP over the preceding three years.

Table II.10 Growth in the world economy, 1969-1995

	1969-1973 a/	1974-1982 a/	1983-1989 b/	1990-1995
Countries with recent debt-servicing difficulties				
f/				
Real GDP	6.6	3.5	1.9	4.1
Investment ratio	22.8	26.1	19.3	23.8
Export volume	4.5	-0.4	4.6	5.0
Import volume	6.9	4.2	-1.8	5.2
Terms of trade	2.5	3.2	-3.1	-0.6
Consumer prices	11.9	34.8	107.8	32.7
g/				
Trade balance	0.2	-6.9	26.4	25.1
Current account balance	-4.8	-34.9	-21.0	-24.9
Net official credit c/	1.7	13.1	20.5	20.7
Net bank credit d/	...	....	0.3	-2.1
h/				
Trade balance	...	-3.9	10.5	6.7
Current account balance	-10.1	-17.4	-8.7	-6.9
Total external debt e/	111.4	222.1	249.1	189.3
Debt service payments	18.8	24.2	31.3	25.8
of which interest payments	7.4	10.2	19.2	15.6
Countries without debt-servicing difficulties				
f/				
Real GDP	5.7	5.1	6.6	5.1
Investment ratio	20.6	25.4	28.5	28.4
Export volume	9.3	5.6	10.8	7.8
Import volume	8.9	7.0	8.5	7.2
Terms of trade	1.8	0.7	-0.6	...
Consumer prices	7.8	15.8	11.3	7.6
g/				
Trade balance	-6.0	-21.0	-23.3	-25.1
Current account balance	-3.6	-14.9	-13.2	-5.8
Net official credit c/	3.1	7.4	7.4	9.0
Net bank credit d/	...	...	5.9	4.4
h/				
Trade balance	-19.8	-14.5	-7.6	-3.8
Current account balance	-12.7	-10.2	-4.6	-1.0
Total external debt e/	110.4	105.4	89.8	67.6
Debt service payments	15.0	11.5	17.0	11.8
of which interest payments	8.0	5.5	7.2	4.9

Source: IMF, World Economic Outlook -Prospects and Policy Issues, preliminary draft of March 1990.

a/ Excluding China.

b/ Net official credit, debt service and interest payments shown as 1971-1973.

c/ Long-term borrowing from official creditors.

d/ Net lending from commercial banks, including impact on debt reductions.

e/ End of period.

f/ Annual changes in percent or percent of GDP.

g/ Annual averages, billions of United States dollars.

h/ As percentage of exports of goods and services period averages.

Table II.11 Inflation in the world economy, 1969-1989
(Annual rates in percentages) a/

	1969-1973	1974-1982	1983-1989
Industrialized countries	5.6	9.6	3.9
Developing countries	10.0	24.2	49.5
Africa	7.5	16.9	49.5
Asia	7.5	9.8	9.4
Europe	6.1	19.0	47.0
Middle East	6.5	15.5	16.0
Western hemisphere	17.0	52.0	177.3
Countries with recent debt-servicing difficulties	11.9	34.8	107.8
Countries without debt-servicing difficulties	7.8	13.6	11.3

Source: IMF, World Economic Outlook, October 1990.

a/ Weighted average change in consumer prices, where weights are average United States dollar values of GDP over the preceding three years.

117. There is clearly an economic limit to the ability to pay. In the case of a company oppressed by debts that it is no longer able to pay for, bankruptcy or a predetermined settlement frequently allows economic recovery with new resources, repaying the old debt left outstanding after the settlement. As was noted by Jeffrey Sachs, the same holds true for national debts vis-à-vis banks, international official institutions and other countries, yet there is no international financial charter providing for such regulations. Nor are individual creditors interested in granting the debtor - motu proprio - a substantial discount on its debt and new loans to start off again. In general, that prompts an increase in the debtor's ability to pay for all his debts, including some towards other creditors. What is beneficial to all creditors is not so for the individual one.

118. In the absence of an appropriate international economic and monetary charter, the market failed in the late 1970s and early 1980s, when the enormous amounts borrowed were far beyond the ability to pay. A further shortcoming in the international economic and monetary order meant that the market failed for the second time at the end of the 1980s when, in renewing future prospects, it was not perceived that all creditors would have benefited from granting debtors a large discount and thus enabling them to pay. Such a policy does not occur spontaneously, since what looks advantageous for the community at large is not necessarily seen as such by the individual.

Notes

1/ See W. N. Eskridge, Jr., "Santa Claus and Sigmund Freud: Structural Context of the International Debt Problem", in W. N. Eskridge, Jr., Dancing along the Precipice: the Political and Economic Dimension of the International Debt Problem, Lexington Books, Lexington, Mass. 1985.

2/ See Charles Humphreys and John Underwood, "The External Debt of Low Income Africa", in Ishrat Husain and Ishac Diwan, eds., Dealing with the Debt Crisis, World Bank Symposium, 1989, p. 46.

3/ As shown below, devaluation aimed at improving the balance of payments resulted in rapidly deteriorating terms of trade with the Baker countries, with almost no effects on the overall value of exports, while they made imports dearer without reducing their total volume.

III. STRUCTURAL ANALYSIS OF THE DEBT ISSUE AND THE ECONOMIC FACTORS OF ECONOMIC RECOVERY

A. Quantitative parameters

119. In order to identify the countries for which the problem of indebtedness is particularly burdensome, a two-tier distinction has been adopted whereby the countries have been grouped according to their income: high income and middle income; in turn, these groups have been further broken down into middle-low and middle-income and heavily indebted countries and not heavily indebted countries.

120. On the whole these distinctions are acceptable but they must constantly be reviewed because, unfortunately, there are countries for which indebtedness was not a severe problem in the early- and mid-1980s, but which are moving into the low- and middle-low income bracket with a $450 per capita income in 1987; however the very meaning of the level of income in dollars is questionable given the differences in income distribution and the different living conditions and climatic variations.

121. The magnitude of the debt is measured on the basis of two percentage values: total debt as a percentage of national income and of the country's exports, and the debt service as a percentage of the country's income and exports, broken down, in turn, into interest and amortization. The reason why the latter two percentages (debt service over national income and over exports) are indicative of a severe situation when they are high can easily be perceived but is not always fully understood. It has taken the industrialized countries virtually the whole of the 1980s to understand this and still they do not appear to have grasped its dramatic objective implications.

122. Debt service, accounting for a large share of national income, means cutting back resources for consumption and domestic investment and in any case a cutback of the resources available to society which is all the more burdensome the lower the average income and the greater the imbalance in income distribution. This latter aspect is to be borne in mind when evaluating the severity of the indebtedness of certain countries, e.g. Latin American or African countries, in which the mean income is inflated by the proceeds from mining resources that are owned by a handful of individuals or by the State and thus benefit an extremely small minority.

123. It must not be forgotten that most of the debt of developing countries is public debt, and when it represents a high share of national income, this spells problems for public revenue, which will mean that taxes have to be raised or spending cut, or both; alternatively more debt will have to be incurred to service the interest or, through two-, three- and four-digit inflation the burden will be transferred to the whole of the country's economy, thus ultimately imposing a heavy strain, principally on the weaker members of the population.

124. Here as well the average income level is important because it affects the degree to which tax burdens can be borne. But there are also other factors that are important such as the volume of tax evasion, the possibility of deriving income from property, the efficiency of the public administration and of public expenditure items, in the presence of strong income imbalances. Quite often the latter lead to food aid measures. In the presence of massive urban unemployment, the solution of inflating the number of civil servants may prove to be a major

social shock-absorber. It is not easy to squeeze current expenses to accommodate debt servicing.

125. In order to honour the debt service when it constitutes too high a share of exports, it will be necessary to reduce imports, adopt restrictive measures and curb demand, and all of this will have an impact on living conditions and on investment and thus threaten political and social stability and the process of economic growth and employment.

126. On the other hand, unless accompanied by adequate domestic measures and if demand is not very flexible, the solution of encouraging exports and improving the trade balance by currency devaluation may generate cost-induced inflation that increases in inverse proportion to the elasticity of imports and exports.

127. The meaning of the relationship between total debt and gross national income on the one hand and exports on the other is not as easy to perceive and is more debatable. There is no doubt that a State with a high debt-to-income ratio will not find many banks and multinational financial institutions willing to grant new loans and new guarantees. When the total debt comes close to or exceeds exports, doubts about ability to pay become even greater. There is a rational explanation for this: besides paying interest, debt servicing implies paying back the principal. If, in order to cope with present difficulties, the latter is postponed, one must come to terms with outstanding arrears that add to the total debt.

128. Moreover, a debt may carry a high or a low interest rate, which may even be above or below market rates. A loan that was obtained in the form of a grant or under soft conditions at rates lower than the market rates will, for a given amount, usually require less servicing than a loan obtained at market rates. This is particularly true for fixed-rate loans that date back to the time when market interest rates had not yet experienced the abnormal upsurge of the 1980s. Given the original conditions on which it was contracted, postponement of the debt will not impose a burden comparable to that of postponement of a debt at a high or variable interest rate tied to the international rates, whose interest rate is the same as or higher than the rates on the international market (as is the case with many debts of developing countries), especially where there are no prospects for improving the rates. While in the latter case delaying repayment merely increases the debt burden, in the former case postponement reduces it, because there is an increase in the number of years during which the country can enjoy the difference between the interest rate being paid and market rates. For this reason it would be desirable to make a distinction between the ratio of the debt derived from soft loans to the gross product and the ratio deriving from burdensome loans, in real terms.

129. Moreover, concessional loans or quasi-soft loans have been granted by institutions such as the World Bank and IMF, which in the case of failure to pay demand adjustment programmes or otherwise discontinue their investment; this is a course of action that they are compelled to take under their statutes and as a result of their funding mechanisms. Consequently, even if in real terms these loans are less burdensome, in financial terms they are burdensome; and this is also

true sometimes for official bilateral loans, especially when these loans are former commercial loans taken up by the government insurance which guaranteed them. Failure to pay automatically puts the country involved on the blacklist in terms of granting further guarantees of finance.

130. Therefore it is not exactly correct to assume that a high total debt with official lenders is less burdensome than an equal level of debt with a bank just because the interest rates are lower. Over all, the debt-to-national income ratio and the debt-to-exports ratio are significant indices of the severity of a debt, irrespective of the relationship between debt service and interest on the one hand and national income and exports on the other.

131. Of course, not all the external indebtedness of developing countries consists of public debt. Part of it is commercial debt for imports, for purchasing foodstuffs and for investments, which is guaranteed by the public authorities; and part of it is debt held by the private sector. However, the relationship with exports mentioned above applies for this debt too because it also implies currency outlays.

132. The relationship with the gross product and/or with gross national income also matters, but in a different way. Indeed, it is not always necessary for income to be available to the Government of the indebted country for debt service: it is not necessary in the case of debts of private enterprises and commercial debts guaranteed by the State when the debtors have property that the State can seize. However, a portion of the commercial debt guaranteed by the State involves public enterprises and State-owned agencies that are subsidized by the State. Hence also in this case the Government is confronted with the problem of finding ways of raising the money required to service the debt.

133. In any case, the relationship with GDP remains a fundamental one in terms of the country's solvency from both an economic and a social standpoint. Servicing an external debt, even when it is a corporate debt and not a government debt, means substracting a portion of the national product and transferring it abroad, thus decreasing, ceteris paribus, national income and pushing it below the national product. This implies cutting back investment or consumption or both. Restricting investment has a negative repercussion on growth and thus on the country's future solvency. Restricting consumption has repercussions on living conditions, and, as demonstrated by surveys carried out by the United Nations Children's Fund (UNICEF), it leads to a deterioration in the economic conditions of the developing countries that are in difficulty. During the 1980s it produced a negative effect on health, especially that of children and mothers, thus impairing the development of the countries' human resources.

134. These are, from a general standpoint, elementary and unequivocal indicators of the degree to which external indebtedness can be tolerated, and not only public debt but also private and parapublic debt, in terms of the total debt and debt service related to GDP and to exports.

135. Two important theorems have emerged in the specialized financial literature during the last few years and, even if hedged round with various ceteris paribus clauses, they appear to be of fundamental importance for assessing the ability to repay debts and to work out policies for a global effective approach to the problem, rather than piecemeal measures.

136. The first theorem is that, in order to find an automatic solution to the problem of indebtedness over time, a necessary but insufficient condition is that the growth rate of GDP of the indebted country, measured in the currency of the debt, must on average be greater than the interest rate, expressed in the same currency. Then if no new debts are incurred, except those derived from the accumulation of unpaid interest, the debt level will gradually shrink as a percentage of GDP of the indebted country.

137. In particular, this principle appears to apply for public debt whose service is financed through the issuing of new securities. If payments for the debt service are lower than the growth rate of GDP, clearly the ratio of the debt stock to GDP will decrease. It may be that service is effected through domestic rather than foreign debt. In this case, the burden of the foreign debt stock on GDP will decrease even if the interest rate is higher than the growth rate of GDP, but the burden of internal indebtedness, which will generate a shift of resources away from the economic sphere and towards public finance, will gradually increase with respect to GDP.

138. The second theorem is that in order to find an automatic solution to the problem of indebtedness over time, a prerequisite is that the growth rate of net exports (the export-import balance, i.e. the surplus of exports over imports) should be higher than the growth of interest rates in this case. Even if all the interest is not paid or if the external debt is renewed, the increase in the debt will be smaller that that of exports; the ratio between debt service over exports and interest over exports will decrease. Of course, this reasoning assumes that principal repayments are offset by new issues of an equivalent amount so that the debt service remains constant.

139. If these two theorems are accepted, it can easily be understood why the problem of indebtedness worsened during the 1980s. Indeed, on average, the interest rate was higher than GDP and the growth rate of exports was lower for those developing countries that are now facing problems.

140. Another important relationship is that between the growth rate of GDP and the growth rate of the debt in relation to new money. If the growth rate of GDP is higher than the growth rate of total debt, the ratio between total debt and GDP evidently decreases. If, on the other hand, the ratio of exports to GDP remains unchanged, the ratio of total debt to exports also decreases. Assuming a constant income elasticity of imports and that their prices do not vary in real terms, the ratio of total debt to the import-export balance will also fall.

141. As regards debt service, if the interest rate on new money is assumed to remain constant, the debt interest/GDP ratio as well as the interest/exports ratio will fall by the percentage points by which the GDP growth rate exceeds the growth rate of the debt, subject however to the conditions described above.

142. The same will apply to amortization.

143. A major distinction must therefore be made between primary debt and secondary debt or new debt. New primary debt is the stock resulting from the servicing of the existing debt stock. Secondary debt concerns the deficit originating from the request for new resources to fund investment or simply to subsidize the current account deficit net of service of the existing debt.

144. When the growth rate of GDP exceeds that of the interest rate, there is room for new borrowing to finance the secondary deficit without causing a deterioration in the country's solvency as measured by the ratio of debt service to GDP.

145. When total debt is equal to GDP, if the interest rate is lower than GDP growth rate, ploughing back interest earnings will bring the total debt down below GDP. If the total debt is, for instance, half GDP, ploughing back interest earnings at an interest rate that is lower than the growth rate makes the total debt stock grow less than 50 per cent of the growth of GDP. And this generates room for new funding, that is to say for a secondary deficit. In order to sustain the growth rate, however, the secondary deficit should be used for investments that, in terms of GDP, earn more than the long-term service of the new debt.

146. The GNP growth rate of heavily indebted countries from 1982 to 1989 was generally, in real terms, much lower than the real interest rates on the debts of those countries. The real GNP growth rate of middle-income heavily indebted countries was 1.4 per cent.

147. Table III.1 shows the mean interest rates payable on the debts of the middle-income severely indebted countries from 1982 to 1989. Obviously this is an oversimplification because it does not take into account currency differences and thus the differences between real and nominal rates. Nevertheless, it shows that the growth of real interest rates was unfortunately higher than that of the real GNP in middle-income heavily indebted countries. The situation of the poorer heavily indebted countries, for which the mean interest rate was lower, is even worse, because of the larger quantity of official and soft loans and of loans granted under primary conditions, but the growth of GNP was even lower (a mean of 0.8 per cent per year).

148. The situation may appear to improve if the growth rate of exports is considered net of imports because, during the period under review, the export growth rate was much steadier than the growth rate of GDP.

149. However, the foreign exchange that should have been available according to the behaviour of these indicators did not materialize in practice because the high indebtedness was accompanied by a reversal in transfers, and thus solvency declined in relation to the balance of payments. Theoretically, if attention were to be focused only on net exports, transfer payments being constant, solvency should improve when real exports grow faster than real interest rates.

Table III.1 Real interest rates and growth rate of heavily indebted middle-income countries

	1982	1983	1984	1985	1986	1987	1988	1989
Mean nominal interest rate in US dollars a/		10.2	10.5	9.3	8.12	8.3	10.1	11
Real GNP growth rate			1983-1986 b/ 1.9			2.7	1.6	0.4

Source: World Bank, Poverty, World Development Report, 1990.

a/ End period.

b/ Projected.

Table III.2 Interest rates on the debt of heavily indebted low-income countries

	1982	1983	1984	1985	1986	1987	1988	1989
Mean nominal interest rate in US dollars a/	6.2	5	6.6	6.6	5	3	4.7	5.8
Real GNP growth rate			1983-1986 b/ -0.1			-1.5	4.3	4.2

Source: World Bank, Poverty, World Development Report, 1990.

a/ End period.

b/ Average for the period.

NB. If real interest rates are calculated by the World Bank, not by subtracting from LIBOR the United States GDP deflator, but through changes in the export prices of debt-burdened countries, the result would be worse.

Table III.3 Export growth in real terms for heavily indebted middle-income countries

	1983-1986	1987	1988	1989	Mean 1982-1989
Export growth	5.0	5.0	9	3.4	4.9
Import growth	-1.9	2.9	7.3	9.2	-0.2

Source: Derived from IMF-World Bank data.

Table III.4 Export growth in real terms for heavily indebted low-income countries

	1983-1986	1987	1988	1989	Mean 1982-1989
Export growth	2.7	-5.1	4.2	10.4	1.1
Import growth	-10.3	-7.6	-0.5	6.8	6.8

Source: Derived from IMF-World Bank data.

150. If this does not occur, as unfortunately it did not because there was a reduction in net transfers, the reference to net exports is insufficient.

151. In such circumstances, the thing that could be done would be to convert part of the debt service to domestic investment so that the ability to pay in the medium term can be guaranteed by the differential growth of exports. This is one possible solution.

152. In the case of heavily indebted poor countries, actual export growth was not very high. The mean growth rate of 1.1 per cent is no higher than the interest rate for the period 1982-1989 (see table III.4).

153. An improvement was achieved in net exports, principally by cutting back imports drastically, and this had negative repercussions on the investment/GDP ratio. Consequently, this caused a reduction in real GNP growth, which was lower than the growth of real interest rates.

154. Thus there emerges a contradiction between the need to expand income and exports in order to service the debt and the actual ability of these variables to grow because debt servicing weighs heavily on the balance of payments. The balance of payments can be corrected only by an increase in transfers from richer countries to poorer countries and/or by a reduction of the servicing of the debt or by the transformation of a part of the service into domestic investment. However, it must be pointed out that, while in a middle-income country a GDP growth rate lower than the interest rate growth rate can be handled by a reduction in living standards, which, though onerous when the tax system is weak, is feasible and compatible with survival, in the poor countries this is not possible. The burden that servicing the debt represents interferes with the very right to survival.

155. Therefore, while for middle-income countries, the conversion of a part of the debt into domestic investment appears to be a step of critical importance, it is not so for low-income countries.

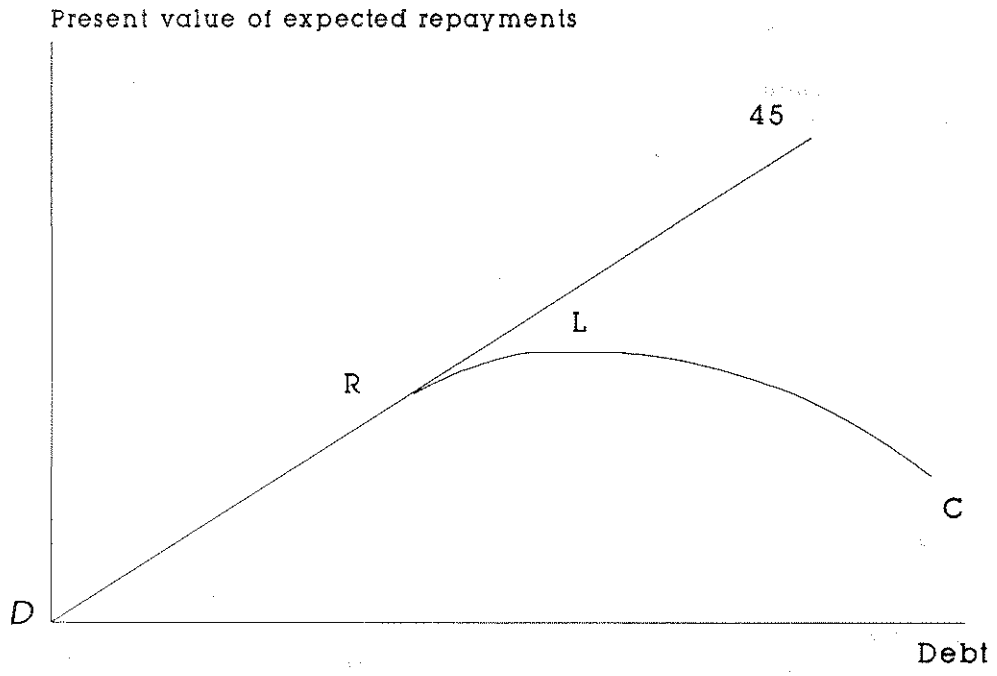
156. In the latter countries this measure appears to play a marginal role in the list of priorities where the first is to reduce the burden of the debt service on GDP so as to secure the minimum income for survival. A major requirement for these countries must be to have the bulk of the burden of servicing the debt remitted.

157. The need to reduce the service of the debt, demonstrated by the foregoing considerations on possible economic development manoeuvres to secure a minimum survival income, is also supported by economic theory.

158. Reference is being made here to the Laffer curve, which was originally devised to solve the problem of the relationship between tax revenue and the rate of taxation, but it can also be applied to the issue of of external debt, as was done by Krugman and Williamson (see figure III.1).

Figure III.1

The debt relief Laffer curve



Note: "Krugman illustrates the relationship between the level of debt and a creditor's expectations in terms of a diagram, reproduced in figure 2. The horizontal axis shows the level of debt and the vertical axis shows the expected present value of repayments. For low levels of debt from D to R, full repayment is expected, and so the outcome lies along the 45 degree line. At higher levels of debt, however, the possibility of nonpayment arises and grows, so that the expected payment line traces out a curve that falls increasingly below the 45 degree line. Beyond some point (L), the disincentive effects outlined above begin to outweigh the option value to the creditors of being able to share in the debtor's good fortune, should outcomes prove unexpectedly favourable. Krugman explains:

> The curve DRLC should by now be a familiar sort of object. It is the Debt Relief Laffer Curve. That is, just as governments may sometimes actually increase tax revenue by reducing tax rates, creditors may sometimes increase expected payment by forgiving part of a country's debt. In both cases the proposition that less is more depends on an initial extreme situation, whether of taxes that provide extreme disincentives or of a debt burden that is crippling in its effect on economic growth. Arguments that debt relief is in everyone's interest are, in effect, arguments that countries are on the wrong side of the debt relief Laffer curve." a/

a/ Williamson, J., Voluntary approaches to debt relief, Institute of International Economics, 1989, Washington, D.C. Quotation from P. R. Krugman, "Financing versus forgiving a debt overhang", and "Market-based debt reduction schemes", National Bureau of Economic Research Working Papers, Cambridge, Mass., 1988.

159. Of course the shape of the curve is not always so regular, nor is it easy to ascertain whether a given debt burden implies a point to the left or the right of L. However, several developing countries with a debt crisis can be considered as in a position to the right of L and therefore a reduction of interest rates or a lengthening of the maturity will improve the situation for debtors and creditors alike. 1/

160. The L level of the optimal debt service would have to be determined on a country-by-country basis, depending on the variables that are felt to be the most critical specific case, but the general macro-economic guiding principle is one of the relation between productivity and interest rate which, in simple terms, harks back to the ratio between interest rate and GDP growth per capita.

161. The best point in the Laffer curve of the ability to pay is given by the growth rate of the per capita product as a proxy of the growth rate per employee. In other words, if the interest rate is higher than the product growth rate per employee, this means that the interest rate is higher than the growth in productivity. 2/

162. Ap obviously depends on several internal and external factors connected with the productivity of L and K, but it also depends dramatically on the amount of R per unit of and, with full employment and constant population, on the amount of per L But that involves no modifications to the principle whereby in the long run i cannot be higher than Ap, if the capital obeys the law of constant or decreasing returns. With the law of increasing returns, i can be Ap, but only to a certain extent, given by the reduction of the K/P coefficient.

163. It is clear that an excessively high interest rate in the long run makes investment impossible, or leads investors towards insolvency. It is also clear that in the long run the golden rule of promoting the growth of developing countries' economies and of favouring full employment is that Ai, particularly as a result of the inflow of external funds, is the product per employee which, with constant unemployment, is the product per inhabitant.

B. International trade policy

164. The analysis of the problems and parameters concerning the critical indebtedness position presented above, suggests the strategies, some of which are compulsory, to be adopted in working out a solution.

165. First of all, in order to produce a situation in which the GDP growth rate is sharply and considerably higher than the real interest rate, it would be imperative, first and foremost, to lighten the burden of interest payments, both for bank loans which, as pointed out above, are inordinately high, and to official lenders when the loans are not of the soft type. In such cases, for the poorer countries that have a smaller capacity to pay and that are in greater need of growth, the conclusion that can be drawn is that their debt must either be written off or be drastically cut back.

166. In broad terms, the sustained growth of a single country, especially if it is a developing country, is bound to be short-lived. Economic growth must involve a number of countries and cover different geographical areas. After a decade of slow growth during the 1980s, characterized by the fight against inflation, against the impending dangers of recession and financial collapse at the international level, it is imperative that the 1990s become a decade of growth, especially for the members of the European Economic Community (ECC). The greater interest that Germany may have in a growth policy as a result of the unification process may be considered a major positive factor and points towards a solution to the problems of the developing countries of Africa, Asia and Latin America.

167. The necessary condition for this is of course that appropriate new resources be made available to these countries in order to have them participate in the expected international trade expansion.

168. Secondly, the problem of the indebtedness of developing countries must be correlated, in general and in specific terms, with the expanding possibilities for exports and with the stabilization of prices of goods that these countries export. The initiatives to be taken at international trade conferences in this direction are closely intertwined with the solution to the problem of indebtedness, whose importance is generally underestimated.

169. As seen above, the 1980s was a decade of high interest rates, and this was a result of the high deficit of the United States and of the monetary policies adopted to fight inflation, compounded by decision-making shortcomings in deciding how to use tax and income policies. Monetary policy is also partially conditioned by an underestimation of the role of IMF and by the difficulties in implementing tax policies.

170. The industrialized world must make the commitment to take action; procrastination is unacceptable in view of the challenges that the 1990s will pose with regard to the South and to the Eastern European countries.

171. The 1990s must not be a decade of high interest rates; and instead of fighting inflation through monetary instruments, which in the long term often turn out to be counterproductive, it should be attacked at its very roots, through healthy tax policies and courageous income and fiscal policies.

172. The fourth aspect, namely the systemic nature of the debt problem of developing countries, concerns the role of the Group of 7 and of the international institutions (IMF, World Bank, regional development banks) in relation to the domestic reorganization of the economy and of the financial situation of the countries burdened by international debt.

173. It is necessary to adopt healthy financial and market economy rules so as to encourage savings, attract, instead of discouraging, domestic investment, increasing the return on investment and creating a more certain political and institutional framework. Such a framework is necessary in order to secure sustained growth of the national product and, moreover, the sacrifices that the taxpayer would have to make can be rendered more acceptable, especially if they are equitably distributed.

174. It is only sensible that any new loan, and even the various forms of development aid, should be subordinated to the establishment of such conditions, because otherwise any form of aid would prove to be useless, and even worse, it would merely strengthen the oligarchies in power in the indebted countries. But the principle of self-determination of the developing countries must be respected while helping them to design such changes based on incentives, co-operation and step-by-step measures.

175. The creation of infrastructure and financial assistance to build infrastructure may serve as an incentive to the process of introducing a market economy and competition. The development of local entrepreneurial resources and the streamlining of public enterprises by eliminating bureaucracy and by divesting them of their monopolistic type of structure may all be promoted through co-operation among the financial bodies and institutions of the multilateral organizations. The changes that need to be made must be presented in the form of gradual steps to be taken within a framework of mutual interdependence.

176. These conditions cannot always be expressed in the terms of "liberalization-privatization-deregulation", which appears to have acquired an excessive doctrinal connotation; as a general formula it would be preferable to use the wording "open economy", based on healthy market rules and on a healthy monetary and fiscal order.

177. It cannot, however, be ignored that the ability to expand the growth of exports lies mostly in the hands of the indebted countries themselves and depends on the decisions taken by their Governments, on the maturity of their citizens and on the far-sightedness of their ruling classes.

178. Adjustment programmes cannot neglect the implications for the people at large; adjustment is not to be seen in ideological terms, but should aim at modernization and mutual openness between indebted countries and industrialized countries.

179. But this is not enough; the growth policy for the underdeveloped continents must be supported by greater efforts on the part of the Western countries and their institutions and they must keep in mind the growth policy of developing countries when framing their policies for public aid as a whole and not only when development aid is involved; account must be taken of the fight against hunger, disease, poverty, desertification and environmental degradation. The taxpayer in the rich countries must gradually realize that it is necessary to grow equitably along with the developing countries.

180. A fifth aspect of this systemic approach, which involves lenders and multilateral development institutions, relates to the new money that can secure the means for sustained growth, without further aggravating the already enormous existing debts, and thus their servicing. Bankers have often maintained that writing off the debts or cutting them back would mean automatically excluding the countries involved from future loans, because it is difficult to convince shareholders and savers to lend more money to those who default on their loan obligations. This idea is rather exaggerated and there is even a paradoxical element in it. Indeed, a country that, because of the restructuring or reduction

of its loan, is relieved of the excessive burden that has oppressed it, objectively should attract more loans and not less; of course this applies only where there is no longer any need to set aside high reserves on the new loans or where at least they can be reduced, in that they are no longer required, at least not in such large amounts.

181. Apart from this observation, there is no doubt that much depends on the conditions that accompany the reduction in the debt, which should ensure that the previous problems do not recur. Moreover, a Government will accept such conditions if it thinks it can improve its financial prospects, which means obtaining fresh capital to keep its investment going and to provide new jobs.

182. There is, however, the danger of becoming trapped in a vicious circle if the programme for reducing indebtedness does not also envisage sources of new money to give new momentum to the growth process. In this area, a major role is to be played by public insurance of commercial loans in relation to money from banking institutions used for investment and for exports. The regional banks and the multilateral institutions can also play a major role. But in order to continue with these initiatives, these multilateral institutions need fresh resources and, given the risks at hand, they need resources without security besides the money they can get from banking institutions.

183. All this implies an unwavering political commitment over and above the technical efforts that can be made and the financial devices that can be designed. In the end, the taxpayer of the industrialized world will inevitably be involved in some form or another.

184. These considerations lead to the last aspect of the systemic approach, namely the regulations governing taxes, accounting practices and the control of bank supervisory authorities so as to promote instead of hindering the measures aimed at reducing the debts of developing countries and at securing new and more advantageous financial regimes. First and foremost this implies the need to harmonize existing systems according to a consistent and uniform code.

C. Factors of domestic policy

185. Since theory has it that the debt problem can be solved only if the growth in GDP and exports of creditor countries denominated in a given currency are higher than the interest rate in that currency and if payments are offset by new funds, a series of factors in indebted countries should be considered, in addition to external factors that make interest rates higher and reduce opportunities for exports and growth. The growth rate depends on both the volume of savings available to the economy and capital income. But the rate of savings cannot be taken as given, as it depends on the domestic policies pursued. Private capital efficiency presupposes the existence of a market that works well. The rate of export growth also depends on the ability to diversify, and this requires the development of a favourable environment for fresh initiatives by those who operate in unfamiliar settings. A domestic opening of the economy has to be accompanied by the opening of financial markets in order to attract foreign investments.

186. Although initially high levels of external debt were not caused by lack of domestic savings but by a tax burden that was too low in relation to the adopted public spending policy, it is now clear that indebted countries have to implement growth-oriented investment policies. The prerequisite for achieving that goal is for many of them the adoption of measures to control inflation and to improve the terms of trade, together with the need to increase domestic savings and hence the share thereof available for use in the domestic economy. Such measures constitute the only way to break the vicious circle of insufficient accumulation and of excessive debt: low income level, low propensity to save, lack of funds for investments, low growth rate, low increase in public revenue, persistent high deficit and social malaise that reduce the chance to curb public expenditure.

187. The budget policies that have been pursued (high deficits with a ceiling on public investments in order to uphold consumption and to raise funds for debt service) have frequently worsened the economic situation. As a result, economic growth has undoubtedly been hampered, because there is a very strong link between public and private investment, particularly in developing countries. The flow of domestic savings available to the economy has therefore been reduced.

188. In certain countries, the excessive centralization of the productive economy - notably in collectivist systems - has reduced investment returns, even with high rates of savings. In others, such as Yugoslavia, high saving levels have been overtaken by even higher investment levels at low rates of return, which has given rise to a high rate of inflation, contributing to a disruption of the economy and to balance-of-payments difficulties. Although privatization cannot be considered a panacea, the adoption of corporate status and the setting up of private structures for public bodies, the implementation of partial privatization through stock exchange listings and through the participation of the private and public companies of industrial countries are in many cases indispensable measures to activate the process of modernization and growth in almost paralysed economies.

189. The rate of savings in Algeria is 33 per cent, yet reliable sources indicate that in the mid-1980s the growth rate, though higher than in many other countries, was lower than expected, considering the volume of investment and the high input-output ratio (around 8-10 per cent in the early 1980s).

190. In addition to privatization in the economies of indebted countries, there is another element in opening up the economy to competition that is to be recommended: deregulation. Deregulation ranges from the abolition of trade monopolies covering production and imports of goods and services, the elimination of price ceilings and of those subsidies aimed at supporting deficits, to the abolition of licences for new entrepreneurial initiatives, to the elimination of rules applicable to public utility companies and to the building sector. A market without rules would be a bad alternative to rigid State economic planning or to the bureaucratic collectivism that often distinguishes indebted developing countries and that can be qualified as one of the causes of their low capital income. Besides, market transition cannot be too slow or piecemeal, because the result will be chaos instead of efficiency. Economic interdependence suggests a broad approach. However, it is necessary to make transitional arrangements, even for a brief period, in order to move towards new and more efficient positions, in which

technical skills are utilized and change is accepted by society. Certainly, the goal cannot be a market without rules, as such a situation would be equally discouraging to economic operators as a collectivist system or a bureaucratic hypercentralized planning system.

191. The third element of an open-door policy is that of financial liberalization. Among the scholars who have dealt with the issue there is fundamental agreement on the causes of the current difficult situation of many developing countries. Their predicament is also due to a persistently negative level of real interest rates on bank deposits, either because of failure to adjust to high inflation rates, or because of a very low rate of capital income, which was expected to favour growth, but which often ended up in an inefficient use of fixed and current assets. Latin America offers a telling example. The rather high GDP/investment ratio existing prior to 1980 fell most markedly in Argentina (from 24 per cent in 1973-1980 to 15 per cent in 1980-1986), in Bolivia (from 25.7 per cent to 7 per cent) and in Venezuela (from 32.3 per cent to 20 per cent), with a less dramatic drop in Brazil, Ecuador and Peru. In the remaining countries things did not change. Savings levels as a percentage of GDP literally collapsed in Bolivia, Argentina, Chile, Costa Rica and Jamaica, while in the remaining countries they merely diminished. African countries in general also experienced a sharp drop in their savings levels. In low-income countries, savings amounted to an average of 8 per cent in 1986, while for several countries it was actually negative. In the Maghreb countries, Tunisia experienced a drop in its savings rate from 19.9 per cent in 1973-1980 to 17.9 per cent in 1980-1986, while Morocco's fell from 11.2 to 6.4 per cent.

192. Interest rates that are too low or negative are a disincentive to the formation of savings, driving them away from the domestic financial system and from productive investment. Therefore, financial repression aimed at keeping rates below their natural levels produces a distortion of the market mechanisms that can damage the whole economy. Clear evidence of this can be found in the data presented by the World Bank for the period 1974-1987 on the relation between GDP growth and the trend followed by real rates. Those countries that experienced a fall in GDP in the above-mentioned period (Nigeria, Zaire, Jamaica and Ghana) have pursued policies of promoting a negative capital yield on savings. Argentina (with up to 27 per cent negative real interest rates on bank deposits) and Peru (up to 30 per cent), although they achieved better results, performed worse than other countries that supported positive real interest rates on savings (e.g., Thailand and Malaysia). Even those countries that in the same period have pursued policies of moderately negative real interest rates, such as Morocco (lowest negative rate of 5.5 per cent), show lower growth results. More complex is the case of countries such as Brazil and the Philippines, which alternated between positive real interest rates and ex-post negative figures even when the monetary authorities had no responsibility for policy.

193. More specifically, as far as the financing of public deficits is concerned, a comparison of the experience acquired in several countries indicates that savings are mainly affected by the imposition of direct and indirect controls on the banking system; control over interest rates is therefore required. In general, control measures have consisted of:

(a) The establishment of high levels of bank reserves with a capital income often equal to zero, equivalent to a tax on financial intermediation. Faced with losses, banks react by raising interest rates for borrowers and by cutting those for lenders. Obviously, the dampening effect on savings is in direct proportion to the inflation rate;

(b) The imposition on the banking system of portfolio constraints. The result is similar to the creation of reserve funds, and constraints become stronger if a lower interest rate is placed on State certificates in real terms or compared with other forms of financial investments. Those constraints have generated on banks a sort of "inflation tax", which entails, among other things, a real cut in the amount of invested capital. Again, such an inflation tax can be passed on to savers;

(c) Government control on all interest rates for the purpose of gaining the best possible placement of State certificates. By keeping them below market level, a liquidity rationing system was set in motion, with further distortion of the global financial system. Argentina, Mexico and Yugoslavia are among those countries that have followed such tortuous paths. The tax on financial transactions was for them an important source of income after 1982. The effects on savings have been strong, with severely reduced figures for the whole period under review. In the Philippines, saving rates were negative between 1983 and 1984, at the same time as taxes on operations of financial intermediation reached very high levels. Other countries have experienced similar problems, but to a lesser extent.

194. It seems unlikely that indebted countries will be able to increase their ability to pay unless real interest rates are raised and until there is a strong expectation that inflation and public deficits will be substantially reduced. Obviously, conditions of permanent hyperinflation discourage every single savings operation. A steady increase in individual incomes would produce a rise in aggregate savings, including for middle-income groups, provided that such savings can be sheltered from inflation.

195. A tax increase becomes essential to the recovery policies of indebted countries. Spending reductions can also be useful for improving budget results, but it would be counterproductive to cut those items embodying investment in physical or human resources. Public tariffs and taxes on the services produced by the State also have to be raised. For instance, the number of toll roads should be increased.

196. Several experts agree that lax budget policies have provided incentives to heavy capital flight. Savers in indebted countries regard them as an early warning of currency devaluation and of new taxes to be imposed on incomes and consumption. According to World Bank sources, in the period 1974-1982 alone the seven most indebted countries of Latin America experienced a capital flight of $92 billion (equal to about 30 per cent of their total external debt), with Argentina itself accounting for $30 billion. Things did not improve after that, as can be seen from the figures of the Morgan Guaranty Trust reproduced in table II.5 above. It has been said that such phenomena mainly struck those countries with free movement of capital and stringent tax policies. However, countries such as Thailand, which did

not adopt stringent fiscal policies although it had no restrictive foreign exchange regulations, experienced no such capital flight. Furthermore, foreign exchange restrictions discourage capital inflow and give incentives to illegal capital flight, which can reach considerable levels. Capital flight also has a strong impact on the social cost of monetary stabilization policies, and hence on their political feasibility. They put the burden of those policies on the poorer members of society, while rich peoples' incomes and capital are protected in real terms from inflation and devaluation. It has been alleged that capital flight per se is not a disease but rather a symptom. It is argued that it is the combination of poor domestic economic policies that causes capital flight and not vice versa. 3/ There is much truth in this statement. However, it should not be exaggerated. Capital flights have often taken place for tax avoidance purposes and because of political uncertainties (as Perasso recognizes). Obviously it might be argued that some taxes and some political unrest are unjust. However taxes, in general, need to be paid and political unrest as a reaction to oppressive regimes can hardly be blamed.

197. The conventional stabilization policies that have been adopted by several countries through sharp devaluations, though much publicized, have not always met their aim of increasing savings and of discouraging capital flight. There are several diverging experiences. In Argentina, after a short investments and savings boom in 1985, the Askal plan led to a sharp increase in the balance-of-payments and public sector deficits, with a fresh outbreak of inflation, compounded by capital flight and by an insufficient inflow of savings and investments. The Cruzado plan implemented by Brazil produced practically the same results. In 1966 Brazilian authorities managed to bring inflation back to two digits and the savings rate went up to 24 per cent of GDP. But in 1987, with a sharp rise of inflation up to a high of 321 per cent, savings prospects became bleak. In Bolivia, the economic policy adopted after 1985 abolished most price controls, wages and interest rates, with a reform of the tax system and a reduction of current account spending. What ensued was a drastic cut in the inflation rate, a sheer drop in the level of expected inflation and new confidence in the national currency. The effect on savings levels, which had dropped to a negative level in the period 1980-1986, soon became visible. In Chile, however, a hyper-restrictive monetary and fiscal policy led first to a decline in individual incomes of 18 per cent during 1982-1983 and then to a subsequent shrink in savings, down to 6.8 per cent of GDP. Once inflation was overcome and with a recovery in terms of real incomes, the savings/GDP ratio rose to 18 per cent in 1986, an all-time high. It still remains to be ascertained, however, if the deflation measures carried out in Chile in the initial period were really necessary, for they may have proved counterproductive because of their severity.

198. The different above-mentioned experiences have led some authors to identify two categories of countries: crisis countries, including many in Latin America, plus Morocco, the Philippines and Yugoslavia, and non-crisis countries, such as the Republic of Korea, Indonesia and Thailand. This distinction is meant to reflect their economic policies and the effects of the latter on savings and investment.

199. The Republic of Korea's macro- and micro-economic performance which enabled it to emerge from its indebtedness problem is a remarkable success that needs to be carefully studied by all developing countries as well as by international financial institutions and bilateral aid institutions. The Republic of Korea switched from a policy of import substitution to one of export promotion through a consistent, credible, competitive real exchange rate, sometimes even undervalued, which varied little. However, it would be wrong to imply that the Republic of Korea was pursuing either a neutral international trade policy or a complete liberalization of imports.

200. As S. M. Collins and Wona-Am Park maintain 4/ tax preferences and interest rate subsidies became important mechanisms to subsidize domestic industries after 1965. Import restrictions have been relaxed since 1980 but were still very important in developing "infant industries" in the 1970s and 1980s. The Republic of Korea was extremely successful in selecting "growth industries" for infant industries protection. On the other hand, Korean fiscal and monetary policy aimed to create positive public savings balance and to increase household savings. The two authors, after having underlined the adamant adherence of the Republic of Korea to fiscal and monetary soundness, note that the Republic of Korea's "financial system has been anything but a unified system in which credit is allocated by market forces". To sum up, according to the two authors, "active intervention has been a mainstay of Korean policy but it benefited heavily from liberalization of trade regimes and capital markets and from a structural adjustment policy with investments in export as a top priority.

201. Crisis countries mainly financed their budget deficits with the implicit tax on financial intermediation, namely through negative real interest rates paid on public sector debt, plus the implicit inflation tax. This was one of the main reasons for the low level of savings and high inflation rates. The coeval external debt and tax crises gave rise to subsequent adjustment policies in order to produce a current account surplus for debt service, based on cutting back public investment, although industrial production by and large was stagnating.

202. Conversely, non-crisis countries refrained from operating through the intermediation tax and acquired funds at market interest rates, thus leaving their levels of public and aggregate investment practically unaltered. They managed to acquire resources for their development and created savings by increasing the tax burden, by imposing a ceiling on current account spending and by a concomitant rise in the rate of income growth.

203. In short, with stagnating or declining savings, aggregate investment in crisis countries fell, whereas in non-crisis countries a rise in the total volume of investment led to a higher growth of domestic savings, generating the surplus necessary for raising financial resources and for financing any public deficit. Consequently, incomes stagnated in crisis countries, while they rose in the other group. Debt servicing was also easier for non-crisis countries and capital flight less dramatic.

204. The most important factors accounting for such different patterns of total savings in the two groups of countries seem to have been different trends in real interest rates mentioned above, and the way in which Governments dealt with the problems of budget financing. The two issues are strictly interconnected, as illustrated above. As has been stated, "the final result of the tax on financial intermediation exemplifies the economic policy dilemmas faced by certain countries ... it was applied in the place of an external financing of the deficit, which became increasingly hard after 1982 ... whereas it led to further drops in real funds, which in turn required an ever increasing application of the inflation tax or of direct controls on interest rates in order to reach the desired level of financing. The conclusion was a tight credit squeeze in the private sector and heavy drop in the volume of investments". 5/

205. Those countries that opted for the solution of public-deficit financing through loans contracted with banks at market interest rates or for the market placement of bond certificates at market interest rates were more successful in achieving an overall growth of savings. This approach certainly does not create distortion in financial markets, although it is necessary to stress that excessive use of such financing leads to the crowding-out of private investment and to a higher public deficit due to a higher service cost. Thailand and the Republic of Korea, by resorting to a limited public debt at market interest rates, experienced even higher growth in their overall savings in the 1980s than in the 1970s.

206. Orthodox budgetary policies are therefore a fundamental component of monetary stability in every programme aimed at stimulating savings and at curbing capital outflows. However, this does not mean that the success of those policies will necessarily be followed by a rise in savings and investments. This will depend also on political stability, on the clear delineation of property rights, on real investment opportunities for large and small private operators and on the price they have to pay for financing their business activities.

207. Wherever possible, it is necessary to enhance the efficiency of the banking system in order to cut down the costs of bank intermediation and the subsequent effects of interest rates penalties on savings, with adverse effects on corporate financing. This entails a reduction in direct controls and increased competitiveness within the system. On the other hand, capital flight has been triggered not only by the mentioned factors above, but also by the scarce opportunities for financial investment. A special effort should be made in designing new financial instruments, and this holds true particularly for those developing countries with a relatively high income level. According to several authors, prompt repatriation of the financial resources exported from indebted developing countries is unlikely, even with successful stabilization policies and the application of positive real interest rates. Therefore, it is necessary to differentiate the forms of investment and above all to bring about a permanent improvement in the economic and financial environment which, among other things, is conducive to the promotion of political stability and to the acceptance of more open access to markets.

208. The points illustrated so far underline the idea that these are pre-conditions for economic and financial recovery, although they are not always related to those

macro-economic factors that are mainly taken into consideration by the international financial institutions responsible for recommending developing countries' adjustments; rather, they are related to micro-economic aspects. 6/ 7/

Notes

1/ Simulations have been carried out to show the effects of providing the highly indebted countries with grants alleviating their external debt and transfer-of-resources problems. First, in the IMF World Economic Outlook of 4 March 1988 and 7 March 1988, a simulation with the MULTIMOD model of the international economy is reported. This simulation represents an attempt at examining the consequences of a grant of $20 billion per year, over five years, from the industrialized countries to the highly indebted developing countries to pay for debt service. By the third year the percentage deviation in the total industrialized countries' GNP is 0.33 per cent which, bearing in mind an OECD global GNP of about $11,000 billion, entails a sum of about $36 billion, something more than 1.5 times the annual sum contributed by these same countries. In the World Economic Survey for the year 1989 (United Nations publication, Sales No. E.89.II.C.1, pp. 40 and 41), the consequences of a set of measures entailing a cut of between $15 and $19 billion in debt service is examined with the help of the LINK model. By the second year, the deviation in developed countries' GNP is 0.4 per cent, which is more than $40 billion and more than twice the relief granted.

2/ Assuming a satisfactory distribution of the product per employee between labour **L** (including entrepreneurs) and capital **K** an **Ap** growth rate in productivity will enable interest to be paid **i > Ap**, without modifying this distribution. An interest **i > Ap** can hold out only temporarily, subject to a capital yield appearing too low from the start. It must be said that, in the long run, **l < Ap** systematically implies the compression ---> 0 of pay per unit of Labour **Lw**. With unemployment, every **l > Ap** implies that new employees **AL** are paid less than existing ones, or indeed that with **i > Ap** all net pay is reduced. With full employment, **i > Ap** can to a certain extent simply lead to better pay for employees **Aw < Ap**. Over a certain level given by **WxL / i x K, i > Ap** implies the reduction of **w**.

3/ See I. T. Cuddington, Capital flight: estimate, issues and explanation, World Bank Discussion Papers, World Bank, 1985; and G. Perasso, Capital flight and foreign debt accumulation: a note on Argentina, in Helen O'Neil (ed.) Third world debt, how sustainable are current strategies and solutions (Frank Cass, London, 1990.

4/ See S. M. Collins and Wona-Am Park, External debt and economic performance in South Korea, in J. Sachs (ed.) Developing country debt and the world economy, National Bureau of Economic Research, The University of Chicago Press, 1989.

Notes (continued)

5/ Easterly, W. R., "Fiscal adjustment and deficit financing during the debt crisis", Policy, Planning and Research Working Paper 138, World Bank, 1989.

6/ See Martin Murtfeld. The debt problem and private capital flows, report presented at the European League for Economic Co-operation, Kronberg Tanners, November 1987.

7/ In an important recent paper, Williamson summarizes in 10 points the "Washington view" on guidelines for the adjustment process of countries facing a debt crisis. The points specifically relate to Latin America but appear more generally applicable.

The first point obviously is reduction of fiscal deficit. However, the target, in the Washington view, has been restricted, excluding from expenditure the nominal component of the interest payments on public debt related to inflation or even concentrating only on primary deficit (which to Williamson seems excessive).

On the other hand, the deficit should include guarantees given to savings and loan institutions by the Government; subsidies paid directly by the central bank; the build-up of future social security holdings (obviously net of future revenue from social security contributions). The receipts from privatizations should not be included in the revenues but in the means of financing the deficit.

A second theme is public expenditure priorities: subsidies are considered as the primary candidate for reduction or preferably elimination (Williamson convincingly argues that a better course would be to limit subsidies, maintaining only those carefully targeted to basic needs and to real improvements in allocation of resources). Public expenditure on human capital (education and health) on the other hand, together with public expenditure for infrastructure, should be considered a priority and improved.

A third theme is tax reform, including broadening the tax base and perhaps reducing marginal rates. A controversial point is taxation of residents' income from flight capital abroad. Williamson argues that attempts should be made to include it in the tax base in order to discourage such practices. At any event one may argue that selective consumption taxation and property taxes bring under taxation residents who may escape income taxation through capital flights and are able to live an affluent life on the earnings therefrom.

A fourth theme has to do with interest rates. Two principles appear dominant in the Washington credo according to Williamson: real interest rates should be positive to discourage capital flight and encourage domestic savings; and interest rates should be market-determined. The interesting view of Williamson is that these two statements should be accepted with the qualification that interest rates should be positive but moderate, so as to promote productive investment and avoid the threat of an explosion in government debt. However, a note of caution must be sounded about too low an interest rate when the supply is inelastic. Financial assistance should be used to increase elasticity, as regards real and human capital. The two principles - market-determined interest rates and moderate

interest rates - may conflict in crisis conditions like those of Latin America. Then, as Williamson says, one must examine whether either principle has been followed and what sort of compromise has been or could be achieved. Williamson argues that segmentation of the credit market to favour priority sectors may provide a prime environment for corruption to flourish.

On exchange rates, the fifth theme, Williamson argues that the dominant Washington view is that one should achieve competitive exchange rates. Williamson's statement that the exchange rate needs to be sufficiently competitive to promote a rate of export growth that will allow the economy to grow at the maximum rate permitted by its supply-side potential, while keeping the current account deficit to a size that can be financed on a sustainable basis deserves consideration. An exchange rate more competitive than that would produce unnecessary inflationary pressure and limit resources available for domestic investment, i.e. the supply-side potential. In any event, these real exchange rates should be stable to justify investment in export industries.

On the sixth theme, trade policy, the Washington view, obviously, is that import liberalization should be constantly pursued and, in particular, import licensing, with its potential for creating corruption, should be abolished. According to Williamson three qualifications are appropriate here: infant industries may merit substantial, even if temporary, protection; a general underrated tariff - between 10 and 20 per cent - with little dispersion, should be accepted to provide a basis for diversifying the economy and to retain a weapon to stimulate regional policy. Finally, protection needs to be dismantled gradually to favour the reconversion rather than the destruction of resources and massive unemployment.

The seventh theme is direct foreign investment. It should be favoured because of the need for foreign capital which otherwise has to be acquired mostly through foreign debt. Direct investment introduces skills and know-how, contributing to domestic supply and exports.

On the eighth theme, privatization, the balanced position of Williamson seems particularly worthy of consideration: privatization can be very constructive where it results in increased competition and useful where it eases fiscal pressure but the belief that public service is always inferior to private acquisitiveness as a motivating force is unconvincing.

On deregulation, the ninth theme, one may not always share the enthusiasm that has been shown in recent years in industrialized countries where there is now an upsurge of serious problems in the deregulated areas of banking, transportation and the environment. Certainly, due attention should be paid to Williamson's statement that the potential pay-off of deregulation is much greater in Latin American countries, which are among the most regulated market economies, "at least on paper", not only through legislation and government decrees but also and particularly through case-by-case decision-making, creating considerable uncertainty and opportunities for corruption.

The tenth theme in the list of Washington views on adjustment policies is that of property rights. Williamson maintains that they are highly insecure in Latin America. In agreeing with this statement, one should point out that a democratic Government with clear and stable constitutional rules, while providing respect for individual dignity and self-determination, leads to a frame of legal principles and institutions where property rights may be firmly and equitably secured. (See J. Williamson "What Washington means by policy reforms", with comments by R. J. Feinberg, S. Fisher, A. H. Metzler, P. Meller in J. Williamson (ed.) Latin American adjustment. How much has happened?, Institute for International Economics, Washington, D.C., 1990.)

On the issue and concepts of fiscal deficit see V. Tanzi, "Fiscal policy and economic restructuring in Latin America", paper presented at the Conference on the Economic Reconstruction of Latin America held by the Fundaçao Getullo Vergas, in Rio de Janeiro, August 1989.

On the issue of excess regulations in Latin America, see B. Balassa, G. Bueno, P. Kuczynski and M. E. Simonsen, Toward renewed economic growth in Latin America, Rio de Janeiro, Fundaçao Getullo Vergas, 1986.

A warning on the possible excess of interventionism comes from an economist of such important theoretical as well as practical expertise as Enrique Iglesias. In the paper "From policy consensus to renewed economic growth", in the same volume, he writes "Our generation was one that believed strongly in the role of the State. I continue to think the State has a major role to play, but perhaps we went too far and asked Governments to do too many things. We asked more of our Governments than they could deliver. The recent history of the region shows that we were unable to build efficient, stable and equitable economies. There is an irony in this, in that many of the inefficiencies that were the result of policies implemented in the name of the poorer class ended up in benefiting the upper classes".

Enrique Iglesias points out that an important consequence (and factor) of the Latin American crisis is the enormous deterioration of institutions in the 1980s across Latin America. "Central banks, planning ministries, economic ministries, public enterprises, all have been affected not to mention the deterioration of public infrastructure, which for us at IDB could become the main agenda in itself. If we devoted all the Bank's money to helping restore and rehabilitate infrastructure, we would scarcely scratch the surface". Probably also this comment applies more generally - with certain exceptions - to other debt-burdened developing countries.

IV. THE SCOPE OF THE PROBLEM IN DIFFERENT AREAS AND GROUPS OF COUNTRIES

209. According to World Bank estimates, in 1989 total debt 1/ was projected to amount to $1,165 billion, while according to IMF estimates it is approximately $1,194 billion, and is expected to reach $1,250 billion in 1990. Taking, for the sake of simplicity, World Bank figures 2/, in 1990 the long-term debt is an estimated $995 billion, while in 1988 it already totalled $980 billion.

210. This order of magnitude of debt indicates a major crisis and raises the issue of a debt moratorium or a significant reduction in debt repayments. Since 1980, interest arrears have accumulated on this debt at the following disturbing rate:

Table IV.1 Interest arrears
(Rounded figures in billions of United States dollars)

1980	1982	1983	1984	1985	1986	1987	1988	1989
0.79	3.17	5.54	7.99	7.50	11.06	19.23	23.60	21.35

Source: World Bank, World Debt Tables, 1989-1990.

211. Moreover, as a rule, the financial cost of debts incurred with banks and private institutions is higher than the cost of debts incurred with other official sources (Governments, i.e. bilateral debts, and international institutions, i.e. multilateral debts). In the latter case, interest rates - most of which are variable - are lower, reaching about 2 per cent, reflecting concessionary elements. Out of a total long-term debt of $995 billion in 1989, debts to private creditors amounted to $465 billions, i.e. 47 per cent of the total. 3/

212. The issue of cancelling or reducing debt in the most highly indebted countries has mainly been considered a matter for the private banking system. This is a wrong perspective - in fact, more than half the debt is owed to official creditors. Almost $200 billion is owed to multilateral organizations, while $270 billion is owed to Governments or agencies thereof, such as investment insurance agencies. Commercial bank credits amount to approximately $330 billion. Considering only countries with particularly severe problems, such credits total $280 billion, thus accounting for respectively 28 per cent and 24 per cent of the overall debt of the developing countries according to World Bank estimates, which also include bank credits.

213. The idea that debt to public agencies, being lent at concessional terms, is less important is largely groundless. In 1988, out of $176 billion in multilateral credits, $57 billion was issued at concessional rates, while the figure for non-concessional credits is a little more than twice that amount.

214. As for bilateral credits, concessional credits are higher: $144 out of $266 billion in 1988, (i.e. 55 per cent). Many credits are guaranteed at market rates by public institutions.

215. In total, in 1988, out of $442 billion worth of loans issued by official creditors, official concessional credits amounted to roughly $200 billion, while non-concessional credits totalled more than $240 billion. The interest rate applied to non-concessional credits is more or less the same as the rate applied by private lenders, notably for trade credits.

216. Lower interest rates are usually those applied to that part of credit consisting of publicly guaranteed bonds, issued to finance loans.

217. In other words, it is not true that the problem of relieving the debt burden principally concerns debt to banks. More than 40 per cent of it, mostly lent at market rates, emanates from official creditors, whose words, in most cases, up to now belie their actions.

218. At the same time, almost $100 billion worth of credit was offered by private institutions other than banks, and slightly less than $50 billion consists of bonds. Out of a total $730 billion non-concessional, long-term credits, debts to banks account for less than half, i.e. 45 per cent. It is therefore a mistake to focus attention only on this aspect. Even other creditors must play their part. If everybody plays his fair part - with the same effort required by the banks as others, the positive outcome will be more evenly distributed.

219. This huge amount of debt accounts for 44 per cent of the gross product of indebted countries and is twice the value of their exports. Interest paid, on its part, accounts for about 3 per cent of GDP and represents 13 per cent of exports. Adding amortization, the percentages of GNP and exports double. These figures, however, are still misleading. In fact, besides interest paid, arrears must be taken into consideration, accounting for 1 per cent of GDP and more than 4 per cent of exports. In 1989, arrears for the middle-income, heavily indebted countries amounted to $3.6 billion, as against $2.8 billion in interest paid. Again in 1989, arrears in middle-income countries totalled as much as $17 billion, as against $40 billion in interest paid.

220. In total, the bulk of arrears in these countries accounts for almost 2 per cent their GDP and 11 per cent of their exports. In theory, in those countries that are officially known as heavily indebted countries, interest due accounts for 6 per cent of GDP and 33 per cent of exports. The total debt of developing countries doubled between 1980 and 1989 (see table IV.2).

221. While GDP increased by barely 30 per cent and exports by 36 per cent, total long-term debt increased by over 130 per cent. However, official credits almost doubled, whereas bank credits increased by 93 per cent. Thus, as credits progressively became public credits, the focus of the problem shifted. Such a shift of emphasis was realized only belatedly, as is shown by the gap existing between the means made available to the Brady Plan and the emphasis laid on it, as well as by the low profile of the programmes worked out within the Paris Club on the basis of the agreement reached in Toronto.

Table IV.2 Overall debt of developing countries deterioration: 1980 - 1989
(data expressed as a percentage)

Items	Variations 1980-1989	On yearly basis
Debt stock	103.60	11.51
Long-term debt	132.40	14.71
Interest payment	67.10	7.46
Official creditors	196.30	21.30
Banks	92.70	10.30
Global debt service	75.80	8.42
Interest (arrears on long-term credits)	2 300.60	255.62
New loans	99.15	11.02
GDP	28.20	8.18
Exports	36.90	4.10
Items	**1980**	**1989**
Net transfers - US$ bn (residual btw. new loans and debt service)	19.61	-51.63
Debt stock/GDP	27.80	44.10
Debt stock/exports	132.20	197.00
Interest (inc. arrears)/GDP	1.60	3.50
Interest (inc.arrears)/exports	7.40	16.70
Service (inc. arrears)/GDP	3.70	3.70
Service (inc. arrears)/exports	17.50	31.00

Source: Elaborated from World Bank, World Debt Tables, 1989-1990.

222. Mainly because of arrears and intervention by official creditors, interest payments and debt servicing (because of some reschedulings) increased considerably less than the overall debt and the total long-term debt. However, this did not help the search for solutions to the problem, since the growth rates of GDP and exports, as already noted, remained rather low. They account for one third of the interest and debt servicing growth rates and little more than one quarter of the overall long-term debt.

223. As a whole, over the nine years considered, the average annual growth rate of the nominal GDP was equal to 3 per cent, with an export growth rate of 4 per cent. On the other hand, the interest rate was equal to 9.5 to 10 per cent on the United States market (non-weighted average) and to 7.4 per cent in indebted countries (including arrears).

224. New money increased by almost 100 per cent, mainly because of rescheduling arrangements and official credits lent to solve difficult situations promptly.

225. In the light of the low nominal growth rates of GDP and exports, as well as the debt crisis, the figures pertaining to net transfers are impressive: they fell from $20 to about -$50 billion.

226. These aggregate figures, while providing a valuable overview of the parameters of the crisis, do not take into account the whole range of situations, which vary from State to State. The following three categories of States hit by the debt crisis emerge: middle-income, heavily indebted countries; low-income, heavily indebted countries; and low-income moderately indebted countries.

227. In middle-income countries, debt to commercial banks accounts for over half of the overall total. In low-income, moderately indebted countries, it accounts for only 8 per cent and, in absolute terms, it amounts to less than $8 billion. In poor, heavily indebted countries total debt to commercial banks barely exceeds 10 per cent of the overall total. As a whole, the debt of these two groups of countries amounts to less than $20 billion, as against $255 billion in middle-income, heavily indebted countries (whose official list is incomplete, since Egypt should also be included).

228. Of course, the ratio is reversed in the case of official credits, and especially concessional official credits. Overall official credit to poor countries amounts to $130 billion, as against $140 billion in middle-income countries. In poor countries official concessional credit totals $44 billion, whereas in middle-income, heavily indebted countries it amounts to $30 billion.

229. The percentage of debt to GDP is a little lower in middle-income, heavily indebted countries and in poor, moderately indebted countries, where the debt burden on exports is lower anyway. As most loans in poor countries are official loans, the burden of interest on the total debt is considerably lower: an average 5.5 per cent of the principal as against 11 per cent in 1989.

Table IV.3 Main debt indicators by class of developing countries

(In millions of United States dollars and percentages)

Items	Middle-income severely indebted countries a/	Poor moderately indebted countries	Poor severely indebted countries
Debt stock	517 669	94 460	107 315
Long-term debt	442 256	82 483	94 533
Official creditors	142 331	64 109	67 521
Bilateral debt	83 856b/	36 690b/	41 597b/
Concessional debt	30 278	17 123	26 618
Private creditors	299 920	18 376	27 012
Commercial banks	255 164b/	7 634b/	11 791b/
Interest paid	39 880	5 206	2 829
	57 100		6 500
Arrears on long-term debt	17 228	0	3 656
Interest on debt stock	11 000	5 500	6 100
Debt service (incl. arrears)	84 000	13 457	10 000
GDP	951 937	159 457	79 600
Exports of goods and services	163 416	36 976	21 535
Exports as a percentage of GDP	17.2	23.1	26.9
Debt as a percentage of GDP	54.4	59.4	74.5
Debt as a percentage of Exports	316.8	255.1	497.7
Interest as a percentage of GDP (incl. arrears)	0.6	3.2	8.1
Debt service (incl. arrears)	34.5	14.1	30.2
Debt service as a percentage of GDP (incl. arrears)	8.8	8.4	12.5
Debt service as a percentage of exports (incl. arrears)	52.0	36.2	46.5
Net transfers	26 316	1 012	1 335
Transfers by banks and other private institutions	16 051	2 781	-648 000
Long-term variable debt	304 230	17 123	16 124
Current balance of payments	-11 911	-5 623	-5 958

Source: World Bank, World Debt Tables, 1989-1990.

a/ Including middle-low income countries.

b/ 1988 figures.

230. This situation affects the ability of these countries to tackle the problem of debt servicing: interest as a percentage of GDP amounts to 6 per cent in middle-income, heavily indebted countries and to 3.2 per cent in poor, moderately indebted countries. The export percentage in poor countries, as well as in middle-income, heavily indebted countries that export mainly raw materials and commodities, is higher, because of their low level of GDP. As a consequence, in poor, moderately indebted countries, interest as a percentage of exports is less than 15 per cent, whereas in middle-income, heavily indebted countries it goes as high as 34 per cent. Adding amortization, in the latter countries debt servicing in theory is equal to over half the exports, whereas in poor, moderately indebted countries it is equal to 36 per cent. The pressure exerted on GDP is also considerable in these countries.

231. However, the situation of poor, heavily indebted countries is by far the worst: interest exceeds 8 per cent of their modest levels of GDP, while debt servicing reaches 12.5 per cent. In order to pay the debt service, half their exports would be needed, but since this is clearly not possible, trade and financial chaos prevails.

232. Table IV.4 gives combined figures for the three groups of countries and highlights the most severe debt problems (the World Bank figures are not updated, in that Egypt should be included among middle-income, severely indebted countries).

233. The three categories of countries certainly have different problems in relation both to total debt and to economic conditions. However, what all of them have in common is the priority nature of their problem, brought about either by their extremely severe debt situation or by the fact that their very poverty is a factor in the crisis, or else by the tragic combination of these two elements in poor, heavily indebted countries.

234. An analysis of their economic aggregates shows that, even though the crisis is extensive and harsh for debtors, yet, from the qualitative viewpoint, its variables have relatively little impact on industrialized countries. As a consequence, the problem is not intractable at the macro-economic level.

235. The overall debt to be considered when aiming at reductions in middle-income, heavily indebted countries and in low-income, heavily indebted countries and virtual debt cancellation in low-income, heavily indebted countries amounts to $720 billion. Short-term credit is linked to commercial transactions by debtor countries, and cannot be tampered with, for technical reasons. Long-term debt amounts to $620 billion.

236. The private share, incurred with commercial banks, totals $280 billion, $250 billion of which is owed by middle-income countries. This is the amount on which attention must be focused when dealing with the different reduction operations, such as bank debt conversion, as suggested by the experience gained through the Brady Plan, as well as by the different official proposals put forward by the banking sector and by independent experts. However, the bank debts of Mexico, Venezuela, Costa Rica and the Philippines must be deducted from this total amount, while that of Egypt must be added, giving a total of $140 billion.

Table IV.4 Main debt indicators of developing countries with major debt problems, 1988

(In millions of United States dollars and percentages)

Items	Heavily indebted countries and low-income moderately indebted countries	Developing countries
Debt stock	719 000	1 165 000
Long-term debt	619 000	994 000
Official creditors	974 000	467 000
Bilateral debt	162 000	270 000
Concessional debt	80 000a/	202 000a/
Private creditors	345 000	465 000
Commercial banks	280 000	396 000
Interest paid	48 000	77 000
Interest paid to banks	25 000 (20 000)b/	34 000 (27 000)b/
Arrears interests	21 000	22 000
Interest due (total)	69 000	99 000
Debt service	87 000	163 000
Arrears debt service	107 000	184 000
GDP	1 191 000	2 640 000
Exports of goods and services	222 000	593 000
Debt as percentage of GDP	60	44
Debt as percentage of exports	324	197
Interest as percentage of GDP	4	3
Interest due as a percentage of GDP	5.8	3.8
Interest as a percentage of exports	21	13
Interest due as a percentage of exports	31.1	16.7
Debt service as a percentage of GDP	7	6
Owed debt service as a percentage of GDP	9	7
Net transfers		52 000
Transfers related to banks and other private institutions	-30 000	-38 000
Bank transfers	-35 000	-32 000
Long-term variable debt	338 000	471 000
Current balance of payments	-23 000	-38 000

Source: World Bank, World Debt Tables, 1989-1990.

a/ 1988 figures.

b/ Figures between parentheses show interest paid on guaranteed credits.

237. Within official credits, the burden consists of reductions and virtual debt cancellation totalling an estimated maximum of $273 billion, $162 billion of which is owed to Governments and roughly $100 billion to international organizations. Apparently, this total is equal to that of bank debt, but this is really an estimated maximum. Part of these credits, i.e. $80 billion, was already lent at concessional rates, and therefore what is involved is a capital value of $190 billion.

238. In poor, heavily indebted countries, there is $44 billion in bilateral debt, which, net of concessional debt, falls to $24 billion.

239. Interest that requires reduction or virtual cancellation and for which guarantees (which are in part the counterpart of reductions) must be granted is due on $69 billion paid and owed by this same group of countries. As for commercial banks, interest paid and interest arrears together amount to $20 to $25 billion. Excluding the countries where the Brady Plan is being implemented and adding Egypt, the amount is $78.5 billion in interest due ($3 billion in interest paid and arrears in 1988).

240. A further $12.5 billion in interest is owed to official institutional creditors - half multilateral and half bilateral. In this case, reduction mechanisms depend directly on political decisions.

241. Even multilateral public financial bodies, when financing themselves in the market or applying to their official subscribers, pay interest comparable to market interest rates, comply with strict financial rules and act according to market rules. State insurance bodies have also to come to terms with their business budgets. As for development assistance policies carried out by Governments and international agencies, loans are distinguished from grants and concessional rates are given in relation to budget requirements, sometimes on too restricted a basis.

242. Such cases, however, unlike the banks' decisions on debt reduction or debt cancellation, do not affect private budgets or the credit system, which fuels itself on private decisions to deposit or purchase shares by lender companies. Such decisions, however, do affect international liquidity sources and public budgets of the industrialized States. The final decision implies the exercise of "quantitatively" influential political power, such as monetary and fiscal power. Decisions will be limited in scope, but not in effectiveness, with respect to the overall balance of industrialized economies and their overall growth capabilities.

243. In the three groups of countries most severely affected by the debt crisis, negative net transfers amount to roughly $30 billion a year. Such transfers could be less of a burden if there were reductions, or cancellations, maturity extensions and new finance available, supported or encouraged by Governments.

244. Assuming a positive capital-income ratio, this would result in an additional flow amounting to $10 billion, or 0.85 per cent of the GDP of the countries concerned. As a total, over a 10 year period, the figure should be in the range of $120 billion, or 10 per cent of GDP. However, the consequences of the above transactions cannot be expressed in quantitative terms.

245. In fact, the debt burden as reflected in interest and amortization leads to deflation and devaluation which, as shown by past experience, have economic and political destabilizing consequences that can hardly be quantified and in any case far exceed the income reduction corresponding to the net transfer of resources.

246. It will be sufficient to note that, if exports account for 20 per cent of GDP - as in the case of the countries concerned - then, given zero import-export elasticity, a 20 per cent deflation of GDP is necessary to pay for debt servicing accounting for 20 per cent of GDP. Since debt service is equal to almost 40 per cent of exports, the required deflation is 40 per cent of GDP. Assuming +0.5 elasticity, the reduction would be equal to 20 per cent of GDP.

247. Assuming an elasticity of 1, which is not very realistic in the presence of competitive devaluations by the indebted countries, the required deflation would be equal to 20 per cent of GDP. On the other hand, an adjustment process of this magnitude would have such profound repercussions on import prices that it certainly would entail heavy inflationary consequences.

248. Finally, since such transactions cannot be accomplished by resorting to monetary intervention alone, in order to reach the desired fiscal results the adjustment process must be staggered. However, the prospects of further devaluation must have detrimental consequences. These can be easily observed from the response of the economies oppressed by the debt to a decrease in financial flows and to a pervasive lack of investment of domestic and international capital.

249. To conclude, while the scope for intervention is economically compatible with the equilibrium and the growth of the industrialized economies, as well as with the means made available by their fiscal systems and the world monetary order, the lack of adequate intervention by these countries has many adverse consequences, whose wide scope gives rise to dramatic crises in the economies of the indebted countries. Without external action, overcoming such crises seems impossible.

Notes

1/ Figures from World Debt Tables, December 1989; subsequent data, only sometimes available, are unofficial.

2/ When the IMF figures differ considerably from World Bank ones, they will appear in footnotes. The difference is mostly due to the fact that the World Bank considers primarily data provided by the Governments of member countries to its Debt Reporting System.

3/ Of course, according to the World Bank estimates which also include bank credits.

V. BANK EXPOSURE AND POLICY IN DEVELOPING COUNTRIES BEFORE AND AFTER PROVISIONING

A. Bank provisioning and the debt game

250. In late 1988, medium- and long-term debts contracted with all banks by public and private bodies - whether or not they were guaranteed by the public institutions of countries lending to developing countries - totalled $636 billion and those of highly indebted countries accounted for $275 billion. Out of the total, $246 billion was owed by Latin America, $56 billion by Africa, $87 billion by Eastern Europe and $138 billion by Asia, only a part of which was due from countries with solvency problems.

251. At the end of 1988, total bank loans from the eight major financial countries to Latin America were estimated at $200 billion, compared with a global total of $235 billion; $77 billion was owed to United States banks above (see tables V.1 and V.2).

252. The flow of bank loans to countries with debt problems is now very much reduced. The reason for such a virtual halt in the flow of fresh capital is to be found in two interrelated events that took place in 1984 and 1985. Many of the creditor banks attempted to get rid of their loans to heavily indebted countries by selling them off. However, the supply of such securities exceeded demand, even at low prices. As a consequence, prices for such loans in what is known as the secondary market for those credits fell gradually.

253. At the same time, from 1987 on debt devaluations on the secondary market, together with usually confidential strategic considerations, led banks in the major creditor countries to build up provision covering their lending to several bodies in heavily indebted States.

254. There are several estimates of prices on the secondary market, depending on the various sources, since it is not an official market. However, data produced by the London International Bank Credit Analysis (IBCA) study group and by Salomon Brothers Inc., New York, suggests that in March 1988 the ratings trend for six heavily indebted Latin American countries was as follows: 7 per cent of the face value of the loan for Peru, 29 per cent for Argentina, roughly 50 per cent for Brazil, Mexico and Venezuela and 60 per cent for Chile. According to Salomon Brothers' ratings, the World Bank activity with the 15 most indebted countries shows an average of 35 per cent of the face value of the loan for 1987-1988, as against 43 per cent for the first quarter of 1988.

255. An analysis of such ratings indicates that, contrary to bank expectations, given the strengthening of their bargaining positions, the large volume of provisioning in 1987 prompted a drop in secondary-market bids.

256. Ratings improved slightly for a short period of time but gradually went down on the whole, on a par with the reduced ability to pay of the debtor countries. In some cases, countries were applying moratoria or were announcing their intention to do so.

Table V.1 Exposure of major countries' banks to separate Latin American States
(end-1986)
(In millions of United States dollars)

World-wide bank exposure $ billions of United States dollars		US $ millions							
		Italy a/ b/	United States a/	United Kingdom a/	Japan b/	Canada b/	France b/	Germany a/	Switzerland a/
26.6	Argentina	704	9 046	3 677	4 300	1 438	1 900	3 266	1 250
0.7	Bolivia	1	89	94	-	84	100	103	15
77.9	Brazil	439	23 624	9 140	8 200	5 559	8 400	6 328	1 710
13.4	Chile	173	6 254	2 178	1 400	989	600	1 024	545
6.9	Colombia	16	2 155	756	1 000	492	600	507	150
5.0	Ecuador	67	2 017	760	700	288	200	331	85
71.8	Mexico	1 365	23 545	8 669	10 000	5 481	5 500	3 834	1 750
5.5	Peru	70	1 158	649	400	147	700	498	205
2.0	Uruguay	8	889	386	80	84	100	85	95
25.1	Venezuela	496	8 733	2 690	3 650	2 057	2 500	2 107	655
234.5		3 339	77 510	28 999	29 730	16 619	20 600	18 083	6 490

Source: Graham Bird Commercial Bank Provisioning against Claims on Developing Countries, World Bank Working Papers, International Economic Department, Washington D.C., October 1988.

a/ Central bank statistics.

b/ Estimates by the International Bank Credit Analysis Group (IBCA), London.

Table V.2 Total liabilities of developing countries to commercial banks in 1988
(medium- and long-term credits)
(In millions of United States dollars)

	Total	United States	France	United Kingdom	Germany	Italy	Japan	Switzerland a/	Netherlands
Total developing countries	636 324	92 594	82 363	60 538	80 592	12 323	83 952	24 059	7 979
By region									
Africa	56 778	3 514	21 419	7 019	9 016	506	4 126	2 559	946
Latin America	246 361	64 701	21 348	27 304	22 398	4 894	35 617	7 422	3 002
Asia	138 817	14 821	11 923	8 186	14 690	99	27 542	2 667	1 312
Middle East	59 825	2 756	6 644	5 033	5 902		819	4 124	320
Rest of Europe	47 547	5 321	7 828	5 370	10 304	297	847	3 214	553
Eastern Europe	86 996	1 481	13 201	7 626	18 282	6 528	14 911	4 073	1 847
Oil-exporting countries	209 110	32 240	28 032	1 898	17 947	2 060	26 251	7 574	1 932
Highly indebted developing countries	275 728	71 450	28 597	32 587	26 750	5 796	39 320	8 423	2 230

Source: Banca Nazionale del Lavoro, Research and External Research Department.

a/ Data referred to 1987.

Table V.3 Market prices of selected developing country debt
(As a percentage of face value)

	October 1985	October 1986	April 1987	March 1988
Brazil	78	76	64	48
Mexico	80	57	59	49
Argentina	65	66	60	29
Venezuela	82	74	74	54
Chile	69	70	70	58
Peru	33	20	18	7

Source: IBCA, London, and Salomon Brothers Inc, New York, from Graham Bird, op. cit.

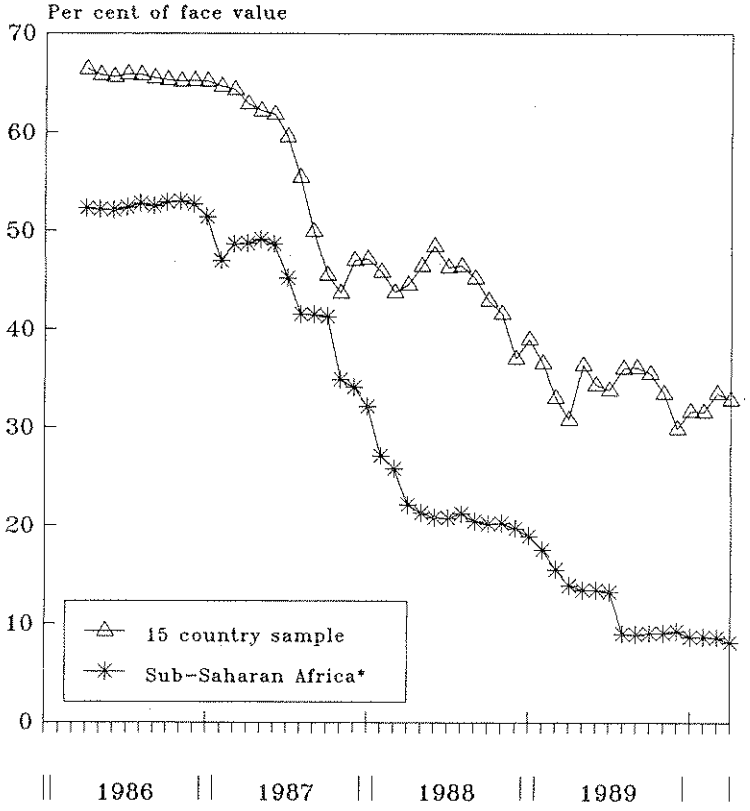
Table V.4 Secondary loan prices, at end of quarter
(As a percentage of face value)

	1987 2nd quarter	1987 3rd quarter	1987 4th quarter	1988 1st quarter	1988 2nd quarter	1988 3rd quarter	1988 4th quarter	1989 1st quarter	1989 2nd quarter	1989 3rd quarter
Highly indebted countries	58	45	46	43	44	41	37	33	33	35
Argentina	47	37	34	28	24	23	21	17	14	18
Bolivia	9	9	11	11	11	10	10	11	11	11
Brazil	61	39	47	51	50	46	40	34	31	28
Chile	69	56	61	57	61	60	57	59	62	61
Colombia	85	79	65	65	65	66	58	50	57	64
Costa Rica	36	25	13	13	11	13	12	13	14	17
Côte d'Ivoire	65	52	40	30	29	27	23	14	14	6
Ecuador	49	33	37	32	26	18	12	10	12	16
Jamaica	42	36	33	33	37	32	40	38	41	42
Mexico	56	47	50	50	50	47	43	40	40	41
Morocco	66	63	52	52	49	50	48	42	43	45
Nigeria	29	25	29	29	28	23	23	21	23	28
Peru	11	10	7	5	6	5	5	3	3	5
Philippines	69	59	50	51	54	52	49	41	49	49
Uruguay	74	66	59	60	60	60	60	56	55	55
Venezuela	70	53	57	53	54	48	41	34	37	40
Yugoslavia	75	60	49	47	46	47	45	44	50	54

Source: Salomon Brothers, 24 October 1989, and World Bank.

Figure V.1

Secondary market bids on bank debt of developing countries, 1986-1990



Source: United Nations Secretariat, Department of International Economic and Social Affairs, based on data of Salomon Brothers.

* Excluding Nigeria.

257. The Peruvian authorities stated that they were unwilling to pay back their debt, and in the first quarter of 1988 their rating on the secondary market fell down to 7 per cent and then fluctuated around that level. Argentina's debt was listed at less than 30 per cent and then fluctuated around 20 per cent. In the first quarter of 1988, ratings for Brazil, Mexico and Venezuela were at 50 per cent, but Brazil's dropped to 30 per cent, while Venezuela's and Mexico's fell to 40 per cent. Chile managed substantially to reduce its debt, which in 1988-1989 was rated at 58 to 60 per cent, against 70 per cent in 1985-1987.

258. For the 15 Baker countries, the United Nations figure, based upon data produced by Salomon Brothers, dramatically illustrates the downward trend. It shows that, from 1986 to 1988, average ratings for those debts fell from almost 70 per cent to less than 30 per cent and that the turning point was in 1987, a time of massive bank provisioning. The fall in secondary market bids can only partially be explained by cases of voluntary and involuntary insolvency, linked to the inability of indebted countries to pay. That drop occurred as a result of the policy adopted by the international banking system from 1987 onwards, through what is known as provisioning, namely the allocation of precautionary reserves in connection with such debts: it was a measure that made new loans to such countries dearer and that strangled debtors by depriving them of sufficient amounts of financial resources indispensable to repay their debts and to make the necessary investments in order to strengthen their future ability to repay.

B. Bank provisioning, the prisoner's dilemma, and the chicken game

259. Secondary-loan prices probably reflect a deep malaise in which emotional and psychological factors, together with reciprocal threats from banks and from indebted countries, strongly affect the price levels.

260. An analysis of provisioning carried out by banks of creditor countries suggests precautionary reserves representing roughly 15 per cent of the total exposure.

261. The trend towards massive provisioning started in early 1987 with the New York Citibank, which was the first bank to announce, with a strong publicity campaign, its decision to build up massive provisions to offset credits with heavily indebted countries.

262. The result of that decision was a rise in the price of Citibank securities in the New York stock exchange and pride of place for Citibank in the financial community since other United States banks had, as compared to their capital stocks and to the total volume of their loans, even higher amounts of outstanding credits.

263. At the end of 1986, Citicorp was the United States bank with the highest exposure in developing countries: over $15 billion. Yet it ranked second for overdue debts, with $3.3 billion, against $4 billion for Bank of America. Its total reserves were almost $2 billion and its overall capital stock, at $9 billion, was much higher than that of Bank of America, while its credit-capital ratio was higher than that of both Bank of America and Manufacturers Hanover Trust Co.

Table V.5 Commercial banks provisions against developing country loans, July 1987 estimates
(In billions of United States dollars)

Creditor countries	Reserves
United States	26.0
15 largest banks	4.0
other regional banks	
Japan	
22 largest banks	1.5
United Kingdom	5.0
France	10.0
Germany	13.0
Canada	2.0
Switzerland	3.0
Others	6.5
Total	71.0

Source: World Bank, updated by G. Bird, op. cit.

Table V.6 Developing countries' exposure, reserves and assets of American commercial banks, 1986, year-end data

(In millions of United States dollars)

									%	%	%	%	%
Citicorp	15 590	196 124	130 904	7 695	9 060	1 698	3 394	1 058	3.92	4.62	50.0	1.30	172
BankAmerica Corp	10 000	104 189	73 955	3 329	4 083	2 172	4 031	(518)	3.20	3.88	53.9	2.94	248
Manufacturers Hanover	8 400	74 397	56 273	3 123	3 766	1 008	2 135	411	4.20	5.06	47.2	1.79	223
Chase Manhattan	8 700	94 766	66 200	4 280	4 882	1 064	1 940	585	4.52	5.15	54.8	1.61	178
J.P. Morgan	n.a.	76 039	34 693	4 880	5 130	910	633	873	6.42	6.75	143.8	2.62	n.a.
Chemical New York	5 900	60 564	39 425	2 810	3 120	668	1 349	402	4.64	5.15	49.5	1.69	189
Bankers Trust	4 000	56 419	29 201	2 721	2 721	590	879	428	4.82	4.82	67.1	2.02	147
First Chicago	2 800	39 147	25 410	2 022	2 347	585	819	276	5.17	6.00	71.4	2.30	119
Security Pacific	1 850	62 606	44 343	2 575	2 875	757	1 198	386	4.11	4.59	63.2	1.71	64
Wells Fargo & Co	1 900	44 577	36 771	1 938	2 343	734	9 709	274	4.35	5.26	75.7	2.00	81
First Interstate	1 600	55 421	34 523	2 757	2 759	535	1 021	338	4.97	4.98	52.4	1.55	58

Source: IBCA, London.

264. However, given the magnitude of its loans to developing countries, Citibank was running great risks, though no greater ones than other banks. The choice made by Citibank can be explained with the concept of the prisoner's dilemma, in which one player is quicker or more determined than the others. 1/ If it had waited to build up provisions until other banks did the same, Citibank would have lost the advantage of the first move (stock exchange gains, proof of reliability to the shareholders and the Government, leading role in the banking community). The quick follow-up by other banks can be satisfactorily explained by the same concept.

265. The assumption that provisions would give banks more trading power is said to be justified by another model: the Nash-Harsanyi model of mini-max balance in trading. In this model the share of the penalty in the game - here, the loss rate on the debt (in terms of secondary-market bids) as a minimum for creditors and as a maximum for debtors and in terms of the official value of debts as a maximum for creditors and a minimum for debtors - depends on the largest bonus of the players, and also on their positions in case of no agreement. The penalty will consist, in the worst case, not in the lending bank going bankrupt but in a loss partly covered by constantly rising reserves.

266. However, from 1992 onwards the United States tax system will no longer allow tax deduction of such reserves, a result of President Reagan's tax reform. The deduction has been gradually reduced since 1987.

267. By its actions Citibank confronted the Unites States tax system with an urgent problem and a strong incentive to solve it in a constructive and comprehensive way before the tax reform. General reserves against bad debts were and still are not deductible in bank balance sheets; but specific reserves against risk countries could be deducted in the form of a specific reduction in the book value of such credits. To obtain it, it was necessary to negotiate with the tax authorities on the basis of the size of the business. However, the effect of provisioning was so pervasive that it led to a depression of secondary loan prices, since it showed that the same banks that were building up provisions had little faith in being able later to collect their debts in full. Above all, it highlighted the banks' refusal to grant fresh loans to the countries in question, given the need to build up provisions for them, thereby acknowledging that such loans had been granted to high-risk countries.

268. Given the United States banking regulations, the consequence of provisions built up on old loans was that such provisioning then became necessary even for fresh loans. There can be little doubt about the higher cost of a new loan if a 30 per cent provisioning is attached to it, particularly because accounting rules make it obligatory to reduce the overall amount by the same percentage; and this procedure will be followed at least until tax benefits accrue.

269. Be that as it may, Citibank pushed the other banks in the United States and in the rest of the world into building up provision. Had other banks not done the same, they would have appeared less trustworthy. A further slowdown in the flow of investments in indebted countries had to follow, given the additional cost of setting up reserves. The result has been a further slackening in the listing of such credits on the secondary market because the ability to pay of debtor countries

was undermined. As occurs in the prisoner's dilemma, in the end all players (here credit banks) end up in a worse position than they would have been had they adopted a joint policy of a different nature.

270. The result was also the onset of a period of non-co-operation between debtors and creditors, which reduced the maximum benefit and raised the cost of losses in the bargaining for both sides because the refusal to grant new loans before full service is paid is for all sides worse than granting new loans. To take an analogy from another game, a situation of generalized handicap emerges that is peculiar to the "chicken" game, in which everyone wants to intimidate everyone else until they eventually agree to surrender, with the result that everybody loses. 2/

271. Banks in the United States and in other creditor countries have built up provisions to the tune of one quarter to one third of the total amount of their loans to debtor countries with repayment problems. Although further examination is still necessary, it is likely that by mid-1990 the level of provisioning will be very close to the higher of these two figures. This represents a tremendous change compared with 1986, when the debt crisis of the third world could still spell crisis for the United States and the international banking systems.

272. Besides, failure to reach an agreement, plus the continuation of the suicidal "chicken" game, led to such a deterioration that provisions became insufficient. It is also true that for an individual creditor the best situation would be for others to make the first move and sacrifice themselves to the advantage of the one who does nothing and obtains the benefit of the agreement with no costs, according to the well known model of the free rider common in tax theory: everybody would like somebody else to pay for financing public expenditure.

273. Although such provisions seem likely to avert a crisis of the banking system, they bear no relation to the market prices of debts deriving from loans granted to countries facing repayment difficulties.

274. Tables V.8 and V.9 show that, for the United States additional reserve provisioning on credits to developing countries led to a rise in the share of total reserves against credits with such countries in the order of 31 per cent for the Bank of America (18 per cent in 1987), with a maximum of 33 to 35 per cent in 1987 for Security Pacific, First Chicago and First Interstate, while Morgan Guaranty reached 25 per cent.

Table V.7 Banks reserves against developing country loans
(In percentages)

	1986	1988
Canada	10-15	35
France	33-45	45
Germany	35-70 (40)a/	50
Japan	5	10
Switzerland	30-60 (40)a/	50
United Kingdom	6-10	35
United States	5	30

Source: IBCA, London, and World Bank, World Debt Tables, 1988-89.

a/ Figures in brackets given an approximate average where there is a considerable range of experience among banks.

Table V.8 Developing countries' exposure, reserves and assets of American commercial banks, 1987-1988

	Developing country exposure	Additional provision	1987 earnings	Total	Developing country		Other	Reserves/ loans %	Reserves/ developing country exposure %		Non - developing country reserves/ NPLs %	Common equity assets %	Total assets %
Citicorp	15 590	3 000	(1 000)	4 900	3 500	1 400	3.7	22.5	41.2	3.30	4.01		
Bank America Corp. b/	10 000	1 100	(750)	3 300	1 800	1 500	4.5	18.0	37.2	2.44	3.13		
Manufacturers Hanover	8 400	1 700	(1 050)	2 700	1 850	850	4.8	22.0	39.8	2.74	3.62		
Chase Manhattan	8 700	1 600	(850)	2 700	2 000	700	4.1	23.0	36.1	3.45	4.09		
J.P. Morgan a/	5 900	1 100	(710)	2 074	1 380	694	4.1	24.8	47.9	3.27	3.79		
Chemical New York c/	4 000	700	(175)	1 300	1 000	300	4.5	25.0	34.1	4.36	4.36		
Bankers Trust	2 800	800	(435)	1 370	935	435	5.4	33.4	53.1	3.89	4.74		
First Chicago	1 850	500	150	1 300	650	650	2.9	35.1	54.3	4.19	4.68		
Security Pacific	1 900	n a	n a	n a	n a	n a	n a	n a	n a	n a	n a		
Wells Fargo & Co. a/	1 600	750	(200)	1 200	530	670	3.5	33.1	65.6	4.45	4.46		
First Interstate													

Source: IBCA, London.

a/ Bank had not announced a reserve increase at the time this table was completed, although they did subsequently.

b/ BankAmerica indicated that its reserve was for 25 per cent of its $10 billion developing country exposure, but that ratio is achieved only after adding back about $800 million of "allocated transfer risk" reserves and prior charge-offs of the developing country loans.

c/ Adjustments have been made in the data for Chemical Bank to reflect the acquisition of Texas Commerce in May 1987.

Note: Several of the banks stated that their developing country reserves were 25 per cent of developing country exposure but this was accomplished by adding back the "allocated transfer risk" to reserves. The table does not add back this reserve and thus the ratios are slightly lower.

The non-performing loan totals are for year-end 1986 and thus do not include the Brazilian loans placed on non-accrual status in the first quarter.

The adjustment equity-to-assets ratios assume that the holding companies pay the same dividends in 1987 as in 1986 and that asset totals at year-end 1987 are the same as at year-end 1986.

Table V.9 Effects of increased reserves for developing country loan exposures for United States banks
(In percentages)
A.

	Stock symbol	Date of reserve addition	Developing countries a/ exposure	Pro forma reserve coverage of: Total b/ loans	Total c/ M.P. loans
Citicorp	CCI	19 May 87	25	3.68	76.1	98.9
Northwest	NOE	26 May 87	34	4.01	98.5	121.4
Chase	CHE	27 May 87	26	4.05	58.5	69.3
Security Pacific	SPC	01 Jun 87	36	2.03	71.0	77.0
Rainier	ROAM	02 Jun 87	33	2.07	98.1	83.4
Mercantile Bancorp	NIAC	02 Jun 87	29	3.19	83.6	94.0
Mercanis National	NCNN	02 Jun 87	35	2.80	160.3	159.2
Bank of Boston	BKB	03 Jun 87	36	3.07	86.4	80.4
Bank of America	BAC	08 Jun 87	19	4.01	60.2	63.6
Chemical New York Corp.	CHL	11 Jun 87	25	4.09	86.8	75.6
First Interstate Bancorp	I	11 Jun 87	33	3.70	85.5	86.8
First Chicago	FNG	12 Jun 87	30	5.52	105.7	90.7
Shalbrut Corp.	SHAS	12 Jun 87	33	1.96	122.2	104.8
NDD Bancorp	NDD	15 Jun 87	30	1.80	171.4	133.2
Mellon Bank Corp.	MEL	15 Jun 87	27	4.44	69.4	71.1
Manufacturers Hanovers	MHC	16 Jun 87	22	4.89	77.4	71.3
Canterre Bancorp	CTBC	16 Jun 87	35	2.64	109.0	91.4
Bankers Trust N.Y. Corp.	BT	16 Jun 87	25	4.95	101.6	76.6

Source: Keefe, Bruyette and Woods Inc., Banscan, New York.

a/ Total least developed country loss reserve allocation as a percentage of developing country.

b/ Overall reserve as a percentage of total loans.

c/ Overall reserve as a percentage of total non-performing loans (including developing country non-performing loans).

Table V.9 (continued)

(PART B)

	Avg. equity / Avg. loans			Avg. equity / Avg. assets			Primary capital / assets		
	1st quar 1987	2nd quar 1987a/	%change	1st quar 1987	2nd quar 1987a/	%change	1st quar 1987	2nd quar 1987a/	%change
Citicorp	7.1	5.2	-26.6	4.7	3.4	-27.1	7.0	7.1	0.9	67	40
Northwest	10.2	9.0	-12.2	6.6	5.0	11.9	8.0	8.9	1.5	75	65
Chase	7.5	5.4	-28.3	5.1	3.7	28.2	6.9	6.9	0.4	74	53
Security Pacific	10.4	10.0	-3.8	4.6	4.4	-5.9	6.4	7.4	15.1	72	59
Rainier	9.2	9.0	-3.1	6.4	6.2	-4.2	7.3	7.5	2.9	86	82
Mercantile Bancorp	10.4	9.7	-7.0	7.1	6.6	-6.9	8.0	0.5	6.0	89	70
Mercanis National	13.5	12.8	-4.5	7.7	7.3	-4.5	8.5	8.9	4.3	90	83
Bank of Boston	7.9	7.5	-4.6	5.7	5.5	-4.5	7.4	7.9	7.2	78	69
Bank of America	5.7	4.2	-25.6	4.0	3.0	-25.2	7.3	7.4	1.1	55	40
Chemical New York Corp.	8.1	5.9	-26.9	5.2	3.0	-26.5	7.3	7.1	-2.2	71	54
First Interstate Bancorp	8.3	6.9	-16.9	5.2	4.4	-16.6	6.9	7.7	10.8	76	57
First Chicago	9.5	6.7	29.6	5.7	4.0	-30.4	8.3	8.2	0.8	69	49
Shalbrut Corp.	9.0	9.4	-4.5	6.5	6.2	-4.4	7.5	7.4	-1.3	87	84
NDD Bancorp	10.4	10.5	1.2	5.8	5.1	1.1	6.9	7.0	1.5	84	84
Mellon Bank Corp.	8.5	6.2	-26.4	5.7	4.2	-25.6	7.2	7.0	-3.2	78	60
Manufacturers Hanovers	6.0	4.3	-37.1	4.9	3.0	-37.5	7.3	7.5	3.2	68	41
Canterre Bancorp	11.9	11.6	-2.1	6.3	6.2	-2.1	7.2	7.5	3.6	87	82
Bankers Trust N.Y. Corp.	10.3	8.1	-21.2	4.7	3.8	-20.7	6.9	6.9	0.1	69	55

Source: Keefe, Bruyette and Woods Inc., Banscan, New York.

a/ Estimates.

Table V.10 Ratio between loans exposed to country-risk and some of the main items in the balance sheets, 1988

Bank group	Total assets %	Total loans %	Total loans abroad %	Net exposure as % of capital stock
United Kingdom				
Nat West	2.5	3.4	10.9	27.1
Barclays	1.8	2.5	13.3	20.4
Lloyds Bank	7.4	11.4b/	30.3b/	88.0
Midland Bank	7.7	12.0b/	30.9b/	93.0
Standard Chartered	6.9	9.2	18.5	87.0
France c/				
Société Générale d/	3.0	7.1	n.a.	41.0
Crédit Lyonnais	3.4	7.4	n.a.	59.7
Paribas	1.9	4.0	n.a.	23.2
Banque Nationale de Paris	3.6	7.3	n.a.	60.5
Spain				
Banco de Bilbao y Vizcaya	1.4	3.1	n.a.	60.5
United States				
Citicorp	5.4	7.5	21.0	84.1
Bank America	9.5	13.0	39.4	149.2
J.P. Morgan	5.5	16.4	28.2	58.6

Source: Company balance sheets, from Banca Nazionale del Lavoro.

a/ Total risk exposure, minus related provisions as a percentage of total capital stock (capital and official reserves, unless otherwise stated).

b/ Shares for 1987.

c/ French bank groups include in their capital stocks the "titres subordonnés à durée indéterminée", regarded by the Basel BRI agreement as a first quality equity.

d/ Estimates by Banca Nazionale del Lavoro, taking as a reference point the exposure level produced by Salomon Brothers at 31 December 1986. In calculating net exposure, account was taken of the rise in the provisioning level between 1986 and 1988.

Table V.11 Countries with the highest concentration of risk exposure, end-1988
(In millions of United States dollars)

Bank group	Country	
Great Britain		
Nat West	Mexico	1 000
	Central and South American countries	2 375
Barclays	Mexico	930
	Brazil	620
	Argentina	570
Lloyds Bank	Brazil	1 810
	Mexico	1 200
	Argentina	840
Midland Bank	Brazil	2 210
	Mexico	1 810
	Argentina	1 270
Standard Chartered	Mexico	520
	Nigeria	610
United States		
Citicorp	Brazil	3 900
	Mexico	2 100
	Argentina	1 300
	Philippines	800
	Venezuela	700
Bank America	Brazil	2 928
	Mexico	2 338
	Venezuela	1 145
	Argentina	672
J. P. Morgan	Brazil	1 800
	Mexico	800
	Argentina	800

Source: Company balance sheets, from Banca Nazionale del Lavoro.

275. In 1987 the ratio between specific provisioning for developing countries and their overdue debts was 34 per cent for Bankers Trust and 36 per cent for Chase Manhattan, with a 53 to 65 per cent for the last banks mentioned above, and with Chemical Bank alone slightly under 50 per cent.

276. In 1988-1989, the coverage level was 50 per cent in Germany, with Deutsche Bank reaching 77 per cent. In France, where the coverage level was 45 per cent, the Société Génerale reached 57 per cent, while Crédit Lyonnais and Banque Nationale de Paris exceeded 50 per cent. In the United Kingdom, where the coverage level was estimated at 35 per cent, the five largest and most highly exposed banks reached about 50 per cent.

277. It is self-evident that nobody in the banking business would be happy to admit that loans granted by them would later be worth very little, since that would attract the criticism of shareholders and the financial world in general. The same is true even if high interest rates have already yielded a good return on loans which later become overdue. The comparison that is made in order to judge the current asset position of a bank is between the face value of its portfolio loans and their real value, and the latter is then compared with the capital stock. Devaluing the face value is equal to lowering the ratio between value of the assets and overall capital stock. In countries where, in line with rules imposed by the bank supervision system, provisions require a face-value devaluation, as in the United States, there is more resistance to building up provisions than in countries like France, where such action is not required.

278. These additional provisions, when accompanied by devaluation, work with any related adjustments as a buffer. Should such adjustments be based on secondary market prices, reserve provisions by United States banks would be insufficient in a large number of cases. Since the bank supervision system requires that all similar debts be reduced by the same percentage, taking the secondary market as a reference point, the resulting adjusted figures would be extremely low. It has been said that cautious bankers cannot make such an explicit renunciation of their credit. It is true that provisions built up by European banks are higher, but they do not imply a direct debt devaluation, in keeping with the rules of the bank supervision system.

279. Germany, whose banks have granted loans to the largest debtor countries in Latin America in the order of $18 billion, has built up provisions for $13 billion. Switzerland's exposure is $6 billion dollars, with provisions for $3 billion. France, whose banks were exposed for $20 billion, has provisions for half of that amount; the United Kingdom has $29 billion of exposure against only $5 billion of provisions; Japan has $29 billion of exposure and only $1.5 billion of provisions and United States banks have $78 billion of exposure, with provisions amounting to $30 billion.

280. It must be said, however, that if a bank grants substantial credit facilities to its debtors, the result is an automatic improvement in relations between other banks and the same debtors. The reason lies in the higher volume of resources made available for them to pay back remaining debts, which leads to a higher listing of their debts on the secondary market. 3/ This again is the stalemate found in the

free-rider theory. The second mover stands to gain, so nobody is going to make the first move and everybody is just waiting for someone else to take the lead.

C. Rules on bank control and accounting regulations governing provisions and debt losses

281. Bank regulations governing provisions and accounting rules on debt losses are very important for bank policies concerning the debts of heavily indebted countries with payment problems. As shown below, the precise system varies from country to country.

282. In the United States, supervisory authorities indicate only informally the provisioning arrangements of which they may approve. As already stated, President Reagan's fiscal reform of September 1986 provided for the phasing out of tax exemptions for provisions, but such a measure will be fully applied only in 1992. Small and medium-sized banks (up to $500 million) will still benefit from the exemption after 1991. However, they have already passed on to the secondary market most of the credits granted to developing countries in difficulties.

283. In the United Kingdom, since 1987 the Bank of England has worked out a method of calculation for the level of provisions appropriate for every country. Tax authorities generally use this scheme as a reference guide and allow an average tax exemption of 80 per cent of such provisions. It would seem that the average level of provisions eligible for such benefit is 30 per cent.

284. In Germany, any bank can decide on its own level of provisions according to each risk country, together with the number of countries for which provisions are justified. Tax authorities accept a deduction of the provisions as decided upon by the bank.

285. In France, the bank supervision authority (Commission bancaire) has singled out those developing countries that require provisions and has worked out percentages. Such provisions are fiscally deductible, presumably not beyond the threshold fixed by the bank supervision authority, even up to 100 per cent of the amount.

286. In Switzerland, since late 1987 banks must have a 39 per cent provision on loans granted to 100 developing countries. Tax deductions are agreed upon by the bank supervision authority. It appears customary to make all amounts tax-deductible, as in Germany.

287. In Japan, provisions are not compulsory. In keeping with laws recently brought into force, provisions are tax-deductible up to 10 per cent of the exposure with developing countries, but the deduction applies only to 10 per cent of loans. In order to make loans deductible, Japanese banks sell their debts below their face value to a company set up for the purpose and located on the Cayman Islands. The loss against the face value is obviously tax-deductible as a capital loss.

288. In Italy, it is important to consider the accounting rules governing the risks offset by the provisions.

289. As already mentioned, in the United States provisions go hand in hand with an accounting adjustment of the capital value of the relevant credits. In the United Kingdom and in France, the cancellation takes place at a later stage, after all attempts at collection have failed. Obviously, non-cancellation leads to an overvaluation of reserves, which calls for some caution when examining data of these banks.

290. Whereas banks in the United States, Japan and France are allowed by their respective supervision authorities to regard such provisions as a rise in their capital reserves, their Swiss, German and British counterparts cannot do the same since such resources are considered threatened by current risks against the capital stock. The United States position is consistent because such risks are eliminated through a reduction in book value of the amounts for which provisions have been made. The same cannot be said of the French position, which provides for no such automatic cancellation.

D. Tax treatment of provisions and debt losses

291. The possibility of building up provisions to obtain exemption from profit taxes is an incentive by itself. Presumably, the decision to make them only partially deductible in the United States has caused a slowdown in provisioning, just as the former tax treatment was a stimulus to implementing them as quickly as possible in order to benefit from an exemption that was going to be phased out.

292. The tax-loss carry forward stemming from debt reduction produces no tax relief in the case of provisions already built up and this reduces the attraction of such reductions. Furthermore, the profit side has an impact on the viability of provisions in terms of tax treatment. When profits are at a low level, a bank cannot benefit from a favourable tax treatment connected with large provisions that exceed total profits. On the other hand, there is no incentive to build up provisions in order to gain a tax benefit if such provisions imply a capital reduction, since this affects the image of the bank as reflected in its standing in the financial community.

293. From the perspective of the banks, tax benefits linked to provisions reduce the capital loss stemming from additional provisioning, as will be reflected in the balance sheet. Tax benefits therefore offer a considerable incentive for a bank that makes enough profits to back such provisions in full, because they can be used to disguise a downward trend in the ratio between capital reserves and current assets.

294. It follows that the same system of credits and tax treatment applied to provisions can yield different results according to the different economic and reserve positions of the banks exposed to lender risk.

E. Provisioning and bank rating

295. The ratio between credits and provisioning related to loans to developing countries with repayment problems is reversed in the case of exposure and provisions. The reason lies in the different capital stock and profitability situations of lenders. The higher their capital stock, the smaller their need to build up extra provisions. If their profits are limited, provisions are not welcome not only because there is no tax benefit, but also in view of the shareholders' disappointment, since on paper they show a capital loss instead of a net profit.

296. However, an examination of the list of provisions on loans to third world countries shows that different levels of capital stock or of profit-making capabilities are not enough to explain everything. The Japanese banking system - with a minimum of provisions - is not very different from that of Germany as far as capital stock and profits are concerned. Provisions in Japan do not entitle banks to any tax benefit, while, as has been observed, perhaps the most liberal legislation can be found in Germany where, after a careful analysis of their assets, banks can make adjustments for an overvaluation of their assets and can deduct from their profits the resulting loss. Therefore, it is not surprising that German banks have always built up heavy provisions. Even if that might reflect the typically conservative nature of German bankers, it is also possible that tax legislation has been an important factor. 4/

297. It is appropriate to note that German legislation reflects tax policy as well as bank policy. Contrary to the opinions prevailing in a few countries, deductions in Germany are not regarded as an automatic privilege granted to taxpayers. Nor can one say that the tax legislation is an example of generalized permissiveness instead of stringency.

298. In France, the procedure is only slightly less liberal than in Germany. Provisions are tax-deductible if they refer to a country included in the the list of 41 drawn up by the bank supervision authority. For those countries the deduction can reach up to 100 per cent of the loan.

299. In the United Kingdom, the Inland Revenue admits a deduction for provisions on loans granted to developing countries using a somewhat flexible and discretionary criterion. The IBCA gives the following provision percentages: Argentina, 5-10 per cent; Brazil, 5-10 per cent; Chile, 5 per cent Cuba, 5-25 per cent; Guyana, 25-30 per cent; Jamaica, 10-25 per cent; Liberia, 25-30 per cent; Mexico, 5-10 per cent; Nicaragua, 10-50 per cent; Nigeria, 10 per cent; the Democratic Peoples' Republic of Korea, 80 per cent; Peru, 15-30 per cent; Yugoslavia, 5-10 per cent; Zaire, 40-50 per cent; Zambia, 30 per cent. 5/

300. Legislation in Japan is more rigid: provisions cannot exceed 5 per cent of the total amount of loans, and only 20 per cent of such loans are fiscally deductible.

301. In countries where deductions for provisions are not allowed, a stronger thrust to sell off debts is to be expected, so as to benefit from deductions. This is the case in Japan, where banks have devised a system of selling a share of the debt to an offshore bank owned in partnership with other companies. On the other hand, it is precisely the lack of tax-deductibility of provisions, except when they are accompanied by a reduction in the debt book value, that in the United States prompts a government incentive to negotiate reductions in the real value of loans.

302. It is hard to avoid the conclusion that explicit recognition of the credit risk by banks that adopt provisioning has to be regarded as a drop in the capital stock-reserves ratio only, with a formalistic concept of bank control.

303. One can surely argue that provisions on existing loans do not raise risks, on old loans or on new loans and that they are simply a recognition of the risks involved. Consequently, bank supervision authorities should request an adjustment of corporate assets value only on the basis of the materialization of those risks. The shift from an undetermined to a quantified risk - when banks are heavily exposed and the situation is in any case one of general uncertainty - is an extremely delicate operation, particularly around levels of 30 to 40 per cent, which are lower than the fall in value in the secondary market, but nevertheless very high.

304. Economic analysis indicates that a reduction in the value of company assets (e.g., by 30 per cent on the face of the materialization of a real risk or in relation to provisions that are a recognition thereof) is illogical in the case of debts on which interest and depreciation amounts have been calculated taking into account a differential element of subjective (i.e., Bayesian) risk of just 30 per cent. In effect, such risk was attached to the loan from the very beginning, acting to ensure that its real value was equal to its face value and not higher, after taking account of the difference between the capitalized flow of the loan inclusive of the differential risk, and the capitalized flow of the average of the other loans of lower risk. If, on the other hand, secondary loan prices are at 70 per cent of their real value but produce a services flow that is 30 per cent higher than that of normal credits, it means that the real quotation of that credit is in fact 54 per cent.

305. The banks' view that secondary market bids related to credits to such countries are too pessimistic seems to be based on the assumption that some substantial reduction and restructuring will occur, thus bringing the whole system back into balance. Of course, new money financing is not to be confused with the trick of false lending in order to capitalize unpaid arrears. As stated by one authoritative expert, the device of simulating a new loan to developing countries with overdue debts by computing it as debt service is a hypocritical operation that is against the interests of shareholders.

306. A mutually agreed reduction of interests and depreciation costs, possibly converting into obligations, does not require a reduction in the value of current assets, at least according to United States banking legislation as interpreted by the Interagency Country Exposure Review Committee (ICERC), the supervisory body responsible for the analysis of exposure with other countries. Until the minimum

profits resulting from the new terms of the restructured debt are in excess of the book value of the restructured loans, such a reduction becomes the objective of a mutually beneficial agreement between debtors and creditors.

307. But the stalemate in the above mentioned game theory is now extremely clear. There is a need for a leadership allowing all players to take concrete steps at the same time. It is also necessary to guarantee the same tax benefits related to them as can result from a reduction in the book value of loans (new United States system) or from provisions (United Kingdom and Germany) or from losses deriving from selling the loans at a discounted price.

Notes

1/ A simple example of the prisoner's dilemma is as follows:

Choice of B (leading commercial bank)

		Co-operate	Unilateral action
Choice A (leading commercial bank)	Co-operate	3.3	1.4
	Unilateral action	4.1	2.2

Co-operation appears therefore the most convenient solution, but unilateral action proves to be the best for either player, if he acts first. If both default, but one does it first and there are two rounds in the game, in the first round A gets 1 and B 4 or vice versa depending on whether it is A or B who defaults; in the second, both get only 2. Numbers are hypothetical. Cp. Benjamin J. Cohen "Il debito globale. Perché la cooperazione è così difficile" in Paolo Guerrieri and Piercarlo Padoan (ed.) L'economia politica della cooperazione internazionale, Angeli, Milan, 1988.

2/ The structure of this game - assuming that surrendering for the debtor means paying all and for the creditor providing new monies is as follows:

(Numbers show ordinal sizes)

Choice B (creditor countries)

		Surrender (provide new money)	Unilateral action (no new money)
Choice of A (debtor countries)	Surrender (pay all debt)	4.3	2.4
	Unilateral action (threat of default)	2.1	1.1

Notes (continued)

The idea is taken from a movie in which bikers challenge each other to a head-on collision. Both are supposed to swerve aside at the last minute to avoid a crash. If they collide, both will be hurt. If one is weaker and he knows that the other knows this, he will be likely to surrender. But if this fact is not known, the collision may well occur.

3/ The theory of the free rider paradigm looks like a prisoner's dilemma paradigm but the winner here is the one who refrains from moving. Everyone is standing still, so the position reached here is the initial one, and not a new one as in the prisoner's dilemma.

4/ A simple formula expressed the benefit of agreed upon debt reductions for remaining creditors. Given Q as the ability to pay of the country in question and D the amount of the debt, Q is the insolvency rate that can be expected. If, because of a debt reduction based on Q, the debt is reduced for creditor A, B will have during time t1 a ratio between Q and $D_{t1} > Q$. If, for instance, Q is 50 and D_{to} is 80, the ratio moves from 0.5 into 0.625.

5/ Graham Bird, Commercial bank provisioning against claims on developing countries, World Bank, International Economic Department, October, 1988.

Part Two

TOWARDS SOLUTIONS

VI. DEBT REDUCTION TECHNIQUES

A. Debt-equity swaps and debt-property swaps

308. Before examining the opportunities offered by this controversial instrument of debt conversion, 1/ it is appropriate to recall that it can be applied to four categories of indebted countries: middle-income countries with large but not dramatic debt problems; middle-income countries in a very serious debt crisis but with sizeable resources, economic activities and expanding capability; poor countries with enormous debt problems and few resources available; and poor countries with serious but not dramatic debt problems, possessing some resources.

309. In varying degrees, in at least three of the four cases it seems appropriate to provide incentives for rational phased debt-equity swaps, i.e., for the conversion of debts into equities. The opportunities offered by debt-equity swaps are greater than it would seem from the operations carried out to date. In the period 1985-1988, such operations in the Baker Plan countries had a face value of $24 billion, with $8 billion for Brazil, $5 billion for Argentina and $5 billion for Chile.

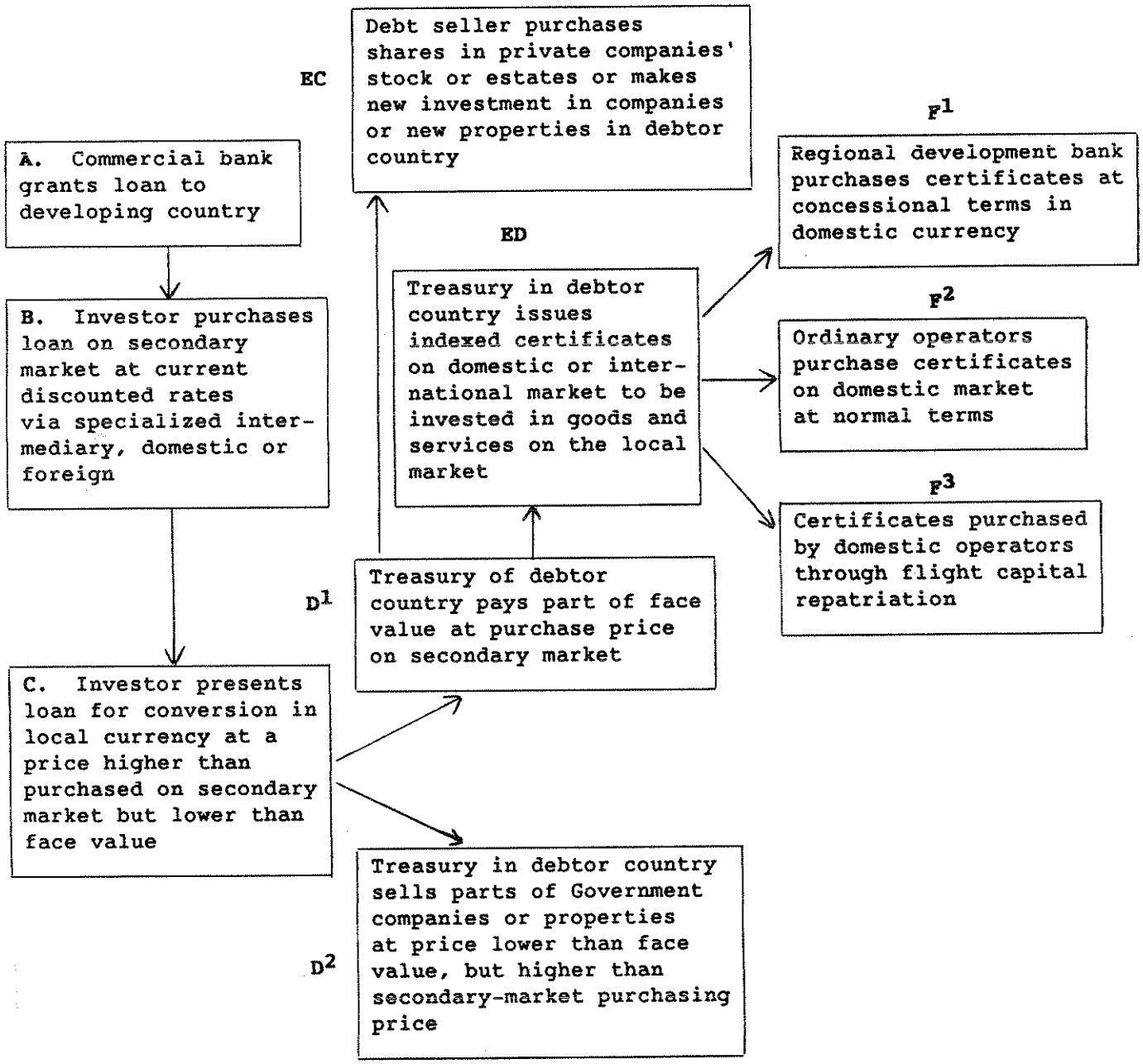
310. Assuming a capital-output ratio of 3, a country such as Argentina, with a GDP of $75 billion, should have a total capital of $225 billion. If Argentina's $50 billion debt (66 per cent of its GDP) is converted into equities at a 50 per cent discount, 11 per cent of Argentina's financial resources ($25 billion) would be enough to pay off the whole of its debt. Moreover, assuming that the total amount of Argentina's flight capital is 50 per cent of the country's external debt, the same target could be achieved with its repatriation. The same applies to Brazil, though with higher figures, since Brazil's GDP is officially estimated at $350 billion, with an external debt of about $100 billion. The nation's capital is estimated around $1,000 billion and, with a 50 per cent reduction, Brazil's debt amounts to 5 per cent of such figure. Of course, this example is purely theoretical and highly simplified.

311. Secondary-market bids for the debts of those two countries are today far lower. Presumably, debtor countries too intend to capture part of the gain resulting from the purchase of those debts below cost, particularly when their market value is less than half of their face value. In any case, for two reasons debtor countries cannot accept that their debt, purchased through secondary-market operations, is converted into equities at a much higher price than that on the secondary market. Firstly, they reject selling off domestic properties to operators who bought those external debt equities. Secondly, a cut in their total debt means a rise in secondary-market bids because of the lower risk of insolvency.

312. However, if there is a fair prospect of making good profits from debt-equity swaps because of lower prices, it must also be true that indebted countries may be led to refuse payment of their debts, in order to cause a fall in related prices, thus increasing what they stand to gain from swapping. They could also default on debts contracted in certain currencies or with certain operators who do not seem to have a special interest in continuing to invest in those countries. The result is that debts remain compressed on the secondary market owing to the strategies implemented by debtors, who want to drive creditors to adopt benevolent attitudes.

This makes the conventional starting point of debt-equity swap operations - i.e. the secondary market - rather artificial. The typical pattern of debt-equity and debt-property swaps is as follows:

Figure VI.1



313. It could also be argued that the above-mentioned estimates of the capital of Argentina or Brazil do not take into account the fact that agriculture is the mainstay of such middle-income indebted countries, and that it is not, in the majority of cases, run by joint stock companies. Land is normally owned not by companies, but by individuals. However, the figures given are hypothetical. At any rate, these considerations emphasize the possibility of having a debt-equity swap together with a debt-real property swap.

314. There are objections to the conversion of external debt into equities or properties for fear of setting off inflation. Here a distinction has to be made between the different situations and attitudes taken by indebted Governments. This fear is groundless when such operations consist only of the purchase by foreign operators of shares of existing State companies. In effect, in such a case, when a Government receives in payment for those equities a certain number of certificates representing external debt contracted by its agencies or companies, it may remain the owner of those certificates and destroy them, thus solving part of its public debt problem.

315. When foreign investment consists in the purchase of private companies' shares, it will be those who pay with external debt certificates who will have to apply to the Government to receive in local currency the value of the external public debt they have acquired.

316. Moreover, this does not mean that a Government pays off its debt by issuing money. It can pay by issuing more public deficit certificates. Placing further certificates of government debt is certainly difficult, but perhaps new certificates can be devised. For instance, payments in national currency can be indexed to a basket of currencies of industrialized countries or to international prices of the raw materials exported by the countries concerned. Certainly, a Government will never issue money for an amount close to the face value of the paid-off debt, but only for a percentage, usually lower than 50 per cent, and obviously based on its secondary-market value.

317. Therefore, the burden of servicing of such a new national debt, once transformed in the way described, might be much lighter than that of external debt service. If interest paid on such debt is not spent but saved, there will be an improvement in the macro-economic balance of that indebted country because overall demand will be left unchanged, whereas its balance of payments will improve, thus increasing its foreign exchange reserves.

318. If interest is spent in part, there will be a growth in overall demand but, as that will be matched by a lighter debt service burden, any demand boom will be met with larger imports - provided there is no change of attitude as regards arrears - leaving the final result of the balance of payments unaltered. At all events, the repercussions of that expansion will be felt only in the course of time.

319. In order to make new productive investments, the purchaser will present the purchased debts to the Treasury in return for investible financial resources. Unlike the two previous cases, this involves an increase in aggregate demand equal to the required reserve of money. If the Treasury confines itself to issuing new

banknotes - thus raising the level of money supply - the result is undoubtedly inflationary. In contrast, if it invites the banking system to absorb equities for an amount equal to the value of the paid off debt, there will be no inflation. In this case, whether there will be less additional investments or less consumption, or whether funds will flow in from abroad, remains to be seen.

320. The adoption of indexed equities can be useful to prevent debt-equity swaps carried out to make new investments from turning out to be a mere diversion of scarce resources towards those investments made through the purchase of external debt. The whole operation is feasible if the discount is large enough.

321. The inflation problem of debt-equity swaps is particularly serious for those debts purchased on the secondary market and then swapped for equities. The debt-equity swap inflation problem loses a lot of weight when the swap is applied not to the debt principal but to debt service, or even to a small part of the principal, for example 1 per cent, as illustrated below.

322. One objection often raised is that, because of the discounts for the investor, such foreign investment does not supplement but replaces other investments that would have been made in any case. Consequently there is a loss for the country in which the investment takes place. Moreover, according to a survey carried out by the International Finance Corporation (IFC) (a World Bank agency, whose functions ought to be strengthened in relation to debt-equity swaps), in debt-equity swaps investments should have an additional and not a substitutive character. 2/

323. World Bank experts have shown that most investments are "new investments" instead of purchases of existing companies to be restructured and relaunched, while extensions of previous initiatives come in between. With different policies, attitudes to investment may change. In any case, it is obvious that, with privatization, foreign investments would have an entirely additional character, similar to the flow of investments made by foreign operators at a later stage, when they may reinvest profits. In order to allow the external debt bought in return for equities already existing or just issued to be transformed into cash or into domestic equities, the country in which the investment takes place must have regulations in order to guarantee that investments will be mostly of the additional and not the substitutive kind.

324. A further objection is raised in this respect that cannot be underestimated: the role of privatization. This issue has often been dealt primarily in ideological terms in relation to national autonomy. For instance, expanding the country's private sector is assumed to yield considerable benefits. Whether privatization produces a shift towards an appropriate and efficient domestic financial market and to industrial, agricultural and service policies capable of making a positive contribution to economic growth is a separate question. Joint ventures may be preferable to privatization alone.

325. The role of government bureaucracy has equally been neglected. Government bureaucrats in debtor countries by their very nature are reluctant to authorize the purchase of public companies and institutions by private operators. First, it means a loss of prestige and of their executive positions (or even of their posts); second, if the operation is made in the interest of the Treasury rather than with a

view to consolidating the company, not only top executives, but also managers and staff in general tend to reject the operation. That need not happen if privatization takes the form of a joint venture. In that case, instead of rejecting the operation, leaders of government companies will generally be in favour of it, particularly if those investments fall within the framework of an international alliance which allows the company access to wider sales opportunities and to the acquisition of know-how. On the other hand, the acquisition of shares of State companies through joint ventures and/or other flexible mechanisms, if accompanied by modernization programmes, means consolidation and new opportunities and hence must be favoured by the staff and by enlightened trade union representatives.

326. Governments are frequently jealous of their own public companies. Privatization is seen as a loss of power. Governments may be afraid of losing their autonomy. It is easy to understand that, if debt-equity swaps were extended to large portions of external debts, with the outright privatization of banks, mines, key industries and public services, developing countries and countries in Eastern Europe would experience a new form of colonization leading to economic dependence. Moreover, given such resistance, dangerous feelings of rejection would work against the autonomous forces and opportunities for the repatriation of flight capital that appear indispensable to help the countries concerned on their way to modernization and development. Instead, special benefits should be granted to nationals who make debt-equity swaps and use the funds previously to invested abroad, thus boosting the repatriation of flight capital.

327. Institutions in indebted countries are very different from one another, as are their levels of development. In general, debt-equity swaps involving partial privatization and encouraging opportunities for relaunching local companies and resources should be seen in the context of an industrial policy, in the widest sense of a policy for productive sectors. Such a policy entails modernization, combined with proper liberalization, deregulation and economic streamlining. It is not so much a question of getting capital from abroad in order to do away with external debt, but rather one of combining policies of debt restructuring and economic adjustment.

328. In effect, it is likely that market forces in a mixed economy - with due consideration for private firms, particularly those run by nationals - will grow through opening the economy to investments from abroad including the repatriation of invested capital. It is also likely that the development of an important market economy sector, stimulated by introduction of clearer and simple rules will lead to a more stable economic policy based on internal and not (only) on external pressures by multilateral institutions.

329. Export companies in particular have benefited from investments in debt-equity swaps. Foreign investments (at least in joint ventures or in trade partnerships) surely facilitate the elimination of export barriers erected by industrialized countries. Debt-equity swaps could then become the stepping stone for new financial flows, supporting new economic initiatives in indebted countries and promoting new export flows from those countries. 3/

330. Indirect financing of productive investments, e.g., by issuing certificates and resorting to bank loans instead of choosing direct financing, has been discussed in important studies relative to indebted countries using the "principal-agent" analysis. 4/ In the case of direct investments, there is a greater identity of interest between the agent, who borrows money, and the principal, who lends it, which reduces the risk of the operation and hence its cost. It is true that there are cases in which direct financing becomes relatively more expensive since sometimes it implies the transfer to lenders of large shares of profits, but only in successful investments, i.e., those that generated an ability to pay.

331. In indebted countries little use has been made of local capital as opposed to external financing primarily because stock markets are of little importance there and often do not even exist.

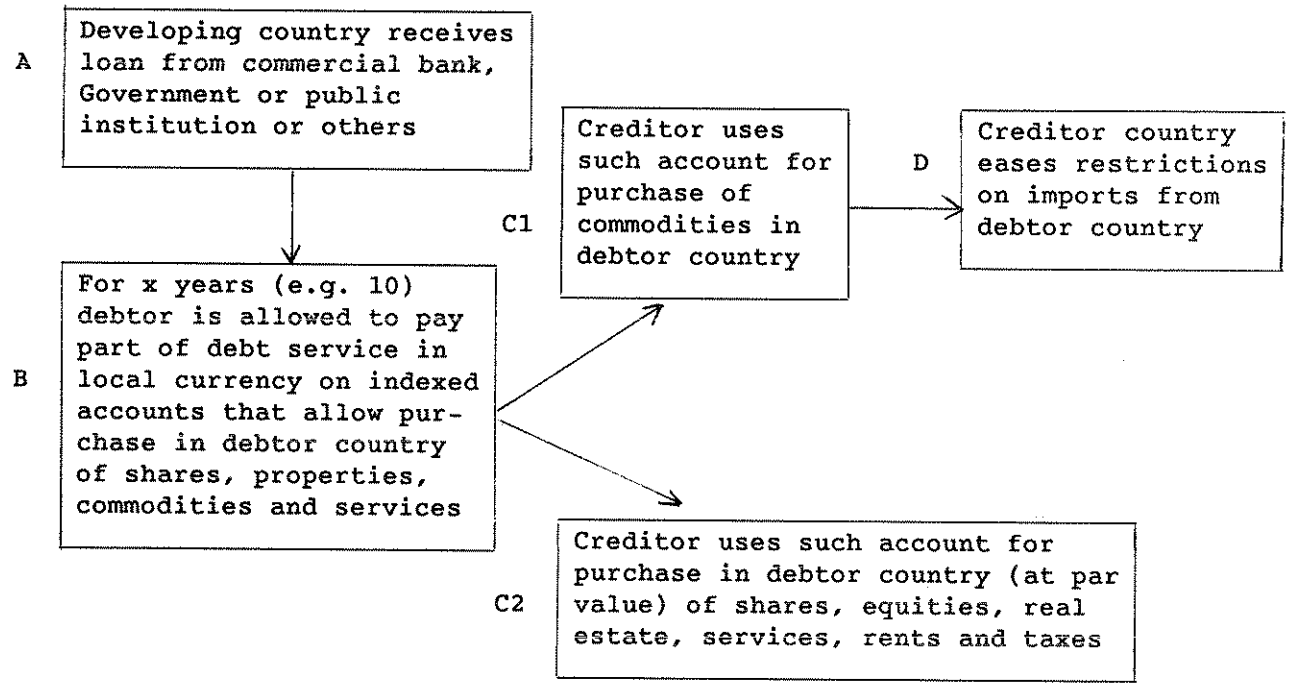
332. In conclusion, a number of factors account for the low level of debt-equity swaps:

(a) Debt-equity swaps should be an essential element in the restructuring of bank debts in all possible cases, for instance by taking up 10 per cent of the debts of the country in question, or 10 per cent of the bank debt service. The discount price should be fixed at the beginning, with reference to secondary market bids, but with a different evolution over time;

(b) Debt-equity swaps should be open-ended, in the sense that national fixed-yield indexed securities should be created, capable of being turned into equities, in addition to the operations already agreed upon in the restructuring plan;

(c) The typical pattern that can be suggested here in relation to debt-equity and debt-property swaps is as follows:

Figure VI.2



(d) Within a debt-restructuring programme, such debt-equity swaps could become the basis of modernization, as well as of medium- and long-term economic and financial adjustments connected with such a programme;

(e) Isolated debt-equity swaps outside the context of restructuring plans would certainly not solve the problem. Since the debt volume tends to grow automatically when a liquidity shortage sets in, as a result of the accumulation of arrears on interests and reimbursements, there is a risk that such isolated operations may promote selling out the assets of indebted countries without relaunching their economies; on the other hand, if carried out properly, those operations can be the starting point of restructuring programmes, with tangible economic benefits.

333. At present, even in middle-income countries, debts with public institutions now account for a large proportion of total volume indebtedness. In particular, in the case of debts with multilateral institutions and with government insurance companies in creditor countries, debt-equity swaps of the flow stock should be carefully considered. IFC could buy equities in return for debts or debt service owed to the World Bank, acting as a buffer between the external and the domestic stock capital share of those companies in which investments take place, or it could act in a temporary capacity until purchasers are found in the market. Such a role can develop only gradually, but it is must be taken seriously as a means for bringing about innovations in development assistance, in line with the evolution of the financial techniques adopted in the industrialized countries.

334. In middle-income countries where restructuring has been implemented, debt-equity swaps can play a role similar to the one they play in highly indebted countries that are eligible for debt-service restructuring, except that in the first group of countries they should be carried out as a complement to the overall restructuring plan in the framework of appropriate incentives to be provided for new finance.

B. Debt-debt conversion

335. The conversion of bank debts into other debts (usually requiring some reduction in debt burden on conversion) can take place in three ways:

(a) Restructuring of bank debt by making terms easier, for instance by turning variable rates to fixed rates; introducing a ceiling on variable rates; cutting the additional rate established on the top of the prime rate; downgrading the debt ranking; extending maturity; tying interest rate and reimbursement obligations to variations in the international price of the raw materials normally exported by the debtor country; paying part of the debt service in local currency loans, indexed and fully expendable in the country for property, goods and services;

(b) Conversion of bank debt into "new" bank debt as a reduction operation; as a result, there is no change in the ranking of the relevant debt as compared to similar debts, but its interest rate is lower, or its capital value is reduced, or its LIBOR or similar market rate is negative instead of positive, or else it is given a period of grace with interest calculated using some concessional method, or indeed a combination of those elements;

(c) Conversion of bank debt into negotiable bonds, with elements of restructuring and/or type (a) or type (b) reductions and with guarantees that compensate in full or in part for the lower yield or the fall in the debt capital value.

336. Restructuring operations of the first kind, although they involve a burden to be shouldered by banks, do not oblige the latter to devalue debt, nor do they affect the debtor's creditworthiness since they only modify market conditions by adjusting them to the ability to pay. Unfortunately, when confronted with the debt crisis of heavily indebted countries, such remedies are effective in only a small number of cases. However, they are not to be underestimated for countries that could pay if given enough room for manoeuvre, which would help to prevent them from falling into the category of debt-ridden countries.

337. The above-mentioned forms of restructuring usually do not generate any tax benefit since they are related to bank loans that retain their market terms. Those benefits could still be given through tax-free provisioning in order to provide incentives for such debt relief. In any case, such operations are in the interest of all creditors if they produce an increase in the ability to pay. In effect, debtors can threaten creditors with payment difficulties because:

Figure VI.3

Commercial debt conversion

I. Restructuring

1. Shift from variable to fixed-rate or ceiling on variable rate or accumulation of interest on a new debt account without penalties for the debtor

2. Rescheduling

3. Debt downgrading

4. Reduction of the rate above LIBOR (the so-called plus)

5. Tying debt service to prices of exported raw materials

6. Payment in local currency (indexed)

II. Reduction of bank debt

1. Reduction of the stock value

2. Interest rates under market levels

3. Extension of maturity and concessional interest rates

4. Period of grace with concessional interest rates

5. Rate under LIBOR or any other reference rate

III. Bank debt-bond swap

1. With type I elements

2. With type II elements

(a) Without third-party guarantees

(b) With third-party guarantees on the principal, the interest or the debt service

(a) If operators learn that a given debt is irrecoverable owing to the debtor's insolvency, the result is a loss of credibility for the institution that holds the debt, together with negative repercussions on the positions of its managers; arrears can make things more obvious or exacerbate a difficult situation, owing to the moral hazard that is implicit in the relation between creditor and debtor;

(b) Arrears reduce debt value in the secondary market, so that creditors who want to divest themselves of debt holdings by resorting to that market wish to avoid them, or at the most they want them to be temporary and infrequent;

(c) Growing arrears with a debt provisioning gap of 100 per cent produce a delicate situation for a creditor with holdings on current account. When years of arrears build up on a debt, its secondary market value drops to 30, 20 or even 10 per cent of its face value, and it is clear that even a 60 per cent provisioning, though very high, is in such a case insufficient, and such provisioning can not be regarded as an asset.

338. Bearing in mind these considerations, it may seem convenient for creditors to support a wholesale shift from restructuring to reduction, in order to make a more suitable credit adjustment to the debtors' ability to pay and to cut arrears. A debtor Government that accumulates arrears is not going to be granted fresh funds and would hardly be trusted by savers. It might seem that this problem only concerns the indebted country, but it is a problem for creditors too, if such a state of affairs affects debtors' ability and readiness to pay. If debtors have a reasonable hope of obtaining funds, provided they pay part of their debts, they will try to honour their debt service within the limitations imposed by their ability to pay. If that ability grows in time with the increase in investment and fresh economic growth, benefits will accrue not only to debtors but to creditors too.

339. However, there is a difference between a situation in which there is only one creditor and one debtor, and another in which there are many creditors. Debt restructuring and reduction allowed to those who have no possibility to pay is not a simple positive sum game in which the two opposing parties have to establish a point of equilibrium to share the payoff. It also produces external benefits to the other creditors so that each creditor is reluctant to offer them first, because other creditors would derive considerable advantages at no cost to themselves if the first one bears the brunt of the debt adjustment.

340. Among the restructuring operations that produce relief, of particular interest are those aimed at putting a curb on the burden of above-LIBOR interest payments, often contracted when prices of raw materials exported by indebted countries are more favourable, or when the real interest rate on the market is at a comparatively low level. The reason for this becomes obvious when one considers that the medium/long-term ability to pay is a reflection of the ratio between the real interest rate on debt and the real growth rate of GDP and exports.

341. However, a simple shift from above-LIBOR to a fixed interest rate - unless the latter is concessional - may yield poor results, or in any case not be adequate for solving the problem of the debtors' ability to pay. The explanation lies in the current period of fluctuating rates, and it is likely that - at least for some time - interest rates may go down from the peaks of the last few years. The restructuring operations that are carried out in peak periods could lead to fixed interest rates that - in periods of low interest rates - are higher than the market.

342. But solutions can be devised for those countries with large medium- and long-term debts by combining the benefit of fixed rates, giving relief in peak periods, with that of variable interest rates that grant relief to those who contract loans in periods of low interest rates. In this case, the easiest solution is a variable-rate ceiling. It gives a limited advantage in the form of downward flexibility, when the ceiling is not put on a highly discounted level (for instance 6 per cent), while it is appropriate in the case of pure restructuring, or in conversions with a small cut in interest rates at concessional level. If the target is downward flexibility of the interest rate in relation to concessional levels, the under LIBOR rate may be adopted. This is a variable market rate, with a reduction percentage. Such a measure may be accompanied by a ceiling on the interest rate, so that at any given time interest payments do not exceed the ability to pay. The worst situation occurs when real interest rates go up and prices of raw materials for export go down.

343. In a world in which interest rates have been out of control for over a decade, with the prospect of high levels at least until the year 2000, and confronted with countries with low growth rates in GDP and exports, there is another measure that can be justified: that of linking the interest rate with the prices of exports, so that when they improve the interest rate increases, and vice versa.

344. Another apparently obvious measure in restructuring operations for countries with low ability to pay is the extension of debt maturity. With the interest rate at the market level, plus the additional risk under normal conditions as a reflection of the above LIBOR rate, the extension of the debt maturity should be a matter of indifference for creditors, assuming that the latter are official credit operators with considerable power to raise capital on the interbank market. It is also advantageous for the debtor country because it affords a greater time-span for reimbursement of the principal. It is true that given a transparent market, without transaction costs and without moral hazard, debtors should be able to raise from other sources the funds needed to repay short- and medium-term loans, using the market to transform them into long-term loans. That assumption is in blatant contradiction with the overall situation of heavily indebted countries, confronted with actual payment difficulties. At any rate, debtor countries can push creditors to extend the maturities of their loans, avoiding deadlines for reimbursement. It is true that such conduct can give rise to penalties for them and to an accumulation of interest higher than the market level and also higher than those attached to the original debt. It is also true that debtors can reply by adopting the arrears attitude, with the effects already illustrated.

345. However, an extension of maturity is not a matter of indifference to creditors when debtors are expected to encounter payment difficulties. In effect, under such circumstances the risk of insolvency is bound to grow. Consequently, the interest rate on those loans is perceived by creditors to be below the market level. Thus an extension of the loan terms appears to creditors as a loss and they are reluctant to accept it. This perception is irrational when the agent-principal or debtor-creditor relation is viewed not from the standpoint of each principal, but that of all principals of the same debtor. If an extension of the debt maturity increases the ability to pay the debt, since payments are now distributed over a longer period, the real risk that a debtor may not pay is reduced. That is reinforced when one takes account of the compatibility of real interest rates with the growth rates of GDP and exports.

346. Therefore, if in a given debtor country there is but one principal, the market may prompt spontaneous extensions of maturity owing to the mutual benefit for both the principal and the agent of the loan. However, if there are many creditors, there will be a market failure. In other words the extension of maturities of individual loans is in the public good, and the benefits are largely reaped by subjects different from those who actually grant the extension. That is how the resulting rise in the overall ability to pay can be low and not enough to compensate individual creditors for the higher accumulated risk associated with the time distribution of reimbursement obligations. 5/

347. A similar case is that of a conversion which has the formal nature of a real reduction instead of a mere restructuring, but which, in risk and uncertainty terms, is of the same kind, consisting of a rebate on interest rates. By bringing the burden of debt service in line with the countries' ability to pay, a rebate lowers the loan risk and produces a higher value compared with secondary market bids against a background of high risks connected with the inability to pay. This operation, too, entails a benefit for all creditors and not only for the creditor who performs the operation. It is in the public good. In this case too, only co-ordinated action can give creditors the chance to pursue their real objective by acting at the same time in the debtors' interests.

348. Likewise, there is a third conversion operation which belongs to the same category of conversion with reduction: debt devaluation. This operation is usually carried out by stipulating a new contract for a security of lower face value, but, as already mentioned, the old contract could be retained. Although the interest rate remains the same as with the old debt, two factors reduce the debt burden: the application of that interest rate to a lower face value and a lower amount of principal to be reimbursed. The total amount of reimbursements is therefore lower but more risky, so that the current discounted flow can be equal to or even higher than that of the larger debt replaced, particularly if a growth process is set in motion as a result of such an operation. This benefit is there for those who accept the reduction only if all or the majority of the remaining creditors accept it. Otherwise the loss, in terms of lower credits to be reimbursed, cannot be offset by a reduction of the default risk in reimbursements since such a reduction can only be small.

349. The conversion of bank debt into negotiable bonds with a face value lower than the amount of the debt, which in reality must be backed by guarantees given by the debtor or by third parties (usually international institutions), can be advantageous for creditors both because it reduces risk (although the bonds will have a lower face value and/or a lower interest burden) and because it allows banks to liquidate a number of loans in the market that could otherwise be sold only in the secondary market at very low prices. These credits are guaranteed and negotiable, and hence they can be kept in portfolios if secondary-market bids fall temporarily or result from wrong evaluations and irrational behaviour. By such conversion, banks can help to push up the value of their credits from the low level to which they had sunk on the secondary market. However, at this point it is necessary to analyse two questions that were raised during the Cernobbio Seminar in May 1990.

350. The first question is whether debtors draw a real advantage from the operation in question, if secondary-market bids for their debts climb up considerably after it is done. As illustrated, banks could then play a strategic and co-ordinated game to avoid depreciation of their loans, just as members of an oil cartel can raise the price of oil through a commonly agreed cut in the supplies. If the result of such operations is a substantial rise in debt values in the secondary market, debtors may find it more difficult to carry out buy-backs or to accept debt-equity swaps. On the other hand, if the country risk remains high, a rise in debt values following the cartel strategies after the conversion of bank debt into bonds will not give debtor countries any tangible benefit in terms of new financial flows promoted by international market forces or in terms of substantial capital repatriation.

351. This is not simply an academic point. In Mexico, the implementation of the Brady Plan was not accompanied by a considerable flow of new funds, and modest capital repatriation seemed to have related more to internal economic adjustment which, on the whole, has been of limited scope considered as a percentage of the previous burden.

352. When debtors are involved in the service of bonds instead of bank debts, they find themselves exposed to a factor of high rigidity. The lenders become anonymous and consequently there is no chance of negotiating with them any payment moratoria in case of difficulties. Surely, arrears can also be accumulated on certificates of government debt, but the credibility cost for those who issue them is much higher than in cases of accumulation with individual banks. As a result, confidence in the total volume of national debt certificates is in effect undermined, with serious problems arising in case of adverse circumstances that bring about payment difficulties. Most of all, that will occur with low debt discount and when a suitable point is subsequently not reached on the Laffer curve of ability to pay. Further problems arise if there are no clauses to take account of some of the major external factors, such as a ceiling on the variable interest rate and a coupling of repayments with the prices of raw materials.

353. Furthermore, it must be noted that, if an extension in the period of loan reimbursement is of great benefit for the debtor, this does not entail any sacrifice for banks offering risk loans if the debt is fully guaranteed by

collateral provided by third parties and by the debtor himself. However, the burden of acquiring part of this collateral reduces the debtor's benefit from an extension of the period. As to the collateral given by international institutions, the latter become potential owners of the loans not honoured by the debtor, who is then in a worse debt position since debts with those institutions have hard negative pledge clauses (i.e. no other loans can be given by other creditors or restructuring accepted by them on existing loans if the credit with these institutions is not honoured).

354. This leads to the second question. In conversion operations with an excessively low discount, it is quite likely that the burden to be shouldered by international institutions exceeds the limited benefit for debtor countries. Operations that are less advantageous for debtors than they are burdensome for financing bodies - in terms of the alternatives forgone - are not a good thing in themselves. Although the funds used by those institutions to guarantee the principal and part of the bonds' service come from additional resources, there is no doubt that these could have been employed more productively, one example being the opportunities they can generate for providing insurance guarantees and co-financing.

355. The reference point for operations of debt conversion with debt reduction is often the secondary market price of that country's bank debt. It is at all events a proxy, i.e. such a price reflects debtors' ability to pay as judged by the market. However, as already stated, such market evaluation is distorted by not only the ability but also the will to pay. After all, it must be stressed that the commercial debt in question is generally an abnormal form of government debt. With government debt the willingness to pay is also influenced by how tax policy is governed by the indebted countries' public expenditure obligations. The political strength of the Government in such countries may not be enough to allow it to raise the means to pay, and there are occasions when Governments in power may be faced with public deficit burdens dating back to the improvident policies of previous Governments, lured into debts by the ease with which they could obtain loans. Sometimes those burdens have been multiplied by interest rates that were too high or that became too onerous owing to a fall in the prices of raw materials.

356. Equity is an important element in judging debt repayments and must be taken into account when discussing the overall ability or willingness to pay of debtor countries, thus complicating the issue by adding emotional elements that are hard to judge.

357. When reducing bank debts, it is necessary to take account of all such matters and also to remember that, if such reductions are accompanied by guarantees or collateral provided by international institutions in favour of banks, electors in Western countries may protest. They may object that debt conversions are too much to the benefit of banks and too little designed to help indebted countries. Controversy may be avoided by stressing the objective parameters of ability to pay, which are commonly accepted. These include per capita income and its associated distribution as derived from social indicators, together with real growth rates of GDP and exports. The GDP growth rate in debt-ridden countries, as already stated, is generally under 2 per cent, and sometimes even below 1 per cent. Consequently,

it would seem that the interest rates that should be in force with debt reduction should not exceed 1 per cent in real terms in order to arrive at an interest rate equal to or lower than the GDP growth rate.

358. A real interest rate higher than 2 per cent, such as that derived from the Brady Plan, appears excessive, assuming an average annual inflation rate of 4 per cent for industrialized countries, which is already quite high. Besides, the same result can be achieved by following the prescriptions for long-term interest rates discussed earlier; those rates were generally around 2 per cent. Debts of countries hit by the debt crisis have interest rates much higher and have grown precisely because of this.

359. Conversion at a real interest rate lower than 2 per cent implies the recognition of abnormal conditions that have produced extremely serious payment difficulties. These can be solved only by the use of interest rates that, at least for a certain period, are below the average long-term rate.

360. Debt reduction certainly interacts with growth rate, particularly if it accompanies adjustment processes that are usually a pre-condition for such a reduction. The ability to pay grows over time as the GDP growth rate increases, and sometimes because the result is a considerable rise in per capita income. Therefore, in the conversion of medium-term loans into 30-year equities a number of solutions may be offered that involve greater concessionality for the first decade, in order to bring the debt service in line with trends in ability to pay.

361. A mere reduction of amortizations in the first decade is not an appropriate step, albeit one of a concessional nature, because the outright postponement in time of the debt burden entails a future burden that undermines the possibility of being able to raise fresh funds and to encourage capital repatriation.

362. Compulsory reduction operations, even if the banking system could gain, are not opportune as they are not well appreciated in the international banking community. According to the information collected in our interviews, international bankers view such operations with little favour since they imply interference of government authorities in a field where operators are obviously very jealous of their market prerogatives.

363. The techniques of using collaterals is not without implications in comparison with the option of converting bank debts into bonds of longer duration, with a discount of the interests or on the principal. By collateralizing the principal only through zero-coupon bonds, risks relative to the principal are eliminated but not those associated with payment of interest. If the reduction of the debt burden discounted at current rates is left unchanged, the larger the principal discount the smaller the risk reduction, because the interest quota on the overall debt service flow becomes higher. Therefore, collateralization of the principal entails opting for a reduction of interest instead of the principal in proportion to the distance between the discount and the highest point in the Laffer curve of ability to pay.

364. If the level of risks of insolvency remains unchanged, collateralization only of the principal reduces the efficiency of the reduction operations because it introduces a distortion between the options available.

365. In a tax regime that allows the deduction of losses and not of provisions, the reduction of principal is usually more advantageous to the taxpayer than reduction of interest. It does, however, raise problems in connection with the indicators of capital strength if the provisions built up without any tax benefit are included in the assets. The magnitude of those problems could be considerably reduced if losses in capital value resulting from debt reduction operations with discounted bonds could be spread over several years.

366. However, the reduction of interest with conversion bonds at par does not produce such problems, but it does not carry the tax benefit of loss deduction. In the first stage, there is a tax benefit in the deduction of amounts that do not include the annual amortization quotas, since reimbursement has been established for the final year when the bonds will have to be redeemed. The collateralization of capital is hence useful for keeping provisions in the assets and can thus be appealing to underfunded or highly exposed banks. It should also be stressed that par bonds with a lower rate of interest produce a capital loss when determining the taxable profit.

367. The distortion of choices due to collateralization focused totally on the principal has positive repercussions for indebted countries, since such a conversion implies moving to a low interest rate as a hedge against future rises. Such an option, which is of interest to the debtor, is discouraged by the tax systems in the United States, Japan and Italy, where provisions are not deductible. The institutions that operate with collateralization will give priority to a conversion carried out through a discount on the principal instead of the interest, since the financial cost is lower in the first case. Discriminatory tax regimes in the United States, Japan and Italy lead banks to prefer deductions based on the principal instead of on the interest lost, although, under neutral tax circumstances, they would prefer reducing the interest in order to gain a higher collateralization level.

368. If a bank has a high capital ratio and can deduct provisions but not losses (as is the case for the United States, Germany and Switzerland), its managers may want to reduce the principal of its loans instead of the interest. The latter will be kept at variable market rates if the collateral savings for those institutions that provide financial backing to debt principals are used for further interest guarantees. Those bonds can then be sold without capital losses and the portfolio will therefore be clean.

369. The scheme for complete collateralization of the debt principal transformed into bonds can be used for strategic operations by those debtors who tend to depress the value of their bank debts before the scheme is implemented. A country that, by accumulating arrears, is successful in reducing the total value of its debt and can thus buy back part of it through intermediaries, will later be able to sell the bonds acquired and make a profit. That country may also transfer those bonds to one of its own institutions. For purchasers, the risk of failure to pay

the interest will be close to zero, since interest is a sort of clearing transaction between a debtor country and one of its institutions, which becomes the owner of the bonds. For operations of that kind, par bonds will be less effective than discounted bonds because the latter entail a greater risk gap between debtors and creditors, given the higher servicing costs.

370. If bonds are depressed on the secondary market since they have a low interest collateral, debtors may be encouraged to undertake extensive operations of in the form of debt buy-backs. Such a prospect can, however, also give rise to other strategic moves. At all events, debtor Governments will have to declare the amount of their own debts that they possess directly or indirectly. Successive buy-backs of their own debt certificates below par should be easier, given the neutral nature of collateralization on principal or on interest.

371. Excessive collateralization may promote insolvency. Therefore, it seems convenient that those bodies that encourage conversions should take up a debt-service quota directly, subject to regular payment by the debtor of its quota.

372. The collateralization scheme exemplified by zero-coupon bonds of the United States Treasury or other similar certificates presents a built-in contradiction that needs examining. If the debt reduction operation is effective, large collateralizations are unnecessary and will become just a formal financial contribution on the part of those who have purchased the zero-coupon bonds. If it is true that some risk remains, the international financial institutions that have purchased the said zero-coupon bonds will have carried out a concessional operation with repercussions on their capital ratio. The same holds true for indebted countries that use reserves as loan guarantees. Moreover, the larger the collateralization, the greater the temptation is for debtor Governments to declare their insolvency if guarantees are provided by third parties. Who can now guarantee the fair behaviour of Governments that in many years' time will have to redeem the value of those bonds? It is hard to understand the logic of collateralization carried out through zero-coupon bonds underwritten by third parties, except as a financial technique.

373. With high interest rates, zero-coupon bonds are surely attractive because of their large potential, since they allow up to one tenth of a 30-year obligation to be insured at 100 per cent. They also imply a waste of resources, for while they give a 100 per cent guarantee against risks that, logically, should be much lower and only marginal, they encourage insolvency. A more rational system would be one in which guarantees are provided by the debtors themselves, who would receive in return financial backing at concessional rates and terms. Doubtless in any such conversion operation there is a grant element that is immediately transparent. It remains true, nevertheless, that proper behaviour can become conditional, thus facilitating a co-operative super-game between debtors and creditors.

374. There are two types of debt conversion that do not seem to alter the debt terms, which may be advantageous for debtors and involve low costs for creditors, who can offset them with a lower insolvency risk, provided that a sufficient number of creditors join the scheme. The first type consists in depositing interests, without paying them, in a debtor's account, without penalties for delayed payment

and at a low rate for the respite thus obtained. The second type involves the payment of at least a portion of the debt service in local currency.

375. The first formula makes sense only if the country in question has a real ability to pay and if every year, possibly backed by international institutions through soft loans, it can buy back more of its debt on the secondary market than the accumulation of unpaid interest. Assuming that secondary-market bids for that debt are low and that the real ability to pay is relatively high, the operation will turn into a well balanced gain for the debtor and the different types of creditors: those who prefer waiting, and those who want to get out now, even with a considerable loss on their own lending. 6/

376. Assuming that the buy-back is financed with soft loans and that the secondary-market price is low, the operation will have a very high potential for success. Supposing that every year 20 per cent of debts is bought back, that accumulated interest is 9 per cent, and that the secondary-market price is 20 per cent, in three years, with a cost equal to 15 per cent of the total debt face value it will be possible to buy back 60 per cent of the debt. By establishing that all banks agreeing to accumulate interest are entitled to sell loan stocks on the secondary market during the three years, at the end of the period, with 15 per cent of funds provided by multilateral bodies, they will have liquidated 15 per cent of their risk loans, with the assurance of total recoverability of the remaining 40 per cent and with a real discount of 45 per cent. On the other hand, if the interest rate applied by multilateral bodies is only 6 per cent on an instrumental loan, the buy-back will cost the indebted country only 1 per cent of the debt stock, and that country will find itself at the end of the three years with a debt that is only 54 per cent of the original one.

377. Of course, such an operation is not without risk, with the result that middle-income countries that want to stay in the international market must view it with caution, as a very interesting instrument but one with a limited scope. In effect, if the buy-back involves large percentages of the debt and if the purchase on the secondary market is carried out at concessional prices owing to deep scepticism concerning willingness to pay, the operation will gradually take the shape of a real, though partial, rejection of the debt.

378. Governments in indebted countries with an interest in economic growth and international co-operation for their development are not to be encouraged to pursue strategies of going into arrears, for this will depress the value of their debt on the secondary market below their real long-term ability to pay. A scheme of this kind is practicable only by predetermining the buy-back price for the ensuing five years and by establishing debt quotas intended for buy-backs, in line with the financial resources made available by the international community.

379. In order to raise the ability to pay, another scheme may be implemented apart from the one illustrated above: allowing total or partial payment of the debt service in local currency indexed to a basket of commodities traded by the country in question. 7/ Indexation is indispensable so that creditors avoid depreciation of their loans as a result of complicated exchange-rate mechanisms. Once the

interest and the principal have been reimbursed, it is necessary that the corresponding creditors' bank deposits in the debtor country are indexed so that inflation does not wipe out those amounts before they can be invested locally in properties, commodities, services or goods for local activities in which creditors are interested (e.g., services related to international trade).

380. It must be recognized that this scheme has its limitations, so that it is very interesting only as a partial measure. In particular, it does not alleviate the public finance problem concerning the ability to pay. If a debtor's difficulties are not confined to raising foreign exchange to honour the debt service but include problems of actually raising the financial resources necessary for paying such service, the conversion of debt service into indexed local currency certificates will not overcome the debtor's difficulty in honouring his commitment. In such cases, if the debt service represents a large portion of GDP, the share of debt service that can be converted into domestic currency certificates can only be a small one. That is the only way in which servicing can be financed either through tax revenues or new certificates of government debt that can be placed on the market. If the share is limited to, say, 1 per cent of the total debt stock which in turn represents 40 per cent of GDP, the flow of indexed local currency available for creditors will not be an important inflationary factor if translated into goods and services owned by the indebted country. For instance, in the case illustrated above the related flow will be 0.4 per cent of GDP.

381. A curb in the flow is also needed to guarantee the creditor the right to purchase properties, commodities and services in the debtor country. Beyond legal safeguards of such rights (which obviously have to exist for the creditor to make use of his purchasing power), there must not be too many certificates allowing this possibility so that creditors can find satisfactory set-offs and so that local economies are not upset by excessive flows of investment and external purchases. Special tax revenues may be used for the purpose of guaranteeing the payment of those amounts. If the amounts are small, as in the case above, the operation should be feasible.

382. Instead of converting a portion of the service of the entire bank debt (or other debts) into local currency, an alternative solution may be the conversion of part of the principal of those debts, into local currency. For instance, instead of deciding that 1 per cent of the interest is payable in local currency (indexed), one alternative may be the conversion of 10 per cent of the debt into equities in local currency, indexed according to the scheme illustrated above. In that case, the principal, too, would obviously be reimbursed in local currency. Assuming an interest rate of 9 per cent, the conversion of 10 per cent of the debt into 30-year bonds in local currency implies an interest burden of 0.9 per cent.

383. With the amortization method of constant quotas (the so-called "French method"), the figure must be raised by about 10 per cent. Considering the overall debt service, the annual flow in indexed local currency available for creditors is still 1 per cent of their total credits. The scheme may be of interest for those countries whose debt burden is not too high and which have important resources. Raising the quota for conversion into indexed domestic debt above 10 per cent could entail problems for creditors seeking a corresponding value for the equities they have purchased.

384. One alternative is the introduction of buy-back policies to accompany a conversion plan as follows: for instance, by establishing that 40 per cent of the debt may be sold on the secondary market at a predetermined price, unless it is converted into indexed local currency in the course of two years. The buy-back should obviously be financed by multilateral financial institutions.

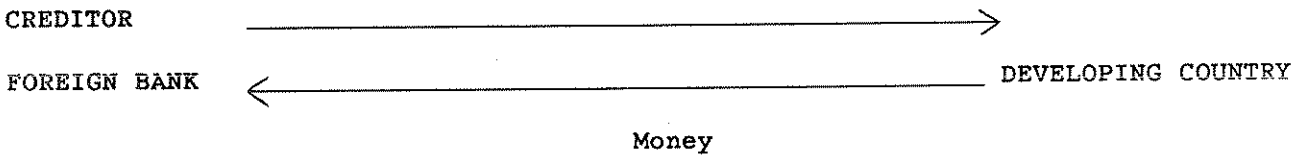
385. In a scheme such as the one above, assuming that 20 per cent of the debt is converted into indexed local currency and 25 per cent is bought back at a 30 per cent value with soft loans at 6 per cent, the remaining burden in foreign exchange on the 25 per cent option would be 6 per cent of 7.5 per cent, i.e. a burden of 0.45 per cent. With a three-year loan and debt service at constant quotas, the final result is about 0.5 per cent, including amortization. On another 20 per cent, the service would be equal to 10 per cent in local currency, which, compared to the original total debt, is equal to 2 per cent. With a total debt amounting to 60 per cent of GDP, the remaining burden would be 1.2 per cent of the original GDP in local currency and it would decrease over the years as GDP rises. Assuming that the original debt service was 14 per cent of the debt, equal to 11.2 per cent of GDP, in foreign currency, it would go down to 6.66 per cent of GDP in indexed local currency, thus equal to 7.9 per cent of GDP. On the whole, the reduction would be on the order of 30 per cent, but it would go up to 42 per cent if denominated in foreign currencies.

C. Buy-back schemes

386. Foreign debt is bought back by the indebted country on the basis of the following scheme: 8/

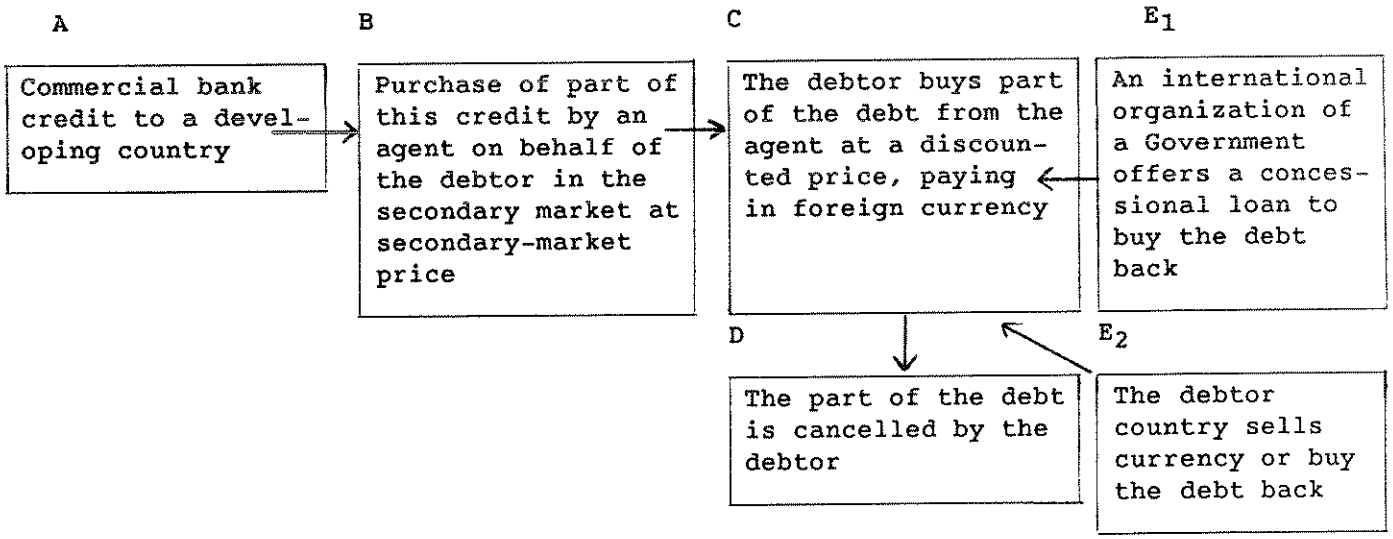
Figure VI.4

Developing country credits sold at the secondary-market price



With this scheme, it must be borne in mind that in general existing international loan contracts do not envisage the possibility for the debtor directly to purchase its own debt back in the secondary market. As a consequence, an agent is always necessary. The standard stages in a buy-back transaction are the following:

Figure VI.5



387. When the debt price on the secondary market is low, the voluntary buy-back of external debt by debtor countries seems to be extremely attractive. When buy-back is protracted, however, it appears to be self-defeating. In fact, as institutional buyers enter the secondary market, the debt price increases. On the other hand, a country deciding to buy its own debt back on the secondary market can be tempted to have a contradictory attitude towards the possible inflow of new money.

388. Indeed, an indebted country having difficulties with its payments and actually applying a moratorium on its own debt will not attract the inflow of new loans, but rather make prices on the secondary market decrease, thus favouring the buy-back of its debts, which are quoted in that same market. For this reason, buy-back should take place in blocks, through transactions agreed once and for all, whose price should be fixed in advance, if possible on the basis of objective indicators, so that the rationale is not that of the market, but rather the result of an agreement.

389. The assumption that on the secondary debt market there exists a single, stable market price is dangerous, because of the many uncertainties (moral hazards) implied in the assessment of possible future insolvency. In fact, there are only one seller or a few sellers and not many buyers, so that the price will be the price found in a bilateral monopoly situation, rather than a price resulting from competition. The assumption that on the secondary debt market there can be a single, balanced price is flawed, particularly in the case of buy-backs, because of the role of the bargaining game.

390. It is to be noted that the buy-back is radically different in nature from the purchase that a third person makes for himself on the secondary market, when the purchaser is not paid or is to be only partially paid by the indebted country. That risk can hardly be assessed and depends anyway on factors beyond his control. A country buying back its own debt - albeit through an intermediary, in compliance with the clause preventing the debtor from selectively buying back his own debt - does not however risk non-payment. It bears a burden whose value is based on the assessment that others have made of that risk, but, as was noted above, it is also affected by its own decisions. Thus, the game is not played by two parties - a seller and a buyer - concealing their preferences from each other and assessing differently their losses should they fail to reach an agreement. The game is played by a party selling something whose value largely depends on the statements and behaviour of the other party, i.e. the possible buyer.

391. Like the debt-equity swap the buy-back implies a consensus among creditor banks, which have to accept that somebody buys their debt back on the secondary market, paying either the going price or a similar one. In order to avoid "free-rider" positions, prices have to be fixed at a level determined in advance. For this reason, too, an agreement reached on the basis of objective criteria seems to be the only suitable way of securing a large-scale buy-backs.

Table VI.1 Cost of buy-back
(As a percentage of the nominal value of the debt)

Countries	Demand	Supply
Algeria	20 501	20 998
Argentina	8 987	9 429
Bolivia	600	654
Brazil	29 507	30 366
Chile	12 376	12 572
Colombia	10 880	11 220
Costa Rica	951	1 041
Dominican Republic	549	627
Ecuador	1 792	1 901
Honduras	630	696
Côte d'Ivoire	706	988
Jamaica	1 764	1 807
Mexico	44 689	45 450
Morocco	8 367	8 566
Nicaragua	161	322
Nigeria	7 602	7 833
Panama	843	955
Peru	743	1 114
Philippines	15 018	15 239
Poland	6 741	7 163
Senegal	1 157	1 229
Sudan	118	237
Uruguay	1 759	1 797
Venezuela	15 595	15 855
Yugoslavia	13 173	13 335
Zaire	1 631	1 716

Source: Derived from Salomon Brothers Inc. data reported in LDC Debt Report, an American bankers' newsletter on developing country debt, May 1990.

392. The buy-back is almost always a public finance operation, for most debts are incurred by Governments and other public institutions or by Government-guaranteed enterprises. It therefore requires public loans. If they take the form of money or short-term securities, inflation might occur. If they are long-term securities purchased by nationals, they could drain savings earmarked for investment. Securities offered at favourable rates generate new savings or attract the repatriation of capital from abroad. Inflation problems are similar to those related to the debt-equity swap, when it is financed directly by the Governments concerned. On the other hand, when credits are considerably depreciated, the pressure exerted by inflation is in any case limited.

393. In order to buy its own debt back, a single Government can be helped with loans from international institutions, which should not lead to inflationary pressure related to the debt service. The pressure is hypothetical, in that it occurs only if the country concerned pays no percentage of its debt. In general, even countries like Peru that in the past have systematically applied a moratorium on their debt service, have always paid a part of it (in the case of Peru, an annual 10 per cent of export earnings).

394. It is necessary to consider what kind of economic framework can lead a country to pursue this policy rather than another one, in order to gain new creditworthiness. Much depends on the situation in which the country believes itself to be, as well as on its expectations. If the country believes it will quite soon restore its creditworthiness, it can judge it convenient to make a sacrifice and agree on debt restructuring. In such a case, buying back the debt on the secondary market at a considerably discounted price does not seem to be advisable (as a possible alternative to the use of resources for debt servicing), since resorting to this mechanism somehow sanctions the state of insolvency of the country.

395. In the case of countries which are far from restoring solvency, like Peru, Bolivia and many African countries, it seems useless to pay even a part of the interest, because the nominal debt would continue to increase (owing to the de facto capitalization of interest), while its price would continue to decrease. Low-income insolvent countries are not denied resources such as grants and soft loans either by international institutions or by industrialized countries. It is however possible for them to be influenced by the ethical behaviour of the Governments receiving aid. If (for example, after general elections following a return to democracy) a reliable Government succeeds a Government which had completely lost its reputation, the new Government will find itself faced with a delicate strategic choice. If it rejects altogether its predecessor's debt, arguing that it does not want to be responsible for the choices made by someone else, it displays questionable ethical behaviour. Within the framework of a super-game each Government has to be responsible for the whole nation, irrespective of the Government that preceded it. It would therefore be wiser for it to show that it is ready to buy its debt back, in proportion to its ability to pay as well as to the value the debt had reached on the secondary market under the preceding Government. If its quotation was influenced by strategic attitudes rather than by the objective possibility of repayment, a few percentage points may possibly be added. In other words, proving good will can indeed positively affect the lenders' perceptions of the debtors' good intentions.

396. If it is impossible to buy the debt back once and for all, the market value of the residual debt would increase in both the short and the longer terms. The cost of pursuing a policy of progressive buy-back is therefore higher than a policy global buy-back, planned through an agreement or through positions taken and backed by an international institution.

397. Unless accompanied by international financing, the buy-back would in any case prove to be impracticable, since it could negatively affect investment and hence the possibility of increasing exports. The required sacrifice could by far exceed the potential benefit, consisting of a return to solvency at some unspecified time in the future.

398. Solvency cannot be regained in a short time. Bolivia is one example: it bought back 47 per cent of its debt to commercial banks (with financing by industrialized countries). The debt's market value remained more or less the same, because the price on the secondary market rose from 6 per cent to 11 per cent, as a consequence of the transaction itself. This allowed for a further buy-back, at favourable terms, but shows that the benefits in terms of creditworthiness are not immediate in the presence of a significant residual debt. It can therefore be said that operations such as those carried out in Bolivia, and in general all partial debt reductions through buy-backs or discounting parts of the debt itself, benefit almost exclusively the creditors (the banks) rather than debtors. The latter are ever more bound to follow the path, favourable to banks, of progressively repurchasing their debt at higher prices, for otherwise all previous partial repayments would have been completely useless.

399. Thus, the buy-back is an acceptable public choice for debtor countries wishing to make the best of having to repay their debts, but only if it is part of overall negotiations leading to new creditworthiness and incidentally solving the problem of debt-induced crises.

400. The assistance of multilateral organizations in buy-backs seems to be a pre-condition for the success of such operations, in order to assist countries financially, guarantee the global character of the buy-back and establish that the buy-back, even if taking place over time, has a reference price, which is the one applied at the time when the global negotiations take place.

401. For purposes of illustration, the buy-back price of the whole debt present on the secondary market may be assessed at the secondary market price plus a 10 per cent variation (as an average of the various situations), to take into account the strategic element contained in those quotations.

Notes

1/ For a thorough discussion, see M. Blackwell and S. Nocera, "Debt-equity swaps" in Frenkel, J. A., M. P. Dooley, P. Wickham, Analytical issues in debt, IMF, 1989.

Notes (continued)

2/ See Bergsman J., Editis, J. and W., Debt-Equity Swaps and Foreign Direct Investment in Latin America. IFC Discussion Paper No. 2, 1988.

3/ The thesis that debt-equity swaps may cause inflationary pressure through the related monetary expansion has been put forward for Brazil, for instance, in the paper by E. Cardoso and D. Dantas in the volume Latin American adjustment. How much has happened, edited by J. Williamson. R. Cline, however, commenting on this paper, in the same volume, observes that if, instead of measuring the monetary expansion through the circulation of paper money in the narrow sense (i.e. M_1), the expansion is related to total money circulation, inclusive of short term treasury bills, the percentage increase in the money supply is a modest 3 per cent "which, certainly, cannot provoke a 1,000 per cent inflation".

An important argument in favour of debt-equity swaps, both as a full privatization device and as participation in a joint venture with public enterprises by other investors, may be the improvement in their economic results, leading to a reduction of the State fiscal deficit. W. Cline in his comments on the paper by J. C. de Pablo on Argentina in the volume quoted above, points out that Argentina's State firms, led by the State railroad, lose some 2 per cent to 3 per cent to GNP annually, leading with revenue from taxes on income, profits and capital gains amounting to less than 3 per cent of GNP. While one may argue that railroads, being an infrastructural public service should be allowed to run at a deficit, the same argument cannot be put forward for the oil companies or other industrial enterprises, which, rather, should provide a surplus to increase domestic sources of investment financing.

Similar problems are described by R. Hausman in his paper on Venezuela in the same volume regarding Venezuelan public enterprises. He argues that out of $23 billion foreign debt, $8 billion only was borrowed by the Government, the rest being loans issued by public enterprises or debts accumulated on them, which the Government was subsequently obliged to recognize as its debt. Often, according to R. Hausman, these debts by the Government derived from the issuance of central government bonds to pay suppliers and contractors for ambitious investment projects for which the resources of public enterprises proved insufficient.

As is pointed out in the chapter XVI, section B, one might devise techniques of financing investment efforts through joint ventures between domestic public enterprises and foreign investors.

A moderate debt-equity swap policy may make it possible to move in this direction without 100 per cent privatization.

According to R. Hausman in the paper quoted above,

> "Some people are starting to take seriously the argument advanced by Pedro Aspe that debt-equity swaps can act as a drag on foreign investments; prospective investors are willing to wait until their best opportunity comes up in the swap auction. At the same time, the fiscal and monetary implications of swaps demand that the amounts be limited in any given period. As a result, debt-equity swaps can actually slow down the inflow of foreign investment".

It should be noted, however, that swaps related to public property per se do not involve monetary expansion since the public debt purchased by the investors is employed by them in acquiring from the Treasury equities or other property owned by it.

Obviously an expansion would take place if the receipts from the sale of assets were used by the Government to finance public expenditures. In this case, a domestic debt would be issued to replace the foreign one.

4/ Corsepius Uwe, Peter Nunnenkamp, Rainer Schweickert, Debt versus equity finance in developing countries, Kieler Studien, Tübingen, 1989.

5/ A simple numerical example may illustrate the point. Assuming that the creditor who grants an extension of the reimbursement period at an interest rate appropriate to the ordinary risk owns one fifth of medium-term credits granted to a given subject; that the extension in question is from 8 years to 15, 20 or 30 years and that an overall debt service with payment in 8 years entails an additional risk of 10 per cent, the result is a 10 per cent debt devaluation when the term is 8 years, 18 per cent for 15 years, 25 per cent for 20 years and 37 per cent for 30 years.

Now, assuming that the whole debt is converted into 15 years, that the global risk connected to the inability to pay is cut by 5 per cent, by a further 5 per cent in the case of 20 years, and by another 10 per cent in case of a 30-year loan, but only fifth of the credit has been converted, taking a benefit of one fifth of the risk for those who carry out the reduction is cut by 1 per cent in the first case, 2 per cent in the second, and by a further 2 per cent in the third but, owing to the extension of terms, the risk grows by 3.6 per cent, 5 per cent and 7.4 per cent respectively, so that individual creditors will reap no benefits from the operation. In other words, an extension of debt maturity is in the public good and can be carried out only through co-ordinated actions that give benefits to debtors and to all creditors.

6/ This scheme was presented by Rudiger Dornbusch at the Cernobbio Seminar.

7/ See Williamson J., The debt crisis at the turn of the decade, Institute for International Economics, Washington, D.C., 1990.

8/ Diwan, I. and S. Claessens, An analysis of debt-reduction schemes initiated by debtor countries. World Bank Working Papers. International Economics Department, Washington D.C., March 1989, and M. P. Dooley. Buy-backs, debt-equity swaps, asset exchanges and market prices of external debt in J. S. Frenkel, M. P. Dooley and P. Wickham, op. cit.

VII. DEBT REMISSION-CONVERSION FOR ENVIRONMENTAL, HUMANITARIAN AND GROWTH PURPOSES

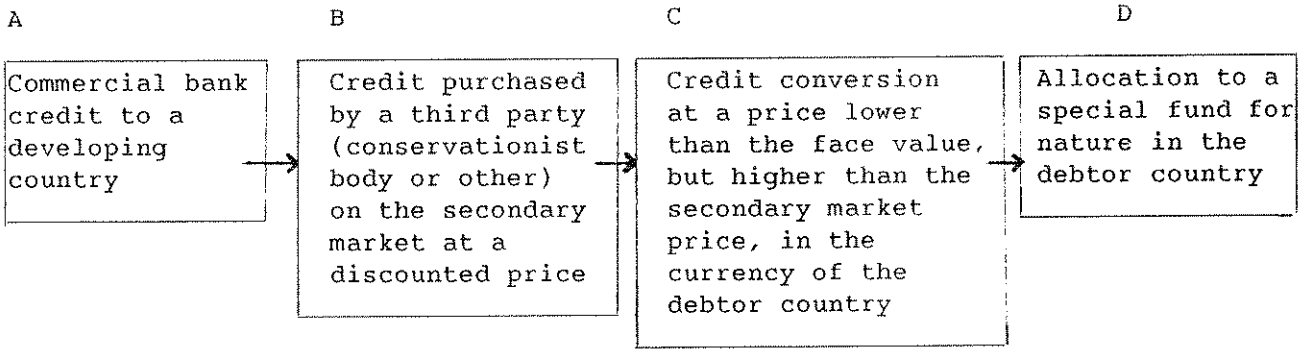
A. Debt-environment swaps

402. A number of heavily indebted countries possess a resource that is progressively being depleted throughout the planet: an uncontaminated natural environment. The demand for this resource is concentrated in the industrialized countries, where there is a shortage of virgin land on the one hand and, on the other, ecological sensitiveness is more acute.

403. In 1984, Mr. Thomas Lovejoy of the World Wildlife Fund (WWF) suggested how indebted countries with an uncontaminated natural environment could convert that resource into cash: by buying back foreign debt securities (indebtedness in foreign currency) in return for domestic resources (in local currency) to be allocated to conservation initiatives, at the discount enjoyed by foreign debt securities of heavily indebted countries on the secondary market. In a standard transaction, the promoters of the initiative in industrialized countries purchase debt securities from creditor banks at a discounted price and give them to the indebted Governments in return for local resources that are used to protect the environment.

404. Generally, certain clauses of the original debt agreement do not allow the debtor to buy back its own debt selectively. Therefore, the debtor cannot be the purchaser of debt securities in the secondary market. The purchaser must be a third party, such as a conservationist body, or a non-profit-making organization that raises funds to carry out the transaction through donations or voluntary contributions. The standard operation is as follows:

Figure VII.1



405. The body promoting the transaction must ensure that these funds are additional funds and are not replacing other funds. Donations can be encouraged by the tax system of the donor country. In creditor countries, in fact, the State can make a contribution by instituting tax relief for donors.

406. The counterpart requested by the donor, in turn, consists of a special guarantee concerning the use to which the donated funds will be put. This, in turn, will affect the counterpart requested by the body promoting the transaction of the final users of the funds raised.

407. Thus, the parties to the transaction and their respective interests are:

(a) Conservationist bodies in the industrialized countries, representing the "green" interests of the environment at world level;

(b) Banks in possession of foreign debt securities of the countries whose debt they intend to reduce or on which they want at most to make minimal profit;

(c) Governments of indebted countries interested in reducing their external debt and minimizing their use of hard currency reserves;

(d) Conservationist bodies of indebted countries, whose task is to raise local funds to finance their campaigns and programmes.

408. Even though the transaction suggested by WWF could satisfy all parties at once, for the agreement to be successful the interests of four different parties would need to coincide, and these are likely to be different given their different economic interests. In fact conservationist bodies in industrialized countries, when purchasing debt securities, look for the highest possible discount, which runs counter to the interests of creditor banks; and the Governments of indebted countries, in turn, try to benefit from the discount and underestimate the negative political and economic impact of the transaction, against the interest of both local and foreign conservationist groups.

409. In the difficult search for a balance satisfying all parties, the financial and legal complexity of the transaction must also be taken into account. Moreover, some political problems may arise and, finally, some theoretical problems have been identified at the macroeconomic level.

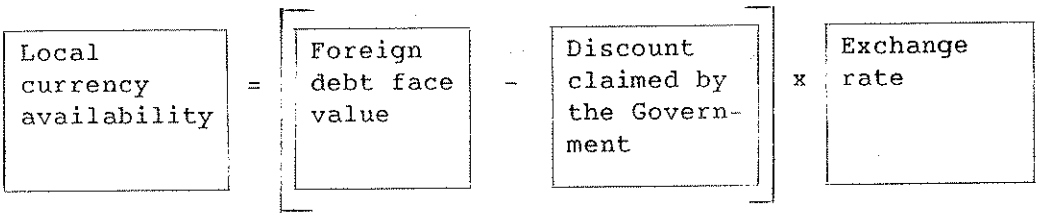
410. Besides the conservationist organizations promoting the debt-environment swaps, there are the Governments of indebted countries and local conservationist organizations. The former must first of all turn foreign debt securities sold by the purchasers/promoters of the transaction into local resources. Local resources can be either physical, e.g. forests or protected areas, or financial, such as payments in local currency or public debt securities, again in local currency. Financial resources must be managed at the local level, generally by local conservationist organizations working in co-operation with public bodies. Under the debt-environment swap, the management of local resources must follow an action plan agreed upon by the two parties, which is the true counterpart to the debt buy-back. All this raises complex problems concerning the definition and monitoring of the commitments undertaken and implies the risk of interfering with the domestic policy of the debtor country.

411. Another set of problems concerns the scope of the commitments undertaken by Governments. Considering the political instability typical of many countries where debt-environment swaps can be carried out, it is in the promoter's interest to have the commitments incorporated in the country's legislation. This, however, can entail considerable political difficulties.

412. A further set of problems concerns the benefits claimed by the local Government providing financial resources in return for the cancellation of its foreign debt.

413. The Government will generally try to obtain part of the discount enjoyed by the purchasers of the foreign debt securities on the secondary market, thus reducing the volume of local resources available for investment. Finally, a problem may arise in the definition of the exchange rate to be applied to the debt expressed in foreign currency, especially when there is an exchange control system or multiple exchange rates.

Figure VII.2



414. Government commitments to supply local resources, either physical or financial, to preserve the environment in return for the buy-back of their foreign debt give rise to a number of political problems. The most serious problem arises when the State appears to lose control of part of its territory. Even when there is no transfer of ownership of State property, strong nationalistic sentiments could rule out even the involvement of foreign organizations in the management of the country's natural resources. Moreover, often in indebted countries, public opinion may oppose the idea that debt must be paid, or somehow bought back, requiring sacrifices that the people consider unfair. It is, therefore, unacceptable to exchange local resources for the protection of the environment.

415. The first debt-environment swap was signed by the Government of Bolivia in July 1987. Conservation International, a United States organization availing itself of funds donated by the Frank Weeden Foundation, was the promoter. A $100,000 donation was used to buy Bolivian public debt securities deposited with a Swiss bank amounting to a total face value of $650,000 through the Citicorp Investment Bank. The average price was therefore $15.38 for each $100 of face value. As a countervalue for the cancellation of this debt, the Bolivian Government committed itself to assigning a 1.5 million-hectare forest belt surrounding the Beni national park as a protected area, and to allocate a budgetary fund in local currency amounting to the equivalent of $250,000 to manage it. Conservation International assumed certain responsibilities in the management of the protected area. Several elements favoured the conclusion of a debt-environment swap in Bolivia: the high discount applied on the country's foreign debt, the full support extended to the project by the President and the Government and the poor economic conditions in the area of intervention. 1/

416. The Government of Costa Rica tested a new type of debt-environment swap, setting a limit to the debt that could be bought back and offering in exchange bonds with a five-year maturity and a repayment staggered between the third and the fifth years for an amount equal to 70 per cent the face value of the foreign debt converted in local currency at the official exchange rate in force on the day of the buy-back. This scheme allowed different conservationist bodies to take part in the swap until the limit, initially set at $5.4 million, was reached in March 1988. The local bodies receiving bonuses initially benefit only from the interest. However, the bonuses can be used as a guarantee for bank loans. The variety of the swap promoters is matched by the variety of environmental programmes and initiatives, the most important of which are two projects for national parks (Corcovado and Guanacaste).

417. Some factors facilitating the conclusion of a debt-environment swap include the country's political and democratic stability and good relations with creditor banks, in spite of the country's considerable indebtedness. 2/

418. In the case of Ecuador, a local organization, the Fondación Natura, the most important conservationist organization in the country, took initiative for an agreement with the Government/central bank to buy back foreign debt in exchange for local initiatives. As in the case of Costa Rica, the agreement set a maximum limit to the debt to be converted, i.e. $10 million face value, in exchange for bonuses in local currency at variable interest, with a nine-year maturity, for an amount equal to 100 per cent of the face value of the debt converted at the official exchange rate on the day of the buy-back. In December 1987, WWF (United States) supplied the Fondación Natura with the first $1 million contribution of foreign debt to be swapped, paid at 35 cents on the dollar. In April 1989, the limit of the debt to be swapped was reached. The various programmes financed by the swap cover six natural parks in the Amazonian and Andean regions, as well as the Galapagos Islands. The Fondación Natura has the task of channelling financial resources on behalf of various other local conservationist groups.

419. In the case of Ecuador, the exchange was facilitated by the presence of a reliable local organization that had negotiating power with the central bank and the Government, as well as good relations with similar organizations in the creditor countries. 3/

420. In June 1988, WWF, the Haribon Foundation (the most important local conservationist group) and the Government of the Philippines initialled an agreement envisaging the conversion of a maximum of $2 million of the country's foreign debt to local currency for an amount equal 100 per cent of the face value of the debt exchanged at the official exchange rate of the day of the buy-back. A first tranche amounting to $390,000 was contributed by WWF at the price of 51 cents on the dollar. A small proportion of the local currency was transferred to the Ministry of Environment and Natural Resources, to cover the administrative cost of certain projects. Among the projects financed through the exchange are two natural parks on Palawan Island, as well as education and training programmes to produce skilled personnel.

421. In the case of the Philippines, too, the role played by a widely known and official conservationist body in the agreement was of fundamental importance. 4/

422. In the case of Madagascar, WWF negotiated directly with the country's central bank and fixed a ceiling of $3 million in foreign debt to be exchanged at 100 per cent of the face value in local currency at the official exchange rate in force on the day of the buy-back.

423. The swap, initialled in August 1989, has a three-year validity. A first $2.1 million tranche has already been purchased by WWF at the price of 45 cents per dollar. The local currency is used to finance different projects related in particular to the Andringita and Marojejy natural preserves. 5/

424. In August 1989, WWF negotiated a debt-environment swap with the Zambian central bank in the amount of $2,270,000, bought at the price of 20 cents on the dollar, exchanged at 90 per cent of the face value in local currency at the official exchange rate in force on the day of the buy-back. The programme to be financed with local funds is rather varied, and includes education programmes, as well as the management of different conservation problems. 6/

425. The limited number of debt-environment swaps carried out so far does not appear to be encouraging.

426. The debt-environment swaps could also take other forms. They appear particularly suitable for a swap against official debt servicing, but not so suitable for buy-backs of commercial debt, as has been the case out so far.

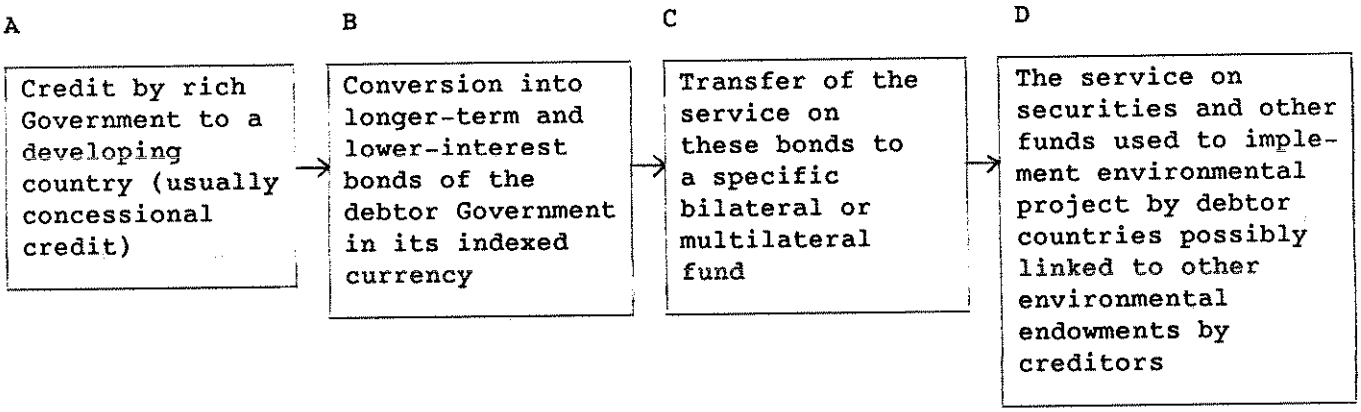
427. Among the new swap proposals, a somewhat questionable solution has been put forward for subtropical forests consisting of the transfer of part of such State properties to some supranational bodies in exchange for official debt cancellation, in order to create "ecological parks". Such transfers however seem inadvisable. A State cannot be deprived of its territory, even if it then comes under the protection of a high-level supranational body, such as the United Nations.

428. On the other hand, the protection of our common heritage, such as the Amazonian forest or the bio-marine heritage of the Mediterranean and the Adriatic basins, is not only a problem of mere static conservation of resources but also involves the services necessary to protect and enhance their value. The Amazonian forest 7/ is rich in fruit, rubber, herbs and biological and chemical substances that could be used for pharmaceutical purposes, whose value can exceed the value of the production of lumber and agricultural products for which they could be substituted. Of course, such changes would clearly require technical assistance and services.

429. One possible new proposal that warrants consideration is that the debt-environment swap could first of all consist of the commitment by the indebted country to conserve the natural resources benefiting from the swap as if they were a protected State property.

430. The debt to Governments or other entities could then be converted into non-tradable, low-interest, long-term bonds, serviced by payment in the indexed currency of the indebted country. The debt service could finance a special nature fund designed to manage protected ecological resources. The scheme for the public, official credits is as follows:

Figure VII.3



431. Bonds would be issued at par by indebted countries and servicing could vary according to the solvency level on the basis of the value of the area set aside for environmental protection.

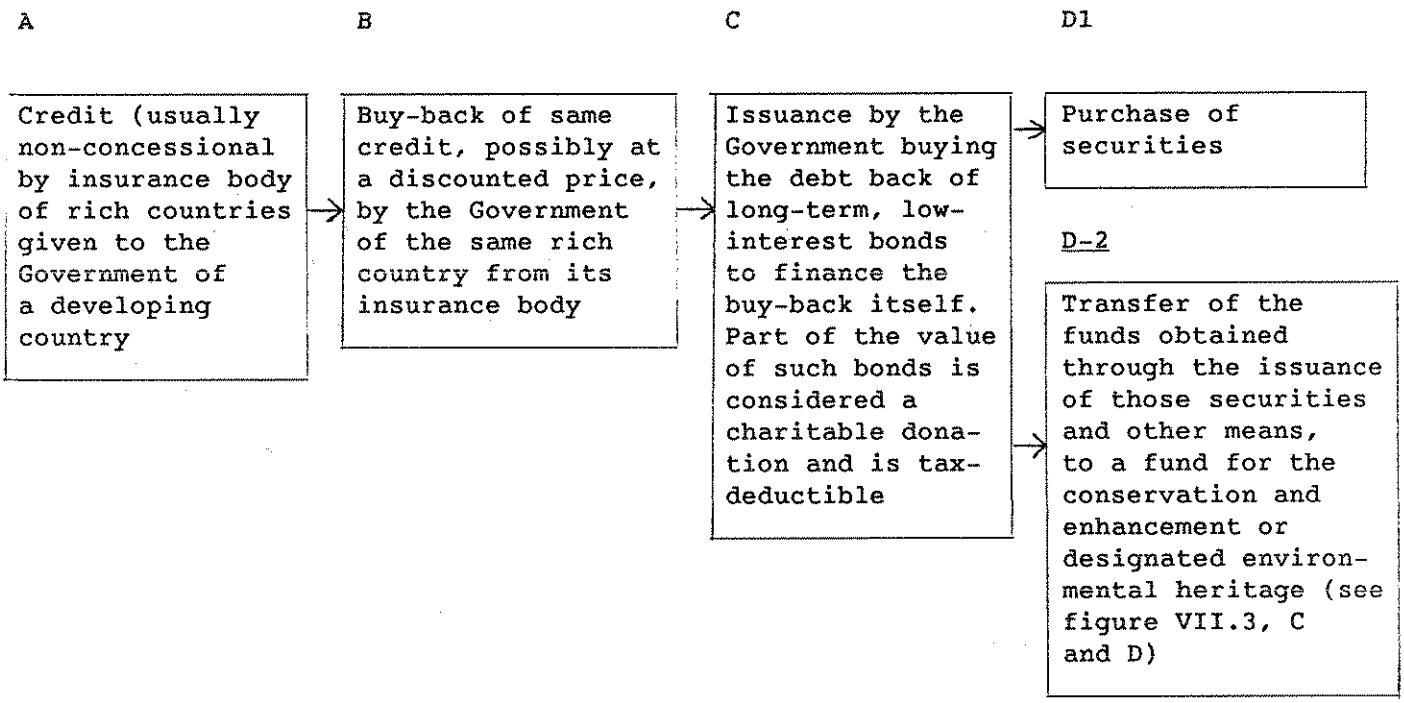
432. A low solvency level and highly valuable natural resources would translate into a security with an extremely low principal and interest service, such as 2 per cent of the original debt value for 50 years. Hence, such resources for environmental protection must be supplemented by others.

433. It would be particularly appropriate for countries with development programmes to make additional contributions to the nature fund, particularly where projects are of mutual benefit, e.g. a Mediterranean or Adriatic project. This could be a useful means, inter alia, of providing currency for the foreign component of the management cost.

434. This kind of swap has no inflationary consequences, except for the low level of annual payment flows in local currency required. Government credits converted into these bonds do not need to be written down in public budgets, since they keep their face value and provide an annual service. The problem remains of the credit and public insurance agencies that finance their activities through the repayment and servicing of these loans. In this case, fresh public funds are needed. However, protection of environmental assets, which is in the common interest, is a concept that is supported by public opinion in the creditor countries. This form of intervention can also be promoted through tax-deductible charitable donations.

435. The relevant scheme is as follows, and offers two alternatives (D1 and D2):

Figure VII.4



436. There is evidence of resistance to cancelling the official debts of developing countries and Eastern European countries, especially if they were incurred to buy commercial and military supplies, which benefit exporters. This resistance, however, could be more easily overcome if credits could be converted into resources to achieve an important environmental objective in the common interest. In the industrialized countries, ecological awareness is widespread, often outstripping concern for the condition of poor countries and the poor in developing countries. The time has come to test how deep this awareness is, above all in relation to a common interest in regional initiatives.

B. Debt-growth swaps

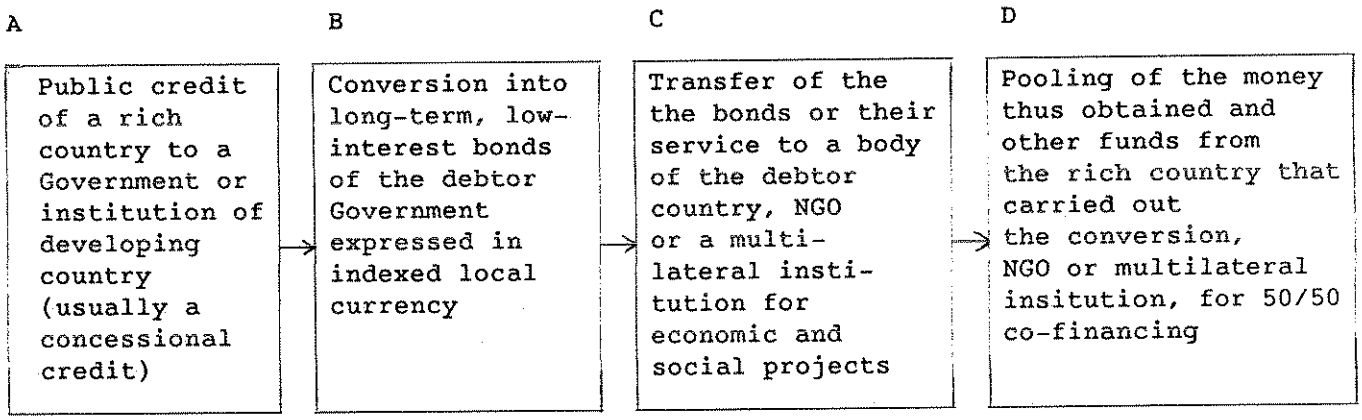
437. A similar conversion mechanism can be envisaged with regard to projects aimed at promoting economic development and social welfare, including the elimination of drug abuse. 8/

438. The techniques described in two of the schemes described in section A above can be extended to development projects, as well as social, education and training projects to be implemented locally, within the framework of bilateral and multilateral direct aid policies.

439. The Governments of creditor countries could convert, in a reduced amount, part of their loans to debtor countries into non-tradable bonds, whose service could be paid in the currency of debtor countries. The relevant receipts, together with extra contributions by creditor countries, could finance special funds devoted to development projects, as well as social education and training projects and to projects for agricultural transformation of areas where illegal drugs are cultivated.

440. The relevant scheme could be set out as follows:

Figure VII.5



441. It may be argued that development assistance would be reduced in cases where public foreign debt is paid through the application of these systems and there would be no net advantage to countries saddled with such foreign debt. With the technique suggested above, however, the volume of economic and social development projects financed by direct aid in indebted countries would not decrease. In fact, the payment of debt service, to be channelled to such funds, would be added to another contribution, of equal value, drawn from other resources.

442. Under such restructuring, for example, if a country paying $1 billion per year for public debt service converted that burden into securities for development and/or welfare in domestic currency at a 80 per cent discount, it could provide $200 million in domestic currency to service such debt. Such an appropriation would feed the fund together with at least $200 million drawn from the creditor country's co-operation funds. The Government of the creditor country would have to bear an additional cost equal to $1 billion per year.

443. The financial outflow by the indebted country would decrease by $1 billion and its public expenditure for the associated interest payment would fall to $200 million in domestic currency, so that its balance of payments and its public finance would register a decrease of 100 per cent and 80 per cent respectively, as compared to the previous burden.

444. At the same time, investment by creditor countries in that country would increase by $200 million at the direct or indirect expense of their tax-payers, whereas the other $200 million that is assumed to have already been provided would remain in that country, thus helping it to take initiatives of its own.

445. Even assuming that co-financing does not add to, but is rather a substitute for development assistance already allocated to that country, there would be no reduction in development expediture, but rather a tangible increase, equal to the bond service resulting from the swap. In addition, another less evident but greater increase, would result from the $800 million cancellation, which would not have otherwise been granted by the creditor country.

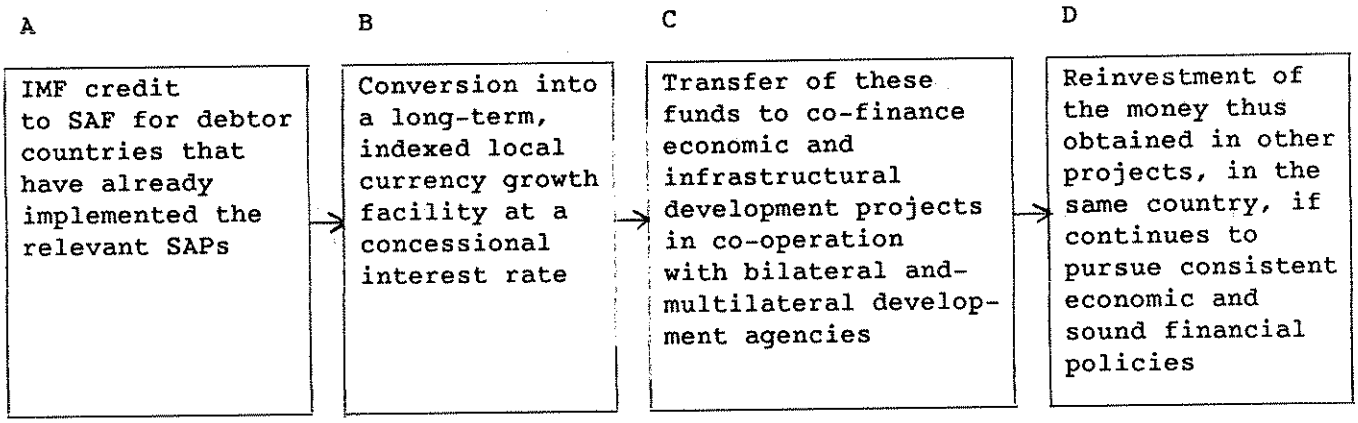
446. It is worth repeating that, although the debt-equity swap at a discounted price envisages a servicing payment in the domestic currency of debtor countries and is made at face value, it does not entail any immediate loss, equal to the real discount, in the creditor countries' budget. The burden actually affects the debt service flow, which is anyway blocked at present.

447. The environment and development funds could be managed at the regional level (for example, in the French-speaking Sahel countries or the Mediterranean countries) by the Governments of creditor and debtor countries operating as a consortium or by international institutions. Along the same lines, profitable economic development projects could be financed by swaps with credits from multilateral agencies. The most suitable multilateral agencies are those institutionally responsible for development. But a conversion problem also exists with the debt to IMF, which is known to play a much more important role than was anticipated, considering how small it is. In fact, the failure to pay debts to IMF blocks recovery programmes. In order to avoid that, the Fund is often satisfied with promises that such programmes will be implemented, and that first steps will be taken.

448. It would be advisable for IMF to consider the possibility of using the Structural Adjustment Facility (SAF), currently confined to long-term hard currency loans, for swaps of the debt-to-development variety for projects such as those described above and to convert accordingly its loans to those countries that have made concrete steps towards the implementation of structural adjustment programmes (SAPs). Thus, their implementation could be promoted and the stage of promises and initial steps could be passed.

449. The relevant scheme is as follows:

Figure VII.6



C. Debt-child survival and welfare swaps

450. Debt relief for children, launched in 1987 by UNICEF, 9/ can be particularly interesting and symbolic. The main idea is to reduce the debt burden or debt service, while at the same time generating additional local resources for programmes benefiting children. To achieve this goal, two main options have been proposed.

451. The first option is for banks and financial institutions to exchange their debt for payment in local currency at an agreed discount to be donated to programmes for children. This could be called a debt-child survival swap.

452. In certain cases, banks may use this transaction for tax relief, by making a charitable donation to their respective National Committees for UNICEF. This option was implemented in the Sudan when six commercial banks, the Midland and Hambros in the United Kingdom and Deutsche Bank and Dresdner Bank, AG, in Germany, and two money centre banks in the United States swapped their Sudanese debt in return for local currency donations for the UNICEF-assisted water supply and sanitation programme in Southern Kordofan. The United Kingdom donations were channelled directly to UNICEF, whereas the German and American bank donations were channelled through the respective National Committees to allow for tax exempt status.

453. The six donations generated the equivalent of $2 million in local currency and resulted in the cancellation of a considerably greater face value of debt. This is enabling UNICEF to extend its water and sanitation project in Kordofan Province through the installation of hand pumps, the building of latrines and the establishment of village seedling nurseries and woodlots.

454. The second option would be for donor Governments or financial institutions to make funds available to indebted countries to buy back their debt at a discounted price on the secondary market on the condition that the borrower sets aside an agreed amount in local currency for programmes for children.

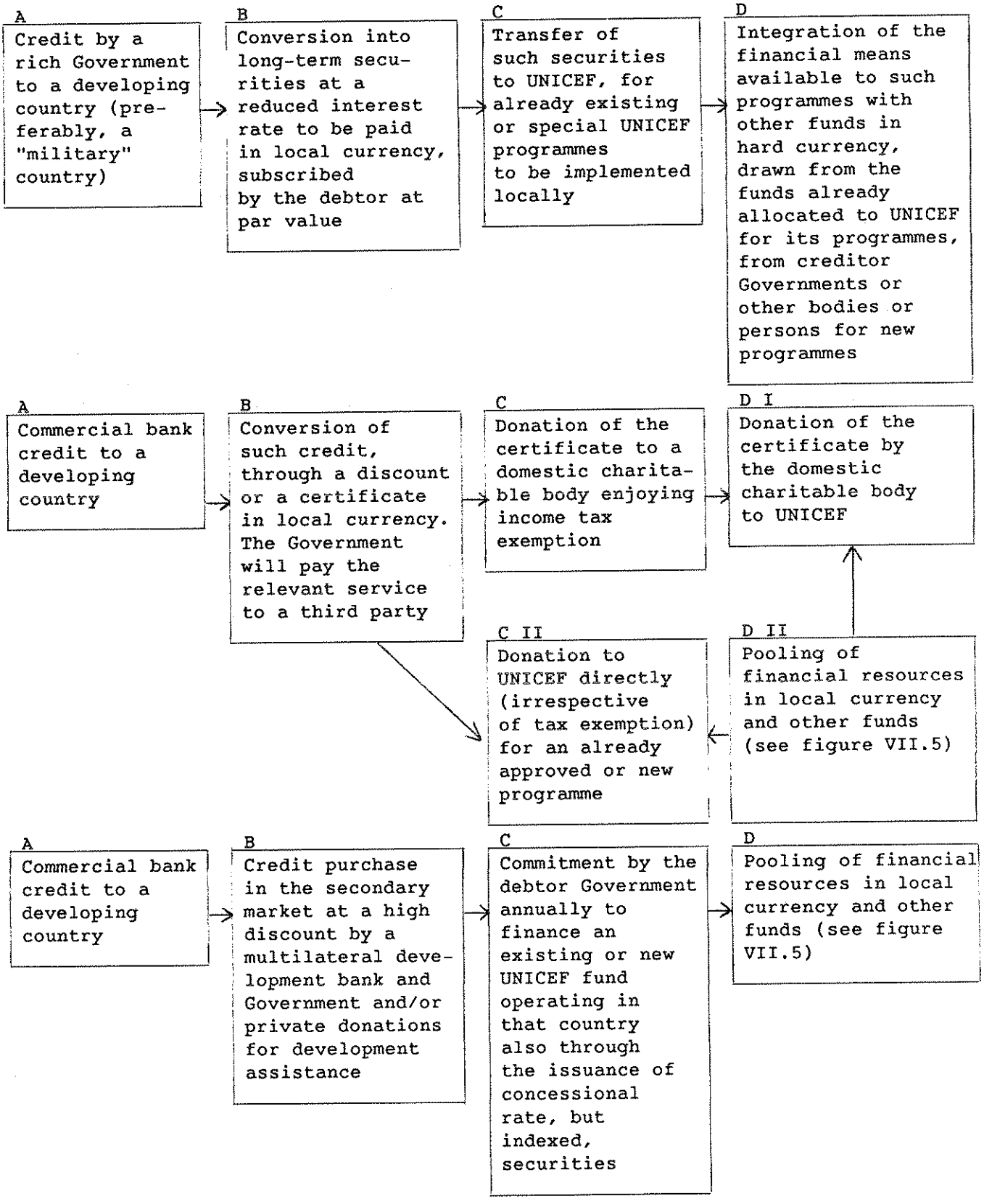
455. This option is currently being explored by UNICEF and the Inter-American Development Bank (IDB). IDB would set up a trust fund for debt relief for social investment, which would make soft loans to the Latin American and Caribbean countries. Donations to the fund would be sought primarily from donor Governments, but also from private institutions. The loans would be used to buy back debt on the secondary market, while at the same time the borrowing country would make an allocation in local currency to a social development project, through either UNICEF or IDB. The scheme is expected to become operational in the near future.

456. Similar initiatives are being discussed by UNICEF and regional banks for African and Asian countries.

457. In principle, UNICEF will not prepare special projects for debt-relief for children but will use existing or future projects for supplementary funding. Nevertheless, it might sometimes be useful to package proposals of special interest to donors. This has now been done for Bolivia, Ecuador, Côte d'Ivoire, Senegal, the Sudan and the Philippines.

458. One also needs to ascertain not only the beneficiary country's interest, but also UNICEF's capacity to absorb local currency. In some cases it might be necessary to supplement the local currency with additional hard currency.

Figure VII.7


A
Credit by a rich Government to a developing country (preferably, a "military" country)
B
Conversion into long-term securities at a reduced interest rate to be paid in local currency, subscribed by the debtor at par value
C
Transfer of such securities to UNICEF, for already existing or special UNICEF programmes to be implemented locally
D
Integration of the financial means available to such programmes with other funds in hard currency, drawn from the funds already allocated to UNICEF for its programmes, from creditor Governments or other bodies or persons for new programmes
A
Commercial bank credit to a developing country
B
Conversion of such credit, through a discount or a certificate in local currency. The Government will pay the relevant service to a third party
C
Donation of the certificate to a domestic charitable body enjoying income tax exemption
D I
Donation of the certificate by the domestic charitable body to UNICEF
C II
Donation to UNICEF directly (irrespective of tax exemption) for an already approved or new programme
D II
Pooling of financial resources in local currency and other funds (see figure VII.5)
A
Commercial bank credit to a developing country
B
Credit purchase in the secondary market at a high discount by a multilateral development bank and Government and/or private donations for development assistance
C
Commitment by the debtor Government annually to finance an existing or new UNICEF fund operating in that country also through the issuance of concessional rate, but indexed, securities
D
Pooling of financial resources in local currency and other funds (see figure VII.5)

Notes

1/ At the end of 1988 Bolivian debt amounted to $5.456 billion; its GNP was about $4 billion and its population to 6.9 million.

2/ At the end of 1988, Costa Rican debt was $4.530 billion; GNP was $4.650 billion and GNP per capita was estimated by the World Bank at $1,690.

3/ At the end of 1988, Ecuador's debt amounted to $10.8 billion and its GDP was equal to $9.5 billion; the population of Ecuador is estimated at 9.9 million. GNP per capita was assessed by the World Bank at $1,120.

4/ At the end of 1988, the Philippines foreign debt amounted to $29.4 billion and its GDP was equal to $40.3 billion; the population of the Philippines is estimated at 58.3 million; and its GNP per capita at $630.

5/ At the end of 1988, Madagascar's foreign debt amounted to $3.6 billion and its GDP was equal to $1.7 billion; the population of Madagascar is estimated at 10.9 million.

6/ At the end of 1988, Zambia's foreign debt amounted to $6.5 billion and its GDP was equal to $3.5 billion; the population of Zambia is estimated at 7.2 million.

7/ The Economist, editorial, 15 September 1989.

8/ J. Williamson, "The debt crisis at the turn of the decade", Institute for International Economics, Washington, D.C., 1990.

9/ R. Jolly, Deputy Executive Director of UNICEF, The Financial Times, 11 September 1987.

VIII. PROPOSALS BY HEADS OF STATE AND GOVERNMENT AND BY THE BANKING WORLD IN CREDITOR COUNTRIES

A. Mitterrand plan

459. The scheme presented by President Mitterrand of France on 6 June 1988 in order to solve the debt crisis covers official credits to the poorest countries in Africa south of the Sahara.

460. It includes three types of debt relief proposals:

(a) Immediate cancellation of one third of the government debts that have already been restructured, including insured commercial debts;

(b) Rescheduling of the restructured debt over 25 instead of 20 years, keeping interest rates at market levels;

(c) Debt restructuring over 15 years, but with market interest rates cut by half.

These proposals were put forward as alternatives, thus making up a menu of choices for the various countries concerned.

461. The French Government chose the first option, with an estimated loss of about $220 million a year. The plan was directed only towards those countries that met the following criteria: per capita income lower than $500, total external debt to GDP ratio higher than 30 per cent and economic recovery policies already being implemented under the direction of multilateral agencies. All industrialized countries favoured this, with the exception of the United States. In May 1989, President Mitterrand announced that France would cancel all its debts with 35 countries in Africa. The amount involved was equal to 16 billion French francs, about 43 per cent of those countries' total debts.

462. At the United Nations General Assembly in September 1988, President Mitterrand proposed to finance debt reduction operations by means of new issues of special drawing rights (SDRs). The idea was to set up a special fund within IMF with the aim of guaranteeing the servicing of some of the debts contracted by developing countries, especially commercial debts. The fund would be financed through the issuing of new SDRs by industrialized countries. The main criticism of the plan is that it produces a distortion in the very nature of SDRs, which were created in order to replace gold in international monetary transactions. 1/

B. Proposal by Helmut Schmidt

463. The proposal of an Independent Group on Financial Flows to Developing Countries headed by Helmut Schmidt, former Chancellor of the Federal Republic of Germany, was published in June 1989 in a report entitled "Facing the World". 2/

464. Effective steps to fight all kinds of protectionism and to abolish all trade barriers are essential, particularly in the field of agricultural products, capital movements and services. To achieve this goal, OECD countries in particular should make a concerted effort to reduce substantially all non-tariff barriers over the

next five years. Over a period of 10 years OECD countries should move to eliminate all tariff barriers as well as the remaining non-tariff barriers. Emerging free trade areas should remove non-tariff barriers against third countries and particularly developing countries.

465. The United States must apply policies designed to reduce its massive fiscal and current account deficits and resume its status as a net exporter of capital by the mid-1990s. In order both to raise its savings rate and to strengthen capital formation, the United States should restore fiscal balance within four years, by both expenditure cuts and, if necessary, tax increases. The United States should reduce incentives for debt creation by abolishing tax provisions which favour debt rather than equity financing.

466. Energetic efforts by Japan and Germany are essential in order to reduce their current account surpluses with the rest of the world and to base their economic growth on domestic demand. The two countries should reduce their current account surplus to 1 per cent of GNP. Both should take budgetary measures, e.g. abolishing preferential tax treatment of private savings and encouraging public expenditure for infrastructure purposes. Japan should increase its official development assistance (ODA) dramatically from below the OECD average to 1 per cent of GNP.

467. The Soviet Union and the other countries members of the Council for Mutual Economic Assistance (CMEA), as well as China, should take steps to integrate their economies more fully into the world economy. To encourage this process, they should be welcomed as full participants in international organizations such as IMF, the World Bank, and the General Agreement on Tariffs and Trade (GATT), provided that they assume the full obligations of membership. The Soviet Union should undertake to become a important donor of ODA.

468. The developing countries should make the creation of a favourable economic environment a priority. A favourable domestic environment has played a key role in the emergence of the newly industrializing economies, fostering their evolution from developing to industrialized countries. Attention must be called to the fact that the primary responsibility for economic and social development lies with the people and leaders of each nation.

469. Sizeable amounts of official development assistance are urgently needed to start and support the growth process in many developing countries. Such assistance should be conditional upon strict standards of efficiency and effective return on capital. Consistent with meeting those requirements, the total amount of ODA provided by the industrialized countries should be doubled over the next five years. The least developed countries and disaster relief schemes should continue to have first claim on ODA funds. In order to ensure the long-delayed increase in ODA resources, a system of automaticity should be explored and implemented in each donor country. Donor nations and international financial institutions should give special consideration to countries that:

(a) Emphasize poverty reduction programmes;

(b) Spend less than 2 per cent of GNP on military expenditure;

(c) Apply or take steps towards efficient family planning policies in order to cope with the problem of population growth;

(d) Implement policies aimed at preservation of the environment.

470. There is no region in the world in which the problems of development are as overwhelming and pressing as in sub-Saharan Africa. This is true in terms of population growth, environmental degradation and declining agricultural and food production, but it is particularly true with regard to the dearth of trained and skilled human resources. The OECD countries - with major participation by the surplus countries - should establish a $1 billion endowment fund to be administered by the African Development Bank (AfDB). The proceeds of this fund should be used to assist the development of leadership in order to create the institutional infrastructure in sub-Saharan Africa so vital to its achieving sustainable political stability and economic growth. In addition, the flow of external financing to this region should be increased over and above projected levels, by means of both further specific debt relief and larger ODA.

471. All Governments should recognize the global implications of the drug problem and should take immediate and collective action. To this end, an international agreement should be reached between all those countries involved in the growth, spread, trafficking and use of drugs.

472. The complexity of the debt issue and its structural variety call for urgent and long-term solutions on a case-by-case basis. This requires fresh institutional approaches. The problem of the heavily indebted countries demands priority attention and immediate action. In this connection, it is essential to recognize that effective co-operation among commercial bankers, international institutions and debtor and creditor Governments requires simultaneous action. This will not be achieved without adequate financing and strong centralized leadership from the heads of the two Bretton Woods institutions. This process might be achieved most efficiently through the creation of a new facility sponsored by the World Bank and IMF. This facility should aim at mobilizing substantially greater funds than those now flowing to the developing countries. Such funds, in addition to those provided by IMF and the World Bank, would be furnished by voluntary contributions from OECD countries, with Japan playing the major role. In time, it might be desirable for this facility to assume an institutional structure in order to raise equity and to borrow from the capital market. It could immediately become a focus for leadership in the negotiation and co-ordination of effective debt relief consistent with development.

473. Commercial banks that wish to maintain an active presence in highly indebted countries should be encouraged to provide increased financing for trade or investment. Commercial banks, in particular those that do not agree to voluntary debt relief or to provide significant new money, should be asked to accept local currencies for a portion of the interest due to them, thereby creating funds for local investment.

C. Proposals by the United States Congress and the Bradley Plan

474. Senator Bradley put forward his proposal for the management of third world debt on 29 June 1986. 3/ The logic of his scheme was essentially derived from the Baker Plan.

475. The idea is to combine a discount on the principal with a discount on interest payments, applicable to the 15 Baker countries according to specific agreements to be reached through annual trade relief summits of commercial banks, official creditors and the World Bank. The purpose of such summits is to overcome the problems posed by fragmented negotiations with debtors, owing to the existence of two separate clubs of creditors: the London Club for commercial creditors, and the Paris Club for bilateral official creditors. As in the Baker Plan, Bradley's Plan covers a period of three years during which he proposes annual summits for creditors to reach an agreement on the combined reduction of principal and interest and on the amount of additional financing for indebted countries. In each of the three years, the reduction of interest would be up to market level while for the principal there would be a maximum 3 per cent write-off calculated on all existing official bilateral and commercial debts.

476. These are of course maximum figures since the real size of the reduction is to be negotiated case by case, in line with the requirements of the debtor country and with its readiness to undertake certain adjustment programmes. Finally, as in the Baker Plan, multilateral agencies would have to raise their financing to developing countries by $3 billion a year over a period of three years. In effect, recognizing that the main objective of commercial banks is the reduction of their bank exposure, the Bradley Plan does not envisage the possibility of new commercial financing.

477. Consequently, it appears self-evident that the proposals of Senator Bradley appear more ambitious than those in the Brady Plan in terms of debt cancellation, with an explicit reference to debt cancellation instead of new loans. They also appear more pragmatic than the Baker initiative. For example, the proposal to leave out new commercial financing (contrary to the objectives for new financing contained in the Baker Plan) and the cancellation levels, though limited, make the needs of heavily indebted countries more urgent. The main limitation of the scheme seems to be the short reference period of reference (three years), which prompts short- and medium-term considerations instead of long-term ones, as is necessary when facing problems of this kind, so closely related to economic growth.

D. Proposals by the Japanese Government: the Okita and Miyazawa Projects

478. In 1987 the Japanese Government made a commitment to invest its current account trade surplus (around $30 billion) in favour of developing countries. That investment would take place in two tranches: the first of $10 billion for immediate use, and the second of $20 billion over a period of three years until 1990. 4/ A combination of public and private funds could be applied in one of the following ways:

(a) Financing of IMF and the International Development Association (IDA);

(b) Setting up of the Asian Development Fund, to be managed by the Asian Development Bank (AsDB);

(c) Financing by commercial banks of international multilateral institutions, including the World Bank;

(d) Extension of co-financing with international development institutions through the Overseas Economic Corporation Fund, the Export-Import Bank of Japan and the Japanese commercial banks;

(e) Increased financing to developing countries through the Export-Import Bank.

The Japanese proposal entails the setting up of a special Japanese fund within the World Bank, aimed at co-financing projects and programmes by the World Bank, and also at giving it a wider operational scope with funds on the Japanese market, for a total amount estimated around $2 billion over three years. The Japanese plan, which is still operative, has been extended to developing countries in Asia, although in the last few years there has been a larger number of projects in favour of Africa south of the Sahara.

479. To assess Japan's involvement in the area, one need only recall that in 1986 it ranked second only to the United States among ODA disbursers, with an amount of $5.6 billion. The reason for the success of the scheme for the recycling of funds lies in the use of the funds for financing productive activities in developing countries which, in return, have to guarantee any contract and a constant evaluation of the projects and programmes financed.

480. The proposal put forward at the 1988 Toronto summit by the Minister of Finance of Japan, Mr. Miyazawa, 5/ contained the following initiatives:

(a) The debt of developing countries would be sold to investors via securities (debt securitization), with medium- to long-term maturities;

(b) Securities would be guaranteed by funds granted by IMF to debtor countries, whose proceeds will be deposited in IMF and used as collateral for the new bonds issued by the Government of the country and the capital from exchange reserve stocks of the debtor country;

(c) Thus guaranteed, bonds would then be exchanged at par with the old debts held in portfolio by the commercial banks, which would then improve their quality and liquidate high-risk debts;

(d) This form of guarantee is tied to the adoption of certain adjustment programmes by the recipient country;

(e) The remaining specific debt would be restructurable with periods of grace of up to five years, during which interest payments would be reduced, suspended or even cancelled. The Achilles' heel of this proposal is the impossibility of giving

collateral guarantees on the reimbursement of principal by those debtor countries with low levels of reserves.

481. Mr. Okita's proposal is similar to those that consider the debt problem as a problem of liquidity and is focused on the granting of new funds to debtor countries by means of a Japanese trust fund, which would raise funds on the Japanese market at market rates, later to use them in developing countries on concessional terms. The difference in interest rate would be financed by using part of the Japanese ODA. The reimbursement of principal on finance given by the Fund on the domestic market would be guaranteed by zero-coupon bonds issued by the Japanese Government and purchased by the Fund itself.

E. Proposals by Raul Alfonsin, former President of Argentina

482. The proposal presented by former President Alfonsin is a combination between debt reduction (principal and/or interest discount) and new finance. 6/ Concerning private debts with commercial banks and public debts (bilateral and multilateral official credits), the idea is to reduce the interest rate by 4 per cent on all existing debts and to restructure debt over 30 years with considerable periods of grace. Multilateral institutions (the World Bank and IDB) together with export credit agencies, should then provide new funds for an amount higher than the reduced interest payment on old debts. Those measures would be conditional on the adoption by the debtor country of programmes for the expansion of debt-equity swap operations and of structural reforms compatible with short-term macro-economic equilibrium.

F. Proposals by banks in Germany: Herrhausen

483. Alfred Herrhausen, the late Chairman of Deutsche Bank, called for the setting up of an interest compensation fund to stabilize and curb the interest payments of those countries which, according to a case-by-case requirement analysis, have undertaken economic adjustment programmes. The IMF-run Fund would fix a ceiling on the interest rate paid by debtors during the entire life of the loan. 7/

484. The Compensation Fund would be financed jointly by Governments, international financial institutions and commercial banks according to their respective debt exposure towards developing countries. Should market rates fall below the predetermined ceiling, the Fund could readjust the top rate, but for the entire duration of the loan the debtor's rate would in any case be not higher than the predetermined level. If there was a difference between the predetermined rate and the market level, it would be convertible into medium- or long-term concessional financing.

485. If debtor countries agree on implementing stabilization and structural adjustment policies over five or six years, over the same period banks and international financial institutions would provide financial backing and new financial packages (voluntary debt cancellation plans, including exit bonds, debt-equity swaps, buy-backs, etc.).

G. Proposals by the United States financial world: Robinson and Seidman

486. The plan of James D. Robinson, III, Chairman of the American Express Company, for solving the problem of developing countries' indebtedness appears the most ambitious among those outlined by the international banking community. It is a combination of debt reduction and new forms of financing to debtor countries. 8/

487. The main point of the plan consists in the setting up of a new development agency for overcoming the debt problems, the Institute of International Debt and Development. Such an agency is not meant to be autonomous or separate from the multilateral ones already in existence and with major expertise in the field. It should take the form of a joint venture between the World Bank and IMF, employing skilled staff from the two bodies, and should have on its Board representatives of the banking community of creditor countries, debtor Governments and creditor Governments, organized in such a way as to ensure the maximum level of participation and equilibrium.

488. Financial resources would be provided by the Governments of industrialized countries.

489. The agency would negotiate agreements with debtor countries on a case-by-case basis, and debtor countries would be expected to adopt policies aimed at achieving domestic economic growth.

490. The main activity of the agency would be the acquisition of bank credits with developing countries at discounted rates, taking into account secondary-market bids, in return for securities issued by the agency itself. In practice, the legal person indebted to banks would change from a developing country Government to the new institution. The obligations undertaken by the agency towards the banking system could consist of irredeemable certificates at variable rates, or participation in financing programmes. By the same token, in the relation between the agency and debtor country, the discount on the purchase of bank debts would be transformed into substantial concessions on the debt terms, with a reduction in debt service.

491. One essential element of the operation would be that the agency would acquire the right to subordinate the purchased debt to the financial resources successively lent to the same debtor, in order to make the disbursement of new resources to that developing country more viable. Consequently, the burden of existing debts would not affect the viability of granting new loans. In any case, the agency could always suspend both the concessions and the subordination in case of non-compliance by the debtor country with the agreed adjustment policies.

492. According to Robinson's estimates, the commercial debts of the 15 Baker countries that could be purchased with a discount would amount to about $250 billion. Assuming an average discount of 40 per cent, those credits would be purchased by the agency by issuing specific bonds for $150 billion, of which $125 billion would be in variable-rate securities and $25 billion in preferred stock. A weak point in the scheme is the high level of risk that would have to be

shouldered by the agency by subordinating debts purchased by banks. However, subordination is an essential element in order to boost new finance.

493. In August 1989, L. William Seidman, Chairman of the Federal Deposit Insurance Corporation (the agency of the federal Government that insures deposits in United States banks) presented a plan bearing his name to complement the Brady Plan. The Seidman plan was never applied, although it was held in high esteem by many in the United States Congress and Administration. 9/

494. The Plan consists of the following points:

(a) Setting up of an international debt insurance agency (international debt insurer) to insure part of the restructured debts or of new loans granted to developing countries. The agency would be owned by banks, international financial institutions and creditor Governments;

(b) The agency would be financially backed by banks, the World Bank and IMF, which would also be committed to underwriting. Governments would also participate, but only for an underwriting commitment. The agency would be managed by a Board, comprising representatives of the shareholders, in proportion to their quotas;

(c) The agency would define the terms and conditions for the insurance of debts of certain countries, and consequently it would establish the parameters for negotiations between debtors and creditors;

(d) Banks would still be in charge of a considerable risk quota. The plan envisages risk-sharing of a co-insurance nature, without however illustrating the real operation;

(e) The financial resources of the agency would be the principal, plus bank premiums, plus the underwriting commitments of Governments and international financial institutions;

(f) By working closely with those institutions, the agency would evaluate the country-risk and establish which debt (new or existing) of which country could be co-insured. Special attention should be given to the country's performance in relation to structural adjustment schemes agreed with the international financial institutions;

(g) In order to take part in the programme, banks would be asked to reduce the debt service through a rebate on interest rates and/or a reduction of the principal;

(h) New loans could be insured only after debtor countries have shown tangible economic progress. New loans should have the same priority as restructured loans. Banks could participate in them only after their Governments' agreement to raise their participation quota in the agency, according to a formula to be agreed upon;

(i) Insured loans would have priority over uninsured loans;

(j) Rules for supervision and tax treatment would be defined by each underwriting country in order to encourage bank participation in the scheme.

495. Promoters of the plan state that the main benefits would be an incentive for banks to reduce debts through an improvement in credits, more favourable tax treatment and less stringent supervision. Such steps might lead to a lower debt service level. At the same time, debtor countries would be encouraged to adopt structural adjustment measures conducive to a renewal of their creditworthiness. Besides, major loss risks would be run by banks, but the scheme would put a limit on the action of free riders and give priority to insured debts. The agency could tackle problems more flexibly than the current group negotiations and could also adapt itself more easily to the different political scenarios of indebted countries. Finally, banks would enjoy portfolio certainty and stability in their credits to developing countries.

496. Detractors maintain that what the plan envisages is not real insurance, but a form of self-insurance on the part of banks, with the addition of some public funds. Seidman is certainly vague about the quantity of those funds. It does not seem likely that banks would be willing to participate without the specific commitment of Governments. It is equally unlikely that banks would make the commitment to participate in the agency's capital stock without previously determining the amount. It has to be noted that, in case of accident, banks would be the most exposed to losses, especially with partial insolvencies, which is most likely to be the case. In order for the plan to be successful, banks would need considerable tax benefits and less stringent supervision. Related costs would have to be taken into account in the overall evaluation of the plan. Others have questioned the legal aspect of giving priority to insured credits over uninsured ones. Furthermore, they regard the introduction of a third player, in addition to the World Bank and IMF, as impractical.

H. Proposals by the Bank of Nova Scotia

497. The main feature of the plan worked out by the Bank of Nova Scotia 10/ is a reduction in the debt service on the interest side, in order to make it more reasonable in comparison with the real ability to pay of the debtor country.

498. The reference criteria by which to judge that capability and hence used to determine the discount size are the debtor's flow of exports and GNP. Reductions on the interest side would be applied on all existing debts.

499. The plan would allow no commercial credits for the debtor country and envisages creditors' capitalization, in local currency and at a given exchange rate, of the concessions granted, together with their successive conversion in the financing of development programmes and projects in the debtor country.

500. Of fundamental importance is the role that would be played by a guarantee fund, run by multilateral institutions and with capital provided by commercial banks and bilateral and multilateral official creditors according to their respective lending commitments. The main purpose of the fund would be to provide a

guarantee against the risk of insolvency and non-payment of the interests on the debts subject to concessions, should exports fall below a given level. The World Bank and IMF would then contribute to the implementation of the plan through various forms of commitment concerning the disbursement of new funds.

501. Finally, the plan would be implemented on a case-by-case basis.

I. Proposal by President Bush 11/

502. During the past decade, the nations of Latin America and the Caribbean have endured a difficult decade of painful economic adjustment. Diminished trade, debilitating financial imbalances, the flight of their own citizens, capital and the harsh reality of insufficient growth have taken a heavy toll.

503. Today, policies designed to unlock the potential for domestic and foreign investment are the region's strongest hope for financial sustainable growth in a world short of resources.

The investment initiative

504. The investments elements of this programme are designed to encourage more open investment regimes to help the nations of Latin America and the Caribbean to attract indispensable capital.

505. The United States proposes to work to develop a new investment sector loan programme in IDB to provide both technical advice and financial support for privatization efforts and liberalization of investment regimes, possibly in conjunction with the World Bank.

506. In a parallel effort, the United States will seek support to establish a multilateral investment fund to advance comprehensive investment reforms in Latin America and the Caribbean. This five-year multilateral fund would provide up to $300 million per year in grants in response to broad investment reforms.

507. These would be specific, market-oriented, investment policy initiatives and reforms aimed at attracting foreign investment. They would also support efforts to privatize Government-owned industries and to finance worker training, education and health programmes to develop vital human capital.

508. The United States would seek to contribute $100 million annually to the fund and would seek matching contributions from Europe and Japan. Because the fund would be designed to serve as an incentive, funds would only be disbursed after reforms are enacted. IDB could serve as a conduit and trustee for these funds, which would complement both IDB and World Bank sector lending programmes.

The debt initiative

509. As a further incentive for investment reform, the United States intends to build on the progress already being made in addressing the debt problems of the region.

510. The experience of Mexico and Chile has shown that reduced debt-servicing burdens, in combination with strong domestic economic reforms, can have a strong positive impact on capital flows and confidence in a nation's economy.

IDB enhancements

511. For this reason the United States proposes that IDB become an additional source of support for commercial bank debt reduction under the existing debt strategy. As in IMF and World Bank, the availability of these resources would be tied to economic reform efforts.

Official bilateral debt

512. Recognizing that many countries in the region are burdened by large official bilateral debt, which has been increasingly difficult to service on a timely basis, the United States proposes to reduce the United States bilateral official debt obligations of Latin America and Caribbean countries on a case-by-case basis.

513. To this end, the Administration will propose a comprehensive legislation to create, under the auspices of the Treasury Department, a facility to carry out a range of operations in support of new investments, capital repatriation and sustainable natural resource use in Latin America and the Caribbean.

514. These operations would include the reduction of concessional aid and PL-480 obligations, the receipt of interest payments in local currency for environmental purposes and the sale of some Commodity Credit Corporation and Export-Import Bank credits.

515. This programme will be available to Latin America and Caribbean countries that have:

(a) Negotiated comprehensive IMF/World Bank economic reform programmes;

(b) Adopted major investment reforms in conjunction with IDB or other multilateral institutions; and

(c) Negotiated commercial bank debt reduction agreements under the existing debt strategy as appropriate.

Treatment of bilateral concessional claims

516. The United States proposes to reduce outstanding concessional aid and PL-480 claims, which total $7 billion for the Latin America and the Caribbean region, while preserving necessary revenues to continue current spending in these programmes.

517. For eligible countries, the United States will substantially reduce outstanding principal of aid and PL-480 loans - provided the necessary economic reforms are in place. Reduced principal obligations would be repaid in annual instalments over several years, depending on the individual circumstances or each country.

518. Although the amount of reduction will be undertaken on a case-by-case basis, it is expected to be substantial, in some cases more than 50 per cent.

519. Participating countries would make interest payments in local currency at an agreed concessional rate. The United States would place these local currency resources in trust funds to support environmental projects or programmes agreed with each country.

Treatment of bilateral commercial claims

520. The United States also proposes to sell in the market a portion of outstanding Commodity Credit Corporation and Export-Import Bank loans to eligible countries in order to facilitate debt-equity and debt-nature swap transactions.

521. Purchasers of the United States claims would leverage these claims into local currency for investment or environmental purposes, as now occurs with commercial bank debt paper purchased in the secondary market. Revenues from the sale of these non-concessional credits would be returned to these programmes for future lending.

Conclusion

522. This programme will help to improve confidence in Latin America and Caribbean countries, encourage new investment flows and stimulate a return of flight capital. Other creditor Governments are encouraged to take similar action.

J. The Houston Summit

523. In the summit meeting of the Group of Seven held in Houston the following statements were made:

> "Significant progress has been made during the past year under the strengthened debt strategy, which has renewed the resolve in a number of debtor countries to continue the reforms essential to future growth. In particular, the recent commercial bank agreements with Chile, Costa Rica,

Mexico, Morocco, the Philippines and Venezuela involve significant debt and debt service reduction is being provided by IMF and the World Bank, as well as by Japan.

"The Paris Club has agreed, in order to support medium term IMF-supported reform and financing programmes, to provide adequate restructuring agreements, notably through multi-year restructuring and through lengthening of the repayment period.

"The combination of debtor reform effort and commercial bank debt reduction has had a notable impact on confidence in debtor economies, as clearly demonstrated through both flows of both new investments and the return of flight capital to Mexico, in particular.

"These measures represent major innovations in the case-by-case strategy that are potentially available to all debtor nations with serious debt-servicing problems that are implementing economic adjustment policies.

"The adoption by debtor nations of strong economic reform programmes with IMF and the World Bank remains at the heart of the debt strategy and a prerequisite for debt and debt service reduction within commercial bank financing packages. It is vital that debtor countries adopt measures to mobilize savings and to encourage new investment flows and the repatriation of flight capital to help to sustain their recover. In this connection, the recent United States Enterprise for the Americas initiative to support investment reform and the environment in Latin America needs to be given careful consideration by Finance Ministers.

"For countries implementing courageous reforms, commercial banks should take realistic and constructive approaches in their negotiations to conclude promptly agreements on financial packages including debt reduction, debt-service reduction and new money.

"Creditor nations will continue to play an important role in this process through ongoing contributions to the international financial institutions, restructuring of official debt in the Paris Club, and new finance. We encourage the Paris Club to continue reviewing additional options to address debt burdens. In the case of the lower middle-income countries implementing strong reform programmes, we encourage the Paris Club to lengthen the repayment period, taking account of the special situations of these countries. We welcome the decisions taken by France with respect to sub-Saharan Africa and by Canada with respect to the Caribbean to alleviate the debt burden of the lower middle-income countries.

"Creditor Governments have also provided special support for the poorest countries through the implementation of Toronto terms in the Paris Club restructuring. All of us have cancelled ODA debt for the poorest countries. We encourage the Paris Club to review the implementation of the existing options that apply to the poorest countries.

"We note and will study with interest the Craxi report on debt commissioned by the Secretary-General of the United Nations".

Notes

1/ A/43/PV.10.

2/ The other members of the Group were Abdul Aziz Al Quarishi, Bernard T. G. Chidzero, Bernard Clappier, Janos Fedets, Fritz Leutwiler, Robert S. McNamara, Isaru Miyazaki, Nam Duk-Woo, Oleusegun Obasanjo and Lord Eric Roll.

3/ See Wertruen P. The international debt problem: options for solution, Congressional Research Service, Library of Congress, Washington, D.C.; and, for a short review, Eugene L. Versluysen, A review of alternative debt strategies, World Bank working papers, 1989.

4/ See World Bank, World Development Report 1988: Opportunities and risk in managing the world economy; Public finance in development; World Development Indicators, p. 2, box 1.3.

5/ The Japanese proposal on the debt of middle-income countries, 19 October 1988; for a discussion, see Latin American Economic System "Examen de iniciativas recientes en el ámbito internacional para la solución del problema de la deuda externa", Estudios sobre relacionnes económicas, agosto 1988.

6/ República Argentina, Conceptos del President Raul Alfonsin. Americas Society, New York, 31 May 1988. See also, "The International Economy Debt Plan Scorecard", a summary of debt plans currently under consideration, International Economy, Washington, October 1989, p. 96; and Latin American Economic System, op. cit.

7/ This proposal has been illustrated by Alfred Herrhausen in a speech, in December 1988 to the international conference of the IMF in Washington, D.C.

8/ J. D. Robinson, III, "A comprehensive agenda for developing countries debt and world trade growth, including a proposal for an institute of international debt and development", Amex Bank Review. Special Papers No. 33, March 1988. See short discussion in E. L. Versluysen, op. cit., p. 38.

9/ See "The Seidman International Debt Coinsurance Plan", International Economy, December 1989-January 1990, p.60 and a discussion of it in the same W. R. Cline, "It is simply a self insurance scheme?" and K. Rogoff, "Look Elsewhere for the Solution of the Debt Crisis", op. cit., p. 59.

10/ Bank of Nova Scotia, "A proposal regarding developing country debt" (mimeo) 1987.

11/ Summary of a press release on United States policy issued by President Bush after the Houston Summit.

IX. PROPOSALS BY INTERNATIONAL AGENCIES, GOVERNMENTS IN DEBTOR COUNTRIES AND INTERNATIONAL ECONOMIC AND SOCIAL INSTITUTIONS

A. Latin American Economic System

524. The proposals by the Latin American Economic System (SELA) are based on combined strategies of debt reduction (principal and interest), new finance and forms of guarantees on the remaining portion of debt.

525. For private debts and bilateral official debt, the reduction strategy is based on a 50 per cent debt cancellation for developing countries, and on the conversion of the remaining part into medium- to long-term bonds (20-40 years) at a fixed interest rate of 5 per cent. Those bonds would be guaranteed by a trust fund managed by IDB and financed by debtors with an annual payment equal to 1 per cent of their new bonds. Therefore, it would be a form of collateral guarantee resulting in great advantages in contracting new bonds, with a shift from country risk to primary risk. SELA perceives the role of the World Bank and IMF possibly to lie in the disbursement of new financial aid within the trust fund based on the available new resources.

526. Governments in creditor countries should adapt their accounting standards and tax regulations in order to offer positive encouragement to commercial banks to take part in such operations.

527. With regard to new resources, the World Bank, IMF and IDB would play a fundamental role, by providing new multilateral funds to finance all the principal and interest payments due to them. In the SELA scheme, IMF would also proceed to a new allocation of SDRs specifically directed to the economic development of heavily indebted countries in the third world.

528. The SELA plan is contained in the paper 'Grounds for the drawing up of a proposal of Latin America and the Caribbean on external debt', approved by the 26 participating countries during the Second High-level Preparatory Meeting of the Regional Conference on External Debt, held on 22 and 23 February 1990.

Debts with commercial banks

529. In relation to debts contracted with commercial banks, the proposal envisages a substantial reduction of the principal's face value, bearing in mind the debt's real value in the secondary market, the targets for national development and the country's ability to pay.

530. The region's average debt on the secondary market was only 27.5 per cent of the original face value in November 1989.

531. Each debtor country will issue debt certificates for the discounted face value by means of long-term bonds with a maturity of at least 35 years.

532. The reimbursement of the principal of those bonds will be guaranteed by Governments through the establishment of a fund financed by annual contributions not greater than 1 per cent of the reduced value of the debt.

533. The bonds' yield will be based on a fixed interest rate to be negotiated and one considerably lower than current levels. That rate will reflect the ability to pay of each indebted country, the trends in interest rates and their positive level. The permanent secretariat of SELA considers 5 per cent to be an appropriate figure.

534. The proposal also envisages the possibility of giving additional guarantees, for instance on the payment of interest, through a new allocation of SDRs or through new bonds issued by IDB, backed by call loans subscribed by countries of the region belonging to the institution, which are currently not used as collateral.

535. SELA's initiative calls for a series of changes in the banking regulations of creditor countries in order to ease the absorption of losses through a reduction in debt service, together with modifications in the clauses of loan contracts.

536. Once the region's common criteria for external debt with commercial banks have been defined, the proposal envisages the application of those criteria on a case-by-case basis, bearing in mind the situation of each country.

Official debt with creditor Governments

537. Concerning official debt contracted with creditor Governments, the target of the proposal is to achieve terms not worse than those reached with the commercial banks.

538. To that end, negotiations should focus on reaching a new flexibility within the Paris Club, including the elimination of the requirements of previous settlements with other creditors and easing the present severe conditionality requirements.

539. Furthermore, it suggests that the Toronto options granted by industrialized countries to the sub-Saharan nations should be extended to the relatively less developed countries in the region, and at the same time could be adjusted to the conditions of the rest of Latin America and the Caribbean.

540. In that case, negotiations would lead to the partial book cancellation of bonds bearing the face value of the debt and to concessional interest rates or, among other possibilities, to longer repayment periods.

Debts with multilateral financial agencies

541. Negotiating efforts with multilateral financial agencies should be aimed at modifying the current policies and operational procedures of such agencies.

542. The World Bank and IDB should reaffirm their function of promoting development and should adjust their operational policies with the aim of easing conditionality criteria, increasing the ratio between the principal and the limit of the financial operations and loan, easing approval and disbursement procedures. With regard to

IMF, consideration should be given to the question of how to finance countries with severe balance-of-payment problems.

543. A rise in IMF quotas is deemed essential in order to help indebted developing countries and to provide a more flexible access to existing financial resources. At the same time it would promote the mobilization of existing resources to back debt reduction schemes.

544. In addition, the proposal stresses that compliance with IMF conditionality must be linked to external conditions, to long- and medium-term structural features and to political, social and administrative constraints on the countries in the region.

Intra-Latin American debt

545. As far as the intra-Latin American debt is concerned, the proposal put forward by SELA supports the mechanisms worked out by the Rio Group, especially regarding the reduction of the debt level, cutting debt service payments and the possibility for debtors to negotiate with some of their creditors.

546. Furthermore, it recommends the introduction of other methods such as a strengthening of intraregional trade, conversion programmes and specific action to promote technical assistance and government procurement.

B. Organization of African Unity

547. At its extraordinary session held in September 1987, the Assembly of the Heads of State and Government of the Organization of African Unity (OAU) held at Addis Ababa in 1987, presented a number of proposals on the debt position of African States. These proposals consist, on the one hand, of measures to be adopted by the African States themselves to alleviate the debt crisis, and, on the other, of measures to be adopted by the industrialized countries and by international financial institutions.

548. The policies to be adopted by the Governments of developing countries in Africa include the following issues:

(a) The systems for managing the external debt at the national level require strengthening through the active support of the international community, so that African countries can enjoy a greater and more centralized control over public debt, as well as the monitoring of private indebtedness. To that purpose, regional and subregional organizations (African Centre for Monetary Studies, AfDB, etc.) would be called upon to ensure greater harmonization of the debt positions of African countries and to help the Permanent Steering Committee in deciding on the guidelines on which those positions ought to be based;

(b) It has been recognized that the economic recovery and development of African economies will largely depend on higher growth of domestic resources, rather than the dependence on uncertain external resources. Consequently, there is

a need for adopting appropriate policies for the mobilization of domestic resources, together with economic measures aimed at curbing inflation and improving economic and financial efficiency. In development planning, it seems necessary to bring about fundamental political and social changes in order to promote self-reliance for recovery and future growth. To that end, practical measures are needed to raise the quality of public and private investments, to provide incentives to international development projects and to improve human resources development programmes with a view to raising productivity and to promoting the development of science and technology;

(c) Against a background of solidarity with the African States, those countries with trade surpluses should invest part of those funds in the African continent, for instance through participation in multinational investment projects that Governments could support and assist in order to promote development and economic expansion;

(d) The system of incentives ought to be strengthened in order to encourage public and private operators in Africa to use their resources in other African countries. This could promote future co-operation, especially in the case of projects devised by subregional and regional financial institutions;

(e) African Governments should adopt new measures aimed at raising the volume of domestic trade, with the support of existing financial institutions.

549. In the case of intra-African trade, credit policies hold a special position because they can reduce the demand for foreign exchange and hence the need for external funds.

550. Debt intervention policies by creditor countries and by international financial institutions focus primarily on the need for total and unconditional debt cancellation for certain least developed and low-income African countries. Hopefully, such a measure would be generalized and hence extended to all African countries, thus confirming the inadequacy of policies of debt restructuring or of interest rate reduction, which would not lead to positive solutions for the problem of African debt, given its nature and magnitude. Furthermore, industrialized countries have to improve the growth rate of the world economy and to promote a more balanced world trade and monetary system.

551. In order to relieve African countries from their debt and to enable them to use part of their export earnings in development-oriented activities in their own countries, creditor countries and international financial agencies have been presented with the following steps:

(a) For bilateral and guaranteed official credits, the proposal is to forgo the reimbursement of loans granted in the past through subsidies and the possibility of repaying part of the bilateral debt in local currency, which could be used for financing development projects and programmes on predetermined terms;

(b) In addition, another proposal entails the adjustment of the terms of guaranteed official credits to the terms currently applied by the African

Development Fund and the consolidation of non-ODA guaranteed official credits in long-term financing at very low real interest rates;

(c) For multilateral financing, it is necessary that multilateral institutions ensure positive and growing net credit flows to African countries with conditions that are compatible with their economic situation;

(d) The financial resources made available would be used mainly for local development projects and for specific programmes of growth;

(e) The proposal is also to bring about greater flexibility in the terms of commercial credits, through discounts on interest rates, rescheduling and periods of grace, in order to take account of the funds available in African countries for the repayment of their debts;

(f) In particular, arrears on short-term commercial loans should be converted into medium-to-long-term financing in the form of debt cancellation.

C. United Nations

552. A proposal put forward by the United Nations gives credit institutions a choice between granting debtor countries a discount on the principal or, at an equivalent financial level, on the interest. More specifically, middle-income heavily indebted countries may be granted a 30 per cent discount. This discount percentage may be applied either entirely to the principal, leaving the interest rate on the remaining principal unaltered, or by reducing the interest rate on any country's total debt. This option certainly gives rise to remarkable technical considerations, since the discount applied to the principal is financially certain, but the calculation of the rate of interest that determines an equivalent discount, using the interest method, will depend on projections of future interest rates. Projections can differ from creditor to debtor and thus lead to different positions in negotiations.

553. It is therefore a question of reducing the debt service on loans with commercial banks. In addition, debtors should be committed to invest the excess flow in economic development projects in order to increase the country's capability to earn the foreign exchange it needs to repay its external debt.

D. Proposals by the World Confederation of Labour

554. During its twenty-second Conference held at Caracas at the end of 1989, the World Confederation of Labour presented a report that begins with an account of generic economic problems and contains a number of solutions to the specific problem of developing countries' indebtedness.

555. The report's premise is that the world economy is marked by general disarray, in an increasingly unstable framework in which the strong become stronger and the weak become weaker. The debt problem is one of the most dramatic results of such a state of affairs.

556. The report defines third world debt as the greatest challenge for democracy, development, justice and progress. It is alarming that, whereas the problem was kept under close scrutiny from 1982 to 1985, when a world-wide banking collapse was averted, attention to the debt issue has lapsed. However, the problem is still there and has deteriorated. During the 1980s in Latin America and even more so in Africa, GDP per capita fell because of the debt burden.

557. Debt is today much more a political than an economic problem, since, from a technical viewpoint, it is kept under control by banks and international financial institutions. Hence, it is no longer a threat to financial equilibrium, but it does pose a threat to social and political stability owing to the impoverishment of nations that would already be poor without it.

558. The World Confederation of Labour has long since identified the primary causes of debt: falling prices in raw materials exported by developing countries, growing interest rates on international financial markets, protectionist measures in industrialized countries, mistaken economic policies, misdirected military spending and capital flight from the third world.

559. After reviewing the main events of the last few years (the dynamics of debt, capital flows, initiatives by Governments and by international institutions, etc.), the report states that there has been no progress in the implementation of a global approach to the debt problem. The Baker Plan, for example, is a case of a partial approach. So far, there have been no high-level talks within the United Nations. The only important discussions have taken place during the annual meetings of IMF and the World Bank.

560. But something is happening. It has been acknowledged that mere economic and financial principles are not enough to solve the problem and that it is necessary to take account of social and political factors in the framework of a global approach to negotiations between creditors and debtors.

561. It seems that the solution to the problem should be found along the following lines:

(a) For Africa, cancellation of part of the debt and long-term consolidation for the remaining part; an important role can be played here by EEC;

(b) For other debtors, debt conversion would be undertaken by an existing institution (IMF, World Bank) or by a new institution, particularly by means of securitization at interest rates below the current level;

(c) Debtor countries have to adjust their policies further and they must make a special effort to halt capital flight;

(d) Industrialized countries, particularly Japan and Western Europe, must make new financial resources available;

(e) Large international organizations such as IMF, the World Bank, OECD and EEC have to play a more decisive role in finding a solution to the debt problem.

562. The report makes a statement of special political significance: most of the debt was accumulated under circumstances of injustice. Debts were contracted to finance enormous military spending, to make up for the capital flight organized by third world élites or to finance projects of dubious validity, under the pressure exerted by enterprises and banks in industrialized countries. It is unacceptable that the consequences of this now have to be paid for by the people living in indebted countries. Those people have a moral entitlement to the remission of at least part of that debt and to the acceptance by banks and Western countries of the responsibilities they also had in the creation of the debt problem.

563. Furthermore, it must be clearly acknowledged that failure to solve the debt problem is a threat to the development prospects and to the survival of democracy in a large number of third-world countries.

564. Those countries need a social pact, so that the necessary adjustments can take place not against a background of spreading poverty, but of greater fiscal and social justice and in a framework of economic expansion.

565. For industrialized countries, it is a matter of lasting growth in the world economy, abandoning agricultural and industrial protectionism and reducing the instability of raw materials prices.

E. Proposal by the United Nations Conference on Trade and Development

566. The proposal by the United Nations Conference on Trade and Development presented in the Trade and Development Report 1988 1/, falls within the category of debt remission proposals carried out through a reduction of the debt stock, started out from the medium-term analysis of the 15 Baker countries and proposed a 30 per cent cut in all debts contracted by those countries with commercial banks. Such a reduction in commercial credits would, according to UNCTAD estimates, be equal to 25 per cent of their total indebtedness. The UNCTAD approach does not consider the issues of enforceability and free riding. The cost of the proposed reductions is regarded as compatible with the levels of bank provisioning.

567. The only condition imposed on debtors is that they invest the entire amount of interest saved, estimated at $10 million for the first year, in export industries, so that increased exports can generate additional foreign exchange.

568. On the basis of the proposed reductions, UNCTAD projects an immediate effect of a 7.2 per cent growth rate in the income of the 15 Baker countries and an average growth of 3.1 per cent in per capita income, namely 2.5 per cent above the level without adjustments. Those projections seem extremely optimistic considering that they are even higher than the best-case estimates of the World Bank in the 1988 World Development Report.

F. Socialist International

569. The Socialist International Committee on Economic Policy has repeatedly dealt with the developing world debt issues from the Global Challenge Report of 1985 2/ to the Stresa Declaration on the Challenge of Global Development of May 1987 to the Estoril Declaration: From Crisis to Co-operation: Common Action for Global Development of April 1988 to the Berlin Declaration of September 1988, to the Lausanne Declaration of April 1989.

570. The Berlin Declaration states that progress now requires a conference of debtors and creditors, with the establishment of a debtors' forum to reinforce the case for a restructuring, rescheduling and writing down of debt. In turn this depends on recognition that key debtor countries soon may be obliged to postpone further debt repayment if a negotiated solution of the debt problem cannot soon be achieved. The new debt conference should negotiate guidelines for a reversal of net transfer of resources from the South, and the fostering of equitable growth. Its action agenda should include:

(a) Conversion into grants of the debts of the poorest countries, and certainly of the countries of sub-Saharan Africa, including the cancellation of multilateral debt, possibly by selling a part of IMF gold reserves;

(b) Rescheduling of the remaining debt of third world countries, through extension of the time period for repayment of principal, including, in particular, those Latin American countries whose scale of current indebtedness not only limits their import capacity, but also threatens the security of financial institutions in first-world countries;

(c) Implementation of the recommendations by the South Commission: (i) to transfer the benefits of the discounts prevailing on secondary markets to the developing countries themselves and (ii) to reduce the burden of interest payments by a combination of capitalization and/or repayment in local currency;

(d) Increasing ODA to the 0.7 per cent of GDP recommended by the Brandt Commission and the United Nations. If this were achieved, and if those countries already exceeding 0.7 per cent were to sustain their exceptional contribution, it would not only amount to a significant increase in the resources of the South, but also create an additional 2 million jobs in the OECD countries of the North;

(e) An increase of SDRs over a five-year period to a United States dollar equivalent of $150 billion, with allocation on a preferential basis to developing countries and/or development institutions such as the World Bank and the three regional banks - Asian, African, and Inter-American - to be used for eligible transactions relating to the finance of trade and development;

(f) A major increase in the funds of both IDA and the International Fund for Agricultural Development (IFAD).

G. European Christian Socialist Association

571. This proposal 3/ is designed to reduce the debt overhang, which is the greatest obstacle to the growth of Latin American countries. Rather than receiving aid as investment for development, the resources and the capital of these nations are transferred to the creditor nations as debt service. Therefore it should be acknowledged that these countries are increasingly insolvent, that they lack capital as a result of insufficient energy resources and imports of food and other essential goods and that sustainable growth requires long-term loans.

572. Most Latin American countries have close ties with the Mediterranean nations of Europe. These ties of blood, culture, religion and other values denote a pressing obligation for the peoples of Europe to offer financial aid, particularly considering the new situation in Eastern Europe and the fierce competition for capital investment.

573. There are two basic aspects to any solution of the debt situation: ethical and economic. Both must be kept in mind if a valid and lasting solution is to be found.

574. The ethical principle has been amply discussed in a document "An ethical approach for the international debt" of the Papal Commission Justitia et Pax, which states that the debt of developing countries is to be considered within the broader framework of economic, political and technological relations that attest to the growing interdependence of all countries. In order to be fair such interdependence must stimulate and encourage new and ampler forms of solidarity, which, however, must respect the equal dignity of each country. The document continues by emphasizing that solidarity requires the acceptance of co-responsibility, which fosters an atmosphere of confidence and trust between creditors and debtors as well as co-operation and promotes the sharing of effort and sacrifices that encourage everyone to participate in the contingency measures necessary to ensure the survival of the poorest nations. The document goes on to request a reform of the monetary and financial institutions in order to avoid the recurrence of critical situations such as those which prevail today.

575. Today, economics must be thought of not only as a positive science but also as a set of standards because the purpose of economics has become to determine the welfare not only of the individual but also of the entire community. In other words, efficiency and fairness must be considered as twin objectives to be achieved simultaneously. A market economy cannot fulfil these objectives. The State

therefore must intervene to ensure the fulfilment of both objectives, i.e. in order to foster a state of well-being for all peoples and all nations. As far as debt is concerned, economists and politicians must seek to build an economic structure which can reduce debt or help the debtors to face up to their obligations.

576. In recent years, both the Baker Plan and the Brady Plan have proved incapable of solving the problem of foreign debt; the consequence has been that they did not increase the financial assistance necessary for development.

577. The suggestion of Jeffrey Sachs seems therefore to be proper and urgent: to introduce at the international level a sort of bankruptcy act or a preventive agreement in order to help a debtor in difficulty not to go bankrupt, particularly whenever its creditors want it to continue to operate if only in their own interest. It is important to point out that the action of all creditors to prevent the bankruptcy of the debtor must be a concerted one. In such a manner creditors can also take advantage of the preventive agreement.

578. International financial institutions such as the World Bank and IMF must be members of the co-operative effort in order to help with decisions, such as those regarding buy-back, guaranteeing a low interest rate and financial assistance in order to help the poorest citizens in the event these measures are implemented.

579. It is absolutely essential to reduce debt interest rates. The truth of the matter is that the debtor country can pay interest only with the income coming from its investment and this depends on productivity, which is a simple economic fact of life.

580. In conclusion, it may be stated that:

(a) The problem of international indebtedness is not merely an economic problem but it is also a political one. The Paris Club and in particular the Group of Seven must convince themselves of the necessity to reduce and even to cancel the debt of the developing countries;

(b) No foreign debt can be paid, conditions being as they are. There must be sustainable economic growth and social development;

(c) Rather than transferring the resources of developing countries to the creditor nations, such resources must be used for the industrialization of the debtor nations;

(d) International economic relations must be changed;

(e) The efforts of Latin America to find a solution within SELA must be acknowledged. SELA is endeavouring to solve the foreign debt problem within the Latin American framework;

(f) The foreign debt problem must be solved by political negotiation;

(g) Without neglecting the different national realities, the foreign debt problem, because of its seriousness, must be solved on a global basis;

(h) The interrelation between the commercial and financial problems of foreign debt and development must be acknowledged.

581. The international debt problem requires solidarity, co-responsibility and co-operation between creditors and debtors, for only in this way can a valid and lasting solution be found, which safeguards human dignity and the rights of both debtors and creditors. The above-mentioned strategy aims to meet all the needs both of creditors and debtors.

H. Italian non-governmental organizations

582. Italian NGOs call for:

(a) The adoption of the UNCTAD proposal on unconditional writeoff of debts towards Italy and for immediate action at the international level for total cancellation of unfair debts that nations in the southern part of the globe are not in a position to pay;

(b) An Italian initiative to bring about a generalized moratorium on debt reimbursement by countries in the southern part of the globe with a view to organizing an international conference under the auspices of the United Nations, in which debtor and creditor countries can reach an agreement on substantial debt reduction and on its transformation into baskets of local currencies for regional development project financing and for the financing of interventions of social and environmental rehabilitation;

(c) The recognition of the existence of a common environmental debt that must be settled through deep changes in the North-South relationship. To this end, people must reconsider their development pattern and way of life, they must consume less and they must generate less environmental, social and cultural upheavals. Priority must be given to a co-operation pattern that safeguards the environment and that views the local population as an active subject of self-sustaining and self-reliant development.

Notes

1/ United Nations publication, Sales No. E.88.II.D.8, ch. IV.

2/ Brandt W. and M. Manley. Global challenge from crisis to co-operation: breaking the North-South stalemate. Pan Books, London, 1985.

3/ Communication dated June 1990.

X. PROPOSALS BY EXPERTS ON DEBT WITH PRIVATE AND PUBLIC ENTITIES

A. Dornbusch and Dornbusch-Modigliani

583. Rudiger Dornbusch, Professor of Economics at Massachusetts Institute of Technology (MIT), is one of the outstanding authorities on debt issues. Dornbusch's proposal envisages debt reduction through a suspension of the service flow. 1/ Its main feature is the transformation of external debt into domestic debt by suspending interest reimbursements in dollars and by committing creditors to reinvest interest in the indebted country during a period of eight years. Such an approach would stimulate debt-equity swaps since the local currency would be reinvested in the economy of the debtor country and not cashed in the creditor's country, although many criticize such an approach because of the risks of inflation that it presents, owing to the expansion in the supply of local currency in the debtor country. The main aim of the Dornbusch proposal is to prevent a transfer of domestic resources to the creditor. The idea is not to create new money but to keep interest repayment in the debtor country. It thus differs from the automatic capitalization of interest, because creditors can automatically manage their investments in local currency and hence monitor their profitability. For their part, debtor countries can work out policies of domestic growth as external debt constraints are eased. The result is therefore a shift from nationalist and protectionist policies to international policies aimed at boosting domestic investments in local currency and so promoting the basic economic objective of redressing the balance of payments and bringing about a favourable investment climate. Of course, creditors' support is necessary for the implementation of such development policies, which are the only way to produce a real growth in the debtors ability to pay and therefore to induce creditors to repatriate out capital.

584. Early in 1989, Professor Dornbusch and Nobel Laureate F. Modigliani worked out a recovery plan for Mexico. The plan provided that Mexico and its creditors would have to comply with the following for a favourable reduction in long-term interest:

(a) Eliminate the option of not repaying the principal and possibly also the interest, as well as similar shock treatment measures;

(b) Allow an increased level of investment through faster income growth;

(c) Institute a marked reduction of the flow of interest payments out of the country, which could bring an end to the repeated financial crises that cause capital flight, and thereby boost capital repatriation.

585. In line with recent developments, the two authors are really proposing a plan that uses market mechanisms to the fullest and tax policy to the least extent possible so that, for some time, interest on external debt, and the principal when due for reimbursement will be paid in non-convertible United States dollars. However, those payments are not frozen in the central bank, and they can be used without limitation for investment in Mexico. Equally, as long as payments are not directly transferable, goods acquired with those funds can be sold again in dollars to non-residents and the resulting profits will be free for conversion. This project is really tantamount to a debt swap applied to interest payments rather than to the principal, by using them to finance reconstruction and development.

The freeze on transfers should last about 10 years, at the end of which creditors would have reimbursed their capital plus the accumulated gains, with the guarantee that they would not face losses due to exchange rate-instability.

586. The scheme contains three fundamental advantages, derived from the recycling of interest:

(a) Resources previously used for financing the trade surplus can now be used for investment. Channelling resources for investment implies a rise in productivity, which would neutralize the bottlenecks that hamper Mexican growth;

(b) The result is a more stable and advantageous environment for conducting business. By eliminating the need for immediate debt service with repeated exchange-rates crises, the Mexican economy would find renewed equilibrium, giving priority to long term investment and growth. There is no better leverage for redressing a situation of capital flight than a return to confidence in the business world, together with the removal of foreign exchange pressure. Therefore, by recycling the debt service, Mexico could paradoxically benefit from an inflow of private capital sufficient to pay creditors a large portion of the interest in dollars. If creditors are inflexible, however, private capital will remain abroad and creditors would run the risk of getting nothing back;

(c) Recycling contains positive aspects for creditor countries too. It avoids the danger that the entire debt will not be paid and that taxpayers in creditor countries will then have to shoulder enormous losses. On the other hand, recycling may provide the financial resources necessary to solve at least to a small degree the problem of the United States trade deficit. Mexico, for its part, would be expected to resist the temptation of wasting resources to meet consumer demand after years of hardship, should adopt stringent fiscal measures and should commit itself to a liberalization of investment opportunities.

587. As to the destination of interest, banks would have three choices:

(a) They could manage directly their non-convertible activities, as is the case with banks engaged in debt-activity swaps. Instead of financing with deposits, these banks would use their own capital as a form of interest payment in local currency;

(b) They could entrust financial institutions in the debtor country to manage profits accumulated in local currency;

(c) They could get rid of their loans in order to avoid the high costs of negotiations, particularly in the case of small banks, which could sell their loans to investment funds specializing in activities in third world countries.

B. Sachs

588. The proposal presented by Jeffrey Sachs, Professor of Economics at Harvard University, in March 1987 to the United States Congressional Subcommittee on International Finance, Trade and Monetary Policy, is based on the subordination of the existing sovereign debt. 2/ The idea concerns primarily heavily indebted countries which, in Sachs' view, are affected mainly by problems of liquidity rather than solvency. Along this line, it would seem that Sachs borrows heavily from the Baker Plan, with an approach to the problem of international indebtedness as a problem of new money instead of debt reduction, which is the logic of the Brady Plan.

589. All existing debts owed to banks would become subordinated to the new instruments of financing, which are of the highest interest for investors, mainly activity funds, multinational corporations, etc. The banking system would be encouraged to subordinate debts in that way, under the supervision of the World Bank and IMF. The right of debtor countries to take part in those adjustments would then be subject to a predetermined international programme of adjustment. The scheme also includes ceilings on the amount of new funds (known as senior funds), which should not exceed an annual amount of 5 per cent of existing debts. In the case of reimbursement of the current debt, principal repayments would be reduced by restructuring operations.

C. Kenen

590. This proposal, which was outlined in 1983 by Professor Peter Kenen of Princeton University, was updated and expanded in 1987. It is the first proposal to recommend the setting up of a new agency, the International Debt Discount Corporation, working in collaboration with IMF. 3/ The Corporation's capital would be distributed and paid for by the industrialized countries.

591. The Corporation would purchase debts at 90 per cent of their face value. The discount applied is hence very small and similar to current prices on the secondary market. The plan also entails swaps with medium-long-term bonds (15 years), with 5 years' of grace and a yield connected to that of United States Government certificates. In addition, Corporation bonds would be negotiable on the secondary market. Credits acquired by the Corporation would then be restructured with a maturity similar to that of bonds, but with three years of grace at a debtor's cost 0.25 per cent higher than the yield of new issue certificates. Obviously, these terms are now totally outdated by market standards.

592. The main advantage of the plan is that it was the first to propose a reduction in the debt stock by means of a new international agency, and thus it became a generic plan.

593. The obvious cost involved in such a scheme is the need for public funds to underwrite the Corporation's capital and to shield lenders from potential losses on the purchased credits.

D. Sengupta

594. This proposal combines operations of guaranteed debt conversion with forms of new finance. It largely follows the principles of the Kenen plan. 4/

595. Sengupta proposes swapping the portion of the bank debt owned by commercial banks, with low-interest rate bonds issued by a debt adjustment facility, which would be a new subsidiary of IMF. In turn, IMF would guarantee creditors the flows of interest payments related to such facility bonds, while the reimbursement of principal would be guaranteed by the Governments of creditor banks. Participating banks would thus gain from a new and totally guaranteed financial activity, compared with the old debt which was not backed by similar guarantees. Participation in that operation would even force creditors to disburse new money, in the framework of the financing packages agreed upon with debtor countries.

596. The prime role played by IMF would be agreed with the debtor country, with the adoption of certain domestic economic adjustment programmes that took into account real prospects of growth in the debtor country and for the future debt service capability.

E. Avramovic

597. This scheme is very similar to the Dornbusch proposal in some respects but it also contains an insurance scheme. 5/

598. The proposal is mainly directed to commercial banks and is divided into two important phases. In the first, for a duration of about six years, debtors would pay the interest on debt as follows: one third in foreign exchange, one third in local currency (which commercial banks can use for investment or domestic financing) and one third to be capitalized through new creditors' finance at market rates. Participating debtor countries will have to set up a collective insurance fund and finance it with payments equal to 0.5 per cent of their total external debts. In the second phase, following the expected rise in the individual countries' ability to pay, the latter should be able to pay back the interest called by their creditors.

599. It is therefore a scheme based on the potential economic growth of debtor countries. It thus requires the definition of appropriate policies for growth and adjustment in order to raise a country's ability to pay and bring it in line with their level of indebtedness, and also to consolidate the financing capabilities of the guarantee fund. In addition, the setting up of a guarantee fund would improve the quality of credits called by commercial banks.

F. Lever and Huhne

600. Lever and Huhne's scheme as regards indebtedness with commercial banks appears to be like a development plan that offers new liquidity to debtor countries or, when that is not practicable, like a plan for non-performing debt cancellation. 6/

601. The proposal entails new financing by commercial creditors, with amounts that enable countries to make payments on their overall debts. On the basis of the adoption by the debtor country of policies for domestic economic growth designed by the World Bank and IMF, countries can obtain a guarantee of interest payments related to new financing by Governments in the countries of creditor banks. For banks not participating in these operations, the proposal is to cancel bad debts.

G. Knox

602. David Knox, until 1987 the Vice-Chairman of the World Bank and responsible for Latin America and the Caribbean, believes that the solution of the debt crisis is linked to the need to reactivate growth. 7/

603. Reviewing the situation in the Latin American countries, Knox notes that in the 1980s GDP grew by an annual average of 1.3 per cent, while per capita incomes fell. Considering that the population growth rate is about 2 per cent a year and that the working age population is growing by about 3 per cent, Knox indicates an annual growth target of 4 per cent as one that can lead to a rise in per capita income. To achieve this result the net transfers of around $20 billion a year during the next 10 years and of about $30 billion in the next 5 years are needed.

604. In the last few years transfers have not exceeded $9 billion a year and cannot increase without a reduction in the debt service, which now absorbs over 30 per cent of the continent's export earnings. The breakdown of Latin American debt changed considerably between the 1970s and the 1980s. Long-term debts grew sixfold between 1970 and 1980 and further doubled again between 1980 and 1987. Official debts, which in 1970 were slightly higher than non-guaranteed private debts, grew by 21 times between 1970 and 1987, while the total amount of private debts rose between three and four times over the same period.

605. The focal point in Knox's analysis is the idea not only of reducing the service towards commercial banks and towards Government creditors but also of modifying the same commitments towards IMF and the World Bank which have made no allowance for rescheduling or restructuring of debts owed to them. These institutions should take the lead and carry out a strategy of agreed insolvency in relation to the loans in their hands.

606. Evidently, insolvencies alone are not enough. They have to be accompanied by policies of growth, aimed at curbing inflation, strengthening the balance of payments, raising savings and investments and improving the efficiency of public and private spending.

607. According to Knox, evidence of all this can be found in Argentina, Brazil and Peru, where unilateral insolvencies have not been matched by appropriate economic policies, whereas in Bolivia and Costa Rica, insolvencies and policies have run side by side. The growth in the first three countries has diminished whereas the other two have begun to grow.

608. Exactly for this reason, the World Bank and IMF must both set an example in situations of controlled insolvencies and thus take the initiative in making proposals for development. In Knox's view, debt service should be reduced by 70 to 80 per cent for commercial credits (in line with secondary market valuations) and by 40 to 50 per cent for debts towards official institutions, both bilateral and multilateral.

H. Raffer

609. The German economist K. Raffer proposes the adoption of United States insolvency procedures for municipalities as a solution to the debt crisis. 8/

610. Chapter 9 of the United States insolvency law, which regulates the insolvency of municipalities, protecting the municipality's governmental powers, could, according to Raffer, easily be adapted to sovereign lenders. Raffer maintains that it, like all good insolvency laws, combines a general framework with the flexibility necessary to deal fairly with individual debtors. Under its umbrella many proposals made such as interest-capping, securitization, counterpart funds, buy-backs, debt-nature (-equity) swaps, etc. could be accommodated. One exception is the "court". Instead of a national court, a neutral court of arbitration would have to be established. As usual in international law, the arbitrators should be nominated by both parties, with creditors and debtors nominating the same number of persons. These members, in turn, would nominate a chairperson to achieve an uneven number. The nomination could be effected by simple majority or by any other percentage that may be wished.

611. In analogy to domestic chapter 9, people affected by a debt adjustment scheme must have a right to voice their opinion on the plan and its effects on them. For the international chapter 9, which, e.g., could be established in the form of an international treaty ratified by all Members of the United Nations - the following points should be stated:

(a) Economic adjustment. There is no doubt that economic reform is necessary in problem debtor countries. The burden of adjustment, however, should not fall entirely on them. Analogous to domestic insolvency proceedings, a reorganization of the debtor to improve future economic performance should also bring about the rehabilitation of the debtor, restoring economic viability. Chapter 9 adjustment should earnestly explore possibilities of foreign exchange savings through domestic production and help to create the base for economic diversification. Monitoring by the arbitrators, agreed upon in the plan, could also help to overcome the problem of petrifying protectionism by following the policy already recommended by Raul Prebisch in the 1950s: lowering protective walls as domestic producers become more competitive. A policy mix of intervention and market forces is necessary.

The risk of petrification can be avoided if the obligation to do so is part of the confirmed plan. Increased aid from OECD countries, be it via counterpart funds or for imports of necessary investment goods, should be forthcoming. This money must be used to finance recovery and must not go to banks;

(b) Capital flight. In several debtor countries, capital flight has been a major problem. Estimates of capital flight for Latin America vary between 35 and 49 per cent of inflows, with Argentina and Venezuela usually in the lead. In the case of Argentina, it appears impossible to find out where the money went. Several indebted countries could be almost free of foreign debt if there were not this gigantic outflow. In analogy with the laws within all countries, the international chapter 9 should provide the possibility of overruling banking secrecy if reasonable suspicion exists that money was obtained illegally, i.e., by an activity that is considered criminal within a creditor country. Embezzlement is a crime anywhere. The details of the definition would, of course, have to be elaborated by jurists, and it will take some time to do so. Retrieving these funds would reduce the debt burden substantially;

(c) Equality of creditors. This view is also reflected in insolvency regulations: in economic theory, the homogeneity of actors allows markets to function efficiently. The understandable self-interest of each lender apart, there is no reason why some should get a better deal. All debts, public and private, should be treated equally, including those to multilateral lenders. The World Bank argues that its excellent rating as a borrower would suffer if it did not pursue its strict policy on repayments. Loan loss reserves would certainly serve the same purpose as well. Recent policy on loan loss reserves suggests that the World Bank already expects increased problems with repayments. Furthermore, the World Bank detailed supervision of projects, as well as the determining influence of the Bank and IMF in terms of structural adjustment, calls for a fair sharing of risks. At present, multilateral institutions insist on full repayment. But if multilateral institutions are regarded as mere lenders, there is no reason why their loans should not be subject to chapter 9, like those of international banks.
On the other hand, the present policy of bailing out private banks has to stop. Not only is this a market imperfection which has contributed substantially, if not led, to the present situation, it is also patently unfair to multilateral and other public lenders;

(d) Commercial banks and banking regulations. Commercial banks by no means represent a homogeneous block of interests. All banks received higher spreads from third world clients, arguing that this was necessary to cover the greater risks involved. United States money-centre banks, however, did not provide for the allegedly higher risk, while many other banks correctly built up reserves. These banks, most notably the Deutsche Bank, openly favour debt relief. It is also patently uneconomic to reward those who, after disregarding the most elementary rules of banking when showering money on the third world, did not even care to build up reserves, in the hope that the Government would not let them feel the consequences of the market. This, in turn, has led to massive misallocations. International differences in tax laws regarding provisions are no excuse: banks should have been familiar with their national tax laws, taking them into account when calculating risk-covering spreads. If the market rate had not allowed

sufficiently high spreads, economic theory would have suggested that they not lend. Furthermore, if independent United States banks can and must provide for risks, there is no reason why money-centre banks should not be able to do so. Finally, Japanese banks have demonstrated that not quite favourable tax regulations regarding provisions against losses can be overcome by innovative legal schemes, in contrast to money-centre banks that preferred to rely on IMF and the Treasury. Presently, however, all banks have increased their reserves substantially;

(e) Assessment of debts. Verification of claims is usual in domestic insolvencies within OECD countries and must also be done internationally;

(f) Moral hazard. This point, and the argument that for countries with better debt management not to get debt relief would be unfair punishment, are pure subterfuge. If they were correct, insolvency procedures would have to be abolished domestically as well. Furthermore, the need to adjust according to the confirmed plan, the loss of face involved in filing insolvency and the fact that confirmation would be denied if obligations could be met (which would automatically confirm that the debtor is able to honour all debts) are doubtless deterrents against capricious use;

(h) Insurance schemes. Establishing an insurance fund to guarantee future payments might be considered. It is also conceivable that it might cover only annual repayments of principal. It should be financed by the debtor and creditors alike: unused funds should be split on fulfilment of the plan according to the ratio of payments to the fund. This optional facility could further raise secondary market prices, which could already be expected to rise on confirmation of the plan.

I. Islam

612. The main feature of the plan of Mr. Shaquil Islam, Council on Foreign Relations, is a country-by-country approach; the negotiation and the co-ordination of debt reductions, as well as policies of economic restructuring have therefore to be analysed case by case, according to the conditions of the debtor country.

613. The basic proposal is to convert variable-rate bank debt into medium-to-long-term bonds issued by the debtor country at a fixed rate below market level. Such bonds would partially be guaranteed by the international financial agencies (World Bank and IMF) and by a Japanese Guarantee Fund. Besides, it is possible that the role played by a certain number of banks, coupled with regulatory measures, may secure the approval of other similar institutions.

614. The debtor country is expected to comply with predetermined programmes of economic development and reform. The plan envisages the setting up of a debt restructuring advisory committee staffed by multilateral institutions and by non-governmental experts from the third world.

J. International Round Table on Regaining and Further Enhancing Development Momentum in the Context of Rapid Global Change 9/

615. The International Round Table held at Sveti Stefan, Yugoslavia, from 28 to 30 June 1990 under the auspices of the World Scientific Banking Meeting Permanent Secretariat and the European Centre for Peace and Development, Belgrade, with the assistance of the United Nations Development Programme (UNDP), the Yugoslav Government and others agreed that the debt situation continued to represent a major obstacle to resumption of economic growth. Also, while substantial progress had been made in economic reforms in many debtor countries, there was still need for improvement, particularly in some critical cases.

616. The participants agreed that there were flaws in the analytical framework now used in formulating international debt policy, particularly the lack of estimates of country capital requirements for resumed growth over the medium term and of estimates of long-run debt servicing capacity which should help to determine the terms of needed cash-flow rearrangement or of debt relief. The amounts of debt relief and cash flow rearrangement now depended on unequal bargaining between the debtor and its creditors, and they had usually been too little and too late. There was also haphazard coverage of debts to be reorganized (debts to public entities of middle-income countries and debts to private creditors of low-income countries were not covered), resulting in an unequal treatment of debtors and unequal impact on creditors.

617. In order to remedy this situation, the report proposes and the roundtable concurs with the establishment of independent teams of experts for each debtor country that wants one, headed by a prominent person in finance, economics or political life, to work out proposals for restoring economic growth at a satisfactory rate, suitable debt reorganization and domestic measures to support them. These teams would draw on all sources of information and advice from debtors, bilateral official creditors, creditor banks and international financial and development institutions. The responsibility for the proposals would rest with the teams. It would be up to the debtors and the creditors whether or not to accept the proposals.

618. The round table considered the new international financial situation that had resulted from events in Eastern Europe. Those events had increased world financial requirements. In view of the likely overcrowding of demand in financial markets and corresponding difficulties that highly indebted countries were likely to encounter in mobilizing external resources in the near future and the time it would take to prepare and agree on a lasting solution of the debt and resource flow problems, consideration should be given to an interim bridging arrangement that would include postponement of amortization and payments of interest partly in foreign exchange, partly in local currency of the debtor and partly through capitalization into new loans. Such an interim arrangement would apply to both private and official loans. The danger of rapid accumulation of debt through interest capitalization would be reduced as it would affect only a portion of the interest, and it would be eliminated if a concessionary rate of interest could be agreed. The ratios would depend on the economic position of the country. The lowest-income countries would require the lowest payments in foreign exchange.

619. In addition to the international debt policy proposals contained in the report, the participants stressed the importance of domestic policy measures in debtor countries, as both international and domestic measures were necessary for the solution of the debt problem. Specifically, it was suggested that:

(a) Direct foreign investments should be promoted as they would add investable resources without incurring additional fixed debt service liability, although magnitudes were not likely to be large in the near future;

(b) Further progress in the fiscal position was needed in most debtor countries. That would relieve the strain on the domestic financial market, leading to a reduction of domestic interest rates and thus of constraints on growth.

The round table further stressed the importance of import liberalization by creditor countries for successful and orderly export and income growth in debtor countries, enhancing their debt-servicing capacity.

620. Finally, concern was expressed in the round-table that a continuing high international rate of interest might prove to be a decisive obstacle to a satisfactory solution of the debt problem. In the last decade, international real interest rates had been two to three times higher than the historical level. That has been a major factor in the continuing growth of debt despite large transfers of resources from debtor countries. The expected overcrowding of financial markets might push the interest rates even higher. In view of the world-wide demand for resources, a large reduction in defence spending would be a major element of fiscal policy to bring about a reduction in the international rate of interest, in addition to the possibility of directly releasing supplementary finance for development.

Notes

1/ The New York Times, 3 May 1988.

2/ Testimony to the Congressional Subcommittee on International Finance, Trade and Monetary Policy, March 1987.

3/ "A bailout for the banks", The New York Times, 6 March 1983.

4/ Sengupta, A. K., "Remedy for debt overhang", The International Economy, July-August 1988, p. 97-99.

5/ See International Economy Debt Plan Scorecard, The International Economy, September-October 1989; see also Debt Crisis of the 1980s: the Beginning of a Wind Down?, Bank of Credit and Commerce International, Washington, D.C., January 1988.

6/ Lever H. and C. Huhne, Debt and danger, the world financial crisis, Atlantic Monthly Press, 1986.

Notes (continued)

7/ Knox, David, Latin American debt: facing facts, Oxford International Institute, 1990.

8/ Raffer, K., "Applying Chapter 9 insolvency to international debts: an economically efficient solution with a human face", World Development, vol. 18, No. 2, 1990, Pergamon Press.

9/ This statement reflects the general findings of the Round-table and not necessarily the views of every participant on every point. The experts were Takahashi, Avramovic, Cirovic, Cabric, Ichimura, Islam, Kyu Lee, Malecki, Nunnenkamp, J. A. T. Ojo, Ostojic and Vidas.

XI. CHANGES IN TAXATION, ACCOUNTING AND BANK SUPERVISION RULES RELATING TO DEBT REDUCTION AND NEW MONEY 1/

A. Introduction and main issues

621. The aim of this chapter is to give an outline of the bank, accounting and tax regulations in the most industrialized countries as regards the way resident banks treat their loans to developing countries with problems of foreign debt.

622. Country analyses show the extent to which accounting and tax regulations can influence bank strategies related to developing countries' debts and also how such strategies still diverge from one country to another.

623. In order to explore the various national situations, the examples given are as standardized as possible and the same order of priority will be given to the analysis of some of the main problems, such as:

(a) Accounting treatment of provisions against debt losses, both generic and specific;

(b) Supervision instructions on the level of provision regarded as necessary in the face of bank exposures to country risk;

(c) Tax deductibility of the various kinds of provisions;

(d) Tax treatment of some operations on loans to developing countries: cancellations, renegotiations, debt sales, debt-debt and debt-equity swaps, debt guarantees.

624. There are considerable variations from country to country in the number of tax incentives to reduce exposure in developing countries by means of provisions or incentives allowing partial cancellation of such debts. Incentives differ not only in fiscal terms, but also in their treatment of related funds concerning the minimum capital ratios required by national supervision authorities and by the Bank for International Settlements (BIS). There are countries in which bank supervision authorities allow general reserve funds to be included in the calculation of such parameters. The result is an incentive to build up such reserves, while it becomes more difficult to detect debt losses originating from debt reconversion, reduction and take-over operations since they all give rise to a capital loss.

625. A review of the present tax and accounting incentives in different countries shows a large number in France and a very small number in Japan, with the United States falling in between. Provisions are regarded as specific in France, and therefore deductible on the basis of tax regulations, while in accounting terms they fall in the category of generic reserves and are consequently included in total capital assets. In contrast, in Japan provisions against loans to developing countries, except for some high risk-countries, are tax deductible only for very small amounts and only 14 per cent of the total is included in the bank's capital assets.

Table XI.1 Tax, accounting and bank supervision required in lending countries

	US	FRG	JAP	UK	F	CH	I
Book record of provisions:							
Both generic and specific deducted from gains a/	Y	N	N	Y	N	N	N
Deduction of specific provision only	N	Y	N	N	Y	N	N
Separate fund in liabilities	N	N	Y	Y	N	Y	Y
Minimum provision levels given by supervisory boards for exposure towards developing countries	Y	N	Y	Y	N	Y	N
Tax deductibility of provisions:							
Without fixed ceiling	N	Y	N	N	Y	N	N
In fixed percentage terms	Y	N	Y	Y	N	Y	Y
Disallowed	Yb/	N	N	N	N	N	N
Deductibility of losses from operations on or transformations of debts	Y	Y	Y	Y	Y	Y	Y
Contamination of remaining portfolio from accepted losses	N	Y	N	N	.	N	N

Source: Research Office, Instituto Bancario San Paolo di Torino.

a/ The accounting definition of specific provision does not necessarily coincide with the tax one: in certain tax jurisdictions a generic provision can have a specific nature in terms of tax treatment.

b/ Not allowed for banks with assets in excess of $500 million.

626. Computing reserves in the capital assets is, on the hand, an incentive for banks to build up provisions, but, on the other, it makes partial cancellations of debts or other debt transformation uninteresting, since it implies a net reduction in the bank's capital assets with no tax benefit in return if the loss has already been covered by provisions; and, when the loss is smaller than the level of provisions, the fiscal result is indeed a taxable gain. Such is now the case with operations of ordinary debt reduction when provisions exceed 50 per cent, because they are based on secondary-market bids.

627. However, the differing treatments of reserves in determining capital ratios should come closer as a result of the full application of the BIS directives on capital ratios, to be in force by 1992. Such directives do not allow specific reserves to be included in the capital, but general reserves are also excluded from primary (or basic) capital and can be included only in the supplementary capital up to 1.25 per cent of the assets, weighted according to their risk level. The minimum capital ratio required by BIS is 8 per cent, but it has to be at least 4 per cent for primary capital alone.

628. Accounting procedures for provisions in order to establish capital ratios are therefore expected to become standardized in the various countries, thus reducing the incentives to build up provisions currently provided by law in certain European countries. Considerable differences may persist, however, in tax treatment.

B. United States

629. The treatment of reserves is ruled by the accounting principles of article 5 of the Financial Accounting Standards. Generic and specific provisions against debt losses are registered and directly deducted from the corresponding item in the assets and, in the profit and loss statement, they reduce income. As regards country-risk provisions, in 1979 the three bank supervision agencies set up a standardized system to determine the country risk and to check the level of provisions against a portfolio of bank loans, run by the Inter-agency Country Exposure Review Committee.

630. The Committee regularly releases provision quotas to be applied to loans granted to certain sovereign States. When such reserves are not directly deducted from the amount of the loan, they must be registered in a separate section of the balance sheet (allocated transfer risk reserve). Such percentage values are the minimum required, but bank managements can decide on higher provisions.

631. United States banks also have to build up reserves equal to the amount of uncollected interest payments in the case of debtors that are behind in their payments by more than 90 days.

632. Following the approval of the 1986 tax reform (due for full implementation only in 1991), such provisions are no longer tax-deductible for banks with total assets in excess of $500 million. In order to make debt losses tax-deductible, banks have to apply the specific charge-off method, whereby debt losses can be charged only when they actually materialize, namely when the debts in question lose

their value in part or in full. However, the way the method is applied by tax authorities to loans granted to developing countries is not entirely clear. The only deductible provisions are those indicated by the Inter-agency Committee, and these are only a marginal share of the total reserves of the United States banking system against loans to developing countries.

633. United States tax authorities distinguish between two types of operations on loans to developing countries: renegotiations and swaps. In the first case, the creditor and the debtor agree to change some or all of the terms of the existing loan; in the second case, it is the nature of the debt itself that is modified. In a swap, a profit or a loss is fiscally regarded as the difference between the new market value and the taxable amount (less provisions) of the transferred debt. At the same time, for fiscal and accounting purposes, renegotiation of a loss is registered only when the non-realized flow of future payments (interests and principal) is lower than the amount of the loan before renegotiation. For fiscal purposes it is therefore more convenient for banks to carry out swaps than renegotiations, thus considering loan transformation as substantial modifications of loan terms, and therefore as swaps instead of renegotiations. Besides, losses resulting from swaps do not contaminate other loans granted to the same debtor and still held in portfolio.

634. During 1989, the new Secretary of the Treasury, Nicholas Brady, gave fresh impetus to political initiatives aimed at finding a solution to the problem of developing countries' debt. Without modifying the accounting and tax systems mentioned above, federal authorities have called on United States banks for more debt transformations and for loss acceptance, for which tax benefits are available, over and above losses from swaps and debt sales on the market.

635. Since minimum provision levels required by the Inter-agency Committee are not tax-deductible, there is an incentive for restructuring operations that produce a tax-deductible loss. It has to be noted, however, that such loss can be detrimental to the calculation of the capital assets in terms of Inter-agency Committee values, although it is rather unlikely considering the high level of provisions already deducted from gains.

636. On the other hand, further impetus for restructuring comes from the rule whereby securities with a non-discounted flow of interest and reinvestment equal to the amount of the original loan are not conducive to loans even when their market value is lower than the face value of the original loan.

C. United Kingdom

637. As a general rule, in the United Kingdom provisions against depreciation of specific assets must be deducted directly from the corresponding item in the balance sheet. Generic provisions against debt losses are registered separately on the liabilities side and are included in the calculation of the capital assets. There is no specific obligation concerning provisions against debt losses, and bank managements are solely responsible for the appropriate level of provisions.

638. The Bank of England does not impose ceilings or standard rules in relation to loans to sovereign States, yet the exposure of each bank is monitored on a consolidated basis by means of monthly and half-yearly reports. In 1987 the Bank of England worked out an analytical method for determining the country risk of some developing countries by which any bank could establish a sufficient level of provision for itself. Provisions against loans to developing countries are regarded as specific and thus can be deducted from the amount of the loan.

639. The Finance Act of 1988 no longer permits the automatic tax deduction of all provision against debt losses, yet it created a system of individual estimates of individual loans, with the requirement of justifying the related provision on account of its uncollectibility. However, the Inland Revenue has not specified which elements are considered acceptable and sufficient for this purpose. In order to determine the fiscal eligibility of provisions, the Inland Revenue uses as a reference guide the tables published every year by the Bank of England, although it is not binding. This is because the precautionary principles that inspire the central bank do not necessarily coincide with those of the Inland Revenue. The issue concerning deductibility of provisions against loans to developing countries is therefore surrounded by some uncertainty.

640. Debt cancellations are allowed for tax purposes only if the debts in question are of proven and irrevocable uncollectibility. In the case of debt securitization (exit bonds), the difference between the face value of the existing loan and the face value of the bonds acquired is tax-deductible. In contrast, all operations of transfer and/or debt transformation (sales, asset swaps, debt-equity swaps, securitization) must be registered in the books at the market value of the equities acquired.

641. Consequently, United Kingdom creditors prefer transformation - transfer operations, which imply a reduction in the face value of debts, and this leads them to prefer high depreciation in the face value of loans, even if a drop in the overall value of the security brings interest down and makes it fixed instead of variable; it extends maturity, but also produces new guarantees and side effects leading to a rise in the value of the debt. At any rate, a generous tax system for provisions against loans to developing countries reduces tax benefits for debt-restructuring operations.

D. Germany

642. By and large, the issue of bank reserves and provisions is extremely specific in Germany because, unlike in the United Kingdom and the United States, banks are allowed by the supervision authorities to build up "secret" reserves. In other words, the amount of provisioning is higher than the real elements of risk that are tax-deductible and that are deleted from the assets in corporate balance sheets. The idea behind "secret" reserves is that they officially are not a reserve but the consideration of true costs, i.e. losses, (even if they have not yet materialized). As a result, there are less stringent obligations to provide information on each and every single loan and operation.

643. Provisions against bad debts are worked out and built up case by case according to the possibility of collecting interest and principal. In the balance sheet, reserves on specific debts are deducted directly from the related item on the assets side. The same treatment is applied to overall provisions, namely those provisions related to groups of debts not of a compulsory nature. Compulsory general allowances required by the Federal Bank Supervisory Administration are treated differently, since they can be registered as a separate item on the liabilities side of the balance sheet. Yet such treatment is not compulsory and the bank can opt for a deduction of general provisions from the corresponding items in the assets side.

644. Banks are not obliged to give information on the level of reserves they have built up against debts. Bank rules in Germany explicitly allow building up provisions higher than the objective elements of risk. These reserves are obviously secret ones that are tax-deductible and advantageous where a highly positive balance sheet results. In practice, all the various forms of provisioning funds on the liabilities side of the balance sheet can conceal secret reserves.

645. Loans granted to sovereign States are regarded as specific and not general risks. The related provisions are therefore directly deductible from the value of the loan on the assets side. However, that does not necessarily imply a burden since supervision authorities have not given any indication as to the level of provision against loans granted to developing countries. They believe such a question falls within the exclusive responsibility of the bank management and their auditors.

646. Given the tax deductibility of reserve provisions, tax authorities are somewhat uncertain due to the failure by supervision authorities to establish the necessary guidelines. Such provisions are therefore not clearly accepted or recognized by tax authorities and general guidelines are so far not available.

647. In the case of Poland, a decision by the Administrative Court confirmed that provisions up to 50 per cent of the debt (later raised to 60 per cent) are tax-deductible. By and large, provision related to countries with balance-of-payments problems, that are behind in servicing their debts or with which renegotiations are in progress have been accepted in the past. Provision higher than 50 per cent - related for example to Latin American countries - may be the subject of discussion with the fiscal authorities. It is also to be noted that, in 1988, tax authorities in Germany made it known that they would regard a face value depreciation of debts of up to 10 per cent of their secondary market bids as tax deductible.

648. As to the tax treatment of other operations on loans to developing countries, in general profits were taxable and losses are deductible. In particular:

(a) Total or partial debt cancellations of debts are tax-deductible. If the depreciation does not produce a new security even when it is lower than the provision rate already fiscally deductible, it does not imply taxable contingent assets since the debt value may be further reduced;

(b) There are no precise indications concerning interest rebates below market level, but if they remain higher than domestic rates, deductibility is difficult to concede;

(c) In debt settlements, the operation is registered at the market value of the assets received. In the case of a debt devaluation, the same treatment is extended to the remaining debts in the portfolio;

(d) In debt-debt swaps, both debts are registered at their market value. Their price is automatically extended to other debts in the portfolio that have the same characteristics;

(e) In debt-equity swaps, both items are registered at their market value; however, when it is hard to establish the value of the equities acquired, they can be assumed equal to the amount of the debt for which equities exchanged;

(f) In case of debt securitization (exit bonds), the operations have to be carried out at the market value of the new security.

649. The German tax system discourages restructuring as it allows the building up of massive and tax-deductible secret reserves. Once they have been built up, there is an inherent risk of being left with taxable contingent assets. Debt conversions into new equities are discouraged in favour of debt reductions without conversion when the amount is lower than that of provision, since debt conversions produce a taxable gain. Interest rebates are also fiscally penalized because, unlike debt reductions, they do not produce a tax deductible loss, except when interest rates are lower than those on the German market. The impact of such discrimination is, however, of little significance when provisions have already been built up so as to offset the depreciation of the principal required by the debt-restructuring programme.

E. Japan

650. The accounting treatment of provisions against risk loans is differentiated for two categories of loans:

(a) Bad debts, namely debts regarded as uncollectable, have to be depreciated or cancelled in the balance sheet at year end and the related amount has to be registered in the profit and loss statement;

(b) For doubtful debts, namely debts involving the risk of insolvency, the provisions have to be registered in a reserve fund on the liabilities side of the balance sheet.

651. For loans granted to sovereign States, the Ministry of Finance has established guidelines that imply the building up of tax-deductible provisions in the order of 1 to 10 per cent and, since 1989, up to 15 per cent, for loans granted to Governments or to private individuals in certain problem countries. The same applies to countries that are one month or more behind in their debt service or

with which renegotiation or other restructuring agreements have been reached. However, a list of such problem countries has not yet been issued and the final decision is left to bank managements. Banks need specific authorization from the Ministry of Finance in order to make debt losses tax-deductible.

652. Tax-deductible amounts vary according to the type of provisions that have been built up. There are three types:

(a) Generic provisions. Tax deductions have been allowed for a long time for all debt losses, regardless of the kind of loan or debtor. Such general provisions are now limited to a maximum of 0.3 per cent of the value of net debts outstanding at year-end;

(b) Provisions for loans to specific countries. Since 1983, Japanese banks have been encouraged to build up 5 per cent reserves on loans granted to certain countries. Only 1 per cent of them is tax-deductible;

(c) Provisions for outstanding foreign debts. Since 1988, a tax deduction has been allowed relative to a special reserve fund for loans to developing countries. Up to 50 per cent of the risk loan, with provisions allowed for loans to Governments, central banks and local governments, provided that they are in one of the following situations:

(i) When debtors are declared insolvent, and if they remain so until the end of the year after they have been notified of their insolvency and when there are no contracts or plans involving new loans to them;

(ii) When year-end such debtors are more than three years behind in their debt service and in repaying the principal and they have not been granted new loans, nor have plans been drawn up for future loans or renegotiations scheduled in connection with previous loans.

653. In computing provisions, 50 per cent of the risk loan must be related to the amount of debts in the balance sheet, from which certain items have to be subtracted, such as the amount guaranteed by third parties, the share insured against loss (if there is one) and guaranteed securities.

654. As for transactions or other operations on loans to developing countries, (conversions, swaps, sales, securitizations, etc.), no statements or indications have been given by the tax or bank authorities in Japan. In renegotiating loans, a loss has to be registered on the assets side of the balance sheet only when the non-actualized future flow of payments and interests is lower than the loan value before renegotiation.

655. In conclusion, since 1988 there has been a considerable level of tax deductibility in Japan concerning provision for doubtful debts to risk countries, which may obviate the tax benefits linked to debt restructuring. Besides, the system whereby restructuring operations do not produce taxable income, reducing losses when they allow a non-discounted flow of interest and principal payments equal to the value of the debt under restructuring, protects the balance sheet and

the profit and loss statement from the impact of such restructuring. Over all, the Japanese system provides no incentive to restructuring but does not discourage it either.

F. Switzerland

656. Bank authorities recommend provision on both specific and general loans and allow the building up of contingency reserves in excess of the risk. They are deducted from assets and thus take the form of reserves. The deduction of provision from the corresponding item on the assets side is allowed, but not until the loss has actually materialized. Provision related to loans not deducted from gains is normally included on the liabilities side under the item "other liabilities". As a general rule, provision for future debt losses related to loans to both domestic debtors and foreign debtors is tax-deductible at 5 per cent and 10 per cent respectively. In addition, as from 31 December 1989, the Federal Bank Commission introduced a compulsory provision quota of 35 per cent of the principal for loans to risk countries, without specifying which they are. Such provisions are also tax-deductible.

657. In 1989 new criteria were introduced concerning the treatment of reserves on loans to developing countries, making a distinction between short- and long-term loans. For loans up to 360 days, the minimum level of provision required is 10 per cent, the figure normally applied to foreign debts; for a longer term the minimum level is 50 per cent.

658. As for debt service, doubtful debts may not be registered among the taxable gains of the year. Indeed, the treatment of interest paid on outstanding debts leaves banks ample room for manoeuvre. Banks can choose between treating them as profits or registering them as a deduction of the outstanding debt or as a deduction of the provisions they have built up.

659. Swiss banks also enjoy considerable freedom in renegotiations, and loss registration is compulsory only when the non-actualized future flow of interest and principal is lower than the debt value before renegotiation.

660. As for the transformation of developing countries' debts, the Swiss authorities have so far given no specific directives. The general rule is that assets cannot be quoted at a value higher than their cost price, with the exception of listed securities, which can be quoted at market value. Lost gains cannot be included in the assets, while expected losses have to be covered immediately by provision. In the case of debt transformation (settlement, sale, swap or securitization), there is no effect on other debts in the portfolio. In other words, a loss does not imply compulsory depreciation (or provision) related to other loans granted to the same debtor.

661. In short, the Swiss tax system does not discourage debt restructuring both because tax deductible provisions usually do not exceed 35 per cent (i.e., the amount of converted depreciations included in the Brady Plan) and particularly because debt reductions lower than provisions do not produce taxable contingent

assets until the new equity acquired through the above-mentioned operations has been transferred. Even for accounting purposes, the Swiss system is neutral in the case of debt reductions similar to cancellations. As already indicated, there is compulsory registration of the loss - with a consequent drop in gains - only when the future non-discounted flow of interest and principal payments is equal to the value of the latter or if, with interest rates down to 5 per cent, a debt with a residual life of 10 years implies assets higher than 50 per cent of the principal, whereas if 50 per cent of the debt is still to be repaid, another 50 per cent comes from depreciation quotas.

G. France

662. Each bank takes it own decisions concerning debt provision policy. However, they all have to report regularly their risk exposure and provision levels to the Banking Commission. Book records submitted to the Banking Commission must report separately how provisions contribute to profit and losses. At the same time, book records presented to shareholders and lodged at the Company Register Office show the various balance sheet items without specific provisions. Generic provisions must be reported as reserve funds in the liabilities side.

663. As regards loans to sovereign States, the Banking Commission enacted the following mandatory guidelines, which came into force on 30 June 1984:

(a) Accounting regulations:

(i) Loans must be reported in the balance sheet as long as initial terms or renegotiations are respected;

(ii) Arrears dating back more than three months must be transferred to a category of immobilized assets, namely the stage preceding the state of debts overdue;

(iii) When provisions have been built up on a loan, at least an identical amount has to be transferred to the other side of the balance sheet;

(b) Provision:

(i) Banks have to build up provision on unpaid interest already registered in the assets when debtors have fallen behind in their payments by more than three months;

(ii) Provision against unpaid interest is not an impediment to building up provision on the principal, which is mandatory after three months from the scheduled payment date and when there are no plans forthcoming for renegotiation agreements.

664. In France there is no specific tax regulation concerning the tax deductibility of bank reserves against debt losses. The latter are therefore treated as reserves against any kind of loss and are deductible only when the loss is the result of

the company's normal activity; probable; clearly identifiable; and attributable to current events. Previously, in keeping with such principles, generic and specific provisions were not regarded by the tax authorities as tax deductible. However, in 1987 the Ministry of the Treasury decided to allow tax deductions for provisions against loans granted to sovereign States. This concession is limited to the provision amount required by the Banking Commission, while provision in excess is provision in excess is governed by general rules.

665. The tax treatment of debt conversion or reduction is governed by the following principles:

(a) Debt cancellations are regarded as tax deductible losses; the use of the corresponding reserve fund that may emerge in the case of higher provision (immobilized in line with the guidelines issued by the Banking Commission) is treated as a taxable asset;

(b) Interest rebates below market levels do not create entitlement to tax deductions since they influence future gains and not current losses;

(c) In the case of debt transformations (swaps or securitizations) any gain or loss is of concern to the fiscal authorities. Transferred debts must be reported at their balance sheet net value and acquired debts at their face value.

666. In the case of swaps against bonds, 15 per cent of the loss exceeding provisions already exempt from taxes is tax deductible, against a standard figure of 42 per cent. The tax treatment of capital gains in France discriminates between short-term gains (taxed at 39 or 42 per cent) and long-term gains (taxed at 15 per cent).

667. The principle whereby provisions against loans to developing and risk countries are reported on the assets side, notwithstanding their tax deductibility - although within certain limits - makes the restructuring of such debts unattractive to French banks. Such restructuring operations imply that losses, equal to the reductions carried out, must be registered as liabilities, thus eliminating or reducing the share of such provisions in the overall amount of assets. This sacrifice in the balance sheet and in the profit and loss statement is not offset by any tax benefit, except in the case of provisions lower than the accepted loss. When the latter is lower than the provision (not entirely unlikely on account of reductions-reconversions like those implied by the Brady Plan), the result is indeed a taxable contingent asset. Restructuring operations involving interest rebates are less appealing from a tax perspective than those implying a depreciation of the debt at nominal value because they do not produce any loss. Yet such discrimination is of little significance with restructuring of loans with considerable build up of reserve provision among assets, which is now frequently the case. Finally, the above-mentioned tax disincentive to restructuring operations for an amount lower than that of provisions is mitigated by the reduced rate applied to contingent assets, since they are related to medium- and long-term debts and are therefore subject to the 15 per cent rate applied to medium- and long-term capital gains.

H. Italy

668. Provision against risks of debt loss, like other provisions, must be registered separately as a single item in the liabilities, whereas the gross amount of related assets must be placed on the assets side. Deductions and offsets can be carried out only when a loss actually materializes.

669. Tax deductibility of provisions is governed by two laws: Law No. 917 of 1986 and Law No. 491 of 1988.

670. Law No. 917 establishes the following conditions for provisions to be tax-deductible:

(a) Provision on debt risks is deductible in each fiscal year up to 0.5 per cent of the total amount of debts shown on the balance sheet, until the fund reaches 5 per cent of total debts existing at the end of the fiscal year. In the case of banks, debts eligible for provision are those resulting from loans granted. Debt losses are registered in the fund and deducted from net earnings only for the part not covered by the fund; if the amount of the fund exceeds 5 per cent of the total debt value, the excess is included in the calculation of net earnings for that fiscal year;

(b) Provision for debt risk related to delayed interest payments is tax-deductible in each fiscal year up to the total amount of the debts in the profit and loss statement, if they have been registered in a special fund on the liabilities side, separate from the generic fund for debt risks. When the amount of the fund is higher than what is owed in interest on delayed payments registered in the balance sheet, the excess is included in the calculation of net earnings for that fiscal year. Debt losses are tax-deductible if they result from verifiable and precise facts, or if the debtor is subject to debt proceedings.

671. Law No. 491 has introduced a new form of tax-deductible provisions against loans granted to countries that have obtained a renegotiation of their foreign debts. Provisions are allowed for each of the three fiscal years from 1988 to 1990 2/ up to 8 per cent of the total amount of debts registered in the balance sheet, i.e. a total of 24 per cent, subject to the registration of the provision in a special fund on the liabilities side, separate from those envisaged by Law No. 917. Such debt losses are deductible in keeping with Law No. 917 up to the amount not covered by the fund. The following items are excluded from debt provisioning: debts or debt quotas guaranteed by the Export Credit Insurance Company and debts for which provisions have already been built up in keeping with Law No. 917.

672. It is obvious that the phasing out of that law is a fiscal disincentive for fresh loans. Yet, there seems to be no tax disincentive to debt conversion or to the reduction of old loans granted to developing countries since they generally entail tax benefits because provisions are allowed up to a maximum of 24 per cent. The disincentive effect of these operations is of an accounting nature since the above-mentioned provisions are registered on the liabilities side, whereas losses resulting from debt restructuring are immediately deducted from the assets and are not written off.

Notes

1/ This chapter was written with the assistance of the Istituto Bancario San Paolo di Torino Research Office.

2/ This implies that the benefits of law No. 491 are still applicable to tax returns filed in 1991. The urgent problem is, therefore, whether the law in 1991 will be extended for the next years.

XII. THE DEBT PROBLEM, THE URUGUAY ROUND AND WORLD TRADE

A. Foreign trade and debt: some observations

673. A few data are sufficient to show how in the last two decades the position of the developing countries has worsened. Excluding the members of the Association of South-East Asian Nations (ASEAN), i.e. rapidly developing countries of South-East Asia, the share of the developing countries in world exports decreased from 15.2 per cent in 1970 to 10.8 per cent in 1988. Preliminary estimates for 1990 show an additional but modest decline. The decline has been particularly painful in Africa, where exports have fallen from 4 per cent to 1.7 per cent of world trade, and Latin America (from 5.7 per cent to 4 per cent). From 1980 to 1987 African exports declined by 3 per cent each year and those of Latin America did not change, while international trade grew at the rate of 4 per cent each year (see table XII.3).

674. It is only in the last three years that the trend has been reversed. However, the exports of the two continents are growing at a slower rate than international trade as a whole and at half the rate of the exports of Asian countries. With 1980 export prices equal to 100, in 1988 the prices of the industrialized countries of the West rose to 117.6 while those of the developing nations were down to 80.6 and those of Africa even lower, to 69.2 (see table XVII.2). Furthermore, Africa and Latin America had negative or zero growth rates between 1980 and 1987 and only a slight recovery in 1988-1989, while on a world-wide basis investment grew at a rate of 3 per cent between 1980 and 1987 and 4 per cent in 1988-1989. All this has meant real growth rates of less than 2 per cent per year whereas the rest of the world grew at more than 3 per cent.

675. The decline of the developing countries in world trade is one of the reasons for the severe debt situation. In order to solve this problem on a medium- or long-term basis there must be an improvement in the international trade situation of the developing nations.

676. The trade situation is characterized by an increase in protectionist measures in the industrialized countries vis-à-vis the main export goods of the developing nations. Agricultural protectionism will be dealt with later. An UNCTAD analysis 1/ (see table XII.1) shows that between 1981 and 1988 non-tariff measures applied to manufactured and semi-manufactured goods of the developing nations had a great impact both in the United States, particularly after the introduction of the steel import programme of 1984, and in EEC. Furthermore, the analysis suggests that non-tariff measures have a sizeable impact on trade flows because, on the one hand, trade in commodities affected by non-tariff measures grows at a slower pace than international trade as a whole and, on the other, such products have been channelled towards other countries. Furthermore, the percentage of anti-dumping investigations initiated by Western industrialized countries for imports coming from developing countries has gone up from 20 per cent of the total in 1980-1982 to 40 per cent in 1986-1988. The application of countervailing duties as a result of anti-dumping actions refers mainly to steel and chemical products of middle-income nations (e.g. Brazil).

677. Several bilateral agreements on voluntary export limitations were signed during the 1980s. About 90 per cent of the agreements involved EEC and the United States. While in 1981 only 0.4 per cent of imports from developing countries were subject to export limitations, the percentage had reached 2.4 per cent in 1988. In 1988 the percentage in the United States has been set at 2.6 per cent. Argentina, Brazil, Mexico, Venezuela and Yugoslavia, heavily indebted middle-income countries, were the ones most severely affected, apart from the new rapidly industrializing countries. Both the non-tariff measures and the voluntary limitation agreements have damaged international trade. Because of the interdependencies upstream and downstream, they have given rise to surplus production capacity with high costs for everyone by limiting competitive production in the developing countries, in order to protect mature industries in the advanced nations.

678. An UNCTAD analysis has examined how protectionism against developing countries products may evolve during the 1990s, if the Uruguay Round does not modify trade policies substantially. The analysis 2/ studies trade flows for different types of goods and their possible evolution, assuming that present protectionist measures will not change for the various goods in the various outlets (United States and EEC) (see table XII.2). The conclusion is that the developing countries with a relatively higher income would face a slightly lower degree of protectionism in the 1990s because their exports are being directed towards relatively less protected sectors. However, in contrast, the lower-income countries would face higher obstacles for their markets.

Table XII.1 Import coverage ratios [a/] on manufactures of all selected non-tariff measures [b/] by country groupings, applied by the group of the three major world markets [c/] 1981 and 1988.
(In percentages)

SITC	Product coverage	NTM coverage in import from: World 1981	World 1988	Developed countries 1981	Developed countries 1988	Developing countries 1981	Developing countries 1988
5-8 less (68)	All manufactures	20.0	23.7	17.2	72.2	29.0	29.4
5	Chemicals	10.9	12.6	11.8	12.5	8.6	11.1
61	Leather	11.1	11.2	11.2	11.2	10.8	10.8
65	Textile yarn and fabrics	45.2	48.4	24.3	26.8	63.0	67.1
67	Iron and steel	47.5	67.6	45.7	72.2	32.0	54.9
84	Clothing	68.8	69.7	29.5	27.9	76.0	77.4
85	Footwear	87.0	23.2	94.0	32.9	83.3	16.4
	Other manufactures	13.7	16.9	15.1	19.8	10.5	8.3

Source: UNCTAD, Trade Control Measures Information System.

a/ Ratios have been computed using 1984 import trade weights. Computations have been made at the tariff-line level and results aggregated to relevant product group levels.

b/ Includes certain para-tariff measures, import deposits and surcharges. Variable levies, anti-dumping and variable levies, anti-dumping and countervailing actions, quantitative restrictions (including prohibitions, quotas, non-automatic licensing, State monopolies, "voluntary" export restraints and restraints under the multi-fibre and similar textile arrangements), import surveillance, automatic licensing and price control measures.

c/ EEC (10), Japan and the United States.

Note: The accuracy of the NTM information has been verified by certain developed market-economy countries. The basic data are currently being verified by other countries. Accordingly the figures in the table are to be regarded as preliminary and subject to revision.

Table XII.2 Impact of hypothetical changes in protectionist responses in the United States and EEC on exports of developing countries in the 1990s
(In percentages)

	Share of 1985 imports in sectors:		Share of 1985 imports sectors which could experience in the 1990s:	
	Under protection a/	Free	Higher protection	Lower protection
	United States			
Imports from all developing countries	56	44	52	49
By income level: b/				
low-income	67	33	75	25
lower middle-income	53	47	64	36
Upper middle-income	57	43	48	52
By share of manufactures in GDP				
under 15 per cent	49	51	69	31
15 per cent and above	57	43	52	48
	European Economic Community			
Imports from all developing countries	80	20	61	39
By income level: b/				
low-income	78	22	71	29
lower middle-income	89	11	75	25
Upper middle-income	79	21	62	38
By share of manufactures in GDP				
Under 15 per cent	73	27	65	35
15 per cent and above	83	17	69	31

Source: UNCTAD, Protectionism and structural adjustment, part I, TD/B/1240, December 1989.

a/ A sector is considered under protection if in 1985 its trade coverage ratio was higher than 5 per cent and free of protection if the ratio was lower.

b/ In terms of GDP per capita (low income: under $450, lower middle-income: $450-$1,800, upper middle-income: over $1,800).

Table XII.3 Value of total exports by region, 1970-1988
(In billions of United States dollars and percentages)

	1970	1980	1985	1986	1987	1988	Share of total world exports 1970	1985	1988
World	321.1	2049.4	1921.7	2069.7	2439.8	2775.6	100.0	100.0	100.0
Developed market economy countries	216.1	1224.1	1230.3	1421.7	1684.8	1931.6	70.4	65.9	71.3
Europe	137.2	812.4	750.1	915.0	1103.2	1225.6	42.7	39.0	44.2
Japan	19.6	132.5	179.8	208.3	228.7	264.3	6.1	9.4	9.5
North America	59.8	279.2	300.4	298.4	352.9	441.7	18.6	15.6	15.9
Developing countries	59.9	591.5	462.8	403.3	491.5	557.7	18.7	24.1	20.1
Africa	12.7	98.1	61.6	46.6	46.8	46.2	4.0	3.2	1.7
Latin America	18.2	111.4	110.7	86.8	94.5	109.8	5.7	5.8	4.0
South and South East Asia	15.0	148.0	169.1	176.0	228.5	282.1	4.7	8.8	10.2
East Asia four a/	6.6	78.4	101.8	114.6	154.3	193.6	2.0	5.3	7.0
Asian four b/	4.7	47.9	48.5	42.0	52.6	63.8	1.5	2.5	2.3
West Asian oil-exporting countries c/	10.1	211.0	94.4	66.6	88.5	81.9	3.2	4.9	3.0
Other West Asia c/	3.9	23.0	27.0	27.3	33.2	37.7	1.2	1.4	1.4
Socialist countries of Eastern Europe	33.2	162.1	164.8	178.4	182.7	191.4	10.3	8.6	6.9
China	1.9	18.7	27.3	30.9	39.3	47.2	0.6	1.4	1.7

Source: UNCTAD. Protectionism and structural adjustment, op. cit.

a/ Hong Kong, Democratic People's Republic of Korea, Republic of Korea, Taiwan, province of China.

b/ Indonesia. Malaysia, Philippines, Thailand.

c/ Iran (Islamic Republic of), Iraq, Kuwait, Saudi Arabia, Bahrain, Oman, Qatar, United Arab Emirates.

d/ Includes developing countries of Europe (Cyprus, Malta, Turkey, Yugoslavia).

B. The Uruguay Round and market access of the most indebted countries

679. In 1986, after five years of preparation, the Punta del Este Ministerial Conference opened the eighth multilateral trade negotiations, under GATT, known as the "Uruguay Round". The decision to start the negotiation was taken at a time when the international multilateral system was in a critical situation, characterized by:

(a) Numerous protectionist policies giving rise to severe micro- and macro-economic imbalances as well as a gradual disappearance of the benefits derived from a multilateral trade system, in particular in the developing countries;

(b) The transformation of the international economy and, inter alia, the growing interdependence resulting from the expansion of the areas of international trade;

(c) The negative consequences of protectionism on the capacity of the indebted nations to promote trade and development and live up to their financial obligations.

The developing countries, and particularly the indebted ones, supported the Uruguay Round in the expectation that it represented an opportunity to create a fair and open multilateral trade system.

680. Several points of the Punta del Este Declaration refer to specific commitments to achieve the above-mentioned objective: (a) elimination of custom duties or at least the reduction of harsher ones and of tariff escalation; (b) reduction of non-tariff measures; (c) liberalization of trade in products manufactured with natural resources, whether processed or semiprocessed; (d) introduction of procedures for the integration of textile trade in the GATT system in such a manner as to liberalize such trade; (e) enforcement of greater discipline in world trade in agricultural products correcting and preventing limitations and distortions, imbalances and instability in international agricultural trade; and (f) complete liberalization of trade in semi-processed or processed tropical products, in terms of both tariff and non-tariff measures.

681. A few months after the conclusion of the multilateral negotiations, while much progress has been made on issues of interest to the industrialized countries with a market economy, there is still much to do to produce an agreement on matters concerning market access for developing countries.

682. Legally the Uruguay Round must be completed not later than the end of 1990 for juridical reasons even if politically there is no reason to consider this date as the end of the attempts to reach an agreement. The negotiating authority granted to the President of the United States by Congress will expire. The negotiations involve 15 specific groups. In spite of the impetus given by the interministerial meetings of Montreal (December 1988) and Geneva (April 1989), negotiations were stalling, particularly in the groups dealing mainly with matters concerning developing countries (agriculture, tropical products, textiles). It is for this reason that at the end of February 1990 the developing countries issued a statement

denouncing the imbalances in the negotiations, particularly concerning (a) market access for exports coming from low- and middle-income countries; (b) the lack of political will for integrating textiles and agricultural products in the GATT discipline; and (c) the proposal to introduce selective safeguard clauses and extensive application norms for anti-dumping measures. According to the declaration the present situation threatens the interests of the developing countries and is therefore unacceptable. The declaration concludes by stating that the Trade Negotiations Committee (the central body of the negotiations) must produce not later than July an overall and well balanced proposal. Such a proposal will be evaluated by the developing countries and, if deemed acceptable, may be finalized during the Brussels meeting in December.

683. The declaration therefore envisages the possibility that the developing countries may walk out of the final phase of the negotiations. This would imply the failure of the Round as a whole or at least the failure of the Declaration of Punta del Este (the starting point of the negotiations), which dealt with the role of trade for development. At the same time this might be an opportunity to assign a greater role for GATT reform to the developing countries.

684. Preliminary estimates, furthermore, show that if the Uruguay Round was to be successful, the industrialized nations would be the main beneficiaries, 3/ in terms of both the net growth of trade and welfare gains. This being the case it would be appropriate for part of the resources to be used to alleviate the debt situation of the poorest and most indebted nations.

685. The Uruguay Round stalled in December 1990 in Brussels because of the disagreement between EEC on one side and the United States and Latin America's largest agricultural countries, Argentina, Brazil, Colombia, Mexico, Chile and Uruguay, on the other. All six Latin American countries have adopted drastic economic liberalization policies but feel disappointed that their efforts have not been adequately recognized by the industrialized countries. EEC has offered reductions in subsidies for agricultural products and exports, which would increase world agricultural prices now depressed by these subsidies. But the Latin American countries are not convinced that these offers justify a further liberalization of their trade policies vis-à-vis exports of European countries.

686. To resume the Uruguay Round in 1992 the items on the agenda have been reduced from 15 to 5: agriculture, services, tropical goods and access to markets.

687. It now seems clear that Europe and Japan have not made enough efforts to understand the common interest of all nations in improving the terms of trade for the tropical products and basic agricultural commodities exported by developing countries of both Latin America and the other continents.

688. It is true that the balance of payments of low-income food-importing countries may then deteriorate in the short and medium term. But more often than not artificially depressed agricultural prices have damaged the agricultural supply of these countries, while aid by developed countries for the agricultural infrastructure and development of low-income countries has been insufficient, as have the demographic policies of food-importing developing countries.

C. Agricultural negotiations

689. The task of the agricultural negotiating group is to bring within the norms and standards of GATT all those measures that have an impact on market access and competition. The negotiations are still dealing with basic issues: extent of liberalization; timing and methods; and monitoring.

690. The United States proposal aims at the abolition within a 10-year period of all direct and indirect subsidies that have an impact on agricultural trade as well as the elimination of all import barriers and harmonization of all sanitary measures. Farmers' income support must not necessarily be abolished but it must not be linked to the type of agricultural crop. Furthermore, it must not distort trade, nor offer incentives to production or protect farmers from market fluctuations.

691. The EEC contends that the total elimination of subsidies is not realistic from a technical point of view and is not feasible from a political standpoint. It has suggested an alternative solution divided into two phases. Only the contents of the first phase have been sufficiently elaborated. It envisages a number of short-term measures, the most important of which are:

(a) An agreement on minimum export prices for cereals to be linked to the stabilization of imports of cereals substitutes (used as feedstock for animals) in EEC;

(b) Respect by all countries members of OECD for the minimum prices set by the International Agreement on Milk and Cheese Products;

(c) Elaboration of a sugar agreement among the OECD nations in order to keep imports at the same level as in 1984;

(d) A commitment by all OECD countries to freeze support levels to a base year, particularly in the most sensitive areas such as cereals, beef, sugar, maize and oilseeds. Reforms for the support and protection of agriculture should be negotiated at a later date with a medium- or even long-term perspective in view.

692. It has been claimed that the common agricultural policy of EEC depresses the prices of numerous agricultural products on the world market. Its elimination would make EEC a net importer of agricultural products and the developing countries would become net exporters. Its elimination, furthermore, would ensure greater stability on the agricultural world market. 4/

693. The conclusion that the liberalization of agricultural markets such as that suggested by the United States would imply some advantages for developing nations, even though causing short-term losses to some of them, has recently been questioned in a study by the International Institute of Applied System Analysis (IIASA). 5/ The main conclusion derived from the interpretation of the various scenarios is that a good many of the OECD countries would secure large economic benefits during the next 10 years as a result of a Uruguay Round agreement for the reduction of agricultural protectionism. However, the developing countries as a whole would be

damaged by additional costs. More specifically, while Kenya, Nigeria, Argentina and Thailand would benefit by the liberalization, Brazil, Mexico, Egypt, Indonesia and India would suffer substantial losses since they are, and will continue to be for several years, net importers of food products, the prices of which would increase as a result of liberalization. This group includes a number of heavily indebted countries, whose position would worsen as a result of the liberalization of agricultural trade. Preliminary simulations by UNCTAD 6/ on the market consequences for the main agricultural products come to the same conclusions. If the principal producing and consuming countries (Australia, Canada, EEC, Japan and the United States) were to modify their policies, Latin America (with the exception of Mexico) would benefit, while Africa and Asia would be net losers.

D. Tropical products and products based on natural resources

694. For the past 30 years, liberalization of trade in tropical products and market access for products based on natural resources (minerals, non-ferrous metals, fish, forest products) have been dealt with as separate sectors in the GATT multilateral trade negotiations. These are products of interest mainly to developing countries, some of which rely almost exclusively on tropical products or on products based on natural resources for their export income. Furthermore, the protectionist measures among importing nations take the form not of duties and quotas but rather of such measures as differential custom tariffs with a very high real protection on retail value, health standards and subsidies and other measures to support processing in the consuming country.

695. Ever since the 1961 GATT Action Programme, liberalization of trade in tropical products and products based on natural resources has been one of the priority measures designed to afford access to the markets of the consuming countries for the developing countries. However, neither the Kennedy Round of the 1970s nor the Tokyo Round of the 1980s was crowned with substantial success. The Punta del Este Declaration acknowledges the importance of international trade in tropical products and of products based on natural resources for a large number of developing nations and rules that negotiations for these products must have the highest priority both from a timing point of view and from the standpoint of the implementation of their results.

696. Negotiations have proceeded in two distinct groups: liberalization on a multilateral basis of trade in products based on natural resources and liberalization of trade in tropical products.

697. The group that negotiates about the products based on natural resources has reached an impasse since it is still busy defining what products are to be included in the negotiations and arguing about what the negotiating approach should be. Some industrialized nations (Australia, and the EEC member States) have submitted data (tariff and non-tariff barriers) for the main products based on natural resources and have also made proposals as to how to calculate protection levels. The developing countries did not have a uniform position until December 1989 when Bangladesh, on behalf of the poorest countries (and not on behalf of the middle-income nations) submitted a document that underlines the right of the

producing nations to defend their products based on natural resources and to secure aid and support for the growth of their exports. It appears doubtful that the Uruguay Round will yield concrete results on this issue.

698. In connection with tropical products, it has at least been possible to specify the true objectives of the negotiations and to submit concession offers by the importing nations. Such concessions consist in: the elimination of custom duties on non-processed products; the elimination or substantial reduction of duties on semi-processed goods; and the reduction of non-tariff measures that have an impact on international trade in tropical products. The specific concessions offered by the importing countries are quite modest, not only because they affect less than 3 per cent of world trade in tropical products but also because they consist almost exclusively in the reduction (50 per cent as on average) of the custom duties of non-processed goods. Since the duties on these products are already very low (an average of 11 per cent in EEC, 10 per cent in Japan and 5 per cent in the United States), the overall benefit, as far as trade creation is concerned, would be quite modest (no more than $33 million) and also, according to an estimate of UNCTAD, it would benefit mostly the industrialized countries. 7/

E. Textiles and clothing

699. A large proportion of the international trade in textiles and clothing is governed by the Multifibre Agreement adopted in 1974, in the wake of the 1961 Agreement on Cotton. The Multifibre Agreement is an anomaly with respect to GATT and its basic principles of non-discrimination and reciprocity. It is in fact a sectoral agreement with the aim of containing, by virtue of a complex system of quotas, low-cost exports from developing countries. International trade in textiles (including finished clothing products) amounts to about $100 billion a year; 45 per cent consists of trade between Western countries (20 per cent within EEC); 30 per cent consists of exports from developing countries and from Eastern Europe to Western countries and the rest concerns trade between developing countries and Eastern Europe.

700. The Multifibre Agreement covered a three-year period, but it was renewed and extended in 1977, 1981 and 1986. The present agreement expires on 31 July 1991. The Punta del Este Declaration specifically states that textile and clothing negotiations must be aimed at formulating procedures that will ensure the integration of this sector within GATT on the basis of the norms and standards of GATT with the purpose of contributing to the continued liberalization of trade. For the developing countries, the issue of the opening of markets for their textiles and clothing exports is a matter of great importance. The 1986 Multifibre Agreement, with 56 participating countries, was predicated on the assumption that it would be the last of its kind and that it would essentially be a tool to facilitate the transition and restructuring of this sector in the importing countries.

701. IMF estimates indicate that the abolition of duties and of non-tariff barriers in the OECD countries would increase the exports of the developing countries by about 82 per cent for textiles and by 93 per cent for clothing. 8/ UNCTAD estimates, on the other hand, claim that full liberalization as well as non-discrimination would permit a 78 per cent increase in textile exports from the developing countries and a 135 per cent increase for clothing. Such calculations probably overestimate the consequences of the present restrictions on trade. It would also be a mistake to conclude that the net benefit for developing nations would be directly proportional to the increase in exports resulting from trade liberalization. Some of the developing countries would lose the income they derive from the markets of industrialized countries thanks to the present quota system. In any case there would be an increase in exports, encouragement of investment and, what is more important, a stimulus to adopt economic policies directed towards the opening up of economies and the promotion of exports.

702. The industrialized nations would also benefit from the abolition of the Multifibre Agreement restrictions. A United Kingdom study group 9/ estimated that the Multifibre Agreement causes an increase in retail prices of between 5 per cent and 10 per cent; liberalization, however, would mean a loss of about 10,000 to 50,000 jobs in the United Kingdom, out of a total 500,000 jobs in the textile sector. An analysis worked out by the Institute of International Economics in Washington indicates that in the United States the annual cost for a protected job is between two and eight times the average wage of the sector. Liberalization, furthermore, would slightly reduce the exchange rate in importing countries, thereby offsetting its deflationary impact and boosting employment and production in other sectors. 10/

703. Whatever results may be expected from the integration of textiles and clothing in GATT and trade liberalization, the real negotiations are still at the early stages. At the December 1988 Montreal interministerial meeting it was not possible even to reach agreement on the approach to be followed during the negotiations. In the following informal meeting in April 1989 an effort was made to start negotiations, but with little success. It was decided, to make things easier, to put emphasis on the time schedules and procedures for the transition phase.

704. In July 1989 EEC submitted proposals based essentially on a draft agreement in order gradually to integrate textiles and clothing in GATT and at the same time to strengthen the safeguard clauses. The United States submitted a trade liberalization programme covering a 10-year period through the implementation of global quotas, which would replace existing bilateral ones. India, for its part, on behalf also of other developing countries, referred to the need to start the integration process on 1 August 1991, immediately after the expiry of the present Multifibre Agreement. In order to facilitate the transition, some of the restrictions would remain in force for a period lasting no more than five years, i.e. until 13 July 1996.

705. It is important to point out that a majority of the developing countries consider that the Multifibre Agreement constitutes a waiver to GATT, which is damaging to them and which they accept only as a temporary concession. As a consequence, it should be abolished without any conditions concerning the

transition period, etc. or related to other parts of the negotiations on liberalization of trade in services, of intellectual property and trade-related investments.

F. Reform of GATT

706. The Punta del Este Declaration specifies that participants in the Uruguay Round will re-examine the articles, the standards and the procedures of GATT and will renegotiate them as appropriate. One of the negotiation groups in the Round is directly concerned with the functioning of GATT.

707. This reform seems to be even more urgent. The failure of the Uruguay Round might stimulate pressure for its inception. It will raise questions as to the GATT method of ambitious negotiations of long duration, during which everyone tries to negotiate all the main items in international trade. In many instances (for example, textiles and clothing) it will be necessary to continue to negotiate after the completion of the Round. In other situations (for example, services, intellectual property, trade-related investment), even in the most optimistic cases, the Round will produce only draft agreements whose specific contents will have to be added later.

708. The international trade scenario, furthermore, has changed dramatically since immediately after the Second World War when the GATT agreement was negotiated as a provisional agreement pending the establishment (which never materialized) of the International Trade Organization (ITO), which should have been, along with the World Bank and IMF, the third pillar in the restructuring of world economy. At that time the major portion of trade consisted of trade in manufactured and semi-processed goods between Western countries. Quotas and duties were the principal restriction on trade. The efforts that started in the 1960s to adapt GATT to the needs of the developing countries have yielded very modest results.

709. It will be even more difficult to harmonize GATT with the commercial procedures of the Eastern European countries. Here the situation is even more complex because trade is mainly restricted not by visible and transparent quotas and duties but by complex mechanisms of non-tariff barriers, bilateral agreements for the voluntary restriction of trade, administrative measures and several forms of "administered trade".

710. For the developing countries to have a voice in defining the new procedures is even more important than the elaboration of a specific negotiation package at the end of the Round.

711. Recently a new proposal has been prepared by Renato Ruggiero, Minister of Foreign Trade of Italy: the idea is to revive the ITO option, obviously adjusting it to the present requirements of international trade.

712. The suggestions of John Jackson 11/ are more specific: GATT must not lose sight of its universal mission but it must also keep in mind the numerous differences in the international trade market. The solution might be the creation

of an overall institution with a few general rules that are universal, clear and transparent; other elements, not necessarily universal and adjusted to specific requirements (trade with developing countries, agriculture, services, East-West trade) would, however, co-exist within this framework. In this sort of scenario, the settlement of controversies would certainly be included in the universal regulations.

G. New regional common markets

713. The results of the Uruguay Round at present seem highly uncertain. Too many stalemates have occurred. However it should be recognized that some of the difficulties being encountered with agriculture, labour-intensive low-quality manufactures and technological services mirror simplistic views of generalized pure laissez-faire. Agricultural markets, in one way or another, need to be regulated at least to an extent. Even if the EEC Common Agricultural Policy deserves criticism, it must be admitted that, with it productivity has markedly increased. Intervention may be now reduced, because it has borne fruit. A similar reasoning must be applied to the United States agricultural policy. It is generally maintained that, for the agricultural developing countries' commodities, stabilization funds are needed and more effective assistance is needed to promote productivity and diversification.

714. Research by IIASA would indicate that a generalized adoption of the United States proposals on reducing the European and Japanese subsidized supply and other subsidized production would lead to world price increases for basic agricultural commodities. This, while improving the trade balance of several highly indebted developing countries, would worsen rather than improve the situation of most agricultural developing countries because they are net importers of food. On the other hand, indiscriminate liberalization of labour-intensive manufactures, without controls relating to ecological safeguards and without principles of non-exploitation of cheap labour in the developing countries, could be dangerous and degrading. Liberalization of high-technology services is desirable and possible provided, however, that rules to control monopoly powers are applied to the weak markets of developing countries. The conclusion must be that in any event one should aim at the development of regional common markets areas, tailored to local requirements and peculiarities, with appropriate procedures, rather than to aim at indeterminate global free trade.

715. The recent United States-Mexico project to establish a free trade area announced by President Bush appears to be promising, because it could be extended to other Latin American and Caribbean countries and to Canada. This is preferable to complete reliance on the Uruguay Round. Similar projects should be instituted in other areas of the world. The time for grand regional policies has come. The issue of the debt burden of Latin America, Africa, Asia would be much easier to solve if, together with the new money, new common markets were to emerge on each of these continents, combining the industrialized and the developing countries of the same region where appropriate.

716. The major objection to the concept of regional common markets is that they might lead to a new form of economic and political colonialism. The danger of neo-colonialism is undoubtedly there in the developing areas that need the external assistance and investments of large industrialized countries of Europe, North America and Asia, and a flow of financial resources provided by international and multinational companies. However, the only alternative is that such a risk can not be obviated by mere economic isolationism, nationalism, militarism or religious fundamentalism, with the concomitant poverty, underdevelopment, lack of democracy, constant danger of human rights violations and lack of cultural progress. The main example of such economic isolationism was anti-imperialistic Marxist collectivism, in its different varieties found in Africa, Asia and Latin America, which led to an enormous rise in the debt of the countries that embraced it, owing to military spending and to the inevitable decline in the volume of economic activity, resulting from an autarchic, bureaucratic, authoritarian, arbitrary and essentially unequal and economically discouraging approach.

717. However, this is not the only manifestation of extreme nationalism and isolationism. The populist approach, based on high military spending, widespread nationalization and budget deficits, marked by demagogy and leading inevitably to runaway inflation, should also be taken into account.

718. Compared with such models, regional policies represent a radical change of course. They are conducive to less conflicting relations between developed and developing countries of the same area and also to co-operation between developing countries themselves, in the framework of large trading areas, sometimes through simple co-operation agreements and other times by means of federations or confederations. There are cases in which the existence of a large region, created by expanding the scope of transnational co-operation thanks to a federated approach, helps to eliminate various problems of ethnic, religious and linguistic diversity. A Middle East regional policy is of general interest to every nation in the industrialized as well as the developing world.

719. Various forms of regional arrangements depend on the different geographical conditions. The regional settings of the Horn of Africa, southern Africa or the western Sahel can affect European countries that have long-standing historical, cultural, economic and religious ties with those regions, but it cannot lead to their participation because of the distance between them. The case of regional arrangements such as EEC and Eastern Europe, Mediterranean countries in EEC and the North African countries of the Mediterranean basin, countries in North America and Latin America and the industrialized countries, and highly indebted countries and developing countries in South-East Asia, is different.

720. Unlike the patterns of pure free trade, the transfer of technology and international finance, regional arrangements imply the establishment of institutions for the development of forms of co-operation among the various interested countries and institutions in the region, hence deterring manifestations of neo-colonialism. They also provide an answer to regional problems that can be solved only on a regional level such as environmental issues that are of concern to a whole continent or to a large specific area (e.g., the Sahel) or issues related to migration, such as facilities at the points of departure and destination, the

civil, political and economic rights of migrants and members of their families in the countries of origin and of destination, their education and professional training and social welfare schemes.

721. Even on the serious problem of illicit drug abuse and trafficking, tangible results can be achieved only through regional co-operation between the countries in which narcotic substances are produced or processed (by providing farm labourers and underemployed workers with a viable alternative), at the same time as fostering close co-operation between law enforcement forces operating against drug trafficking in producing and consuming countries.

722. Some environmental problems have a global dimension. For example, the destruction of tropical and equatorial forests, which emit carbon dioxide into the atmosphere, plays a major role in the creation of the greenhouse effect. The protection of the natural heritage is vital for the whole world. Nevertheless, it can hardly be denied that such problems also have a regional and not just a global dimension and this can be tackled without interfering with the legitimate needs of national autonomy only against a background of large regional policies and arrangements. The regional implications are complex. In effect, certain ethnic groups are undoubtedly entitled to survival as well as to autonomy and to the protection of their territory. On the other hand, there are millions of poor people in Brazil, southern Venezuela and other countries that contain portions of the Amazonian forest who are equally entitled to find adequate means for their own survival. Besides, it is in the interest of neighbouring industrialized countries to stop the systematic annihilation of immense forests (as is currently occurring) at the cost of enormous, far-reaching climatic disruptions.

723. But the maintenance of such equilibrium requires a consistent policy, based on positive projects and not on mere negative protectionist measures that turn out to be unjust to millions of poor people, apart from being in themselves weak and unsustainable. Positive planning can reconcile environmental safeguards with social and economic interests by providing more advantageous solutions from all points of view.

724. Scientific and technological research must frequently be at the basis of regional co-operation, pooling the efforts of universities and research centres in industrialized countries, with the human capital and territorial resources of the developing countries in the region. This is the road to follow for an appropriate solution to the energy problem, which certainly cannot be solved by burning more timber and which apparently cannot be adequately solved by building large dams in the place of forests. It is also a problem that ought not to be settled by simply resorting to the use in new nuclear power stations of radioactive substances now available thanks to disarmament.

725. The essence of regional strategies is to face globally (hence including Eastern Europe) the major problems of energy and protection of the environment from the various forms of pollution, which require considerable financial resources as well as forms of scientific and technological co-operation. Regional development banks can play a major role in this respect, while a solution to those problems would be otherwise almost impossible to find.

726. Thanks to regional institutional arrangements, two other problems can be solved, and they are very important in the debt context: capital repatriation and direct investment. This can be achieved by creating an environment of economic certainty through the definition of property rights and the establishment of appropriate monetary regulations; by developing forms of co-operation in tax matters, not only to prevent tax evasion but also to avoid double or excessive taxation; by establishing rules to prevent abuses of monopoly power and by elaborating rules that, while protecting free trade, provide means for the stabilization of markets, the standardization of products and other purposes, as the EEC does.

727. It is now being argued that EEC regulation of the markets for its basic agricultural produce is not the expression of free trade and that the setting up of regional common markets with stabilization mechanisms may lead to further barriers to world trade. Such an argument can easily be refuted by making it very clear that regional institutions and co-ordination mechanisms should not create new external tariff and non-tariff barriers and should lead to the gradual reduction of external restrictions while producing gradual reductions internally. The commitments brought about by the Uruguay Round and the GATT reform, which now appear indispensable, should provide guidelines for the regional common market areas aimed at promoting and not at hampering forms of co-operation on a world and multinational scale and at facilitating common agreements and actions that, via negotiations between individual countries, appear much more difficult and less stable.

728. In addition to such a horizontal policy, the vertical approach certainly remains fundamental, such as forms of co-operation between industrialized countries - led by the Group of Seven - and between developing countries, especially under the auspices of the United Nations and its institutions.

Notes

1/ See UNCTAD, Trade and Development Report 1989, Geneva, 1990.

2/ UNCTAD, Protectionism and structural adjustment, Geneva, 1990.

3/ See UNCTAD, The Uruguay Round, selected papers, Geneva, 1989; and Finger M.J. and Olechowski A. (ed.) The Uruguay Round: a handbook on the multilateral trade negotiations, World Bank, Washington, D.C., 1987.

4/ GATT, Synoptic table of all negotiations proposals submitted pursuant to para. 11 of the review agreement, Review agreement of agriculture, Geneva, 1990.

5/ IIASA, Towards free trade in agriculture, Laxenburg, Austria, 1989.

6/ UNCTAD, The effects of policy changes by major agricultural trading nations on markets for selected agricultural products and the implications for developing countries, Geneva, 1990.

Notes (continued)

7/ UNCTAD, Protectionism and structural adjustment, op. cit.

8/ Kirmani M., Molajani P. and Mayar T. Effects of the increased market access on exports of developing countries, in IMF Papers, December 1984.

9/ Silberston A. The MFA and the UK economy, Her Majesty's Stationery Office, 1984.

10/ Institute of International Economics, Trade protection in the United States, 31 case studies, Washington, D.C., 1986.

11/ See Jackson J., Restructuring the GATT system, Royal Institute of International Affairs, London, 1990.

XIII. ADJUSTMENT POLICIES OF INDEBTED COUNTRIES

729. Adjustment loans have come to represent an essential component of the activity of international organizations like IMF and the World Bank. Gross disbursements by the two institutions from 1980 to 1987 reached $26 billion and $16 billion respectively. More crucially, adjustment loans have increasingly been seen as the catalyst for further official and commercial lending and for the introduction of far-reaching reforms in the economic structure of debtor countries. Adjustment programmes sponsored by IMF and the World Bank have, however, been faulted on many grounds, because of their alleged deflationary bias, their disregard for income distribution and poverty considerations and sometimes their inappropriate design. 1/ Most of these criticisms have not gone unnoticed within both IMF and the World Bank. 2/ However, it was only with the advent of adjustment loans in the 1980s that these agencies made an explicit effort to combine short-run stabilization goals with growth-oriented policies. The effectiveness of the growth-oriented adjustment programmes is, however, still open to question. The purpose of this chapter is to provide a preliminary evaluation of adjustment loans based on existing empirical evidence.

730. Adjustment programmes aim at reducing and even eliminating major macro-economic imbalances, often imputed to excessive aggregate demand and burgeoning public deficits, and at restoring conditions for sustained non-inflationary growth. The plurality of objectives addressed by adjustment programmes, together with the attempt to adapt the structure of conditionality to the peculiarities of the countries concerned and to the prevailing international environment, make it difficult to identify a general approach to the design of such programmes. Still, some general features common to most adjustment programmes can usefully be identified, together with some noteworthy changes that have occurred in their basic design. 3/

731. Early adjustment programmes, mostly supported by IMF, used to have an inherent short-run focus. Their broad objectives appear to be the attainment of a viable balance of payments and, if possible, of low inflation. Little consideration is given to the objective of maintaining growth. The emphasis on short-run considerations is well reflected in the short time-span (less than one year) of such programmes. Financial programming represents a basic component of this approach and is based on the assumption of a stable money demand function, whereas price behaviour is assumed to depend mainly on the evolution of the exchange rate. An increase in the supply of money (fuelled, say, by budgetary expansion) will then lead to an equivalent loss of foreign exchange reserves, on impact if capital is internationally mobile or in the medium term if international capital flows are restricted. This approach emphasizes the link between monetary and fiscal policies, which certainly needs to be kept in the forefront, but it fails to consider the implications of such policies for output.

732. A recurrent critique of early adjustment programmes is their excessive emphasis on demand-restraining measures with insufficient consideration of their effects on output. 4/ The new generation of adjustment programmes tries to redress this imbalance. As a matter of fact, the second oil shock and subsequently the debt crisis have made it clear that adjustment in developing countries cannot be approached from a short-term perspective. The so-called growth-oriented adjustment programmes aim at combining demand management policies with supply-enhancing

measures with the stated objective of fostering growth. A crucial role is played in this context by a host of micro-economic reforms with a view to increasing economic efficiency, in particular facilitating the transfer of resources from the non-traded goods to the traded goods sector. Where a situation of excess demand for traded goods (i.e. a trade deficit) and of excess supply of non-traded goods (i.e. resource unemployment) prevails, external equilibrium may be achieved by expenditure-reducing policies, but the latter could be extremely costly in terms of output and employment forgone.

733. Alternatively the country may rely on expenditure-switching and supply-enhancing measures. As a matter of fact a real depreciation may induce an increase in both the export of traded goods (by providing producers in the sector with more favourable price incentives) and the domestic demand for non-traded goods (by shifting domestic demand away from traded towards non-tradable commodities). Supply and demand measures in this framework complement and reinforce each other.

734. The price responsiveness of both demand and supply however play a crucial role in determining the effectiveness of supply-enhancing measures. For instance, a country will have to rely on costly demand retrenchment measures to contain its external deficit, if a real depreciation fails to elicit a significant decline in the excess demand for tradables. Yet, as pointed out by a number of critics, 5/ in several developing countries, the current belief is that there is a relatively low responsiveness to price of economic aggregates, either because of structural and institutional constraints (as in most African countries) or because of policy-induced rigidities (as in many Latin American countries). The traditional argument about low elasticities has been buttressed by the contention that devaluation may be contradictory both from the demand side (by redistributing income from low savers to high savers) and the supply side (by increasing the real cost of both imported and labour inputs and/or by reducing the real volume of available credit). Under these circumstances, adjustment programmes may fail to elicit a positive supply response and will have to rely mostly on recessionary policies.

735. At the beginning of the 1980s the developing countries were hit by a combination of higher interest rates (which increased the burden of the foreign debt accumulated mostly in the previous decade) and falling terms of trade (induced to a large extent by the recession in the industrialized countries). According to existing estimates, external shocks accounted on average for a loss of approximately 5 per cent of GDP in developing countries. The problem of adjusting to the new international environment was compounded by the sudden foreclosing, following Mexico's announcement in the summer of 1982 that it was no longer able to meet its foreign debt obligations, of further commercial lending. Net private capital flows to developing countries fell from a peak of $53 billion in 1981 to $30 billion in 1983, to become negative in 1987. The picture looks even bleaker for the heavily indebted countries of Latin America and the Caribbean. It also becomes manifest how developing countries have had to effect a significant transfer of resources to developed countries and to commercial banks in particular. The problem was aggravated by the fact that the need for the resource transfer coincided with a marked decline in the purchasing power of developing countries' exports.

736. Developing countries may carry out the required transfer of resources either by expanding aggregate supply or by contracting domestic absorption. It is now recognized that the pattern of adjustment differed significantly across countries. In some countries, mostly in East Asia, adjustment was carried out by increasing exports and supply, with no significant slowdown in growth. In the majority of developing countries, particularly in Africa and Latin America, the brunt of adjustment fell on absorption, in particular on investment, with little increase in supply. Table XIII.1 highlights how adjustment in these countries was achieved by import compression rather than by export expansion and reveals the contrast with the experience of Asian countries where both import and exports increased at sustained rates. In terms of the framework outlined above, it appears that only Asian countries were able to rely effectively on supply-enhancing and expenditure-switching policies, whereas other countries were forced to emphasize expenditure-reducing policies.

Table XIII.1 Pattern of adjustment in developing countries

	1973-1980	1980-1987	1988
GDP per-capita a/			
Africa	0.4	-2.6	-0.4
Latin America	2.8	-0.6	-0.9
Latin America excl. Brazil	2.0	-1.5	-0.9
Asia	4.0	5.5	7.0
Newly industrializing countries b/	7.1	6.3	6.9
Exports a/			
Africa	0.2	-1.6	3.6
Latin America	0.8	2.9	6.8
Latin America excl. Brazil	-0.4	2.1	4.7
Asia	9.0	9.2	14.6
Newly industrializing countries b/	13.2	11.4	19.9
Imports a/			
Africa	7.5	-6.8	3.2
Latin America	3.4	-5.6	8.3
Latin America excl. Brazil	4.9	-6.0	7.8
Asia	8.3	6.0	13.4
Newly industrializing countries b/	9.5	7.5	17.6

Source: Lynn and McCarthy, Recent Economic Performances of Developing Countries, World Bank Working Papers, Washington, 1989.

a/ Average yearly growth rate.

b/ Newly industrializing countries in Asia.

737. Institutional and structural constraints were paramount in determining the pattern of adjustment in African countries. As far as Latin America countries are concerned, however, it has been argued that their inability to adopt a less costly mode of adjustment must be attributed to the rigidities in their economic structure, which, in turn, can be attributed to misguided past trade and industrial policies. Several decades of import substitution policies have added to the inflexibility of their economic structure by discouraging export growth and export diversification and by increasing the rigidity of import requirements, which often consist mainly of intermediate and investment goods. Under these circumstances expenditure-switching policies can hardly work in the short term. Similarly expenditure-reducing policies happen to be very costly in terms of output and employment forgone because of the artificially low propensity to spend on tradable commodities. The theoretical underpinnings of the Baker Plan and of World Bank-sponsored adjustment programmes derive from the recognition that only a significant transformation in the economic structure of semi-industrialized countries can alleviate the cost of the required resource transfer and establish the basis for sustained growth. However one must also consider the severe constraints on trade expansion resulting from protectionist policies of developed countries.

738. An empirical evaluation of adjustment loans is fraught with difficulties. First, it is necessary to recognize that a given country's performance will be influenced to a sizeable extent by trends in the international environment. Next, any assessment should take into account what policies would have been in the absence of the IMF-World Bank programme. Finally, it is essential to bear the initial situation in mind; failure to do so may irreparably bias the assessment of the programmes' effectiveness. If, for instance, a country suffers in the initial period from a negative temporary supply shock that leads to a deterioration in the external balance and also makes it more likely that it will rely on IMF-World Bank lending, an outside observer may falsely attribute the subsequent improvement, when the negative shock reverses itself, to the operation of the adjustment programme. More generally, there will tend to be an overoptimistic assessment of the effectiveness of adjustment programmes whenever initial disequilibria are likely to be subsequently reversed either by autonomous policies or by offsetting shocks. Empirical evaluations of adjustment programmes that take into account both the initial situation and changes in the international economic environment are relatively recent. The following relies on the works by Khan, the World Bank and Faini et al. 6/

739. Khan's study focuses exclusively on IMF programmes. It provides empirical evidence as to the effect of such programmes on the balance of payments, the current account balance, inflation and growth. It relies on a large sample of 67 countries over the period 1973-1986, both with and without adjustment programmes. The study concluded that the IMF programmes appear to have exerted a positive and significant impact on the current account and, to a lesser extent, on the balance of payments and on inflation. However, income growth in adjustment programme countries, even after taking into account the initial situation and the international environment, was significantly lower than in non-programme countries. In addition, it was found that the adverse impact on output declined and the positive effect on the other indicators improved under the programmes of

over one year's duration that were implemented during the 1980s. To sum up, the evidence suggests that IMF programmes lead to an improvement in the external balance and in the inflation record, but also exert a significantly deflationary impact. Programmes implemented in the 1980s have a less marked deflationary effect.

740. A recent assessment by the World Bank of the effectiveness of adjustment lending evaluates only World Bank-supported programmes. This effectively limits the scope of the analysis to the 1980s. The study focuses on a new set of indicators, i.e. savings, investment and exports, all measured as a proportion of GDP, in addition to the growth rate. The different choice of indicators reflects somewhat the different mandates of the World Bank and IMF. By comparing performance between the 1970-1980 and the 1985-1988 periods, the report comes to the following conclusions: (a) there is evidence of a significant negative impact of adjustment lending on investment; (b) growth in programme countries does not differ significantly from growth in non-programme countries; and (c) savings and exports, as a percentage of GDP, respond positively, albeit not strongly, to the implementation of an adjustment programme. These results can be usefully compared with the earlier analysis in Faini, de Melo, Stanton and Senhadji-Sem-lali, which first pointed out the negative association between adjustment lending and investment. They also found that growth was not significantly affected by such programmes, which also appeared to exert a favourable impact on the current account.

741. Overall empirical evidence strongly suggests that adjustment programmes have been fairly effective in eliciting an improvement in the current account and facilitating the external transfer of resources. The relatively weak effect on exports indicates, however, that the export response was moderate and most of the adjustment was achieved through import compression. As far as the impact on growth is concerned, the evidence is mixed. The contention that early IMF stabilization programmes suffered from a deflationary bias finds considerable support from the Khan study. 1/ The adverse growth effect appears to be less pronounced in programmes implemented more recently and/or programmes supported by the World Bank. The fact remains, however, that, contrary to initial hopes, the so-called growth-oriented programmes have not always favoured a resumption of growth in developing countries. Furthermore the fall in investment rates associated with adjustment lending casts a shadow on the sustainability of the adjustment effort.

742. Whereas adjustment programmes have unquestionably provided an important contribution in helping developing countries to achieve a significant improvement in their external balance, there are reasons to doubt that adjustment in its present form can be sustained for a prolonged period of time. The reason is simple. After a decade of adjustment efforts, there are no signs of sustainable recovery. On the contrary, many countries exhibit the symptoms of adjustment fatigue, which may undermine their determination to carry out further reforms and pursue prudent macro-economic policies. Concern about the lack of sustainability in the adjustment process takes many facets, but three areas can be singled out where such concern is paramount: (a) the behaviour of investment; (b) the evolution of poverty and income-distribution indicators; and (c) the public finance situation.

743. Table XIII.2 provides some information about the pattern of investment over time. Investment fell earlier and farther for the heavily indebted countries. Part of the fall in the propensity to invest must be attributed, as was mentioned earlier, to adjustment programmes themselves. It is possible to argue that the decline in investment reflects the increase in the cost of capital, resulting from higher international interest rates, real depreciation and internal reforms. According to one interpretation the higher cost of capital has removed previous distortions in factor prices, which used to favour capital-intensive production, thereby leading to an improvement in efficiency in the use of capital resources. 8/ The supporting empirical evidence comes from the significant reduction achieved in the incremental capital-output ratio (ICOR) in the majority of developing countries (see table XIII.2) and the fact that adjustment programmes appear to affect investment but not growth. Accordingly, it is argued, the same growth rate can now be achieved with a smaller investment effort. The fall in investment should be seen, in this context, as part of an adjustment process to a different constellation of factor prices. Unfortunately this interpretation does not stand up under closer analysis. First, it overlooks the fact that the drop in ICOR may be attributable to a higher utilization of existing capacity and/or to the fall in infrastructural public investments brought about by financial stringency. In both cases the improvement in ICOR may not be sustainable. More crucially, however, econometric evidence indicates that only a small part of the decline in private investment (34 per cent and 24 per cent for manufacturing and primary exporting countries respectively) can be attributed to the increase in the cost of capital. 9/ The remaining portion represents a pure growth loss which reaches an annual average rate of 2 per cent for exporters of primary goods and 1 per cent for exporters of manufactures. Leading explanations for the fall in investment (at least for the portion not accounted for by the increase in the cost of capital) focus on the debt overhang and macro-economic disruption brought about by the debt crisis. It is pointed out that a highly indebted country will refrain from investing in so far as a sizeable proportion of the future benefits of investment will be appropriated by its creditors. 10/ Perhaps one could broaden this argument, considering the impressive capital outflows from heavily indebted countries. Under the second interpretation, investors are discouraged from investing because of the great uncertainty surrounding the prospects of the economy. If capital cannot be disinvested once installed, companies would rather wait for the uncertainty to be dispelled and will not be willing to commit immediately new fixed resources to production. The policies of the countries pressed by the debt burden doubtless have often changed and, as noted, adjustment policies have had a different deflationary bias. A vicious circle ensues, when low investment leads to a further deterioration in the economic situation. Debt relief will improve the investors' outlook and may therefore even benefit the creditors. Support for this interpretation is scant, but a recent study of 20 developing countries suggests that, after taking into account the cost of capital and short-term output expectations, investment decisions appear to be negatively affected by a large debt burden, as measured by the debt-export ratio, in particular after 1982. 11/ This study, therefore, provides ample evidence for the contention that a large debt burden significantly retards growth.

Table XIII.2 Efficiency of investment and cost of investment, 1970-1988
(Unweighted period averages)

Period	Private investment a/	Public investment a/	Total investment a/	Ind. deflator (q) GDP deflator (p)	Private ICOR b/	Total ICOR b/	Cost of capital index c/
				Manufacturing exporters			
1970-1974	12.8	6.2	19.0	1.00	1.08	1.64	54
1975-1982	14.7	7.9	22.6	1.01	2.14	2.41	100
1983-1988	12.3	8.5	18.8	1.03	1.88	2.67	233
				Primary exporters			
1970-1974	14.6	5.6	20.2	.98	1.29	1.80	38
1975-1982	14.7	7.3	22.0	1.05	1.51	2.32	100
1983-1988	10.9	8.0	17.0	1.07	1.50	2.31	158

Source: Faini and de Melo, op. cit.

Note: δ = Depreciation rate ($\delta = 0.07$).
I = real private investment.
q(p) = investment (GDP) deflator.
GDP =real GDP.
i = nominal interest rate.

a/ Ratios to GDP expressed in real terms.

b/ $IC(t) = \dfrac{I * p(t)}{(GDP(t) - (1-\delta)) * GDP(t-1)}$

c/ $r = (i + \delta - q)\ (q/p)$.

744. Concern about the impact of adjustment on income distribution was forcefully raised in a UNICEF report. 12/ Evidence on the issue is meagre, particularly because of strong data limitations, which in turn reflect a surprising disregard for the issue. A priori, the impact of adjustment on the poor does not need to be unfavourable. To a large extent such an impact will depend on the economic location of the poor, their consumption pattern and, crucially, government policy. For instance, adjustment generally results in an increase in the relative price of traded goods, i.e. in real depreciation. If, as in Chile, the poor are concentrated in the tertiary urban sector, they are most likely to suffer from the change in relative prices. In Ghana, where most poor are located in the rural sector instead, the price realignment attendant on adjustment that favoured agricultural commodities had a positive effect on the pattern of income distribution. But being employed in the right sector is not enough for the poor to gain from adjustment. In Kenya, for instance, lack of infrastructure and a fairly concentrated pattern of land holdings have prevented the poor from benefiting from the relative price change.

745. Other aspects of the adjustment process are also worth mentioning. The economic contraction associated with a stabilization process will reduce employment and increase poverty. On the other hand, the reduction in inflation may benefit the poor, in so far as they are less able to escape from the inflation tax burden and to protect their assets from the ravages of inflation. Fiscal contraction can also cut both ways. Reductions in food subsidies and in education and health spending will generally affect the poor adversely, but a significant share of this expenditure benefits less deserving groups. A redirection of public spending towards, say, targeted subsidies, primary education and preventive health spending may be compatible with both an austere fiscal stance and a net benefit for the poor. Severe cuts in public investment should be avoided, whenever possible, in so far as they deprive the economy of badly needed social and productive infrastructure and such investments, consisting of public works, are highly labour-intensive.

746. A recent World Bank report compares the behaviour of a number of social indicators across countries depending on whether or not they have implemented a Bank-supported adjustment programme. 13/ The evidence is mixed. There is no sign that poverty has increased in adjustment countries. Similarly there is no evidence of adjustment lending having a systematic effect in reducing food consumption. Infant and child mortality have declined in most countries, irrespective of whether they undertook an adjustment programme or not. However, primary enrolment ratios have registered a marked decline in programme countries, suggesting little success in redirecting the flow of public expenditure. More crucially, concern for income distribution and poverty issues still plays a marginal role in the design of adjustment programmes. As a matter of fact, the share of adjustment loans with at least one social policy reform is still extremely low (34 per cent in 1989), despite a rapid increase from previous years. Similarly, conditions relating to social policy reform represented only 7 per cent of all conditions in adjustment lending in 1989. Yet the dividends from greater attention to these issues seem large. Existing evidence indicates that, whenever compensatory programmes have been undertaken (in the form of food-for-work programmes, temporary employment opportunities, severance payments for terminated public workers, targeted food

stamp programmes), the adverse impact of adjustment on the poor has been greatly reduced and even reversed. 14/

747. It has been repeatedly mentioned how adjustment programmes have been successful in eliciting an improvement in the current account of the balance of payment and in facilitating the external transfer of resources. A complicating factor stems from the fact that most of the burden of debt servicing has fallen on the public sector. While reasons for this state of affairs vary from country to country (ranging from Brazil, where the public sector went into debt to finance an ambitious programme of public investment, to Argentina, where the accumulation of foreign debt stemmed from an attempt to defend an overvalued exchange rate, and to Chile, where the public sector was forced to renege on its statements and reduce a financially embattled private sector), its implications are substantially similar, i.e. in addition to transferring abroad a significant portion of domestic resources, the need has arisen to carry out an internal transfer from the private sector to the Government to allow the latter to respect its debt obligations. This has happened at a time when deteriorating terms of trade and increasing interest rates (together sometimes with previous overexpansionary fiscal policies) jeopardized budgetary equilibria and foreign borrowing was essentially denied to the public sector.

748. A developing country's options for dealing with a deteriorating budgetary situation are usually fairly limited. The first obvious strategy would be to raise taxation. There are several reasons why such an option is difficult for most developing countries. First and foremost, the tax system is extremely backward in such countries. Many forms of income escape direct taxation and most government revenue comes from the taxation of trade flows. Yet falling terms of trade and the need to restrict imports meant that these traditional souces of revenue have been contracting rapidly. Second, increased taxation has been politically unpalatable, both because of the scant support for a tax increase just to service foreign debt and because the social groups that would have been called upon to contribute higher taxes were not necessarily the same as the ones who benefited from the accumulation of foreign debt. Expenditure cuts represent a possible alternative to taxation, yet the rigidity of current expenditures has meant that the brunt of adjustment in this respect has fallen on public investment. The remaining deficit has had to be financed in some way. As mentioned earlier, foreign borrowing has been precluded. Similarly, domestic borrowing did not constitute a valid option, essentially because of the danger that any attempt substantially to tap thin domestic financial markets would have sparked off an explosive debt increase. Under these circumstances money financing emerged as the residual option, with obvious severe effects on inflation. For several countries, in fact, the actual level of inflation is significantly higher than the (inflation-tax) revenue-maximizing level.

749. None the less, developing countries made a significant attempt at fiscal adjustment. Primary deficits have been cut substantially. Yet the increase in both doemstic and foreign interest rates have implied that the overall budget deficit has in many instances deteriorated. Furthermore most of the cuts in government expenditure have fallen on public investment, a pattern that is not likely to be sustainable in the medium term. An internal World Bank assessment of adjustment lending indicates that in conditions of deteriorating public services

cuts in public investment can be a major cause of unsustainability. The need to finance such a deficit by highly distortionary means increases the uncertainty about the prospects of the economy and discourages investment; yet a sustained volume of investment is a prerequisite for the success of the adjustment process.

750. In short, adjustment to external shocks and to a new international economic environment has generally proved to be extremely costly for most developing countries. Adjustment programmes supported by the World Bank and IMF have pursued the objective of minimizing such costs by providing new finance, at a time when commercial borrowing had essentially dried up, and by supporting far-reaching economic reforms, with a view to enhancing the efficiency in resource use and thereby establishing the conditions for the resumption of sustained growth. The theoretical and operational underpinnings of adjustment lending have changed significantly in recent years. It is now well recognized that adjustment problems in developing countries be effectively addressed only in the long run. Yet the empirical record of the adjustment process is far from satisfactory. Adjustment in its present form is often not sustainable. There are still no tangible signs of sustained economic recovery in several developing countries. Falling investment rates cast a shadow over future growth possibilities and undermine the process of resource allocation, a cornerstone of adjustment programmes. The deteriorating public finance situation compounds the uncertainty about future macro-economic development and further discourages investment. Finally, worsening income distribution and poverty undercut essential social support for the adjustment process. Adjustment programmes can none the less provide a significant contribution to the economic recovery of developing countries. They need, however, to be amended in a number of crucial areas and to be enhanced through more significant permanent financial inflows at concessional terms.

751. Growth-oriented adjustment programmes cannot succeed unless and until investment recovers from its present low rates. By providing selective debt relief together with incentives for new money, it will be possible to raise investment to levels compatible with the resumption of growth and to favour the process of resource reallocation in the domestic economy. Debt relief may also have a positive impact on the public sector accounts. It would then improve the country's macro-economic outlook and indirectly encourage investment.

752. Existing evidence strongly suggests that investment and export growth are negatively affected by instability in the macro-economic environment. Debt relief should therefore be accompanied by enhanced conditionality to prevent the resumption of unsustainable macro-economic policies that would bring short-term benefits but at the cost of further long-term disruption.

753. The achievement of macro-economic stability should play a paramount role in the design of adjustment programmes. Reforms aimed at enhancing the process of liberalization should be postponed if, as in the case of tariff reductions and financial liberalization, they lead to a marked deterioration in the public budget that would be hard to rectify. Close collaboration between the World Bank and IMF is essential in this respect. The macro-economic underpinnings of World Bank-sponsored adjustment programmes should be carefully spelled out. This joint action by the international financial institutions should be framed within a global

view and a systemic action, and for this an ad hoc political view at the appropriate international level may be necessary.

754. Notwithstanding the need for severe fiscal policies, cuts in social expenditure should be limited to those that are not really socially justifiable, as may be the case with part of the food subsidies, and cuts in infrastructural public investments should be resisted. Existing evidence strongly suggests that a large share of public investment is complementary to private investment. Investment may not recover in several developing countries because of the deteriorating state of public infrastructure. Adjustment programmes should include explicit conditions in this area. The need for higher public investment has already been introduced in the set of performance conditions for a number of adjustment programmes supported by the World Bank. This trend should be encouraged. The attendant need to monitor the choice of public investments and select only socially efficient projects may allow the World Bank to play a more prominent role in its more traditional specialization of project financing.

755. Adjustment programmes should include explicit provisions to protect the poor in the course of the adjustment process. The simple monitoring of the impact of adjustment programmes on poverty is important but insufficient. A more active stance is required, by redirecting public expenditure towards, say, primary education and preventive health care and by targeting consumer subsidies and special employment programmes. An enhanced public investment programme would also benefit the poor in the short term because of its employment-generating effect and in the long run through the provision of basic social infrastructures.

756. A very important aspect in adjustment processes is the question of structure and the political options. Debt was often originally caused by public deficit, owing to high military spending and unsound peacetime domestic and external policies. There is a strong link between peace and development and between peace and debt reduction. That link must be borne in mind when outlining adjustment processes, ensuring respect for peoples' rights and promoting their self-determination in the framework of constitutional and other reforms that can develop civil and political liberties, together with democracy and free elections.

757. The pursuit of peace policies and the recognition of the right to self-determination for conflicting nations, together with the spread of democratic institutions result, for the economic standpoint, in adjustment processes entailing a lower burden of unproductive public expenditures and a better environment for market investments and enterprises. Arbitrary regimes are certainly not in favour of investments. In a system of rules and regulations, liberties are interrelated. There is a very close link between respect for economic rights and respect for the various freedoms and the rule of law. Obviously, international financial institutions have no specific voice in matters of constitutional reform and national foreign policy, but the adjustment processes they propose must be integrated with the choices made within regional institutions settings that can view the problems of debt and development in connection with the issues of peace, disarmament, democracy and respect for human, civil and political rights.

758. Often the argument has been made that democracy and workers' unions are bad for the adjustment efforts of debt-burdened developing countries and that authoritarian Governments are better at bringing about the recovery of these countries.

759. However, this argument is not validated by empirical research, which in this area is particularly difficult because the types of Government and the kinds and levels of unionization of labour are not readily classifiable.

760. On the contrary, it has been demonstrated that popular consensus is an important feature of consistent, long-run adjustment policies and that mature unions are a positive factor in carrying out hard stabilization policies. 15/

761. On the other hand, it is now clear that, while democratic Governments and labour democracy reinforce the cause of peace and welfare, authoritarian Governments and weak unions dominated by populist-nationalist tendencies too often lead to high military expenditures and to war.

762. The issue of human rights surely stands out. It has been reaffirmed on several occasions that adjustment processes must have a human face. Therefore, since such a statement implies less stringent monetary and fiscal measures, it would not be tenable for those Governments that are asking for debt reduction and remission to accept any undermining of humanitarian principles. This holds true particularly for the policies that should be made subject to respect of human rights. The principle that it is the debt service and not the principal that must be remitted, reduced or converted in local projects should be constantly conditional on respect of human rights by the beneficiary Governments.

Notes

1/ See, for instance, Sidney Dell and Roger Lawrence, Balance of adjustment processes in developing countries, report to the Group of Twenty-Four, Pergamon Press, 1980; D. Avramovic, Conditionality: facts, theory and policy, Bank of Credit and International Commerce, Washington, D.C., May 1987.

2/ Libro V., M. Goldstein and M. Khan (eds.), Adjustment with growth, IMF, Washington, D.C., 1988 and World Bank, Financing adjustment with growth in sub-Saharan Africa 1986-1990, Washington, D.C., 1986; World Bank, Beyond adjustment. Toward sustainable growth with equity in sub-Saharan Africa, Washington, D.C., 1989.

3/ See ch. III above, note 7.

4/ See, for instance, S. Dell, "Stabilization: The Political Economy of Overkill", in J. Williamson (ed.), IMF Conditionality, Institute of International Economics, Washington, D.C., 1983.

5/ See R. Devlin, Debt and Crisis in Latin America. The Supplyside of the Story, Princeton University Press, 1989. p. 244.

Notes (continued)

6/ R. Faini, J. de Melo, A. Senhadji-Sem-lali, L. Stanton, Growth Oriented Adjustment Programs forthcoming on World Development. A Statistical Analysis, Centro Studi Luca D'Agliano Ld'A-QEH Development Studies Working Papers, Centro Studi Luca D'Agliano; QEH, International Development Centre, Oxford University, September 1989 and R. Faini, J. de Melo, A. Senhadji-Sem-lali, L. Stanton, Performance under Adjustment Lending, World Bank 1988, mimeo; World Bank, Adjustment Lending: An Evaluation of Ten Years Experience, Washington, D.C. 1989; M. Kahn, The Macroeconomic Effects of Fund Supported Adjustment Programs, An Empirical Assessment, IMF (mimeo) 1988.

7/ The opposite view is expressed in B. Balassa, Structural and Sectoral Adjustment Policies of the World Bank, Congress of the International Institute of Public Finance, Buenos Aires, August 1989.

> "We find that the average decline in the GDP growth rate in the loan recipient countries was less than in the comparator groups. Similar results were obtained in regard to per capita GDP. At the same time, in both cases, a majority of loan recipient countries experienced an improvement in their relative position vis-à-vis the non-recipients.
>
> "It is further apparent that the loan recipient countries made an adjustment effort in the period following the first loan. To begin with, economic expansion was concentrated in the traded goods sectors, industry and agriculture, both of which experienced an improvement in the loan recipient countries relative to the comparator groups. Also, the growth of consumption declined sustantially in absolute terms as well as relative to the non-recipient countries. In turn an acceleration is observed in the growth of investment that holds the promise for future economic growth.
>
> "The average export growth rate fell less in the loan recipient countries than in the comparator group and a much larger number of countries experienced an improvement rather than a deterioration relative to the non-recipients. At the same time the loan recipient countries attained a substantial improvement in their current account balance position as their domestic savings ratios declined less than in the comparator group. Finally, despite increases in absolute terms, the loan recipient countries improved their relative position as far as external debt indicators are concerned.
>
> "Inflation, as measured by the consumer price index, decelerated in a majority of countries receiving adjustment loans vis-à-vis the comparators, although the average increased substantially due to hyperinflation in Bolivia. In turn, money supply growth rates increased more in the loan recipient countries than in the non-recipient countries while real discount rates increased in the majority of the loan recipients. Finally, expenditure-GDP ratios increased less in the loan recipient than in the non-recipient countries."

Notes (continued)

8/ B. Balassa, op. cit.

9/ R. Faini and J. De Melo, "Adjustment, Investment and the Real Exchange Rate", Economic Policy, 1990, forthcoming.

10/ Sachs, J., "The Debt Overhang of Developing Countries," Journal of Development Economics, 1989.

11/ Faini and de Melo, op. cit.

12/ G. A. Carnia, R. Jolly, F. Stewart (eds), Adjustment with an Human Face, Oxford University Press, 1988.

13/ World Bank, Adjustment Lending: An Evaluation of Ten Years of Experience, Washington, D.C., 1989.

14/ See World Bank, Poverty. World Development Report, 1990, chapter 6, Transfers and safety nets.

15/ See S. Haggard and R Kaufman, "The politics of stabilization and structural adjustment", in Developing country debt and economic performance, vol. I, The international financial system, edited by J. D. Sachs, National Bureau of Economic Research, University of Chicago Press, 1989, p. 224 and 239.

XIV. PLANS IMPLEMENTED OR UNDER WAY RELATING TO THE RELIEF OF THE BURDEN OF DEBT WITH COMMERCIAL BANKS: THE BAKER PLAN AND THE BRADY PLAN

A. Baker Plan

763. The debt crisis broke out in August 1982, when Mexico announced a temporary moratorium on its debt service. The prevailing idea in the West was that there was a mere liquidity shortage and not a real economic crisis, and the measures taken were a rescheduling of loans (at market interest rates, then very high) and a hidden rescheduling, in the form of new bank loans - again, at high interest rates - used by debtors to pay for the interest and for the rates of their loans that became due for payment. A crisis of the banking system of the industrialized countries was nevertheless averted but, as has been observed, this did not solve and indeed exacerbated the crisis of indebted countries since the latter received no fresh funds to fuel their development, but only that small amount that was needed for them to survive. 1/

764. In order to find a remedy, in October 1985 the United States Secretary of the Treasury linked the solution of the debt problem to the generation of new growth in the 15 and then 17 low- or medium-income countries falling into the category of developing (i.e. excluding the Soviet-type countries) and defined as particularly indebted. They were Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Côte d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela and Yugoslavia.

765. Since development requires funds for investment and a well functioning market system, the Baker Plan envisaged:

(a) Lower amortization flows and the provision of fresh money, so as to cut the gross transfer of resources from the Baker countries to the industrialized countries - a transfer already totalling $60 billion, equal to 14 per cent of their debt and 40 per cent of their exports - and to step up flows in the opposite direction;

(b) Supply side measures, comprising deregulation, privatization, liberalization, protection of savings and application of market rules to credit.

766. No reduction of the debt burden was applied either to its face value or to the annual interest because to cancel debts would appear as a dangerous and unacceptable precedent. What was allowed instead was a rescheduling, namely the putting off in time of the debt amortization burden, by relying on the benevolent attitude of banks, facilitated by the interest rate cuts on world markets. On the other hand, at the base of the operation for cutting net monetary outflows from the Baker countries was the commitment to increase the volume of activity of the bank trading system in those countries by $21 billion in three years (i.e. $7 billion each year from 1986-1988), while $9 billion were related to multilateral development banks over three years. In practice, faced with a net outflow of $40 billion a year, the measure entailed a $10 billion cut to be brought about by means of new funds and lower amortizations, leaving the aggregate burden of debt service through time unaltered but with a heavier future burden.

767. According to authoritative sources, a meaningful reduction in the volume of net outflows over a three-year span would have to be at least double the size. 2/

In addition, low inflows were matched by heavy capital flights by private residents of those countries, as well as from other indebted countries. Such a phenomenon seemed to be largely connected to the fear of future non-convertibility in dollars of domestic bank deposits and also to the fear of heavy taxes and of a moratorium on the use of domestic financial expansion, owing to the burden of external debt on domestic financial resources. Since the Baker Plan provided no substantial relief from the future burden of external debt - it actually made it heavier because of amortization rescheduling - it did not encourage capital repatriation, nor did it offer a strong disincentive to capital flight. The problem of capital flight from indebted developing countries and from Latin America in particular certainly became, on that occasion, as now, a strong ethical and political issue. The lack of patriotism of the economic leaders of highly indebted countries is a strong handicap to development led by domestic market resources requiring the considerable private capital accumulation typically found in take-off periods, and this was decisive, for instance, in the economic success of the heavily indebted Asian countries.

768. The Baker Plan entailed deregulation, liberalization and privatization measures which were expected to stimulate capital repatriation, although the focal point, the issue of getting public finances in order, was left untouched. Nor was it so easy for Governments to take such measures without fresh imports of capital. The Baker Plan called for but gave no incentives to fresh capital investment from abroad, for which it is necessary to have the prospect of creditworthiness on the part of debtor countries. Nor can the same ethical considerations about a duty to invest be made with regard to domestic capital.

769. The Baker Plan focused too much on the issue of immediate liquidity and neglected the financial implications of structural readjustment, leaving it to the future of market forces. It is not known whether market forces would have been enough to counteract the adverse medium- and long-term financial factors left in existence by the Plan, since not even the new money commitments it entailed were met.

770. If multilateral development banks are added to IMF and to the bilateral export credit agencies, net disbursements to the Baker countries over the three-year period 1986-1988 instead of going up, went down by $4 billion a year, from $9 billion to $5 billion, taking into account only multilateral development banks, capital flow in the three years was $0.3 billion a year, instead of $3 billion. As for commercial banks, they reached 60 per cent of the set target of an additional $7 billion a year. 3/ The account of fresh money was closed approximately at zero, with $4 billion more for commercial banks and $4 billion less for international bodies.

771. The inadequacy of the Baker Plan regarding the issue of fresh money is apparent when considering in detail the financial flows to the original 15 Baker countries from multilateral financial institutions together with commercial bank loans (see tables XIV.1 and XIV.2 below).

Table XIV.1 Multilateral financial flows to the 15 countries of the Baker plan
(In billions United States dollars)

	1985	1986	1987	Jan - Sept 1988
World Bank				
Loans	3.98	5.66	5.62	3.38
Principal payments	1.56	2.25	3.20	2.69
Interest payments	1.55	2.28	3.08	2.32
Net flows	0.87	1.13	-0.66	-1.63
Inter-American Development Bank				
Loans	1.51	1.58	1.34	1.15
Principal payments	0.36	0.48	0.58	0.59
Interest payments	0.59	0.79	0.92	0.86
Net flows	0.56	0.31	-0.16	-0.30
International Monetary Fund				
Loans	2.56	2.54	2.78	2.38
Principal payments	0.88	2.62	4.00	2.75
Interest payments	1.20	1.17	1.17	0.91
Net flows	0.48	-1.25	-2.39	-1.28
Total				
Loans	8.05	9.78	9.74	6.91
Principal payments	2.80	5.35	7.78	6.03
Interest payments	3.34	4.24	5.17	4.09
Net flows	1.91	0.19	-3.21	-3.21

Source: Cline, W.R., From Baker to Brady: managing international debt.

Note: Principal payments and debt service data do not include Peru's debt.

Table XIV.2 Loans from commercial banks
(In billions of United States dollars)

	Commitments for new loans from September 1985 a/	Variation in total existing credits September 1985 to June 1988 real figures
Argentina	2.0	7.1
Bolivia	0.0	-0.1
Brazil	5.9	2.1
Chile	1.5	-1.7
Colombia	2.0	0.2
Ecuador	0.2	-0.3
Côte d'Ivoire	0.4	0.2
Mexico	7.7	-3.8
Morocco	0.0	0.5
Nigeria	0.3	0.6
Peru	0.0	-0.9
Philippines	0.3	-0.9
Uruguay	0.1	-0.1
Venezuela	0.0	-0.3
Yugoslavia	0.3	-0.5
Total of 15 Baker countries	20.3	2.1

Source: Cline, W.R., op. cit.

a/ Does not include the effect on cash flows of spread reduction, but does include the effect of rescheduled operations.

b/ As communicated by banks of industrial countries and by offshore banking centres to the Bank for International Settlements; includes the effect of cancelled debts, sales to non-banking entities, interests on delayed payments, conversions, transfers to public agencies for export as insurers or guarantors, which entail a heavy underestimation of net loans.

772. In the first case there is a reduction in net flows, in the second a $2 billion increase, resulting from new commitments for $20 billion, and almost an equal amount of debts paid off or of amortizations of existing debts. Even considering that some of the amounts wiped out are regarded as actually cancelled by the banking system since they are a conversion into stocks and shares (in other words, a credit transfer to non-banking entities, with the handing over to those entities of credits insured and guaranteed by insurance companies), this is in any case a disappointing level of net contribution.

773. Conditions of domestic economic adjustment expected through the Baker Plan did not materialize because neither debtor countries nor institutions in creditor countries complied with the Plan's directives.

774. A small but clear indication of the Baker Plan stalemate is found in the fall in secondary market bids for debts of the Baker countries. According to Salomon Brothers indicators, average quotations of 70 cents per dollar at the beginning of the Baker Plan fell to 35 cents at the end of the three years. 4/

775. The Baker initiative, however, did, contain a few good properties which are worth recalling. Priority to economic growth as a starting point and as a condition for readjustment and fresh money is to be considered a fixed point. The goal of modifying real factors conducive to capital outflows from indebted countries is another fixed point. The attention in the Baker Plan to policies aimed at improving market efficiency and at encouraging savings is undoubtedly positive, although such a doctrine contains an excessive number of schematic elements.

776. Nor was the Baker Plan philosophy entirely disproved by facts. Following economic policies similar to those proclaimed by the Plan (although less free-trade oriented), certain countries having strong political leadership and a class of dynamic businessmen who believed in their own country and stable institutions, managed to solve the problem of excessive external debt and to experience at the same time strong growth, which is the economic basis of debt repayment.

777. There is no doubt that specific economic policy recommendations to indebted countries were marked by shortcomings and contradictions. Shortcomings were evident because the privatization and liberalization systematically proclaimed in those recommendations did not always produce the same beneficial effects and cannot be regarded as a panacea. If carried out in such a way as to favour a few powerful economic groups, the policies recommended would strengthen the market control of private entrepreneurs who prefer power to competition.

778. After all, elements of aggressive protectionism and mercantilism are widely applied by the heavily indebted countries who have managed to solve their debt problems and by large industrial countries such as Japan, countries that now dominate industrial markets. As to deregulation, the problem is finding the golden mean.

779. There is a critical limit beyond which such recommendations become counterproductive, a limit that has undoubtedly been exceeded by the Baker

countries too often; but without rules the market ends up free-riding, which is all the more dangerous when private operators are not sufficiently used to the modern market economy. A system with too many rules means that bureaucracy will stifle the market. It also means that bureaucracy cannot guarantee compliance with all the rules, yet a lack of rules can be tantamount to chaos and uncertainty. Without rules, the banking and financial system of the developing countries would tend to look like a gambling den.

780. In short, it cannot be denied that, in broad terms, the Baker approach stemmed from potentially effective principles, although they required a case-by-case application.

781. The fundamental reason why the experiment ground to a halt lies in the paucity of means. The guidelines of the Plan were not observed (even when they were tied to modest targets) owing to the absence of an authoritative institution endowed with its own means and related powers. The supply side policies were in themselves a good idea, but especially in the Baker Plan countries they should have been complemented by infrastructural outlays, funds invested in human resources, energy saving, transport improvements, land reclamation and irrigation, conservation and distribution and diversification in food supply. Therefore, there was a need for multilateral bank action containing strong concessional elements.

782. There is a contradiction between the supply philosophy derived from Laffer, which places a limited burden on the shoulders of economic operators in order to let them expand their activities, and the Baker Plan approach, whose supply-related recommendation - without tackling the question of debt reduction and unable adequately to develop the issue of new finance - neglected the Laffer curve of external debt, envisaging stringent fiscal measures and the high cost of money.

783. During the same period of the Baker Plan, the United States, with its supply side policy and with extremely high foreign finance, was expanding, relaunching its economy and compressing inflation, despite a permissive fiscal policy, by means of high interest rates, which were keeping the value of the dollar high and financing a balance-of-payments deficit of over $100 billion. In contrast, the Baker countries were asked to relaunch their economies and to fight inflation by adjusting to a net trade surplus of $30 billion, and they even went as far as $40 billion owing to the operative weakness of the Plan with respect to fresh money. The balance-of-payments surplus of Brazil is the largest in the world after Japan and Germany. Compared with GDP, it is the highest. Yet Brazil is a country that could very well do with a net inflow of capital, for economic, social and environmental reasons.

784. Having said that, the GDP of the Baker countries, after a 3.2 per cent growth in 1985-1986, grew by 2 per cent in 1987 and by 0.8 per cent in 1988. In short, the GDP growth rate remained well below real interest rates. All this happened despite the favourable trend for the world economy, with interest rates relatively low and other concomitant circumstances. It is true, however, that developments differ from country to country: Bolivia, Brazil, Côte d'Ivoire, Mexico, Nigeria and Yugoslavia appear to be bogged down in serious troubles, whereas Chile and Colombia, to a certain extent, are emerging from the crisis; Morocco and Venezuela overcame their difficulties but are now plagued with them again.

785. Devaluation, suggested by international institutions as a necessary condition in the Baker Plan, has not, on the whole, produced satisfactory results, despite the favourable international trend (although performances differ from country to country).

786. Tariff barriers against certain agricultural and non-agricultural exports, plus demand rigidity for certain raw materials subordinate export elasticity to exchange-rate fluctuations, and can give good results.

787. Agricultural protectionism remains an issue of particular concern, as are steel, textiles and clothing, footwear and many other products that those countries are able to export. 4/

788. The point is that in the countries reviewed in the Baker Plan during the first year of application, exports fell by 15 per cent instead of rising. They rose by 10 per cent in the following year and only in 1988 did they record a 7 per cent growth compared with 1985, an average for the three years 1986-1988 of only slightly more than 2 per cent per year, again, less than real interest rates (see figure XIV.1).

789. We know that the relation between interest and exports fell to 26-27 per cent against the previous 30 per cent. Such a small drop in the 17 Baker countries was not due to a favourable export trend, but principally to an increase in arrears, which went from $1.5 billion in 1985 and $2.5 billion in 1986 to $7.7 billion in 1987 and $7.9 billion in 1988 (of which $1 billion, $1.6 billion, $6.3 billion and $5.5 billion respectively were with commercial banks). The fall was partly caused by voluntary relief measures, in the form of debt-equity swaps and through debt buy-backs.

790. Those operations, varying in importance from country to country, have sometimes produced inflation, but on the whole they appear to have yielded substantially positive results.

791. Imports were already hypercompressed, so that their value rose only slightly from one year to the next. In 1988, the Baker countries trade surplus was $30 billion, against about $36 billion in 1985 (see figure XIV.4).

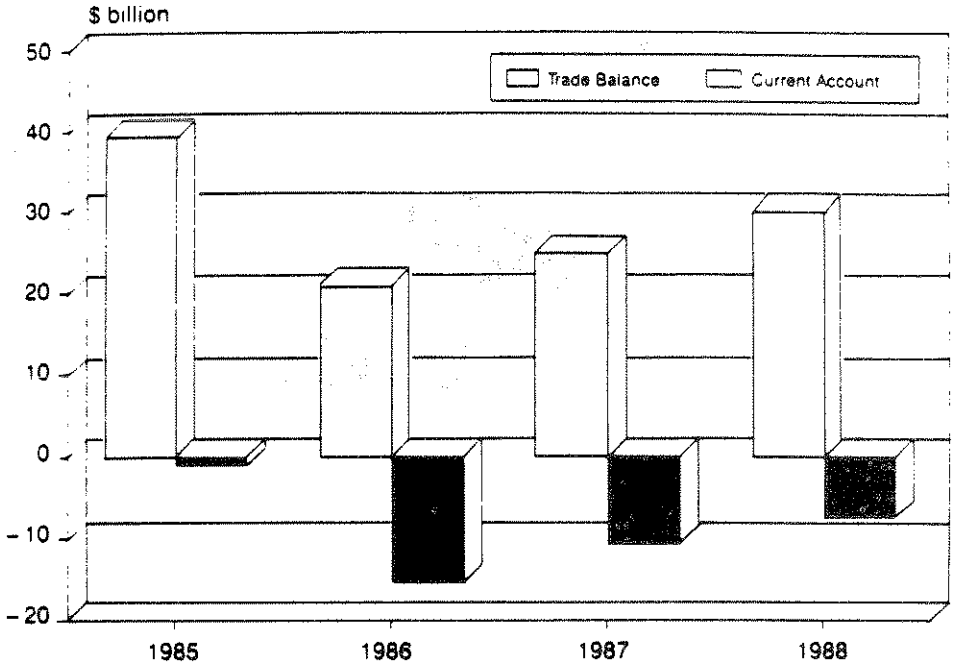
792. Devaluations have fuelled inflation. It is not surprising that, at the end of the Baker Plan's three-year period, the average inflation rate in the Baker countries (116 per cent in 1987, 223 per cent in 1988) is the second highest in this century, after that experienced by Germany following the First World War. It is not coincidental that Germany was at that time oppressed by the burden of external debt, the result of immense war reparations. From 1982 to 1988, cumulative inflation was 470,000 per cent in Argentina, 120,000 per cent in Brazil, 29,000 per cent in Peru and 5,000 per cent in Mexico.

793. At any rate, debtor countries were generally not pushed to perform their assigned role. Insufficient fiscal pressure, often due to lack of political will, inadequacy and even corruption of the bureaucratic apparatus faced by non-reducible spending, kept domestic consumption demand high. So, with the deficit remaining high, investment suffered most of all.

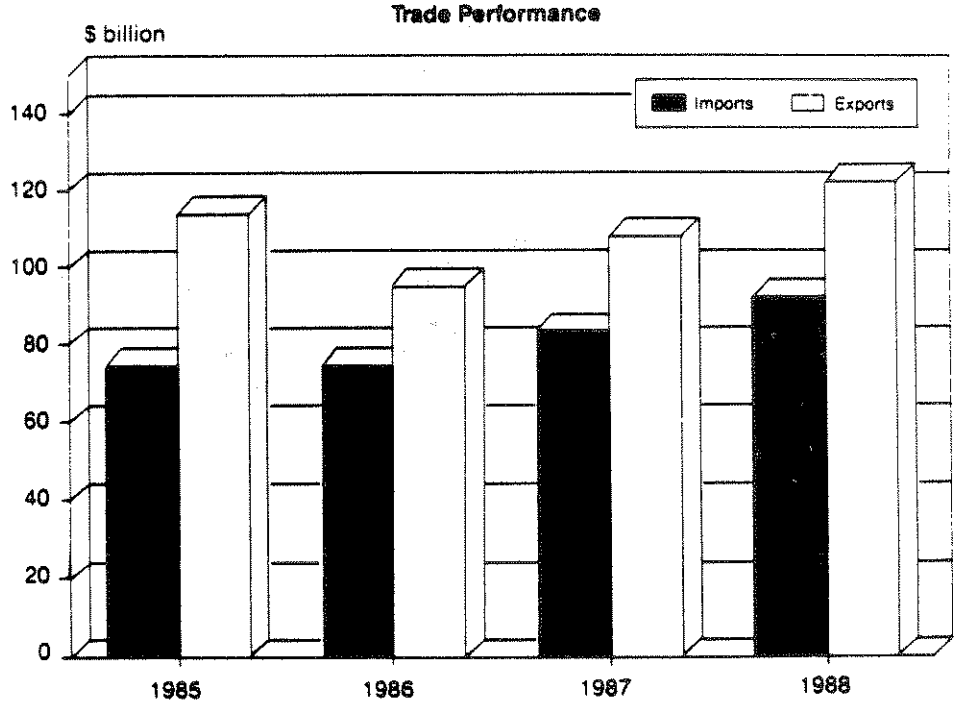
Figure XIV.1

Baker Plan Countries*

Current Account Balance**



Trade Performance



* Includes Argentina, Bolivia, Brazil, Chile, Colombia, Cote d'Ivoire, Ecuador, Mexico, Morocco, Peru, the Philippines, Nigeria, Uruguay, Venezula, and Yugoslavia.

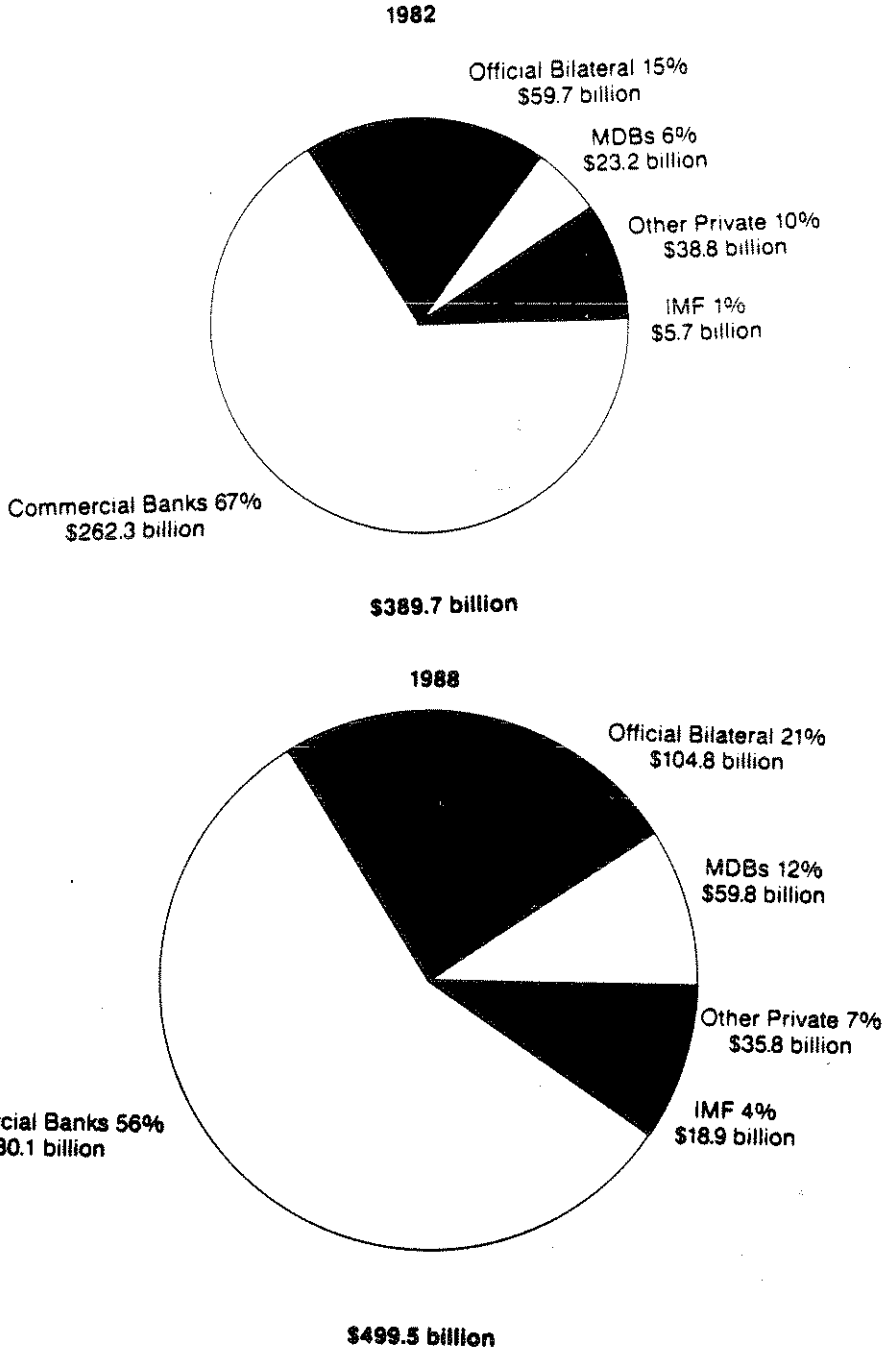
** Excludes official transfers.

Source: The Institute of International Finance, Inc. The Way Forward for middle-income countries, January 1989, p. 9.

Figure XIV.2

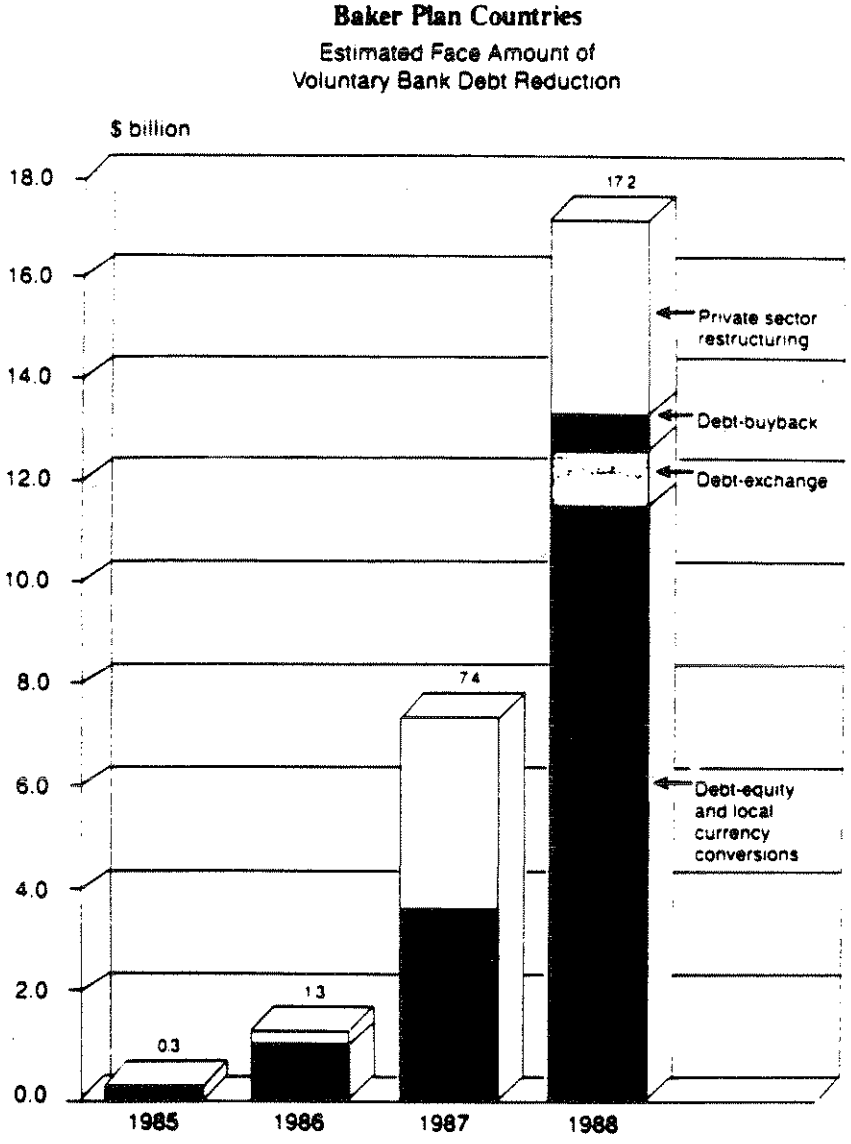
Baker Plan Countries

Estimated Total External Debt



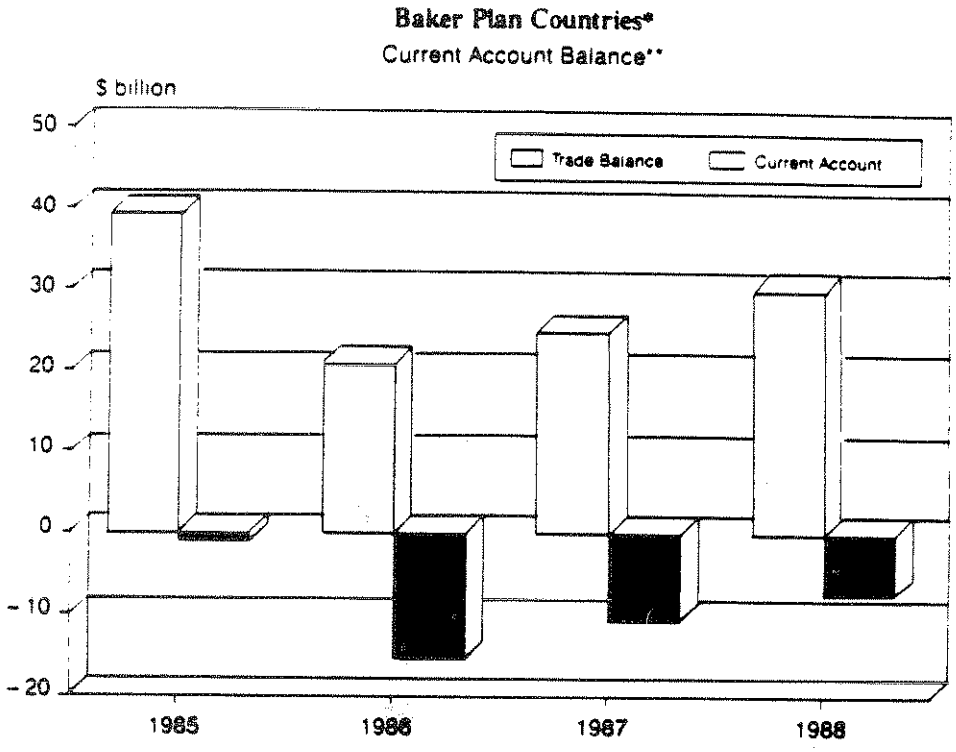
Source: The Institute of International Finance, The Way Forward for Middle-income Countries, January 1989, p. 13.

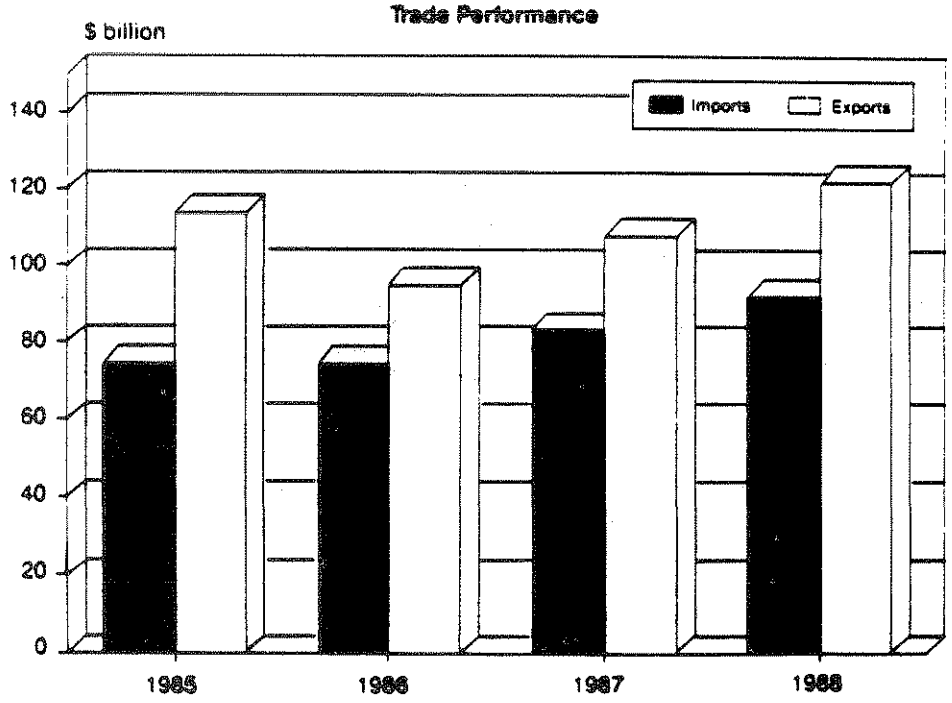
Figure XIV.3



Source: The Institute of International Finance Inc., The Way Forward for Middle-Income Countries, January 1989, p.

Figure XIV.4





* Includes Argentina, Bolivia, Brazil, Chile, Colombia, Cote d'Ivoire, Ecuador, Mexico, Morocco, Peru, the Philippines, Nigeria, Uruguay, Venezuia, and Yugoslavia.

** Excludes official transfers.

Source: ibid., p.

794. The overall debt figure for the 15 Baker countries during the years of the Baker Plan went up from $424 billion to $448 billion and then to $470 billion. The big change was in the debt breakdown. Banks accounted for 67 per cent in 1982 and for 56 per cent in 1988. Other private sources went from 10 to 7 per cent. Bilateral and multilateral institutions rose from 23 to 44 per cent. By now, the debt issue is for those countries hardly a private-sector problem. Almost 50 per cent of it is a problem for the public sector, despite strong resistances to acknowledging the fact.

795. William Cline, who studied the Baker Plan in detail, stated that:

> "The initiative is misleading in its capital flow targets for the public sector by not taking an integrated approach to all official lending, and by remaining silent on the IMF role. The IMF shift from an active new lending role early in the crisis to minimal (or negative) new lending meant that the targets for lending expansion by multilateral development banks overstated the net capital contribution that could be expected from the international institutions. It was argued that IMF was not a development agency and thus could not be expected to continue indefinitely its high-level net lending; but, from the broader development objectives of the Baker Plan, a comprehensive view of public-sector financing for the debt problem was necessary. This also applied to bilateral export-credit agencies, which had provided considerable financing before the debt crisis but cut back - much like the private banks - after its onset." 2/

796. Of course, it should be noted that a bulk transformation of the financing to heavily indebted countries (particularly medium-income ones) into a financing by bilateral and multilateral institutions, driving out the system of commercial banks and the other sources of market financing, would be a big mistake. First of all, available resources would increasingly be taken away from direct development aid, except in cases of an increase in the GDP growth rate, which is highly desirable but does not seem to be easily and rapidly attained. Besides, bank and financial market control is essential for an efficient system and for a market-based economic development, which is the only kind capable of working, as shown by the failure of the collective experience in Eastern Europe.

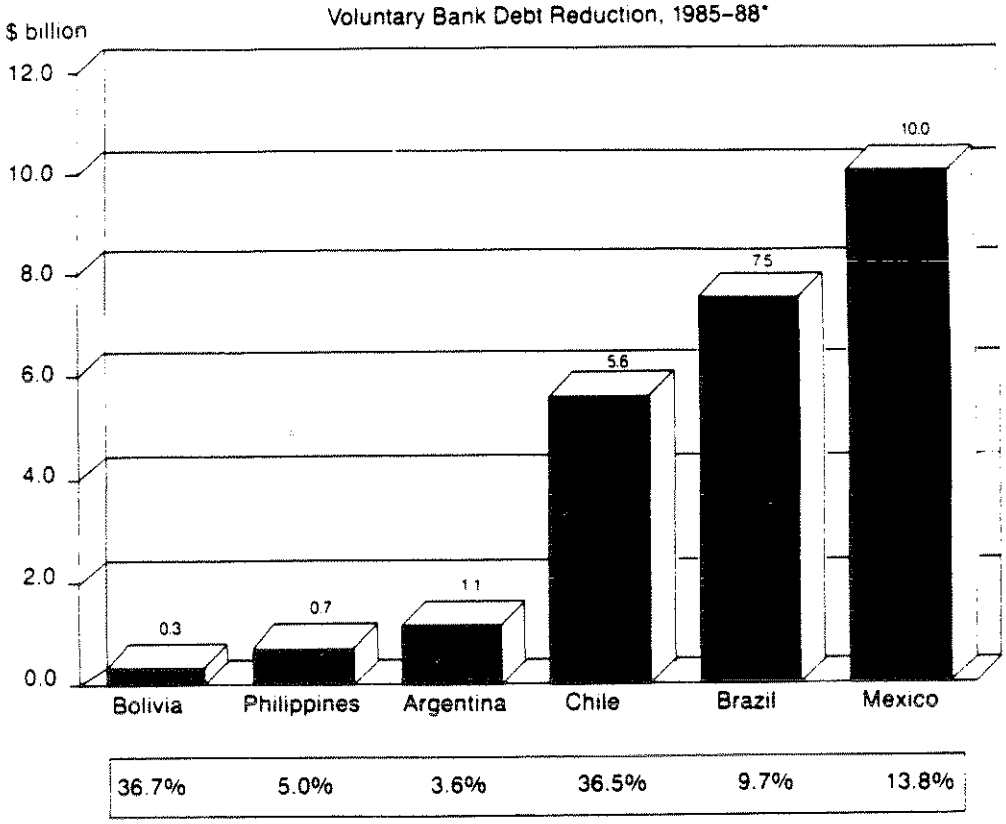
797. Of course, a substantial share of public action is indispensable, both in order to have a variety of driving forces instead of an economy led by a few families and to carry out those long-term projects which private enterprise alone is neither willing nor able to undertake. Public economies in heavily indebted countries must be helped in order to become a driving force for development. In this respect, it seems appropriate to quote another statement by William Cline, from his already-mentioned study:

> "Seeming interventionism by industrial countries was awkward. Although liberalization of imports and foreign investments and slimming of the State sector were desirable in many debtor countries, adjustments and growth could have been possible through other fiscal corrections and increased State firm efficiency according to each country's political traditions."

Figure XIV.5

Selected Baker Plan Countries

Estimated Face Amount of Cumulative
Voluntary Bank Debt Reduction, 1985-88*



* Includes conversions of bank debt to equity and local currency financial assets, debt buybacks, debt exchanges, and restructuring and settlement of debt owed by the private sector.

Source: Institute of International Finance, Inc. The Way Forward for middle-income countries, January 1989, p. 22.

B. Brady Plan

798. The Brady Plan, outlined by the United States Secretary of the Treasury on 10 March 1989, is a new approach to the search for a solution to the problems of international debt. It is a proposal made up of three fundamental points:

(a) The Plan underlines the need for any effort to solve the problem to be based on the commitment of developing countries to implement structural reforms that ensure more sustained real growth. In particular, that commitment has to focus on incentives for investment, in order to boost domestic savings and to stimulate the repatriation of flight capital;

(b) The Plan stressed the efforts that creditors (that is, banks, international financial agencies and Governments of industrialized countries) are called upon to make by providing financial instruments that can cut the debt stock, as well as the burden of its service. That would appear to be an essential prerequisite since a rise in the creditworthiness of many debtor countries and their return to the international financial markets are factors linked to a real reduction in the overall debt volume;

(c) Of paramount importance is the role played by international financial institutions in the framework of the debt crisis. The crucial matter is whether they should continue to disburse the necessary financial resources or indeed suspend operations until precise agreements have been reached between creditor and debtor.

799. In order to understand the nature of the ingenious and courageous techniques of bank debt restructuring provided for by the Brady Plan, it is necessary to recall the proposal put forward by Morgan Guaranty Trust concerning the Mexican debt.

800. In January 1988, Morgan Guaranty Trust proposed the conversion of the Mexican bank debt into a longer-term equity debt in Eurodollars consolidated by what are known as collaterals. The bond certificates would be issued by the Mexican Government at a face value lower than the bank debt, also, but not only, because they would be more secure than the original loan. The official proposal did not indicate the amount of the discount, but at that time newspapers reported a discount of 40 to 50 per cent, equal to the secondary market price of the Mexican debt. Certificates would have a 20-year period of maturity, yielding interest in line with LIBOR plus a margin of 1-5/8 per cent, namely the market rate applicable to the country at that moment. Interest would be paid every six months, and the principal in total after 20 years. Principal repayment would be guaranteed by zero coupon bonds issued by the United States Treasury, bought by the debtor country and deposited at the New York Federal Reserve in the name of Morgan Guaranty. It should be noted that, at an 8 per cent rate, the zero-coupon bonds necessary to guarantee deadline payment of a 20-year loan are only about 21 per cent of its face value. The discount of this restructuring arrangement would be determined in an auction, during which each creditor bank must submit five sealed bids, which debtors could accept or reject.

801. The initiative had no immediate success, probably because it lacked political support. Hence, incentives based on moral suasion and funds disbursed by international agencies in industrialized countries were missing. In consequence, guarantees for Mexico, which would allow a reduction of the discount requested from banks, could not be obtained. It is sufficient to note that, of the 500 creditor banks, only 139 took part in the operation, and that the largest banks in the United States did not participate. In practice, the operation turned into a swap of $3.67 billion in debts for $2.56 billion in equities, with a reduction in the overall external debt slightly higher than $1 billion, with annual savings of around $100 million in debt service.

802. The Brady Plan, launched in March 1989, started with Mexico and was based on the above schemes, which were to be applied upon the acceptance by the debtor country of a credible plan of economic restructuring, in line with IMF and (not very clearly) World Bank guidelines. 5/ First of all, the bank debt was rescheduled on a 16-year basis, with 4 years of grace. Then banks were offered the following options:

(a) To convert rescheduled debt into guaranteed bond certificates, with a 35 per cent reduction in the face value. In practice, the interest rate would be that applied on the market for guaranteed bank debts (LIBOR plus 13/16 of 1 per cent);

(b) To convert debt into certificates without reducing the face value, at an interest rate of 6.25 per cent, namely below market levels;

(c) To provide in four years 25 per cent of their exposure towards Mexico in new funds. The restructured debt would not have any guarantees other than the commitment by the Mexican Government to pay at established deadlines.

803. The certificates in options (a) and (b) would fall due in total after 30 years, being covered by collateral guarantees made by United States Treasury zero-coupon bonds bought by the Mexican Government (or by equivalent certificates in other currencies) at 30 years and at a rate of 7.98 per cent. Such guarantees also cover 18 months of interest with a sliding system: as interest is paid by Mexico at corresponding deadlines, the guarantee moves ahead by 18 months.

804. It is noteworthy that with an interest rate of 8 per cent the amount zero-coupon bonds necessary to guarantee repayment of a 30-year loan at deadline is only 10 per cent in round figures. The leverage effect is therefore very high, and it is even higher when there are discounts on the principal, as in option (a).

805. To finance the purchase of such "enhancements" through collaterals, Mexico uses its own resources, i.e., financing from the World Bank, IMF and the Government of Japan. The cost of such instruments is $7.1 billion. Debts included in the agreement amount to $48.5 billion, out of a public sector total bank debt of $55.9 billion. Another debt of $3.5 billion is expected to be withdrawn through debt-equity swaps in 1992.

Table XIV.3 Countries covered by the Brady Plan existing external debt with commercial banks, 1988
(In millions of United States dollars)

	Mexico	Costa Rica	Philippines	Venezuela
Guaranteed long term debt	55 926	1 464	9 769	21 679
Non-guaranteed long-term debt	7 458	317	992	488
Total debt with commercial banks	63 384	1 780	10 761	26 562
Interest arrears	0	275	127 a/	0
Reimbursed principal	3 700	25 a/	721	1 734
Interests paid	5 635	79	982	2 448
Summary				
Total debt	101 566	4 530	29 448	34 657
Total reimbursed principal	6 242	147	1 320	2 421
Total interests	7 590	185	982	2 675
Gross domestic product	175 203	4 531	40 381	60 043
Exports	32 093	1 674	11 068	12 821

Source: World Bank, World Debt Tables, 1989-1990.

a/ Including official debtors.

806. Banks have made the following choices:

(a) Swapping 41 per cent of the debt ($40 billion) with equities bearing a 35 per cent discount;

(b) Swapping 47 per cent ($22.5 billion) with equities at par, at lower rates;

(c) New financing basis made of 12 per cent ($6 billion).

807. The package produces a $7 billion reduction in debts with the first option and $7.75 billion with the second. Savings on interest amount to $2.2 billion in 1990 and $1.5 billion per year in the following years. New funds generated are only $1.5 billion per year in 1990-1992.

808. Several bankers in Europe and the United States reported that the United States Treasury brought considerable pressure to bear on lending banks to persuade them to join in. At any rate, the agreement was signed in February 1990, after nearly one year of negotiations.

809. In the period of 1990-1992, savings on debt service are estimated at an average $3.2 billion a year. 6/ Cuts on interest payments will be $1.5 billion a year and those on amortizations will amount to an annual $1.67 billion. As Mexico's GDP is slightly higher than $150 billion, the cut is 2 per cent of GDP and about 15 per cent of its exports, with a 20.4 per cent fall in 1988 debt-service figures, and with a 17.4 per cent cut in the interest burden.

810. Debt rescheduling was matched by economic and financial measures that have apparently raised Mexico's reputation in international financial circles, in multilateral institutions and commercial banks alike. 7/ In 1989, $3 billion in Mexican capital was repatriated 8/ and there are hopes of a higher amount in 1990. Of course, Mexico had no arrears on long-term loans, in contrast to Costa Rica and the Philippines (the other countries addressed by the Brady Plan). Besides, since the bulk of fresh funds agreed upon by commercial banks in the process of rescheduling the Mexican debt is low, the issue of fresh funds flowing in still remains open. It should also be noted that the only debts that have been restructured are those with banks.

811. With regard to the Philippines, the Brady Plan presented a few different options. The Philippines' bank debt is close to $10 billion, only half of which is in medium-term loans subject to restructuring. The agreement entails the buy-back of part of the Philippines' debt with a 50 per cent discount. Authorities in the Philippines had announced their intention to buy back $1.3 billion of their national debt, while offers received amounted to $1.8 billion. An alternative was a cut in interest rates to 13/16 of 1 per cent over LIBOR. Banks were asked to provide fresh funds within two years in the form of bond certificates or loans of at least 15 per cent of their medium-term exposure towards that country, on the same terms as the consolidated debts existing in 1985 (that is, 15 years with 8 years of grace). A final understanding was reached on a contribution of $700 million, backed by some guarantees, partly given by the Government of the

Philippines. As in the case of Mexico, bank reluctance to provide fresh financial resources became self-evident.

812. Those banks that contribute new finance can convert part of the credit granted to the country before 1985 into non-collateral equities, for an amount equal to 50 per cent of the new funds contributed. Debt-equity swap operations are also in progress. Although such an agreement is of considerable importance in itself, it is necessary to stress that it affects only one fourth of the Philippine's total debt. Without appropriate action on debts with official agencies, the overall effect of the agreement with the Philippines will remain rather limited.

813. Reaching an agreement with Costa Rica required a great deal of hard work because of the $295 million it owed in arrears on interest payments. The agreement that has been reached refers to $1.8 billion, that is to say almost all the national debt held by international commercial banks - $2.1 billion, including arrears.

814. Banks have been presented with the following options:

(a) To allow Costa Rica to buy back part of its medium-term bank debt at 80 per cent of its face value;

(b) To swap the other medium-term bank debts against 30-year bond certificated at par value and with a 6.25 per cent interest rate;

(c) To convert arrears into 15-year mortgage loans, with market interest rates and a 20 per cent advance payment.

With the 6.25 per cent bond certificates, enhancement lies in collateral for interest, but not for the principal. IMF and the World Bank finance such collaterals and also the buy-back of the Costa Rican Government.

815. According to the United States Treasury, once the agreements are finalized, the medium-term debt reduction should be about 60 per cent, while the overall cut in interest burden should be on the order of another 60 per cent on average, bringing that burden down to a level that reflects Costa Rica's ability to pay. Recent data are not yet available for a final evaluation on the actual achievement of that target but, nevertheless, much stress is being laid on the concept of a reduction aimed at matching a country's ability to pay. This represents a fundamental development in the operational guidelines of the Brady Plan as compared with the initial application it had with Mexico, which - as has been stated - did not yield good results, presumably owing to a lack of financial resources.

816. In the case of Costa Rica, the amount of the loans involved was far lower than in Mexico ($2 billion out of $4 billion in total debt) and, besides, moral suasion allowed a buy-back at extremely good prices and in a relatively short time. It is true that although absolute figures were low, they were very high compared with the Costa Rican debt. The problem of free riding was fully visible here. The value of the remaining debt was to rise markedly on the secondary market. The banks have accepted buy-back operations with an 80 per cent discount on a high percentage of

bank debts, while the rest were being restructured. The problem of arrears was therefore solved, which suggests that banks have refused to become free riders.

817. The Brady Plan scheme for Venezuela is still under consideration. It includes a wide range of medium-term options, as is logical if one considers the size of Venezuelan medium-term bank debt: $27 billion, or 80 per cent of a total figure of $34 billion. In the bargaining game, Venezuela is given the power to propose and therefore the power of veto, which somehow strengthens its bargaining power and defeats the plans of the free riders.

818. The secondary market values of Venezuela's debt ranged in 1989 from 38 to 34 per cent; they were rather high compared with Costa Rica's debt at the beginning of the Brady Plan. Taking that as a reference point implies a 60 per cent discount. If the same principle is applied to countries like Brazil and Argentina, the discount would become much higher. Surely, there is a moral hazard in connection with the debtor's convenience - as a creditor's agent - assuming a non-paying attitude because of his interest in devaluing the debt, which obviously runs counter to the creditor's interest. The creditor's high-handed attitude when he is about to grant a discount is apparent when he considers only those objective reasons that reduce the debtor's ability to pay.

819. With regard to the second group of options, with the conversion of bank debts into enhanced bond certificates, in line with the Mexican programme, the rates under negotiation would be slightly less favourable to Venezuela. The discount for 30-year bond certificates would reduce the face value of the debt to 30 per cent, while for 30-year bond certificates with interest reduction, the proposed rate is 6.75 per cent.

820. Enhancements are similar to those included in the Mexican scheme, for both principal and interest. However, the collateral for interest is 14 months. On the other hand, each bond certificate has a "warrant" that, after six years, enables the bearer to "consider" advance payments of up to a certain amount, should the price of Venezuelan oil exceed a given level.

821. There is yet another option, not included in previous packages of the Brady Plan. Banks will be able to convert their credits into 17-year bond certificates, at a 5 per cent interest rate for the first two years, 6 per cent in the third and fourth years, 7 per cent for the fifth and then at market interest rates. The new finance option, with some changes, which had little success in the Mexico agreement, was proposed once again. Banks will be able to give new loans in the form of bearers' bond certificates for an amount equal to the 20 per cent of their credit exposure for which they would accept none of the other options. The two new elements are a rate of 20 per cent rather than 25 per cent and the reduction of the already small commission concerning interest on bond certificates issued in replacement of bank debt.

822. Negotiations are under way for the Brady Plan with Morocco and Uruguay, while the North American and Japanese banking world view with interest the possibility of carrying out negotiations with Brazil. 9/

823. However, the effectiveness and suitability for Mexico of such a painfully achieved agreement is still uncertain. 10/ The agreement of July 1989 between the Government of Mexico and the Bank Advisory Committee, dealing with approximately $48.4 billion of Mexico's eligible long- and medium-term debt, has been examined by Nora Lustig, 11/ who briefly reviewed the various methods that have been used for estimating the amount of debt relief implied by the agreement.

Effect of total nominal debt

824. Assuming the mix mentioned above, the total nominal debt will undergo practically no change. The amount that is reduced through the discount bond option (approximately $7 billion) is roughly the same as the sum of the loans required for collateral, plus the loans provided by the commercial banks that chose this option (approximately $5.7 billion and $1.4 billion each). One can argue, however, that the agreement will actually reduce the increment in total debt that would have accumulated under the previous conditions had Mexico continued punctual service of the debt and at the same time maintained its growth goals. 12/ Moreover, of greater importance than the changes in the nominal debt are (a) the present value of the total savings implied by the agreement over the next 30 years and (b) its impact on the more immediate cash flow.

Reduction in the discounted value of total debt service

825. If debt relief is defined as the reduction in the discounted value of debt service in proportion to the face value of the outstanding debt, then the relief implied by the agreement is roughly equal to 25 per cent, or $12 billion. 13/ This would imply a discount of almost 40 per cent on approximately $7 billion available for the enhancements. 14/ However, these calculations assume that Mexico would service its debt in full during the next 30 years, something that secondary market prices do not support. 15/ Thus, the perceived gain may be overstated.

Effect on the immediate cash flow

826. The estimated savings in the cash flow over the first five years range from $3.5 billion to about $1 billion per annum. The latter is equal to the former excluding: (a) forgone amortizations, assuming that these would have been rescheduled, as in the past; (b) the Mexican sourced collateral equal to $1.3 billion that the country had to generate by drawing on its own reserves; and (c) the funds that are "diverted" from the official loans to finance the guarantees assuming that these loans would have been available anyway and could have been used by Mexico for balance-of-payments purposes.

827. To put these numbers in perspective - Ms. Lustig continues - it is useful to note that for the years 1983-1988 the average annual total interest payments for Mexico were about $9.6 billion and interest payments on medium- and long-term debt were $6.7 billion. The global net resource transfer was equal to $8.7 billion for the same period. Thus, the net impact on cash flow may seem somewhat disappointing when compared with Mexico's total interest obligations or net resource transfer. However, the key question is whether the relief is enough to cover the financing gap associated with the country's growth goals.

Table XIV.4 External debt to commercial banks
(In millions of United States dollars)

	Costa Rica
Guaranteed long term debt	1 464
Non-guaranteed long-term debt	317
Total debt with commercial banks	1 780
Interest arrears	275
Reimbursed principal	25 a/
Interests paid	79

Source: World Bank, World Debt Tables, 1989-1990.

a/ Including official debtors.

Table XIV.5 External debt to commercial banks
(In millions of United States dollars)

	Venezuela
Guaranteed long-term debt	21 679
Non-guaranteed long-term debt	488
Total debt with commercial banks	26 562
Interest arrears	
Reimbursed principal	1 734
Interests paid	2 448

Source: World Bank, World Debt Tables, 1989-1990.

Table XIV.6 Value of the Latin American and Carribbean debt on the secondary market, 1986-1989

	1986			1987			1988			1989		
	January	June	December	January	June	December	January	June	December	January	June	December
Argentina	62	65	66	64	52	35	32	25	21	20	13	13
Bolivia	..	6	7	8	9	11	11	11	10	10	11	11
Brazil	75	74	74	72	62	46	46	51	41	37	31	22
Chile	65	67	67	68	70	61	61	60	56	60	61	59
Colombia	82	81	86	86	85	65	65	65	57	56	57	64
Costa Rica	..	48	35	35	36	15	15	11	12	13	14	17
Ecuador	68	64	65	65	50	37	35	27	13	13	12	14
Guatemala	..	52	60	61	67	77	57	..	..	..	..	..
Honduras	..	40	40	40	39	22	22	22	22	22	17	20
Jamaica	..	45	45	45	38	33	33	38	40	40	41	40
Mexico	69	59	56	57	57	51	50	51	43	40	40	36
Nicaragua	..	4	4	4	5	4	4	2	2	2	1	1
Panama	..	69	68	68	67	39	39	24	21	19	10	12
Peru	25	20	18	18	14	7	7	6	5	5	3	6
Dominican Republic	..	45	45	45	45	23	23	20	22	22	22	13
Uruguay	..	63	66	68	74	60	59	60	60	60	57	50
Venezuela	80	76	74	75	71	58	55	55	41	38	37	34
Average a/	..	64.9	64.2	63.7	58.5	46.5	45.1	45.4	37.7	35.2	31.9	28.0

Source: United Nations, Department of International Economic and Social Affairs, based on bid prices compiled by Salomon Brothers.

a/ Weighted by amount of bank debt.

Table XIV.7 Secondary market prices of bank loans, 1990

	10 May Bid	10 May Offer	25 April Bid	25 April Offer
Algeria	82.50	84.50	81.00	83.00
Argentina	15.25	16.00	13.50	14.25
Bolivia	11.00	12.00	11.00	12.00
Brazil	25.75	26.50	27.75	28.30
Chile	63.00	64.00	64.00	65.00
Colombia	64.00	66.00	64.00	66.00
Costa Rica	21.00	23.00	21.00	23.00
Dominican Republic	14.00	16.00	14.00	16.00
Ecuador	16.50	17.50	14.50	15.50
Honduras	19.00	21.00	19.00	21.00
Côte d'Ivoire	05.00	07.00	06.00	08.00
Jamaica	41.00	42.00	39.00	41.00
Mexico	44.00	44.75	41.50	42.25
Morocco	42.00	43.00	42.00	43.00
Nicaragua	02.00	04.00	03.00	05.00
Nigeria	24.75	25.50	24.75	26.50
Panama	15.00	17.00	15.00	16.00
Peru	04.00	06.00	05.00	06.00
Philippines	51.00	51.75	50.00	50.75
Poland	16.00	17.00	15.00	16.00
Senegal	32.00	34.00	32.00	34.00
Sudan	01.00	02.00	01.00	02.00
Uruguay	46.00	47.00	45.00	46.00
Venezuela	45.00	45.75	44.00	44.50
Yugoslavia	80.75	61.50	80.75	61.50
Zaire	19.25	20.25	19.25	20.00

Source: Salomon Brothers Inc.

828. In addition to the above, the agreement entails other factors, which, although they cannot be easily quantified, are of considerable weight. On the one hand, Ms. Lustig recognizes that the agreement removes the uncertainty that was introduced in the past by the need for periodic rescheduling of the principal. Now, no more payments on the principal will be due until the one-time payment in 2019, which is already fully covered by the zero-coupon bonds purchased as guarantees for that very purpose. On the other hand, the agreement allows for greater flexibility since Mexico can now buy back any amount of the outstanding debt on the market as long as it is not in arrears. The prolonged, expensive and time-consuming process of obtaining the necessary waivers to carry out buy-back operations has now been removed.

829. However, Ms. Lustig states that the agreement introduces two new rigidities: (a) a larger proportion of the debt will not be reprogrammable at all as in the case of IMF and World Bank loans; and (b) some analysts consider that it will be more difficult to reprogramme the par and discount bonds than the commercial loans. In addition, according to some observers, bond holders are more prone than commercial debt-holders to engage in legal action if faced with defaults.

830. The question raised by Ms. Lustig is whether the debt relief implied by the agreement will be enough to allow a resumption of growth in Mexico. She reports that the dominant view, especially in government and multilateral circles, is that the agreement is consistent with the growth targets stated by the Mexican Government in its development plan, and which were also ratified by the multilateral agencies (IMF and the World Bank) as part of their lending policy for Mexico. This view assumes a gradual recovery from a yearly output growth rate of nearly 3 per cent in 1989 to rates approximating an annual average of 5 per cent for the 1992-1994 period.

831. The expectations are that this resumption of growth will be possible as a result of both the direct effect of the agreement on debt-service reduction and its indirect effect on confidence-building. These indirect effects, coupled with the other policies implemented by the Mexican Government, will result in a solid export base, higher foreign investment flows and - it is hoped - some capital repatriation. A particular important corollary of the increased confidence will be lower domestic real interest rates. In turn, these lower interest rates will reduce the burden imposed by domestic public debt on the Government's fiscal stance and stimulate investment.

832. Ms. Lustig points out that there are clear indications that the secondary or indirect effects on confidence-building were felt soon after the agreement was announced in July 1989. In particular, within two weeks of the announcement, domestic interest rates fell by 20 percentage points, which, according to some estimates, contributed to a domestic debt relief to the Government of about 4 per cent of GDP. More recently, nominal interest rates have risen by 10 percentage points, but real interest rates are still substantially below the levels prevailing during the months that preceded the announcement of the agreement. In addition, there are signs that some capital repatriation has taken place and that foreign investments are forthcoming.

833. Ms. Lustig concludes that, given the amount of credit enhancements available, the discount obtained by Mexico (either through discount bonds or below-market interest rates on par bonds) is most probably the largest that could have been obtained in a semi-voluntary, market-based setting such as the current operation. Since only 18 months of interest payments enjoy guarantees, from the banks' perspective 28-1/2 years out of 30 years of interest payments are still pure risk. Thus, the actual market valuation of the new documents (discount and par bonds) implies a higher discount than the observed nominal one (e.g., higher than 35 per cent).

834. The long duration of the negotiating process of the Brady Plan stems from bank contractual waiving, or mutual interference. On one hand, since they belong to a lending pool, they are usually linked by the sharing clause, which implies that, in case of beneficial gains, any of them has to share their gains with all the others. Most of the loans to developing countries have been granted by lending pools, often with many members. On the other hand, banks are usually bound by the negative pledge clause, whereby it is impossible to meet a given obligation contracted at a later stage before complying with a previous one. In the abstract, the negative pledge clause is not based strictly on a time schedule: by their nature, certain credits have priority over all others, even if they come before in time. The same applies to credits given by the World Bank and IMF, and for funds obtained by Governments from foreign agencies under given circumstances.

835. This can only give more strength to the negative pledge clause that ties up commercial bank loans with one another. A restructuring that allows the tightening up of a guarantees on a given bank credit by putting it on a priority scale compared with credits of equal age is normally not practicable when banks have allowed one another the negative pledge clause, turning themselves into a creditor cartel comparable to OPEC. 16/

836. The Brady Plan was an attempt to break that cartel by means of moral suasion. But, given its lack of an institutional mechanism capable of operating like a cartel through a comprehensive all-or-nothing offer, 17/ it has to adapt itself to long negotiation and to submit to substantial concessions, compared with its original line of action. In fact, the lack of interest guarantees (except for 18 months) strongly reduces the scheduled enhancement of bond certificates. One need only consider that a 30-year loan without interest, assuming a real market rate of 4 per cent and accounting for a 4 per cent annual inflation rate, has a current value of about 10 per cent of its face value.

837. The second explanation for the long time taken to reach agreement is that it was linked to the credible acceptance of an economic and financial adjustment plan. Short of a permanent institution responsible for the solution of the debt problems, the related negotiations will be based on an ad hoc procedure and not one where one party can react negatively to the moves of the other, in case the latter does not keep its promises.

838. The time period therefore becomes an indispenable element of the agreement, although it is impossible to reach it with the adjustment process already under way, given the interrelated nature of debt reduction and the adjustment process.

839. The third reason for all the difficulties and delays encountered in the finalization of the Brady negotiation seems to lie in a paradox contained in the current tax systems. Some systems, such as those in Switzerland, the United Kingdom, Germany, France and partly the United States, allow tax deductions of large provisions on risk loans at the time such provisions are built up, while other systems, such as those of Japan, Italy and particularly the United States, allow only the deduction of losses. In the last few years, large banks with important loans granted to indebted countries have generally built up considerable provisions. In some countries, such as the United States, this has meant the writing down of the capital value of credits, for bank surveillance purposes. Banks in the first group are not very interested in loss-making operations because they cannot get a tax benefit from them, while their risk is in any case covered by provisions. Their credit can always be recovered, especially if other banks agree to undertake ample restructuring. At any rate, the present administrators need not upset shareholders and deposit holders with outright debt write-offs, which could give them a bad impression. Supervisory authorities in the United Kingdom and France allow no devaluation of those credits until they are demanded for payment. Why, then, should they accept an official reduction in the value of those credits?

840. In countries where the tax deduction of losses is allowed in connection with such credits, but not for provisions (or at least not to a full extent), banks have not always had the possibility of building up large provisions to be used to counteract the considerable accounting losses recorded during the fiscal year of the restructuring.

841. A way out of the paradox could be to allow the fullest possible tax deductions for provisions, but only in the form of a tax deferral. If after a certain period of time, say five years, creditors are unable to collect on loans due, those provisions should not be used to back the restructuring of the debts in question or to carry out real devaluations of them, and said provisions should become taxable. This could be applied to tax systems like that of the United States and Japan, which do not (or will not) allow any more provisioning on loans to risk countries. Furthermore, accounting depreciation quotas should be allowed for losses recorded in a given fiscal year when such losses result from operations of an overall reduction or reconversion, as with the Brady Plan.

842. In countries where only deductions for debt losses are allowed and no provision can be made in anticipation of such losses, drops in the debt values imply a tax benefit since for tax purposes banks treat them as a capital loss. The same does not apply to interest reductions, as the face value of credits remains unchanged, to the extension of debt maturities or to commitment to new loans.

843. This is one of the explanations for the marked preference for the first of the three options in the Brady Plan and, to a certain extent, for the second, while the third played an absolutely minor role.

844. Despite the above-mentioned debt relief for Mexico, bank supervisory boards in the United States will not authorize new loans to Mexico if they are not accompanied by provisioning amounts equal to those established in the past, which is illogical and acts as a brake on new bank finance.

845. Once again, the tax factor emerges in all its critical importance to ensure equality among the various options. It should be established that permanent reductions and maturity extensions of loans, together with commitments to new loans implemented with in the framework of a restructuring plan, carry with them a tax benefit equal in percentage terms to that of provisions or of recorded capital losses.

846. Besides, it is illogical that a large restructuring with guarantees on the remaining debt should not have positive effects on the quality parameters for evaluating the portfolio or the ratio of capital to the bank's exposure.

847. Expectations of wide use of the Brady Plan seem far from likely against a background of modest financial resources that have reduced insurance guarantees and therefore discounts, are deprived of authority at least concerning the deadlines for making a choice among the several options, lack the incentives needed to overcome the waivers, and are not accompanied by appropriate tax and banking measures to stimulate the various options and to give them equality of treatment in tax, banking and accounting systems. At the present pace, it seems impossible to tackle urgent problems of such gigantic proportions as those related to the debts of heavily indebted countries in Latin America, Africa and Eastern Europe.

848. However, the Brady Plan has shown the widely beneficial feasibility of substantial debt reduction by presenting several options, in line with the various positions and degrees of acceptability to the creditors, subject to the commitment of international public agencies and Government will, particularly if a single institutional reference figure can develop its leadership. The observations of the banking world on the Brady Plan can be summarized in the following points made, on its behalf by William Rhodes, main negotiator for the Brady Plan. 18/

849. The first point to be made is that the programme is underfunded. Other industrial countries should follow Japan's lead in recycling schemes. France and Spain are reported to be willing to do so.

850. In addition, and this is the second point, Governments should also play their part. Therefore, government export development agencies should restore lines of credit more rapidly to countries that are making progress in economic reform. Through the Paris Club, creditor Governments should lengthen their restructuring and grace periods and lower interest payments, much as the commercial banks have been asked to do for countries in which Brady-like programmes are applied. This action is a fundamental step towards the success of the operations of bank debt conversion into bond certificates enhanced by collaterals or other guarantees. In effect, if a country's overall ability to pay after debt conversion is not adequate, the risk that needs to be insured becomes high. Hence, the conversion operation entails heavy burdens of enhancement with equal results and, above all, again takes up issues of a moral hazard.

851. If other debts are converted in addition to bank debt, leaving rates of individual discount unaltered, the ability to pay is increased and the insurance risk on converting certificates is reduced, while the moral hazard can be restricted.

852. William Rhodes' statement that "Governments too should do their part" fits not so much with equity objectives but secures the viability of co-operation. If Governments support creditors' co-operation, the agreement's pay-off increases enormously from the resulting reduction of the risk factor of individual insolvency in the debt service to be insured.

853. The third point in William Rhodes' remarks refers to the flexibility of multilateral agencies that allocate financial resources for the various operations. Banks should be allowed a choice between the various options available without a predetermined constraint being made of quotas assigned to each option. Fungibility is needed or - in the words of William Rhodes - a co-mingling that allows each of the indebted countries to maximize the benefits obtainable with available resources.

854. The fourth point relates to co-financing by the new expanded co-financing operation of the World Bank. It is a facility intended both for countries that have not restructured their debt, such as Colombia, and for countries such as Mexico and Chile (and, looking to the future, Venezuela and Uruguay) that have finalized the Brady Plan agreements and accepted the terms of economic adjustments that are the normal prerequisites of such a plan. On the one hand, there is a need to reward and sustain those countries that have finalized such agreements, so that other countries that keep accumulating arrears without committing themselves to agreements of restructuring can understand how much better it is to seek an alternative solution. On the other hand, countries without arrears that are candidates for the Brady Plan restructuring scheme must be helped to take advantage of financial and economic opportunities that are of interest to them. This is all the more urgent since as the Brady Plan, owing to its limited resources and other factors, is proceeding at a manifestly slow pace, as has already been made clear.

855. The fifth point refers to the system known as up-fronting, namely the immediate disbursement of financial resources that multilateral institutions are called upon to allocate in order to ensure the implementation of restructuring operations concerning bank debts. In part, these funds are not disbursed immediately and are made available in various stages. In the case of Mexico, as stressed by William Rhodes, commercial banks have had to agree among themselves to make an advance bridging disbursement of those funds. That bridge was not easy to build and meant a waste of considerable time and energy, which could have been used for more fruitful purposes in the negotiations, such as seeking ways to increase new financing. It should be pointed out that such a problem has arisen because there is no permanent authority responsible for restructuring. Otherwise, there would be no need for commercial banks to perform bridging operations, which would then be among the ordinary tasks of the authority arranging waiver clauses and promoting debt restructuring in a systematic framework.

856. The sixth point is related to the interference with the negative pledge clause in connection with World Bank credits. Its removal, as William Rhodes states, would increase the number of restructuring techniques which commercial banks would find practicable.

857. The last and crucial point touched upon by William Rhodes is that of incentives to increase the supply of new financial resources. In nearly all packages, major stress is laid on the continuation of the flow of financial resources to the countries in question. The problem assumes a particularly acute form in Mexico and the Philippines. Once the sacrifices of restructuring have been endured in terms of economic and financial conditions to be met and in terms of arrears payments, and with no inflow of new financial resources, there is no incentive for debt-ridden countries to co-operate rather than renege on their obligations. Their co-operation makes sense only if it takes place in the context of a super-game, in which the burden of complying with certain conditions is offset by the benefit of obtaining new finance. If prospects indicate a halt in the super-game, the debtor country will have no interest in being loyal. 19/

858. Frankly, these remarks have been occasioned by studies on the debt problem rather than by William Rhodes, who at any rate emphasized that there was a group of important banks in several industrialized countries willing to continue their operations in developing countries, especially in Latin America and Asia. Citibank, the only case among the large banks, has announced its interest in operating also in Africa.

859. It has been stressed how right it is to provide incentives to those who make such a choice for the development of developing countries. Such incentives include trade-finance facilities, on-lending, project financing, new money bonds, debt-equity conversions and co-financing with the World Bank and regional development banks, such as IDB. Co-financing with the World Bank certainly gives an incentive to commercial banks, since the negative pledge clause denies access to new World Bank loans for those who have not complied with such co-financing. Debt-equity conversion is included in the Venezuelan package, with the possibility of converting 30 per cent of the loans into stocks at par value. In the other cases, incentives may lie in guarantees similar to those given for the interest bonds and principal bonds used in debt restructuring.

860. Not only does William Rhodes stress the role of incentives for new finance as a positive solution to the problems besetting indebted countries, he also insists on the pervasive effect that could emanate from the concession of new loans by multilateral agencies to indebted countries with large arrears in payment that they are unwilling to adjust.

861. There is no doubt that this super-game makes it clear that, if a country can see the prospect of obtaining new loans from new bodies although it has not yet reimbursed old creditors, it will not be particularly keen to pay interest on those loans. Yet, it must be noted that IMF did not make secret promises on the granting of new loans to countries with heavy arrears. It has made and does make promises in certain conditions, depending on economic and financial adjustments as an instrument to support their performance. It is certainly difficult to choose a line that can meet both the need to avert the economic and financial collapse of an indebted country applying to IMF for rescue and, at the same time, the need to induce that country to honour its debts, within the limits of its ability to pay.

862. Even in the case of private company debts held by other bodies within a given country where full application of the law is allowed on the mandatory demand of arrears payment, conditions may obtain where a bankruptcy makes such a mandatory demand completely useless. And, even then, it may pay to provide some loans to a company in financial difficulties in order to increase its future ability to pay. Undoubtedly, in that case new loans are added to old ones unless a deal is made, while in the case of IMF loans, they come before those previously granted by commercial banks. But IMF is the lender of last resort. It must be able to exercise those macro-economic functions that, in cases of large private bankruptcies, are performed in the various economic systems by central banks.

863. Avoiding debtors' non-compliance and disloyalty spurred by such interventions is a delicate issue, which has presented itself several times in the course of history. 20/ But it cannot be solved by rejecting the macro-economic function of an international lender of last resort to developing countries if they are to be given rights equal to those given to industrialized countries and if there is a real will for long-term global loyalty, instead of the risk of irrational conduct.

864. ECLAC has made the following criticisms of the Brady Plan:

(a) Underfunding. It has repercussions on the too modest interest guarantees, which, together with the complexity of the schemes, make an inefficient financial instrument;

(b) Underco-ordination. The incentives for banks to forgo their demands are not strong enough and what follows is a tendency to step back. According to an ECLAC report:

> "there is no substitute for a coherent institutional framework that makes each country's offer of debt reduction - within the context of an officially supported adjustment programme - one that most banks cannot refuse. The framework must include incentives for good social behaviour and sanctions for antisocial free-riding. The Brady Plan lacks such a coherent structure." 21/

865. In their joint evaluation of the first results achieved by the Brady Plan, the World Bank and IMF acknowledge that, so far, fewer agreements have been finalized than expected. They state that it is desirable that negotiation delays should be overcome but without jeopardizing adjustment programmes and without increasing the vulnerability of those countries whose debts have been restructured in the face of future adverse conditions and, within a debt context, without producing a transfer burden between private and official creditors. The two agencies also affirm that, all in all, Governments have not made efforts comparable to those required from banks concerning official credits towards heavily indebted medium-income countries, while for the poorest even the Toronto plan seems inadequate. Financial resources for debt structuring are therefore to be added to those made available by multinational agencies for development purposes, in order not to reduce funds available for developing countries less affected by debt problems. The World Bank and IMF state that debtor countries should encourage and not discourage direct foreign investments, together with specific project financing and trade operations by commercial banks, and also encourage the repatriation of flight capita.

This implies the adoption of market-oriented reform measures, including the provision of timely repatriation of dividends, the development of local capital markets, the full protection of domestic courts in case of private default and the elimination of financial repression and unfair taxation practices.

Notes

1/ Latin America and the Caribbean: Options to reduce the debt burden, Economic Commission for Latin America and the Caribbean (ECLAC), 1990, p. 9.

2/ Cline, W.R., From Baker to Brady: Managing International Debt, p. 88.

3/ Ibid., p. 90.

4/ The Institute of International Finance, Annual Report, 1988, p. 27.

5/ Subsequently the plan has been applied to Costa Rica, the Philippines and Venezuela (see table XIV.1).

6/ Statement by David C. Mulford, Under-Secretary of the Treasury for International Affairs before the Subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, Urban Affairs, United States Senate, 21 March 1990.

7/ As reported to the authors of the present report in interviews with Mexican Government officials.

8/ For the debtor-creditor relationship as agent and principal, see Corsepius, Uwe, Peter Nunnenkamp and Rainer Schweickert, op. cit., Debt versus equity: financing developing countries, an empirical analysis of the agent-principal model of international capital transfers, (J. C. B. Mohr, Tübingen, 1989).

9/ As reported to the authors of the present report in interviews at the banks. See also remarks by William R. Rhodes, Senior Executive, International Citicorp, Citibank, to the Subcommittee on International Financial Transactions, Ministry of Finance, Tokyo, 13 April 1990.

10/ In the seminar held at Cernobbio.

11/ Nora Lustig.

12/ Some authors include the implicit reduction in total debt associated with the portion of the debt which will be subject to the 6.25 per cent (below market) interest rate.

Notes (continued)

13/ These calculations come from Sweder van Wijinbergern, Mexico's external debt restructuring in 1989/90: an economic analysis, 4 March 1990, World Bank. The 25 per cent is equal to the ratio of $12 billion (reduction in the discounted value of the debt service during the next 30 years obtained through the agreement) divided by $48 billion (total eligible outstanding debt). All these estimates are sensitive to the interest rates assumed in the projections.

14/ Obtained from the following: (12-7)/12.

15/ The average price for the Mexican debt in the secondary market was 39.5 cents to the dollar in 1989.

16/ Charles Plunkhlin, "Waiver clauses: Brady's Achilles' heel", International Economy, May-June 1981.

17/ R. Dornbusch, "The Brady plan won't work", International Economy, May-June 1989, p. 46.

18/ From the interviews and discussion of the authors of the present report held at Citibank, New York, on 23 April 1990.

19/ Chakravarti and Hollis.

20/ See, among others, Dornbusch, op. cit., and as quoted in the appendix to the present report.

21/ ECLAC, op. cit.

XV. DEBT-EASING PLANS OF BILATERAL AND MULTILATERAL OFFICIAL CREDITORS

A. The Paris Club and the Toronto programme

866. The Toronto programme applied by the Paris Club, in accordance with the Toronto Group of Seven agreements finalized in Berlin at the World Bank and IMF Annual Meeting of 1981, is a typical example of stinginess disguised as generosity. It concerns the restructuring of developing countries' debts with Governments in rich countries but, while the Brady Plan calls on commercial banks to implement substantial debt reductions for all the heavily indebted countries, the Toronto programme addressed only the Governments in the poorest among the heavily indebted countries, leaving out both poor countries with medium debt levels, together with middle- and low-middle-income countries, although heavily indebted. Furthermore, it presents a menu of options, each of which contains advantages and disadvantages for the indebted countries to which it is addressed and, as becomes clear from examples given below, the options all contain future incremental burdens.

867. However, these limited and questionable benefits are applied by the Paris Club not to all debts with bilateral official institutions, but only to non-concessional lending with Governments. Concessional lending to Governments is not eligible for restructuring, nor is bilateral non-concessional lending to official entities of other than Governments. Estimates indicate that debt-service obligations covered by the Paris Club represented only one third of the non-concessional debts with bilateral official creditors of the five countries whose debts were restructured in 1988. In addition, the benefit during the initial period, compared with conventional restructuring, consists only of a reduction in interest on delayed payments. It has been estimated that the immediate additional benefit for the five countries in question is a mere $10 million per year. Furthermore, creditor countries are financing this restructuring with the development assistance resources, thus reducing the additionalities of the Toronto commitment. 1/

868. The three options, as illustrated in the Toronto communiqué, are as follows:

(a) Concessional interest rates with shorter maturities;

(b) Longer reimbursement periods with commercial interest rates;

(c) Partial cancellation of the debt service obligations during the consolidation period.

869. The only advantage of option (b) in comparison with conventional restructuring lies in savings on interest for delayed payments. Yet it is clear, or at least it should be, that long-term non-concessional lending produces the same burden as short-term non-concessional lending, provided that both require payment of market interest rates. Support for this option derives from the greater risks of not being paid run by creditors with long-term loans, and hence an extension of the period is a concession in itself. It can be argued that it is exactly such an extension of the period that can reduce the risk as the burden is shared over several years and, if interest remains unchanged and is not concessional, there is no real discount for debtors nor a burden for creditors. It is true that debtors

benefit from a short-term advantage, but their future burden grows. The weak point of all the Toronto options, as can be easily seen from figures XIV.1 and XIV.2, is the growth of the future debt burden.

870. Option (a) seems the most logical to solve the problem of difficult or impossible payments because it includes a reduction in the interest burden, yet it can be criticized for two reasons. First, the reduction is not enough for poor countries since it amounts to 0.5 per cent or to 3.5 per cent, according to the smaller percentage. Assuming an interest rate of 9 to 10 per cent, the reduction is only 3.5 per cent, that is to say comparable to the level of the Brady Plan, but one that fails to help middle-income heavily indebted countries out of the crisis and a fortiori fails to help poor heavily indebted countries. The initial programme of the Brady Plan involved a greater reduction. However, since approval by the commercial banks is needed, and taking into account the financial balance of the most exposed banks, sights have been lowered.

871. In government lending this issue is of secondary importance since debts with developing countries are very small. For the poorest countries' debts the 3.5 per cent discount is really too small in both distributional and economic terms, given their ability to pay. Furthermore, maturity extension subsequently gives rise to a burden concentration that makes it more difficult to overcome any crisis and lays the foundation for further restructuring.

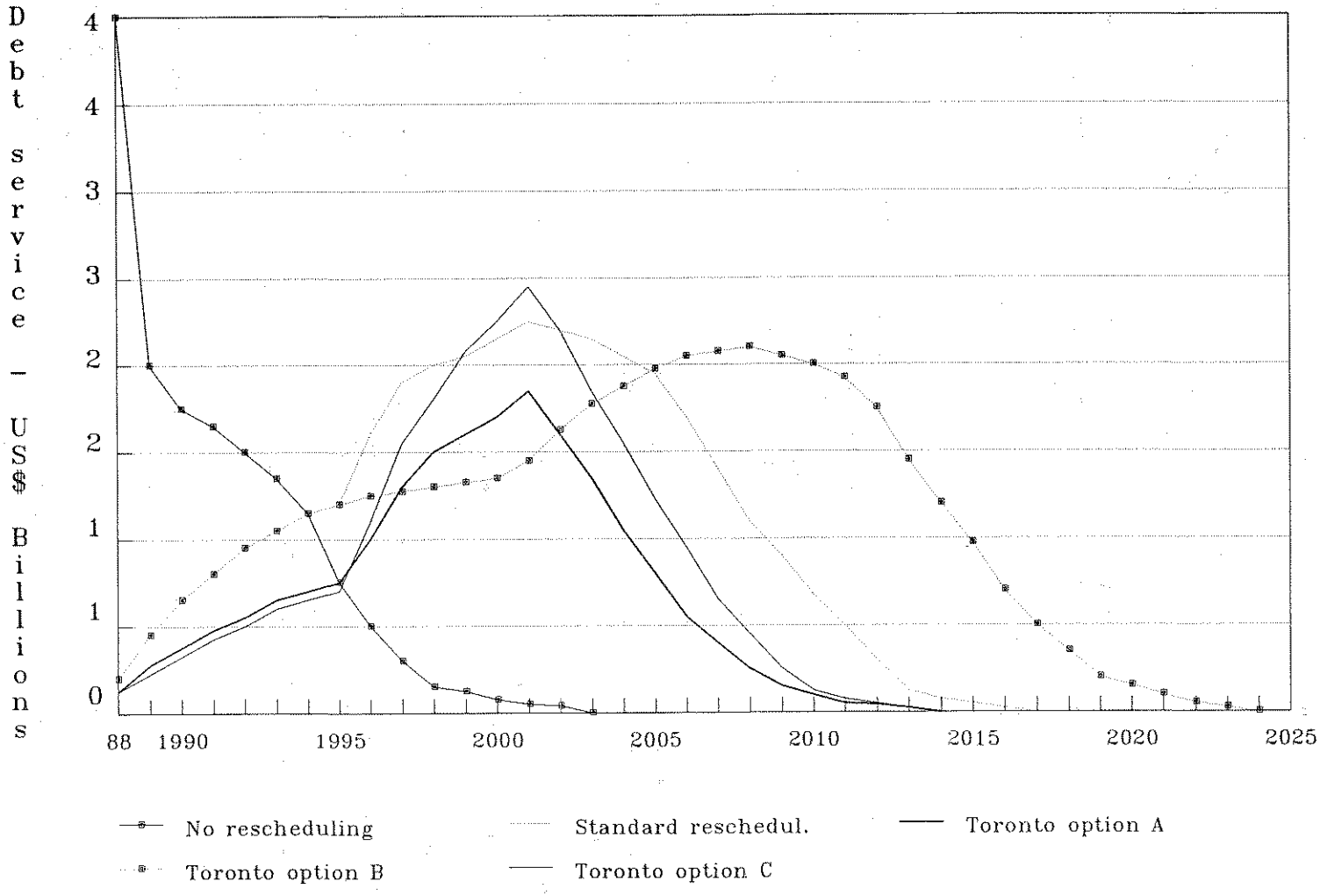
872. More generally, future accumulation of debt burdens prevents low-income indebted countries from having access to commercial credits and investments, hampering their return to the market, usually regarded as a fundamental feature in adjustment plans.

873. Governments obviously disregard the secondary market for their credits. But if they took into account the secondary market for bank credit in low-income heavily indebted countries, they would realize that the ability to pay is estimated at about 10 per cent and less. It rarely happens that secondary-market values for low-income countries in Africa reflect elements of moral hazard, based on strategies suitable for devaluing their debt in the secondary market. Usually, insolvency vis-à-vis credits held by multilateral and bilateral public institutions is now occurring dramatically, thus reflecting a really impossible situation. It is true that such insolvency reflects wasteful projects implemented in the past by the Governments of indebted countries, owing to serious mistakes in their economic structure and to excessive military spending. It is also true that those countries often need a stringent perestroika, but it is also true that their real ability to pay, also in relation to their debts with public bodies, is given by the secondary-market debt values, which would imply debt discounts much larger than those identified by the Toronto programme.

874. On the other hand, the variety of options cannot be justified by the different regulations covering taxation, bank supervision authorities and corporate bookkeeping. Efforts to bring Governments' behaviour into line with the needs of the various low-income indebted countries should hence be easier and the time period shorter.

Figure XV.1

Debt Service - Toronto term comparison for 22 SPA countries a/
1988-2025

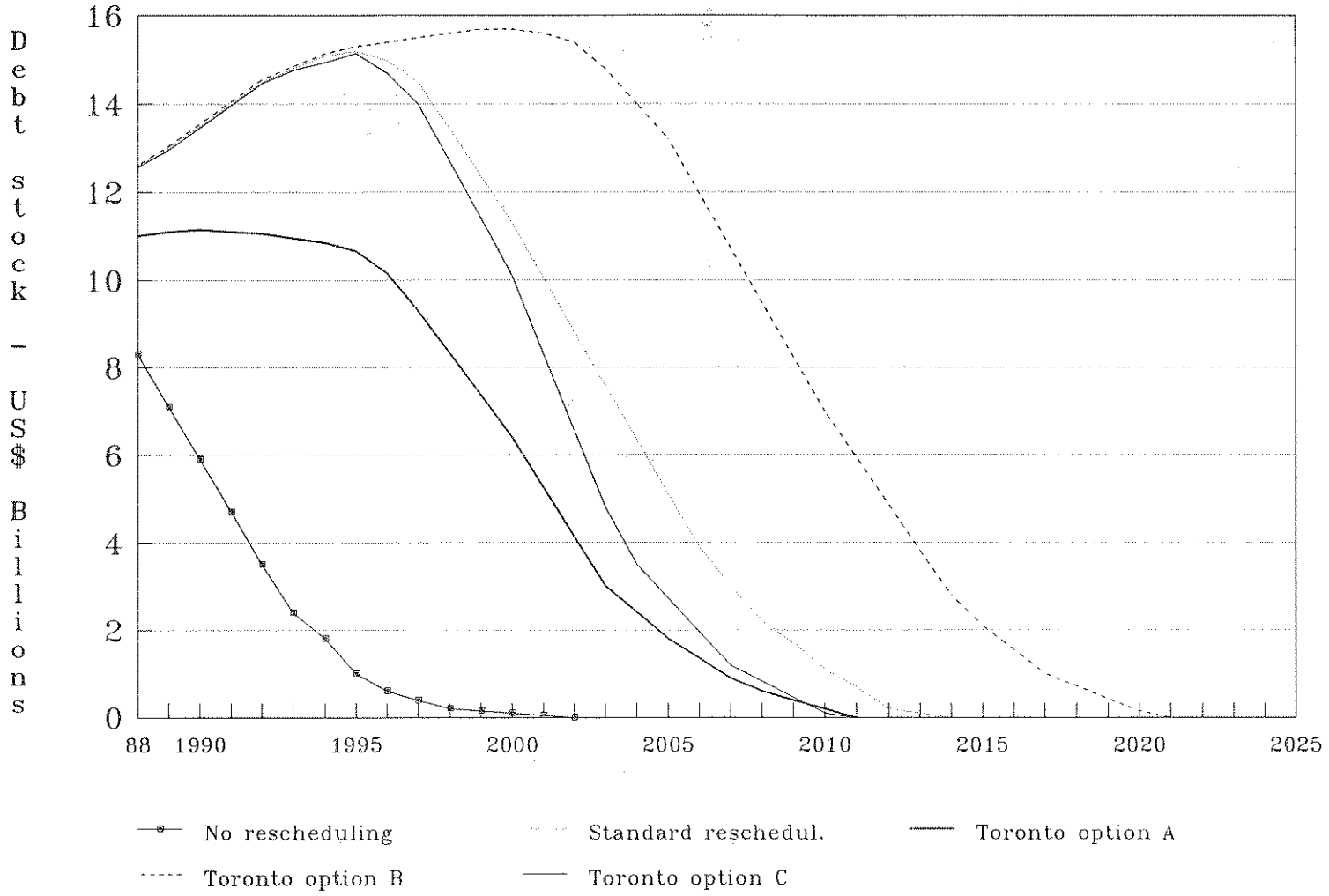


Source: Charles Humphreys and John Underwood, op. cit.

a/ Countries covered by the World Bank's Special Programme of Assistance to Sub-Saharan Africa.

Figure XV.2

Debt Stock - Toronto terms for 22 SPA countries a/
1988-2025



Source: Charles Humphreys and John Underwood, op. cit.

a/ Countries covered by the World Bank's Special Programme of Assistance to Sub-Saharan Africa.

875. The fact that the debt rescheduling arrangements concerned with debt to Governments through the Paris and London Clubs quite often have not produced the desired results is evidenced by the fact that several countries in sub-Saharan Africa had to go to the Paris and London Clubs several times to reschedule their debts. In 1983-1985, for example, countries in sub-Saharan Africa went to the Paris Club 40 times to renegotiate their debts. Between 1980 and 1988 sub-Saharan Africa engaged in 105 reschedulings with the Paris Club, all with time-consuming procedures. 2/

876. The same holds true for one element of the Toronto agreement that until now has been neglected, namely the commitment to debt cancellation for the poorest countries. The list of debt cancellations is so far extremely limited. Between 1980 and 1988, donor countries wrote off only $1.2 billion in debts to low-income heavily indebted countries, whose debts amount at present to $104 billion. Other debts in the amount of $1.1 billion have been cancelled among the low-income countries that do not belong to severely indebted category.

877. The effect of such cancellation is insignificant because the debts were at very low interest rates, and probably could have benefited from the Paris Club treatment. The benefit for low-income heavily indebted countries resulting from such cancellation is estimated by IMF at a mere $80 million a year out of $1.2 billion in debt service. It represents 6.6 per cent of that debt service.

878. It is an insignificant figure even for the poor countries in question. Italy, however, has announced the cancellation of debts with Governments for $440 million out of a total debt of $1.2 billion. Other countries have announced debt cancellations for the poorest heavily indebted countries. If all promises are kept, the total amount will be $5 to $6 billion in loans granted on highly favourable terms, with additional debt service savings of $400 million a year, out of an annual total figure of $8 billion.

879. Such cancellation can be hindered by formal problems related to the State budgets of creditor Governments and of their lending agencies, and by politico-psychological problems connected with the gravity of the precedent of turning loans into grants. There are also ethical issues relating to the reasons why those debts were contracted, and those are not always sound.

880. The answer can be found by turning loans with very low interest rates into very long-term loans which, in financial terms, would amount to an 80 to 90 per cent cancellation of the debt value, as capitalized flow. Another solution lies in the payment of the residual service in local currency, with the indebted countries pursuing objectives of an environmental, economic and social nature. This proposal will be enlarged upon below.

B. The World Bank and international financial institutions

881. In December 1988, at a conference of donor countries, the World Bank launched the Special Programme of Assistance to sub-Saharan Africa (SPA) for low-income debt-ridden countries in sub-Saharan Africa. This programme does not tackle

directly the problem of those countries' debts with the World Bank or with other multilateral public bodies, nor does it tacke the issue of financing operations or debt repurchase, swap or cancellation with commercial banks. At 10 per cent of the face value, the medium-term bank debt of those countries could be paid off with $350 million dollars. 3/ During the three-year period 1988-1990 the programme provides for heavily concessional finance for specific structural programmes and for the financial relief of the balance of payments of indebted countries in order to allow them to purchase essential imports.

882. The programme carries three strict conditions: (a) eligibility for IDA credits (as a poverty indicator); (b) indebtedness problems (originally a debt service accounting for at least 30 per cent of exports projected over the three years; and (c) implementation of an adjustment programme approved by the World Bank. Interventions are of two types: more IDA loans and more co-financing of adjustment operations with other bilateral or multilateral donors.

883. The World Bank has financed such initiatives by asking industrial countries for a commitment of $6.4 billion for those African countries during the three years. Unfortunately, those financial resources are usually derived from the normal ODA.

884. In late 1987 IMF set up the Enhanced Structural Adjustment Facility (ESAF) to help low-income countries with longstanding balance-of-payments problems to adjust their policies and to launch a more effective medium-term process of growth. This programme is in addition to the Structural Adjustment Facility (SAF) set up in March 1986.

885. Together, the two programmes will provide low-income countries - especially in Africa - with $11.7 billion in 10-year credits at a highly concessional interest rate of 0.5 per cent with a five-year grace period. Almost two thirds will come from ESAF and one third from SAF.

886. This is not a negligible amount, considering the conditions of extreme financial stringency besetting poor countries, particularly in Africa. In effect, without such support and without the World Bank's SPA, the picture would be tragic instead of merely dramatic, but these interventions are both ad hoc and insufficient, since they do not squarely face the issue of the burden of existing debt. Therefore, the Facility does not tackle the debt problem directly, and this can only point towards technical difficulties within IMF, together with the excessively rigid positions by some of the most influential countries within IMF. Those rigid positions are reflected in the conditions attached to SAF and ESAF.

887. The 0.5 per cent concessional lending by IMF is linked to the quotas of the various countries within IMF. In addition, it has a maturity of 10 years, which involves an annual 10 per cent disbursement on average. Although the interest burden accumulated is low, the five-year grace period only makes the problem worse, with a concentration of the reimbursement burden in the second five-year period, causing problems of liquidity that are absolutely critical.

888. Although, given the current dollar inflation rate, the loans in question have a negative real interest rate, reimbursement is required too quickly and the low-income countries in question are not in a condition to pay until the structural and institutional causes of their low ability to export are removed, as well as the reasons for their low growth rates.

889. Even the 165 per cent extension of the share of IMF concessional lending to low-income countries does not solve the problem. In a certain way, it only postpones it, driving those countries more and more away from the usual financial market channels and increasingly discouraging the investment of domestic savings as well as direct foreign investments, the only exception being some powerful multinational corporations capable of overcoming by themselves every possible barrier to the retention of foreign exchange earned by their exports.

890. There are fears that in many cases reimbursements will simply not be possible. As of now arrears towards IMF are expanding dangerously. This not only undermines IMF's reputation but, since it is the privileged creditor, arrears with it also have far-reaching negative effects on the creditworthiness of countries reduced to insolvency. Extreme penalties imposed on those countries, such as expulsion from IMF, are unthinkable owing to their inequity and to their devastating economic effects. But even depriving those countries of their voting rights within IMF appears to be a disproportionately severe sanction. Insolvency is normally the result the economic and political impossibility to pay, and the situation cannot be reversed by the threat of sanctions. It has to be met with financial policies that can leave debtors wider room for manoeuvre such as an extension of payment deadlines and the possibility of paying in local currencies.

891. After all, it is in the interest of industrial countries, beginning with the Group of Seven, that IMF appears to be and really is a respectable institution, capable of collecting its debts regularly. Consequently, those debts should be formulated in such a way as to be payable with a large element of concessionality for public debts and the concessional supply of new finance in order to help poor countries to develop.

892. The problem concerning credits from Governments, IMF and the World Bank, as it relates to arrears, is not confined to poor countries but also concerns middle-income and low- to middle-income countries. The potential role of these institutions is twofold: financial back-up of buy-back operations with swaps or cancellation for middle-income heavily indebted countries in terms of debts with commercial banks; and financing debt reduction with multilateral official creditors and, if relevant, with State insurance companies in the industrialized countries. The first type of intervention is being implemented through the Brady Plan with considerable limitations and problems deriving from the need to leave concessional elements out of such operations, since they are financed with the ordinary means available to such institutions. The concessionality principles that have inspired rescue operations by lenders of last resort are different, in the face of the financial crises that hit the banking and industrial systems in the industrialized countries in the 1930s or in more recent years.

893. Actions by lenders of last resort imply at least the potential use of authority to replace the liquidity destroyed by the crisis. The time is ripe for the Group of Seven to give the multilateral institutions controlled by its members an effective role as lenders of last resort, both with developing countries, in the strict sense, and with Eastern European countries. Otherwise, the dramatic financial crises of such countries will have negative repercussions on world stability.

894. A serious shortcoming in the Toronto plan is that it includes only creditor countries represented by the Paris Club, namely the Western countries plus Japan. The Arab oil-exporting countries are excluded. Starting with Saudi Arabia, they play a very important role in the financing of developing countries, with particular reference to African developing countries and to non-oil-exporting Arab countries. A similar exclusion took place with the Brady Plan in connection with regional development banks. Regional banks in Arab oil-exporting countries are very important. In particular, since 1980 Saudi Arabia has provided aid in the form of grants and highly concessional lending to the tune of about $60 billion, 40 per cent of which was in the form of loans. Some of those loans have been granted by the Saudi Development Bank with concessional interest rates of 1 to 4 per cent on the basis of a rotating fund of $6 billion which is tied to its endowment fund of the same amount. The loans in question cannot be restructured without causing damage to the operational character of the fund if new soft loans to developing countries are to be offered. However, a sizeable share of the loans of Saudi Arabia and of the other Arab countries has been granted on the basis of techniques that differ from those of rotating funds and could be included in the restructuring of the Paris Club, should the Arab oil-exporting countries be asked to join it.

895. On the other hand, the regional institutions financed by the Arab countries play or could play a role comparable to that of the World Bank in supplying new funds for structural adjustment programmes in indebted countries. This holds true particularly in the case of the Saudi Development Bank, whose interest rates are highly concessional.

896. The Saudi Arabian Government has expressed its regret at not having been called upon to play a role concerning the problem of debt with commercial banks, with Governments and with multilateral institutions, and also concerning the question of new finance for indebted countries.

897. In a more co-ordinated context of Governments' and multilateral institutions' action in relation to those debts, Arab oil-exporting countries and their regional financial institutions can in actual fact offer a substantial contribution to the solution of the problems of Africa and the Middle East since a systemic crisis has to be faced in a systematic way. Arab oil exporting countries already play an exemplary role in development assistance. In the 1980s, Saudi Arabia's ODA as percentage of GDP was many times that of Western countries. Even now, when such aid is being cut, the figure was 2.75 per cent of GDP in 1989, i.e., about $2 billion a year. It may be conjectured that one of the factors accounting for the curb in aid was Arab disappointment at not having been called upon to play the role that such a high figure warrants, when at the same time Western countries are

still giving only 0.4 per cent of their GNP and have made no progress yet towards the 0.7 per cent target that was set in the early 1980s. The figure itself (0.7 per cent instead of 1 per cent) implies a reduced commitment towards the poor countries by the rich. Failure to reach the 0.7 per cent presents a picture of ineffectual action that deserves careful consideration. In practice, 0.3 per cent of GNP is about $40 billion on the basis of the 1989 GNP in high-income countries. The whole problem of transfers from poor countries to rich countries - which has arisen as a result of the debt problem would be eliminated.

Notes

1/ See Charles Humphreys and John Underwood, "The External Debt Difficulties of Low Income Africa", in Ishrat Husain and Ishac Diwan Dealing with the Debt Crisis, World Bank Symposium, 1989.

2/ Taylor, A.B. "The debt problem of sub-Saharan Africa" in A. O'Neil (ed.) Third world debt, How sustainable are current strategies and solutions? Frank Cass, London 1990, p. 22.

3/ Charles Humphreys and John Underwood, op. cit., p. 56.

XVI. THE INTERNATIONAL FISCAL CONSTITUTION, DEVELOPMENT CREDITS AND NEW FINANCE

A. Transfers between rich countries and developing countries: the international constitution of public debt

898. Resource transfers from developed to developing countries, which had been positive until 1984, became close to zero in the subsequent years and are now negative (see table XVI.1). The main reasons for this phenomenon are the huge amount of interest paid by developing countries to developed countries ($54 billion in 1988) (see table XVI.2) and the reduction in the private market net flow of financial resources to developing countries. The merchandise trade balance of developing countries still shows a deficit; however that of highly indebted countries has a surplus of $26 billion, equal to 25 per cent of the value of imports and to 20 per cent of exports. Furthermore, if workers' remittances are added to merchandise trade, there is a surplus rather than a deficit in the aggregate trade and services balance of payments of developing countries. This was necessary to achieve equilibrium or to avoid an unbearable disequilibrium in the general balance of payments, inclusive of foreign aid, given the very small private market financial and the high interest and payments on loans (in spite of arrears). The positive effects on the general balance of payments from transfers originating from development aid were totally nullified, and the final result was a negative balance for developing countries.

899. In 1982, as shown in table XVI.1, developing countries received a net flow of $60 billion: some $50 billion in public aid and over $70 billion in private financing, a total of $128 billion, minus $60 billion for debt service. The total balance fell to $35 billion in 1983, to $20 billion in 1984 and to only $3 billion in the following two years. The result for 1987 was a small negative balance and for 1989 a negative balance of $8 billion. The prime cause is deflated private market flows, which gradually shrank from $75 billion in 1982 to $17 to 8 billion in the years 1986 to 1989. The main reason for this drop lies in the lower level of private loans which, in the early 1980s, were largely made up of commercial bank loans. From $62 billion in 1982, that flow became $10 billion in 1986, zero the following year, $4.5 billion in 1988, and a negative $2 billion in 1989. In contrast, direct investments were stable, at around $10 billion a year.

900. However, it must be noted that official flows also diminished, and this was particularly the case with non-concessional lending, which fell from $18 billion in 1982 to $5 to 6 billion in 1987-1989. This was due to the lower level of World Bank flows (close to zero), while IMF flows became negative in 1985. It is true that they are institutions that provide their finance on a revolving fund principle, but it is also true that, while their net financing was considerable in the early 1980s, it is now practically non-existent. This has repercussions, because of the limitations on the concessional financing available to these bodies. The flows of services to them were sustained by the commercial banking system, which is rather improper. On the other hand, loans from regional banks did not grow enough to fill the gap left by the institutional and operational constraints on the international financial institutions.

901. It must be noted that net transfers from developing countries would have been much higher had they not accumulated arrears. Although this situation was not brought about directly by a halt in the flows of finance from industrialized

countries to developing countries, it can certainly be indirectly ascribed to it. Arrears, on the other hand, caused a further reduction in these flows. After all, the trend is the result of different situations in the various regions of the world and in the various groups of countries, and this is not an arbitrary matter but is rather the result of existing rules and institutions. Indeed, bank loans were never very important in heavily indebted countries compared to development assistance so that, when loans fell to zero and even to negative levels but development aid remained unchanged at an annual average of $6 billion, the trend in transfers was not reversed from positive to negative, but in constant dollars was just halved (see table XVI.3). Had the countries in question not accumulated arrears on their public and private debt service, transfers would not now be positive. It is hard to deny the rich countries' obligation towards them, an obligation of solidarity that they do not adequately fulfil through their public institutions and through others under their control.

902. Although the international financial institutions have some, albeit limited, concessional facilities and instruments, their flows to those countries have now become negative. Private aid ($1 billion a year) is higher than direct investment and accounts for one quarter of government grants. Almost all low-income heavily indebted countries are in Africa. Reported figures refer primarily to Africa and those relevant to all poor countries in Africa (see table XVI.4) are slightly different. The situation of poor countries in Asia (usually not heavily indebted although they could rapidly become so unless properly assisted) is better (see table XVI.5). Net transfers towards them were $9.5 billion in 1982 and $5.8 billion in 1989. Public flows towards them were essentially the same in 1982 and 1989, while they grew in the years in between. This led to an increase in positive transfers that allowed them to avoid the crisis into which low-income Africa countries have been plunged. International Development Association (IDA) net flows to those countries amount to $2 billion out of the $8 billion provided by rich countries for promoting development. The ratio of all such aid to the total population is very low and only the minor role played by bank loans and direct investment in total transfers towards those countries has prevented matters from getting worse. It is not a case of banks first going in and then pulling out; they simply never went in.

903. A more severe problem of negative transfers occurs with heavily indebted middle-income countries, mainly concentrated in Latin America, but is also to be found in Eastern Europe and in North Africa (see table XVI.6). These countries have experienced net transfers that rose from $14 billion in 1983 to $23 billion in 1989, with a peak of $27 billion in 1986. Private loans, amounting to $37 billion in 1982, fell to $16 billion in 1983, $12 billion in 1984 and $7 billion in 1985. Since 1986 the flow has been negative. Direct investments, too, have been dramatically reduced in the countries under review. Public financing also shrank, particularly as a result of a fall in the amount of non-concessional lending. In 1989, financial flows of official aid were half those in 1982.

904. In Latin America the problem is worse. Negative transfers have been experienced since 1982, and by 1989 totalled $231 billion. This is the result of the considerable rise in debt service and of the large drop in new money.

Table XVI.1 Aggregate long term net flows and transfers of resources towards developing countries
(In billions of dollars at 1987 prices and exchange rates)

	1982	1983	1984	1985	1986	1987	1988	1989
Development aid and private aid	52.8	50.3	55.2	53.8	46.7	40.2	38.3	40.4
.Grants and concessional lending	34.0	31.8	36.5	40.4	35.2	34.7	33.2	34.3
.Official lending at primary terms	18.8	18.6	18.7	13.3	11.5	6.5	5.1	6.1
Private market flows	75.1	50.6	40.7	26.5	17.3	9.9	17.3	8.2
.Banks	61.7	40.9	29.6	21.7	10.2	0.1	4.5	-2.3
.Direct investments	13.3	9.7	11.1	4.6	7.1	9.8	12.6	10.6
Aggregate net flows a/	127.8	100.8	96.0	80.1	64.0	50.2	55.4	48.6
Net transfers b/	60.4	34.9	19.6	2.8	3.7	-3.3	-0.9	-8.2

Source: Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

a/ 3 = 1 + 2.

b/ 4 = 3 + current balance of developing countries.

Table XVI.2 Trade deficit and surplus and interest payments on external debt of developing countries, 1988
(In billions of dollars)

	Developing countries merchandise trade a/			Interest payment on external public debt
	Imports	Exports	Deficit surplus	
Low-income economies	131	107	-24	10
Lower middle-income economies	163	172	+9	30
Upper middle-income economies	176	168	-8	14
All low- and middle-income developing economies	470	449	-21	54
Sub-saharan Africa	33	29	-4	3
East Asia	168	174	+6	9
South Asia	36	22	-14	3
Europe, Middle East and North Africa	138	103	-35	12
Latin America and Caribbean	79	101	+22	25
Severely indebted economies	102	128	+26	28

Source: World Bank, World Development Report, World Development Indicators, 1990.

a/ Workers' remittances, which obviously are not included in the merchandise trade, amount to about $30 billion.

Table XVI.3 Aggregate long-term net flows and transfers of resources towards low-income highly indebted countries
(In billions of dollars at 1987 prices and exchange rates)

	1982	1983	1984	1985	1986	1987	1988	1989
Development aid and private aid	8.3	8.2	9.0	8.0	8.4	7.3	7.4	8.0
Grants and concessional lending	7.3	7.8	6.5	5.9	8.0	8.1	7.5	7.9
Official lending at primary terms	1.3	1.9	1.1	0.0	0.8	0.4	0.2	0.4
Private market flows	6.1	2.2	-1.3	-2.1	+0.4	1.2	0.3	0.2
Banks	4.5	2.0	-0.6	-1.5	-0.3	0.4	0.0	-0.1
Direct investments	1.6	0.2	-0.7	-0.6	0.8	0.8	0.2	0.3
Aggregate net flows a/	14.4	10.5	7.7	6.0	8.8	8.5	7.7	8.3
Net transfers b/	12.0	7.9	6.7	2.7	7.1	6.9	5.4	5.8

Source: Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

a/ 3 = 1 + 2.

b/ 4 = 3 + current balance of developing countries.

Table XVI.4 Aggregate long-term net flows and transfers of resources towards low-income African countries
(In billions of dollars at 1987 prices and exchange rates)

	1982	1983	1984	1985	1986	1987	1988	1989
Development aid and private aid	10.0	10.1	11.4	11.1	10.3	9.8	8.9	9.2
Grants and concessional lending	8.7	8.3	10.3	10.6	9.5	8.3	8.7	8.9
Official lending at primary terms	1.3	1.9	1.1	0.1	0.8	0.5	0.2	0.4
Private market flows	6.1	2.2	-1.1	-2.0	+0.5	1.2	0.3	0.3
Banks	4.5	3.0	-0.4	-1.4	-0.3	0.5	0.1	0.0
Direct investments	1.6	0.2	-0.7	-0.6	0.8	0.8	0.2	0.3
Aggregate net flows a/	16.1	12.4	10.3	9.2	10.8	10.1	9.2	9.4
Net transfers b/	13.9	9.9	7.2	6.0	9.1	8.5	6.9	7.0

Source: Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

a/ 3 = 1 + 2.

b/ 4 = 3 + current balance of developing countries.

Table XVI.5 Aggregate long-term net flows and transfers of resources towards low-income Asian countries
(In billions of dollars at 1987 prices and exchange rates)

	1982	1983	1984	1985	1986	1987	1988	1989
Development aid and private aid	10.8	9.1	10.1	10.9	9.2	8.4	9.05	9.02
Grants and concessional lending	8.9	8.1	9.3	9.7	7.9	7.2	7.4	7.3
Official lending at primary terms	0.9	1.1	0.8	1.2	1.3	1.3	2.1	2.0
Private market flows	2.1	2.5	3.3	6.0	6.8	8.5	6.2	3.4
Banks	1.9	1.5	3.1	5.5	6.5	7.0	6.1	3.3
Direct investments	0.2	0.1	0.3	0.5	0.3	1.5	0.1	0.1
Aggregate net flows a/	11.9	10.6	13.4	17.0	15.0	15.9	15.7	12.6
Net transfers b/	9.5	7.9	10.2	13.4	12.6	13.0	11.1	5.8

Source: Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

a/ 3 = 1 + 2.

b/ 4 = 3 + current balance of developing countries.

Table XVI.6 Aggregate long-term net flows and transfers of resources towards medium-income highly indebted countries
(In billions of dollars at 1987 prices and exchange rates)

	1982	1983	1984	1985	1986	1987	1988	1989
Development aid and private aid	9.7	8.8	10.2	9.7	9.3	6.8	6.5	4.5
Grants and concessional lending	3.8	3.3	3.1	4.4	3.7	3.7	3.4	2.9
Official lending at primary terms	5.9	5.4	7.1	5.3	5.6	3.1	3.1	1.6
Private market flows	39.9	16.1	15.4	7.6	1.4	4.7	3.8	-1.4
Banks	37.3	16.4	12.3	6.9	-0.2	2.4	0.3	-2.8
Direct investments	2.6	-0.3	3.1	0.8	1.5	2.3	3.5	1.2
Aggregate net flows a/	49.6	24.8	25.6	17.3	10.6	11.5	10.3	2.9
Net transfers b/	8.7	-13.9	-18.9	-27.0	-21.0	-16.0	-19.6	-22.0

Source: Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee).

a/ 3 = 1 + 2.

b/ 4 = 3 + current balance of developing countries.

905. The issue of acquiring new financial resources is closely connected with that of easing the debt burden, for two reasons. There are countries that have restructured their debts and are, so to speak, putting their houses in order. They have a critical need for fresh resources to support their investment programmes and to make sure they can be carried out, subject to their meeting the conditions of international creditworthiness. It is also important that guarantees cover the repatriation of capital without running the risk of insolvency.

906. If debtor countries know that they will be regarded as creditworthy, whatever easing arrangements are made they will make sacrifices to pay back their debts, even if they have to remain insolvent.

907. Governments will face the unpopular issue of tax and price increases and measures aimed at improving economic efficiency if they know they can rely on a return in terms of international credit-worthiness that ensures access to an adequate level of foreign financing. However, this is not an automatic process that follows adjustment or commercial debt reduction plans.

908. There is a delicate transition period marked by the misgivings of those particular banks that have experienced large losses on previous loans and have been highly exposed, vis-à-vis the level of provisioning, in the country in which restructuring is to be carried out.

909. It is necessary to overcome the dangerous deadlock in which banks, international investors and domestic capital exporters all adopt a wait-and-see policy, waiting for someone else to make the first move.

910. On the other hand, in addition to countries that have overcome or are in the process of overcoming their crisis, there are countries that may plunge into similar crises, owing to the process of transformation of their economies from collectivist or semi-collectivist to market models. The issue is very urgent in Eastern Europe, but it is also present in other areas. There are countries in Africa, Latin America and Asia that need to adjust their economies to the market and to break away from the bureaucratic economic planning of the past.

911. If market transition is not accompanied by new instruments for international financing, it can produce new forms of external debt, or it may simply not be sustainable because of excessive or prolonged deflation and a halt in the growth process. The latest IMF report contains alarming indications of such a slowdown in the growth process in developing countries and in Eastern Europe, including the Soviet Union. Growth in world production, estimated at 3 per cent for 1990, was 2.5 per cent in 1989. This can be ascribed, first of all, to a downward adjustment of the figures covering the countries of the former Soviet bloc, whose 1990 growth rate is now estimated at 0.1 per cent. Another reason is that the actual 1989 growth rate was 0.4 per cent and not 1.7 per cent as was widely expected. Even the current estimates for 1990 will have to be adjusted by similar percentage reduction, the result being a negative growth rate in GDP of 1.2 per cent, coupled with high inflation rates. In 1988, the growth rate was positive at 1.8 per cent.

912. Previous estimates for 1989 covering the economies of non-oil-exporting developing countries have been reduced by 0.4 per cent and those for 1990 by 1.2 per cent. The annual growth rate is expected to fall to 3 per cent in the two years, compared with the previous 4.7 per cent. This figure reveals a series of markedly different trends in developing countries hit by the debt crisis and those that have not suffered such a crisis or have managed to muddle through because they were hit only marginally, because they were helped by increased prices of the raw materials that they export and by new financial flows or because they adopted sound fiscal measures and policies that put a premium on enterprise and saving.

913. However, the debate on the supply of new money should not be confined to bank loans only. The scope must be broadened to include the various instruments and institutions promoting financial flows between industrialized countries and developing countries. As already indicated, the volume of development assistance often plays a decisive role in determining the net balance of flows between the former and the latter countries. Yet it is also important to consider the effect of such aid in supporting the investments made by market operators.

914. It will be hard to avoid new problems of external debt in low- and middle-income countries if development aid policy maintains its current low profile. The result must be a clash between grants and soft loans and between aid requirements of poor countries and that of middle-income countries; between the need for additional financing from the international financial institutions (World Bank and, on a different level, IMF) and the need for additional finance and expansion in the number and in the scope of regional banks; between the need to support the growth process of third-world countries and the need to support the transition to a market economy by the former Communist countries; between the intervention needs of middle-income countries that have had, or run the risk of having, serious debt problems and the financial needs of low-income countries that did not have these problems, thanks to their lower level of spending and their managerial capability.

915. The deficit control action performed by IMF is not supported by appropriate instruments for reaching the adjustment-with-growth objective. There is a need for more intervention by multilateral agencies and special bodies, with additional resources to finance growth. The World Bank and regional banks should finance on concessional terms public infrastructure that provide external economies and economic benefits only in the very long run.

916. The function of offering collateral and of support and incentives for debt reduction operations creates further tasks for these institutions and implies new elements of risk.

917. Not all problems can be solved by soft loans or by concessional insurance. Even highly concessional lending must be reimbursed, although over a longer period. Nor can insurance guarantees simply exempt debtors from fulfilling their obligations. They simply postpone the burden. In some cases, it must be clear from the very outset that a loan is not suitable and that only a grant is appropriate. In the case of certain projects that offer social or environmental but not economic benefits (not even in a generic form), credit financing is not

suitable, especially in the case of low-income developing countries, with low export capabilities and with low resources as a result of their public finance and balance-of-payments situation. It is a mistake to consider ex post facto that a debt problem is hard to solve when, since its inception, it ought to have been solved in a different way and with different instruments.

918. Part of the debt problem has arisen because, instead of grants, the instruments used were bank financing and official soft loans or even normal loans. Such a mistake must not be repeated, but it is important instead to have new funds for development plus a set of rules that should be complied with by all institutions, both public and private. As to the choice between ordinary and concessional loans, and between the latter and grants, the rules of an international fiscal and monetary constitution will have to be governed by objective critieria, covering the type of financial intervention (general or on specific projects), income level, export capability, social requirements and the economic situation of the country in question. On the other hand, it is necessary to accept the principle that help is deserved only by those who direct their efforts towards solving their problems as far as possible with the resources of their taxpayers and their savers. The phrase "as far as possible" implies compliance with the principle of respecting the fundamental human rights upon which the principles of civilization accepted by democratic nations are based. At any rate, there are problems in the developing world that must be shared by the world community, to which industrialized nations also belong.

919. Inevitably, the adoption of the principles of an international fiscal and monetary constitution for solving the problems under scrutiny involves raising the share of ODA as a percentage of GNP from the present 0.35 per cent per annum gradually to 0.75 per cent. No set of rules for financial flows to developing countries can work effectively unless this is understood. It must not be forgotten that transformation from grants to soft loans and concessional lending, based on such treatment as most favoured-debtor treatment or even less-favoured-debtor treatment, has often been caused by the scarcity of financial resources available for development aid.

920. A 0.1 per cent rise in the share of ODA in GDP appears indispensable to bring about a reduction in the accumulated bilateral debts owed by developing countries to official creditors. The reduction has to be carried out in line with the country's ability to pay and following a systematic approach. A further 0.25 per cent rise appears indispensable in order to finance economic adjustments in indebted countries, to ease the transition from collectivist to semi-collectivist economies, to support the process of economic growth, to safeguard the common environmental heritage and to guarantee respect for the elementary human requirement of survival. Based on the expected levels for 1991, a 0.1 per cent of GNP in rich countries is equal to $16.5 billion. In addition to the $16.5 billion related to current losses due to reductions of bilateral official credits, with development aid at the level of 0.7 per cent a further $40 billion would be made available. With one tenth of such a flow, the implementation of the Brady Plan would be made much easier. (The reference being made is obviously to grants.)

921. Assuming an interest rate of 9 per cent with amortization in 30 years equal to about 1 per cent per annum, a grant element of 5 per cent will produce twenty-fold increase in the capital stock in 30 years. Therefore, an amount of $37 billion (0.2 per cent of current GDP) will mobilize a capital stock of $40 billion, that is to say $24 billion every year.

922. The rules of international finance should exclude the acceptance of generic public debt under the guise of bank debt, and particularly of external bank debt. Real public debt can only take the form of negotiable bonds, and its issue on the international market must be subject to certain limitations based on real parameters that will avoid a repetition of the serious problems of the past.

923. Fear that bank-debt reductions carried out under the Brady Plan and its buy-back on the secondary market at low prices may discourage banks from operating in developing countries is largely unfounded.

924. Financing government budget deficits with bank loans is usually not a reponsibility of commercial banks, and even less in the case of balance of payments. If a given country has run into debt with banks as a result of ambitious policies of overall expansion of its global demand, the mistake has been made by the lenders as well as the borrowers.

925. As recently stated by the president of Venezuela concerning his country's debt with commercial banks, unfortunately the debt was not contracted with the aim of promoting the growth of Venezuela, nor did lenders take into consideration the purposes for which funds were borrowed, so that there were evident responsibilities on both sides. As to Latin America in general, the objective constraints of indebtedness were not taken into account either by borrowing Governments or by lenders. He said that was why the problem had now assumed a political rather than an economic dimension. 1/ Further transformations of such unhealthy economic practices into political issues must be avoided.

926. Indeed, one could go further and reply to James Buchanan, Nobel Laureate in economics, that there is no moral obligation on the part of future generations to pay for the debts contracted by the Government to fuel consumption spending decided on in the past by the voters of that time (or by their representatives) for their own benefit and without any kind of participation by those who are now called upon to pay and who derived no benefits whatsoever from those decisions. 2/ This argument may be countered by saying that creditors have the right to be paid on the basis of a contract freely entered into and that consequently present debtors have a duty to honour such a contract, in keeping with the ethical principle that obligations must be fulfilled.

927. However, Buchanan objects, if original borrowers had taken into account the inherent risk element, given that the burden was going to fall upon future generations who do not feel bound by agreements reached by their forebears and designed for their own special benefit, there is no ethical obligation fully to respect such contracts but, at best, only a partial obligation, which implies discounting risk factors.

928. Buchanan's statement can give ex post facto grounds based on economic ethics for the discount on loans contracted by Governments with banks, as an exception to the principles of a fair fiscal order and in order to avoid the future repetition of such pervasive forms of indebtedness, reserving medium- to long-term public loans from abroad only for investments. Future generations can thus be bound by the operation, because it has been carried out for their benefit. Moreover the related discount, applied after a period of eight years in which the loan has generated interests that did include such risk, has to be calculated by considering that during the period in question a certain share of the obligation was honoured, for which there was no ethical entitlement.

929. On the other hand public external debt has to be considered very carefully because it implies a particularly serious obligation for future generations. Hence, it has to be linked to specific investments as far as possible. Besides, it should be as transparent and measurable as possible, and thus should be expressed in bonds whose issues are known, and not in bank loans, where one creditor does not know what other creditors have or have not done.

930. Such debt should not carry an interest rate determined by external and erratic factors with no relationship, or maybe an inverse relationship, to the ability to pay of those on whom the burden will fall. This is the case with LIBOR plus, which depends on fiscal and monetary policies adopted by large industrialized countries and on their propensity to save and their investment cycles.

931. Nor is it wise that loans should be denominated entirely in currencies with highly unstable exchange rates, as demonstrated by movements in the dollar in the 1980s. The European currency unit (ECU) or another basket of currencies formulated in order to avoid compensating for fluctuations seems preferable. Besides, debt service should be linked as far as possible to the price fluctuations of the raw materials and basic commodities exported by the borrowing country, in order to generate a burden that is articulated over time according to variations in the ability to pay.

932. The case of a country that borrows not for overall budgetary purposes but to finance specific investment projects is somewhat different. In that case, it will be necessary to consider the financial viability of the projects and their collective economic profitability. If the latter condition is met but not the first, the issue of international debt, even by means of bonds on market terms, appears a very risky solution for a country with low tax revenues, although it may have good export capability.

933. In that respect, regional development institutions must play a more important role, with the adoption of concessional formulas such as those applied by the Overseas Financial Corporation of Japan (a loan duration of 30 years at a rate of 1 to 3 per cent).

934. Earmarking specific tax revenues for debt servicing must also be explored. This would put a limit on international debts that have no fiscal basis, by making it very clear that collective investments require efforts to be made by the domestic taxpayers and also within the framework of international co-operation.

935. As far as profitable public investments are concerned, international lending should take place only if payback formulas enable the lender to recover the debt service.

936. The solution of a mixed economy may also be an appropriate one in many cases. In others, full privatization raises no problems concerning the legitimate need of all countries to avoid being colonized by multinational corporations.

937. If external loans are being sought not by Governments but by individual enterprises to finance their investments or exports, a commercial bank will be able to check their appropriateness. This check was often not applied to the operations of global government lending in the early 1980s by the international banking system.

938. A return to creditworthiness for the developing countries oppressed by the burden of external debt must not be used to repeat the mistakes of the past. It has to be used primarily to restore the viability of specific productive projects, and also to ensure that domestic savings transferred abroad are secure.

939. Even in this case there are mutual responsibilities. Governments in debtor countries have applied unreasonable terms to savers and enterprises. The wealthy of these countries had no faith in the future of their countries. And responsibilities extend to permissive international legislation that offers tax havens as a means of attracting foreign capital.

B. Innovative instruments of new finance: project financing; merchant banking; commodity bonds; direct investments

940. Commercial banks and other private financial concerns have an important role in international finance where public debt issues would not be appropriate.

941. The main lending operations for the flows of international bank loans (including government incentives, the most important of which are insurance guarantees and co-financing) can be classified in three groups: (a) project financing, (b) commodity financing and (c) financing of business operations.

942. The first group of lending operations is related to the implementation of profitable investment projects. The most interesting options are those of the build-transfer-operate (BTO) formula and the build-operate-transfer (BOT) formula. They involve management by the foreign operator, with the double advantage of exporting both technical and managerial know-how, plus the fusion of the two operators who in normal loan transactions are usually distinct: the principal and the agent. Typically, the benefit derived from this form of management reassures the lender about debt service, while the international economic operator A who has built the project will incur the risk of the operation but take any consequent profit. The subject B (public or private) of the country in which the project is implemented is the ultimate owner in the BOT option, while with the BTO formula the ownership will be immediate, thus involving heavier responsibilities. In both cases the subject will get a share of the profits net of the debt service and for the entire duration of the loan. When the debt has been paid off, the subject can

choose between leaving the operation, being a partner in it or using it for certain services and so on. If the original project is expanded or if international connections emerge along the way, the most appropriate option may be permanent partnership with A, both for those connections and for guaranteeing new lending flows.

943. There are several variations applicable to these formulas from a financial perspective. Subject A could finance the project directly, providing guarantees for the international bank loan with its overall creditworthiness, instead of the specific profits from that project. Investor A could also be an industrial financial group using its own resources. What is essential for the BTO and BOT scheme is that the subject can conduct the business derived from project implementation, rewarding himself with profits that he is fully entitled to transfer abroad in any currency.

944. A distinction must yet be made between operations involving services that are fully or partially international, such as the running of an airport or of a hotel group or of international highways and operations involving domestic services like the making and running of a telephone network or a highway. In the first case, profits are, wholly or in part, in foreign currency and there are no exchange risks for A. But there are problems about the rate to be applied to B in order to pay his share. In the second case, profits are in local currency. Therefore, A can claim his rights from the country of B for the foreign currency transfer of his profits. In this respect, the creditworthiness of the country of B (in terms of A's balance of payments) is in this case very important.

945. The second group of operations concerns both the financing by subject A of exports carried out by enterprise B of a given developing country, and the financing of more far-reaching operations of industrial credit for enterprise B that are involved in export activities.

946. The most interesting model is that of merchant banks, used particularly by Japanese operators, and which has been proposed by Japan for specific although still limited operation with Mexico. The service given by the bank C to enterprise B consists in this case not only of the loan, but also of technical assistance in order to find an exportable product and most of all in the service of international trade. In this way enterprise B, although small, can sell in international markets.

947. Another interesting model is that of commodity bonds. These are quasi-equity, negotiable certificates. Although they imply reimbursement of the subscribed capital and the payment of dividends in the period of maturity, they are linked to a real standard by a formula that can produce a variation in the value of the capital and of the dividends.

948. A common standard used is the price of a commodity, i.e. a primary product or raw material, which is quite distinct from merchandise. Commodities in use or under consideration are metals (mainly gold and silver) or other minerals (especially oil). These are chosen not only because the amount of dividends, or the amount of the capital has to be reimbursed, or both, will vary with the price

of the chosen commodity, or possibly a basket of commodities, but also because it is possible that a given quantity of the chosen commodity is stockpiled to cover and guarantee the bonds issued. This means that mineral raw materials are more natural choices than other products for guarantee. They can indeed play that role even simply by remaining in the ground.

949. The function of a real standard and if necessary that of a real guaranteed stock could also be met by non-mineral raw materials, timber, for instance, or even agricultural raw materials that are not perishable or not easily so, such as cereals. If effective forms of guarantee can be devised, these bonds may be applied to any kind of commodities. Commodity bonds lessen the risk to the debtor associated with downward fluctuations of the prices of their export commodities.

950. Commodity bonds seem to meet the specific needs of important categories of potential lenders:

(a) Institutions and investors such as pension funds, insurance companies, etc. who want to limit inflation risk. They may be interested in subscribing to certificates that have indexed yields and/or principal, which is why commodity bonds would suit them. Such bonds may also have another positive feature, as real guarantee backing, consisting of current or future stocks of the same commodity standard;

(b) Companies engaged in manufacturing or in trading that can use standard commodities as input. By subscribing to certificates that index the interest or have an indexed principal according to increasing rates, these operators will offset the higher costs of purchasing their inputs with higher financial profit;

(c) Speculators, who will be particularly active when prices are expected to increase.

951. A large number of commodity bonds was issued in 1980-1981, when world inflation was higher. For example, in 1980 the Sunshine Mining Co., which exploits the largest silver mine in the United States, made an issue for a total of $25 billion. Each bond had a face value of $1,000 and was linked to the value of 50 ounces of silver (the price at the time of issuing was $16 an ounce, thus the reference value for each bond was $800 in all). The dividend was 8.5 per cent, that is to say 85 dollars per year. The reimbursement value has as a minimum level the issuing face value ($1,000). The economic significance of the operation is clear. The producer of the commodity, who expects a price increase, proposes to fund bidders to participate in the probable future benefits of the increase. At the time of issue he expects his proposal to be rewarded by more favourable terms than those found in the market.

952. As regards the link between fluctuations in the prices of raw materials and commodity bonds, it is appropriate to avoid an inflexible link that, in case of steep price rises, could lead to very high dividend payments or a rise in the principal to be reimbursed. It would make debt service in general considerably worse. Conversely, with downward fluctuations the result would be the need to issue bonds under par. They thus look like mechanisms with upper and lower limits

to the variation in dividend payments and/or in the amounts to be reimbursed. However, raw material prices fluctuate, and commodity bonds must show continuity. If they are long-term issues, raw material price fluctuations may be absorbed during their period of maturity. As well as being used in the three cases mentioned above, they can also finance exports or mixed operations by developing countries, within the framework of innovative bank financing for exploiting new sources of raw materials.

953. This was indeed the opinion expressed by the then United States Secretary of State Henry Kissinger at the fourth session of UNCTAD in 1976 while putting forward a proposal aimed at setting up an international resources bank. As is well known, the bank was not set up, but the Multilateral Investment Guarantee Agency (MIGA) was recently established instead.

954. There are of course other financial instruments aimed at reducing the risks connected with fluctuations in the price of raw materials (future contracts, fixed-price long-term contracts, etc.), but, unlike commodity bonds, they do not bring financial resources to developing countries. Commodity bonds, unlike direct investments, do not presuppose any control over the developing country's resources, except for the need to build up stocks of standard commodities as guarantees.

955. So far, the number of commodity bonds issued has been extremely limited. There may be several reasons. There are countries in which certificates indexed to inflation, like commodity bonds, are banned, but the main reason seems to be the lack of an effective secondary market. A remedy for this could be found if one institutional authority assumed the task of guaranteeing issues or even the task of setting up a secondary market and running it along normal lines.

956. Given the current constraints restricting the products that can serve as commodity standards and given the likely volume of stocks of those commodities that it would be realistically possible to build up in order to guarantee issues, for Latin America the potential role of commodity bonds seems to be small taking account of its overall GDP and the volume of its exports. Yet estimates for Africa (almost $6 billion) should promote such an instrument as one of considerable interest for that continent. Commodity bonds could also be used to develop new initiatives by the international banking system along the lines illustrated above.

957. The development of this financial instrument can usefully be supported by one or more multilateral financial institutions (e.g., the regional development banks). Alternatively, they could act as issuing bodies or as guarantors. In the first case, issues could be subscribed to by new investors, thus building up guarantee stocks and completing the task of creating a secondary market in which new investors or indeed the banks owning the swapped credits could negotiate commodity bonds.

958. The multilateral financial body should also act as guarantor in operations which it regards as viable and development-oriented. In that case, it should obviously possess an appropriate guarantee fund and have access to the debtor's stock of commodities in order to make good any losses. Even partial guarantees, say 50 per cent, may turn out to have a high leverage on financial resources to be channelled towards operators in developing countries.

959. The financing of productive operations connected with fixed and floating capital and the financing of sales (through factoring) are part of the daily activity of commercial banks.

960. It is not easy to perform such activities with developing countries when the enterprises that need funds have no international standing and/or do not have foreign exchange earnings to pay for their external loans, but new methods can be devised to facilitate those operations. In particular, international banks could establish in developing countries a number of subsidiaries that will lend to enterprises through the domestic market, taking advantage of the guarantees and the co-financing of regional banks and of bilateral bodies for public development aid.

961. This obviously means that developing countries must make sure that conditions in their territories make the operations of overseas banks viable. They should thus refrain from allowing manifestations of xenophobia and mistrust, which have repercussions first of all on those who give voice to them.

962. While investment in mining in certain parts of the world, however difficult and risky, is constrained by the location of natural resources, there are sectors (e.g., primary processing of industrial manufactures) in which investments in developing countries is only one alternative among many. In fact these are the sectors in which investment has never reached a substantial level.

963. Using a simplified model, obstacles to direct investment can be categorized according to whether they are located in the investor country or in the recipient country.

964. With regard to investment constraints in developing countries, although there are marked differences from country to country, a common set of obstacles may be found in developing countries:

(a) National legislation concerning direct investment and joint ventures that provides strong disincentives for investment in the key sectors of the economy. This is the case of many countries in Latin America or North Africa, where foreign investment, even in joint ventures, has so far been banned in certain sectors or indeed discouraged for strategic reasons, local interests and so on. Without modifying the rules, it is inadvisable to set in motion a process of investment in such areas, when local entrepreneurship does not look sufficiently well equipped from a technological and particularly from an organizational point of view to bring the same projects to fruition alone;

(b) Non-convertibility of the local currency or extremely high risks in the exchange rates that make production partly directed to the external market highly risky. Today, when part of the product is destined for the domestic markets of developing countries, the investment is, however, more feasible;

(c) Developing countries' lack of access to the international financial system. In joint ventures, this means that the investors of the industrial country have to assume the whole risk. Assuming the whole risk is very expensive and leads the local partner to eschew his responsibilities, while he should be able to find

assistance, for instance from regional banks or subsidiaries of external banks operating locally;

(d) In addition to this difficulty, many developing countries cannot exceed the limit on external indebtedness set by international monetary authorities. This often hampers the setting up of joint ventures in developing countries and, in any case, is a strong barrier to the development of local enterprises;

(e) Finally, in many developing countries there is no domestic market that can guarantee an investment return with prices in line with international levels.

965. Nevertheless, some of the constraints in developing countries are created by the investing countries themselves. Those constraints are of both a financial and an economic nature.

966. The first type includes the cautious attitudes of lenders in order to obtain guarantees for the reimbursement of loans, and those attitudes are certainly stricter in relation to several developing countries that are heavily indebted or actually insolvent.

967. The result of that situation is that:

(a) Bank financing is often confined to the conversion of old debt, instead of adding new money (debt-debt, debt-equity swaps);

(b) A privileged position is enjoyed by only some sectors, usually those connected with the primary processing stage of raw materials and those that can rely on market outlets and on good profit prospects, linked to favourable terms for raw materials;

(c) In the case of large projects with the above-mentioned features, access to funds is contingent on a long and accurate risk evaluation by the export agencies or international institutions (World Bank, IFC, MIGA, etc.) and by banks, which subordinate their participation to the attitude taken by the others in a complicated process that consumes large amounts of time and energy;

(d) The only medium- to long-term assistance to credit issuance occasionally made available by the export agencies is often linked to bilateral government agreements.

968. A different problem concerns legislation covering development co-operation, which rarely takes into consideration the constraints on developing countries and is therefore ineffectual. A telling example is given by the Italian legislation on joint ventures for development, which has remained largely inoperative.

969. The second category of economic considerations includes the adoption of protectionist measures directed against developing countries. The case of agricultural protectionism in Europe and in the United States is well known. Studies have been carried out to show that all the debts of Latin America could be paid off in a few years if agricultural protectionism, which makes imports

impossible, were eliminated. Apart from agricultural protectionism, in Europe there are cases of protection against industrial semi-manufactured goods that equally prevent productive investment, for instance in Middle Eastern countries.

970. Such negative factors are offset by considerable absolute advantages, as with labour and raw materials costs, that make a number of investment projects in agriculture, mining and semi-manufactures potentially very interesting. The same advantages seem to be present in the economies of Eastern Europe, so that the real issue is more one of allowing development rather than altering the terms attached to debt.

971. In order to implement appropriate industrial projects that can take full advantage of the areas in question, it is necessary to do away with such constraints. It is unlikely that this will take place under a purely national approach, whereas it should be practicable with a systematic international approach.

972. Unlike other depressed areas, many developing countries do not lack absolute advantages. The investment process is hampered more by bureaucratic and legislative constraints in developing countries and in investing countries, by protectionist measures and by financial constraints. The latter are mainly to be found in industrialized countries and are readily intelligible if one considers the risks connected with projects in developing countries that normally have to be taken by financial institutions or by individual enterprises, which is reflected in a low propensity to assume large-scale risks on the basis of a simple calculation of prospective profits.

973. In simple terms the development of the developing countries is blocked by a series of interrelated measures. The elimination of these obstacles and the subsequent growth in developing countries are beneficial to both developing countries and industrialized countries, yet no individual operator has the necessary incentive to break the rules that protect him, albeit imperfectly; nor does he find it convenient. There is no chance of reaching a co-operative solution that would lead to growth if each operator negotiates from his position assuming an uncooperative posture.

974. A much easier solution can be reached by adopting the multinational approach: the development of developing countries is a world problem whose solution is beneficial to all.

975. To give one example, one option could be lending with reduced guarantees, insured by the multilateral institution for investments and international joint ventures in certain sectors, but only so long as developing countries suspend bureaucratic regulations that prevent the implementation of the project (e.g., exchange regulations or a ban on the export of dividends). In return, industrialized countries should eliminate or reduce their own barriers. The trade-off can be facilitated by the lifting of protection in industrialized countries. For instance, products of international joint ventures in developing countries could be treated in the countries of destination just like domestic products.

976. Direct investment can take various forms in co-operation between private and public economic entities in developing countries. The international enterprise can be entirely expatriate, or else financed by local economic units through a share in its capital stock (equity); it can assume a mixed-economy form; or it can be a joint venture between entities in the two geographic areas. With an enterprise in which investors with voting rights are all expatriate, there can be forms of collaboration with domestic capital owners, who could be issued with bonds convertible into shares or with preference shares without voting rights, although they would still be equities. All these proposals are of special interest for providing opportunities for attracting external resources. Their success must largely depend on taxes and exchange rates.

977. There are very delicate issues of equity here, as can be seen from the decisions taken by the Governments of developing countries. In particular, they have to assess the validity of imposing taxes on the dividends distributed anonymously to nationals and/or to foreigners (final withholding) or instead opting for an interim accounting treatment.

978. A mixed formula is one in which the subscriber to bonds can choose between accepting the deduction as final without reporting him to the revenue service, or reporting him on receiving the dividend in order to get a reimbursement. Residents ought to be favoured by receiving more advantageous treatment than non-residents. It must be noted that the latter option, although of little interest when the tax regime is in line with the United Kingdom and United States systems in which company taxes are added to personal income taxes, becomes attractive when company taxes are treated as partial payment of personal income tax and are credited to the recipient of bonus shares distributed as dividends, as is usual in some EEC countries. In that case, the taxpayer may be entitled to considerable amounts of tax credits; in effect, the company tax rate is often as high as 50 per cent, so that the tax credit on dividends is 100 per cent.

979. In any event, the development of a local stock market and of residents' interest in it presupposes a realistic tax regime that should take into account conditions existing elsewhere and provide incentives to risk capital. The same holds true particularly in those developing countries that still do not have inflation under control and for those that are just entering the market.

980. International mixed companies, set up with funds from domestic public companies and with external funds, seem to be a highly suitable device for developing countries in key sectors of their economies, in order to reconcile the need to maintain economic and financial autonomy with that of attracting management and know-how from industrialized countries. But it is a solution with considerable practical limitations.

981. In effect, foreign investors will ask for full control of the company's management so as to reduce risk, improve efficiency and adjust the business to the needs of the owners. Gaining managerial control and keeping 49 per cent of the capital stock may not satisfy foreign operators, since they may fear that the management is in the hands of those who hold the majority, especially if it is a Government or a company that works on a concession basis. Much depends on the

psychological environment that the Government can create by opening its economy and readjusting its finances.

982. On the other hand, giving 51 per cent of the company to foreign operators may not look like a good solution to domestic operator, especially if the Government itself is the domestic partner, even though the latter always has the last word in matters of concessions. It may be preferable to hand over the company in total when it is not active in strategic sectors or when the financial resources available are limited.

983. Countries that are moving away from a closed and largely centralized economic system should consider with great interest the various forms of mixed economy in which the State has the majority or the minority share, according to the need to move quickly towards an open market economy on a rather wide economic front.

984. The solution using joint ventures is also interesting for such economies, where partnership between external capital and domestic operators is not complete, but covers only specific initiatives and projects. In this case too, what developing countries stand to gain through co-operation is not just a financial contribution, but, most of all, technical and managerial skills. Joint ventures between external operators and private domestic operators, carried out through companies in which all partners participate in the capital and in the management, seem extremely appropriate in the sector of small- and medium-sized enterprises.

985. The following passage makes the point with reference to African countries, although it can be more widely applied to all developing countries: 3/

> "A first step towards a more balanced approach arises from the 'learning by doing' issue. 4/ Most of the skills of the competitive environment are built up through learning by doing. This implies that skills are specific to a productive unit or to a country, and straightforward transfer of skills does not take place. Consequently, if the pattern of technological innovation (i.e. learning) depends on the level of skills already available in the firm or in the country, also learning is localized.
>
> "The learning by doing argument is one of the explanation of the technological gap between advanced and developing countries: given their low level of technological and managerial skills, developing countries will not be able to keep pace with technological innovation and productivity increases of advanced countries; thus they will specialize in industries with a low learning potential (limited technological innovations). A low level equilibrium trap may follow. 5/
>
> "Localized learning is not limited to the geographical dimension, but also helps to explain the segmented structure of industry. Local private entrepreneurs are mostly concentrated in small informal industries, whereas larger, formal industrial firms are the domain of foreign investors or of the local public sector. The main riddle is the 'missing middle': 6/ the lower level of competitiveness and the lack of technical dynamism of small-medium local private firms. Local entrepreneurs often lack the right skills and

values to enter the more sophisticated formal sector. Although the issue is also a matter of general schooling and training and of overall social transformation, experience in the modern sector seems to be a crucial requirements for formal activities". 7/

986. The high capital/output ratio that concerns many countries in Latin America, Africa and Eastern Europe has often been explained by the inefficiencies of State planning, protectionism, multiple exchange rates, subsidies and inflation. These factors are undoubtedly important, but it would be wishful thinking to believe that their elimination alone will restore high efficiency and lower the capital/output ratio in the absence of an industrial mentality.

987. Financial flows are not enough to generate economic growth. It is wrong to believe that it is enough to pump in more resources in order to bring about more growth in backward economies. Technical assistance embodies the critical task of avoiding a situation in which the inflow of fresh funds may raise illusory expectations as well as create new difficulties in paying for them. Hence the need for a drastic change of mentality in developing countries on the issue of capital imports. Yet, it is also imperative to promote solutions that do not cause subordination but disseminate useful skills and new entrepreneurship.

Notes

1/ Interview by Lucio Lami, Il Giornale, 3 June 1990.

2/ See J.M. Buchanan, "The ethics of default" in J. M. Buchanan, C. K. Rowley, R. D. Tollington (eds.), Deficits, Basil Blackwell, 1987.

3/ Barba Navaretti G., Joint ventures and autonomous industrial development: the magic medicine? The case of the Ivory Coast, Oxford University QEH and International Development Centre, Luca d'Agliano, Turin, April 1990.

4/ Arrow, K., "The Economic Implications of Learning by Doing", Review of Economic Studies, June 1962.

5/ Stiglitz J., "Market failure and development, American Economic Review, Papers and Proceedings, 1989.

6/ Sanjaya L., Long term perspectives on sub-Saharan Africa, background paper, World Bank, May 1987.

7/ Iliffe J., The emergence of African capitalism, London, MacMillan, 1983.

Part Three

SUGGESTIONS FOR REGIONAL AREAS AND GROUPS OF COUNTRIES

XVII. AFRICA

A. North Africa

988. The magnitude of Africa's debt burden can be grasped from the following figures: $250 billion, of which North Africa accounts for about $105 billion and sub-Saharan Africa about $145 billion.

989. The countries of North Africa are officially classified as middle-income because their per capita income is higher than $500. Their per capita incomes range from less than $600 in Egypt, slightly more than $600 in Morocco, about $1,200 in Tunisia, to $2,700 in Algeria and, presumably, the Libyan Arab Jamahiriya. But Egypt, Morocco, Tunisia belong to the group of countries with per capita incomes countries between $500 and $1,300 that should be classified as intermediate, i.e. falling between those defined as poor and the middle-income countries. As the result of consideration of a preliminary draft of this report in July 1990, the Group of Seven recognized them as a class of countries separate from the middle-income ones for the purposes of the strategy to alleviate the debt burden and to supply new finance at low or moderate concessional rates for economic and social growth. This implies broadening the list of Toronto-eligible countries and also extending that scheme to cover wider requirements of a more systematic approach to meet demands. This would also simplify ad hoc consideration of these countries as candidates for concessional facilities offered by the international financial institutions. Finally, recognition of this category of countries has implications for any analysis of their development aid policies.

990. Debt and development problems of North African countries are of common interest to Africa and Europe. A regional development bank, patterned on the IDB, the Overseas Development Corporation of Japan and the Saudi Development Bank, seems necessary to channel new financial resources to these countries for investment in infrastructure and to sustain, through insurance and co-financing, their productive investment.

991. For middle-income countries such as Algeria and the Libyan Arab Jamahiriya the problem is essentially that of obtaining new finance. Public insurance corporations and commercial banks of industrialized countries should pay closer attention to the new innovative formulas of financing, which differ from traditional loans.

992. Additional problems affect Morocco, Tunisia and particularly Egypt, most of whose debts have been contracted with Governments as non-concessional loans and with the international financial institutions. Thus, interest payments and amortization reach $1 billion. It is a heavy burden, almost equal to 30 per cent of total exports and reaching 10 per cent of GDP.

993. Even Tunisia's external debt, $6 billion or 10 per cent of GDP, is 70 per cent with official institutions, of which $2.8 billion is with bilateral lenders and $1.6 billion with multilateral lenders. The related debt service is heavy: $1.13 billion in 1988, of which $400 million represents interest, equal to 13 per cent of its GDP and to 30 per cent of its exports.

994. Egypt's debt, 90 per cent of which is held by official institutions, is close to $50 billion, owing to accumulated arrears; its GDP is $35 billion. There is a further $4.7 billion of debt owed to multilateral institutions, and $22 billion with bilateral institutions. Accrued interest totals $3 billion, a figure approaching $4 billion if amortization is included; this is equal to one third of the value of its exports and 11 per cent of GDP.

995. The sum of $10 billion of Egyptian debt is military debt, mostly owed to the United States. This debt, originally $4.5 billion, was needed to finance defence supplies of common interest to Egypt and to Western countries. This $4.5 billion was lent to Egypt at a 14 per cent interest rate and has now increased to $10 billion, i.e., 20 per cent of Egyptian debt, because of arrears. This seems to be an abnormal case that deserves major concessions in the terms of repayment.

996. As a general rule, as with intermediate countries, it seems advisable to aim for a substantial reduction of Governments' bilateral credits and of those of Government-backed public insurance, increasing their maturity to 30 years and diminishing their interest service even by 60 per cent with a share, say one fourth, of the remaining service being devoted to funds to improve the environment, human resources development and child welfare. Environmental projects relating to the Mediterranean basin and vocational education programmes for the emigrants deserve particular consideration.

997. It is very important that the domestic restructuring policies of these countries should be tackled with determination. What is often required are improvements leading to increases in public revenues, modifications and simplifications of a host of corporatist regulations of a centrally planned nature and the dismantling of collectivist and semi-collectivist institutions, in order to produce effective modernization of market structures. However, the adjustment process must be selective. One cannot ask a country in which the staple diet is maize suddenly to double its price, jeopardizing survival for a few hundred million dollars.

B. Poor indebted countries, and sub-Saharan Africa in particular

998. Since poor, indebted African countries have a moderate bank debt of only $9 billion, and since their relative economic share in international trade is almost nonexistent, the problem of debt, which is extremely onerous for them, receives only lukewarm and sporadic attention. Big international banks consider their debts negligible, a problem which need not cause administrators, shareholders and supervisory authorities much concern. These poor countries do not offer a market that attracts the interest of big industrial units and trading companies. This statement must also be broadly true for all poor, severely indebted countries.

999. If the debt burden is measured on the basis of national product and exports, it is evident that even a moderate per capita debt can constitute a heavy burden when per capita income is below the poverty level, estimated at around $400 per year, and when, as a consequence, the value of per capita exports is lower than $200 per year. On the other hand, if compared with financial and trade parameters of private and public institutions of creditor countries, these figures seem to be modest. Thus a credit volume that is insignificant to rich countries entails an unbearable interest burden for poor countries; an interest flow amounting to a few billion dollars, which is irrelevant in the framework of the huge volume of world payments, constitutes an exhausting and sometimes crippling burden for poor, indebted countries.

1000. In terms of the public finance of poor countries, paying the required interest is tantamount to sacrificing the most basic needs. Moreover, given the inflexible nature of exports, in the absence of appropriate intervention it is almost always necessary in order to pay the debt service to decrease the value of imports by the same percentage. Hence, a tragic and insoluble dilemma emerges: is it preferable to cut the already low investment rate or to decrease the supply of commodities, which, in general, is already below the survival threshold?

1001. Most of the overall debt of sub-Saharan African countries has been incurred with Governments or government agencies, above all State agencies insuring international trade, as well as with multilateral organizations, although not particularly high interest rates are paid. However, part of the bilateral debt to official organizations stems from credits lent at market rates or at more burdensome rates than market ones: as outstanding debts, they were bought back by the above State insurance agencies.

1002. Among poor countries, sub-Saharan Africa is the most indebted region. At present, its debt is equal to 115 per cent of its annual GDP. Sub-Saharan Africa takes the lead among the different geographical areas: its debt burden exceeds the debt burden of both North Africa and the Middle East (equal to 80 per cent of GDP), of Latin American and the Caribbean countries (roughly equal to 50 per cent of GDP) and also of Eastern Asia and the Pacific (which is 25 per cent of GDP).

1003. In all countries, the debt burden varies according to the dollar exchange rate. Since debt in sub-Saharan Africa, as given in World Bank statistics, is mostly expressed in currencies other than the dollar, the decrease in the dollar exchange rate with respect to the other Group of Seven currencies led to an increase in the debt burden of sub-Saharan Africa, both in absolute terms and in comparison with debt in other areas (see tables XVII.1 and XVII.2). In so far as sub-Saharan countries export in dollars, this implies an effective additional burden.

1004. In addition to overall interest payments amounting to $4.5 billion, arrears in sub-Saharan Africa are equal to $3.5 billion, or a total of $8 billion. However, the debt service, even net of interest arrears, totals as much as $10.7 billion: interest due is equal to 6 per cent of GDP, whereas debt service is equal to 8.6 per cent. Moreover, interest due equals 21 per cent of the value of exports.

Table XVII.1 Sub-Saharan Africa: comparative debt indicators
(1987 figures, percentages unless otherwise indicated)

	Sub-Saharan Africa	Low income countries	Severely indebted countries
Long-term debt	**84**	**83**	**85**
Multilateral long-term	23	28	13
Bilateral long-term	37	44	14
Private long-term	24	11	58
Debt to IMF	5	8	5
Short-term debt	11	9	10
Total debt a/			
As a percentage	100	100	100
In billions of dollars	123	68	472
Concessional debt			
As a percentage of the total	37	57	6
Debt ratios			
Debt-to-exports ratio	292	415	272
Debt-to-GNP ratio	81	83	48
Debt service-to-export ratio	15	19	25
Interest payment-to-export ratio	7	8	16
Average conditions of new commitments			
Interest	3.4	2.1	7.7
Maturity (years)	29	34	15
Grant component	50	62	13

Source: World Bank, World Debt Tables, 1988-1989.
Refer to these tables for detailed data on country groupings.

a/ Excluding private non-guaranteed debt.

Table XVII.2 Comparison between sub-Saharan countries and the other developing countries: comparative economic indicators

	Sub-Saharan Africa	Low income developing countries	All developing countries
Growth of GDP per capita 1980-1986 (annual percentage)	-3.1	5.6	1.8
Growth of private consumption per capita 1980-1986 (annual percentage)	-2.4	3.5	0.9
Gross domestic saving as percentage of GDP, 1986	11.0	25.0	24.0
Gross domestic investment as percentage of GDP, 1986	14.0	29.0	24.0
Central government financial balance as percentage of GDP, 1986 a/	-6.0	....	-6.0
Growth of export volume 1980-1986 (annual percentage)	-2.1	6.5	4.8
Growth of import volume 1980-1986 (annual percentage)	-7.5	7.2	0.5
Evolution of terms of trade 1980-1986 (annual percentage)	-13.0	-9.0	-7.0
Gross international reserves, expressed in number of months of import coverage, 1986	2.1	4.2	3.5

Source: World Bank, World Development Report, 1988.

a/ IMF, World Economic Outlook, April 1989, table A 19.

1005. Debt servicing amounts to $28 billion. These percentages per se are not excessively high, but they do become considerable in view of the poor resources available and the economic situation of these countries. In fact, their per capita GDP declined by 3 per cent over the period 1980-1986, and per capita consumption decreased by 2.5 per cent. The debt burden also reduced the already modest capital accumulation, which accounted for 14 per cent of GDP.

1006. The most difficult, although not the only, dimension of the problem of the excessive debt burden of poor countries is therefore to be found in sub-Saharan Africa. Sometimes, debt has gone hand-in-hand with military expenditure, despotic dictatorships and wasteful use of funds. A perestroika is necessary.

1007. It has been observed that "export credit agencies ... undertook a particularly large expansion in their lending to Africa. The export credit overhang remains one of the most intractable components of sub-Saharan Africa's debt (even though there has been little new lending for some time), since this is contracted primarily on commercial terms". 1/

1008. In the period 1980-1986, as a result of the pressure exerted by these loans, which totalled $126 billion including $69 billion owed by extremely low-income countries, per capita GDP in sub-Saharan Africa decreased by 3.1 per cent, consumption by 2.4 per cent and exports by 2.1 per cent per year. Owing to the 13 per cent decline in the terms of trade, imports decreased even more, i.e. by 7.5 per cent per year. The savings rate was as low as 11 per cent and investment, because of the poor inflow of external funds, stood at about 14 per cent of GDP.

1009. Even if there are local contributing factors, such as the allocation of part of the debt to military expenses and wars that brought about a decrease in GDP, the crux of the problem must still be the low growth rate of GDP, falling even below the already rather low interest rate on debt.

1010. An attempt was made to tackle the problem through a steady and moderate inflow of resources, in excess of the debt servicing. Besides the above-mentioned political and military factors (which were mostly related to or heightened by the cold war), such a low growth rate is also attributable to repeated natural disasters, as well as to the fall in the prices of raw materials, which, in these countries, account for most exports. Thus, in the period 1980-1987, the price of coffee, the main export item in Ethiopia and Burundi, decreased by 30 per cent in real terms: the price of cotton, which is the main export item in the Sudan, decreased by 32 per cent; the price of iron ore, accounting for over 63 per cent of exports in Liberia, decreased by 17 per cent, while the price of oil, the most important export item in Nigeria, fell by 53 per cent.

1011. As a result of this situation, in the period 1974-1982 the deficit in the sub-Saharan African current balance of payments already accounted for 6.7 per cent of GDP, notwithstanding the presence of sinking fund loans amounting to 3.4 per cent of GDP, lent at an interest rate accounting for 2 per cent of GDP. This state of affairs, together with the lack of well-structured development assistance policies, did not allow it to attract significant investments.

1012. Over the 1983-1988 period, the deficit in the current balance of payment had to decrease. The burden of arrears on interest reached almost 4 per cent of GDP, while sinking fund transfers of resources also increased, reaching 6 per cent of GDP. As a consequence, the net contribution to the current balance of payments accounted for only 2.3 per cent of GDP.

1013. Thanks principally to bilateral and multilateral loans, the overall resource flow accounted for 7 per cent of GDP, whose share of net investment was however only 2.3 per cent. Considering that the public deficit was equal to 6 per cent of GDP, a considerable decrease in the accumulation of capital ensued, which dropped from 21 per cent to 17.5 per cent of GDP between the beginning and the end of the second period.

1014. As is shown in table XVII.3, in the period 1983-1986, a balance was reached between imports and exports in these poor countries, whereas in the subsequent four-year period 2/ an increasingly significant trade deficit was registered. It increased from $2.1 billion to $3.6 billion which, out of $28 billion f.o.b. imports, accounted for 12.5 per cent of GDP.

1015. Also in this case, the crucial aspect of the debt problem of poor, severely indebted countries, is that, while the figures are low in absolute terms, they are in fact very high in comparison with the extremely low value of the macroeconomic aggregates pertaining to these unfortunate countries.

1016. In the services sector, the deficit in the import-export balance is even more burdensome: it increased steadily, from $7.6 billion in 1981, $7.4 billion in 1982 and $7.9 billion in 1983 to $10.7 billion to $11.1 billion in 1988-1990, a consequence of the increase in the debt service, which rocketed from $2.7 billion in 1983 to $5.8 billion in 1990. Apart from interest payments, however, the deficit in the services sector also includes services of a different nature, including technological ones. In contrast, income on external investments officially does not increase this deficit, but rather contributes $500 million per year, thanks to the remittances from African workers abroad.

1017. Since 1988, indebtedness in these countries has been ranging betweeen $7 to $8 billion per year (table XVII.4), less than in the early 1980s, when it amounted to $9.2 billion (which, at today's prices represents a considerably higher amount). 3/ Long-term debts owed to official creditors are by now the most important source of finance, whereas medium-term bank credit plays only a small part. Other types of bank credits, however, still play a significant role. Most official debts belong to what are known as "special finance" operations; from 1985 to 1989 IMF credit actually decreased by $1.5 billion.

1018. The explanation is both simple and tragic. These countries are not in a position to pay for the service credits provided by IMF, which, therefore, in compliance with its rules, cannot make them new loans. For this reason, the countries cannot implement the IMF proposals for recovery plans, whose incentive is the granting of financial support by the IMF itself, irrespective of how IMF interest rates are worked out.

Table XVII.3 Sub-Saharan Africa:
balance of payments: current accounts, 1981-1990
(In billions of United States dollars)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Exports (f.o.b)	21.3	19.9	19.7	19.7	21.5	20.8	22.3	22.6	23.7	24.3
Imports (f.o.b)	26.4	23.8	21.2	20.5	20.0	22.0	24.4	26.1	26.9	28.0
Trade balance	-5.1	-3.9	-1.5	1.1	0.8	-0.8	-2.1	-3.5	-3.1	3.6
Services (net)	-7.6	-7.4	-7.5	-7.9	8.5	9.7	9.9	-10.7	-10.4	-11.1
Goods and services balance	-12.6	-11.3	-9.0	-6.8	-7.7	-10.7	-12.0	-14.2	-13.5	-14.8
Unrequited transfers	3.0	3.1	3.5	3.6	4.3	4.9	5.5	6.1	6.7	6.4
Current account balance	-9.6	-8.2	-5.6	-3.3	3.3	-5.8	-6.5	-8.1	-6.8	-8.4
Memorandum										
Exports of goods and services	27.2	25.3	24.8	26.5	25.5	26.6	28.7	29.3	30.7	31.7
Investment income (net) a/	-2.4	-2.4	-2.7	-3.2	-3.6	-4.0	-4.6	-5.1	-5.2	-5.8
Of which, Interest payments b/	-3.0	-3.1	-3.1	-3.7	-1.1	-4.5	-5.2	-5.7	-6.0	-6.5
Oil trade balance	-0.5	-0.1	0.8	1.6	1.3	0.1	0.3	0.1	-0.1	0.2

Source: IMF, World Economic Outlook, October 1989.

a/ Comprises all investment income, except payments of income on foreign direct investment; receipts from direct investment abroad by residents are included.

b/ Including dividends and other investment income payments not related to foreign direct investment.

Table XVII.4 Sub-Saharan Africa: summary of external financing, 1981-1990
(In billions of United States dollars)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Deficit on goods, services and private transfers	12.9	11.5	9.0	6.6	7.1	10.2	11.4	13.5	12.8	14.0
Non-debt-creating flows, net	4.0	3.8	3.8	3.9	4.5	5.2	5.5	5.9	6.6	6.3
Set transactions net	-0.7	-0.2	-0.3	-0.5	-0.2	0.2	0.2	-0.2	-0.2	-0.2
Of errors and omissions	-0.3	-0.8	-1.1	-0.3	-0.4	-0.3	-0.6	0.4	...	...
Base of reserves	0.5	0.5	-0.2	-0.1	-0.5	-0.7	-0.1	-0.1	-0.5	-0.6
Net external borrowing	9.2	8.2	6.8	3.7	3.8	5.8	6.4	7.4	6.9	8.4
Reserve-related liabilities	1.7	0.9	1.4	0.2	0.1	-0.6	-0.2	0.1	-0.7	1.1
Of which,										
Net credit from IMF	1.6	0.7	1.3	0.5	...	-0.4	-0.5	-0.2	-0.4	1.1
Long-term borrowing from official creditors	4.9	5.4	4.9	-5.2	2.9	5.7	5.0	4.8	5.9	6.8
Other net borrowing	2.6	1.8	0.5	-1.7	0.8	0.7	1.6	2.6	1.6	0.5
Memorandum										
Borrowing from commercial banks	4.1	2.3	0.1	0.9	0.3	-0.1	0.1	0.6	1.3	1.0
Exceptional financing	1.7	2.0	2.4	3.0	3.9	5.7	5.7	6.6	7.4	7.0

Source: IMF, World Economic Outlook, October 1989.

Table XVII.5 Gross capital accumulation in sub-Saharan Africa

	1981	1982	1983	1984	1985	1986	1987	1988	1989
Percentage of GDP	20.9	19.7	17.7	17.2	17.9	18.9	18.3	17.9	17.5

Source: IMF, World Economic Outlook, October 1989.

1019. Without radical reductions in their debts and exceptional concessional terms granted by IMF and the World Bank, the economic problem of sub-Saharan countries seems to be insoluble. In their absence, the prerequisities are lacking for a domestic recovery, linked to their insolvency with IMF. It is extremely important to launch the recovery process effectively. In most cases, it is necessary to increase public revenues and eliminate or simplify countless regulations (inspired by an attitude of corporate dirigisme), as well abolish any kind of collectivism and pseudo-collectivism and aim at radically modernized market structures. As previously mentioned, in 1990, according to the World Bank, debt in sub-Saharan African countries totalled about $125 billion. According to IMF figures (which cover fewer countries), it is estimated at $111 billion (table XVII.6).

1020. Leaving aside short-term debt, which accounts for 10 per cent of the total and is guaranteed by commercial transactions, and considering only long-term debt, debt to banks and other private lenders amounted to 20 per cent only in 1988, and debt to Governments and multilateral institutions accounted for the remaining 70 per cent. This latter percentage continued to increase thereafter, while debt to the banking system and to private creditors declined further (table XVII.6).

1021. This problem is totally different from the problem of middle-income, heavily indebted countries, 58 per cent of whose debt is to private institutions.

1022. As shown in table XVII.1, in sub-Saharan African countries' bilateral credits are extraordinarily high, and in fact account for 37 per cent of long-term debt. However, while such credits include a considerable proportion of grants, this is not the case for official debts, stemming from insurance on export credits, which, as a rule, do not include grants and in general are characterized by high interest rates.

Table XVII.6 External debt of sub-Saharan Africa by class of creditor year-end, 1981-1990
(In billions of United States dollars)

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Total debt	49.3	54.0	56.4	58.7	68.7	81.0	97.5	100.2	101.7	111.0
Short-term	6.1	6.5	6.0	5.5	6.7	7.5	8.7	9.3	9.3	10.2
Long-term	43.2	47.5	50.4	53.2	61.9	73.5	88.8	90.9	92.4	100.8
To official creditors	27.7	31.8	34.9	37.8	44.9	54.8	66.8	70.2	72.2	80.4
To financial institutions	10.0	10.3	9.9	9.5	10.0	10.1	11.4	10.7	11.0	11.8
To other private creditors	5.5	5.5	5.6	5.8	7.1	8.6	10.6	10.0	8.7	8.6

Source: IMF, World Economic Outlook, October 1989.

1023. Debts to multilateral institutions account for a large proportion of the debts: in fact, for 23 per cent of long-term debts. In this case, too, a percentage consists of grants. However, since these debts have a strict date of repayment (in that "reimbursements" are necessary to finance new loans), sometimes they become more burdensome than debts to banks, for which reschedulings can be envisaged.

1024. Turning now to the policy of sinking fund aid and grants to poor countries facing difficult problems, some financial devices implemented by multilateral organizations appear to be illogical, even though they can be absolutely reasonable given the rules that apply to them.

1025. Up to 1989, interest paid on the debt of sub-Saharan African countries was estimated at $4.5 billion by the World Bank, while arrears constituted a further $3.5 billion. Thus the total comes to about $8 billion, accounting for 6.4 per cent of $125 billion. The relevant deflator being equal to 4 per cent per annum, the real interest rate is 2.4 per cent, which is possibly equal to the "natural" long-term rate of growth of the world economy.

1026. In sub-Saharan Africa, it is difficult to find a GDP growth rate higher than this interest rate, and in any case a capital flow would be necessary. In order to escape from the tragic situation in which sub-Saharan African countries find themselves, there is no alternative but to reduce their debts significantly.

1027. Official bilateral debts amount to $50 billion, half of which are concessional debts.

1028. As for the poorest countries, eligible along the lines of what has been already decided by France and Italy, ethical duty calls on lenders to cancel the service of these credits, imputing the loss to the budget of each of the relevant years. Eight hundred million is actually paid on the latter, whereas $200 million is paid on non-concessional debts. Amortization amounts to a further $700 million, $300 million of which is paid on concessional debts.

1029. A 2 per cent reduction of interest and amortization flows on such debts, with the remaining service to be paid in local currency, would actually lead to a "sacrifice" of only $1 billion per year of the revenues of ODA States.

1030. A further $2 billion, 50 per cent of which represents interest and 50 per cent amortizations, is paid to multilateral organizations ($600 million is paid for concessional transactions $180 million for interest and the remainder for amortizations). A 2 per cent conversion of debt into domestic currency would make multilateral organizations lose only $1.16 billion per year, which is hardly an exceptional burden.

1031. Commercial bank flows amount to $1.2 billion, half of which come from interest, and half from amortization. This accounts for 7.5 per cent of the total of $16 billion in medium-long term credits. The implementation of a courageous debt reduction strategy along the lines of a strengthened Baker Plan policy could lead to a 3.5 per cent reduction per year in the percentage of debt service on the

principal paid in hard currency with another 2 per cent paid in local currency equal to roughly $1 billion in hard currency: $300 million could be provided by external resources, $300 million could be paid in the domestic currency of debtor countries and $300 million could be immediately sacrificed by banks, through a restructuring equal to 50 per cent of their debt. Similar but smaller reductions should be granted to the middle income countries.

1032. $3.2 billion per year in interest could be globally remitted in various ways, while the remaining $0.8 billion together with the amortization would take the form of counterpart funds, as already indicated. The $5 billion less in debt service, $3.5 billion related to public budgets and $0.7 billion each to banks and the multilateral institutions may not appear to be large amounts, given the size of the financial flow of rich countries, but they are enormous for poor countries and could possibly smooth the way for them to find more new money. As emphasized, the aim is to achieve a 6 per cent GDP growth, which is considered both possible and imperative.

1033. Even those like Greene 4/ who argue against generalized forgiveness of bilateral debt recognize that donors should also acknowledge that sub-Saharan Africa is likely to require far longer to achieve external viability than was previously anticipated. Thus, substantial new commitments of foreign assistance will be needed. Without these changes, it is difficult to foresee an end to the sub-Saharan African debt problem, much less the underlying problems of poverty and stagnation that still cripple many, if not most, sub-Saharan countries more than two decades after their independence.

C. Egypt

1034. In North Africa, the Egyptian debt situation is very serious and, as will be seen, it presents a number of particular features that require specific forms of intervention.

1035. With a population of 50 million and a gross domestic product (GDP) of $36.8 billion, 5/ Egypt's debt has now reached between $46 billion and $50 billion 6/ which accounts for between 125 and 136 per cent of GDP. A very substantial proportion of this is the result of the capitalization of unpaid arrears.

1036. In 1988-1989, debt service charges after the restructuring laid down by the Paris Club in May 1987 totalled $6.6 billion ($2.8 billion of which was for medium- and long-term interest charges), compared with $2.5 billion in 1987-1988, $3.6 in 1986-1987 and $4.4 billion in 1985-1986 (of which $1 billion, $1.3 and $1.8 billion, respectively, were in medium- and long-term debt interest).

1037. As this shows, the restructuring provided only temporary relief. Egypt is unable to pay its debt-servicing charges, which account for about 18 per cent of GDP. 7/ Moreover, debt service charges account for about 53 per cent of exports, or $12.6 billion, 8/ while interest charges alone account for 22.43 per cent. 9/ Egypt pays only about one third of this charge because it is difficult to increase the export surpluses, which currently stand at $2 billion.

1038. The burden of this debt and the arrears and the dispute with IMF have prevented Egypt from obtaining international financing. Yet the Egyptian economy is full of potential and is capable of high development rates.

1039. The economic structure needs a great deal of intervention before it can become an open economy that can exploit savings and entrepreneurial energies. Data on the GNP growth over the past few years are questionable: according to official government sources, GDP has grown in real terms, even after the debt crisis became more acute, from 4.8 per cent in 1985-1986 to 4.2 per cent in 1986-1987 and 5.3 per cent in 1987-1988. 10/

1040. According to IMF estimates based on government figures, the real situation is probably much more worrying: after the 4.8 per cent in 1985-1986, there was a 1.5 per cent decline in 1986-1987, followed in 1987-1988 by an increase of only 0.5 per cent, while the trend was probably negative again in 1988-89: a 1 per cent decline.

1041. Since 1981, agricultural production has risen by 24 per cent, despite the difficulties in obtaining supplies of capital goods, giving an annual average growth rate of 3.5 per cent.

1042. However, the Egyptian population is growing rapidly, and the increased agricultural production is still quite unable to meet the huge demand for food imports. These account for over 20 per cent of aggregate imports and were worth about $10 billion in 1987-1988 and 1988-1989.

1043. One black spot in the Egyptian economy is the Government's financial difficulties. Government revenues have been declining as a result of the fall in international oil prices. But taxes account for about 15 per cent of GDP, while non-tax government revenues, income from the Suez Canal and the State oil company, and a few of the numerous other State-owned enterprises, account for 5 per cent.

1044. Self-financing by public enterprises is also about 5 per cent of GDP, but since the extractive, manufacturing, energy and transport industries are almost entirely in the public sector, the whole investment effort is sustained by public funding, which is almost equivalent to GDP.

1045. Recently, the deficit fell sharply to 13 per cent of GDP, but public investment also declined to about 14 per cent of GDP.

1046. Any further containment of the deficit would raise serious problems because of the private savings rate, which appears to hover around 12 per cent of GDP. However, inflation is not out of control even though more recently it has been pushed upwards again by the measures to liberalize prices and exchange rates at the prompting of the international monetary authorities in order to reduce the distortions in the economy. In 1988-1989, the inflation rate was 25 per cent for wholesale prices and 2 per cent for urban retail prices.

Table XVII.7 Egypt: Central government revenues and expenditures as a percentage of GDP

	1985-1986	1986-1987	1987-1988	1988-1989	1989-1990
Revenues of which	35.5	30.6	28.9	26.3	25.5
Central Government, taxes	18.1	15.6	14.7	14.3	15.2
Non-tax revenues	8.9	6.2	6.0	5.7	4.8
Expenditures of which	57.0	48.2	48.5	43.0	38.3
Current, of which	36.0	30.1	26.6	27.3	24.5
Wages and salaries	9.6	8.4	8.3	7.7	7.4
Subsidies	6.0	5.2	5.5	4.9	3.6
Interest charges	4.3	3.3	5.2	4.9	4.5
Defence	7.3	6.2	5.4	4.8	4.2
Investment	21.6	18.2	19.9	15.2	14.0
Overall deficit	21.5	17.6	19.6	16.7	12.8

Source: Ministry of Finance, Central Bank of Egypt, and IMF estimates.

1047. Debt-burdened Egypt, with its high public sector deficit and without any fresh capital injections, cannot afford the investment needed to develop agricultural productivity and bring more land under cultivation (at present only a tiny proportion of the total area of Egypt is under cultivation). For one thing, its gross savings ratio, after allowing for the deficit, accounts for only 8 per cent of GDP (from 14 per cent in 1965). Investment stands at 18 per cent of GDP, with external aid and non-payment of a substantial share of the debt-service charges. And industry and the infrastructure (connected to the development of tourism, which brings in about $3 billion in foreign exchange, of which $2 billion is officially recorded) also require substantial additional capital. It is certainly not going to be easy to comply with the IMF suggestion to develop the market economy and boost private enterprise if Egypt adopts the restrictive measures it has suggested, especially the suggestion that interest rates should be raised continually over a short period of time, which the small- and medium-sized firms could not cope with.

1048. However, even if interest rate increases are kept lower than IMF suggests, Egypt still cannot meet its financing requirements without lightening the debt burden and acquiring fresh external funding, because domestic consumption can only be marginally reduced.

1049. It should be noted that Egypt's debt situation is anomalous in one respect: $10 billion, which is one fifth of the aggregate debt and over one quarter of the amount owed to Governments and multilateral governmental institutions, is owed for military procurement from companies that were in a position to charge monopoly prices that benefited the whole of the industrialized world and, more specifically, guaranteed the continuity of oil supplies to the West. This $10 billion debt, with a 14 per cent service charge, is now over twice the original debt, to which interest arrears have since accrued, plus a penalty for arrears.

1050. It is owed not to banks but directly to the Governments of the "friendly" countries that supplied military aid of common interest, charging an interest rate of 34 per cent.

1051. From the ethical point of view, there are sound arguments for drastically cutting this debt, or rather the interest burden and the annual repayment rates. In other words, the fact is that Egypt has already made payments in kind through the defence services it has supplied and its contribution towards protecting the status quo in an explosive region - a service rendered to the community of the industrial countries "at no extra charge". Yet servicing this debt poses a dramatic problem for Egypt because it amounts to a $1 billion a year, and if this is not paid in full, all of the United States aid earmarked for Egypt, which it desperately needs, will be suspended pursuant to a measure adopted by the United States Congress.

1052. The bulk of Egypt's debt - 75 per cent - is owed to Governments and intergovernmental organizations, which means that Egypt cannot benefit from facilities of the kind provided under the Brady Plan. In these circumstances its hopes are pinned on a new Toronto-type restructuring arrangement to be decided upon in the Paris Club, and on new financing initiatives supported by friendly

States members of the European Community. Some 25 per cent of Egypt's overall debt is owed to the United States.

1053. After deducting the portion of military debt, which is a separate issue, the proportion of the debt owed to the United States is comparatively small compared with the 30 per cent owed to the other industrialized countries. Debts with the Arab world and the Islamic States are quite high: 22 per cent, of which about one half is owed to governments, with the rest owed to Arab aid agencies. Only 9 per cent of the debt is owed to the World Bank and IDA. 11/

1054. According to IMF estimates for 1988-1989, $24.8 billion, or 54 per cent, of the $45.7 billion owed to Governments are in bilateral loans granted by Governments of the United States, France, Germany, Japan, Kuwait and Saudi Arabia. And even Egypt's medium- and long-term trade debt, which is owed to Governments through public insurance guarantees, accounts for a substantial portion of the whole: $8.5 billion, or 18.5 per cent of the $45.7 billion total owed to France, Italy, Japan, Germany and the United Kingdom.

1055. This means that the key to solving this problem is in the hands of the Governments of the rich countries that have economic dealings with Egypt. Faced with Egypt's payment difficulties, only SACE (the Italian public insurance company) has continued to provide assistance. All other public insurance agencies have withdrawn. But Egypt is an interesting customer for the very countries that have withdrawn their guarantees.

1056. The latest two-way trade data with Egypt show that the United States and the European countries, with the sole exception of Italy, buy very little from Egypt, while exporting a great deal to it. In the industrialized countries, there are various obstacles to Egypt's exports of agricultural products and manufactured goods. But any further increase in oil exports depends on reduced domestic consumption, which, inter alia, involves substantially developing hydroelectric power and investing in rationalizing the country's vehicle stock (most freight is transported by road).

1057. To increase its natural gas exports, gas pipelines and storage facilities need to be built. At the present time, Egypt's oil export revenues are low, but it should be noted that not all of Egypt's oil exports improve the country's balance-of-payments situation; part of them represent the share of revenues owed to the industrialized countries whose companies collaborate with Egypt's State enterprises to prospect for and extract the oil. This latter share totals 14 million tons, compared with the 10 million tons exported for the benefit of Egypt.

Table XVII.8 Egypt: external debt, 1989

(In millions of United States dollars)

Total non-military debt	40 000
Of which:	
Official development aid	10 000
Non-bank trade claims	11 000
Guaranteed bank claims	3 500
Other bank claims	4 500
Multilateral loans	7 000
Other	4 000
Military debt	10 000
Total external debt	50 000

Sources: IMF/OECD/BIS/MEED estimates, Ministry of Planning.

Table XVII.9 Distribution of debt by main credit groups
(In percentages)

	Percentages
United States	25
Other OECD	30
Arab and Islamic states	12
Eastern Europe and China	5
Arab aid agencies	10
World Bank/IDA	9
Regional aid agencies	4
Other	5
Total	100

Source: Central Bank of Egypt.

1058. Increasing exports and making specific investments in renewing the country's infrastructure are therefore closely linked. Equally closely linked are reducing food imports and investing in new productive land and in the technological cycle for processing, storing, transporting and conserving basic foodstuffs.

1059. The price of Egyptian oil on the domestic market is two thirds less than the pre-tax market delivered price in a processing country, comparable in terms of geographical vicinity, like Italy. It might be argued that this does not cover the refining costs and the original market price set by the international market. There is therefore a huge concealed subsidy. It is true, as IMF maintains, that Egypt could export more refined oil if it were to lower the high level of domestic consumption by implementing a more realistic price policy. But it is far more complicated than IMF seems to suppose.

1060. Table XVII.12 shows that the problem is subdivided into two clearly distinct issues: the consumption of petrol for motor-cars, for which the Egyptian price is in line with international prices, except that the Egyptian excise tax is very low; and the other products, particularly gas oil, diesel oil, fuel oil and kerosene, for which the Egyptian price is very low and certainly encourages consumption. But apart from the adjustment for jet fuel, which is particularly necessary because Egypt imports 80,000 tons of it, the fact remains that the main components of Egyptian domestic consumption - heavy oils, diesel oils and kerosene - play a very important role in the system of industrial, commercial and private costs.

1061. Any rapid increase in the price of fuel oil and naphtha would have negative repercussions throughout the whole area of industrial production and transportation services, and would also raise the price of electricity for which this product is very largely used. It is doubtful whether a rapid increase in the market price would reduce the demand of commercial transportation and electricity for industrial purposes significantly except through an unwelcomed disorganization of production, although it is obvious that this would give a powerful boost to inflation. Similar considerations apply to diesel oil and gas oil.

1062. Even though energy-saving could be achieved efficiently and rapidly by replacing the old trucks and equipment with new vehicles and facilities, the fact remains that financial resources would be required to do this, and it would immediately worsen the import situation in all respects. Lastly, kerosene - which is used to heat foods and for lighting - could be replaced by liquid gas (butane is cheap but hard to export). But this would require a service that cannot be improvised and a package of investments.

1063. IMF is suggesting an adjustment shock therapy, coupling these rapid price increases with a drastic cut in food subsidies, a 25 per cent devaluation of the currency and a 30 per cent increase in interest rates. Additionally, the multiple interest rates and foreign exchange rates should be abolished, and the controlled farm prices should be deregulated entirely. Lastly, wide-ranging financial and economic deregulation should be carried out rapidly.

Table XVII.10 Production and distribution of Egypt's oil
(In millions of tons)

	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988
Total production	39.1	43.4	42.6	44.0	44.3
Domestic refining	18.3	20.4	20.4	22.0	21.0
Exports	20.8	22.2	22.8	23.9	23.3
Of which:					
Egypt's share	2.3	11.6	10.9	9.8	10.0
Partners' share	8.4	10.6	11.9	14.1	13.3
Change in stocks	0.1	1.1	-0.6	-1.9	0.6

Source: Egyptian General Petroleum Corporation.

Table XVII.11 Egypt's main commercial partners
1989
(In millions of United States dollars)

Imports		Exports	
United States	2 146	Italy	1 554
Germany, Federal Republic of	1 175	Germany, Federal Republic of	334
France	988	France	313
Italy	875	United Kingdom	272
United Kingdom	478	United States	250

Source: Statistical Office of the European Communities (EUROSTAT); United States Embassy in Egypt.

Table XVII.12 Comparison between the Egyptian domestic price, the price to Italian refineries and Egyptian domestic oil product consumption

	Domestic price	Price to Italian refineries	Domestic price as a percentage of Italian price	Consumption 1987-1988 (millions of tons)
	(Egyptian pounds)			
High octane petrol	559	513	109	213
Standard petrol	490	472	104	7 908
Naphtha	52	411	13	8
Kerosene	86	411	21	2 406
Gas oil	81	377	22	4 121
Diesel oil	74	377	20	34
Fuel oil	35	249	14	8 505
Butane	52	488	11	758
Fuel Perfect	246	421	58	402
Asphalt	27	100	27	559

Source: Egyptian General Petroleum Corporation; Petroleum Intelligence Weekly; and IMF estimates.

1064. This programme appears to be pointed in the right direction. There is, however, a question of timing. As far as prices and exchange rates are concerned, adjustments must be made gradually in order to avoid fuelling inflation and wiping out the benefits. In addition, it would be untenable to sacrifice all forms of easy-term credit and current measures to stimulate and protect the domestic economy on the altar of laissez-faire ideology. This is not the model being adopted now or used in the past by Europe, the United States, Japan or the South-East Asian countries that have rapidly industrialized. Forms of mercantilism have always gone hand-in-hand with industrial, agricultural and financial growth.

1065. There is no doubt that the Egyptian economy is greatly in need of liberalization and a favourable environment for a market economy and private investment. These activities have been restricted by excessive government control and far-reaching bureaucratic planning. The current model has to be superseded. The Egyptian Government apparently intends to do this, even though, as always, there is internal resistance, and the process is slow. Negotiations with IMF relate only to a loan of a mere $340 million. But failure to reach an agreement on this loan with IMF is holding up loans from all other international institutions, admission to the Paris Club and assistance from insurance companies, bilateral aid agreements, bank loans and access to the Brady Plan. This places IMF (and the World Bank, to a degree) in a difficult position: to those who see it merely in terms of its monetary duties, it appears to make too many concessions, but to those who judge it by the macroeconomic and political effects of its decisions it is deemed too rigid.

1066. Economic liberalization measures should probably be encouraged more than is envisaged under the IMF programme, in order to raise economic productivity and enable business to prosper. Egypt's public enterprises need a managerial-type market structure. In some cases, jointly owned companies with foreign public and private equity interests might offer new managerial skills and give an impetus to exports.

1067. The most sensitive part of the IMF therapy, alongside oil product pricing and food subsidies, is the 25 per cent devaluation of the currency. A sudden devaluation of this magnitude could be dangerous and counter-productive given that Egypt imports 60 per cent of its staple commodities, and also in view of the Egyptian export balance. Exports of commodities other than petroleum in 1988-1989 were worth only $1.5 billion, out of a total of $11.7 billion, less than 10 per cent. Devaluing the Egyptian pound by 25 per cent might perhaps increase the immediate competitiveness of certain agricultural foodstuffs and textiles, so long as it does not fuel inflation, which would rapidly wipe out the benefit. But there are bottlenecks on the supply side, particularly export credit, which curbs the effect of theoretical increased competitiveness.

Table XVII.13 Egypt's exports
(In millions of United States dollars)

	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988-1989
Petroleum products	2 640	2 589	2 027	1 224	1 386	1 110
Other commodities	1 393	1 294	1 209	1 361	1 710	1 479
Miscellaneous services	1 627	1 633	1 567	1 875	1 796	2 089
Tourism	228	410	315	380	886	920
Revenues from the Suez Canal	974	897	1 028	1 148	1 269	1 307
Migrants' remittances	3 930	3 497	2 973	3 012	3 384	3 530
Investment income	1 097	1 042	914	825	964	1 217

Source: Central Bank of Egypt; Egyptian government ministries; Egyptian General Petroleum Corporation; and IMF estimates.

1068. In any event, the amounts involved are small in terms of the volume of exports. Apart from petroleum products, they refer almost entirely to services for which the exchange rate of the Egyptian pound to the United States dollar and other industrialized countries' currencies is not directly relevant. Declining revenue from petroleum products certainly has nothing to do with the exchange rate of the Egyptian pound. The supply has risen, although not substantially. The sharp fall in revenue is due to the slump in the price to $14-$12 FOB per barrel in 1989. Devaluing the Egyptian pound is quite irrelevant in this regard because it is a dollar-denominated market. As for revenues from the Suez Canal, these do not depend on the value of the Egyptian pound but on the traffic using the Canal and the toll charges. Fortunately, this item is expanding. Here again, exchange rate variations are irrelevant. The same applies to miscellaneous services, led by freight transport charges, which are already competitive and are largely linked to oil exports and are therefore denominated in dollars. And not even foreign exchange income from foreign investments is likely to be affected by any devaluation of the Egyptian pound.

1069. In principle, there might be changes in the remittances of migrants and income from tourism, not because migration or tourism depends on this stimulus (in the case of tourism, raising domestic prices would eliminate any benefit of devaluation), but because an official exchange rate linked to the free market rate might encourage Egyptian migrants abroad and the suppliers of tourism services to change all of their valuable foreign currency on the official market. However, the two exchange rates are not very far apart at the present time. The large rise in

income from tourism and migrants' remittances since 1987-1988 can be explained by the gradual realignment of the two exchange rates. An adjustment to the exchange rate of less than 25 per cent might therefore be enough. On the other hand, IMF does not maintain that the measures it is suggesting are going to improve significantly the balance-of-payments situation using present policies.

1070. IMF maintains that the balance of payments on current account will be improved by gradually expanding exports of goods and by increased remittances from migrants: this should result from the increased remuneration accruing to them owing to the drastic rise in interest rates that IMF suggests (and which, for some reason, it does not believe likely to have an adverse effect on the export of goods and on the tourism industry). To make it more attractive to migrants to deposit their remittances in Egyptian banks, financial schemes specially tailored for migrants, with pass-books for their relatives, linked to the future purchase of farm and building land from the Egyptian Government might be more useful still, coupled with a slight increase in interest rates. With regard to the imports of goods, IMF itself has forecast that, if the currency is devalued as it has suggested, the balance would worsen and not improve because of the demand for goods.

1071. Lastly, abolishing the entire flour subsidy would considerably reduce the well-being of the people, most of whom live on mere subsistence incomes, which would fall below the subsistence threshold if the prices of too many staple commodities were to be increased. A selective abolition of the subsidy seems advisable. Per capita wheat consumption is 200 kg, compared with 120 kg in Pakistan, but in Egypt the per capita calorie availability is 3,340, compared with 2,315 in Pakistan, and 25 per cent of children in Pakistan are born under weight, compared with 7 per cent in Egypt.

1072. Generally speaking, more flexible and gradual policies would appear to be more appropriate in economic terms, and from the point of view of public support, in order to combine financial recovery with the growth of the Egyptian market economy. Another reason for this is the fact that a "market change-over" needs stimuli, not hurdles, in the path of the small and medium firms, and it needs public support in view of the difficulties that it might generate in the immediate future.

1073. Debt restructuring, obtaining guarantees from friendly countries so that the flow of investment can resume, greater willingness on the part of creditor countries to procure more Egyptian exports, and new forms of collaboration with Egypt, are all linked to Egypt's desire to open up to a market economy and to pursue its financial recovery by implementing gradual, but not short-lived, measures. Conditionality must take the form of a two-way relationship between all these component parts of the recovery process.

1074. By the year 2005, Egypt will have a population of 67 million. The fact that it can develop in the direction of progress is to the good of the whole of the African-Middle Eastern-European area. If it fails, it will generate poverty, fundamentalism, social instability, unrest and forced migration towards the rich countries on the opposite coast.

D. Ghana

1075. According to IMF estimates, Ghana's total debt at the end of 1988 was around $2.9 billion, or 56 per cent of the country's gross domestic product (GDP), with a debt-to-export ratio of 302 per cent. The situation seems to have improved since 1987, when the total outstanding debt was in excess of $3 billion (68 per cent of GDP and a debt-to-export ratio of 343 per cent). Most of Ghana's debt is owed to bilateral and multilateral institutions (almost 62 per cent of the public and publicly guaranteed debt in 1988). Long-term debt was 56 per cent of the 1988 total. Debt service continued to rise and went from $385 million in 1986 (48 per cent of exports of non-sectoral goods and services) to $651 million in 1988 (68 per cent). At any rate, IMF expects a substantial improvement in 1989 and 1990 data.

1076. In 1983-1987 Ghana received special financial treatment, as can be seen from the table provided by IMF, in which the terms granted to this country have been compared with those of other groups of nations (table XVII.14). According to the World Bank, the interest-to-export ratio was 13:1 in 1989, and the interest-to-GDP ratio was 2:4. Arrears on interests on long-term debts amounted to $7 million in 1988. In 1987, Ghana rescheduled $42 million worth of debts through the private banking system. In November 1987, Ghana received from IMF an ESAF of $245 million special drawing rights (SDRs), plus an SAF of $130 million.

1077. Ghana's economy has always relied on the primary sector (table XVII.15). Agriculture accounted for 47.2 per cent of the 1988 GDP, and cocoa alone, of which Ghana is the world's third largest producer, after Brazil and Côte d'Ivoire, was 7 per cent of the total. The mining potential is very high (gold and other minerals). Based on data provided by Ghana's Central Statistics Office, cocoa, gold and timber account for 86 per cent of total 1988 exports. The service sector, thanks most of all to the expansion of the overall system, accounts for 50 per cent of GDP, and the industrial sector, which is well-diversified by sub-Saharan standards and includes mining, manufacturing and construction activities, accounts for 14 per cent.

1078. In 1987, Ghana's GDP was $5.1 billion, with an average real growth of 5 per cent per year since 1983 and a GDP per capita of about $390, showing a downward trend of 1.6 per cent in the period 1965-1987. The population numbered 13.7 million in 1988, with an annual high growth rate of 2.7 per cent. Life expectancy at birth was very low in 1987: only 54 years. Equally preoccupying is the daily calorie intake per capita: only 1,759.

Table XVII.14 Average terms of new commitments during 1983-1987

	All developing countries	Sub-Saharan African countries	Low-income African countries	Ghana
Interest (in percentages)	7.8	6.9	3.1	3.0
Maturity (years)	15.7	23.9	30.9	32.2
Grace period (years)	5.1	6.0	7.4	7.4
Grant element (in percentages)	14.2	34.9	53.7	55.6

Source: IMF.

Table XVII.15 Ghana: composition and growth of gross domestic product by sector, 1983-1988
(As a percentage of real GDP)

	1983	1984	1985	1986	1987	1988 Prov.
Agriculture, forestry, and fishing	53.4	53.9	51.7	50.7	48.4	47.2
Agriculture and livestock	(37.1)	(39.5)	(36.9)	(35.1)	(33.4)	(33.3)
Cocoa	(7.8)	(6.6)	(7.1)	(8.0)	(7.8)	(6.9)
Forestry and logging	(6.5)	(6.1)	(5.8)	(5.6)	(5.4)	(5.2)
Fishing	(1.9)	(1.8)	(1.9)	(2.1)	(1.8)	(1.7)
Industrial production	11.6	11.6	13.0	13.3	14.1	14.7
Mining and quarrying	(1.1)	(1.1)	(1.2)	(1.1)	(1.1)	(1.4)
Manufacturing	(6.9)	(7.2)	(8.5)	(9.0)	(9.4)	(9.7)
Electricity, water and gas	(0.9)	(0.7)	(0.9)	(1.0)	(1.1)	(1.1)
Construction	(2.7)	(2.6)	(2.5)	(2.3)	(2.5)	(2.5)
Transport, storage, and communications	4.0	4.2	4.3	4.3	4.6	4.8
Distribution and other services	33.8	33.0	33.7	34.1	35.6	36.0
Wholesale and retail trade	(9.8)	(9.9)	(10.7)	(11.1)	(12.4)	(12.6)
Finance, insurance, real estate and business services	(8.7)	(8.8)	(8.6)	(8.8)	(8.8)	(8.9)
Public administration and defence	(13.9)	(12.9)	(12.8)	(12.5)	(12.2)	(12.5)
Other services	(1.4)	(1.4)	(1.6)	(1.8)	(2.1)	(2.1)
Less: Imputed bank charges	3.7	3.7	3.8	3.8	4.0	4.1
Plus: Import duties	0.9	1.0	1.2	1.4	1.3	1.4
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0

Source: IMF, Ghana: Recent economic developments, October 1989.

1079. In conjunction with IMF, Ghana has been pursuing a policy of economic recovery since 1983, aimed at achieving a sustained growth in GDP and at achieving external solvency in the medium term. The basic elements of this policy are:

(a) Adjustment of relative prices to promote productive activities, exports, savings and investments;

(b) Eventual elimination of government control of the economy and a shift towards reliance on market forces;

(c) Restoration of a stable monetary climate;

(d) Incentives for savings and private investments.

1080. Such typical measures were adopted following the 1983 shrinking of gross investments to 3.7 per cent of GDP and of savings to 3.6 per cent, owing to permissive fiscal policies. The same figures in 1988 were 12.3 per cent and 10.6 per cent respectively. Public and private savings are exactly on the same level (5.3 per cent), while public investments stand at 7.9 per cent, against 4.4 per cent for private investments (table XVII.16). This result was achieved because of the reform of the tax system, directed at increasing efficiency and equity, at bringing about a rationalization of public spending and a stringent monetary policy, trailed by a gradual liberalization of interest rates. Domestic savings are still insufficient at 5.3 per cent of GDP in 1988 and well below the 1975 level (14.34 per cent).

1081. A bridgehead in the readjustment policy was the depreciation of local currency through a gradual liberalization that started in 1983 and lasted until early in 1989. The purpose was that of reaching relative prices, promoting import substitution and expanding the export basis. Notwithstanding a net improvement in the balance of payments in 1987 and 1988 compared with the period 1983-1986, with a surplus of $139 million and $125 million respectively, against an overall deficit of $378 million, export diversification remained low, thus reflecting only a partial success for the whole operation.

1082. Ghana therefore remains extremely vulnerable to international fluctuations in the price of cocoa, so much so that despite an increase of 1.4 per cent in volume, in 1988 export earnings decreased by 6.4 per cent owing to a generalized price drop in the market. It was because of the high quality of its cocoa that Ghana avoided more serious consequences, given that the price drop was much greater because of the production coming from other countries.

1083. The steady price of gold, together with an increase in production brought about by investments in the gold mining sector, raised the related export share to 19 per cent ($169 million in absolute terms). The trend in timber exports was equally good, and exports of electricity, manganese and diamonds also rose. But, according to IMF estimates, the index of exports concentration is still 58 per cent. The total value of exports has been calculated by the World Bank at $900 million.

Table XVII.16 Ghana: Savings and investment and sectoral financial balances, 1970-1988

	1970	1975	1980	1983	1985	1988
Gross national savings	11.2	13.8	5.0	3.6	8.1	10.6
Of which: domestically generated	(11.3)	(12.9)	(4.5)	(2.4)	(6.0)	(3.8)
Gross investment	14.1	12.7	5.6	3.7	9.6	12.3
External current account deficit	-3.1	0.4	0.2	-0.3	-2.5	-1.7
Statistical discrepancy	-0.1	-0.7	0.8	-0.2	-1.0	...
Public sector financial balance	-3.0	-12.5	-7.6	-2.7	-3.0	-2.6
Government savings	2.3	-1.8	-4.9	-1.8	-1.1	5.3
Public investment	5.3	10.7	2.8	0.9	4.2	7.9
Private sector financial balance	...	12.9	7.8	2.4	0.5	0.9
Private savings (including statistical discrepancy)	8.8	14.9	10.7	5.3	6.0	5.3
Private investment	8.8	2.1	2.9	2.9	5.4	4.4

Source: IMF, op. cit.

Table XVII.17 Ghana: Summary of fiscal developments, 1983-1989
(As a percentage of GDP)

	Budget						
	1983	1984	1985	1986	1987	1988	1989
Narrow coverage							
Total revenue and grants	5.6	8.4	11.8	14.4	14.9	14.5	15.7
Revenue	5.6	8.1	11.3	13.6	14.1	13.4	14.4
Grants	...	0.3	0.5	0.8	0.8	1.1	1.3
Total expenditure and net lending	8.2	10.2	14.0	14.3	14.3	14.2	14.9
Current expenditure	7.4	8.6	11.2	11.9	10.8	10.5	10.7
Wages and salaries	2.0	2.0	4.2	5.1	4.8	4.7	4.8
Capital expenditure	0.6	1.2	2.1	1.9	2.5	2.8	3.0
Net lending	0.2	0.3	0.6	0.5	0.7	0.6	0.4
Special efficiency	...	...	...	...	0.4	0.3	0.8
Budget balance	-2.7	-1.8	-2.2	0.1	0.5	0.4	0.8
Net foreign financing	0.4	0.7	1.0	-1.1	-0.2	0.2	0.1
Net domestic financing	2.3	1.1	1.2	1.0	-0.4	-0.6	-0.9
Bank financing	1.4	1.1	0.9	0.5	-1.0	-1.1	-0.6
Broad coverage							
Total revenue and grants	5.6	8.8	12.4	15.9	16.7	16.1	17.5
Total expenditure and net lending	8.2	11.1	15.4	19.2	19.1	18.7	20.7
Overall balance	-2.7	-2.3	-3.0	-3.3	-2.4	-2.6	-3.1

Source: IMF, op. cit.

1084. Although precise data are not available, the World Bank is convinced that imports rose in 1988 to $1.4 billion, with a real term increase of 5 per cent. All major items showed a marked increase initially, later reduced owing to declining prices on the international market, with the exception of oil. The excess of imports over exports, associated in the debt service related to the rising debt stock, has led to a worsening in the current account side of the balance of payments, net of public transfers, from 3.9 per cent of GDP in 1983-1986 to 5.0 per cent in 1987 and 5.1 per cent in 1988. However, despite the positive net flow of official aid ($175 million in 1988), the net balance was only 1.7 per cent in 1988, against 2.3 per cent in 1987.

1085. The external equilibrium of the country depends not only on external fluctuations in the price of raw materials, but also - given the heavy weight of cocoa in total exports - on weather conditions. The latter have a strong impact also on the GDP growth rate, owing to the share relative to cereals and other crops, and on the people's standard of living. The Government has adopted policies of price increases in real terms for producers and at the same time improving rural services and infrastructures.

1086. The situation remains difficult, however, owing to the low productivity of small farmers, who make up most of the agricultural sector. Production grows at too slow a pace (6 per cent in 1988) for a country still beset by food problems.

1087. The inadequacy of the communication network, the low stock capacity, and the general lack of information on food production are the causes of the high rate of instability in the prices of food supplies, resulting in distortions of the market, and in socially undesirable situations and fuelling inflation (33 per cent in 1988).

1088. Another reason for concern in the primary sector is the intensive exploitation of forests, with serious consequences on the environment. In 1988, the World Bank supported and funded a pilot project aimed at stabilizing the production of timber by ensuring at the same time sufficient earnings for producers. Such a project may be an important premise for a debt-environment swap programme, along the lines suggested in chapter VII of the present report.

1089. The sector where Ghana has achieved the best results is undoubtedly the readjustment of public accounts (table XVII.17). Policies adopted since 1983 have produced a constant rise in revenues, which were expected to reach 15.7 per cent of GDP in 1989. Revenues coming from the taxation of company gains, brought about by greater efficiency on the part of the revenue service, an expansion of the tax base and increased profits, rose considerably up to 1.9 per cent of GDP in 1987 and 2.8 per cent in 1988. Total revenues from the taxation of personal incomes was 0.5 per cent of GDP in 1989, as the Government kept it at a low level through a policy of reduced fiscal drag and of tax deductions. The current tax on sales was introduced on 1986 and its yield reached 1.1 per cent of GDP in 1989.

1090. Yet the major source of revenues is still the tax on cocoa exports, which rose to a high of 3.6 per cent of GDP in 1987, but fell slightly in 1989. Within the policies aimed at promoting exports, the Government has abolished taxes on exports of gold and timber.

1091. In the framework of a far-reaching tax reform adopted during 1989, tax rates applied to industrial firms have been reduced, and the same occurred with the rates of sales tax. To offset this, taxes on oil products were raised, despite the fact that they had been more than doubled in the last few years.

1092. The considerable net improvement in the level of revenues allowed for more to be spent on education, health and agriculture and to bring expenditure on the current account side up to 3 per cent of GDP. The Government has pursued a wage increase policy with marked differentiations between wage levels in order to find a solution to the serious situation caused by the flight abroad of a large number of local professionals.

1093. Improvements to the economic and social infrastructure were also carefully considered with the creation in 1986 of public investment programmes, largely financed by external sinking funds. Their activity was primarily focused on agriculture, energy, housing and mining, which were up to about 7 per cent of GDP in 1988. With the support of the World Bank, the Government launched a programme for the dismantling or reorganization of public enterprises, whose number had reached 230, including controlled and connected bodies. The project envisages capital consolidation for 14 enterprises that are considered of strategic importance (oil production, mining, transport, water supply, cocoa production) and the dismantling of 32 enterprises. The overall budget deficit for 1989 is estimated at 3.1 per cent of GDP.

1094. Ghana is rightly regarded as the country in which the policies suggested by international financial institutions have been most successful. Public and private financial institutions do not show any special concern for the fate of Ghana's debt. The country's economic outlook is certainly not dramatic, as are those of other sub-Saharan countries. Nevertheless, the living conditions of most of the population remain bad. Food security has not yet been reached and to this end the World Bank is still engaged in the development of programmes for the promotion of small-scale production as an antidote to food scarcity and to high prices of food supplies. Overall economic productivity is still low. The severe policies adopted so far have not fully restored monetary stability, while they have pushed out of the country a high number of professionals and intellectuals.

1095. The interest on debts ($127 million in 1988) is highly onerous for an economy whose structures are still fragile, and has a strong impact on development opportunities. Private investments themselves are at depressed levels, which indicates that private entrepreneurship still has to be developed.

1096. Official debt reduction for low-income countries along the lines previously illustrated is strongly recommended for Ghana. Its per capita income of $390 (1987) could resume a growth path if the debt burden were reduced, and the fact that Ghana was able to cope with the debt crisis though sound and courageous policies should be a reason to provide it additional assistance.

E. Nigeria

1097. In 1988, Nigeria's GDP was around $29 billion, and its total debt amounted to more than $30 billion. Debt service was equal to $6.4 billion (that is, 81 per cent of total exports), three times higher than five years before, and it rose to $6.6 billion in 1989. Interest due is currently in excess of $2 billion.

1098. Nigeria has applied repeatedly to the Paris Club for rescheduling, but has not been able to carry out regular payment on the amounts due. Members of the Paris Club own about 50 per cent of Nigeria's outstanding debts, while those of the London Club have about 20 per cent. The latest rescheduling was agreed upon in spring 1989, after the 1988 debt servicing had risen by $4.4 billion and in the light of the slow and difficult process that leads to such an agreement. In spite of the restructuring and of an intervention from IMF and the World Bank, Nigeria is not in a position to bear its debt burden. Recurrent popular uprisings demonstrate that there is a limit to the ability to pay, and that such limits can be pushed - rather dangerously - only with force.

1099. In 1980-1988, the country's economy experienced an annual fall of 1.5 per cent in GDP (against a 6.9 per cent rise in the period 1965-1980). The recession was particularly deep in 1983-1984 and, after a small recovery, in 1987. Investments in that year fell by 21.7 per cent over and above the already depressed levels of the previous year. By and large, gross investments dropped from 22.8 per cent of GDP during the period 1973-1980 to 19.5 per cent in 1980-1987. Inflation is rising and the current account deficit of the balance of payments is higher than $2 billion.

1100. Nigeria's population amounts to 107 million inhabitants (i.e., one fourth of the total population on the African continent) and is growing at an annual rate of 3.1 to 3.3 per cent. This country had to bear the brunt of the decline in oil prices (oil revenues account for 80 per cent of foreign-exchange revenues) and had to abandon many development projects that were already not economically viable owing to the higher cost of capital, borrowed at LIBOR plus.

1101. Equally alarming is the health situation. Infant mortality was 85 per thousand in 1987 and the daily calorie intake per person was insufficient by the standards of the Food and Agriculture Organization of the United Nations (FAO).

1102. Under such circumstances and with extreme difficulty, the Nigerian authorities are continuing with the adjustment efforts begun in 1986 under the aegis of IMF. These efforts entail the typical measures aimed at achieving economic liberalization (including the privatization of public enterprises), currency devaluation, the reduction of multiple exchange rates, a rise in real interest rates, the elimination of domestic price control and improved fiscal discipline. The purpose is to provide incentives to the export-oriented sectors, encourage savings, improve public efficiency and promote the goals of the Lomé Convention.

1103. There have been mixed results: GDP rose more than expected in 1988, thus fuelling inflation, which dangerously approached 50 per cent; shortcomings were experienced in the agricultural sector; the exchange rate fell more than anticipated; and there were indications that external imbalances were far from over.

1104. The social and political situation has become increasingly tense and the Government has problems in keeping it under control. Yet, Nigeria is particularly favoured in terms of natural resources. According to the latest of the Organization of Petroleum Exporting Countries (OPEC) estimates, the country's oil reserves are very large and its quality is good. It has the potential to produce large quantities of natural gas, tin, uranium and other minerals.

1105. The free world must have a special interest in strengthening democracy in Nigeria by devising programmes for debt reduction, not only bank debt but also the official debt. Incentives should also be provided for new investments that can help Nigeria in resolving its tormenting economic problems.

1106. Agriculture is the most urgent problem facing Nigeria, which it will only be able to solve with the support of the international community since it does not have the resources necessary to make the required investments. This country has not reached food self-sufficiency, not only because of the preoccupying population growth but also because of the inadequacy of the infrastructure, the transport systems and in the techniques adopted. Agricultural production is stagnating (see table XVII.18). The policy of transforming agricultural produce into the foreign exchange needed to import other food supplies in order to reduce dependency on food imports has shown its limitations, so much so that the Government had to ban the export of most food products since it was fuelling inflation and food scarcity. From 1983 to 1988, the agricultural sector's share of exports was remarkably low, and food imports in 1987 were 10.5 per cent of all imports.

1107. The lack of investments in rural areas was also due to difficulties in public finance, whose revenues are essentially dependant on oil profit taxes, oil royalties and the gains of NUPC (the Nigerian oil company) (see table XVII.19). These revenues account for over 70 per cent of total revenue and were clearly adversely affected by the drop in oil prices in the early 1980s. The public deficit then soared immediately to unbearable levels and in 1987 it was still 10.3 per cent of GDP.

1108. The outlook is typical of that of other developing countries: the State treasury has to bear all burdens related to investments for infrastructures and social spending because local finance is virtually non-existent. Foreign lending in such cases seems unavoidable.

Table XVII.18 Nigeria: Estimates of agricultural production

(In thousands of tons)

	1985	1986	1987
Cocoa	110	100	105
Cassava	1 378	1 564	1 486
Palm kernels	360	350	353
Rubber	58	60	51
Maize	1 190	1 336	1 202
Millet	3 684	4 111	3 905
Coconut	102	104	105
Batata	4 738	5 209	4 886
Rice	196	283	297
Cotton seeds	46	30	32
Sorghum	4 991	5 455	5 182

Source: Central Bank, Lagos.

Table XVII.19 Nigeria: major revenue categories as percentages of federally collected revenue and of gross domestic product, 1982-1988

	1982	1983	1984	1985	1986	1987	1988 Prel.
Federally collected revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Taxes on income and profit	50.3	49.1	50.8	56.2	55.6	49.9	48.9
Of which: Company income tax	5.1	9.6	6.4	6.6	5.4	4.2	5.2
Petroleum profit tax	45.0	39.2	44.1	49.0	45.4	45.6	43.6
Taxes on domestic production and consumption	5.3	7.5	5.6	7.1	5.5	2.8	3.0
Taxes on imports	12.7	9.7	7.5	7.4	10.3	9.2	11.3
Nontax revenue	31.7	33.7	36.0	29.2	28.5	37.9	36.1
Of which: Petroleum royalties, etc.	20.6	22.0	30.3	23.1	17.0	22.9	28.6
Subtotals:							
Petroleum revenue	65.6	61.2	74.5	72.2	62.4	68.5	72.2
Nonpetroleum revenue	34.4	38.8	25.5	27.8	37.6	31.5	27.8

Source: Data provided by the Nigerian authorities to IMF.

1109. The highly restrictive and tough policies that were undertaken at the suggestion of IMF led to drastic cuts in maintenance activities related to material and immaterial infrastructures, thus affecting all projects, not only those associated with inefficient spending, but also those useful for economic development. Attempts to promote savings (down to 12.8 per cent of GDP in 1980-1987 from the previous 24.4 per cent of 1973-1980) by raising interest rates were met by only partial success, since the increase in nominal rates was trailed by generalized price rises. Although 1987 saw a rise in the propensity to save, no progress was made in encouraging capital repatriation. Rather, the policy of currency devaluation prompted further outflows and on this point even the experts of IMF are rather pessimistic.

1110. Therefore, there seems to be little chance for Nigeria to make an automatic or rapid entrance into a completely free market economy as a means of solving its debt burden problems.

1111. First of all, it is necessary to curb the debt burden and subsequently to encourage the inflow of external funds, in a concessional form and with incentives, such as those previously reviewed.

1112. One fundamental feature of the Nigerian debt lies in the high percentage of loans granted by public institutions and guaranteed by the Governments of the creditors: up to 98 per cent in 1987 if one considers only long-term debts and 90 per cent by calculating total outstanding debts. In 1988, bilateral lenders accounted for almost 50 per cent of the total debt, multilateral organizations (mainly the World Bank) for 10 per cent and commercial lenders for 40 per cent. Official credit reduction can thus have a particularly important role to play here. The private share of long-term debt remains very high (about 60 per cent in 1988).

1113. The current conditions under the Brady Plan (e.g., Mexico and Venezuela) do not seem to be suitable for the Nigerian ability to pay. According to estimates by IMF and the World Bank, the gap to be filled in 1990-1993 will be in excess of $8 billion, with interest climbing to 11 per cent of GDP. As in the case of other low-income countries, the economic fate of Nigeria is in the hands of the Governments of the richest countries. Not all have expressed their readiness to assist in that sense, and some have not even signed the bilateral agreements in the framework of the second Lomé Convention with the Paris Club in March 1989.

1114. Nigeria's major trading partners are Western countries: in 1987 the United States of America purchased 41 per cent of the country's total exports, while its import share was 6 per cent, the United Kingdom of Great Britain and Northern Ireland was the largest importer, with 16 per cent; Germany bought 8 per cent of total exports and accounted for 11 per cent of total imports; significant flows are also related to France, Italy and the Netherlands. An easing of the debt burden could open up a large number of trade opportunities if one considers that Nigeria has a tremendous need to expand its railways and road networks, modernize its manufacturing industry and mechanize its agricultural sector.

Table XVII.20 Nigeria: composition of exports, 1983-1988
(Indices 1985 = 100)
(Value in millions of United States dollars)

	1983	1984	1985	1986	1987	Prel. 1988
Oil Value	9 954	11 568	12 203	6 385	6 994	6 433
Cocoa Value	312.7	239.2	257.7	264.8	374.5	268.4
Cocoa butter	39.8	30.9	52.0	32.0	13.2	9.4
Rubber Value	20.6	21.7	23.2	23.3	15.1	33.0
Palm kernels Value	22.9	11.0	8.9	5.4	7.6	12.5
Other non-oil Value	20.0	20.2	21.3	73.6	358.5	770.7

Sources: Data provided by the Central Bank of Nigeria, Federal Office of Statistics and IMF, Nigeria: Recent economic developments, August 1989.

Table XVII.21 Nigeria: composition of imports 1983-1988
(In percentages)

	1983	1984	1985	1986	1987	Prel. 1988	
Import groups							
Consumer goods	41.5	37.0	22.1	21.8	24.1	28.7	
Durable	9.6	8.8	7.8	3.6	4.7	1.0	
Non-durable	31.9	28.2	14.3	18.2	19.4	27.7	
Capital goods	32.4	32.2	34.0	36.2	42.2	32.0	
Raw materials	215.9	29.7	41.4	41.9	33.5	39.3	
Miscellaneous	0.2	1.1	1.6	0.1	0.2	....	
Total	100.0	100.0	100.0	100.0	100.0	100.0	
Import groups	Composition of imports by SITC categories a/						
Food	15.1	14.7	8.6	9.8	10.5	7.8	
Beverages and tobacco	0.1	0.1	0.1	0.2	0.2	0.3	
Crude materials	1.9	2.0	2.3	2.9	4.0	2.7	
Mineral fuels	1.5	1.6	2.0	0.7	0.4	1.0	
Animal and vegetable oils and fats	1.1	1.2	1.0	3.6	0.4	0.3	
Chemicals	10.8	11.0	18.3	13.2	16.9	19.4	
Manufactured goods	21.7	17.3	21.1	19.3	25.1	22.7	
Machinery and transport equipment	41.2	45.4	43.4	46.1	38.2	41.3	
Miscellaneous manufactured goods	6.5	5.8	3.0	4.2	3.8	4.3	
Other	0.1	...	0.2	...	...	0.2	
Total	100.0	100.0	100.0	100.0	100.0	100.0	
Memorandum item							
Imports (c.i.f. in million United States dollar) b/	12 676	9 832	9 165	7 466	6 392	6 231	

Source: Data provided by the Central Bank of Nigeria, Federal Office of Statistics, and IMF estimates.

a/ Standard industrial trade classification.
b/ Estimated assuming c.i.f. margin equals 10.7 percent of import value.

1115. IMF states - with theoretical correctness - that at the basis of economic recovery there is a need for exchange rates to be entirely determined by the market. But, in a country like Nigeria, where oil accounts for 28 per cent of GDP and for 85 per cent of export earnings, the exchange rate has almost no impact on most exports since oil is in any case priced in dollars, according to international decisions that do not depend on the cost of local currency. On the contrary, the cost of importing indispensable goods is very high and currency devaluation can trigger inflation thrusts. The situation could be mitigated by a reduction in demand through the introduction of specific taxes on consumption rather than by devaluation. Besides, it is easy to tax luxury items when they are imported.

1116. Easing controls too quickly and too broadly while retaining multiple exchange rates would only produce a harmful devaluation which, as stated by Nigerian authorities, could set off a painful inflation spiral that would mostly affect the poorest and could even further disrupt the current account side of the balance of payments. Furthermore, confidence in the national currency would be severely weakened and people would tend to export capital and to index wages and salaries to the dollar. The introduction of gradual policies would seem to be a wiser course.

1117. If Nigeria has to rely on market forces to obtain the necessary adjustments, it is also true that imposing an excessively tight schedule in such a process entails great danger, resulting in a decrease in the productive sector, worse living conditions for the less wealthy and the threat of a financial crisis, which international authorities are beginning to predict.

1118. Ideologies have sometimes capitalized on the harsh reality of a situation. Take, for example, the proposal that real prices be fixed in order to reduce the consumption of oil and to promote its export, while at the same time reducing smuggling activities. Such a step would theoretically be ideal as far as efficiency is concerned, but would lead - if adopted in a non-selective way without promoting renewal of the transportation system - to an immediate drop in real incomes, especially for the poorest, who, according to the Nigerian Government, spend 27 per cent of their incomes on transportation.

1119. On the issue of opening the domestic market to imports of food supplies, other free trade and the privatization of public enterprises, although the IMF guidelines seem endorsable in their substance, they are too drastic in their timing and formulation and overlook the role of selective consumption taxation in holding down any expansion in affluent consumption, which the country can no longer bear.

1120. Nigeria undoubtedly needs to become more efficient and to eliminate distortion. Yet it must also be given the chance to develop domestic production and to pursue development goals that go beyond short-term economic profitability in order to put into practice the goals repeatedly expressed by the EEC in statements connected with the Lomé Convention.

Notes

1/ Tony Killick and Matthew Martin, "African debt: the search for solutions", United Nations Africa Recovery Programme, Briefing Paper No. 1, June 1989.

2/ The figures related to 1989 and 1990 are IMF estimates.

3/ Between 1981 and 1990, the purchasing power of currencies in industrialized countries dropped by an average 25 per cent.

4/ See Joshua Green, "Sub-Saharan African debt" in J. A. Frenkel, M. P. Dooley and P. Wickham (eds.), Analytical issues on debt, IMF, 1989.

5/ According to estimates in the World Bank World Report and estimates for 1988. These estimates must be treated with caution because the Egyptian Government has not supplied any statistics on national income since 1985-1986, and has only published data on the national product at factor cost in Egyptian currency. Obviously there is a problem of deciding on the correct exchange rate.

6/ Estimates of the Central Bank of Egypt and the 1989-1990 World Tables, respectively.

7/ The 1988 GDP, which is assumed to be the same as in 1988-1989.

8/ Calculated on 1988's exports, including migrants' remittances and income from services (tourism and the Suez Canal).

9/ Data on GDP growth in the last period are controversial: according to Government sources there is growth even since the debt crisis has become severe.

10/ Egypt, Ministry of Planning, Second Five-Year Plan, 1987-1988 - 1990-1991, appendix, table 8.

11/ According to IMF estimates, the proportion is even smaller, and stands at 2.5 billion Italian lire out of a total of 45.7 billion lire.

XVIII. LATIN AMERICA AND THE CARIBBEAN

A. Transfers from Latin America and the Caribbean to industrialized countries

1121. Latin America and the Caribbean is the only developing region which, for almost a decade, has been transferring resources to the rich countries. From a net inflow of $10 to $11 billion to Latin America and the Caribbean in 1980 and 1981 there has been a shift to an outflow of $18 billion in 1982, $31 billion in 1983 and probably as much as $25 billion in 1989 (see table XVIII 6B). The amount would have been much larger if arrears had not been accumulated, because of debt fatigue - an alarming unhealthy situation that aggravates the problem and complicates its solution. Since 1982, Latin American and Caribbean countries have transferred $231 billion to rich countries in net financial flows. From 1982 to 1989, payments for interest and amortization amounted to $382 billion, equivalent to almost four years' exports. As a result of the compound interest on arrears, the debt, which was $340 billion in 1982, reached $416 billion in 1989 (see table XVIII.4).

1122. Exports of Latin America and the Caribbean increased in volume by 57 per cent from 1980 to 1988 but value increased by only 40 per cent because of the decline of prices of the main export commodities (see tables XVIII.8 and 9). If, instead of deflating the interest rate (LIBOR plus) due from these indebted countries to foreign banks by the industrial countries' price index, the unit price in international currencies of exports from Latin America and the Caribbean is used as a deflator, over the last 10 years, the real interest rate ranged from 25 per cent to 10 per cent. The surplus needed to service the foreign debt has been obtained mainly by restricting imports through devaluation, a money squeeze and controls as well as by forced reductions in investment and in real wages (see tables XVIII.25, 10 and 11). Generally, debt service has been financed by the State budget, but only to a limited extent. It has been financed mainly by monetary expansion, causing a flight of capital abroad.

1123. The average annual inflation rate of Latin America jumped from 57 per cent in December 1981 to 994 per cent in December 1989, with peaks of 3,000 per cent and above in Argentina, Uruguay and Peru, while Brazil reached 1,500 per cent and Venezuela ranged between 80 per cent and 90 per cent. Other countries, like Chile and Mexico, have been able to control galloping inflation. Several States have returned to a democratic form of government. Not a few are now adopting more coherent economic policies together with less permissive fiscal policies than those of past years.

1124. Latin America and the Caribbean have huge reserves of natural resources, the utilization of which has been hindered by the heavy debt burden. In the 1980s, GDP grew by only 1 per cent per year (see table XVIII.2). Per capita GDP, therefore, declined by 0.8 per cent per year: almost 10 per cent (see table XVIII.3). The explanation is to be found mainly in the squeeze on investment brought about by the great financial net outflow already mentioned. The loss of growth, however, should be measured not only by the reduction in capital caused by this outflow. There is also the deflationary gap caused by the restriction of internal demand in order to create a trade surplus and by the disincentives to savings and capital

accumulation arising from the uncertainties of financial prospects and from the distorting policies that indebted Governments have often adopted, either out of necessity or because of ideological and operational mistakes (for the decline of savings see table XVIII.25). The loss of growth has cut the ability to pay, and the crisis has become more acute.

1125. For Latin America and the Caribbean as a whole, within the framework of a systemic action, the present yearly outflow of $25 billion should be substantially reduced. This could be done by a recycling plan to eliminate and eventually reverse this outflow, using both public and private contributions. This, however, must be done without creating a new burden of official debt, for example by different and diversified ways of raising new money: from direct investment; co-financing between private and public operators on specific projects; new financial formulas such as BTO and BOT; commodity bonds; bilateral and multilateral grants; credits on advantageous terms for public works and human resources development and repatriation of capital. The industrialized countries should concentrate on this problem of transfers from Latin America because it is so pervasive generally and give renewed attention to the relation between the debt problem and the problem of restoring growth of developing countries.

1126. The structural plan of recycling and reductions to save Latin America and the Caribbean from crisis and to enable them to grow according to their full capabilities needs four supports. First of all, Governments giving bilateral credits to middle-income countries should grant reductions and alleviations comparable to those already conceded to such countries by commercial banks under the Brady Plan. The programme should be reinforced by the conversion of a share of the debt service into counterpart funds, paid in indexed domestic currency and earmarked for growth, environment, human resource development and child welfare. Proposals outlined for intermediate African countries also apply to intermediate countries in Latin America and the Caribbean, i.e., those with a per capita GDP from $500 to $1,300. A country that deserves particular attention in the case of debt with official creditors is Jamaica, because of the causes and conditions of its debt burden. A second support, in fact, is needed. International financial institutions fail to consider the balance between their disbursements and debt services for payments to Latin American and Caribbean countries. It is advisable that the balance should be positive, by use of facilities similar to those available to the poor countries, even if the concessions are smaller. This is required to sustain the adjustment process and finance the delicate period of transition towards liberalization following any deal along the lines of the Brady Plan. The third support is that of providing public resources to finance infrastructure on concessional terms and providing incentives to private initiatives to create new money in the form of product and export diversification. The fourth support is the refinancing and strengthening of the Brady Plan. Brazil and Argentina (not to mention Peru, Ecuador and Bolivia, which belong to the intermediate group), cannot find relief in a Brady Plan agreed upon on the Mexican terms or according to the proposals being negotiated with Venezuela. Initiatives covering interest payments need to be more effective, in addition to putting this option on a par with the reduction of the principal. Within this framework consideration should also be given to the above-mentioned possibility that for some countries a share of interest could be paid in bills denominated in domestic

currencies but indexed and fully convertible at par into domestic credits or properties. Incentives are also needed to speed up the conclusion of the agreements and to introduce the new money option. Large-scale concessions are also needed to finance buy-backs which, in some extreme cases, appear as the best solution and, in others, extend the menu of options.

1127. Those in Latin America and the Caribbean, too, should act responsibly. Governments, above all those of the middle-income countries, should take action that could prove unpopular as a result of higher taxes and which would mean that bureaucratic entities have to adapt themselves to mixed managerial economy formulas and to privatization measures. Rich people also should be more conscious of their responsibilities, investing at home rather than abroad. Everybody should make it a duty to pay taxes and to renounce populism. On the other hand, the permissive policies have lead to a decline of real wages and particularly of wages of low-income urban workers (tables XVIII.10 and 11). From a distributional viewpoint a careful economic restructuring is badly needed: resumption of growth and of real wages are interrelated outcomes and should be joined to the frame of sound fiscal policy as objectives for Latin America as well as for the international financial institutions and the regional policy agencies.

1128. The recovery of growth in Latin America and the Caribbean is in the common interest of all in order to sustain international political, economic and social equilibria as well as to prevent such scourges as drug trafficking, disorderly migration and destruction of the environment caused or aggravated by underdevelopment. After the "lost decade" of the 1980s citizens of this region are entitled to a decade of hope and progress in the 1990s, with external help, but also by helping themselves, in an atmosphere of constructive institutional co-operation.

Table XVIII.1

LATIN AMERICA AND THE CARIBBEAN: MAIN ECONOMIC INDICATORS[a]

Indicators	1982	1983	1984	1985	1986	1987	1988	1989[b]
Gross domestic product at market prices (index, base year 1980 = 100)	99.0	96.1	99.5	103.0	106.8	109.8	110.5	111.7
Population (millions of inhabitants)	375.5	383.6	391.8	400.3	409.0	417.8	426.5	435.5
Per capita gross domestic product (index, base year 1980 = 100)	94.6	89.8	90.9	92.1	93.4	94.0	92.6	91.7
Growth rates								
Gross domestic product	-1.4	-2.9	3.5	3.6	3.6	2.9	0.6	1.1
Per capita gross domestic product	-3.5	-5.0	1.2	1.3	1.3	0.7	-1.5	-1.0
Consumer prices[c]	84.6	130.5	184.7	274.1	64.5	198.5	757.7	994.2
Terms of trade (goods)	-9.2	1.3	6.6	-4.4	-10.3	-0.5	-1.5	1.9
Purchasing power of exports of goods	-7.7	11.0	13.4	-4.2	-10.7	7.4	7.8	3.5
Current value of exports of goods	-8.8	0.1	11.5	-5.6	-15.1	14.0	13.7	8.7
Current value of imports of goods	-19.9	-28.5	4.0	-0.3	2.6	13.1	13.0	8.0
Billions of dollars								
Exports of goods	87.5	87.5	97.6	92.1	78.3	89.2	101.5	110.3
Imports of goods	78.4	56.0	58.3	58.1	59.6	67.4	76.2	82.3
Trade balance (goods)	9.1	31.5	39.3	34.0	18.7	21.8	25.3	28.0
Net payments of profits and interest	38.8	34.4	36.7	35.3	32.2	31.4	34.2	38.3
Balance on current account[d]	-41.0	-7.3	-0.5	-3.4	-15.8	-10.7	-10.3	11.1
Net movement of capital[e]	20.2	2.9	10.0	2.5	8.7	14.9	5.3	13.7
Global balance[f]	-20.8	-4.4	9.5	-0.9	-7.1	4.2	-5.0	2.6
Total gross external debt[g]	326.9	351.4	367.1	377.3	393.6	416.3	413.0	415.9
Net transfer of resources[h]	-18.6	-31.5	-26.7	-32.8	-23.5	-16.5	-28.9	-24.6

Source: ECLAC, on the basis of official data.

[a] The figures for the gross domestic product and consumer prices refer to the group of countries included in table 2, except Cuba (23 countries) and in table 5, respectively. The data on the external sector relate to the 19 countries mentioned in the table on the balance of payments of Latin America and the Caribbean. [b] Preliminary estimates, subject to revision. [c] Variation from December to December. [d] Includes net unrequited private transfer payments. [e] Includes long and short-term capital, unrequited official transfer payments, and errors and omissions. [f] Corresponds to the variation in international reserves (of opposite sign) plus counterpart items. [g] See the notes to the table "Latin America and the Caribbean: total disbursed external debt". [h] Corresponds to net inflow of capital, less net payments of profits and interest.

Table XVIII.2

LATIN AMERICA AND THE CARIBBEAN: GROWTH OF TOTAL GROSS DOMESTIC PRODUCT

	Annual growth rates								Cumulative variation
	1982	1983	1984	1985	1986	1987	1988	1989[a]	1981-1989[a]
Latin America[b]	**-1.4**	**-2.9**	**3.5**	**3.6**	**3.6**	**2.9**	**0.6**	**1.1**	**11.7**
Oil-exporting countries	**-0.6**	**-5.1**	**2.7**	**2.4**	**-0.9**	**1.4**	**1.6**	**-0.3**	**7.0**
Bolivia	-4.4	-6.5	-0.3	-0.1	-2.9	2.1	2.8	2.5	-6.3
Ecuador	1.1	-1.2	4.8	4.8	3.4	-9.1	17.0	0.5	25.7
Mexico	-0.6	-4.2	3.6	2.6	-3.8	1.5	1.1	3.0	11.9
Peru	0.3	-11.8	4.7	2.3	9.0	7.3	-8.6	-10.0	-5.1
Trinidad & Tobago	0.3	-13.6	-3.4	-2.9	-2.8	-6.8	-3.4	-3.5	-31.8
Venezuela	-1.2	-5.5	-1.5	1.7	6.0	2.2	4.9	-8.5	-3.8
Non-oil-exporting countries	**-1.8**	**-1.4**	**4.0**	**4.4**	**6.5**	**3.7**	**0.1**	**1.9**	**14.6**
Argentina	-5.8	2.6	2.3	-4.6	5.8	1.8	-3.2	-5.5	-13.5
Barbados	-5.2	0.4	3.6	1.0	5.1	3.2	3.0	3.0	12.4
Brazil	0.6	-3.4	5.1	8.4	7.5	3.7	-0.3	3.0	21.0
Colombia	1.0	1.9	3.8	3.8	7.1	5.8	3.6	3.0	36.9
Costa Rica	-7.3	2.7	7.8	0.7	5.3	5.3	2.8	5.0	20.9
Cuba[c]	3.9	4.9	7.2	4.6	1.2	-3.8	2.0	1.5	42.8
Chile	-13.1	-0.5	6.0	2.4	5.3	5.4	7.1	8.5	27.5
El Salvador	-5.7	0.6	2.3	1.8	0.5	2.7	1.5	-1.0	-6.3
Guatemala	-3.4	-2.7	0.0	-0.6	0.3	3.6	3.8	4.0	5.6
Guyana	-10.8	-9.9	2.2	1.1	0.2	0.7	-3.0	-2.0	-20.9
Haiti	-3.4	0.6	0.4	0.4	1.0	-0.3	-0.2	0.5	-4.1
Honduras	-1.8	-0.1	2.5	1.5	5.1	4.0	3.9	2.5	19.8
Jamaica	0.0	1.9	-0.8	-5.5	2.5	5.8	0.5	1.0	7.9
Nicaragua	-0.8	4.6	-1.6	-4.1	-1.0	-0.7	-8.0	-3.0	-9.6
Panama	4.9	-0.1	-0.4	4.8	3.5	2.0	-16.4	0.0	0.4
Paraguay	-0.8	-3.0	3.2	4.0	-0.3	4.5	6.7	5.5	32.1
Dominican Republic	1.3	5.0	0.3	-1.9	3.1	7.1	1.6	3.0	25.7
Uruguay	-10.1	-6.0	-1.3	0.2	7.8	6.4	0.2	0.5	-2.0

Source: ECLAC, on the basis of official data.
[a] Preliminary estimates, subject to revision. [b] Does not include Cuba. [c] Refers to total social product.

Table XVIII.3

LATIN AMERICA AND THE CARIBBEAN: GROWTH OF PER CAPITA GROSS DOMESTIC PRODUCT

	Annual growth rates								Cumulative variation
	1982	1983	1984	1985	1986	1987	1988	1989[a]	1981-1989[a]
Latin America[b]	**-3.5**	**-5.0**	**1.2**	**1.3**	**1.3**	**0.7**	**-1.5**	**-1.0**	**-8.3**
Oil-exporting countries	**-3.1**	**-7.4**	**0.1**	**-0.1**	**-3.3**	**-1.0**	**-0.8**	**-2.6**	**-14.2**
Bolivia	-6.9	-9.0	-3.0	-2.8	-5.6	-0.6	0.0	-0.4	-26.6
Ecuador	-1.7	-3.8	2.0	2.1	0.7	-11.5	14.1	-2.0	-1.1
Mexico	-3.0	-6.5	1.2	0.2	-6.0	-0.8	-1.1	0.8	-9.2
Peru	-2.3	-14.1	2.1	-0.3	6.2	4.6	-10.9	-12.4	-24.7
Trinidad & Tobago	-1.2	-15.0	-4.9	-4.5	-4.3	-8.3	-4.9	-5.3	-40.8
Venezuela	-4.0	-8.1	-4.2	-1.0	3.1	-0.5	2.1	-10.8	-24.9
Non-oil-exporting countries	**-3.9**	**-3.4**	**1.9**	**2.2**	**4.6**	**1.6**	**-1.9**	**0.1**	**-4.8**
Argentina	-7.2	1.1	0.9	-5.9	4.4	0.5	-4.4	-6.7	-23.5
Barbados	-5.2	0.0	3.2	0.6	4.7	2.4	2.6	2.2	8.1
Brazil	-1.6	-5.6	2.8	6.1	5.2	1.5	-2.4	0.9	-0.4
Colombia	-1.1	-0.2	1.7	1.7	4.9	3.7	1.6	0.9	13.9
Costa Rica	-10.0	-0.3	4.8	-2.1	2.4	2.5	0.1	2.3	-6.1
Cuba[c]	3.3	4.3	6.5	3.9	0.3	-4.7	1.0	0.4	33.5
Chile	-14.5	-2.2	4.3	0.7	3.6	3.7	5.3	6.7	9.6
El Salvador	-6.5	-0.3	1.3	0.5	-1.2	0.8	-0.4	-3.1	-17.4
Guatemala	-6.1	-5.4	-2.8	-3.3	-2.6	0.7	0.8	0.8	-18.2
Guyana	-12.6	-11.7	0.3	-0.8	-1.6	-1.1	-4.6	-3.6	-33.1
Haiti	-5.1	-1.2	-1.4	-1.5	-0.8	-2.1	-2.1	-1.6	-18.6
Honduras	-5.4	-3.6	-1.2	-1.9	1.6	0.7	0.7	-0.7	-12.0
Jamaica	-1.5	-0.4	-2.2	-6.9	1.0	4.1	-1.0	-0.5	-5.8
Nicaragua	-4.0	1.2	-4.8	-7.3	-4.3	-4.0	-11.1	-6.4	-33.1
Panama	2.7	-2.2	-2.6	2.6	1.3	-0.1	-18.2	-2.0	-17.2
Paraguay	-4.0	-6.0	0.0	0.9	-3.3	1.4	3.6	2.6	0.0
Dominican Republic	-1.1	2.5	-2.0	-4.1	0.8	4.7	-0.7	0.7	2.0
Uruguay	-10.6	-6.6	-1.9	-0.4	7.2	5.8	-0.4	-0.1	-7.2

Source: ECLAC, on the basis of official figures for the gross domestic product. The population data used in the calculations for this table correspond to unpublished estimates preparared by the Latin American Demographic Centre.

[a] Preliminary estimates, subject to revision. [b] Does not include Cuba. [c] Refers to total social product.

Table XVIII.4

LATIN AMERICA AND THE CARIBBEAN: TOTAL DISBURSED EXTERNAL DEBT [a]

	End-of-year balance in millions of dollars						Growth rates				
	1984	1985	1986	1987	1988	1989[b]	1979-1981	1982-1983	1984-1987	1988	1989[b]
Latin America	**367 058**	**377 274**	**393 649**	**416 352**	**412 986**	**415 900**	**23.0**	**11.1**	**4.3**	**-0.8**	**-0.7**
Oil-exporting countries	**153 434**	**156 444**	**161 640**	**168 215**	**167 975**	**170 505**	**24.6**	**10.3**	**2.6**	**-0.1**	**-1.5**
Bolivia [c]	3 208	3 294	3 536	4 162	3 993	4 100	13.4	9.5	7.2	-4.1	2.7
Ecuador	7 596	8 111	9 077	10 267	11 034	11 700	21.1	19.7	8.7	7.5	6.0
Mexico	96 700	97 800	100 500	102 400	100 400	99 900	30.8	12.0	2.2	-2.0	-0.5
Peru	12 068	13 877	15 630	16 942	18 725	19 980	1.0	14.0	8.0	10.5	6.7
Venezuela [d]	33 862	33 362	32 897	34 444	33 823	34 825	26.0	4.1	-0.2	-1.8	3.0
Non-oil-exporting countries	**213 624**	**220 830**	**232 009**	**248 137**	**245 011**	**245 395**	**21.7**	**11.8**	**5.6**	**-1.3**	**0.2**
Argentina	46 903	49 326	51 422	54 700	59 000	61 100	42.1	12.8	5.0	7.9	3.6
Brazil [e]	104 926	105 126	111 045	121 174	113 300	111 100	14.5	10.2	5.6	-6.5	-1.9
Colombia	12 350	14 063	14 987	15 663	16 454	16 950	28.0	16.1	8.2	5.1	3.0
Costa Rica	3 752	3 742	3 922	4 194	4 100	4 500	13.3	14.7	4.4	-2.2	9.8
Chile	19 659	20 403	20 716	20 660	18 971	17 610	30.7	7.6	3.5	-8.2	-7.2
El Salvador	1 949	1 980	1 928	1 880	1 913	1 825	19.1	8.4	-0.1	1.8	4.6
Guatemala	2 495	2 694	2 674	2 700	2 647	2 830	19.3	25.0	6.0	-2.0	7.0
Haiti [c]	607	600	697	741	785	800	21.1	22.3	7.9	5.9	1.9
Honduras	2 392	2 794	3 018	3 105	3 045	3 260	17.8	17.0	9.6	-1.9	7.1
Nicaragua [c]	4 362	4 936	5 760	6 270	7 220	7 570	27.4	21.5	13.5	15.2	4.8
Panama [f]	4 368	4 774	4 935	5 324	5 400	5 500	13.3	14.2	5.0	1.4	1.9
Paraguay	1 654	1 772	1 855	2 043	2 002	2 150	12.4	24.5	8.6	-2.0	7.4
Dominican Republic	3 536	3 720	3 812	3 795	3 844	3 900	24.4	14.0	3.5	1.3	1.5
Uruguay	4 671	4 900	5 238	5 888	6 330	6 300	36.1	22.0	6.6	7.5	-0.5

Source: ECLAC, on the basis of official figures.

[a] Includes debt owed to the International Monetary Fund. [b] Preliminary figures. [c] Public debt. [d] Total debt according to official figures and data supplied by the international financial agencies. [e] Up to 1984, correponds to World Bank data. [f] World Bank data.

Table XVIII.5 Latin America and Caribbean arrears

(In millions of United States dollars)

	1970	1980	1981	1982	1983	1984	1985	1986	1987	1988
ARGENTINA										
Int.,arr.	...	0	0	0	837	2 074	777	486	361	2 128
Cap.,pag.	772	1 853	1 960	1 294	1 367	824	1 017	2 043	1 552	1 340
Int.,pag.	338	1 337	2 045	2 436	2 419	3 280	4 396	3 707	3 672	2 803
BOLIVIA										
Int.,arr.	...	0	12	51	77	172	309	365	415	368
Cap.,pag.	19	145	128	124	107	150	174	104	71	132
Int.,pag.	7	173	180	191	205	213	157	99	77	94
BRAZIL										
Int.,arr.	...	0	0	0	0	0	0	0	3 428	0
Cap.,pag.	456	6 830	7 412	7 534	3 705	4 529	2 004	3 329	3 423	3 637
Int.,pag.	223	6 331	7 973	9 381	7 732	7 222	7 255	6 290	6 382	11 685
CHILE										
Int.,arr.	...	0	0	0	0	0	0	0	0	0
Cap.,pag.	207	1 462	1 799	1 260	913	444	329	360	340	597
Int.,pag.	104	918	1 420	1 943	1 361	1 983	1 637	1 405	1 389	1 019
COLOMBIA										
Int.,arr.	...	0	0	0	0	0	0	0	0	0
Cap.,pag.	137	263	374	398	614	682	754	1 121	1 412	1 720
Int.,pag.	59	310	461	705	625	620	867	978	1 184	1 213
ECUADOR										
Int.,arr.	...	0	0	0	0	0	44	58	486	949
Cap.,pag.	26	535	805	1 177	253	217	372	268	249	271
Int.,pag.	10	365	539	715	456	803	735	650	279	297
MEXICO										
Int.,arr.	...	0	0	0	0	0	0	0	0	0
Cap.,pag.	1 017	4 760	4 504	4 531	4 828	5 656	5 072	4 433	3 531	6 242
Int.,pag.	283	4 580	6 117	7 769	8 140	10 250	9 382	7 676	7 691	7 590
PARAGUAY										
Int.,arr.	...	0	0	0	8	14	27	52	40	95
Cap.,pag.	7	81	95	61	54	77	81	132	128	175
Int.,pag.	3	44	36	45	48	61	80	91	96	114
PERU										
Int.,arr.	...	0	0	0	0	374	703	1 319	1 904	2 489
Cap.,pag.	333	1 113	1 531	1 156	576	471	514	355	269	150
Int.,pag.	162	670	670	696	539	539	456	270	204	174
URUGUAY										
Int.,arr.	...	0	0	0	0	0	0	0	0	0
Cap.,pag.	51	130	103	292	212	150	193	106	153	313
Int.,pag.	17	121	148	179	226	295	292	255	273	257
VENEZUELA										
Int.,arr.	...	0	0	0	0	0	0	0	0	0
Cap.,pag.	67	2 972	2 522	2 410	1 633	1 863	988	2 007	2 124	2 421
Int.,pag.	53	1 475	1 553	2 024	2 180	1 955	1 777	2 223	2 469	2 675

Source: World Bank, World Debt Tables, 1989-1990.

Table XVIII.6A

LATIN AMERICA AND THE CARIBBEAN: BALANCE OF PAYMENTS

(Millions of dollars)

	Net service payments[a]			Net payments of profits and interest[c]			Balance on current account[d]			Net capital movements[e]			Global balance[f]		
	1987	1988	1989[b]	1987	1988	1989[b]	1987	1988	1989[b]	1987	1988	1989[b]	1987	1988	1989[b]
Latin America	**3 197**	**3 736**	**3 460**	**31 421**	**34 179**	**38 315**	**-10 711**	**-10 309**	**-11 095**	**14 874**	**5 274**	**13 665**	**4 163**	**-5 035**	**2 570**
Oil-exporting countries	**129**	**-9**	**-700**	**11 105**	**12 175**	**13 825**	**-1 453**	**-10 870**	**-5 490**	**5 196**	**-176**	**8 035**	**3 743**	**-11 046**	**2 545**
Bolivia	139	109	100	277	283	235	-526	-314	-220	478	271	270	-48	-43	50
Ecuador	315	245	215	914	1 010	1 000	-1 263	-657	-605	1 163	671	820	-100	14	215
Mexico	-2 083	-2 426	-2 400	7 195	7 712	8 380	3 722	-3 130	-5 500	1 951	-3 666	6 500	5 673	-6 796	1 000
Peru	422	452	305	1 344	1 600	1 720	-2 283	-2 108	-455	1 524	1 984	1 425	-759	-124	970
Venezuela	1 336	1 611	1 080	1 375	1 570	2 490	-1 103	-4 661	1 290	80	564	-980	-1 023	-4 097	310
Non-oil-exporting countries	**3 068**	**3 745**	**4 160**	**20 316**	**22 004**	**24 490**	**-9 258**	**561**	**-5 605**	**9 678**	**5 450**	**5 630**	**420**	**6 011**	**25**
Argentina	719	715	540	4 478	5 124	6 500	-4 232	-1 586	-1 690	2 281	3 490	1 190	-1 951	1 904	-500
Brazil	2 361	2 999	3 690	10 316	11 371	12 300	-1 456	4 909	110	3 588	-1 888	100	2 132	3 021	210
Colombia	565	291	450	1 968	1 789	1 800	344	-460	-455	58	636	540	402	176	85
Costa Rica	47	-9	-110	297	332	350	-442	-356	-600	480	598	660	39	242	60
Chile	463	645	680	1 700	1 919	1 985	-869	-282	-925	1 005	1 106	1 160	136	824	235
El Salvador	-47	-87	10	147	146	120	-233	-186	-395	182	272	250	-51	86	-145
Guatemala	107	124	80	170	166	180	-528	-477	-455	474	395	495	-54	-82	40
Haiti	80	94	135	21	24	30	-146	-182	-260	162	204	150	16	22	-110
Honduras	69	79	15	238	264	270	-341	-349	-285	406	368	290	65	19	5
Nicaragua	129	98	85	208	151	155	-766	-732	-525	504	562	545	-262	-170	20
Panama	-790	-800	-790	12	-28	-5	149	625	95	-187	-630	-105	-38	-5	-10
Paraguay	-111	107	10	174	122	150	-158	-158	-80	196	-10	195	38	-168	115
Dominican Republic	-485	-485	-645	306	318	320	-441	-218	-230	308	341	215	-133	123	-15
Uruguay	-39	-26	10	281	306	335	-139	13	90	221	6	-55	82	19	35

Source: 1987 and 1988 : ECLAC, on the basis of figures supplied by the International Monetary Fund; the 1987 and 1988 figures for El Salvador and Nicaragua and the 1988 figures for Brazil and Guatemala, are ECLAC estimates; 1989: ECLAC, on the basis of official figures.

[a] Does not include net payments of profits and interest. [b] Preliminary ECLAC estimates. The figures have been rounded to the nearest ten or five. [c] Includes interest due. [d] Includes net unrequited private transfer payments, which were of a significant level in 1989 for the followinrg countries: Colombia, El Salvador, Guatemala, Mexico and the Dominican Republic. [e] Includes short- and long-term capital, unrequited official transfer payments, and errores and omissions.

[f] Corresponds to the variation in international reserves (of opposite sign) plus counterpart enterprises.

Table XVIII.6B

LATIN AMERICA AND THE CARIBBEAN: NET CAPITAL INFLOW AND TRANSFER OF RESOURCES
(Billions of dollars and percentages)

	Net capital inflow (1)	Net payments of profits and interest (2)	Transfer of resources (3) = (1)-(2) (3)	Exports of goods and services (4)	Transfer of resources/ exports of goods and services (5) = (3)/(4) (5)
1973	7.9	4.2	3.7	28.9	12.8
1974	11.4	5.0	6.4	43.6	14.7
1975	14.3	5.6	8.7	41.1	21.2
1976	17.9	6.8	11.1	47.3	23.5
1977	17.2	8.2	9.0	55.9	16.1
1978	26.2	10.2	16.0	61.3	26.1
1979	29.1	13.6	15.5	82.0	18.9
1980	29.7	18.1	11.6	107.7	10.8
1981	37.6	27.2	10.4	116.1	9.0
1982	20.2	38.8	-18.6	103.2	-18.0
1983	2.9	34.4	-31.5	102.4	-30.8
1984	10.0	36.7	-26.7	113.7	-23.5
1985	2.5	35.3	-32.8	109.3	-30.0
1986	8.7	32.2	-23.5	95.5	-24.6
1987	14.9	31.4	-16.5	108.2	-15.2
1988	5.3	34.2	-28.9	122.9	-23.5
1989[b]	13.7	38.3	-24.6	133.8	-18.4

Source: 1973-1988: ECLAC, on basis of figures supplied by the International Monetary Fund; 1989: ECLAC, on the basis of official figures.
[a] Percentages. [b] Preliminary estimates.

Table XVIII.7 Latin America and the Caribbean

Consumption, investments and savings (1980-1987)
(As a percentage of GDP)

	1980	1984	1985	1986	1987
Consumption	77.2	78.2	77.9	80.2	80.4
Investments	24.2	16.7	17.5	17.4	18.2
Savings	20.3	16.3	16.9	15.2	16.2

Source: World Bank, World Economic Development, 1989.

Table XVIII.8

LATIN AMERICA AND THE CARIBBEAN: PRICES OF MAIN EXPORT COMMODITIES

(Dollars at current prices)

	Annual averages					Growth rates				Cumulative variation
	1970-1980	1986	1987	1988	1989[a]	1986	1987	1988	1989[b]	1989/1970-1980
Unrefined sugar [c]	12.8	6.1	6.8	10.2	12.3	48.8	11.5	50.0	20.6	-3.9
Coffe (mild) [c]	121.8	192.7	112.3	135.1	119.2	32.3	-41.7	20.3	-11.8	-2.1
Cocoa [c]	86.3	93.8	90.6	72.1	59.9	-8.3	-3.4	-20.4	-16.9	-30.6
Bananas [c]	11.8	22.1	26.5	24.6	19.7	20.1	19.9	-7.2	-19.9	66.9
Wheat [d]	125.1	115.0	115.0	146.0	171.0	-16.7	0.0	27.0	17.1	36.7
Maize [d]	127.5	112.9	109.4	135.7	143.8	-16.6	-3.1	24.0	6.0	12.8
Beef [c]	82.2	95.0	108.2	114.2	112.7	-2.8	13.9	5.5	-1.3	37.1
Fish meal [d]	354.7	321.0	383.0	544.0	406.0	14.6	19.3	42.0	-25.4	14.5
Soya beans [d]	232.4	208.0	216.0	304.0	285.0	-7.6	3.8	40.7	-6.3	22.6
Cotton [c]	61.2	52.9	76.1	63.4	72.2	-14.3	43.9	-16.7	13.9	18.0
Wool [c]	131.5	147.7	182.9	207.1	194.4	5.0	23.8	13.2	-6.1	47.8
Copper [c]	69.6	62.3	80.8	117.9	132.5	-3.1	29.7	45.9	12.4	90.4
Tin [c]	3.9	2.6	3.1	3.3	4.1	-51.9	19.2	6.5	24.2	5.1
Iron ore [d]	17.6	21.6	22.1	22.3	24.2	-1.8	2.3	0.9	8.5	37.5
Lead [c]	25.3	18.4	27.1	29.8	29.9	4.0	47.3	10.0	0.3	18.2
Zinc [c]	29.7	38.0	42.4	60.2	84.0	-5.9	11.6	42.0	39.5	182.8
Bauxite [d f]	103.5	165.2	164.8	164.8	-	0.5	-0.2	0.0	-	-
Crude petroleum [g]										
Saudi Arabia	10.0	12.5	16.3	12.8	15.9	-49.0	30.4	-21.5	24.2	59.0
Ecuador	-	15.0	18.0	15.2	17.2	-43.6	20.0	-15.6	13.2	-
Mexico	-	13.0	16.6	12.9	14.9	-47.2	27.7	-22.3	15.5	-
Venezuela	10.1	12.5	16.2	12.3	15.7	-47.9	29.6	-24.1	27.6	55.4

Source: UNCTAD, Monthly Commodity Price Bulletin 1960-1984 and October 1989: International Monetary Fund; *International Financial Statistics*, Yearbooks, 1981 and November 1989; *Petroleum Intelligence Weekly*, 1984-1989, various issues; Energy Economics Research Limited, Oil and Energy Trends, April 1989; ECLAC, on the basis of official data.

Note: Unrefined sugar, FOB, Caribbean ports, for export to the free market. Coffee mild arábica, ex-dock New York. Cocoa beans, average of daily prices (futures), New York/London. Central American Bananas, CIF North Sea ports. Cotton, Mexican M 1-3/32", CIF Northern Europe. Wool, clean, combed, grade 48's, United Kingdom. Beef, frozen, and deboned, all sources, United States ports. Fish meal, all sources, 64-65% protein, CIF Hamburg. Wheat, United States No. 2, Hard Red Winter. Maize, Argentina, CIF North Sea ports. Soya beans, United States, No. 2, yellow bulk, CIF Rotterdam. Copper, tin, lead and zinc, spot cash prices on the London Metal Exchange. Iron ore, Liberia, C 61% Fe, CIF North Sea ports. Bauxite, Guyana (Baltimore). Petroleum, Saudi Arabia: Heavy-27 (U.S. Gulf Coast); Ecuador: Oriente-30 (U.S. Gulf Coast); Mexico: Maya Heavy-22 (U.S. Gulf Coast); Venezuela: Tia Juana-22 (Caribbean).

[a] January-September average. [b] January-September average as compared to average for 1988. [c] US cents per pound.
[d] Dollars per metric ton. [e] Dollars per pound. [f] 1988: January-May average. [g] Dollars per barrel.

Table XVIII.9A

LATIN AMERICA AND THE CARIBBEAN: EXPORTS OF GOODS, FOB
(Indexes 1980 = 100 and annual growth rates)

	Value				Unit value				Volume			
	Index	Rates			Index	Rates			Index	Rates		
	1989[a]	1987	1988	1989[a]	1989[a]	1987	1988	1989[a]	1989[a]	1987	1988	1989[a]
Latin America	**124**	**14.0**	**13.7**	**8.7**	**79**	**5.4**	**4.0**	**6.9**	**157**	**8.3**	**9.4**	**1.6**
Oil-exporting countries	**98**	**19.7**	**-0.2**	**14.9**	**65**	**14.9**	**-7.8**	**13.9**	**151**	**4.3**	**8.1**	**0.9**
Bolivia	67	-4.9	4.6	17.1	88	-3.7	-2.5	11.5	77	-1.3	7.2	4.9
Ecuador	93	-7.5	9.0	6.2	57	2.1	-9.4	10.5	162	-9.5	20.4	-3.8
Mexico	141	28.8	0.0	9.9	64	10.9	-6.3	9.5	221	16.2	6.7	0.5
Peru	89	5.2	1.3	28.7	98	11.5	16.0	7.5	90	-5.6	-12.7	19.6
Venezuela	66	15.8	-3.2	23.0	62	26.1	-13.6	23.0	107	-8.2	12.1	0.0
Non-oil-exporting countries	**147**	**10.3**	**23.4**	**5.2**	**90**	**-1.5**	**11.6**	**3.0**	**163**	**12.0**	**10.6**	**2.1**
Argentina	117	-7.2	44.0	2.6	86	4.7	14.6	5.5	136	-11.3	25.7	-2.8
Brazil	172	16.5	29.5	2.3	86	-2.2	10.7	0.0	201	19.1	16.9	2.3
Colombia	143	6.2	-8.8	10.6	95	-19.4	4.0	8.5	151	31.7	-12.3	2.0
Costa Rica	132	2.3	8.9	9.4	93	-6.8	6.4	-1.5	142	9.8	2.3	11.0
Chile	169	24.4	35.0	12.8	103	17.6	28.5	11.0	164	5.8	5.0	1.7
El Salvador	46	-24.0	3.0	-17.9	65	-28.4	11.0	-8.5	72	6.1	-7.1	-10.3
Guatemala	77	-6.5	9.5	9.5	83	-18.0	8.5	-2.0	93	14.0	1.0	11.8
Haiti	70	10.1	-25.7	-4.0	94	10.9	-8.6	-7.5	74	-0.8	-18.7	3.8
Honduras	114	-5.3	5.8	8.6	99	-9.6	8.3	-3.0	116	4.9	-2.4	12.0
Nicaragua	58	19.3	-20.3	10.6	93	3.8	1.5	-4.0	62	15.0	-21.5	15.0
Panama	115	5.7	7.2	11.2	117	-3.5	10.1	1.0	98	9.5	-15.8	10.1
Paraguay	318	65.9	15.4	15.7	113	22.3	10.0	4.0	280	35.6	4.9	11.3
Dominican Republic	110	-1.5	25.6	18.6	108	-8.9	29.8	16.5	102	8.2	-3.2	1.8
Uruguay	147	8.7	18.8	11.1	103	12.0	9.7	6.0	143	-2.9	8.3	4.8

Source: ECLAC.
[a]Preliminary estimates.

Table XVIII.9B

LATIN AMERICA AND THE CARIBBEAN: IMPORTS OF GOODS, FOB
(Indexes 1980 = 100 and annual growth rates)

	Value				Unit value				Volume			
	Index	Rates			Index	Rates			Index	Rates		
	1989[a]	1987	1988	1989[a]	1989[a]	1987	1988	1989[a]	1989[a]	1987	1988	1989[a]
Latin America	**91**	**13.1**	**13.0**	**8.0**	**100**	**5.8**	**5.6**	**5.2**	**91**	**6.9**	**7.0**	**2.7**
Oil-exporting countries	**97**	**11.5**	**31.4**	**-2.0**	**100**	**3.8**	**7.7**	**5.4**	**97**	**7.5**	**22.1**	**-7.1**
Bolivia	94	8.3	-25.0	11.3	98	-0.9	5.9	4.5	97	9.3	-29.2	6.6
Ecuador	77	25.9	-21.4	7.2	90	3.6	6.9	5.0	86	21.6	-26.5	2.1
Mexico	121	6.5	55.3	20.9	102	4.9	7.4	5.0	119	1.5	44.6	15.1
Peru	61	23.1	-13.4	-31.0	93	2.1	5.1	6.0	66	20.5	-17.6	-34.9
Venezuela	70	12.3	31.1	-34.4	98	3.8	6.7	4.0	71	8.3	22.9	-36.9
Non-oil-exporting countries	**87**	**14.2**	**8.7**	**16.7**	**99**	**7.1**	**4.2**	**5.0**	**88**	**6.7**	**-3.3**	**11.1**
Argentina	43	22.6	-8.9	-17.5	115	6.7	8.4	6.5	37	14.9	-15.9	-22.5
Brazil	81	7.4	-2.4	27.0	98	9.2	3.8	6.0	83	-1.6	-6.0	19.7
Colombia	115	11.2	19.1	9.2	101	4.9	4.5	4.0	116	6.1	13.9	5.0
Costa Rica	125	19.3	2.7	35.0	101	2.4	4.1	6.0	124	16.5	-1.4	27.3
Chile	115	28.9	21.0	30.0	98	12.5	5.6	6.0	117	14.5	14.5	22.8
El Salvador	114	2.5	4.0	6.0	118	4.8	5.3	6.0	96	-2.2	-1.2	0.0
Guatemala	106	52.1	6.2	10.8	101	4.1	3.6	6.0	106	46.2	2.5	4.5
Haiti	97	2.6	-8.8	9.2	109	1.5	0.1	5.5	90	1.1	-8.8	3.7
Honduras	104	2.3	2.5	8.0	114	2.1	1.8	6.5	91	0.2	0.8	1.3
Nicaragua	68	1.0	-2.2	-24.1	102	6.6	2.0	6.0	66	-5.2	-4.1	-28.4
Panama	110	6.7	-19.3	30.8	95	2.4	2.0	4.0	116	4.2	-20.9	25.8
Paraguay	176	42.5	-1.8	15.6	76	10.2	1.1	7.0	231	29.4	-3.0	8.1
Dominican Republic	127	17.7	1.0	20.3	93	4.3	2.3	5.0	137	12.9	-1.2	14.7
Uruguay	67	32.6	3.0	1.2	92	8.9	2.9	7.0	73	21.7	0.1	-5.4

Source: ECLAC.
[a] Preliminary estimates.

Table XVIII.10

LATIN AMERICA AND THE CARIBBEAN: REAL AVERAGE WAGES

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
	Annual average indexes (1980 = 100)									
Argentina [b]	100.0	89.4	80.1	100.5	127.1	107.8	109.5	103.0	97.3	88.7
Brazil										
Rio de Janeiro [c]	100.0	108.5	121.6	112.7	105.1	112.7	121.8	102.4	107.1	105.6
São Paulo [d]	100.0	104.7	107.2	94.0	97.9	120.4	150.7	143.2	152.1	156.2
Colombia [e]	100.0	101.3	104.7	110.1	118.1	114.6	120.1	119.2	117.7	119.1
Costa Rica [f]	100.0	88.3	70.8	78.5	84.7	92.2	97.8	89.2	87.5	...
Chile [g]	100.0	108.9	108.6	97.1	97.2	93.5	95.1	94.7	101.0	102.9
Mexico [h]	100.0	103.6	104.4	80.7	75.4	76.6	72.3	72.8	72.1	...
Peru [i]	100.0	101.8	110.2	93.4	87.2	77.6	97.5	101.3	77.4	36.9
Uruguay [j]	100.0	107.5	107.1	84.9	77.1	88.1	94.0	98.5	99.7	98.9
	Percentage variation [k]									
Argentina	11.8	-10.6	-10.4	25.5	26.5	-15.2	1.6	-5.9	-5.5	-8.8
Brazil										
Rio de Janeiro	5.2	8.5	12.1	-7.3	-6.7	7.2	8.1	-15.9	4.6	-1.4
São Paulo	8.4	4.7	2.4	-12.3	4.1	23.0	25.2	-5.0	6.2	2.7
Colombia	0.8	1.3	3.4	5.2	7.3	-3.0	4.8	-0.7	-1.3	1.2
Costa Rica	0.8	-11.7	-19.8	10.9	7.9	8.9	6.1	-8.8	-1.9	...
Chile	9.0	8.9	-0.3	-10.6	0.1	-3.8	1.7	-0.4	6.7	1.9
Mexico	-2.9	3.6	0.8	-22.7	-6.6	1.6	-5.6	0.7	-1.0	...
Peru	12.4	1.8	8.3	-15.2	-6.6	-11.0	25.6	3.9	-23.6	-52.3
Uruguay	-0.4	7.5	-0.4	-20.7	-9.2	14.3	6.7	4.8	1.2	-0.8

Source: ECLAC, on the basis of official data.
[a] Preliminary figures. [b] Average total monthly wages in manufacturing. Twelve-month average; 1989: January-October average. [c] Average wages in basic industry, deflated by the CPI for Rio de Janeiro. Twelve-month average; 1989: January-August average. [d] Average wages in manufacturing in the State of São Paulo, deflated by the cost-of-living index for the city of São Paulo. Twelve-month average; 1989: January-June average. [e] Wages of manual workers in manufacturing; 1989: first semester. [f] Average remunerations declared by persons covered by the social security system. [g] Average remunerations of wage-earners in non-agricultural sectors. Twelve-month average; 1989: January-October average. [h] Average wages in manufacturing; twelve-month average. [i] Wages of private-sector manual workers in Metropolitan Lima; 1989: average of January, April and June. [j] Index of average real wages. Twelve-month average; 1989: January-October average. [k] With respect to the same period of the preceding year.

Table XVIII.11

LATIN AMERICA AND THE CARIBBEAN: URBAN REAL MINIMUM WAGES

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989[a]
	Annual average indexes (1980 = 100)									
Argentina[b]	100.0	97.8	97.8	136.9	167.7	117.1	111.1	122.3	95.6	77.1
Brazil[c]	100.0	106.0	106.8	95.9	87.4	88.9	89.0	72.6	68.7	70.6
Colombia[d]	100.0	98.9	103.6	107.9	113.5	109.4	114.2	113.0	109.9	110.7
Costa Rica[e]	100.0	90.4	85.9	99.3	104.4	112.2	118.7	118.6	116.5	116.5
Chile[f]	100.0	115.7	117.2	94.2	80.7	76.4	73.6	69.1	73.4	79.7
Ecuador[g]	100.0	86.2	75.9	63.6	62.8	60.4	65.0	61.4	53.6	42.3
Mexico[h]	100.0	101.9	92.7	76.6	72.3	71.1	64.9	60.6	53.6	50.7
Paraguay[i]	100.0	103.9	101.9	94.2	93.8	99.6	108.3	122.6	134.2	140.6
Peru[j]	100.0	84.2	77.8	89.2	69.0	60.3	62.5	66.1	57.6	26.7
Uruguay[k]	100.0	103.4	104.6	89.6	89.9	94.1	88.3	91.1	85.6	78.6
Venezuela[l]	100.0	86.2	78.5	73.9	66.5	96.8	92.3	95.3	76.2	68.6
	Percentage variation[m]									
Argentina	17.3	-2.2	0.0	40.0	22.5	-30.2	-5.1	10.1	-21.8	-19.3
Brazil	2.6	6.0	0.8	-10.2	-8.9	1.7	0.1	-18.4	-5.4	2.7
Colombia	2.5	-1.1	4.8	4.2	5.2	-3.6	4.4	-1.1	-2.7	0.7
Costa Rica	1.4	-9.6	-5.0	15.6	5.1	7.5	5.8	-0.1	-1.8	...
Chile	0.3	15.7	1.3	-19.6	-14.3	-5.3	-3.7	-6.1	6.2	8.6
Ecuador	65.5	-13.8	-11.9	-16.2	-1.3	-3.8	7.6	-5.5	-12.7	-21.1
Mexico	-6.7	1.9	-9.0	-17.4	-5.6	-1.7	-8.7	-6.6	-11.6	-5.4
Paraguay	8.2	3.9	-1.9	-7.6	-0.4	6.2	8.7	13.2	9.5	4.8
Peru	23.8	-15.8	-7.6	14.7	-22.6	-12.6	3.6	5.8	-12.9	-53.6
Uruguay	-4.6	3.4	1.2	-14.3	0.3	4.7	-6.2	3.2	-6.0	-8.2
Venezuela	62.8	-13.8	-8.9	-5.9	-10.0	45.6	-4.6	3.3	-20.0	-10.0

Source: ECLAC, on the basis of official data.

[a] Preliminary figures. [b] National minimum wage; 1989: January-October average. [c] Minimum wage for the city of Rio de Janeiro, deflated by the corresponding CPI; 1989: January-September average. [d] Minimum wage for upper urban sectors; 1989: January-June average. [e] National minimum wage. [f] Minimum income; 1989: January-October average. [g] General minimum official living wage; 1989: January-October average. [h] Minimum wage in Mexico City, deflated by the corresponding CPI; 1989: January-August average. [i] Minimum wage in Asunción and Puerto Stroessner; 1989: January-September average. [j] Minimum wage in Metropolitan Lima for non-agricultural activities; 1989: January-October average. [k] National minimum wage for persons over 18 years of age; 1989: January October average. [l] National minimum wage for non-agricultural activities. [m] With respect to the same period of the preceding year.

Table XVIII.12

LATIN AMERICA AND THE CARIBBEAN: PRICES OF EXTERNAL DEBT PAPER ON THE SECONDARY MARKET
(As a percentage of face value)

	1986			1987			1988			1989		
	January	June	December	January	June	December	January	June	December	January	June	November
Argentina	62	65	66	64	52	35	32	25	21	20	13	13
Bolivia	...	6	7	8	9	11	11	11	10	10	11	11
Brazil	75	74	74	72	62	46	46	51	41	37	31	21
Colombia	82	81	86	86	85	65	65	65	57	56	57	64
Costa Rica	...	48	35	35	36	15	15	11	12	13	14	17
Chile	65	67	67	68	70	61	61	60	56	60	61	59
Ecuador	68	64	65	65	50	37	35	27	13	13	12	15
Guatemala	...	52	60	61	67	77	57	...	...	...	...	...
Honduras	...	40	40	40	39	22	22	22	22	22	17	21
Jamaica	...	45	45	45	38	33	33	38	40	40	41	40
Mexico	69	59	56	57	57	51	50	51	43	40	40	35
Nicaragua	...	4	4	4	5	4	4	2	2	2	1	1
Panama	...	69	68	68	67	39	39	24	21	19	10	12
Peru	25	20	18	18	14	7	7	6	5	5	3	6
Dominican Republic	...	45	45	45	45	23	23	20	22	22	22	13
Uruguay	...	63	66	68	74	60	59	60	60	60	56	50
Venezuela	80	76	74	75	71	58	55	55	41	38	37	35
Average [a]	...	64.9	64.2	63.7	58.5	46.5	45.1	45.4	37.7	35.2	31.9	27.5

Source: United Nations, Department of International Economic and Social Affairs (DIESA), on the basis of figures provided by Soloman Brothers, High Yield Department.

[a] Weighted according to bank debt.

B. Chile, Colombia, Mexico, Venezuela, Peru, Bolivia, Ecuador and Jamaica

1129. There is a big difference between Chile, Mexico, Venezuela and Colombia on one side, and Bolivia, Ecuador and Peru on the other, with Uruguay, Argentina, Brazil and Jamaica in situations of indebtedness somewhere in between. 1/ The difference in the financial and trade conditions of the three groups of countries is reflected in the secondary market price of their commercial debt. The quotations of the debt of the group of better-perspective countries since December 1987 are constantly and often markedly above the average weighted prices of Latin American debt (see table XVIII.12).

1130. The quotations of the countries with the worst prospects are well below that average, with Nicaraguan debt worth only 1 per cent of its face value and that of Peru only 6 per cent of its face value.

1131. Quotations of debt of the countries in between the two extremes of indebtedness, such as Brazil or Argentina, are also in between. The present possibilities of alleviating the burden of Latin American debt are only partially related to the correction of the economic behaviour of these countries in the next decade. They are related to a more complex international trade perspective in which a very relevant, even if not always decisive component, is the distinction between oil- and mineral-exporting countries and the other countries. The value and volume of oil and gas exports may play a decisive role.

1132. Among the countries that had the highest drop in per capita income in the 1980s, Venezuela is one with better perspectives for solving its debt problems, after some further adjustment of its economy, because of its enormous oil and gas reserves and other important mineral resources.

Table XVIII.13 External debt of Chile
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	12 081	20 384	21 502	19 645
Multilateral long-term	351	1 532	3 218	3 391
Bilateral long-term	1 023	575	686	947
Total long-term	9 398	17 628	18 020	16 121
Public or guaranteed public	4 705	12 897	15 554	13 760
Commercial banks	2 533	10 080	10 821	8 617
Other private operators	548	605	762	748
Bonds	250	105	66	57
Loans received	3 551	1 649	1 560	1 947
Debts reimbursed	1 513	575	708	866
Interest payments	1 193	1 942	1 659	1 273
Total debt service	2 706	2 517	2 367	2 139
Interest percentage on debt	2.23	9.52	7.71	6.48
Gross domestic product	26 574	14 224	17 375	20 339
Exports	6 276	4 669	6 492	8 450
Current account in balance of payments	-1 971	-1 328	-808	-168
Debt/exports (per cent)	192.5	436.6	331.2	232.5
Debt/GDP (per cent)	45.2	143.3	123.8	96.6
Debt service/exports(per cent)	43.1	53.8	36.5	25.3
Interest/exports (per cent)	19.0	41.6	25.5	15.1
Interest/GDP (per cent)	4.5	13.6	9.5	6.3

Source: World Bank, World Debt Tables, 1989-1990.

Table XVIII.14 External debt of Colombia
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	6 941	14 241	17 008	17 001
Multilateral long-term	1 350	2 408	5 773	5 612
Bilateral long-term	1 043	1 891	2 527	2 512
Total long-term	4 604	11 142	15 354	15 392
Public or guaranteed public	4 089	9 574	13 829	13 853
Commercial banks	1 371	3 406	4 221	4 461
Other private operators	289	852	1 203	1 164
Bonds	36	16	106	104
Loans received	1 071	2 315	1 368	2 346
Debts reimbursed	263	754	1 412	1 765
Interest payments	688	1 226	1 268	1 374
Total debt service	951	1 980	2 680	3 140
Interest percentage on debt	9.91	8.60	7.45	9
Gross domestic product	33 278	33 898	33 871	33 549
Exports	5 928	4 721	7 645	7 172
Current account in balance of payments	206	1 809	336	467
Debt/exports (per cent)	170.5	301.7	222.7	237
Debt/GDP (per cent)	20.9	42.0	50.2	46.5
Debt service/exports(per cent)	16.0	41.9	35.1	43.8
Interest/exports (per cent)	11.6	26.0	16.6	19.2
Interest/GDP	2.1	3.6	3.7	3.8

Source: World Bank, World Debt Tables, 1989-1990.

Chile

1133. Chile, since 1985, benefited from the increase of price and of sales of its main export item, copper (table XVIII.8). In 1987 the unit price of Chilean exports increased by 17.6 per cent, in 1988 by 28.5 per cent and in 1989 by 11 per cent, while the volume increased by 5.8 per cent, 5.0 per cent and 1.7 per cent. As a result, in 1989 the unit value of Chilean exports was 103 per cent of the 1980 value against the average index for Latin America of only 79 per cent of 1980 values (see table XVIII.9). The expansion of quantities of Chilean exports too was above the average: an increase of 64 per cent as against an average increase of 57 per cent for the region. Therefore Chilean exports in 1989 showed a cumulative increase of about 70 per cent on 1980 exports while the Latin American average increase was only 24 per cent.

1134. Obviously this improvement of Chile's trade balance was not only a consequence of the favourable trend of these external factors. It had, and has, also to do with the fiscal and monetary adjustment process which yielded a budgetary surplus and a positive rate of interest. Irrespective of whether the policies adopted were totally appropriate, it should be added that, while in 1989 average real wages in Chile were around the 1980 level, minimum urban wages were down by 20 per cent (see tables XVIII.10 and 11).

1135. The evidence that in Chile the costs of adjustment have been unnecessarily heavy is given by Meller. 2/ First of all export expansion in Chile took several years. Because the economy was not so flexible, the process was slow to compensate for the contraction in production of non-tradable goods generated by the overly austere adjustment process. Secondly, the contraction of real wages, which was a necessary ingredient of that policy, unlike in the Swedish experience of the 1980s, was not negotiated with the unions, nor did the workers share in the benefits of export expansion. Thirdly, domestic private investors have been slower to react to the adjustment process than public sector investment.

1136. Moreover, the international commercial banks did not provide a sizeable new flows of funds.

1137. This may have been due to the lack of confidence in the political stability of the authoritarian regime ruling the country. At times, according to Meller, the Government played the role of Santa Claus to high-income groups and foreigners in the privatization process, and some of the deregulations now appear to be excessive even if the former regulations were objectionable. Meller draws the conclusion that "the process of learning from these past mistakes has been a very costly one for the Chilean society".

1138. On the other hand, according to Stallings, 3/ one must recognize that the Chicago line adopted by the Pinochet Government in 1976 after three years of incoherent economy policy was a rather disastrous experiment, which was pursued systematically only until the leadership of Finance Minister Sergio de Castro ended. De Castro pegged the exchange rate at 39 pesos to the dollar, deregulated the capital market, cut tariffs from 100 to a flat 10 per cent and encouraged foreign borrowing from the private sector.

1139. These actions generated a boom in 1977-1981, with growth rates of GDP of 8 per cent a year. The boom brought GDP back to the 1971 level, but not real wages. This expansion, however, resulted in a great external imbalance. The current accounts balance showed continuous huge deficits: nearly $2 billion in 1980; $4.7 billion in 1981; $2.3 billion in 1982; $1.1 billion in 1983 and again $2 billion in 1984, the last year of the De Castro economic policy. GDP went down dramatically, by 0.14 per cent in 1982, and again by 0.7 per cent in 1983, while in the next two years only half of this fall was recovered. The fiscal deficit increased to 4 per cent in 1983 and 1984, from a surplus of 3 per cent in 1980. The unemployment rate, which was 12 per cent in 1980 and 11 per cent in 1981, climbed to 22 per cent in 1982 and 1983 and then fell slightly to 19.2 per cent in 1984. Thus real wages in 1985 were down 14 per cent from the 1981 levels and only 4 per cent above the level of 1980, the middle year of the miracle period. This means that in 1985 they were below the 1971 level.

1140. External debt, meanwhile, soared from $15.6 billion in 1981 to $19.7 billion in 1984. The Finance Minister Escobar Cerda, who took office in May 1984, abandoned the previous Chicago line, adopting what has been described as an "interventionistic model". The fiscal deficit increased to 6.3 per cent of GDP while the unemployment rate dropped slightly to 16.2 per cent.

1141. He was followed in February 1985 by Herman Büch who, in the words of Stalling, adopted a "long-term model resting on a small State and an open economy, but a short-term model that is mildly interventionist". To sum up, while it is certainly true that the Chilean economy in the dictatorship period saw an important change from the previous highly interventionistic economic policy and permissive monetary and fiscal policy, it would nevertheless be wrong to assert that Chile has recovered because it has consistently adopted an orthodox Chicago line or that its recovery has been a success story rather than a hard, slow-going process, burdened by unnecessary costs.

1142. Chile's prudent budgetary policy was based mainly on restricting spending rather than expanding the tax burden beyond its modest 18.5 per cent of GNP (which to a large extent is made of taxes on exports). This combination of positive factors has helped Chile both in reducing its debt burden and in getting capital from abroad without the need for a Brady Plan. A key element of the debt burden reduction, as previously noted, has been the debt-equity swaps applied to public enterprises: $2.7 billion up to August 1989 by non-residents and $2.4 billion by residents on $8 billion in debt alleviation and a $21 billion debt burden in 1986.

1143. Buy-backs also contributed to this $8 billion debt alleviation. However, it should be emphasized that the last buy-back for $550 million, which was tried by Chile in 1989 failed, because the discount Chile asked for (41 per cent) was considered too high. As noted, there is an inherent contradiction between using buy-backs to solve the debt problem and the recovery from the debt crisis as a result of successful debt alleviation operations and successful adjustment policies.

Colombia

1144. Colombia is the only other important country of Latin America (with Chile) that has experienced a positive growth rate of its per capita GDP from 1980 to 1989: an increase of 13.9 per cent as against an average deline of 8.3 per cent (see table XVIII.3). This relative success (the yearly growth rate of GDP averaged 3.5 per cent) has been obtained through a prudent (low level) fiscal policy (revenues and expenditures range around 13-14 per cent of GDP) and a moderate monetary policy (see tables XVIII.2 and 28). This has resulted in an inflation rate oscillating around 20 per cent, permitting a substantial expansion of investments for industrial production (see table XVIII.25). The monetary restriction of the end of 1988 intended to slow down inflation has reduced the growth rate to 3 per cent. However, the delicate situation related to the fight against the drug business requires an intensification of the investment process and makes the problem of alleviating the debt burden and obtaining new finance an urgent one.

1145. According to Hommes, 4/ Colombia's orthodox macro-economic policies failed to ensure a satisfactory rate of growth.

1146. Whereas during the late 1960s and early 1970s the economy grew at acceptably high rates (above 6 per cent per year) this growth has not been emulated since 1974, except during the periods of external bonanza. The reduction in the rate of growth cannot be explained by a reduction in the investment rate, since the rate of capital accumulation has been uniform in the period 1945-1987, apart from short-run fluctuations.

1147. According to Hommes, the increase in productivity has fallen off because the rate of growth has fallen and, therefore, economies of scale and "learning-by-doing" do not develop at a pace sufficient to generate a circle of higher productivity-higher growth.

1148. Perhaps a more important explanation lies in the hindrance to export growth summarized by Hommes as follows: "deficiencies in transportation and port infrastructures, government regulation, import controls on raw materials and machinery, lack of technological modernization, and lack of secure, stable access to large industrial markets".

1149. The instability of trade policies in the past has increased the uncertainty of local producers about future trade policies and this, Hommes argues, may prevent investment in import-substituting sectors even under the existing highly protective conditions. Obviously a fortiori this uncertainty may discourage investments in export industries.

1150. The need to consider the class of countries with an intermediate income as a separate class from the middle-income countries, emphasized in the review of the debt issues of African countries, appears equally urgent for Latin America in general and Colombia in particular. Colombia is the only country in Latin America where both the average wage and the minimum urban wage have shown a real increase (of about 20 per cent and 10 per cent) (see tables XVIII.10 and 11) since 1980.

But the low income level in the countryside together with the high urban unemployment rate are powerful engines of drug supply.

1151. The level of education is rather high in Colombia compared to the local per capita income (see tables XVIII.29 and 23). The percentage of the population employed in agriculture is still very high, although it no longer indicates a predominantly agricultural economy (see table XVIII.26). As is increasingly the case in Latin America, 70 per cent of the total population is concentrated in the cities, and 51 per cent of them live in cities with over half a million inhabitants (see table XVIII.31). There is a large pool of people, often with formal schooling, who are underemployed or unemployed and who could become involved in drug-trafficking.

1152. Colombian debt is largely owed to bilateral and multilateral public entities, not to commercial banks. In 1988, out of a debt stock of $17 billion long-term debts to commercial banks were estimated by the World Bank at $4.5 billion. Adding the long-term debts to other private entities brings the figure to $5.7 billion. On the other hand, debts to bilateral and multilateral organizations were $8.1 billion, 47.5 per cent of the total debt.

1153. Since the main problem of Colombia is of an ethical political nature, namely, the ability of its public institutions to rise to the challenge posed by the perverse investments in drug-trafficking, it must be clear that it is necessary to provide a political answer to the debt problem. Heavy debt burdens are considered by the people in drug-trafficking countries to have connotations of ethical and sometimes political rebellion. Debt is regarded as an ethical justification for illegal actions and sometimes the overthrow of Governments.

1154. Colombia has made significant progress in the last few years in diversifying its production and exports. Agriculture, which accounted for 30 per cent of its GDP in 1965, shrank to 19 per cent in 1987, while industry went from 25 per cent to 35 per cent, mostly because of the growth of industries other than manufacturing. Agro-foodstuff production, vital for export diversification, grew from 31 to 34 per cent of the total (see table XVIII.27A), as did the relative share of the chemical and other industries, with a drop in the high share of the textile industries. The share of energy and mineral exports rose from 18 to 33 per cent, while manufactured goods rose from 6 to 20 per cent. Although the share of textiles and clothing in total industrial output fell, their share in exports doubled from 2 to 4 per cent. Also, exports of machinery are now taking place for the first time, although in small quantities (see table XVIII.27B). The share of exports of agricultural commodities fell from 75 to 46 per cent. Despite the debt burden and other problems, the GDP growth rate was 2.9 per cent between 1980 and 1987 (see table XVIII.23). Exports rose from less than $5 billion in 1985 to $7.6 billion in 1987, $7.2 billion in 1988 and $7.3 billion in 1989 (see table XVIII.14), and the trend would have been better if the price of coffee had not collapsed (see table XVIII.8).

1155. The percentage of debt overhang on exports was smaller, although the burden rose on GDP. There are no arrears in the debt service. Colombia's efforts must be supported.

1156. At any rate, to be able to reduce the external debt is one of the main outcomes that can improve the government position and can help to bring about conditions that are more favourable to economic development.

1157. Colombia's rate of savings net of surplus on the current account is insufficient to sustain its growth process and fell in the last 10 years compared to the previous decade. It went from 19 per cent in the period 1973-1980 to 16 per cent in 1980-1987. In the same period, and thanks to external funds, investments were around 20 per cent. But the debt service has ultimately eliminated this outcome and has dramatically reversed the situation. In 1987, for instance, the savings rate was 26 per cent, while the trade and services surplus was 7 per cent. Therefore, only 19 per cent was invested. The government budget is almost balanced, although at reduced levels of revenues and expenditures, i.e. around 13 per cent of GDP.

1158. By raising revenues, the Government could surely boost investments to bolster the growth rate, which is too low at 3 per cent, although the population growth rate is now under 2 per cent and still decreasing (see table XVIII.24). But it is equally certain that a debt service effort equal to 7 per cent of GDP retards growth. Therefore, the equation less debt equals more growth equals less drug-trafficking stands out very clearly. The point is how to translate it into political action by operating in the first place on debts to public institutions, by converting debt service into local investments for development and for initiatives with a special focus on the eradication of drugs and narco-trafficking.

1159. For bank debts, it is necessary to bring about the alleviation measures contained in this report to strengthen the Brady Plan, bearing in mind that the country in question is an intermediate-income one, with no arrears in its debt service. Surely there is another important message: the setting up of a large free trade area, recently proposed by President Bush. The problem of supporting the price of coffee could then be successfully dealt with.

1160. Superficially to label the regional grouping approach as neocolonialism overlooks, inter alia, the payoff of economic and customs unions in terms of control of drug-trafficking within the common zone. Furthermore, currency smuggling can be brought under control, and there is greater certainty for international investors, who can rely on the institutions that preside over the new regional area. In other words, investors will have a new and more solid framework that is capable of meeting the challenges posed by international criminal activities.

1161. So far, creditor banks have adopted a stopgap remedy to the debt problem through a $1.7 billion loan with 12-year maturity at an interest rate of 0.875 per cent above LIBOR to refinance part of the 1989-1990 debt service. It is clearly only a temporary alleviation before some more consistent plan is applied.

Mexico

1162. Mexico's debt problem has already been discussed in chapter XIV in the context of the Brady Plan; it is mainly the direct or indirect consequence of the oil boom of the 1970s and of the subsequent fall of oil price at the beginning of the 1980s. To overcome the persistent fall in prices of its main exports (-36 per cent in 1989), Mexico has been obliged to more than double its volume of exported commodities (with 1980 = 100 the index stood at 221 in 1989) (see table XVIII.9). The value of Mexican exports in 1989 showed an increase of 41 per cent over 1980. In 1982, oil-exporting Mexico decided to nationalize the banking system and simultaneously to adopt expansionary policies that caused further disruptions. Inflation jumped from 28 per cent to about 100 per cent and remained fluctuating around this figure; it went up to 160 per cent in 1987, when oil prices recovered to $16 per barrel from the $13 of the previous year. As might be expected, the centrally planned and populist policies coupled with a worsened oil price caused a steady decrease of real wages. In 1983 average wages were 20 per cent below the 1980 level while minimum real urban wages decreased further to 77.6 per cent of the 1980 figure (see tables XVIII.10 and 11). In the subsequent years the decline continued and the gap between average and minimum wages widened, with the former at 72 per cent and the latter at 53 per cent of the 1980 level in 1988.

1163. At the beginning of 1989, a new Mexican Government came to power and changed the general policy of the country through the adoption of a series of measures to restore the functioning of a market economy, ensure soundness in the public economy and restore confidence. Among other things, it reprivatized the banking system and tightened monetary and fiscal policy.

1164. The Government's recovery policy was also helped by a modest rise in the oil price. The rate of inflation, which had dropped to about 50 per cent in 1988, decreased further to 18 per cent. GNP, after a period of recession lasting since 1982, increased by 3 per cent in real terms (see table XVIII.2). Income per capita resumed a positive rate of growth, after a three year decline (see table XVIII.3). According to an analysis by the United Nations Economic Commission for Latin America and the Caribbean,

> "that happened largely because of the favourable expectations resulting from the stabilization strategy, which in turn served as the basis for the negotiations to reduce the burden of the external debt. The agreement reached with the creditor banks was decisive for economic recovery, insasmuch as it made it possible, besides facilitating the increase in imports necessary to expand external trade, to attract more foreign investment and to induce the return of Mexican capital. Private investment - foreign and national - turned out to be the agent that stimulated economic activity, despite high domestic interest rates, since public investment remained limited for budgetary reasons." 5/

1165. Clearly the decisive factor in starting economic co-operation among investors, creditors and the Government has been the spread of confidence in a sound government policy, as well as for a country that has important resources and - now - favourable trade relations with the great United States market. The Brady Plan, as noted, will save Mexico only $2 million in debt service per annum, in the immediate future. However, it has given to Mexico a mark of credibility that appears very important in enticing capital inflows. 6/

1166. In spite of these optimistic notes, however, Mexico's recovery should still be considered at risk. The application of the Brady Plan to Mexico was faulty in its new finance option. On the other hand the burden of the debt service is still high, both because nothing has been done to alleviate debt vis-à-vis official creditors and because the interest on the new bonds is largely at variable rates above LIBOR. If interest rates were to rise by one and a half points, Mexico's $2 billion yearly benefit from the Brady Plan reductions would evaporate. Equally, there is no assurance that oil prices in real terms will always be steady or rising as at present rather than bending.

1167. Mexico, on the other hand, has great economic potential, and its recent firm commitment to the pursuance of such policies as privatization, liberalization, deregulation, deflation and moralization has strengthened them. It now needs both some reduction in official debt service and new finance along the lines previously described to be able to resume a steady high growth path.

Venezuela

1168. Venezuela's debt problem originated in a way similar to that of Mexico. This too was an oil exporting country, which - when the oil price went down - indulged in easy finance, while persisting in centrally planned policies to cope with the adverse consequences of this fall, thus aggravating its debt burden. Unlike Mexico, Venezuela, however, never built up arrears on its debt. Inflation was hidden for a prolonged period through artificial multiple rates of exchange. Then it emerged at the rate of 40 per cent in 1987 and 35 per cent in 1988 partly as consequence of a three year period of heated expansion of GNP (+6 per cent; +2.2 per cent; +4.9 per cent) (see table XVIII.2). The dependence of the Venezuela economy upon oil is even greater than that of Mexico, so the recovery of the oil price to a mediocre $15.6 per barrel in 1989 together with a mild monetary squeeze was enough to create a surplus of the goods' balance of payment of nearly $5 billion after a deficit of $1.5 billion in 1988. The 8.5 per cent GDP drop 1989 must be measured on the 13 per cent increase of the previous three years, while the unusual 90 per cent inflation rate of 1989 is the result of having "revealed" the concealed inflation of the previous period of artificial multiple and exchange rates.

1169. Had Venezuela received timely assistance from Brady Plan policies during its most delicate period of transition to a normal market economy, some of its high adjustment costs might have been avoided. In any case, even though the process has been slow, an agreement under the Brady Plan, after the agreement with Mexico, is now near to conclusion for Venezuela, on terms similar to those for Mexico.

1170. There is still controversy on the discount terms of an important buy-back, which Venezuela might afford through its foreign currency reserves. Venezuela's growth potential is very high. Even if it cannot yet benefit from conditions of trade with the United States as favourable as those of Mexico, Venezuela has better export prospects because of its huge oil, gas and hydropower resources and its iron and bauxite mines. To develop them, however, inflows of new finance and of technological and managerial know-how are required. A satisfactory conclusion of the Brady Plan arrangement is needed to achieve this. Several of the techniques of new finance, discussed previously, and related public policies should find a particularly appropriate ground here.

1171. Felipe Larrain, in his comments on the paper by R. Hausman on Venezuela in the volume edited by J. Williamson mentioned above, points out that

> "Since the inauguration of the Perez Administration in early 1989, Venezuela has undertaken one of the most aggressive adjustment programmes in Latin America. The programme includes unification of a system of multiple exchange rates; sharp increase in the prices charged by public enterprises, especially in the energy sector; elimination of price controls; trade liberalization and relaxation of interest ceilings".

According to Larrain the reason why Venezuela accumulated a massive foreign debt at a time when the public budget and the current account of the balance of payments enjoyed significant cumulative surpluses lies in the massive capital flight, stimulated by very low domestic interest rates and exchange rate overvaluation, which led to fear of a future massive devaluation. It was favoured by the complete convertibility of the currency. It should be added that, for this reason, the massive investment projects undertaken by public enterprises had to be financed through foreign loans. According to R. Hausman, on the other hand, several public enterprises had losses, which did not appear in the current State budget but were subsequently covered by the Government, through foreign debt.

1172. In the early period, adjustment was postponed and huge subsidies were paid to sustain artificially low prices, depleting international reserves.

1173. In 1989, according to Larrain, there was no alternative to a sharp adjustment, since reserves had reached the very low level of 15 days' imports, while the fiscal deficit was over 10 per cent of GDP and repressed inflation was very high.

1174. It should be noted however that, as the Hausman paper shows, Venezuela's courageous adjustment policy was and is in fact a gradual one.

1175. Multiple exchange rates have been gradually unified, but a different rate was kept for capital transactions, where a floating rate was adopted in March 1989. Domestic interest rates were liberalized in March 1989 and they soon reached the level of 42 per cent. But the liberalization was considered illegal by the Supreme Court, which obliged the Central Bank to set limits to the interest rates. This limit was set at 42 per cent for loans and at 27 per cent for deposits. On the other hand, the Congress provided a subsidy for the difference between the market

rate and the 19 per cent interest rate on mortgages, which costs 2 per cent of GDP. Import prohibitions have been totally eliminated by the Perez Government, except on some luxury goods. Import quotas were cut by 70 per cent and a gradual programme of tariff reduction was adopted: in June 1980 their maximum level was reduced to 80 per cent for consumer goods and 50 per cent for industrial inputs. For the next step (March 1990) the targets were 50 per cent for consumer goods and 30 per cent for industrial inputs. The tariff structure was simplified and clarified. Agricultural goods have been excluded from the reform but some liberalization, particularly for wheat and cotton, has taken place.

1176. According to Hausman, rather than leaving the exchange rate to fluctuate while reserve and monetary targets are fixed, as IMF suggests, an exchange rate band should be adopted, fixing the volume of interventions and using the interest-rate policy to make the two compatible.

1177. He explains this position with the argument that dollar holdings by residents are five times M_2 and therefore quantitative monetary targets seem arbitrary. On the other hand,

> "If the exchange-rate policy is blamed for the crisis, a devaluation in an oil-exporting economy will drastically reduce or eliminate the fiscal deficit in the short run, and the Congress will then attach little importance to tax reform. Instead, subsidies to those affected by the devaluation will tend to receive more attention. Since nominal prices do not affect real long-run equilibria, the balance-of-payments problem will reappear once internal prices adjust to the devaluation. In this context, fixing the real exchange rate through a crawling peg will simply transform bad fiscal policy into higher inflation".

1178. Second, since the principal short-run effects of a devaluation are a tax on wages and on monetary wealth, it is to be expected that behaviour will change in order to avoid the tax. Money demand will fall through capital flight, and wage contracts will be negotiated more frequently, following the Pazos-Simonsen mechanism. 7/

Peru

1179. In the group of debt burdened Latin American countries that officially belong to the middle income group but really belong to a lower-income class, Peru is perhaps the most typical case. Its per capita income in 1989 was 25 per cent below that of 1980, like that of Venezuela. However, the per capita income of Peru in 1987, $1,100, was only about one third of that of Venezuela, $3,000 (see table XVIII.3).

1180. Compared with Venezuela's debt of $35 billion against a GDP of $56 billion in 1990, the Peruvian of $20 billion against a GDP of $22.7 billion represents a much bigger burden on GDP (see tables XVIII.4 and 15). The two proportions are 63 and 88 per cent, and interest due represents 27 per cent of the exports of Venezuela but 37 per cent of those of Peru. Peru has accumulated its heavy debt burden mostly through deliberate arrears. This policy dates back to 1984 when its

Government unilaterally decided to devote only 10 per cent of its income from exports to debt service. In 1989 arrears amount to $2.5 billion with exports at $3.5 billion and imports at $1.9 billion. Actual debt service in 1989 was only $320 million.

1181. Peru's rate of inflation was around 100 per cent until 1987, then jumped to 1,722 per cent in 1988 and to about 3,000 in 1989. GDP declined by 8.6 per cent in 1987 and 10 per cent in 1988 after two years of artificial boom brought in through a complex of contradictory centrally planned measures and permissive monetary and fiscal policies (see tables XVIII.1 and XVIII.2). An unfortunate but, in some aspects, courageous and well-intentioned policy of inward-centred growth was artificially planned to counter the extremist Marxist violence. This policy, however, led to hyperinflation and, as was communist extremism, was repudiated by the people in the recent elections. The majority of Peruvians, however, did not agree to the ideological opposite: extreme laissez faire.

1182. The heterodox (shock) economic policies applied by the Government of Alan Garcia from 1985 to 1989 consisted in attempting to fight inflation and to spur growth through a combination of selective controls and shock freezes of prices, rates of exchange and interest rates and of a permissive fiscal policy. One author recently commented on this policy as follows: "The correct conclusion is not that the goals were impossible, but that with more awareness, more consensus-building, more coherence and building of confidence, more progress could have been made. Again, we remind the reader that when alternative and more orthodox policies have been tried in Peru, these have typically produced stagnation and accelerated inflation, except when an externally induced export boom has happened to rescue the economy".

1183. The critical point in this analysis seems to be the issue of coherence between the short and the long run. Specifically, for example, the package requires that food prices must be controlled, threatening the development of local production to relieve the dependence on imports, and interest rates typically are to be held low, threatening the scope for long-run development of new financial structures to promote a more broadly based and equitable growth process. The exchange rate must be frozen, threatening the healthy evolution of the tradeable sector. Public utility prices must be held down, threatening the pursuit of a healthy financial position and the long-term ability to grow of the State enterprises.

1184. It is probably true that less discriminatory and more gradualistic policies to spur the supply for growth in a situation of wide-scale unemployment of most factors of production, as the Peruvian economy was in the middle of the 1980s, could prove more successful. The point, anyway, needs careful consideration. 8/

1185. A different view is given by Wise, 9/ who points out that Garcia's inaugural announcement of the "10 per cent solution", limiting the payment of service on the long- and medium-term commercial and bilateral debt to no more than 10 per cent of annual export earnings, differed very much from the previous Belaunde moratorium because he made it a prerequisite for Peru's economic reactivation and subsequent debt repayment and because he vowed to service punctually any other debt, such as that with multilateral institutions and that contracted after 1988.

1186. On the other hand, according to Wise, the structuralist approach of Garcia's original plan constituted an ambitious coherent programme based on the Kalekian model aimed at balancing the expansion of productive potential and mass consumption and capturing the economic surplus for reinvestment to sustain this consumer-led recovery. Import substitution was promoted, together with export expansion, while redistributive reforms should aim at the expansion of the popular inward-centred productive sector. But after the success of the first 18 months, several difficulties appeared because it was hard to move from price freeze to liberalization without inflation and because negotiations with the big industrial groups and organized labour on "concertation" of economic and industrial policy were difficult and time-consuming. The planned privatization of 30 to 40 public enterprises was blocked by lack of buyers, while tax revenues dipped because of the depressed world economy and the depression of oil and mineral prices and the price freeze, while tax cuts did not generate the expected expansion of the tax base because of tax evasion related to the shadow economy.

1187. In this context of increased financial difficulties, both external and internal, and of a "vociferous opposition of the left", according to Wise, the policy of Garcia shifted to populist lines. In mid-1987 he announced the intention of nationalizing the banks and insurance companies to fight against capital flight and obtain more instruments for the slow-going concertation policy. Wages were allowed high increases to regain popularity among the workers and terms of trade between industry and agriculture were shifted in favour of the former; then, because of the unpopularity of this policy, it was retracted.

1188. The conclusion of Wise is that, given the limitation on the executive and the chaotic nature of the Peruvian State, "it is tempting to see the demise of Garcia's programme as almost structurally determined. Yet APRA's modernization effort also brought these various institutional drawbacks more clearly into focus and helped raise important policy questions about how to proceed, even if many of the answers are still a long way off".

1189. Peru has important and diversified natural resources. Energy and minerals account for 74 per cent of exports. The industry sector accounts for 33 per cent of GDP while agriculture is only 11 per cent. Manufacturing has grown in Peru to 23 per cent of GDP. Both industry and exports are rather diversified (see table XVIII.26). A real possibility for recovery exists for the new Government through an adjustment policy that, however, at first sight, does not to appear to be easily applicable. Much help from the international community is needed.

1190. The normal menu of the Brady Plan as negotiated with Mexico and Venezuela does not seem applicable to a country with the income level problems of Peru. Given the very low price of the commercial bank debt on the secondary market (see table XVIII.12), debt conversion in collateralized bonds of lesser value or with reduced service hardly appears appropriate. A discount similar to the average 35 per cent of the Brady Plan is obviously inapplicable, but a 50 per cent discount would conflict with reality.

1191. A buy-back at an agreed price, complemented by some debt-equity swap relating to public enterprises, may be a better general solution for debt with private

banks. However to do this, Peru needs concessional finance. On the other hand the deal cannot be left to spontaneous secondary market behaviour. It remains to be seen how the market will assess the good will of the new Peruvian Government. The same general deal should cover the value, price and timing of debt purchases.

1192. On the other hand, the problem of Peruvian arrears is a particularly delicate one, since they are the result of a voluntary unilateral decision not to pay rather than of inability to pay. Objectively, it is not possible for the new Peruvian Government to pay these arrears without soft loans that spread them over a long period of time.

1193. The situation of urban poverty of Peru is dramatic now; the average calorie intake is only 2,246 per day (see table XVIII. 30); minimum urban wages, in real terms, at the end of 1989 are 27 per cent of the 1980 level while average are 37 per cent (see tables XVIII.10 and 11). It should be noted that almost 70 per cent of Peru's population lives in urban communities. Intermediate income countries with such dramatic conditions of the working class like Peru deserve specific attention. Bilateral debt reduction programmes and special aid credit policies, particularly for economic and social infrastructures need to be highly concessional. On the other hand, partial conversion of debt to public entities in Peru too could be tied to the eradication of narco-business, through projects for agricultural and human resources development.

Table XVIII.15 External debt of Peru
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	10 038	14 174	18 118	18 579
Multilateral long-term	513	1 339	2 094	2 030
Bilateral long-term	2 596	3 346	4 349	4 226
Long term-total	7 480	11 677	13 978	13 898
Public and guaranteed public debt	6 218	10 335	12 545	12 475
Commercial banks	1 706	3 765	3 912	3 873
Other private lenders	1 377	1 788	2 182	2 339
Obligations	25	5	7	7
Loan disbursements	1 622	711	679	412
Debt reimbursements	1 281	564	269	150
Interest payments	964	620	333	210
Total debt service	2 245	1 184	572	359
Debt percentage on debt	9.60	4.37	16.07	1.13
Gross domestic product	19 699	17 026	43 699 a/	39 265 a/
Exports	4 832	3 925	3 659	3 730
Current account in balance of payments	-101	137	-1 477	-1 128
Debt-to-exports ratio (per cent)	207.7	361.1	495.2	498.1
Debt-to-GDP ratio (per cent)	51.0	83.2	41.5	47.3
Debt service/ (per cent) exports ratio (per cent)	46.5	30.2	15.6	9.6
Interest-to-exports ratio (per cent)	19.9	15.8	8.3	5.6
Interest-to-GDP ratio (per cent)	4.9	3.6	0.7	0.5

Source: World Bank, World Debt Tables, 1989-1990.

a/ In the World Bank, World Development Report, 1990, GDP of Peru of 1988 is assessed at $25.67 billion. The debt-GDP ratio thus rises to about 70 per cent.

Bolivia

1194. Bolivia has an external debt of $5.5 billion and has now accumulated over $1.5 billion of arrears on interest payments. Its debt was incurred almost entirely with multilateral and bilateral public financial institutions and with Governments (see table XVIII.16). Bolivia is among the poorest countries in Latin America. Its GDP is only $4 billion, with a population of almost 7 million, and its per capita income is lower than $600 (see table XVIII.23). It is on the bottom line of the intermediate-income countries, which deserve particular attention for bank debts and particularly for debts contracted with public institutions.

1195. This is reflected in the various social and economic indicators for Bolivia, compared with the Latin American average. Among them, life expectancy stands out, with a mere 53 years for Bolivia, against an average of from 61 to 72 for the other countries. The calorie intake pattern portrays conditions of undernourishment, with only 2,100 calories per day (see tables XVIII.23 and XVIII.30).

1196. In addition to these negative records, Bolivia has two more that cast a long shadow on its future. Its GDP declined by an average of 2.1 per cent a year in the period 1980-1987, while its population growth rate is among the highest in South America, at 2.7 per cent a year, and with no sign of slowing down (unlike for instance in Chile, Ecuador, Colombia, Argentina and Brazil) (see tables XVIII.23 and 30).

1197. The 2 per cent decline of GDP, closely linked to the drop in exports (see table XVIII.16), to the debt burden and to the subsequent and unavoidable recourse to external financing and compounded by a population growth rate approaching 3 per cent, resulted in an annual decrease of 0.5 per cent in per capita GDP, which is falling sharply below the poverty line. The reason for such negative trends in the development pattern is fairly easy to identify: it is the low level of investment, which went from 25 per cent of GDP in the period from 1965 to 1980 to 8.3 per cent, while domestic saving is now only 1.6 per cent of GDP (see table XVIII.15). The inflation rate is 600 per cent, while state revenues have increased from 9 per cent to 32 per cent of GDP. Almost 30 per cent of such revenues derives from taxes and another 30 per cent comes from export duties (almost entirely on oil) that have dwindled in percentage and in value terms owing to the price drop. Bolivian exports have gradually shrunk from $1 billion to $700 million (see table XVIII.16). Exports of goods are now higher than imports (mainly essential goods); but in comparison with 1980, in volume imports have been curbed less than exports, which did not show a dramatic drop (see tables XVIII.9A and 9B). Public spending exceeds revenues by 4 per cent of GDP. Fortunately, the public deficit is almost non-existent thanks to external grants.

1198. About the restructuration measures undertaken by successive Bolivian Governments since 1985, Jeran L. Cariage, Executive Director of IDB for Bolivia, Paraguay and Uruguay, writes "the adjustment measures ... enabled Bolivia to break the phenomenon of hyperinflation, which had spiralled at an annualized rate of 24,000 per cent by September 1985. With the help of multilateral and bilateral organizations, the country achieved a positive net flow of resources that

contributed to reversing the trend of negative growth that had persisted from 1980 to 1985. Bolivia returned to a period of growth only in 1987, recording a modest 2.2 per cent growth that year and 2.8 per cent in 1988. For 1989 a 3 per cent growth rate is expected. Had it not been for the external shocks that reduced Bolivia's exports to about one half of their 1989 levels, economic growth would have resumed in 1986 and might have been much higher thereafter". 10/

1199. In their deep and less optimistic analysis of the causes of the Bolivian economic crisis, Morales and Sachs 11/ argue, perhaps with some exaggeration, that the "Bolivian crisis is a reflection of political and economic conflicts in Bolivian society that have undermined the development process during this century". The reason why Bolivia is now the poorest country in South America, with a per capita income of about $500, is that between 1952 and 1985 its GDP growth rate was only 2.4 per cent (i.e. almost the same as the population growth rate) and in the 1980-1985 period it went down at the rate of 4.5 per cent a year with an inflation rate of 570 per cent a year. Morales and Sachs maintain that this inability to grow and the persistent inflationary situation were due to the fact that the battle over shares of income and wealth occupied the bulk of political and social action; and that this has taken place in the context of the secular decline of the key Bolivian mining sector.

1200. According to Morales and Sachs, in 1980 coca exports by Bolivia equalled in value total exports of tin and petroleum products (mostly natural gas).

1201. Price stability, the two authors point out, has been established in Bolivia from 1986 onwards, but the many deeper problems in the Bolivian economy and society that helped to cause the hyperinflation remain in place and in some cases have worsened.

1202. Income distribution, being highly unequal, as Morales and Sachs explain, is naturally a persistent source of political conflict.

1203. They maintain that a key to more equitable (less skewed) income distribution in Bolivia should be an increase in the tax burden on high incomes through a tax on land holdings and higher taxes on luxury consumer goods. A second kind of policy to promote more equitable distribution of income would be greater public spending on education in the rural sector, where most of the Bolivian poor live. The authors note that "investment in human capital of the rural peasantry is key factor of long-term economic development".

1204. After having underlined the failure of State capitalism in Bolivia and elsewhere in the last two decades, Morales and Sachs warn against the dilemma between strict laissez-faire and collectivism. They believe that a more modulated approach is more likely to succeed, in which one would recognize the Government's responsibilities for infrastructure and social investment in health and education, but where the limitations on the role of the State in the productive sector are also recognized. "The capacity for honest, capable public administration is limited, but these limitations could be lessened by an effort to raise the standards and capacity of State bureaucracy, with a determined effort at improved training of civil servants".

1205. There is also a need for some geographical shift in the locus of economic activity from the highlands to the lowlands. Coca production, they emphasize, cannot be the basis of a vibrant Bolivian economy, which requires export diversification.

1206. Bolivia now suffers from a vicious circle of poverty and debt. Bolivia is mostly indebted to Governments, their agencies and the international financial institutions (see table XVIII. 16). It is a debt that, considering the country's desperate economic conditions, cannot be paid back. Actually, the price on the secondary market of debt with banks is about 10 per cent of face value (see table XVIII.12). The transfer of resources implied by such debt is a contradiction because this country from a humanitarian point of view is entitled to substantial development assistance. In keeping with the guidelines expressed in this report, substantial debt forgiveness appears for these countries indispensable and urgent.

Table XVIII.16 External debt of Bolivia
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	2 700	4 805	5 631	5 456
Multilateral long-term	447	724	1 122	1 323
Bilateral long-term	649	1 343	2 391	2 448
Long-term total	2 274	4 066	4 841	4 651
Public and guaranteed public debt	2 182	3 511	4 641	4 451
Commercial banks	733	1 056	1 000	579
Other private lenders	279	351	93	66
Obligations	73	38	36	35
Loan disbursements	553	178	257	456
Debt reimbursements	145	198	244	190
Interest payments	220	168	101	119
Total debt service	365	366	345	309
Debt percentage on debt	8.14	3.49	1.79	2.18
Gross domestic product	2 893	2 599	3 716	4 025
Exports	1 046	738	667	692
Current account in balance of payments	-6	-282	-423	-148
Debt-to-exports ratio (per cent)	258.2	651.3	844.2	788.3
Debt-to-GDP ratio (per cent)	93.3	184.9	151.5	135.5
Debt service/exports ratio (per cent)	35.0	49.5	51.7	44.7
Interest-to-exports ratio (per cent)	21.1	22.7	15.1	17.2
Interest-to-GDP ratio (per cent)	7.6	6.4	2.7	3.0

Source: World Bank, World Debt Tables, 1989-1990.

Ecuador

1207. In addition to Colombia, Peru and Chile, Ecuador also belongs to the category of intermediate-income countries. Its GDP is around $10 billion, like its debt (see table XVIII.17 and 23). Unlike Bolivia, medium to long-term debt with commercial banks is very important and constitutes about 50 per cent of the total. Undoubtedly, this makes debt service harder. Ecuador is now one of the countries with the largest arrears: $950 million in 1988 (see table XVIII.5). The causes of Ecuador's difficulties lie in the drop in oil prices and in the consequent dramatic loss of ability to meet its international financial obligations.

1208. Ecuador, however, is among those debt-ridden countries that have a slightly positive GDP growth rate but that, given the higher growth rate of the population, had a negative per capita growth rate at the end of the 1980s. Population grew by 2.9 per cent a year during 1980-1987, while GDP grew by 1.5 per cent. The population growth rate is expected to fall to 2.2 per cent, but this would not be enough to generate a positive per capita GDP, given the average rate of growth of GDP in the last few years.

1209. Moreover, the average calorie intake per day in Ecuador is even lower than in Bolivia: 2,060 calories in 1986 (see table XVIII.30). Saving is 21 per cent of GDP and investment is 23 per cent (see table XVIII.25), with the difference owing to a 2 per cent deficit in the international balance of payments. The annual inflation rate in 1980-1988 - despite all existing difficulties - was kept at 31 per cent. Revenues of the central Government were 14 per cent of GDP in 1988 while public spending was 17 per cent of GDP, with a gap of 2.4 per cent that, given the good rate of savings, seems to be within reasonable limits. 12/ Exports rose in volume by an annual average of almost 6 per cent, while imports shrank in volume by almost 1 per cent and the terms of trade, taking 1980 as 100, were 50 in 1988.

1210. To sum up, Ecuador appears to be eligible for a special attention under the Brady Plan, because of its limited ability to pay and its difficult economic conditions, although it does have prospects of development in the framework of a balanced financial policy. But industrialized countries have to increase their development assistance, which amounted in 1988 to only $13 per person. It must be stressed that, although most of the Ecuadorian debt is with commercial banks, one third (about $3.5 billion in 1988) is with Governments and public institutions. Given the low income level and the poverty rates of Ecuador, debt reduction is highly recommended for such debts.

Table XVIII.17 External debt of Ecuador
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	5 997	8 622	10 500	10 864
Multilateral long-term	323	824	1 838	1 933
Bilateral long-term	991	1 024	1 452	1 698
Long-term total	4 422	7 239	9 128	9 378
Public and guaranteed	3 300	7 142	9 098	9 353
Commercial banks	1 706	4 963	5 471	5 425
Other private lenders	225	331	337	297
Obligations	55	0	0	0
Loan disbursements	1 289	696	712	700
Debt reimbursements	535	675	462	672
Interest payments	473	817	319	336
Total debt service	1 008	1 492	780	1 007
Debt percentage on debt	7.88	9.47	3.03	3.09
Gross domestic product	11 152	11 237	9 766	9 587
Exports	2 953	3 323	2 465	2 649
Current account in balance of payments	670	949	1 131	588
Debt-to-exports ratio	203.1	259.5	425.9	410.1
Debt-to-GDP ratio (per cent)	53.8	76.7	107.5	113.3
Debt service/exports ratio (per cent	34.1	44.9	31.7	38.0
Interest-to-exports ratio (per cent)	16.0	24.6	12.9	12.7
Interest-to-GDP ratio (per cent)	4.2	7.3	3.3	3.5

Source: World Bank, World Debt Tables, 1989-1990.

Jamaica

1211. Jamaica is a special case. 13/ It was devastated in 1988 by Hurricane Gilbert, which caused damage in the amount of $1 to 1.5 billion, equal to 30 to 45 per cent of the GDP for the same year. Exports have fallen and imports have risen, and an adjustment programme was launched based upon suggestions put forward by the IMF. While the growth rate expected for 1988 was 5 per cent before the hurricane, it was subsequently adjusted to 0.5 per cent. The hurricane has thrust Jamaica into a very difficult situation, particularly in relation to the major national industry, namely tourism.

1212. Another important cause of Jamaica's debt crisis is the decline in the price of bauxite and the fall in the volume of exports of aluminium and bauxite. As a consequence, while in 1980-1988 they account for 75 per cent of the value of exports, by 1986 they accounted for only 50 per cent and subsequently for even less. It should be noted that by 1988, while bauxite and aluminium exports earned Jamaica about $320 million, sugar and bananas another $100 million and non-traditional exports another $220 million, tourism alone earned about $520 million.

1213. Public revenues have shrunk and, in order to avoid an unbearable deficit, public investments in infrastructures have been reduced. Jamaica's per capita GDP is $1,070 and its population is about 2.5 million. The GDP growth rate between 1980 and 1988 was unfortunately very low: only 0.6 per cent, which meant a fall in per capita GDP by about 2 per cent a year. The debt total was $4 billion in 1989, mostly with Governments ($1.4 billion) and multilateral institutions ($1.6 billion) (see table XVIII.18).

1214. In the years prior to the hurricane, Jamaica closely followed the adjustment programme that was agreed upon by IMF and the World Bank. This produced some positive developments, such as a lower inflation rate, a smaller budget deficit and, lastly, a recovery in the real growth rate of the GDP. Unfortunately, since a large portion of Jamaica's debt is with multilateral financial institutions, this country cannot benefit from the same debt remissions that can be obtained for other debts.

1215. On the other hand, debt servicing accounts for half of Jamaica's earnings from exports of goods and services. Jamaica's savings rate was around 19 per cent of GDP (1988) and the investment rate is higher than that (27 per cent of GDP in 1988), because of the serious needs that have emerged after Hurricane Gilbert.

1216. The merchandise balance of trade shows a very high deficit: $650 million with exports of $980 million in 1989-1990 (see table XVIII.19). However, trade in services has a positive balance, given the high contribution of tourism of $550 million, so that the deficit on trade in goods and services is around $360 million, from which almost $350 have to be deducted for public and private net transfers.

1217. A net inflow of new finance, together with substantial alleviation of the debt with government institutions, could help Jamaica along the road to economic recovery, with sustained investments and a balanced State budget; the inflation rate has already been brought below 20 per cent. Some suggestions to Jamaica by the international financial institutions imply a drastic reduction of food subsidies. This must be examined very carefully in relation to the social problems of the country, in which per capita GDP is so low. It is true that the Government budget deficit (see table XVIII.20) is estimated at 8 per cent of public expenditure, but 28 per cent of it accounts for investments, with the result that the State budget makes a contribution to savings.

1218. Jamaica, because of its per capita income of about $1,000, is not eligible for any ODA-like concessional lending by the World Bank or IMF and for any Toronto alleviation. This appears illogical, as we have maintained, because it is necessary to take account of the peculiar conditions of the class of countries which, not being "poor" in the technical sense, still cannot be considered as true middle-income countries. For them, concessions should be made available on debt with public institutions, although to a smaller extent than to low-income countries. On the other hand, it seems appropriate to provide Jamaica with concessional lending to meets its needs arising from extraordinary events, considering its previous commitment to economic and social development.

Table XVIII.18 Jamaica: external debt

(In millions of United States dollars)

Particulars	Stock 31/3/1987	Inflows 1987-88	Payments principal	1987-88 interest	Total	Stock 31/8/1988	Inflows 1988-89	Payments principal	1988-89 Interest	Total	Stock 31/3/1989
Commercial Banks	396.13	5.73	6.81	34.02	40.83	395.05	0.66	10.56	38.23	48.79	385.15
Bilateral	1 005.43	298.21	115.68	81.17	196.85	1 187.96	265.00	55.74	65.70	121.44	1 397.22
Multilateral	1 706.10	266.67	239.98	144.42	384.40	1 732.79	166.72	279.03	150.43	429.46	1 620.48
IMF	742.40	56.34	190.45	44.26	234.71	608.29	48.63	215.80	47.03	262.83	441.12
IBRD	477.32	73.91	30.61	78.61	109.22	520.62	45.20	40.35	79.19	119.54	525.47
CDB	85.16	9.32	6.32	5.54	11.86	88.16	8.83	5.22	5.63	10.85	91.77
IDB	388.02	112.59	8.29	13.67	21.96	492.32	42.71	15.63	18.43	34.06	519.40
Other	13.20	14.51	4.31	2.34	6.65	23.40	21.35	2.03	0.15	2.18	42.72
Other	420.45	188.31	129.89	18.26	148.15	478.87	237.89	163.51	14.63	178.14	553.25
Total	3 528.11	758.92	492.36	277.87	770.23	3 794.67	670.27	509.84	268.99	777.83	3 956.10

Source: Government of Jamaica, 1989.

Table XVIII.19 Jamaica: Balance of payments, 1989-1990 - 1991-1992

(Projections, in millions of United States dollars)

	1989-1990	1990-1991	1991-1992
Merchandise	-649.7	-651.2	-678.9
Exports	982.5	1 093.0	1 181.1
Imports	1 632.2	1 744.2	1 860.0
Services (net)	289.9	264.2	349.8
Travel a/	546.0	625.0	710.0
Investment income b/	-459.4	-469.4	-475.5
Other	203.3	108.6	115.3
Goods & services	-359.8	-387.0	-329.1
Transfer (net)	288.8	209.0	212.0
Private	124.0	139.0	140.0
Official	104.8	70.0	72.0
Current account	-131.0	-178.0	-117.1
Net capital movements	326.0	155.0	130.0
Direct investment	66.0	20.0	20.0
Official	288.0	65.0	40.0
Private	32.0	70.0	70.0
Financing gap	....	-100.0	-51.1
Changes in reserves (increases = minus)	-195.0	-77.0	-64.0

Source: Government of Jamaica, 1989.

a/ This is largely tourist receipts.

b/ The majority represents outflows (interest payments).

Table XVIII.20 Jamaica: accounts of the central government

(In millions of United States dollars)

	1989-90	1990-91	1991-92	1992-93
Total revenue and grant	1 221	1 343	1 489	1 624
Tax revenue	1 046	1 192	1 335	1 469
Non tax revenue	44	45	47	49
Bauxite levy	48	52	55	57
Capital revenue	48	36	36	36
Grants	47	18	16	13
Total expenditure	1 321	1 483	1 666	1 859
Current expenditure	1 007	1 138	1 286	1 441
Interest payment	351	340	343	350
Other	656	798	943	1 091
Capital expenditure	314	345	380	418
Current supplies	214	206	203	183
Overall deficit	-100	-140	-177	-235
Financing	100	140	177	235
External a/	144	54	47	40
Domestic	-44	46	51	54
(a) Non-banks	36	46	51	54
(b) Banking system	-80	..	..	..
Gap	..	40	79	141

Source: Government of Jamaica, 1989.

a/ Including divestment of $72 millions.

C. Brazil and Argentina

1219. The debts of Brazil and Argentina, together, amount to $172 billion, nearly two thirds of the total of $298 billion for Latin America. Considering that Uruguay's unsolved problems with its debt of $6.3 billion derive primarily from the present economic crises of Brazil and Argentina, it should be clear that the bulk of the problem of Latin America debt devolves on these two countries. Here the viability of the Brady Plan to provide a general solution to the debt problems of Latin America and the Caribbean will be tested, together with the capability of the international financial institutions to cope with these enormous issues in the context of their present institutional framework.

Brazil

1220. Brazil is the world's largest debtor. In 1988, its foreign debt amounted to $114.5 billion, plus $11.5 billion in arrears (see table XVIII.21). Its debt, however, has peculiar aspects and origins which should be assessed only in the light of the country's structure. Brazil, with a population of 140 million people, a GDP of nearly $400 billion and a per capita GDP of $2,160 in 1988, is one of the 10 largest world economies (see tables XVIII.21 and 23). By its productive structure it could be defined an industrializing country. The contribution of the agricultural sector to GDP in 1987 was of the order of that of Italy in 1967. In the period 1965-1980 it was one of the world's fastest growing economies, with an average rate of 9 per cent a year (see table XVIII.23). The Government is a major investor in the productive sector: about 40 per cent of the 1987 GDP came from the enlarged public sector. The sector's deficit in the same year was 31.4 per cent of GDP; and it grew to 48.5 per cent in 1988. Total general government revenues averaged 22.7 per cent of GDP in the period 1984-1986. Clearly, foreign debt is, first of all, a problem of public debt.

1221. A peculiarity of Brazil's public external debt is that public entities as a whole hold over 70 per cent of the country's external debt.

1222. On the other hand there are now about 630 State corporations. According to Pang, "in relative terms, Brazil used its borrowed resources much more productively than other Latin American nations. A much larger percentage went for investment than consumption. Likewise, Brazil made a greater effort to increase its exports to make debt service possible. But clearly not enough control was maintained to match the maturity of loans with the time necessary to get the projects under way and generate the exchange revenues to repay the loans. Consequently, once the adverse international shocks struck, Brazil was forced to borrow money just to pay interests and the positive impact of debt ceased". 14/ One must perhaps add that when State firms are corporations open to private investors they may finance themselves on the stock market, while if they are organized as public entities they can finance their expansions only through either undistributed profits or debts, and when there is a threat of high domestic inflation, only debt denominated in foreign currency may be a viable alternative.

1223. The difficulties and ambiguities of measuring Brazil's budgetary deficit because of the high inflation and the direct financing by the monetary authorities are described by Cardoso and Dantas. 15/ It should be added that, if a large ex ante nominal deficit causes high inflation, the real ex post deficit, i.e. net of depreciation of the domestic stock of debt, may become very low or even negative. But then a very high interest rate on the next nominal ex ante deficit will be required to overcome the expectation of its depreciation or the debt will be bought by the central bank, depreciating the currency stock and so on.

1224. Another ambiguity in measuring Brazil's budgetary deficit lies in the fact, pointed out by Sweder van Wijnberger in his comments on the paper on Brazil by E. A. Cardoso and D. Dantes, 15/ that asset sales were used to "reduce" the Brazilian deficit during the Crusado plan. This, as van Wijnberger observes, is a mere accounting trick since asset sales are equivalent - from the point of view of draining savings from the public budget - to issuing debt. "Assets sales should be looked at as a way of financing a given deficit rather than a means of reducing it". In the same vein, if an asset sale is used by the Government to wipe out an existing foreign debt through a swap, it could not be imputed to the current deficit of budgetary revenues on public expenditures to "reduce" this deficit. In this case, indeed, foreign savings are used to acquire domestic property but no increase in domestic investments takes place. This inflow of foreign savings cannot be imputed to the revenue side of the budget, because it has already been used to wipe out the foreign debt. If this imputation was done and the other revenues did not exceed public expenditures by the same amount, a domestic debt would have to be issued to replace the foreign debt.

1225. Brazil is an inward-looking economy. Total exports and imports accounted for an average of 13.6 per cent of GDP in the period 1986-1988, grew to 16.6 per cent in 1989 and are expected to be 15.4 per cent in 1990. In the boom years (1973-1980) Brazil's gross investments averaged 23.9 per cent of GDP (see table XVIII.25). Gross savings averaged 19.3 per cent, that is 4.6 percentage points below investment. The total government sector public debt was 22.3 per cent of GDP, and since resort to the domestic private capital market is limited, the Government resorted to international banks to finance the gap. In terms of GDP, the peak was reached in 1986 when the foreign debt reached 41 per cent of GDP. Now it is about 30 per cent of GDP but more than 300 per cent of exports which, as noted, are a small percentage of GDP (see table XVIII.6B). These structural elements are the causes of Brazil's inflation and foreign debt and make the question of solving the Brazilian debt problem unique. On the other hand, Brazil's balance of trade had a surplus of $11 billion in 1987, $19 billion in 1988 and $16 billion in 1988.

1226. Brazil is endowed with a wealth of agricultural, mineral and water resources and produces about 80 per cent of its total energy requirements. The vast size of the country poses a heavy strain on the economy in terms of building the necessary infrastructure, because of the large investments needed. The squeeze on public investment in the last 10 years has had an adverse impact on this sector in particular. The road network has practically not expanded since 1975, and the railroad network has contracted.

1227. In 1987, the agricultural sector of Brazil accounted for about 9.5 per cent of GDP. The development of the sector generally satisfactory: it is one of the most dynamic of the country. Brazil is the world's largest producer of citrus fruit, coffee, manioc and bananas. It is the second largest in cocoa, soybeans and sugar.

1228. The mining sector is also quite important. Brazil is one of the three largest producers of iron ore and tin and is the fourth largest of bauxite. Other significant mining products are phosphates, uranium, titanium, copper, gold and platinum. Coal reserves are estimated at 15 billion tons. Oil reserves are growing as a consequence of new discoveries; oil production has trebled since 1980 and reached 600,000 barrels a day in 1988. The overall growth rate of the sector averaged 8.32 per cent a year in the period 1980-1988.

1229. Manufacturing production is concentrated in the metallurgical and mechanical, food processing, textiles and clothing, automotive, non-metallic minerals and chemicals industries (see table XVIII.27). The last mentioned is the most dynamic (3.22 per cent a year in the period 1980-1988). Annual growth rates above 2 per cent have been registered in the food-processing and electric equipment and telecommunication subsectors.

1230. Direct foreign investments in Brazil were estimated at more than $26 billion in 1986. According to the last industrial census (1980) foreign capital companies accounted for, on average, 26 per cent of the value of industrial production and 19 per cent of employment. In four sectors, including the automotive and electrical equipment-telecommunications sectors, they produced 75 per cent of total output.

1231. However, as noted, the weight of the public sector in the economy is very significant: in 1987, the Government and government enterprises contributed about 40 per cent of GDP. This is the result of specific development policies (large investments in key sectors) and the political choice of controlling strategic sectors. More than 150 companies are controlled by the federal Government. It has a quasi-monopoly in oil refining, electric and nuclear energy, telecommunications and aviation and, in partnership with foreign capital, has a leading role in the steel sector, the petrochemical industry and iron ore mining.

1232. The influence of market forces on prices is limited for two reasons: (a) the trend to maintain politically acceptable prices for goods and services controlled by the Government (steel, power, fuels, transport and communications and (b) the existence of a highly articulated system of price controls. The latter has been widely used to freeze prices, a measure frequently used in the various plans to fight inflation. As a consequence there were wide distortions in the allocation of resources, leading to sectoral inefficiencies and compressions in corporate profits, also a result of the high administrative costs of such controls.

1233. The Government intervenes in the economy also through a widespread system of incentives, federal and regional, to encourage investments to modernize or expand capacity in specific sectors, investments in specific areas of the country and exports. Interventions to encourage exports are in the form of exemptions from

taxes on output, reductions in taxes on profits in relation to the volume of exports and elimination of custom duties on goods to be used in the production process. Other benefits take the form of subsidized export financing to domestic capital companies. This scheme of export incentives is seriously jeopardized by the current fiscal crisis.

1234. In the period 1985-1988, Brazil exported on average 20 per cent of its manufacturing output as against 6.3 per cent in the period 1970-1975. Brazil is increasingly an exporter of manufactures (see table XVIII.27B), and the manufacturing sector is becoming more and more export-oriented. The main items exported are steel products, automotive equipment, metallurgical products and machine tools, footwear and orange juice concentrates. The remaining 46 per cent of exports comprises agricultural products (mainly coffee and soybeans) and minerals (mainly iron ore). Brazil's main trading partners are the EEC and the United States countries at about the same level. Among the EEC countries, the most important trading partner is Germany. Italy is the second largest buyer, but is hardly important as a supplier. Trade with the other countries of Latin America is no more than 10-12 per cent of total, the main individual partner being Argentina.

1235. The success of the Brazilian export industries is the best proof of the degree of competitiveness and integration that the country has reached. The new Government appears to intend to follow the route of the integration of Brazilian industry in the international economy through adequate industrial, commercial and exchange rate policies, but the last-mentioned is heavily dependent on the level of inflation. Moreover, pegging the cruzado/United States dollar exchange rate to inflation has drawbacks. For instance, it does not take into account the fluctuation of the dollar against the EEC currencies, although EEC is Brazil's largest commercial partner.

1236. Furthermore, the exchange rate itself is a very dangerous tool to employ within the Brazilian context. In the export-oriented manufacturing sector, there is a heavy presence of multinational corporations. Their export products are priced not only in relation to the level of local production costs, but also on on the basis of wider corporate economic considerations. This fact in itself is neither positive nor negative; however, it introduces a variable that has little to do with exchange rate fluctuations. Since the primary commodities export sector is also dominated by multinationals, the same consideration applies here. Moreover, the pricing of most of these commodities is in United States dollars.

1237. The growth rate of the Brazilian population, which was 2.4 per cent a year in the 1965-1908 period, is now still near 2 per cent a year (see table XVIII.24), and the population is relatively young; in 1980 half of the people were below 20 years of age, which may explain why the growth rate of the labour force is higher than that of the population. This fact is likely to cause a further increase in unemployment.

1238. Income distribution is very uneven. The poorest 50 per cent earn less than 14 per cent of total income, as against 27 per cent in Italy; the highest decile earns 46 per cent of total income (26 per cent in Italy). Illiteracy is widespread. Secondary school enrolment is at 35 per cent of the people of the

appropriate age group, compared with 93 per cent in industrialized countries (see table XVIII.29). The welfare system is modest. The adjustment policy, therefore, has to cope with big social problems, ranging from poverty to unemployment to lack of equal opportunities in a free market economy.

1239. Brazil's economic growth after the Second World War has passed through three cycles. The main characteristic of the first one (1948-1961) is an average growth rate of about 7 per cent a year in real terms. The industrial development of this period was of the import substitution kind, in a highly protected environment, with a major participation, both direct and indirect, of the public sector.

1240. During the second cycle (1967-1980) there was an average growth rate exceeding 11 per cent a year up to the first oil shock, and thereafter a slowdown. Brazil's reaction to the oil shock was heavy investment in oil exploration and extraction, as well as in developing alternative energy sources. It also accelerated, rather than slowing down, investment in the steel, chemical and petrochemical, pulp and paper, non-ferrous metals and capital goods industries. Most of this investment was either public or publicly supported. The increase of the rate of investment was much higher than the growth of domestic savings and has been financed by increasing resort to foreign debt.

1241. After 1981, problems started to arise. There was the 1981-1983 recession as a consequence of the world recession and the debt crisis. A new period of growth took place thereafter as a consequence of the increase in the domestic demand for investments and, in 1986, for consumption. A new slowdown took place in 1987-1988. The growth potential of Brazil is still high, considering supply and demand. However, there is a major constraint in the form of the low level of investments, which has become a common denominator after the debt crisis.

1242. Brazil's external debt has grown continuously in the last 30 years. With a limited tax base and a narrow domestic capital market, foreign debt has become the main source of finance for investments, both private and public. Starting from 1979, and particularly after 1982, medium- and long-term net capital flows were reduced and became negative in 1985. The increase in total debt thereafter is the consequence of capitalization of interest and debt refinancing. Interest payments have contributed heavily to the surplus of trade balance and to the negative flow of resources from Latin America and the Caribbean to the OECD countries, starting in 1980. From 1985, the net outflow of resources has been about $8 billion per year.

1243. Financing growth with a large amount of foreign debt has not been altogether wise in the Brazilian context, if the debt eventually has to be repaid. Over a 33 year period ending in 1987, Brazil's stock of debt, in 1987 United States dollars, has increased at a rate 24 times faster than the increase in the country's per capita income, also expressed in 1987 United States dollars.

1244. In early 1986, as the inflation rate accelerated to an annual rate of over 450 per cent, the Brazilian authorities modified the prevailing indexation arrangements in an attempt to put an end to inflation. They introduced the cruzado plan, which was named after the new currency that replaced the cruzeiro and

included a price and exchange rate freeze, a temporary deindexation of most financial assets and a modification of wage indexation.

1245. By November 1986, the measured rate of increase in consumer prices fell sharply. However, this decline was accompanied by growing distortions in relative prices, scarcities and widespread illegal price premia. The internal economy performed well: real GDP grew by 7.5 per cent and real wages by 10 per cent. The overall fiscal deficit fell to 11 per cent of GDP from the 28 per cent level reached in 1985. However, external performance weakened considerably in 1986, reflecting domestic demand pressures and the appreciation of the exchange rate. The trade surplus declined from $12.5 billion in 1985 to $8.3 billion in 1986. Arrears to the Paris Club accumulated to $3.6 billion and the gross foreign reserves of the Central Bank declined by $4 billion by the end of the year.

1246. In late 1986, authorities began to dismantle the price freeze to restrain the growth of domestic demand. Inflation rose rapidly, reaching 23 per cent per month by the second quarter of 1987. Another price freeze in June slowed inflation down to 5 per cent per month. When the freeze was suspended, inflation picked up to 12 per cent during the fourth quarter. It accelerated further to 18 and 24 per cent per month during the first and second quarters of 1988.

1247. In 1987, industrial production rose by only 1.1 per cent, but a record agricultural harvest made real GDP grow by 3.6 per cent. Industrial production weakened further in 1988, declining by 2.5 per cent and, with agricultural production down slightly, real GDP fell by 0.3 per cent. The sharp increase in inflation on the total volume of the indexed public debt made the overall fiscal deficit rise to 31 per cent of GDP in 1987 and to 48 per cent during 1988. Since November 1986, the authorities have adjusted the exchange rates daily in line with domestic inflation as measured by the consumer price index (CPI). Time-lags resulted in a real appreciation of the cruzado of about 11 per cent by the end of 1988.

1248. There was a considerable strengthening of Brazil's foreign trade performance in 1987. The trade surplus reached $11.2 billion; merchandise exports grew by 17 per cent in dollar terms and imports by only 6 per cent. This performance improved further in 1988, with exports rising by 29 per cent and imports declining slightly; consequently, the merchandise trade surplus reached $19.2 billion.

1249. At the beginning of 1989, the authorities announced rapid disinflation programme with price freezes, prohibition of indexation in contracts, and a 145 per cent evaluation of the cruzado in United States dollar terms. Initiatives to trim the federal government work force were not implemented, and Congress withheld its approval of proposals to close down or sell off public enterprises. The programme was far from successful and was quickly abandoned in April. During 1989, GDP grew slightly by 1.5 per cent, as a consequence of 0.5 per cent increase in industrial production and 2.5 per cent increase in agriculture. However, consumer prices had risen at the end of the year by 1,200 per cent (see table XVIII.7). Exports stagnated, and imports grew slightly.

Table XVIII.21 Brazil: external debt
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	70 838	104 593	123 865	114 592
Multilateral long term	3 126	7 358	12 311	11 413
Bilateral long term	3 876	8 091	12 949	13 199
Long term total	57 312	90 704	106 021	101 355
Public and guaranteed public debt	40 707	73 528	91 587	89 741
Commercial banks	24 261	50 074	56 302	56 091
Other private lenders	6 039	6 097	8 445	7 546
Obligations	3 405	1 908	1 580	1 592
Loan disbursements	11 428	2 467	3 615	6 194
Debt reimbursements	6 830	3 749	4 572	5 103
Interest payments	7 856	9 030	7 527	13 213
Total debt service	14 686	12 778	12 099	18 316
Debt percentage on debt	1.10	8.63	6.07	1.15
Gross domestic product	231 874	216 844	314 642	373 153
Exports	23 280	29 386	28 396	36 564
Current account in balance of payments	12 807	-241	-1 428	4 448
Debt-to-exports ratio (per cent)	304.3	355.9	436.2	313.4
Debt-to-GDP ratio (per cent)	30.6	48.2	39.4	30.7
Debt service-to-exports ratio (per cent)	63.1	43.1	42.6	50.1
Interest-to-exports ratio (per cent)	33.7	30.7	26.5	36.1
Interest-to-GDP ratio (per cent)	3.4	4.2	2.4	3.5

Source: World Bank, World Debt Tables, 1989-1990.

1250. In mid-March 1990, the newly elected president, Collor de Mello, launched a very audacious stabilization programme based upon: (a) a radical monetary reform, by which all bank deposits and savings were frozen for 18 months, thus heavily draining liquidity; (b) a tax reform that increases individual tax rates, introduces taxes on capital gains and on wealth and eliminates exemptions for farmers and exporters; (c) a price control mechanism for 45 days; (d) abolition of the official exchange rate, thus allowing daily exchange rate fluctuations; (d) liberalization of foreign trade by lowering tariffs and eliminating quotas and bans; and (e) a freeze on pay rises.

1251. The programme is unprecedented for Brazil and is reminiscent of the schemes introduced in the Germany and Japan after the Second World War. It has not cleared Congress yet and is enforced by presidential decree. A major battle is being fought. In May, the Government had to withdraw after only one day measures to raise taxes on financial transactions. In June, the Supreme Court ruled unconstitutional a decree that froze wages. In the meantime, there are indications that the country's output may drop in 1990.

1252. According to L. C. Bresser Pereira, 16/ the acceleration of inflation that took place in the 1980s in Brazil, may be partially explained by the fiscal crisis, but certainly the distributive conflict that characterizes an economy where income is so unevenly distributed as the Brazilian economy is the fundamental cause of inflation and its acceleration.

1253. The external debt, as it aggravated directly and indirectly the distributive conflict, obviously played an important role in the acceleration of inflation.

1254. The theory of inertial inflation has been developed by L. C. Bresser Pereira and Y. Nakano 17/ and in a paper by L. C. Bresser Pereira 18/ whereby the maintenance of the level of inflation is defined by the indexation (formal or informal) of prices according to past inflation, with an endogenous factor of acceleration caused by the change of indexators used by economic agents as they perceive that the going rate of inflation is too high so that the previous indexator is insufficient to protect them.

1255. This perception, in turn, according to the theory, depends on the existence of exogenous factors of acceleration of inflation.

1256. It follows from this theory that a heterodox shock is needed to break down the inertial component of inflation.

1257. The freeze on bank deposits, prices and wages adopted by de Mello belong to this family of heterodox shocks.

1258. The cornerstone of the heterodox part of the first de Mello plan of March 1990 was the freeze of most of the bank deposits, for an undetermined period. However, while inflation went down drastically in the first six months following the plan, its spiral recovered in the next period, to become close to the 80 per cent monthly level of the beginning of 1990.

1259. The Achilles' heel of the courageous stabilization policy by de Mello seems to lie in its orthodox components relating to fiscal policy. The perverse effects of the oil price increase related to the Gulf crisis must be added to the lack of revenues to face the expenditures. The cornerstone of the heterodox part of the second de Mello plan, of late January 1991 consists in the wages-prices freeze, also set forth for an undetermined period. Tariffs of the main public utilities were increased, before the freeze, by important amounts: nearly 60 per cent for telephone and electricity; about 45 per cent for fuels and 70 per cent for stamps. Wages also are to be granted a "last increase" before the freeze.

1260. As for the orthodox measures, the second de Mello plan decrees the end of the generalized system of indexation of the economy. Escalator clauses applied to wages, rents, interest rates, loans, bank deposits on monthly, weekly or even daily basis (typical "overnight" indexation of the short-term bank deposits), have been abolished. The interest rate is going to be determined by the market.

1261. The privatization programme of de Mello too is an ambitious effort towards market economy and international co-operation while not underestimating the role of the State as entrepreneur.

1262. Foreigners are called upon to buy shares from a huge list of public corporations, however without the right to purchase more than 40 per cent of their voting stock. If debt-equity swaps are carried out, a discount of 25 per cent will be applied to the face value of the purchased foreign debt in favour of the Brazilian Treasury and in any event only 12 per cent a year of the profit from the investment seems to be allowed to be exported from Brazil (this percentage may appear too modest).

1263. Brazil's position vis-à-vis its foreign creditors is commonly recognized to be strong. It is first of all the world's largest debtor. It has also the capacity to generate foreign resources quickly through an increase of exports, and the creditors know it. Moreover, as a large, inward-looking economy, it is impervious to world opinion or sanctions by creditor banks. Finally, the large amount of foreign investment in the country may act as an insurance policy against sanctions by creditor Governments. On the other hand, the resilience of Brazilian exports has three constraints: (a) any further increase would be at the expense of internal demand; (b) funds would be diverted from investments, which would be further compressed; and (c) a major increase would require large public subsidies at a moment when government finances are going through a crisis.

1264. Debt-equity swaps in Brazil absorbed $5.7 billion in 1988. A slowdown is likely as it will become increasingly difficult to identify new worthwhile projects and because a domestic opposition can be expected as a result of a nationalistic fear of losing control of key sectors. One creditor bank estimates that in the period 1988-1993 these conversions would not exceed $20 billion.

1265. These facts do not imply that Brazil cannot or will not meet its foreign debt obligations. It only means that the bargaining is going to be much tougher than elsewhere and that debt reduction will have to take place in a more significant manner than in other countries at a comparable income level.

Argentina

1266. The total external debt of Argentina was $51.4 billion in 1986, 65 per cent of GDP; it grew to $59.5 billion by the end of 1989, 86 per cent of GDP. It is projected to grow further to $60.2 billion in 1990 (96 per cent of GDP) (see table XVIII.22). The theoretical debt service ratio reached 120 per cent in 1987, went down to 87 per cent in 1989, and is expected to be 79 per cent 1990. The share of debt with commercial banks is slightly less than 50 per cent.

1267. From 1983 Argentina has been accumulating debt arrears, which were more than $2 billion in 1988 (see table XVIII.5) and currently are in the order of $4.5 billion. Arrears have been built up not only with banks but also with Governments and international financial institutions, including IMF. It was only through a bridge loan arranged by Brazil, Mexico and Venezuela that the arrears to the IMF have been eliminated.

1268. It is estimated that an amount of capital equal to about one third of Argentina's total foreign debt ($57.8 billion) had fled abroad by the end of 1987. This is twice as much as Brazil (16 per cent), but much less than Mexico (42 per cent) and Venezuela (77 per cent). The flight from the austral that has taken place in the last few years and the withdrawing of foreign investments from Argentina are not good signs as to the country's capacity to attract a voluntary repatriation of the capital.

1269. The reduction of Argentina's debt is a challenge. Unlike Brazil, the country is unable to generate a trade surplus large enough to meet interest payments and at the same time maintain an acceptable rate of growth. In 1985 and 1987 the net transfer of financial resources averaged 3 per cent of GDP, as in Brazil, but the rate of growth was barely positive, while Brazil had a rapid expansion. The view has been expressed that Argentina should be forced into a unilateral debt reduction scheme. Meanwhile the country participates in fewer debt-equity swaps than Brazil, in part for nationalistic reasons and in part for fear of worsening inflation.

1270. Argentina's foreign debt has deep-rooted origins in the uncertainties about the development model that the country should have adopted. By the 1950s, a process of industrialization under protectionist policies had largely run its course, and growth slowed.

1271. In the mid-1950s there was a shift in economic strategy as relative prices were realigned in favour of the agricultural sector, and exports rose, but this policy was not sustained. Through the 1960s, inflation was high by international standards, averaging about 20 per cent a year. National saving remained at about one fifth of GDP as did fixed capital formation, while output growth averaged 3.25 per cent a year, down from 5 per cent of the 1950s but still enough to increase per capita income.

1272. By the mid-1970s the natural consequence of the no-growth prospects of Argentina's industrial development model was a major outbreak of social unrest. The political turmoil that followed interacted with passive fiscal and monetary policies to produce a wage-price spiral that boosted inflation to over 300 per cent

a year in 1975-1976. In the following years an attempt was made to correct the situation through a phased opening of the economy and the gradual reduction of the fiscal imbalance (see tables XVIII.28A and 28B). However, the exchange rate was not permitted to fluctuate freely and its periodic devaluations were too little and too late, as they were used mostly as an anti-inflation tool. The peso completely lost its competitiveness, but inflation was not brought under control. Fiscal and external current account imbalances started to be financed with foreign savings and external indebtedness increased sharply. By 1981 the situation had reached crisis proportions, and the Government reintroduced trade and payments restrictions.

1273. Burdened by the foreign debt, economic growth, which had slowed to 2 1/2 per cent in the 1970s, contracted by close to 1 per cent in 1981-88, which implied a large decline in per capita income (see table XVIII.28). In 1982, at the outset of the world crisis, Argentina was unable to meet its external debt obligations, and external and domestic imbalances widened. In 1981-1988 average inflation exceeded 300 per cent a year. National savings fell off sharply, and domestic fixed capital formation dropped to about 15 per cent of GDP from more than 23 per cent in the 1970s, despite an increase in the use of foreign savings equivalent to 4 percentage points of GDP. 19/

1274. What followed was a saga of plans. "Plan Austral" of 1985, "Plan Primavera" of 1988 and the economic packages of May 1989 had a common denominator: the use of increasingly imaginative schemes of wage and price controls. However, they had also in common insufficient follow-through on the fiscal and credit fronts, inability to curb the operational deficits of the public sector enterprises, inability to attract repatriation of capital, unwillingness to protect savings from inflation and negligible yields from tax increases. The net results were 4,200 per cent inflation in 1989 and a 5.4 per cent drop in per capita income.

1275. De Pablo and Broda 20/ suggest that a new macro-economic model is necessary for those countries in which labour, capital, technology and so on are simultaneously in excess supply and in which the lack of credibility therefore becomes the operative constraint. Commenting on this thesis, de Pablo 21/ in his paper on Argentina, argues that in incredible countries the lag between a policy reform and the emergence of results is explained not so much by inertia (time deposits are made for seven days in Argentina) as by credibility arguments. The typical Argentine develops a wait-and-see attitude to determine whether this time the programme is going to be different from the previous one, before acting.

1276. De Pablo adds that in the economic profession in Argentina, the role of fiscal balance in achieving macro-economic equilibrium is much clearer today than a decade ago.

Table XVIII.22 Argentina: external debt
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	27 157	50 947	58 423	58 936
Multilateral long-term	1 087	2 011	3 983	4 049
Bilateral long-term	816	2 804	4 758	4 711
Long-term total	16 774	41 905	51 039	49 544
Public and guaranteed public debt	10 181	37 330	49 186	48 166
Commercial banks	6 065	20 719	29 154	28 998
Other private lenders	1 373	2 022	1 923	1 651
Obligations	839	9 774	9 368	8 757
Loan disbursements	4 708	4 584	4 422	2 777
Debt reimbursements	1 853	3 500	2 943	1 853
Interest payments	2 329	5 071	4 069	3 168
Total debt service	4 182	8 570	7 012	5 021
Debt percentage on debt	8.57	9.95	6.96	3.14
Gross domestic product	56 120	69 486	76 846	97 343
Exports	11 202	10 329	8 690	11 512
Current account in balance of payments	4 774	-952	-4 239	-1 812
Debt-to-exports ratio (per cent)	242.4	493.2	672.2	512
Debt-to-GDP ratio (per cent)	48.4	84.2	76.0	60.5
Debt service-to-exports ratio (per cent)	37.3	83.0	80.7	43.6
Interest-to-export ratio (per cent)	20.8	49.1	46.8	27.5
Interest-to-GDP ratio (per cent)	4.2	8.4	5.3	3.3

Source: World Bank, World Debt Tables, 1989-1990.

1277. This is an important point since it is well known that the most popular primitive version of the structuralist approach would sponsor economic expansion through fiscal deficit, to a theoretical level of full employment, adopting a mild view on the tax burden. And this disregards (unlike the monetarist, shock approach) the rigidities of supply and the inefficiencies in the infrastructure that halt the expansion of supply and the mobility of resources, and the lack of credibility of public policy underlined above. According to de Pablo, politicians have become particularly outspoken against tax evasion. Later on, commenting on the first period of the stabilization policy of the new Menem Government, de Pablo asserts that while the heterodox portion of his plan (notably the freeze of key prices and other freezes) has worked, the orthodox portion (mainly in fiscal policy) is lagging.

1278. William F. Cline, 22/ in his comment on the de Pablo paper, argues that the Austral plan of June 1985, the Mini Austral of March 1987, Austral II of October 1987 and the August 1988 Spring Plan all collapsed for essentially the same reason. The Alfonsin Government was unable to close the fiscal gap. As for the new Menem programme, which adopts a major tax reform, he comments that it remains to be seen whether interest groups will permit the programme to succeed.

1279. Sebastian Edwards, 23/ in his comment, after having mentioned that the Menem programme is based on three main components - deep fiscal reform, modernization of the productive structure and privatization of public enterprises, plus a debt reduction scheme involving at least a 50 per cent forgiveness, argues that institutional changes geared towards enhancing the credibility of the programme should be implemented. And in this context, he maintains that the most promising reform would be that recently adopted by Chile of creating a complete independence for the Central Bank.

1280. However, he points out that at the very bottom of Argentina's incredible recent economic history with inflation and stagnation is a conflict over income distribution: no segment of society is willing to shoulder its share of the burden of taxation.

1281. It seems appropriate to add that the well-to-do should have the responsibility of being the first to accept to shoulder their share.

1282. According to Dornbusch and de Pablo, 24/ the Austral Plan was an important step towards the furtherance of stabilization. "The Austral Plan has in fact not brought price stability. Inflation today is back to the 100-200 per cent rate. But the important achievement is that inflation was brought down from more than 2,000 per cent and this was accomplished without a decline in economic activity, rise in unemployment or reduction in the purchasing power of wages. ... Today there is a little risk that stabilization will collapse. That confidence makes it possible and fruitful for the Government to concentrate on the two key issues: how to achieve further budget improvement so as to bring inflation down to less than 20 per cent and how to restore investment and growth. External debt and debt service have a bearing on each of these questions".

1283. The two critical factors, according to the two authors, are the fiscal choice to translate the reduction in external debt service into higher investment and growth and the willingness of capital markets to lend on a major scale to Argentina.

1284. After having noted that the average tenure of central bankers of Argentina is less than one year, Dornbusch and de Pablo point out the nexus between financial stability and political and institutional stability.

1285. The early 1990 conversion of the Australes bonds and term deposits into ten year government bonds denominated in United States dollars at LIBOR and some tighter fiscal policies have brought inflation down to 11.4 per cent at 15.2 per cent, well above the 2 per cent a month target agreed with IMF. A much tougher stance will have to be taken on the fiscal front if the agreed target has to be met.

1286. Argentina has abundant natural resources. The most important one is land, which with its fertility and size can support a strong agriculture and livestock sector. Fishing reserves on the Atlantic coast are a major resource exploited on a concession basis by foreign fleets. The subsoil is well endowed with iron ore, copper, uranium, oil and gas. The country is practically self-sufficient in the energy sector. A slight surplus in oil counterbalances slight deficits in coal and gas. Self-sufficiency is likely to be reached also in the latter as soon as the gas fields of the south are in full production. About 10 per cent of the energy production is hydropower and 3 per cent nuclear.

1287. Agriculture and services contributed 65.3 per cent of GDP in 1986; industry, at 34.7 per cent, was down from 38.1 per cent in 1970. These facts show how difficult it is to develop industry in a country whose growth is based upon and continues to be conditioned by a rich and competitive agricultural sector. In fact the exchange rate at which agricultural exports are competitive is overvalued for industrial products. Also the wealth, which tends to be accumulated in the agricultural sector, is not recycled automatically to industry; actually agriculture's profits are transferred to industry only when the yield is far better. Moreover, the balance of international commercial relations requires that export of agricultural products be offset by imports of foreign manufactured goods, at the expense of local industry. Finally, agricultural production is subject to natural cycles and therefore prices and exchange rates become subject to exogenous cycles as well; such discontinuity in exchange rates does not help industrial development.

1288. Argentinian industry has been import-substitution oriented, with the following characteristics: (a) the Government normally plays a major role in investing in the sector; (b) there is usually a transfer of resources from the exporting sector (agriculture in Argentina) to the industrial sector; (c) a high level of protection shelters the industrial sector; and (d) there is no pressure to pay attention to a rational, non-artificial exchange rate policy unless it is to the advantage of the exporting sector. Such a model makes a relatively small-scale economy vulnerable to artificial price hikes, stockpiling and profiteering.

1289. Argentina's economy suffers from some constraints, both external and internal. In particular these include a widespread agricultural protectionism of the importing markets which prevents a full exploitation of the country's agricultural export potential; the major role played by the Government in the industrial sector poses serious problems of efficient use of resources and the high protectionism behind which the local industry operates does not promote competitiveness or better integration with the world economy. Argentina is therefore wrongly running an inward-looking economy, in spite of the fact that it is a relatively small market. Total exports plus imports were slightly above 15 per cent of GDP in 1986-1987. Their share increased thereafter only because GDP dropped.

1290. Agricultural production, after high growth at the beginning of the 1980s, has become substantially stable. In terms of per capita output, there was no growth between 1980 and 1987. The sector results reflect the opposite trends of the two main components: crops and livestock. The unimpressive overall performance of the sector is the consequence of the lack of investment. Total production, however, is significant both in Latin America and in world terms.

1291. The process of de-industrialization of the country started at the end of the 1970s. The subsectors that survived better than others are agro-industries, petrochemicals and steel. Some products have a good export performance, in particular, the processing of agriculture related products but not excluding some manufactured products of industrial origin. The role of foreign capital is decreasing to the advantage of national capital, mostly related to the public sector.

1292. The public sector - rightly or wrongly - is a major actor in the economy, both directly and indirectly through a system of incentives. The government presence is predominant in the hydrocarbons and other mineral sectors, in transportation and public services and in the defence industry. Government participation is very significant also in the manufacturing sector through the Dirección Nacional de Fabricaciones Militares, an agency that manages several companies in diverse fields ranging from railroad components to agricultural machinery. Some companies are controlled directly by the armed forces.

1293. Government policy is officially committed to a programme of privatization and some has been carried out. However, there is a strong resistance to this approach by the labour unions and the military apparatus because of the many companies they run. Argentina's strong nationalism is a major obstacle to the privatization of some national symbols.

1294. The Government offers a number of industrial incentives based on the location, sector of activity and export content. Most are in the form of exemption or reduction of income or other taxes and of custom duties.

1295. Since 1980 the economy, already inward-looking, has become more so. In 1980, imports plus exports were at about 31 per cent of GDP; in 1987, they dropped to 14 per cent. This is due both to a lack of financial resources after the 1982 debt crisis and to the lack of competitiveness of Argentinian products. As for

agricultural exports, Argentina is facing growing protectionism in major markets as the size of most important protected areas increases. In 1972 the 12 countries now members of EEC absorbed almost half of Argentinian exports; in 1987, only 30 per cent. EEC, however, is still Argentina's main trading partner. The second largest partner is the United States. Trade with the USSR is also large, but the flow is not steady: it fell from about 24 per cent of total exports in 1982 to 3 per cent in 1986 and rose again to 9 per cent in 1988.

1296. The excessive reliance of Argentinian exports on agriculture would require that the industrial export component be encouraged. However, the practices so far followed are aimed mainly at protecting domestic companies, discouraging non-agricultural exports. A step in the right direction is the law on industrial promotion, which provides for special incentives for export-oriented companies and for the ones that use advanced technologies. Nevertheless, a further rationalization and trimming of the remaining incentives is needed.

1297. Traditionally the Argentinian industrial market is highly protected. A liberalization programme was started by Martinez de Hoz at the end of the 1970s, but was not accompanied by an appropriate exchange-rate policy. The highest barriers are non tariff and are built around permits for specific goods. According to a programme agreed with the World Bank, the whole protection scheme should be reduced.

1298. The exchange rate policy has been rather erratic during that last few years. Keeping the exchange rate for the austral stable in real terms and competitive is a must for any attempt to develop industry. Export oriented industrialists do not have enough weight to influence the Government. Congress and unions are biased in favour of the pressure groups of farmers and protected industries. The World Bank and IMF should use conditionality in this regard to break the stalemate for the good of the country.

1299. As the World Bank claims, a substantial reform of public finances and of the financial sectors is also required. In particular there is an urgent need for a tax reform, together with a system to identify responsibilities and expenditures limits for the central and local administrations, as well as for the social security system. The financial sector reform should be aimed at avoiding inefficiency of services and segmentation of markets. Public deficits should be reduced, through increased taxes.

1300. It is difficult to apply the Brady Plan to Argentina and certainly almost impossible to apply it on such terms as those currently agreed with Venezuela. On the other hand, the present report puts forward additional instruments to strengthen the Brady Plan debt reduction policy and to broaden it into a systemic policy. There is no reason why a major effort should not be undertaken from both sides to relieve Argentina from its present deadlock.

Notes

1/ On the achievements and difficulties of Costa Rica's democratic Government in coping with the debt crisis in the period 1978-1987 see M. Nelson, "Crisis management, economic reform and Costa Rica" in B. Stallings and R. Kaufman (eds.) Debt and Democracy in Latin America, Westview Press, San Francisco, 1989.

2/ Patricio Meller, "Three policy experiments" in J. Williamson (ed.), Latin American adjustment. How much has happened?, Institute for International Economics, Washington, D.C., 1990.

3/ Barbara Stallings, "Political economy of democratic transition: Chile in the 1980s" in B. Stallings and R. Kaufman (eds.), op. cit.

4/ R. Hommes, in J. Williamson (ed.), op. cit.

5/ ECLAC, Preliminary Overview of the Economy of Latin America and the Caribbean, Notas sobre la economía y el desarrollo, No. 485/486, 1989.

6/ This was emphasized by Mexican Ministers in our meetings in Caracas.

7/ F. Pazos, Chronic inflation in Latin America, New York, Praeger, 1978, and R. Dornbush and M. H. Simonsen "Inflation stabilization: the role of incomes policy and monetization", in R. Dornbush (ed.), Exchange rates and inflation, Massachusetts Institute of Technology Press, Cambridge, 1988.

8/ R. Thorp, "Structural attempts at short-term management in the 1980s: the case of Peru under Alan Garcia", in Helen O'Neil (ed.) Third world debt: how sustainable are current strategies and solutions?, Frank Cass, London, 1990.

9/ Carol Wise, "Democratization, crisis and the APRA's modernization project in Peru", in B. Stallings and R. Kaufman (eds.), op. cit.

10/ See J. L. Cariaga, "Three policy experiments" in J. Williamson (ed.), op. cit.

11/ J. A. Morales and J. Sachs, in J. Sachs (ed.), Developing country debt and the world economy, National Bureau of Economic Research, Washington, D.C. 1989.

12/ The gap between revenues and expenditure in the central government does not coincide with the deficit because it does not include either external grants or the balance between loans and loan reimbursements by the central government.

13/ R. Kitchen, "Jamaica's external debt: its origin and management" in Helen O'Neil (ed.), op. cit.

14/ Gul-Soo Pang in B. Stallings and R. Kaufman (eds.), op. cit.

15/ Eliane A. Cardoso and Daniel Dantas in J. Williamson (ed.), op. cit.

Notes (continued)

16/ L. C. Bresser Pereira, "The perverse macro-economics of debt, deficit and inflation in Brazil", in Taker Fukechi and Mitzuro Kagani, Perspectives on the Pacific basin economy: a comparison of Asia and Latin America, Institute of Developing Economies, Tokyo, 1990.

17/ L. C. Bresser Pereira and Y. Nakano, Inertial inflation, Lynne Riener, publisher, 1987.

18/ L. C. Bresser Pereira, "A teoria da inflacao reexaminada" in J. M. Rego (ed), A aceleracao da inflacao recente, Editora Bienal, Sao Paolo, 1989.

19/ For the dramatic drop in savings and investment in Argentina, see table XVIII.26; in the period 1980-1987 investments went down to 14.4 per cent per year with savings dropping off to 9.5 per cent per year.

20/ J. C. de Pablo and M. A. Broda, "Política ecónomica en países increibles", Meeting of the Economic Society, Santiago, August 1989.

21/ J. C. de Pablo in J. Williamson (ed.), op. cit.

22/ William F. Cline, in ibid.

23/ Sebastian Edwards, in ibid.

24/ R. Dornbusch and J. C. de Pablo, "Debt and macro-economic instability in Argentina" in J. Sachs (ed.), op. cit.

Table XVIII.23 Ten countries in Latin America and the Caribbean: a/ basic indicators

	Mill. inhab. 1987	Life expect. 1987	Territory (000 km²)	G D P 1965	G D P 1987	Growth rate 1965-80	Growth rate 1980-87	Per capita GDP 1987	Growth rate 1965-87	Inflation rate 1965-80	Inflation rate 1980-87
Bolivia	6.7	53	1 099	710	4 470	4.5	-2.1	580	-0.5	15.7	601.8
Paraguay	3.9	67	407	404	4 570	6.9	1.3	990	3.4	9.4	21.0
Ecuador	9.9	65	284	1 150	10 610	8.7	1.5	1 040	3.2	10.9	29.5
Colombia	29.5	66	1 139	5 570	31 940	5.6	2.9	1 240	2.7	17.4	23.7
Chile	12.5	72	757	5 940	18 950	1.9	1.0	1 310	0.2	129.9	20.6
Peru	20.2	61	1 285	502	25 150	3.9	1.2	1 470	0.2	20.6	101.5
Brazil	141.4	65	8 512	19 450	299 230	9.0	3.3	2 020	4.1	31.3	166.3
Uruguay	3.0	71	176	930	6 420	2.4	-1.3	2 190	1.4	57.8	54.5
Argentina	31.1	71	2 767	16 500	71 530	8.5	-0.3	2 390	0.1	78.2	298.7
Venezuela	18.3	70	912	9 820	.....	3.7	0.2	3 230	-0.9	10.4	11.4

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.24 Ten countries in Latin America and the Caribbean: a/ population

		Population growth rate %			Total population		
		1965-1980	1980-1987	1987-2000	1967	2000	2025
Bolivia	44	2.5	2.7	2.7	7	10	16
Paraguay	61	2.8	3.2	2.7	4	6	9
Ecuador	62	3.1	2.9	2.2	10	13	19
Colombia	66	2.2	1.9	1.7	29	36	48
Chile	67	1.7	1.7	1.4	13	15	19
Peru	68	2.8	2.3	2.1	20	26	36
Brazil	78	2.4	2.2	1.8	141	178	234
Uruguay	79	0.4	0.5	0.7	3	3	4
Argentina	82	1.6	1.4	1.1	31	36	43
Venezuela	88	3.5	2.8	2.2	18	24	34

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.25 Ten countries in Latin America and the Caribbean: investments/savings as a percentage of GDP, historical record a/

	Gross investments			Gross savings		
	1965-1973	1973-1980	1980-1987	1965-1973	1973-1980	1980-1987
Argentina	19.1	23.4	14.4	20.4	22.6	9.5
Bolivia	25.4	24.7	8.3	21.3	18.3	1.6
Brazil	21.3	23.9	19.7	19.1	19.3	17.0
Chile	14.3	17.3	17.4	11.9	12.1	7.7
Colombia	18.9	18.8	19.9	15.8	19.0	16.0
Ecuador	19.0	26.7	23.3	12.7	21.2	17.5
Paraguay b/	15.0	n.a.	25.0	14.0	n.a.	18.0
Peru	24.1	23.9	27.0	20.9	19.7	23.0
Uruguay	12.0	15.7	12.8	12.0	11.3	9.7
Venezuela	31.1	34.2	21.4	31.9	35.8	24.2

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

b/ Figures for the years 1965 and 1987 only.

Table XVIII.26 Ten countries in Latin America and the Caribbean: a/ economic structure

	Agriculture		Industry		Manufacturing		Service sector	
	1965	1982	1965	1982	1965	1982	1965	1982
Bolivia	23	24	31	24	15	13	46	53
Paraguay	37	27	19	26	15	16	45	47
Ecuador	27	16	22	31	18	18	50	53
Colombia	30	19	25	35	18	19	46	46
Chile	9	n.a.	40	n.a.	24	n.a.	52	n.a.
Peru	18	11	30	33	17	23	53	56
Brazil	19	11	33	38	26	28	48	51
Uruguay	15	13	32	32	n.a.	27	53	55
Argentina	17	13	42	43	33	31	42	44
Venezuela	6	6	40	38	n.a.	22	55	56

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.27A Ten countries in Latin America and the Caribbean: a/ economic structure

	Agro-foodstuff		Textile and clothing		Machinery and means of transport-ation		Chemical sector		Other	
	1970	1986	1970	1986	1970	1986	1970	1986	1970	1986
Bolivia	33	37	34	16	..	2	3	4	29	41
Paraguay	56	n.a.	16	n.a.	1	n.a.	5	n.a.	21	n.a.
Ecuador	43	33	14	13	3	7	8	10	32	38
Colombia	31	34	20	14	8	8	11	13	29	31
Chile	17	27	12	7	11	4	5	8	55	55
Peru	25	26	14	11	7	10	7	11	47	44
Brazil	16	15	13	12	22	24	10	9	39	40
Uruguay	34	29	21	18	7	8	6	10	32	35
Argentina	24	24	14	10	18	16	9	12	35	37
Venezuela	30	23	13	8	9	9	8	11	39	49

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.27B Ten countries in Latin America and the Caribbean: a/ exports

	Energy and minerals		Other raw materials		Machinery and means of transport-ation		Other manufactu-red goods		Textile and Clothing	
	1965	1987	1965	1987	1965	1987	1965	1987	1965	1987
Bolivia	92	93	3	5	..	..	4	2	..	..
Paraguay	..	1	92	87	..	..	8	12	..	..
Ecuador	2	41	96	55	..	1	2	3	1	n.a.
Colombia	18	33	75	46	..	1	6	20	2	4
Chile	89	69	7	23	1	3	4	6	..	..
Peru	45	71	54	11	..	3	1	16	..	n.a.
Brazil	9	22	83	33	2	17	7	28	1	3
Uruguay	..	..	95	55	..	3	5	41	2	17
Argentina	1	4	93	65	1	6	5	25	..	3
Venezuela	97	91	1	1	..	2	2	6	..	n.a.

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.28A Ten countries in Latin America and the Caribbean: a/ central government spending as a percentage of total spending

	Defence		Education		Health		Housing and social infra-structure		Economic services		Percentage of GDP		Percentage of DIS	
	1972	1987	1972	1987	1972	1987	1972	1987	1972	1987	1972	1987	1972	1987
Bolivia	18.8	5.8b/	31.3	11.6b/	6.3	1.4b/	0.0	6.0b/	12.5	5.8	9.6	32.0	-2.3	??
Paraguay	13.8	12.1	12.1	12.2	3.5	3.1	18.3	32.3	19.6	10.1	13.1	2.9	-4.7	??
Ecuador	15.7	11.8	27.5	24.5	7.3	0.8	0.8	0.9	19.8	22.6	13.4	16.3	0.2	??
Colombia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	13.1	14.2	-2.5	??
Chile	6.1	10.7	14.3	12.5	8.2	6.0	39.8	42.6	15.3	9.2	43.2	31.9	-1.3	??
Peru	14.5	n.a.	14.5	n.a.	5.5	n.a.	1.8	n.a.	30.7	n.a.	16.1	14.2	-0.9	??
Brazil	8.3	3.1b/	8.3	3.0b/	6.7	6.4b/	35.0	23.7b/	23.3	11.2b/	18.4	26.1	-0.3	??
Uruguay	5.6	10.2	9.5	7.1	1.6	4.8	52.3	49.5	9.8	8.3	25.0	23.9	-2.5	??
Argentina	6.0	6.0	20.0	6.0	n.a.	1.9	20.0	32.7	30.0	18.1	19.6	26.4b/	-4.9	??
Venezuela	10.3	5.8	18.6	19.6	11.7	10.0	9.2	11.7	25.4	17.3	18.1	22.0	-0.2	??

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

b/ 1986.

Table XVIII.28B Ten countries in Latin America and the Caribbean: a/
Central government revenues as a percentage of total current revenues

	Taxes on income, profits and capital gain		Social security contributions		Taxes domestic consumption		Taxes on goods of international consumption		Non-taxed earnings		Total revenues as a percentage of GDP	
	1972	1987	1972	1987	1972	1987	1972	1987	1972	1987	1972	1987
Bolivia	15.4	6.5	5.9	5.0	30.8	14.3	46.2	28.6	8.0	28.6	9.6	32.0
Paraguay	8.8	12.2b/	10.4	12.7b/	26.1	26.1b/	24.8	11.4b/	12.9	15.1b/	11.5	9.6b/
Ecuador c/	19.6	65.0	0.0	0.0	19.1	13.7	52.4	17.3	3.8	2.0	13.6	18.5
Colombia	37.1	27.0	13.7	8.6	15.2	27.7	19.8	19.1	7.1	11.5	10.6	13.8
Chile	14.3	14.0	28.6	6.7	28.6	42.5	14.3	10.1	14.3	20.0	30.2	30.9
Peru	17.3	24.3	0.0	0.0	32.7	56.7	15.4	22.6	13.5	4.3	15.2	11.9
Brazil	20.0b/	20.8	27.7	27.7b/	35.4	20.5	7.7	2.3	6.2	23.4	18.9	22.1
Uruguay	4.7	8.2	30.0	27.3b/	24.5	43.6c/	6.1	13.7	12.6	4.7c/	22.7	23.6c/
Argentina	0.0	6.2c/	33.3	25.2	0.0	37.4c/	33.3	12.0c/	3.7	1.5	20.7	8.1
Venezuela	54.2	43.0	6.0	4.2c/	6.7	8.8c/	6.1	23.4	25.9	18.3c/	18.5	22.7c/

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

b/ 1986.

c/ Years different from those indicated.

Table XVIII.29 Ten countries in Latin America and the Caribbean: a/ education

	Primary						Secondary						Higher	
	Total		Male		Female		Total		Male		Female		Total	
	1965	1986	1965	1986	1965	1986	1965	1986	1965	1986	1965	1986	1965	1986
Bolivia	73	87	86	93	60	82	18	37	21	40	15	34	5	19
Paraguay	102	99	109	102	96	97	13	30	13	30	13	29	4	17
Ecuador	91	114	94	n.a.	88	n.a.	17	55	19	n.a.	15	n.a.	3	37
Colombia	84	114	83	112	85	115	17	56	18	55	16	56	3	17
Chile	124	110	125	110	122	109	34	70	31	67	36	73	6	17
Peru	99	122	108	125	90	120	25	65	29	68	21	61	8	27
Brazil	108	105	109	n.a.	108	n.a.	16	36	16	n.a.	16	n.a.	2	n.a.
Uruguay	106	110	106	111	106	109	44	71	42	n.a.	46	n.a.	8	42
Argentina	101	109	101	109	102	109	28	74	26	68	31	79	14	38
Venezuela	94	110	93	110	94	110	27	46	47	41	28	50	7	27

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.30 Ten countries in Latin America and the Caribbean: a/ health and nutrition

	Population per physician		Daily calory intake		Underweight newborn babies
	1965	1984	1965	1986	1985
Bolivia	3 300	1 540	1 869	2 143	15
Paraguay	1 850	1 460	2 627	2 853	6
Ecuador	3 000	830	1 940	2 058	10
Colombia	2 500	1 190	2 174	2 543	15
Chile	2 120	1 230	2 592	2 579	7
Peru	1 650	1 040	2 325	2 246	9
Brazil	2 500	1 080	2 402	2 656	8
Uruguay	880	510	2 812	2 648	8
Argentina	600	370	3 210	3 210	6
Venezuela	2 210	700	2 321	2 494	9

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

Table XVIII.31 Ten countries in Latin America and the Caribbean: a/ urbanization

	Urban population		Percentage of urban population in cities with over 500,000 inhabitants	
	1965	1987	1960	1980
Bolivia	40	50	0	44
Paraguay	36	46	0	44
Ecuador	37	55	0	51
Colombia	54	69	28	51
Chile	72	85	38	44
Peru	52	69	38	44
Brazil	50	75	35	52
Uruguay	81	85	56	52
Argentina	76	85	54	60
Venezuela	70	83	26	44

Source: World Bank, World Development Report and World Development Indicators, 1989.

a/ Only major countries have been examined, excluding Mexico, whose external debt has already been restructured.

XIX. ASIA

1301. The debt issue affects countries in the south of Asia, including India, Pakistan, Bangladesh, Sri Lanka and Myanmar. This part of the Asian continent, with a GDP of $345 billion in 1989, has 30 per cent of the world's population and almost half of the world's poor (46.4 per cent in 1985). The average per capita income is $280 (see figure XIX.1). In 1980-1989 the GDP growth rate in South-East Asia was 5.5 per cent. Despite the relative decline to 4.8 per cent in 1989 the growth rate is among the highest in the world, second only to that of East Asia, with 5.7 per cent (and 8 per cent between 1980 and 1989). According to World Bank estimates, 1/ between now and the year 2000 the GDP growth rate in south Asia is expected to be around 5.1 per cent, with a per capita GDP growth rate of 3.2 per cent, equal to that of the 1980-1989 period owing to the decline in the population growth rate, which will nevertheless remain high (see table XIX.1).

1302. Among the countries that had acute debt problems from which they have been able to recover, in Asia, in addition to the Republic of Korea, mention should be made of Indonesia and the Philippines. According to Wing Thye Woo and Anwar Nasution 2/ Indonesia did not experience a debt crisis in 1982-1984, as Mexico and Brazil did, mainly because of three factors: the concessionality of most of its loans, high export orientation and prudent management of the maturity structure.

1303. On the other hand, the two authors argue that the ratio of the budgetary deficit of Indonesia to GNP, which was in 1981 as high as that of Mexico and Brazil, was bearable, in the Indonesian conditions. "The reserve position of the country is crucial for avoiding debt crisis."

1304. The problems of the Philippines before Aquino's Government are described by R. S. Dohner and P. Intal, Jr. 3/ These problems were "poor returns from investments, difficulties in mobilizing domestic resources to fund investment, and the maintenance of a trade regime that did not sufficiently encourage exports. In addition, the Marcos Government created a political and economic environment that discouraged independent investment, led to capital flight and eventually crippled much of the productive economy".

1305. According to the two authors, the Philippines debt crisis, which is not yet completely solved, but where important steps towards a solution have been taken under Aquino's Government "is largely a micro-economic story". The manufacturing sector, which was overprotected, was sluggish and agricultural exports were increasingly taxed, so that the failure to respond to the external shock (fall in oil price and interest rate increase) by betting heavily against devaluation and waiting so long to declare a moratorium was not the fundamental cause of the debt crisis. The true solution, according to the two authors, over and above debt alleviation and new money, requires a fundamental adjustment in resource allocation.

1306. The reason for such a sustained rate of growth lies in the first place in the high rate of investment (see table XIX.2): 22.3 per cent of GDP between 1980 and 1989 in south Asia, against 19.9 per cent in 1973-1980. At a certain point in the modernization process, growth slows down and major effort is required in terms of accumulating technology and fixed capital. Besides, a higher rate of growth per unit of investment has been achieved by the countries in South-East Asia. Exports

from that region increased between 1980 and 1989 by an average 6 per cent a year, against 4.4 per cent in Latin America and the Caribbean, 14.7 per cent in eastern Asia and no increase in sub-Saharan African countries. Product diversification is responsible for a better export trend in East Asia, together with well organized international trade, led by Japanese trading companies and promoted by several institutions in the countries under consideration. South Asia has achieved a diversification level that is higher than that of Latin America and the Caribbean, and this was certainly due also to the high level of investments.

1307. While the terms of trade for Latin America and the Caribbean deteriorated between 1980 and 1989, those relative to South Asia were improving by 10 per cent, although they did not reach the average levels of 1970-1980 (see figure XIX.2). This meant a 60 per cent rise in the value of exports, second only to South-East Asia's 240 per cent increase (see figure XIX.3).

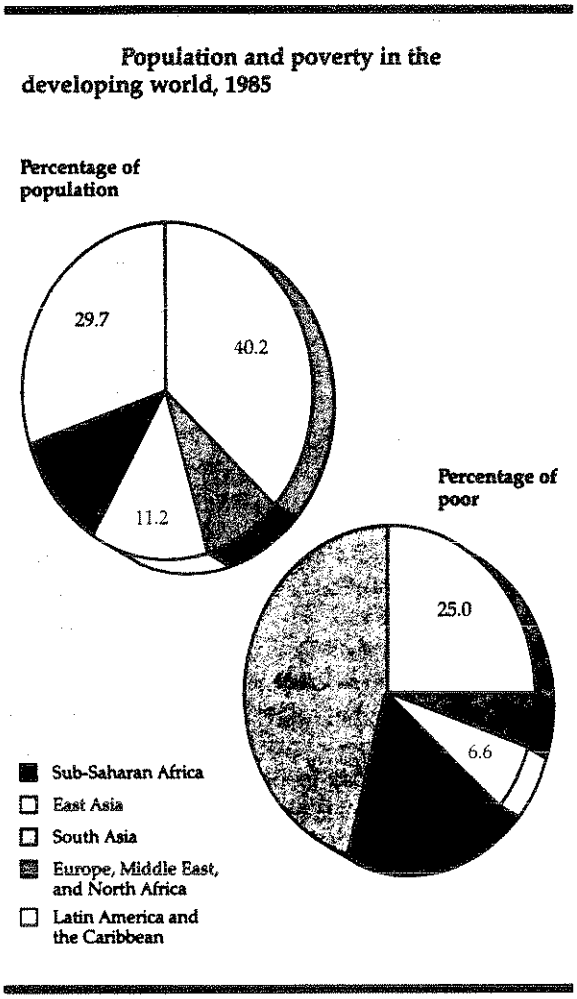
1308. World Bank projections to the year 2000 indicate a total of 350 million poor still living in South Asia (see figure XIX.4). Inter alia, this implies that the debt burden on some of these countries requires constant attention, owing to the link between growth and the debt burden, the selectivity of the adjustment processes and development assistance.

1309. Development here depends on agricultural growth in line with the population growth rate and an increase in the diversification of the industry sector to change the productive structure according to the modernization. In effect, the 1990 World Bank report on poverty states that

> "Progress in Asia depends critically on developments in China and India. If economic reform falters in China or if India is unable to maintain its recent momentum, the prospects for reducing poverty will be far less bright. Alternative projections based on slower growth and policies less favourable to the poor show an additional 150 million poor, mainly in India". 4/

Figure XIX.1

Population and poverty in the developing world, 1985



Source: World Bank, Poverty World Development Report, 1990.

Table XIX.1

Economic growth rates in the various groups of countries of the world

Prospects for the 1990s

Group and region	Real GDP growth rates			Real GDP per capita growth rates		
	Trend, 1965–80	*Recent experience, 1980–89*	*Forecast, 1989–2000*	*Trend, 1965–80*	*Recent experience, 1980–89*	*Forecast, 1989–2000*
Industrial countries	3.7	3.0	3.0	2.8	2.5	2.6
Developing countries	5.9	4.3	5.1	3.4	2.3	3.2
Sub-Saharan Africa	5.2	1.0	3.7	2.0	−2.2	0.5
East Asia	7.3	8.4	6.6	4.8	6.7	5.1
China	6.4	10.1	6.8	4.1	8.7	5.4
Other	8.1	6.4	6.3	5.5	4.2	4.6
South Asia	3.6	5.5	5.1	1.2	3.2	3.2
India	3.6	5.6	5.2	1.2	3.5	3.4
Other	3.9	5.0	4.8	1.2	2.2	2.4
Eastern Europe	5.3[a]	1.4[a]	1.9	4.5[a]	0.8[a]	1.5
Middle East, North Africa, and other Europe	6.3	2.9	4.3	3.9	0.8	2.1
Latin America and the Caribbean	6.0	1.6	4.2	3.4	−0.6	2.3

Source: World Bank, Poverty World Development Report, 1990.

a/ Estimates.

/...

Table XIX.2

Performance indicators in the world economy, 1989

Group and region	Real growth of GDP		Growth of export volume		Gross domestic investment/GDP[a]	
	1980–89	1989	1980–89	1989	1980–89	1989
Industrial countries	3.0	3.6	4.8	7.6	20.9	21.5
Developing countries	4.3	3.3	6.1	8.1	24.3	24.6
Sub-Saharan Africa	1.0	3.5	0.0	10.1	16.1	15.2
East Asia	8.4	5.1	14.7	8.1	30.0	30.7
South Asia	5.5	4.8	6.1	9.6	22.3	21.4
Eastern Europe[b]	1.4	0.0	3.8	2.0	29.4	24.8
Middle East, North Africa, and other Europe	2.9	2.5	6.4[b]	1.4[b]	25.9	24.1
Latin America and the Caribbean	1.6	1.5	4.9	4.4	20.1	20.6

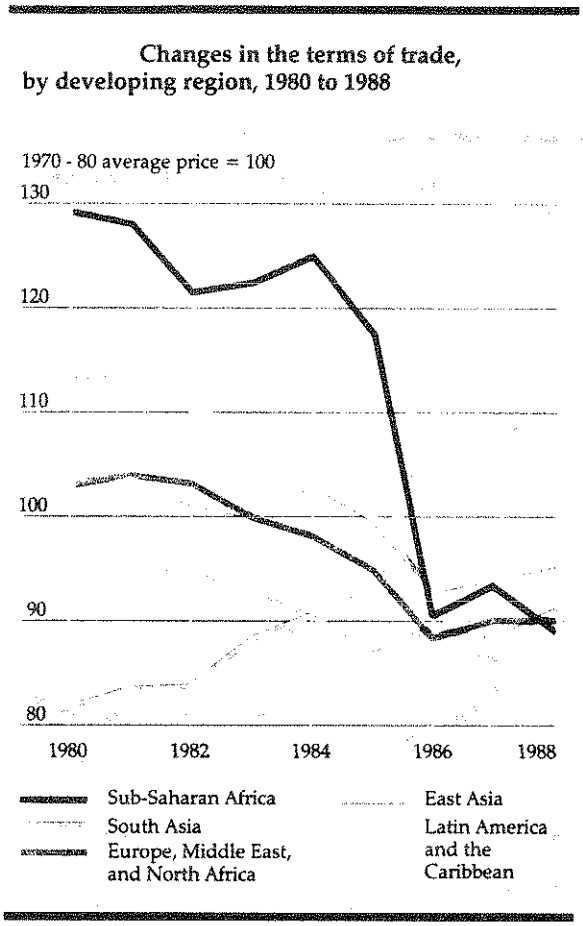
Source: World Bank, Poverty World Development Report, 1990.

a/ Data for 1989 are preliminary.

b/ Estimates.

Figure XIX.2

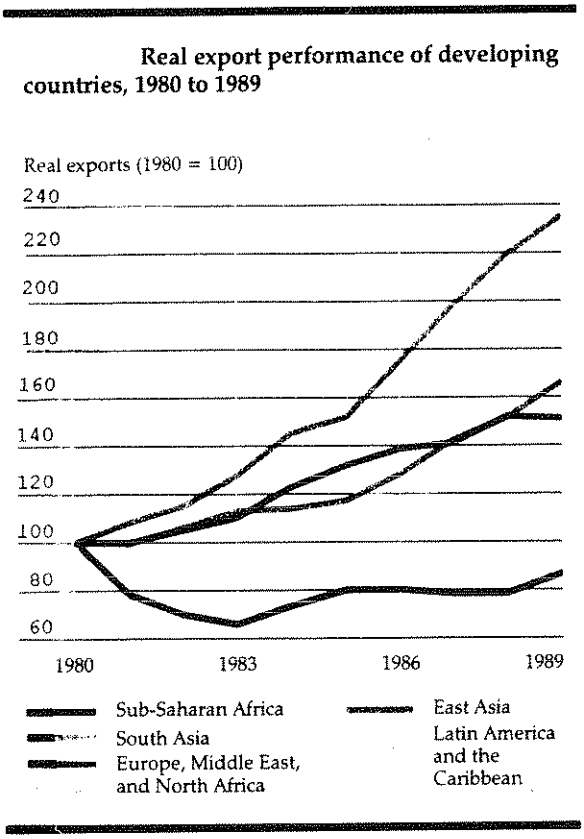
Changes in the terms of trade, by developing region, 1980 to 1988



Source: World Bank, Poverty, World Development Report, 1990.

Figure XIX.3

Real export performance of developing countries, 1980 to 1989

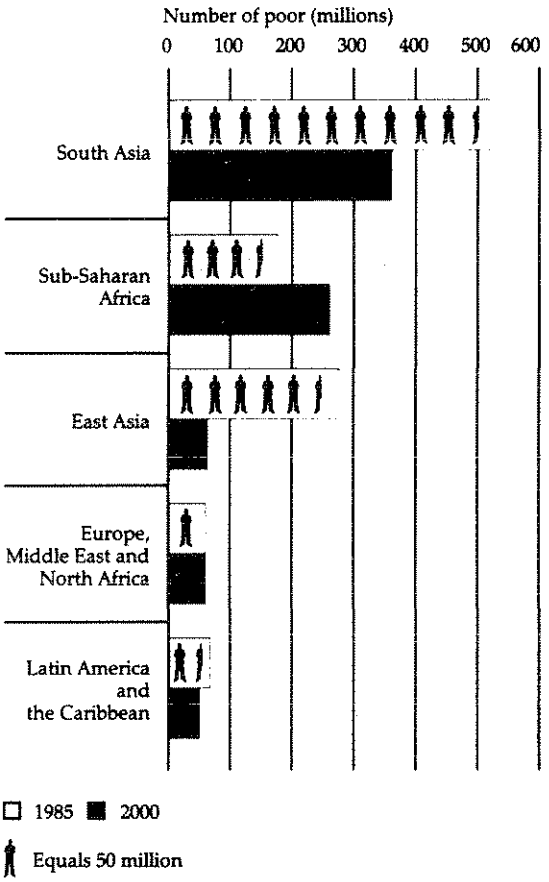


Source: World Bank, Poverty, World Development Report, 1990.

Figure XIX.4

Poverty in the developing world, 1985-2000

Poverty in the developing world, 1985 and 2000



Source: World Bank, World Development Report, 1990.

India

1310. India is the most populated country in South Asia and the second in the world after China, with which it shares the world's highest number of poor. Its GDP is around $260 billion, with a population of 816 million that will grow to over 1 billion in the year 2000. Per capita income was $340 in 1988, with a daily calorie intake of 2,238 according to most recent estimates. The debt stock rose in recent years to such an extent that a careful study is needed of the problems that may arise from its service. The figure was $57.5 billion in 1988 and it became $63 billion in 1989, including deposits of non-residents, that were not taken into account by the Government. Bank debts are still low with only $15 billion in 1988, plus another $3.5 of obligations and other private debts. Interest payments are now $3 billion, while loan reimbursement is slightly higher (see tables XIX.4 and 5).

1311. New loans to India account for almost all this amount. This means that India can redress its current account balance-of-payments deficit (about $6.7 billion in 1987-1988, which rose to $9 billion in 1988-1989) only by means of grants. According to the World Bank, official aid from all countries was only $2 billion in 1988, namely $2.60 per capita, equal to 0.8 per cent of GNP. As can be seen, ODA grants are lower than interest disbursements and cover only 30 per cent of the balance-of-payments deficit. The small flow of grants and other financing to India, net of reimbursements, is insufficient to fill the gap that still remains in the balance of payments. Hence, India's foreign exchange reserves fell during 1988-1989 and 1989-1990 down to $2.3 billion. Out of a gross total of $4 billion, including IMF credits, India's debt service problems could become dramatic.

1312. Exports of goods and services, notwithstanding their dynamic growth, account for less than 10 per cent of GDP, so that the debt service/exports ratio is rather high. It now stands at 30 per cent, while the interest/exports ratio is 14 per cent. Fortunately for India, most of its debt is concessional or with a prime rate and contracted with multilateral institutions, so that the interest burden is only 5.2 per cent and even that of amortizations is not higher than 5.7 per cent a year. But what must be carefully examined is the 262 per cent debt/exports ratio in 1988, particularly considering that exports of goods and services appear to have been overestimated by the Government then in power. Even the overall volume of such debt must be borne in mind, most of all because as much as $18 billion is owed to multilateral institutions.

1313. India, for all its scant resources, has to its credit some social and economic achievements that are not given wide coverage in the industrialized world, but which are laudable and exemplary. Despite the low income level, life expectancy is 57 years and the inflation rate was only 7.4 per cent between 1980 and 1988. Investments went up from 17 per cent in 1965 to 24 per cent in 1988-1989 and, similarly, savings grew from 15 per cent to 21 per cent, while exports rose from a mere 4 per cent to 7 per cent of GDP. The growth rate of the per capita GDP has been constantly rising from 1975-1976, with a growth of 4 per cent a year during 1975-1976/1979-1980, 5.4 per cent during 1980-1981/1984-1985, and 5.7 per cent during 1985-1986/1988-1989. The return on investment is also high and

Table XIX.3 India: External debt
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	20 561	40 886	55 325	57 513
Multilateral long-term	6 070	12 400	16 588	18 061
Bilateral long-term	10 245	10 084	13 464	12 995
Long-term total	18 658	32 924	47 783	51 168
Public and guaranteed public debt	18 322	31 427	46 131	49 695
Commercial banks	1 794	6 798	12 712	15 045
Other private lenders	210	1 500	2 081	1 799
Obligations	2	647	1 278	1 795
Loan disbursements	3 203	4 127	6 137	6 400
Debt reimbursements	765	1 573	3 125	3 325
Interest payments	614	1 897	2 637	3 074
Total debt service	1 379	3 470	5 762	6 401
Gross domestic product	172 652	213 478	256 414	257 895
Exports	15 018	15 463	18 993	21 900
Current account in balance of payments	-2 926	-5 905	-6 282	-7 000
Debt-to-exports ratio (per cent)	136.9	264.4	291.3	262.6
Debt-to-GDP ratio (per cent)	11.9	19.2	21.6	22.3
Debt service-to-exports ratio (per cent)	9.2	22.4	30.3	29.2
Interests-to-export ratio (per cent)	4.1	12.3	13.9	14.0
Interests-to-GDP ratio (per cent)	0.4	0.9	1.0	1.2

Source: World Bank, World Debt Tables, 1989-1990.

Table XIX.4 India: economic development data

BALANCE OF PAYMENTS	1986/87	1987/88	1988/89	1989/90 a/
	($US million)			
Exports of goods b/	10 460	12 644	14 208	17 050
Imports of goods b/	17 728	19 812	23 849	25 332
Trade balance	-7 268	-7 168	-9 641	-8 282
Non-factor services (net)	995	544	732	625
Resource balance	-6 273	-6 624	-8 909	-7 658
Interest income (net) c/	-2 045	-2 471	-2 985	-3 622
Net transfers d/	2 327	2 698	2 979	2 720
Balance on current account	-5 991	-6 397	-8 915	-8 560
Direct investment	208	181	287	425
Official loans & grants (net)	1 764	2 932	3 035	2 589
Gross disbursements	2 604	4 036	4 006	3 674
Amortization	840	1 104	971	1 085
Private borrowing (net)	2 067	1 140	1 641	3 291
Non-resident deposits	1 812	1 970	2 608	2 298
Net transactions with IMF	-648	-932	-1 068	-870
All other items e/	962	1 498	1 392	297
Errors and omissions	-102	-731	-412	-280
Increase in reserves	-72	339	1 432	810
Gross reserves (end of year) f/	6 730	6 391	4 959	4 149
Net reserves (end of year) g/	2 439	2 737	2 594	2 555
Fuel and related materials				
Imports (petroleum) b/	2 187	3 148	2 938	3 686
of which: Crude	1 672	2 395	1 910	2 572
Products	515	753	1 028	1 114

MERCHANDISE EXPORT (Average 1985/86-1988/89 b/)	$US Million	%
Tea	458	4.9
Iron ore	446	4.0
Chemicals	634	4.5
Leather and leather products	811	6.6
Textiles	1241	11.2
Garments	1179	9.7
Gems and jewelry	1961	14.0
Engineering goods	1092	8.4
Others	3872	36.6
Total	11693	100.0

EXTERNAL DEBT, 31 MARCH, 1989	$US Million
Outstanding and disbursed	57513
Undisbursed	50646
Outstanding including undisbursed	78159

DEBT SERVICE RATIO FOR 1988/89 a/ h/	29.3%

IBRD/IDA LENDING, 31 MARCH, 1989	$US Million	
	IBRD	IDA
Outstanding and disbursed	5403	12019
Undisbursed	7217	3822
Outstanding including Undisbursed	12620	15841

Source: World Bank International Economic Department, September 1989.

a/ Estimated.
b/ Net of crude petroleum oil exports.
c/ Figures given cover alinvestment income (net). Major payments are interest on foreign loans and charges paid to IMF, and major receipts is interest earned on foreign assets.
d/ Figures given include workers' remittances but exclude official grant assistance which is included within official loans and grants, and non-resident deposits which are shown separately.
e/ Includes exchange rate adjustments to the evaluation of reserves and financing of imbalances in rupee trade.
f/ Excluding gold.
g/ Exclude net use of IMF credit.
h/ Amortization and interest payments on foreign loans as a percentage of total current receipts.

increasing. In effect, a 5.7 per cent growth rate in per capita GDP, which, taking into account an annual population growth rate of 2 per cent, is equal to an annual rate of almost 8 per cent, is obtained with an investment of 24.5 per cent of GDP, so that the capital-output ratio reaches the respectable figure of 3 per cent, regarded as the best level in development literature.

1314. As stated by IMF in its country reports, India's recent success in economic growth has been achieved primarily thanks to an increase in the productivity of the means of production, with a 2.9 per cent a year growth rate. There is no doubt that the level of economic backwardness of this large nation is still high and that there are still large productivity gaps between agriculture and the other productive sectors, despite the progress made in agriculture. Value added per employee in agriculture was $340 in 1981, against $1,261 in industry, a fourfold difference. And the gap was even greater in the service sector. The percentage of India's labour force employed in agriculture was 70 per cent in 1980 and it shrank to 60 per cent in 1990, but the rate is still enormous and shows how India's economy is still largely a subsistence one.

1315. All this must be borne in mind in order to assess the debt problem and the implications of the adjustment process suggested by the international financial institutions. Furthermore, stress must be laid on the very low volume of the revenues of the central Government: only 11 per cent of GDP in 1988-1989 and indeed over the last five years. The rate is even lower if one considers only revenues from direct and indirect taxes of the central Government (only 5 per cent of GDP).

1316. Current public spending by the central Government is 14 per cent of GDP and it has risen in the last five years by almost 1 per cent of GDP. If local governments are also taken into account, total public revenues were slightly higher in 1988-1989 compared with the period 1984-1985/1988-1989, but not all of them were from taxes. Besides, current public expenditure reached 23 per cent in 1988-1989 against 22 per cent in 1984-1989. The current account deficit is now 3.3 per cent against 2.6 per cent in 1984-1989, to which total net capital expenditure must be added, meaning deficit-financing of 6.7 per cent of GDP.

1317. Over all, the public deficit amounts to 10 per cent of GDP. It is reduced to 9 per cent if account is taken of non-grant external aid. This has obviously produced a high level of indebtedness. Besides, capital account spending fell from 7.4 per cent to 6.7 of GDP, which is dangerous because a substantial share of capital account spending is thus taken away from India's budget while it could be used primarily for infrastructure, badly needed in agriculture and industry and in the society at large.

1318. As already mentioned, the way in which the Government solved the problem was by increasingly resorting to the international financial market and by borrowing from bilateral and multilateral public agencies. Concessional lending disbursed by the World Bank and by IDA has already amounted to $12 billion and another $4 billion has been committed but is undisbursed. The total amount of undisbursed loans by bilateral and multilateral official institutions is in the order of $20.6 billion. India's debt, including these amounts, would reach $78 billion, bringing this country to the same level as the most indebted countries in the

world, even though, fortunately, most of that debt is on highly concessional terms. However, the procedures for utilizing such amounts are very slow, primarily because of reported bureaucratic complications in the institutions in India that are responsible for the approval of the projects to which the loans are related. The cautious attitude adopted by the Indian Government in approving the projects is absolutely to be appreciated, since it must be stressed that, unlike grants, loans are in any case a burden for future generations, even when their rate of interest is low and they have a long maturity.

1319. However, the balance of payments and the State budget show a deficit that is financed by using even more burdensome means than the one mentioned, and this requires further measures from India and from the international community.

1320. According to the views expressed in IMF reports, the present Government of India is not showing sufficient determination in adopting the economic adjustment measures that have been suggested and is moving too cautiously because it is perhaps afraid of eroding its support in the electorate but also because it is not convinced of the need for shock therapies. Inflation has been effectively brought under control, unlike in the highly indebted countries of Latin America. Wholesale prices are rising by only 8 per cent a year, which is excellent considering the high GDP growth rate.

1321. The adoption of a gradual adjustment process seems to be a wise choice in the case of India, a country with so many poor that it has to reconcile the requirements of growth with those of financial adjustment. However, a few distinctions have to be made. A line must be drawn between action to curb public expenditure and action to raise public revenues. Thanks to food aid, India has managed to avoid famine, but 50 per cent of its population under the age of five still suffers from malnutrition. For this reason, the issue of reducing food aid has to be tackled with great cautiousness, as the World Bank report on poverty would indicate.

1322. Thanks to spending on education, the Government of India has raised the average level of education of the country's labour force from 0.5 to 2 years compared to 20 to 30 years ago. Ninety-two per cent of the children are now attending primary school, as against 74 per cent some 25 to 30 years ago, while 35 per cent goes to secondary school and 28 per cent receives a technical or higher education. Yet the illiteracy rate is still above 50 per cent, and 70 per cent for females.

1323. Compared to 20 to 30 years ago, life expectancy has grown by 14 years, from 44 to 58; the infant mortality rate has fallen in the same period from 15 to 10 per 1,000 live births, and the mortality rate has decreased from 20 to 10 per 1,000. The number of people per physician has been effectively reduced by half and 75 per cent of the population has access to medical care. Despite the high number of poor, India has achieved such difficult goals and now is no longer a country in desperate conditions. Those social achievements, together with the continuing economic progress reflected in the above-mentioned figures, can allow the people of India to hope for a better future, in a way still barred to many other nations of the world.

1324. Public spending, including spending on civil servants that sometimes solves unemployment problems, can hardly be cut, but public revenues, considering the income gaps inside the country, are unjustifiably low.

1325. Forty per cent of the population belonging to the low- and low-to-middle-income categories produces 16 per cent of the total income, according to estimates of 15 to 20 years ago, which should not be too far from the current situation, while 10 per cent of the population produces 34 per cent and the top 20 per cent produces half of the total income, that is to say, in terms of GDP, $135 billion.

1326. This is a large tax base, from which it should not be too difficult to raise tax revenues. Among other considerations, it must be noted that 30 per cent of central government revenues is made up of taxes on foreign trade and that another 20 per cent is related to the production of goods and services, so that only 50 per cent is made up of direct and indirect taxes. Taxes on profits and incomes amounted to 21 per cent of the total revenues of the central Government in 1972, but they fell to a mere 14 per cent in 1987, while indirect taxes fell from 45 per cent to 35 per cent of the total revenues. Therefore, the Government of India is confronted with the urgent task of increasing the total amount of tax revenues.

1327. Another important aspect of the adjustment process, in an area in which the suggestions made by the international financial institutions can be fully shared and indeed strengthened, relates to the efficiency of public companies and to the constraints imposed on them and on small companies by the existing legislation. On the other hand, if a cautious gradualism on several delicate aspects of the adjustment process related to customs duties and exchange rates can be justified on account of India's need to strengthen the process of developing its infant industries, what cannot be understood is the protectionist attitude against foreign investors, which are still not allowed to possess more than 40 per cent of the capital stock of companies operating in India. If one adds to that the reserve quotas for public companies and small enterprises, it is evident that India tends to reject foreign investments that are clearly needed, instead of attracting them, thus making it more difficult to find a solution to the problem of its external indebtedness.

1328. Nevertheless, more should be done for India by the international community, particularly by writing off interest payments and amortizations related to loans granted to India, in order to convert those funds into local environmental projects, in keeping with the guidelines laid down in the present report and concerning countries with the lowest income levels. It goes without saying that problems will result whenever the debt service is used to finance new loans. But those problems are not insoluble. What is needed under the circumstances is the inflow of new resources in order to restore a flow of new finance to the level that it would have been had the debt service not been recycled back to the debtor country.

1329. Among low-income countries, India shares with China the lowest level of development assistance as a percentage of GDP, with 1988 rates of 0.9 per cent for India and 0.6 per cent for China, while the average for the other poor countries was 6.6 per cent (see table XIX.6). The enormous number of inhabitants of India means that even a very small increase in per capita aid to this country requires a huge rise in the overall figure. However, these figures represent very little for the rich countries compared with their average income levels. The total amount of aid granted to India, slightly more than $2 billion for 815 million people, is equal to 0.015 per cent of the GDP of industrialized countries, which amounted to $13,500 billion in 1988 (see table XIX.6).

Table XIX.5

Official development assistance: receipts

		Net disbursement of ODA from all sources								
		Millions of dollars							Per capita (dollars)	As a percentage of GNP
		1982	1983	1984	1985	1986	1987	1988	1988	1988
Low-income economies		**12,969 t**	**12,443 t**	**12,500 t**	**13,946 t**	**16,853 t**	**18,591 t**	**21,912 t**	**7.6 w**	**2.4 w**
China and India		**2,168 t**	**2,509 t**	**2,471 t**	**2,532 t**	**3,254 t**	**3,300 t**	**4,087 t**	**2.1 w**	**0.6 w**
Other low-income		**10,801 t**	**9,934 t**	**10,029 t**	**11,414 t**	**13,599 t**	**15,291 t**	**17,825 t**	**18.2 w**	**6.6 w**
1	Mozambique	208	211	259	300	422	651	886	59.3	70.6
2	Ethiopia	200	339	364	715	636	634	970	20.5	17.4
3	Chad	65	95	115	182	165	198	264	48.9	28.8
4	Tanzania	684	594	558	487	681	882	978	39.6	31.2
5	Bangladesh	1,341	1,049	1,200	1,152	1,455	1,635	1,592	14.6	8.2
6	Malawi	121	117	158	113	198	280	366	46.0	30.6
7	Somalia	462	343	350	353	511	580	433	73.4	42.9
8	Zaire	348	315	312	325	448	627	580	17.4	9.0
9	Bhutan	11	13	18	24	40	42	42	30.3	14.0
10	Lao PDR	38	30	34	37	48	58	77	19.6	14.4
11	Nepal	200	201	198	236	301	347	399	22.2	13.0
12	Madagascar	242	183	153	188	316	321	305	28.0	16.2
13	Burkina Faso	213	184	189	198	284	281	298	34.9	16.0
14	Mali	210	215	321	380	372	366	427	53.5	22.0
15	Burundi	127	140	141	142	187	202	187	36.5	17.1
16	Uganda	133	137	163	182	198	279	359	22.1	8.4
17	Nigeria	37	48	33	32	59	69	120	1.1	0.4
18	Zambia	317	217	239	328	464	430	478	63.3	12.0
19	Niger	257	175	161	304	307	353	371	51.1	15.5
20	Rwanda	151	150	165	181	211	245	253	38.0	11.0
21	China	524	669	798	940	1,134	1,462	1,990	1.8	0.5
22	India	1,644	1,840	1,673	1,592	2,120	1,839	2,098	2.6	0.8
23	Pakistan	916	735	749	801	970	879	1,408	13.3	3.7
24	Kenya	485	400	411	438	455	572	808	36.0	9.4
25	Togo	77	112	110	114	174	126	199	58.9	14.7
26	Central African Rep.	90	93	114	104	139	176	196	68.4	17.5
27	Haiti	128	134	135	153	175	218	147	23.5	5.9
28	Benin	81	86	77	95	138	138	162	36.3	9.0
29	Ghana	141	110	216	203	371	373	474	33.9	9.1
30	Lesotho	93	108	101	94	88	107	108	64.4	26.3
31	Sri Lanka	416	473	466	484	570	502	599	36.1	8.5
32	Guinea	90	68	123	119	175	213	262	48.5	10.3
33	Yemen, PDR	143	106	103	113	71	74	76	32.3	7.2
34	Indonesia	906	744	673	603	711	1,246	1,632	9.3	2.1
35	Mauritania	187	176	175	209	225	182	184	96.6	18.4
36	Sudan	740	962	622	1,128	945	898	918	38.6	7.8
37	*Afghanistan*	9	14	7	17	2	45	72	. .	. .
38	*Myanmar*	319	302	275	356	416	367	451	11.3	. .
39	*Kampuchea, Dem.*	44	37	17	13	13	14	18	. .	. .
40	*Liberia*	109	118	133	90	97	78	65	26.8	. .
41	*Sierra Leone*	82	66	61	66	87	68	102	26.0	. .
42	*Viet Nam*	136	106	109	114	147	111	148	2.3	. .
Middle-income economies		**10,621 t**	**9,998 t**	**10,352 t**	**10,538 t**	**11,741 t**	**12,851 t**	**11,931 t**	**12.4 w**	**0.7 w**
Lower-middle-income		**9,969 t**	**9,473 t**	**9,869 t**	**9,947 t**	**10,981 t**	**12,000 t**	**11,089 t**	**15.8 w**	**1.0 w**
43	Bolivia	148	174	172	202	322	318	392	56.7	9.1
44	Philippines	333	429	397	486	956	770	854	14.3	2.2
45	Yemen Arab Rep.	412	328	326	283	257	348	223	26.3	3.8
46	Senegal	285	323	368	295	567	641	568	81.2	11.4
47	Zimbabwe	216	208	298	237	225	294	273	29.3	4.3
48	Egypt, Arab Rep.	1,441	1,463	1,794	1,791	1,716	1,773	1,537	30.6	4.3
49	Dominican Rep.	136	100	188	207	93	130	118	17.1	2.5
50	Côte d'Ivoire	137	156	128	125	186	254	439	39.1	4.5
51	Papua New Guinea	311	333	322	259	263	322	379	101.9	10.8
52	Morocco	774	398	352	785	403	447	482	20.1	2.2
53	Honduras	158	190	286	272	283	258	321	66.4	7.3
54	Guatemala	64	76	65	83	135	241	235	27.0	2.9
55	Congo, People's Rep.	93	108	98	71	110	152	89	41.5	4.1
56	El Salvador	218	290	261	345	341	426	420	83.4	7.7
57	Thailand	389	431	475	481	496	504	563	10.3	1.0
58	Botswana	101	104	102	96	102	156	151	127.7	7.8
59	Cameroon	212	129	186	159	224	213	284	25.4	2.2
60	Jamaica	180	181	170	169	178	168	193	80.3	6.0
61	Ecuador	53	64	136	136	147	203	137	13.6	1.3
62	Colombia	97	86	88	62	63	78	61	1.9	0.2
63	Paraguay	85	51	50	50	66	81	76	18.7	1.3
64	Tunisia	210	205	178	163	222	274	316	40.5	3.2
65	Turkey	647	356	242	179	339	376	307	5.7	0.4
66	Peru	188	297	310	316	272	292	272	13.2	1.1
67	Jordan	798	787	687	538	564	579	425	108.8	9.3

Table XIX.5 (continued)

		Net disbursement of ODA from all sources								
		Millions of dollars							Per capita (dollars)	As a percentage of GNP
		1982	1983	1984	1985	1986	1987	1988	1988	1988
68	Chile	−8	0	2	40	−5	21	44	3.4	0.2
69	Syrian Arab Rep.	962	813	641	610	728	684	191	16.4	1.3
70	Costa Rica	80	252	218	280	196	228	187	69.9	4.0
71	Mexico	140	132	83	144	252	155	173	2.1	0.1
72	Mauritius	48	41	36	28	56	65	59	56.4	3.0
73	Poland	. .	. .	. .	. .	. .	. .	. .	. .	. .
74	Malaysia	135	177	327	229	192	363	104	6.1	0.3
75	Panama	41	47	72	69	52	40	22	9.3	. .
76	Brazil	208	101	161	123	178	289	210	1.5	0.1
77	*Angola*	60	75	95	92	131	135	159	16.8	. .
78	*Lebanon*	187	127	77	83	62	101	141	. .	. .
79	*Nicaragua*	121	120	114	102	150	141	213	58.8	. .
	Upper-middle-income	652 *t*	525 *t*	483 *t*	591 *t*	760 *t*	852 *t*	841 *t*	3.3 *w*	0.1 *w*
80	South Africa	. .	. .	. .	. .	. .	. .	. .	. .	. .
81	Algeria	136	95	122	173	165	214	171	7.2	0.3
82	Hungary	. .	. .	. .	. .	. .	. .	. .	. .	. .
83	Uruguay	4	3	4	5	27	18	41	13.4	0.5
84	Argentina	30	48	49	39	88	99	152	4.8	0.2
85	Yugoslavia	−8	3	3	11	19	35	44	1.9	0.1
86	Gabon	62	64	76	61	79	82	106	98.3	3.2
87	Venezuela	13	10	14	11	16	19	18	0.9	0.0
88	Trinidad and Tobago	6	5	5	7	19	34	8	6.8	0.2
89	Korea, Rep. of	34	8	−37	−9	−18	11	10	0.2	0.0
90	Portugal	49	43	97	101	139	64	102	9.9	0.2
91	Greece	12	13	13	11	19	35	35	3.5	0.1
92	Oman	133	71	67	78	84	16	1	0.4	. .
93	Libya	12	6	5	5	11	6	6	1.3	. .
94	*Iran, Islamic Rep.*	3	48	13	16	27	71	82	1.7	. .
95	*Iraq*	6	13	4	26	33	91	10	0.6	. .
96	*Romania*	. .	. .	. .	. .	. .	. .	. .	. .	. .
	Low- and middle-income	23,589 *t*	22,442 *t*	22,852 *t*	24,484 *t*	28,594 *t*	31,442 *t*	33,842 *t*	8.8 *w*	1.3 *w*
	Sub-Saharan Africa	7,496 *t*	7,305 *t*	7,595 *t*	8,616 *t*	10,572 *t*	11,902 *t*	13,416 *t*	28.9 *w*	8.8 *w*
	East Asia	2,989 *t*	3,121 *t*	3,243 *t*	3,262 *t*	4,080 *t*	5,071 *t*	5,985 *t*	3.9 *w*	0.7 *w*
	South Asia	4,852 *t*	4,623 *t*	4,585 *t*	4,655 *t*	5,888 *t*	5,630 *t*	6,616 *t*	6.0 *w*	1.9 *w*
	Europe, M.East, & N.Africa	5,953 *t*	4,930 *t*	4,738 *t*	4,999 *t*	4,867 *t*	5,233 *t*	4,217 *t*	13.3 *w*	1.1 *w*
	Latin America & Caribbean	2,295 *t*	2,460 *t*	2,689 *t*	2,949 *t*	3,181 *t*	3,601 *t*	3,600 *t*	8.7 *w*	0.4 *w*
	Severely indebted	2,757 *t*	2,803 *t*	2,891 *t*	3,430 *t*	4,145 *t*	4,305 *t*	4,590 *t*	10.3 *w*	0.5 *w*
	High-income economies	. .	. .	. .	. .	. .	. .	. .	. .	. .
	OECD members	. .	. .	. .	. .	. .	. .	. .	. .	. .
	†Other	1,477 *t*	2,084 *t*	1,948 *t*	2,553 *t*	2,711 *t*	2,124 *t*	1,993 *t*	62.5 *w*	0.5 *w*
97	†Saudi Arabia	57	44	36	29	31	22	19	1.5	0.0
98	Spain									
99	Ireland									
100	†Israel	857	1,345	1,256	1,978	1,937	1,251	1,241	279.3	2.8
101	†Singapore	20	15	41	24	29	23	22	8.2	0.1
102	†Hong Kong	8	9	14	20	18	19	22	3.9	0.0
103	New Zealand									
104	Australia									
105	United Kingdom									
106	Italy									
107	†Kuwait	6	5	4	4	5	3	6	3.0	0.0
108	Belgium									
109	Netherlands									
110	Austria									
111	†United Arab Emirates	5	4	3	4	34	115	−12	−8.0	−0.1
112	France									
113	Canada									
114	Denmark									
115	Germany, Fed. Rep.									
116	Finland									
117	Sweden									
118	United States									
119	Norway									
120	Japan									
121	Switzerland									
	Total reporting economies	25,067 *t*	24,525 *t*	24,800 *t*	27,037 *t*	31,304 *t*	33,566 *t*	35,836 *t*	9.2 *w*	1.2 *w*
	Oil exporters	4,376 *t*	4,884 *t*	4,192 *t*	4,836 *t*	4,556 *t*	5,176 *t*	4,580 *t*	7.8 *w*	0.7 *w*
	Nonreporting nonmembers	16 *t*	13 *t*	12 *t*	24 *t*	33 *t*	46 *t*	42 *t*	1.3 *w*	. .

Source: World Bank, Poverty, World Development Report, World Development Indicators, 1990, including technical notes.

Table XIX.6

Official development assistance from OECD & OPEC members

		Amount									
		1965	1970	1975	1980	1984	1985	1986	1987	1988	1989[a]
OECD		Millions of U.S. dollars									
99	Ireland	0	0	8	30	35	39	62	51	57	47
103	New Zealand	..	14	66	72	55	54	75	87	104	87
104	Australia	119	212	552	667	777	749	752	627	1,101	1,017
105	United Kingdom	472	500	904	1,854	1,429	1,530	1,737	1,871	2,645	2,588
106	Italy	60	147	182	683	1,133	1,098	2,404	2,615	3,193	..
108	Belgium	102	120	378	595	446	440	547	687	597	..
109	Netherlands	70	196	608	1,630	1,268	1,136	1,740	2,094	2,231	2,089
110	Austria	10	11	79	178	181	248	198	201	301	279
112	France	752	971	2,093	4,162	3,788	3,995	5,105	6,525	6,865	..
113	Canada	96	337	880	1,075	1,625	1,631	1,695	1,885	2,347	..
114	Denmark	13	59	205	481	449	440	695	859	922	926
115	Germany, Fed. Rep.	456	599	1,689	3,567	2,782	2,942	3,832	4,391	4,731	4,953
116	Finland	2	7	48	110	178	211	313	433	608	705
117	Sweden	38	117	566	962	741	840	1,090	1,375	1,590	1,813
118	United States	4,023	3,153	4,161	7,138	8,711	9,403	9,564	9,115	10,141	..
119	Norway	11	37	184	486	540	574	798	890	985	919
120	Japan	244	458	1,148	3,353	4,319	3,797	5,634	7,342	9,134	..
121	Switzerland	12	30	104	253	285	302	422	547	617	559
	Total	6,480	6,968	13,855	27,296	28,742	29,429	36,663	41,595	48,167	..
OECD		As a percentage of donor GNP									
99	Ireland	0.00	0.00	0.09	0.16	0.22	0.24	0.28	0.19	0.20	0.17
103	New Zealand	..	0.23	0.52	0.33	0.25	0.25	0.30	0.26	0.27	0.22
104	Australia	0.53	0.59	0.65	0.48	0.45	0.48	0.47	0.34	0.46	0.37
105	United Kingdom	0.47	0.41	0.39	0.35	0.33	0.33	0.31	0.28	0.32	0.31
106	Italy	0.10	0.16	0.11	0.15	0.28	0.26	0.40	0.35	0.39	..
108	Belgium	0.60	0.46	0.59	0.50	0.58	0.55	0.48	0.48	0.40	..
109	Netherlands	0.36	0.61	0.75	0.97	1.02	0.91	1.01	0.98	0.98	0.93
110	Austria	0.11	0.07	0.21	0.23	0.28	0.38	0.21	0.17	0.24	0.22
112	France	0.76	0.66	0.62	0.63	0.77	0.78	0.70	0.74	0.72	..
113	Canada	0.19	0.41	0.54	0.43	0.50	0.49	0.48	0.47	0.50	..
114	Denmark	0.13	0.38	0.58	0.74	0.85	0.80	0.89	0.88	0.89	0.93
115	Germany, Fed. Rep.	0.40	0.32	0.40	0.44	0.45	0.47	0.43	0.39	0.39	0.41
116	Finland	0.02	0.06	0.18	0.22	0.35	0.40	0.45	0.49	0.59	0.63
117	Sweden	0.19	0.38	0.82	0.78	0.80	0.86	0.85	0.88	0.89	0.98
118	United States	0.58	0.32	0.27	0.27	0.24	0.24	0.23	0.20	0.21	..
119	Norway	0.16	0.32	0.66	0.87	1.03	1.01	1.17	1.09	1.10	1.02
120	Japan	0.27	0.23	0.23	0.32	0.34	0.29	0.29	0.31	0.32	..
121	Switzerland	0.09	0.15	0.19	0.24	0.30	0.31	0.30	0.31	0.32	0.30
OECD		National currencies									
99	Ireland (millions of pounds)	0	0	4	15	32	37	46	34	37	35
103	New Zealand (millions of dollars)	..	13	55	74	95	109	143	146	158	145
104	Australia (millions of dollars)	106	189	402	591	873	966	1,121	895	1,404	1,283
105	United Kingdom (millions of pounds)	169	208	409	798	1,070	1,180	1,194	1,142	1,485	1,578
106	Italy (billions of lire)	38	92	119	585	1,991	2,097	3,578	3,389	4,156	..
108	Belgium (millions of francs)	5,100	6,000	13,902	17,399	25,527	26,145	24,525	25,648	21,949	..
109	Netherlands (millions of guilders)	253	710	1,538	3,241	4,069	3,773	4,263	4,242	4,400	4,430
110	Austria (millions of schillings)	260	286	1,376	2,303	3,622	5,132	3,023	2,541	3,717	3,691
112	France (millions of francs)	3,713	5,393	8,971	17,589	33,107	35,894	35,357	39,218	40,814	..
113	Canada (millions of dollars)	104	353	895	1,257	2,104	2,227	2,354	2,500	2,888	..
114	Denmark (millions of kroner)	90	443	1,178	2,711	4,650	4,657	5,623	5,848	6,196	6,769
115	Germany, Fed. Rep. (millions of deutsche marks)	1,824	2,192	4,155	6,484	7,917	8,661	8,323	8,004	8,292	9,318
116	Finland (millions of markkaa)	6	29	177	414	1,070	1,308	1,587	1,902	2,550	3,025
117	Sweden (millions of kronor)	197	605	2,350	4,069	6,129	7,226	7,765	8,718	9,742	11,688
118	United States (millions of dollars)	4,023	3,153	4,161	7,138	8,711	9,403	9,564	9,115	10,141	..
119	Norway (millions of kroner)	79	264	962	2,400	4,407	4,946	5,901	5,998	6,412	6,345
120	Japan (billions of yen)	88	165	341	760	1,026	749	950	1,062	1,169	..
121	Switzerland (millions of francs)	52	131	268	424	672	743	759	815	900	914
OECD		Summary									
	ODA (billions of U.S. dollars, nominal prices)	6.48	6.97	13.86	27.30	28.74	29.43	36.66	41.59	48.17	..
	ODA as a percentage of GNP	0.48	0.34	0.35	0.37	0.36	0.35	0.35	0.35	0.36	..
	ODA (billions of U.S. dollars, constant 1980 prices)	20.68	18.83	21.85	27.30	28.74	29.14	30.55	30.81	33.22	..
	GNP (trillions of U.S. dollars, nominal prices)	1.35	2.04	3.96	7.39	8.03	8.49	10.39	12.05	13.48	..
	GDP deflator[b]	0.31	0.37	0.63	1.00	1.00	1.01	1.20	1.35	1.45	1.44

Table XIX.6 (continued)

		Amount									
		1976	1979	1980	1982	1983	1984	1985	1986	1987	1988
OPEC		Millions of U.S. dollars									
17	Nigeria	80	29	35	58	35	51	45	52	30	14
81	Algeria	11	281	81	129	37	52	54	114	39	13
87	Venezuela	109	110	135	125	142	90	32	85	24	49
93	Libya	98	145	376	44	144	24	57	68	63	129
94	Iran, Islamic Rep.	751	−20	−72	−193	10	52	−72	69	−10	39
95	Iraq	123	658	864	52	−10	−22	−32	−21	−37	−28
97	Saudi Arabia	2,791	3,941	5,682	3,854	3,259	3,194	2,630	3,517	2,888	2,098
107	Kuwait	706	971	1,140	1,161	997	1,020	771	715	316	108
111	United Arab Emirates	1,028	968	1,118	406	351	88	122	87	15	−17
	Qatar	180	282	277	139	20	10	8	18	0	4
	Total OAPEC	4,937	7,246	9,538	5,785	4,798	4,366	3,610	4,498	3,284	2,307
	Total OPEC	5,877	7,365	9,636	5,775	4,985	4,559	3,615	4,704	3,328	2,409
OPEC		As a percentage of donor GNP									
17	Nigeria	0.19	0.04	0.04	0.08	0.04	0.06	0.06	0.11	0.13	0.03
81	Algeria	0.07	0.90	0.20	0.31	0.08	0.10	0.10	0.19	0.06	0.02
87	Venezuela	0.35	0.23	0.23	0.19	0.22	0.16	0.00	0.08	0.02	0.04
93	Libya	0.66	0.60	1.16	0.15	0.51	0.10	0.24	0.34	0.25	0.52
94	Iran, Islamic Rep.	1.16	−0.02	−0.08	−0.15	0.01	0.03	−0.04	0.04	−0.01	0.02
95	Iraq	0.76	1.97	2.36	0.13	−0.02	−0.05	−0.07	−0.05	−0.08	−0.05
97	Saudi Arabia	5.95	5.16	4.87	2.50	2.69	3.20	2.98	4.67	3.88	2.70
107	Kuwait	4.82	3.52	3.52	4.34	3.83	3.95	3.17	2.91	1.23	0.41
111	United Arab Emirates	8.95	5.08	4.21	1.39	1.26	0.32	0.45	0.41	0.07	−0.07
	Qatar	7.35	6.07	4.16	2.22	0.40	0.18	0.15	0.47	0.00	0.08
	Total OAPEC	4.23	3.31	3.22	1.81	1.70	1.60	1.39	1.80	1.10	0.86
	Total OPEC	2.32	1.75	1.85	0.96	0.82	0.76	0.61	0.95	0.63	0.45

		Net bilateral flows to low-income economies									
		1965	1970	1975	1980	1983	1984	1985	1986	1987	1988
OECD		As a percentage of donor GNP									
99	Ireland	..	..	..	..	0.03	0.03	0.05	0.06	0.07	−0.07
103	New Zealand	..	..	0.14	0.01	0.00	0.00	0.00	0.00	0.06	0.03
104	Australia	0.08	0.09	0.10	0.04	0.05	0.06	0.05	0.04	0.05	0.11
105	United Kingdom	0.23	0.15	0.11	0.11	0.10	0.09	0.09	0.09	0.09	0.10
106	Italy	0.04	0.06	0.01	0.01	0.05	0.09	0.12	0.16	0.16	0.16
108	Belgium	0.56	0.30	0.31	0.24	0.21	0.20	0.23	0.20	0.14	0.10
109	Netherlands	0.08	0.24	0.24	0.30	0.26	0.29	0.27	0.32	0.31	0.31
110	Austria	0.06	0.05	0.02	0.03	0.02	0.01	0.02	0.01	0.04	−0.04
112	France	0.12	0.09	0.10	0.08	0.09	0.14	0.14	0.13	0.14	0.14
113	Canada	0.10	0.22	0.24	0.11	0.13	0.15	0.15	0.12	0.14	0.14
114	Denmark	0.02	0.10	0.20	0.28	0.31	0.28	0.32	0.32	0.32	0.36
115	Germany, Fed. Rep.	0.14	0.10	0.12	0.08	0.13	0.11	0.14	0.12	0.11	0.11
116	Finland	..	..	0.06	0.08	0.12	0.13	0.17	0.18	0.18	0.23
117	Sweden	0.07	0.12	0.41	0.36	0.33	0.30	0.31	0.38	0.29	0.31
118	United States	0.26	0.14	0.08	0.03	0.03	0.03	0.04	0.03	0.03	0.04
119	Norway	0.04	0.12	0.25	0.31	0.39	0.34	0.40	0.47	0.38	0.42
120	Japan	0.13	0.11	0.08	0.08	0.09	0.07	0.09	0.10	0.07	0.07
121	Switzerland	0.02	0.05	0.10	0.08	0.10	0.12	0.12	0.12	0.10	0.10
	Total	0.20	0.13	0.11	0.07	0.08	0.07	0.09	0.09	0.09	0.09

a. Preliminary estimates. b. See the technical notes.

Bangladesh

1330. With its 110 million inhabitants, Bangladesh is among the poorest countries in the world. It had a per capita GDP of $170 in 1988. Half of its population lived in conditions of extreme poverty in the early 1980s. In other words, they were unable to get enough food to lead a reasonably active life. 5/ Some progress has been made subsequently, through food-for-work programmes and group development programmes and by increasing real wages in agriculture, which have reached their pre-independence level. However, the slight decline in the percentage figures of the extremely poor during 1981-1986 has not been sufficient to curb the increase in absolute numbers owing to a high rate of population growth: between 2.4 per cent and 2.7 per cent. Moreover, in 1988 Bangladesh was struck first by catastrophic floods, which are unfortunately rather frequent, and then by a cyclone that devastated its already poor economy and increased the number of inhabitants who live in conditions of extreme poverty.

1331. The growth rate of the economy fell to 2.7 per cent in 1988 and to 2.4 per cent in 1989, after a 1981-1987 average of 4 per cent (see table XIX.8). This meant a zero level of per capita growth. In the next few years, with the support of the industrialized countries, Bangladesh is expected to experience a growth rate of about 5 per cent which, with a population growth rate of 2.4 per cent, means an average annual increase of 2.5 per cent. This would represent substantial progress, taking into account the very low starting level and the conditions of extreme poverty in which almost half of its population is still living. Development assistance is about 8 per cent of GDP, and it is only thanks to it that the poor economy of Bangladesh can barely find the means to develop.

1332. Exports account for only 6 per cent of GDP, and imports account for 16 per cent. But the process of export growth and diversification of the traditional agricultural commodities like jute is considerable, although it has been slowed down by the floods. Furthermore, half of the low income of Bangladesh is still produced in the agricultural sector, where one third of the population is active. Agriculture has not been able to absorb fully the rapidly growing labour force or generate adequate foreign exchange earnings. There is growth in industry, which accounts for 14 per cent of GDP, and expansion in labour-intensive exports is important for achieving employment and balance-of-payments objectives. However, the lack of skill and education and the poor health of the labour force of Bangladesh impede this transition. The adult literacy rate is only about 29 per cent and per capita public expenditure on education is among the lowest in the world. 4/ On the other hand, it must also be noted that public revenues only account for 9 per cent of GDP, while public expenditures reach 16 per cent, thanks to external grants.

Table XIX.7 Bangladesh: economic indicators a/

	1988	1989	Estimate 1990	Projections 1991	1992	1993
GDP growth rate b/	2.7	2.4	5.5	4.6	4.7	4.8
GDP deflator b/	7.6	7.9	8.5	7.0	6.5	6.0
Consumer prices	11.4	8.0	9.0	7.5	6.5	6.0
GDP per capita (growth rate)	0.2	..	3.1	2.2	2.3	2.4
Gross fixed investment/GDP b/	11.8	11.0	10.8	11.9	13.2	14.1
Domestic savings/GDP	2.5	0.7	1.5	2.8	4.2	5.4
National savings/GDP	5.9	4.1	4.3	5.6	7.0	8.0
Public fixed investment/GDP b/c/	5.3	5.0	4.6	5.0	5.5	6.0
Public national savings/GDP c/	-0.4	..	-0.6	0.3	1.3	1.9
Private fixed investment/GDP b/	6.4	6.0	6.2	6.9	7.6	8.1
Private national savings/GDP	6.3	4.1	4.9	5.3	5.7	6.1
Government revenue/GDP	8.9	9.1	9.3	9.8	10.3	10.8
Government expenditure/GDP	16.7	16.3	16.4	16.4	16.8	17.4
Deficit (-)/GDP	-7.7	-7.2	-7.1	-6.7	-6.5	-6.6
Domestic bank financing/GDP	-0.1	-0.7	1.1	0.3	0.3	0.3
Domestic credit growth rate	13.4	13.4	20.3	15.4	13.0	12.0
Broad money growth rate	18.3	16.3	17.0	16.4	14.6	14.3
Export growth rate	14.7	4.4	16.6	11.3	12.2	13.6
Non-traditional export growth rate	26.8	7.4	16.2	16.7	16.0	21.3
Exports/GDP	6.5	6.3	6.6	6.8	7.3	7.5
Non-traditional exports/GDP	4.3	4.3	4.4	5.0	5.3	5.8
Import growth rate	14.0	13.0	6.2	6.0	9.3	9.9
Imports/GDP	15.7	16.5	15.7	16.1	16.1	16.2
Current account (millions $US)	-1,111	-1,402	-1,477	-1,478	-1,609	-1,733
Current account/GDP	-5.8	-6.9	-6.5	-6.3	-6.2	-6.1
Aid disbursements (millions $US)	1,640	1,669	1,600	1,730	1,938	2,127
Aid disbursements/GDP	8.6	8.2	7.0	7.3	7.5	7.5
Debt service (millions $US)	523	528	640	668	600	598
Debt service ratio d/	22.5	21.0	23.6	22.7	18.7	16.8
Debt service/GDP	2.8	2.6	2.8	2.8	2.3	2.1
Real effective exchange rate e/	100.4	111.8	..	..	..	..
Gross reserves (months of imports)	3.6	3.4	1.9	2.0	2.2	2.6

Source: Data provided by the Bangladesh authorities; and IMF and World Bank staff projections. IDA Report and recommendations of the President and the Executive Directors on a proposed financial sector adjustment credit to the Peoples Republic of Bangladesh, 1990.

a/ Data are for fiscal years ending 30 June.
b/ Official national accounts are being reviewed. Present data (based on the 1984/85 series) understate private investment in industry, construction and transport sectors.
c/ Owing to data limitations, operating surpluses and deficits of public enterprises are included in private savings, while a portion of public enterprises' investments (that channelled through the ADP) is included in public sector investment.
d/ Debt service as a percentage of receipts from exports of goods, services and private transfers.
e/ Index for the end of period.

1333. Public investments can thus be up to 5 per cent of GDP, while private investments account for 6 per cent, egual to the level of national savings, of which two thirds come from the remittances of migrant workers. The inflation rate is under control, at about 10 per cent of GDP. But the level of external debt has been constantly rising. It has now reached $10 billion, a rather preoccupying level if compared to the GDP of Bangladesh, which amounted to about $20 billion in 1988-1989 (see table XIX.8). The external debt is almost entirely with public institutions. Half of it is multilateral and half bilateral. Fortunately, interest rates are highly concessional. On average, they account for less than 2 per cent of the face value of loans, owing to the predominant share of IDA loans among multilateral loans (one third of the total long-term debt). But the reimbursement burden is beginning to be felt: it was $300 million in 1988. Debt service is equal to 24 per cent of export earnings, including the remittances of migrant workers.

1334. The proposal to forgive the debt service of poor countries' debts to Governments and to transform it into local projects for the development of human resources, for the environment and for development must find a special application in the case of Bangladesh, whose indicators of extreme poverty must attract the attention of the rich countries, now more than ever. The problem of periodic floods that are so responsible for the conditions of extreme poverty is now being studied by scientific institutions. It would also be of great significance if environmental protection projects were launched in parallel with those studies. In addition, the debt service could be converted into food-for-work projects connected with the pressing need for infrastructure and also into education projects aimed at raising the literacy rate of the population and hence at improving its work skills and employment prospects.

1335. Unquestionably, there are problems that Bangladesh itself must face with determination, since each must do his part. Bangladesh has already demonstrated a firm commitment to projects aimed at reducing trade barriers and raising the efficiency of public companies. But more has to be done in order to create favourable conditions for entrepreneurs to invest and to reduce the bureaucratic inefficiencies that hamper the implementation of infrastructure investments. Bangladesh does not plan to carry out debt restructuring schemes because, for all its scant resources, it has managed to keep its house in order so far. But this is not a good reason for penalizing Bangladesh in the context of debt alleviation and development programmes.

Table XIX.8 Bangladesh: external debt
(In millions of dollars)

	1980	1985	1987	1988
Debt stock	4 035	6 535	9 718	10 219
Multilateral long-term	1 230	2 801	4 174	4 579
Bilateral long-term	2 110	2 931	4 405	4 561
Long-term total	3 398	5 880	8 804	9 330
Public and guaranteed public debt	3 398	5 880	8 804	9 330
Commercial banks	0	2	2	1
Other private lenders	58	145	222	193
Obligations	0	0	0	0
Loan disbursements	885	693	1 314	1 030
Debt reimbursements	122	201	380	306
Interest payments	75	136	184	178
Total debt service	197	338	565	484
Debt percentage on debt	1.85	2.08	1.89	1.74
Gross domestic product	12 806	15 945	17 482	19 200
Exports	1 174	1 584	1 953	2 070
Current account in balance of payments	-844	-614	-309	-359
Debt-to-exports ratio	343.7	412.6	497.6	492.0
Debt-to-GDP ratio	31.5	41.0	55.6	53.0
Debt service-to-exports ratio	16.8	21.3	28.9	23.3
Interests-to-export ratio	6.4	8.6	9.4	8.6
Interests-to-GDP ratio	0.6	0.9	1.1	0.9

Source: World Bank, World Debt Tables, 1989-1990.

1336. In addition to the above-mentioned policies related to bilateral debts, which essentially call for an increase in development assistance on the part of the rich countries in the form of grants, it is necessary to step up the element of conditionality in new development assistance and to maintain policies of direct food aid. The corresponding policies followed by Bangladesh bear witness to the feasibility of managing them without depriving the agricultural sector of incentives. As already mentioned, infrastructure in the poorest countries cannot be financed at market rates, or with a moderate level of concessionality. In the case of social infrastructure, the share of grants should reach almost 100 per cent, while it should be around 90 per cent in the case of economic infrastructures, when they are not a direct source of income. Otherwise, with a rising debt level, the growth of market investments is hampered. And this holds particularly true for those countries where savings are highly mobile, since the latter largely consist of remittances of migrant workers and export earnings from the modern sector. Credit must be given to the international community, and especially to multilateral organizations, for all the efforts they have been making on behalf of Bangladesh. Their commitment has to be maintained and strengthened.

Sri Lanka

1337. Sri Lanka has 16 million inhabitants, each with an income of $420. It is a poor country, but not an extremely poor one, although it has been devastated by a civil war that has left part of the population alarmingly poor. Moreover, the result of those events and of their impact on the working conditions of the population was also that Sri Lanka's external debt reached astonishing levels in the course of few years: $5.2 billion in 1988, with a GDP of about $7 billion and a debt service of about 2 per cent of the total exports (see table XIX.9). In 1989, the external debt further grew to $5.5 billion, while 1990 estimates are close to $6 billion. The average GDP growth in 1987-1989 was about 2 per cent. Consequently, with a similar trend Sri Lanka's external debt would become about 80 per cent of GDP. The population growth rate is considerably slower than in other poor countries of Asia and in developing countries in general: it was about 1.5 per cent in recent years and it is now about 1 per cent. Therefore, even in the worse years for Sri Lanka's economy, i.e. those of the civil war, per capita GDP actually grew somewhat. But the growth potential of Sri Lanka is greater. A rate of 4 per cent is considered feasible because the share of investments compared to GDP is very high (around 23 per cent) and the industrial sector, which now accounts for a GDP share similar to that of agriculture (23 per cent), has a higher rate of growth.

1338. Sri Lanka's indebtedness essentially derives from its public deficit. In 1988 central Government revenues were less than 20 per cent of GDP, while public spending exceeded 30 per cent. This means a deficit of 13 per cent of GDP, which leads to a trade deficit equal to 10 per cent of GDP. The therapy suggested to Sri Lanka by international institutions, rightly concerned because of the existing imbalances in this country's public finance, largely consisted in cuts in the programmes aimed at eliminating poverty, reducing subsidies for fertilizers and supporting the price of wheat. At the same time, the Government committed itself to reducing the number of civil servants, privatizing some public companies, creating more opportunities for private enterprises and liberalizing foreign trade.

Table XIX.9 Sri Lanka: external debt
(In millions of United States dollars)

	1980	1985	1987	1988
Debt stock	1 841	3 538	4 732	5 189
Multilateral long-term	216	694	1 051	1 139
Bilateral long-term	872	1 472	2 295	2 383
Long-term total	1 230	2 935	4 182	4 253
Public and guaranteed public debt	1 227	2 836	4 066	4 139
Commercial banks	57	379	333	267
Other private lenders	83	291	387	350
Obligations	0	0	0	0
Loan disbursements	344	463	481	912
Debt reimbursements	94	164	321	315
Interest payments	85	156	175	169
Total debt service	179	143	-14	428
Debt percentage on debt	4.61	4.40	3.69	3.25
Gross domestic product	3 998	5 953	6 653	6 909
Exports	1 492	1 937	2 139	2 232
Current account in balance of payments	-655	-414	-327	-40
Debt-to-exports ratio (per cent)	123.4	182.7	221.2	232.0
Debt-to-GDP ratio (per cent)	46.1	59.4	71.1	75.1
Debt service-to-exports ratio (per cent)	12.0	16.5	23.2	21.3
Interests-to-export ratio (per cent)	5.7	8.0	8.2	7.6
Interests-to-GDP ratio (per cent)	2.1	2.6	2.6	2.4

Source: World Bank, World Debt Tables, 1989-1990.

This translated into larger imports, owing to the monetary policies adopted, and led to a further devaluation of the rupee, thus encouraging exports. These conditions will obtain until a higher inflation rate sets in (8 per cent in 1986 and 15 per cent in 1989). Cutting down the poverty programmes as a means to solve financial imbalances can only give rise to considerable uncertainty, since such a measure should be the last one to be adopted and not the first, although it is surely the easiest to be taken, since the voice of the poor is normally rather feeble. Consideration also has to be given to the problem of hidden capital flight that takes place as a result of inflated figures on the bills of lading for imported goods.

1339. Sri Lanka's external debt is largely made of multilateral debt, and particularly bilateral debt (over half than the long- and medium-term debt in 1988). It is fortunately at highly concessional terms, with an average interest rate slightly higher than 3 per cent. But the debt service has now reached $500 million, with exports rising at a slower rate than imports and with remittances from abroad on the wane. Against a similar background, it is easy to understand the suggestion of the World Bank, calling on donors to support the balance of payments of Sri Lanka instead of committing themselves to individual projects. Yet, this policy must be supported by economic and social considerations concerning the relationship between finance and development. Grants connected with the balance of payments support should consist mainly of food for work, in order to fight poverty and to accelerate growth.

1340. Sri Lanka's greatest problem, in connection with the inflow of private funds for investments (such as the remittances of migrant workers), lies in the adoption of a peace policy, based on forms of federal or federated government that allow the peaceful coexistence of people of different origins. This is a big problem of regional policy, which requires action at the international level and which cannot be solved by simply adopting the initiatives proposed by the international financial institutions. Donor support for Sri Lanka in its economic efforts may be meaningless in the absence of a full understanding of the need for international leadership in the establishment of a regional order, based on one side on new forms of integration and on the other on new forms of autonomy.

Myanmar

1341. Myanmar is among the poorest countries in the world, with a per capita GDP of $256 (see table XIX.10). This fact is neglected in international statistics because this country, out of political choice, does not provide data to the World Bank and to the other international official institutions responsible for co-operation and development. Its economy is semi-collectivistic, centrally planned and rigidly regulated, with a public sector that produces 40 per cent of GDP and 80 per cent of the non-agricultural GDP. 6/ The public sector has a monopoly over energy production, mining, telecommunications, banks and large industries. Moreover, it controls foreign trade. Myanmar's external debt, which was $2.2 billion in 1983-1984, almost doubled in 1988-1989, to $4.2 billion. By including undisbursed loans, the total figure is in excess of $5 billion, against a GDP of about $10 billion. Amortization arrears have also accumulated ($200 million), as well interest arrears ($100 million) (see table XIX.11).

Table XIX.10 Myanmar: Basic data, 1983/84 - 1988/89

	1983/ 1984	1984/ 1985	1985/ 1986	1986/ 1987	1987/ 1988	1988/ 1989 Prov.
	(Annual percentage change) a/					
Output and prices						
GDP at constant market prices	4.7	4.9	2.9	-1.1	-1.1	-8.3
Consumer prices b/	5.7	5.3	6.3	14.7	22.0	22.6
Consolidated public sector finances						
Total receipts	2.1	-1.6	7.5	8.5	-12.1	-15.0
Excluding grants	4.5	-1.4	5.6	9.3	-12.8	-14.6
Total expenditure	-3.4	2.9	6.3	0.4	3.6	8.5
Current expenditure c/	8.3	14.6	12.1	2.2	8.3	19.0
Capital expenditure d/	-12.8	-8.6	-1.0	-2.0	-3.2	-8.7
Money and credit						
Domestic credit	13.8	16.7	15.9	12.8	11.5	18.9
Public sector, net	15.1	17.8	16.1	10.4	15.4	20.0
Private sector	2.1	4.4	13.6	41.5	-25.6	3.4
Broad money	16.2	14.7	2.1e/	30.3	-25.8e/	32.4
External sector						
Exports (mainly f.o.b.)	10.2	-12.2	-7.2	-6.9	-17.1	-11.3
Of which: Rice and rice products	18.2	-28.3	-41.4	-1.9	-35.9	-80.8
Imports (mainly f.o.b.)	-31.0	-6.9	3.5	-8.9	-1.5	2.7
Export volume	12.8	-11.0	1.1	-1.1	-7.9	21.5
Import volume	-29.2	-2.3	-2.9	-20.6	-12.3	-5.1
Export unit value	-2.3	-1.3	-8.4	-5.8	-10.0	13.1
Import unit value	-2.6	-4.8	6.6	14.8	12.4	8.1
Terms of trade	0.3	3.7	-14.0	-18.0	-19.9	4.7
Overall balance						
(In millions of U.S. dollars)	20	-56	-57	30	-29	-151
Gross official reserves f/						
(In millions of U.S. dollars)	117	57	58	47	80	118
(In months of merchandise imports)	(2.3)	(1.2)	(1.1)	(1.0)	(1.7)	(2.7)
Exchange rate indices,						
trade-weighted f/ (depreciation -)						
Nominal effective rate	1.6	8.0	-4.2	1.6	0.5	3.0
Real effective rate	4.3	9.2	-1.9	25.5	0.7	28.7

Source: Data provided by the Myanmar authorities to IMF and IMF estimates.

a/ Unless otherwise specified.

b/ The Yangon consumer price index (period averages).

c/ Includes unallocated component of total expenditure.

d/ Includes credit to cooperatives.

e/ During both these years major demonetizations occurred.

f/ End of period.

Table XIX.10 Continued

Myanmar: Basic data, 1983/84 - 1988/89

	1983/ 1984	1984/ 1985	1985/ 1986	1986/ 1987	1987/ 1988	1988/ 1989 Prov.
	(In percent of GDP) a/					
Investment and savings						
Gross fixed investment	18.0	15.1	15.5	12.7	11.0	14.8
Gross national savings	14.3	11.5	11.3	9.6	8.8	11.3
Consolidated public sector budget						
Total receipts	19.8	18.1	18.6	19.1	15.0	13.1
Of which: Tax revenue	9.2	8.6	8.3	7.4	6.6	5.3
Total expenditure	27.2	26.0	26.4	25.2	23.2	25.9
Overall balance (commitment basis)	-7.4	-7.9	-7.8	-6.0	-8.2	-12.8
Overall balance (cash basis)	-7.4	-7.9	-7.8	-6.0	-7.9	-12.1
Excluding grants	-8.5	-8.9	-9.1	-7.2	-9.0	-12.9
Domestic bank financing	4.8	6.0	6.1	4.4	6.4	9.8
Foreign financing, net	2.7	1.9	1.7	1.7	1.6	2.3
External sector						
Current account balance	-3.7	-3.6	-4.3	-3.1	-3.0	-3.5
	(In millions of U.S. dollars) a/					
External debt						
Medium- and long-term debt	2,224	2,244	2,936	3,650	4,265	4,298
Use of Fund credit	88	74	67	41	10	--
Total debt	2,312	2,318	3,005	3,691	4,275	4,298
(In percent of GDP)	(37.1)	(37.2)	(40.1)	(41.3)	(39.4)	(44.0)
Debt service obligations	162	164	205	257	301	319
(In percent of current receipts, including private remittances)	(34.4)	(38.4)	(52.5)	(69.4)	(88.2)	(95.0)

Source: Data provided by the Myanmar authorities to IMF and IMF estimates.

a/ Unless otherwise specified.

Table III.10 continued

Myanmar: Basic data, 1983/84 - 1988/89

Area:	676,540 sq. km
Population (1988/89)	39.4 mn. (2 percent annual growth)
Density (1988/89)	58.2 per sq. km.
GDP (1988/89)	$ 10,077 mn. (K 64,465 mn.)
Per capita GDP (1988/89)	$ 256 (K 1,636

Table XIX.11 Myanmar: external medium- and long-term public debt, and debt service payments, 1983-84 - 1988-89 a/
(In millions of United States dollars)

	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988/1989
Total debt outstanding (end of period)	2 312	2 318	3 005	3 691	4 275	4 298
Fund credit	88	74	67	41	10	
Other credit b/	2 224	2 243	2 939	3 650	4 265	4 224
Concessional loans	1 830	1 901	2 588	3 307	3 893	3 913
Bilateral	1 263	1 234	1 852	2 466	2 968	2 925
Multilateral	567	666	736	841	925	988
Nonconcessional loans	395	343	351	343	372	311
Suppliers' credits	162	147	152	143	147	122
Financial institutions	233	196	199	200	225	189
Arrears on interest payments						74
Net disbursements (cash basis) c/	244	207	181	218	229	209
Concessional loans	230	220	238	275	229	240
Bilateral	160	112	189	196	159	153
Multilateral	70	108	49	79	70	87
Nonconcessional loans	14	-13	-57	-57		-31
Suppliers' credits	7	-3	-20	-27	-7	-18
Financial institutions	7	-10	-37	-30	7	-13
Debt service payments (cash basis)	170	175	222	289	220	131
Concessional loans	60	70	95	139	123	72
Bilateral	51	55	74	110	92	43
Multilateral	9	15	21	29	31	29
Nonconcessional loans	93	92	104	110	59	45
Suppliers' credits	40	40	46	51	24	22
Financial institutions	53	52	58	59	35	23
Fund Credit	17	13	23	40	37	14
Memorandum items:						
Arrears on payments (flow)						
On principal					63	131
On interest					32	77
Outstanding debt/GDP (per cent)	0.37	0.37	0.40	0.41	0.39	0.44
Outstanding debt/exports of goods and services (per cent)	5.1	5.7	7.8	10.1	13.7	15.5

Source: Data provided by the Myanmar authorities to IMF and World Bank Debt.

a/ Data on debt service payments (cash basis) differ from those implied by commitments and arrears data.

b/ Including Trust Fund loans and arrears on principal repayments.

c/ Excluding Fund Credit.

1342. Most of the external debt is fortunately bilateral and concessional, with Japan being by far the largest creditor. But, given the small level of exports, Myanmar is now unable to pay. The financial adjustment of this country is a problem that can be ascribed to the transition from a collectivistic system to a market system, made worse by underdevelopment and an isolated economy. Myanmar's exports of goods and services account for 3.5 per cent of GDP, while imports are around 5.5 per cent.

1343. Until recently, farmers were obliged to hand over their harvests to the Government, which then exported part of them. The recent partial liberalization of exports has been a failure because prices were not remunerative and because tools and equipment for farmers are almost impossible to find on the market. Besides, the activities carried out in agriculture, forestry, oil extraction and other sectors are all declining owing to the shortage of capital goods, maintenance services and management. Poverty and the extremely low level of education can only make matters worse. The GDP is shrinking at an amazing rate, thus illustrating the catastrophic economy: -1.1 per cent in 1986-1987; -4.2 per cent in 1987-1988 and -8.3 per cent in 1988-1989. All sectors are now affected by the crisis and inflation is rising (see table XIX.12).

1344. The international community has a responsibility to help this poor indebted country. This task is rather different from the one related to the collectivist economies of Eastern Europe, which are in transition towards democracy and a market system. There is a need for substantial aid for investments and for a commitment to debt reduction and restructuring, in order to allow the market to develop against a background of sustained growth, which would be otherwise impossible. Without doubt, it is necessary that the Myanmar Government responds to the commitment on the part of the international community with an appropriate process of transition to an open market economy.

Table XIX.12 Myanmar: output and prices, 1983-84 - 1988-89
(Percentage changes)

	1983-84	1984-85	1985-86	1986-87	1987-88	1988-89 a/
GDP at 1985/86 prices	4.7	4.9	2.9	-1.1	-4.2	-8.3
Agriculture	4.9	2.7	2.2	0.4	-6.4	-13.2
Nonagricultural	4.5	6.5	3.3	-2.1	-2.8	-5.1
Livestock and fisheries	6.8	9.9	2.0	1.9	3.8	4.2
Manufacturing and processing	2.0	8.8	2.9	-7.9	-6.1	-7.6
Services	4.9	5.5	4.1	3.6	3.1	-4.4
Trade	4.2	4.5	3.7	-4.2	-6.9	-7.9
Implicit GDP deflator	2.0	2.5	1.6	6.6	17.4	5.9
Consumer price index (annual average)	5.7	5.3	6.3	14.7	22.0	22.6

Source: Data provided by the Myanmar authorities to IMF and IMF estimates.

a/ Provisional.

Table XIX.13 Myanmar: balance of payments, 1983-1984 - 1988-1989 a/
(In millions of United States dollars)

	1983-1984	1984-1985	1985-1986	1986-1987	1987-1988	1988/1989
Trade balance	-199	-207	-253	-224	-269	-311
Exports, mainly f.o.b	409	359	333	310	257	228
Of which: border trade						76
Imports, mainly f.o.b	-608	-566	-586	-534	-526	-540
Of which: cash imports	-270	-277	-228	-98	-98	-38
Services (net)	-80	-66	-87	-84	-101	-107
Receipts	48	45	50	56	55	50
Payments	-127	-111	-137	-140	-156	-157
Of which: interest due	-68	-65	-74	-95	-113	-117
Transfers (net)	47	47	42	51	65	67
Current account balance	-232	-226	-298	-257	-305	-351
Nonmonetary capital movements (net)	236	187	226	273	241	194
Official grants	66	59	88	99	106	86
Long-term capital (net)	182	136	150	189	149	119
Disbursements	272	230	269	337	322	309
Repayments due	-90	93	-119	-148	-173	-190
Other capital (net)	-7	-1				
Trust Fund (net)	-4	-7	-11	-14	-15	-11
Errors and omissions (net)	16	-19	15	14	41	6
Overall balance	20	-56	-57	30	-24	-151
Exceptional financing						
Accumulation of arrears					95	208
Monetary movements	-20	56	57	-30	-71	-57
Gross reserves	-38	60	-1	11	-33	-38
Use of Fund credit (net)	18	-14	-8	-26	-30	-10
Other liabilities		10	65	-15	-7	-9
Memorandum items:						
Current account balance/GDP	-3.7	-3.6	-4.3	-3.1	-3.0	-3.5
Gross reserves (end of period)	117	57	58	47	80	118
In months of merchandise imports	2.3	1.2	1.1	1.0	1.7	2.7
Debt service ratio a/						
Commitment basis	34.4	38.4	52.5	69.4	88.2	95.0
Cash basis	34.4	38.4	52.5	69.4	63.1	34.9

Source: Data provided by the Myanmar authorities to IMF and IMF estimates.

a/ Including Fund repurchases.

Pakistan

1345. Pakistan has an emerging debt problem. Although its debt-maturity profile is quite acceptable and the debt service ratio (30.3 per cent in 1988 and 30.4 per cent in 1989 and 1990) looks much better than that of some other countries with a comparable debt/GDP ratio, the latter has reached a level that could push the country into a crisis situation. In fact, while so far the debt has been incurred mostly for development reasons at favourable terms, in the last four to five years recourse to foreign debt has been increasingly used for deficit financing.

1346. In percentages of GDP, the debt increased from 1.1 per cent to 3 per cent in the period 1985-1990. Recourse to foreign savings to finance the budget is what brought most of the debt-ridden countries of Latin America to the current crisis situation. Pakistan's economy is also characterized by the fact that it is neither a peacetime nor a wartime economy.

1347. Over the period 1981-1988, economic development was quite satisfactory. The average annual rate of growth of GDP was in excess of 6 per cent, with manufacturing output rising at an average of 8.2 per cent per annum, and agriculture at 3.6 per cent. A slowdown took place thereafter and an average rate of growth of 5.5 per cent was recorded. This same rate is expected for the current fiscal year despite a slowdown in large-scale manufacturing. Private sector investment has been relatively strong. Overall price performance was also good during the 1981-1988 period. The average annual rise in the CPI decelerated from 9 per cent in 1981-1985 to less than 5 per cent in 1986-1987, reflecting lower price increases for domestic output and declining rates of inflation abroad. Notwithstanding the strong output growth, the country's per capita income remains low (about $350 in 1987) because of the high rate of population growth (3 per cent per annum).

1348. While some progress has been made in education, health and the reduction of infant mortality, the adult literacy rate is only around 25 per cent. The income distribution is quite skewed: the highest 20 per cent accounts for 42 per cent of private income, whereas the lowest 20 per cent of the population accounts for 8 per cent only.

1349. Pakistan is a highly regulated economy. In agriculture, government intervention is quite heavy in the form of procurement prices set by the authorities to provide incentives to domestic production and protect farmers' incomes. Several factors are taken into account when prices are set, i.e. production costs, export targets and the level of world prices. In the manufacturing sector the approval procedure for new investments is quite cumbersome. Public sector enterprises are dominant in the strategic manufacturing sectors. There is a de facto public monopoly in water resources development and management and in the energy sector. In the credit sector, banks are mostly public and very heavily regulated with stringent credit limits, both general and sectoral. This overregulation of the economy has left little room for the expansion of the private sector. However, since 1988 a deregulation effort has taken place, for instance in easing the approval procedure for new investments and in the privatization of some government enterprises.

1350. Pakistan is basically an agricultural country. Agriculture accounts for one quarter of GDP, employs over half of the labour force, provides a substantial part of raw material inputs for domestic industry and is the source of about 60 per cent of export earnings, when the weather is favourable. Rice, cotton, sugarcane and wheat account for more than half the total value added in agriculture and wheat alone accounts for more than 20 per cent. The performance of the sector has been quite satisfactory in the period 1985-1989, with a growth rate averaging slightly below 6 per cent as a result of good weather conditions in these years and the measures taken by the Government to enhance productivity. In particular input and output prices are reviewed annually to permit timely adjustment, thus improving production incentives. Procurement procedures have been streamlined and a pricing mechanism has been set up.

1351. The use of fertilizers is encouraged. In order to keep down the corresponding rise in budgetary outlays for fertilizer subsidies, the Government has completely deregulated the sector. However fertilizer pricing is still characterized by a series of problems. Water for irrigation is subsidized. Operating and maintenance costs are subsidized at about 40 per cent only. Consumer prices and related marketing arrangements for certain major agricultural commodities, such as wheat and flour, have been liberalized in recent years. The Government is providing the sector with credit, which has been expanding satisfactorily during the recent years. Agricultural research, the construction of storage capacity and the development of fisheries have been financed at annual growth rates exceeding 19 per cent in 1987 and 1988. The increase of financing was limited to 10 per cent in 1989 owing to the tightening of fiscal policy.

1352. Manufacturing in Pakistan contributed to about 17 per cent of GDP on average during the period 1981-1989. Large-scale industries accounted for about 75 per cent of this share. Important industries include heavy industries such as petroleum refining, iron and steel products, fertilizers, chemicals, cement, transportation and a variety of machinery. There are also large-scale enterprises in pharmaceuticals, cotton textiles and food processing. Cotton textiles, petroleum refining and food processing are actually the largest industries. Public sector enterprises are dominant in the steel, oil, cement, machinery and automotive industries and constitute the major share of the petroleum products, caustic soda and fertilizer industries. Small-scale private sector entities are involved in various manufacturing activities, including textiles.

1353. Over the years 1984-1988, the sector grew at an average annual rate of more than 8 per cent in real terms, slowing down at an overall rate of 3.1 per cent in 1989, owing to the decline of large-scale manufacturing. The good growth performance of the sector in the 1980s, resulted in part from measures introduced by the Government to encourage the activity, promote investment and diversify domestic production, as well as a number of measures to streamline bureaucratic procedures for investment approval and to keep bureaucratic delays under control. In the 1980s, the Government's development priorities moved away from large industrial schemes. It therefore limited public investment in the industrial sector to completion of ongoing projects, the largest of which is the Pakistan steel mill. Most of the public manufacturing sector enterprises suffer from production and profitability problems, owing to pricing policies, underutilization

of capacity, labour inefficiency and undercapitalization. The sector's profitability fell from a 5.5 per cent average in 1985-1988 to 5 per cent in 1989 as a ratio of pretax profits to sales, in spite of the system of economic indicators introduced in the early 1980s. This is one of the causes of the public sector deficit which, as noted, is increasingly financed through foreign debt.

1354. The energy sector absorbs about one third of total development expenditures, i.e. 8 per cent of total expenditures, and generates roughly 10 per cent of government resources. Pakistan has significant commercially exploitable hydropower, oil, gas and coal resources, which, however, are being exploited very slowly. The per capita consumption of commercial energy is about 215 kg of oil equivalent, among the highest in the group of low-income economies, reflecting inefficiency in industrial production. The exploitation and development of primary energy resources is dominated by public sector entities, with some small private enterprise participation. Power generation and distribution, as well as the distribution of natural gas and petroleum products, are undertaken entirely by the public sector, so that efforts to accelerate the development of energy resources are shouldered entirely by public economy.

1355. In 1989 domestic crude oil production represented 38 per cent of the country's total requirements. Natural gas production was subject, in the early 1980s, to Government-controlled producer prices that failed to encourage private participation. Since 1985 a new formula has been applied, to which the private sector responded favourably. Total gas production increased by 25 per cent in the following year and, although at a slower pace, it has continued to increase thereafter.

1356. In the period 1980-1988, the expansion of the electricity generation and transmission capacity was below target due to financial and implementation constraints. As a result, severe power shortages, especially during peak hours, developed from 1985 on. The situation was addressed satisfactorily in the last two years, reflecting the high priority given to the subsector in the annual development programmes, but to finance this effort, electricity tariffs increased at annual rates exceeding the consumer price growth.

1357. In an economy with strong public control development planning plays a major role. Pakistani planners have been quite successful in shifting priorities away from sectors that experience showed not to be the most profitable. The sixth five-year development plan (1984-1988) focused mainly on re-orienting public investment away from large-scale industrial projects towards the priority sectors of agriculture, irrigation, energy, rural development and social services. The plan achieved its major objectives despite some shortfalls in the area of fiscal and external sector performance. The seventh five-year development plan (1989-1993) aims at high rate of economic growth while improving income distribution. Its major objectives include full employment, restoration of equilibrium in public finances, self-reliance in agriculture, the provision of adequate social services and the development of human resources. The private sector is expected to assume an increasingly important role, through a further deregulation of the economy. In particular it is expected to diversify the export structure. However, if direct investment from abroad could partially replace public debt, the performance would be better also from the financial point of view.

1358. The least positive sector of the Pakistani economy is indeed public finance. The poor tax performance is not matched by a high domestic propensity to save. To avoid inflationary pressure, recourse to domestic banks to finance fiscal deficit has decreased, while foreign borrowing has grown to 2.4 per cent of GDP in 1989 (see table XIX.14). Consequently foreign credits had to be used to finance the deficit, caused both by the high profile of the public sector in the economy and by the volume of subsidies to offset structural imbalances.

1359. As mentioned, the economy is also affected by a no war-no peace situation. Current expenditures on defence were 25 per cent higher than total development expenditures in the period 1985-1989 and accounted for more than two thirds of the average final deficit during the period (see table XIX.14). As a consequence total external debt (including estimates of the foreign loans to finance military imports) reached 52.6 per cent of GDP in 1990 and is projected to grow in absolute terms.

1360. Government fiscal revenues are far from satisfactory. In the period 1985-1989 they averaged 17.5 per cent of GDP; however, some improvements took place in 1989. The Government is envisaging a package of tax measures and improvements in the tax-collection system to increase tax yields. A positive aspect is that the other public finance bodies show a surplus, although small.

1361. Pakistan's banking system consists of the central bank, the State Bank of Pakistan, 24 commercial banks and 4 Government-owned sectoral banks. Some private finance companies have been authorized recently. In the four-year period 1985-1988, credit expansion has been three percentage points above the annual nominal rate of growth of GDP, and hence some restrictions were introduced in the last year of that period.

1362. It must be pointed out that the recourse of the Government and its enterprises to the internal capital market creates large distortions and imbalances in capital allocation because of the scarcity of savings. In fact, relative to other comparable countries, saving rates are low in Pakistan. Total domestic savings averaged 8.4 per cent of GDP over the period 1980-1988. The average level increased to about 14 per cent as a result of large workers' remittances. But even so, savings remain too low. Moreover, workers' remittances are decreasing, and their future is far from bright unless interesting new investment possibilities are opened up for them.

1363. To attract the scarce resources available, the Government thus had substantially to increase the interest rates on its direct borrowing. This policy distorts the financial system, as the differential between high bank rates and government debt rates became excessive. On the other hand financial non-intermediation also grew. Together with foreign indebtedness there has been a rapid accumulation of domestic public debt, which rose from 25 per cent of GDP in 1981 to 49.6 per cent in 1989 (see table XIX.15).

Table XIX.14 Pakistan: summary of public finance
(In percentage of GDP for each financial year)

	1985	1986	1987	1988	1989
Total tax & non tax revenues	16.4	17.5	18.1	17.4	18.1
Surplus of autonomous	0.6	0.6	0.3	1.1	0.8
Total expenditures	24.7	26.1	26.6	27.1	26.4
of which:					
Development expenditures	6.7	7.3	6.1	7.2	6.3
Current expenditures	18.1	18.9	20.5	19.9	19.9
of which: defence a/	5.2	5.3	5.9	5.5	5.1
Fiscal deficit	-7.8	-8.1	-8.2	-8.6	-7.3
External financing	1.1	2.1	1.7	2.2	2.4
Domestic non-bank financing	2.6	4.9	4.5	4.4	4.8
Domestic bank financing per budgetary report b/	4.1	1.1	2.0	2.0	0.4

Source: Pakistani authorities data, IMF and estimates.

a/ Including interest and estimated foreign loans to finance military imports.

b/ Net.

Table XIX.15 Pakistan: foreign debt
(In millions of United States dollars)

	1987	1988	1989	1990	1991 a/
Total foreign debt (IFD) b/	17 400	18 400	20 000	21 300	22 200
Ratios					
IFD/GNP	52.2	48.2	49.6	52.6	49.7
IFD/total government revenues c/	246.2	242.5	258.8	260.9	252.5
Debt service ratio	30.6	30.3	30.4	30.4	27.6

Source: FINTESA, Studi Paese, Pakistan, 1990.

a/ Projections.

b/ Including loans to finance military imports.

c/ Excluding government transfers.

1364. Pakistan's exports are characterized by structural difficulties owing to their concentration in a limited number of commodities and products, mainly of agricultural origin. These exports face a number of significant impediments in foreign markets such as quantitative restrictions or specific limits for textiles and leather goods in the United States, EEC and other importing countries. Rice exports have to compete with the heavy subsidization by other countries. Raw cotton and rice accounted for about one quarter of total exports in 1989 and cotton-based manufactures for about one third. The remaining exports are both traditional (leather, carpets and synthetic textiles) and non-traditional (leather garments, sporting goods, surgical instruments, fruits and vegetables). Export performance has reflected the substantial fluctuations in the domestic agricultural production compounded by the adverse impacts of the variations in the world market prices for the major export commodities.

1365. Furthermore, the major positive item in Pakistan's balance of payments, workers' remittances, is experiencing a declining trend. They were above export earnings from goods in the early 1980s but have declined below that level with the contraction of the economic boom in the Middle East oil-exporting countries, where expatriate workers are concentrated. Over the nine years ending in 1989, the current account showed wide fluctuations (see table XIX.16).

Table XIX.16 Pakistan: current account deficit of GNP

1981	1982	1983	1984	1985	1986	1987	1988	1989
3.2	4.9	1.8	2.1	5	3.4	2.1	4	4.7

Source: IMF country review.

1366. It should be noted that official foreign reserves have declined further since 1984. In 1987 they covered only 1.4 months of balance of payments outlays and in 1988-1990 an average of less than 20 days' outlays. The above fluctuations reflect variations in the volume and prices of agricultural exports, the exchange rate and domestic financial policies, which interact with the declining trend of workers' remittances and the overall decline of the country's external competitiveness.

1367. While the value of Pakistan's exports, expressed in constant 1985 dollars, has increased steadily between 1985 and 1990, there have been wide fluctuations in the performance of individual exports (see table XIX.17).

1368. Besides, too high a portion of total imports is channelled through public sector agencies, thus reducing the supply of factors of production to the market sector. Non-oil imports of the public sector are influenced by development and defence imports, as well as by requirements of purchasing abroad a considerable number of basic commodities such as wheat, fertilizer and edible oils.

Table XIX.17 Pakistan: exports of goods

Total exports (c.i.f.)	1985	1986	1987	1988	1990
	(Financial year 1985=100 in $US terms)				
	100	123	148	176	185
Growth rate (c.i.f.)	(Annual percentage changes)				
Cotton	114.4	83.9	-12.9	33.8	53.7
Rice	-47.4	54.1	-12.6	19.1	-14.6
Cotton base manufactures	-6.4	19.1	63.0	14.7	5.6
Other traditional exports	-20.0	16.3	48.1	18.9	-18.4
Non traditional exports	-7.5	-2.8	4.9	19.2	1.2

Source: Ministry of Finance and Economic Affairs of Pakistan.

1369. Table XIX.16 shows the growth of external debt in the last five fiscal years, including estimates of military foreign debt, as well as some creditworthiness ratios. Unless a major effort is made either to increase tax revenues or to decrease public expenditures, the foreign debt situation in going to worsen dramatically. So far Pakistan has been able to meet its debt service obligations because of the rather favourable maturities profile. However, the increasing resort to foreign debt to finance the budget deficit is bound to affect that profile adversely. New finance in the form of direct investment could be stimulated through further liberalization of investments. Together with the domestic effort, the international community also should increase its efforts in favour of Pakistan, along the lines indicated in the present report.

1370. This is, indeed, one of the countries where poverty is concentrated: the poor, in Pakistan, according to the most recent findings 7/ comprise 18.7 per cent of the total population of 106 million. If the share is less than that of countries like India or Côte d'Ivoire and Costa Rica; nevertheless the absolute numbers are very large. In this light foreign aid to Pakistan, only $13 billion in 1988, appears still too modest.

1371. It is true that the public sector deficit is the main cause of Pakistan's foreign debt, most of which is with multilateral or bilateral public institutions. Undisbursed debt amounted to $7 billion in 1988.

Notes

1/ World Bank, Poverty, World Development Report, World Development Indicators, 1990.

2/ Wing Fhye Woo and Anwar Nasution, "The conduct of economic policies in Indonesia and its impact on external debt" in J. Sachs (ed.), Developing country debt and the world economy, National Bureau of Economic Research, Washington, D.C. 1989.

3/ R. S. Dohner and P. Intal Jr., "Debt crisis and adjustment in the Philippines" in J. Sachs (ed.), op. cit.

4/ Ibid., p. 5.

5/ IDA, report and recommendations of the President to the Executive Director on a proposed financial sector adjustment credit to the People's Republic of Bangladesh, 1990.

6/ IMF, Myanmar: Recent Economic Developments, December 1989, Washington, D.C.

7/ World Bank, Poverty, World Development Report, 1990.

XX. EASTERN EUROPEAN COUNTRIES

1372. Indebted countries in Eastern Europe can be classified as medium-income countries since their per capita income ranges from $1,930 for Poland (1987) to $2,240 in Hungary, $2,480 in Yugoslavia and probably $2,480 in Czechoslovakia. 1/ Investments and savings as a share of the GDP are very high: 29 and 30 per cent for Poland (1987), 27 and 26 per cent for Hungary and a positive 39 and 40 per cent for Yugoslavia. The German Democratic Republic has been omitted, since it has now acceded to the Federal Republic of Germany. At the end of 1988, Eastern European debt excluding that of the USSR amounted to $100 billion, 40 per cent of which was for Poland and 20 per cent for Hungary. For those two countries, the debt burden is similar to the medium burden of the 15 highly indebted countries named in the statistics of the World Bank, which include one country from Eastern Europe, namely Yugoslavia.

1373. The Yugoslav economy, in spite of the great political difficulties, is undergoing an important positive evolution, gradually opening itself to international markets and adopting a responsible business structure. Consistent macro-economic rules, relating to income policy, interest rates and prices and fiscal and monetary policy, have been introduced even if at the cost of high inflation, which merely reveals a huge hidden inflationary situation.

1374. Considering the main indicators, Yugoslavia's foreign debt situation appears one of constant improvement: the ratio of the total debt stock to GNP, which was close to 50 per cent in 1985, went down to 33.5 per cent in 1989 and seems to be stabilized at a similar percentage in 1990 (the indicators for the highly indebted countries in 1985 and 1989 on the other hand are 61 per cent and 81 per cent).

1375. The ratio of foreign debt stock to exports has experienced an even more favourable improvement as a result of the great increase in exports, in contrast with the dwindling trend of GDP caused by the deep economic restructuring process. From 130 in 1985 the ratio of total foreign debt stock to GNP went down to only 84 per cent in 1989 and to near 70 per cent in 1990. (In 1985 and 1989 the ratio of total debt stock to exports of highly indebted developing countries was 312 and 337.)

1376. As for the debt-service-to-exports ratio, the situation of Yugoslavia was already sustainable in 1985 when it was 19 per cent (in 1984 it was 27 per cent), as a result of rescheduling. It improved further in 1989, falling to 16 per cent (the ratios of highly indebted countries for 1985 and 1989 are about 40 per cent).

1377. The volume of Yugoslavia's foreign debt, however, has decreased in the last few years and its composition changed because of the perception of the risks related to political instability. From nearly $10 billion, the non-guaranteed commercial banks' credit to Yugoslavia fell to $8 billion in 1985 and further to $3.5 billion in 1989.

1378. Total Yugoslav foreign debt fell from $19.2 billion in 1985 to $17.8 billion in 1989: but the figure must be interpreted in the light of the fact that the dollar has depreciated against the European currencies in which the Yugoslav debt is mostly denominated. On the other hand, official creditors' debt, particularly bilateral debt, increased from 1985 to 1989 by almost $2 billion.

1379. In 1990 sizeable multilateral credits were granted to Yugoslavia, recognizing its positive efforts at economic restructuring. However, the political problems that have weakened the central Government, together with the negative effects of the Gulf crisis on the Yugoslav economy, mainly through the increase of oil price, had revamped the inflation spiral at the end of 1990. The inflation rate, which was about 200 per cent in 1988 and rose to 1,240 per cent in 1989, was down to 8 per cent a month in the first 10 months of 1990, but it subsequently surged again to 80 per cent a month. The perverse effects of the Gulf crisis on the Yugoslav economy are related not only to the increased oil prices but also to the adverse trade and payments conditions as emphasized by the crisis of the Soviet economy.

1380. More than 50 per cent of Yugoslavia's oil imports (10 million tons per year) came from the USSR and the remainder from Iraq, to which Yugoslavia had an important flow of exports and credits. The embargo has meant for Yugoslavia a loss of more than 3 million tons of oil to be delivered yearly by Iraq in lieu of payments due.

1381. On the other hand, with the USSR too, Yugoslavia has a trade surplus and foreign credits, which in different conditions could be repaid through oil exports. However, USSR oil is now sold in hard currencies, while the Yugoslav trade surplus with the USSR is being offset through barter deals.

1382. Banking reform, tax reform and broader perspectives for joint ventures with foreign investors appear now to be the essential elements to ensure that Yugoslavia receives the capital and know-how inflows it needs to implement successfully its restructuring process. This is a difficult task in the light of the combined perverse effects of the Gulf crisis and the crisis of Soviet economy.

1383. The debt problem of Yugoslavia appears to be essentially a problem of new money, a new regional policy and a new order in internal relations, as well as in relations with European countries and the countries on the other side of the Mediterranean. More efforts by the existing international financial institutions and the new institutions to be created in the Mediterranean area should be encouraged to rebuild peace, security and economic growth in the Balkan region.

1384. The Eastern European countries may also be considered to include Turkey, which may become a member of EEC in the 1990s. Turkey was considered a model debtor in the 1980s, after having been a problem country in the 1970s. According to M. Calasun and D. Rodrik, 2/ problems remain, because "the public sector budget remains the Achilles' heel of the Turkish macro-economy". Debt accumulation has been marked by recourse to "rather exotic arrangements whose long-term stability is problematic". Private investments in tradeables are sluggish.

1385. However, it must be pointed out that during the last decade Turkey has made notable efforts to transform an essentially agricultural economy, intended for an internal market, into an industrial economy also geared to exports.

1386. The success of this policy is shown by the great export growth. Exports increased from $2.9 billion in 1980 to $11.6 billion in 1989. The economic transformation that occurred in Turkey in the 1980s can be clearly seen from the

changes in the structure of its foreign trade. Eighty per cent of exports, which had a ratio of 2 to 3 in favour of agriculture in 1980, now consist of manufactured goods: textiles, iron and steel, leather, etc. Raw materials and intermediate commodities account for 66 per cent of imports, followed by capital goods (24 per cent).

1387. As for geographical structure, OECD countries lead both as purchaser (62 per cent in 1989) and as supplier; Germany is the first (19 per cent as purchaser and 15 per cent as supplier). The Gulf countries follow. The first was Iraq, whose share as a supplier had grown in 1989 to 11.5 per cent, but had drastically fallen as a purchaser (4 per cent) because of its shortage of means of payment.

1388. Turkey's trends in foreign trade during the most recent period have shown a marked deterioration. Exports, which grew quickly during most of the 1980s, slowed down in 1989-1990. This is firstly due to the abrupt real appreciation of the Turkish lira, which, between the first quarter of 1989 and the first quarter of 1990, appears to be 30 per cent. During the first four months of 1990 exports therefore increased only by 1.6 per cent compared to the same period of the previous year. Imports, on the other hand, stimulated by the quick recovery of the economy and by the above-mentioned revaluation of the lira, marked a growth of 31 per cent.

1389. The trade deficit climbed, in the same period, from $800 million to $2.2 billion. This deterioration of trade trends is also due to the liberalization measures adopted by the Government in recent times: while the main import barriers were reduced, several important fiscal benefits granted to exports were abolished.

1390. Now, with the Gulf crisis, the Turkish balance-of-payments situation has become critical: workers remittances, tourism and receipts from exports to the Middle East have fallen substantially.

1391. The total external debt did not change substantially in the years before the Gulf crisis: it has stood at $40 billion since 1987, with a decreasing share of short-term credit (12 per cent in 1989). It is necessary to recall that two thirds of the debt is denominated in currencies other than the dollar, mainly deutschemark and yen. The relationship between debt stock and GNP has decreased from 263 per cent in 1980 to 203 per cent in 1989, while in the same period the debt-service-to-exports ratio increased from 35.7 to 43.1. The Gulf crisis has again worsened the picture.

1392. Whatever the truth of these different statements, after the Middle East crisis, affecting workers' remittances and foreign trade as well as transportation services and tourism, Turkey's debt overhang is again a problem, deserving careful attention.

1393. In terms of reduced growth in GDP and exports, the behaviour of Eastern Europe during the 1980s shows a similar trend to the average of the 15 highly indebted countries (see figure XX.1). However, ascribing such a low growth to the debt issue would be a mistake. All countries in Eastern Europe, including the

USSR, had a low growth in the 1980s, regardless of their debt burden, which - in certain cases and for several years - was for most of these countries rather low.

1394. The primary cause of the low economic growth of the 1980s (since the mid-1970s) in the countries of the former Soviet bloc lies in the exhaustion of the cycle of extensive development and of imitation of the technological progress of the mass industries in the West, which was either learned during the joint activities performed in the Second World War, or was inherited by the new regimes from advanced industries located in that area. In the 1980s, total investments in Eastern Europe and in the USSR were no lower than in the previous decade. In some cases, they even reached Japanese levels. Labour productivity, however, rose very little, and the capital yield in the USSR was low and indeed negative.

1395. The negative consequences of all this were mutually felt in all countries of the economic bloc in a pervasive spiral owing to the closed nature of the Council for Mutual Economic Assistance (CMEA). It is hard to know whether the USSR suffered greater damage from this international trade system than the other Eastern European countries. In all of these countries, the supply of poor-quality CMEA products, which were not competitive with those on the international market, was a feature of imports and exports; it affected capital goods and consumer goods, intermediate products and finished products, components and the assembly process. Most of all, it hit the services and trades sectors of financing, transport, storage, wholesale trade and telecommunications and the organization of industries and systems. This was even more serious at a time when in the rest of the world the international market and services' innovations were gaining momentum.

1396. On the other hand, with regard to international openness, although import and export flows were mostly within the CMEA countries, it cannot be said that those countries were commercially restricted. The export share of GDP in 1987 was 38 per cent for Hungary, 24 per cent for Yugoslavia and only 18 per cent for Poland, with an average of 22 per cent in underdeveloped medium- and low-income countries.

1397. Given its bureaucratic, centralized and essentially monopolistic nature, economic planning became increasingly incapable of competing with Western and Japanese free market enterprises in providing flexibility and organizational and productive efficiency and in focusing on a growth based on quality and software instead of hardware.

1398. The open economy challenge made the difference. This is why the Soviet economic bloc failed, leading even to the decline of Czechoslovakia and the German Democratic Republic, in spite of their important tradition of advanced industries, and of Hungary, notwithstanding its solid agricultural tradition and small-sized industries. Yugoslavia was left vacillating between the bloc and the West: instead of acting as an intermediary and promoting the opening of the former towards the latter, it was acting like a buffer State, with a so-called self-managing system, which in practice implied the elimination of all economic responsibilities, public and private, and was preparing for monetary and political disruption.

1399. It is now clear that the general deterioration in the East was taking place at a pace faster than Western analysts had anticipated, although capital accumulation was not declining. From 1974 to 1984 productivity in the USSR fell by 1.4 per cent a year, while it grew by 1.3 per cent in the industrialized countries; labour productivity grew by a mere 1 per cent, against 2.7 per cent in the industrialized countries (see table XX.1), and the trend was similar in the other Eastern European countries. Indeed, with an investment of 29.4 per cent of GDP in 1980-1989, Eastern European GDP grew by only 0.8 per cent per year (see table XX.2). In 1981-1988, the growth rate in agriculture was 2.3 per cent in Eastern Europe (0.6 per cent in the USSR), while it was 2.6 per cent in industrialized countries. Although the figures are similar, they represent an enormous difference in productivity because in the industrialized countries such growth was reached by an agricultural labour force that was 5 per cent of the total, while in Eastern Europe (and in the USSR) agriculture still accounted for 21.5 per cent of the total labour force. Besides, there was an enormous waste in moving goods from production to consumption, at times higher than 30 per cent. It seems that this is the main cause of the shortages of primary goods in both the cities and in the countryside. Industrial growth in the East was 1.3 per cent in 1981-1988, half the figure for the industrialized countries, but with higher investments (see table XX.3).

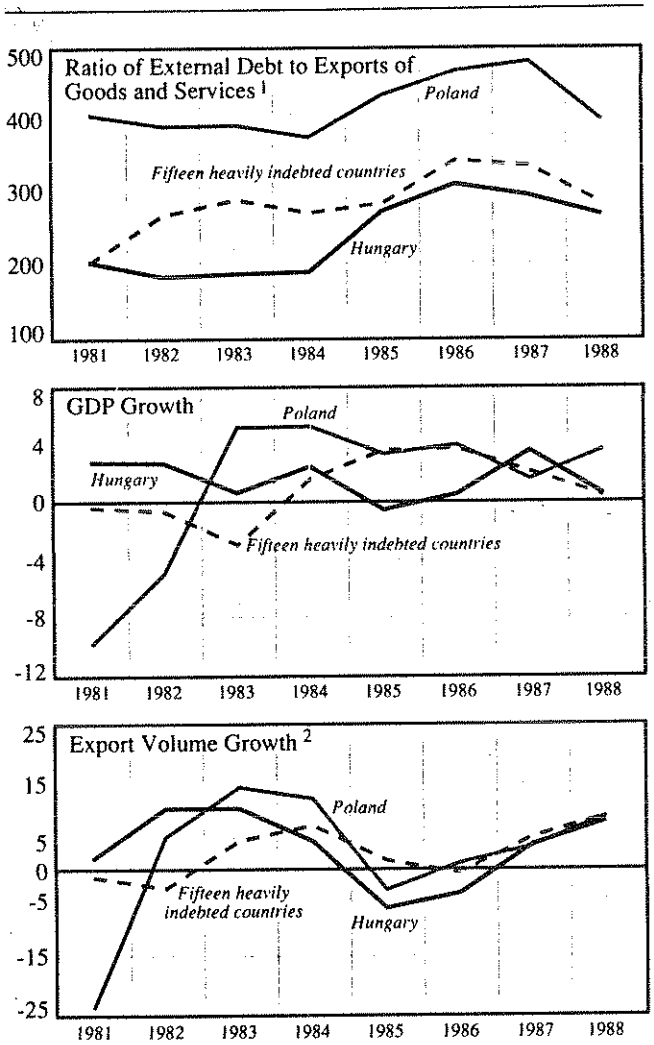
1400. What becomes clear from the above is that the financing problems of these countries lie not in the quantity, but in quality and in an effective absorption capacity. Too much financing without selectivity could lead to ineffectiveness and excessive indebtedness, thus reducing the solvency of these countries and hence direct investments and the flows of new finance, different from the conventional bank loans. The latter will indeed develop if these countries open up to the market system and are financially sound.

1401. The external debt accumulated by some of the countries in question is often ascribed to the inefficiencies of the collectivistic enterprises, which were run without financial constraints since the Governments offset losses by obtaining financing directly from abroad, or by shifting the burden to the population. Managers were not rewarded on the basis of the results achieved, but rather on their political ability to move within and through the complexities of bureaucratic regulations. There is now a need for massive changes, first, in the mentality of economic and financial managers as far as financial managers of constraints are concerned.

Figure XX.1

Hungary, Poland and 15 heavily indebted countries: External debt, GDP and export volume, 1981-1988

(In percentages)



[1] Hungary and Poland: convertible exports including foreign income receipts.
[2] Hungary and Poland: non-ruble exports.

Source: IMF, World Economic Outlook 1990.

1402. Since the fall of the communist regimes, remarkable progress towards a market economy has been made in Poland and Hungary, and the process is ongoing in Czechoslovakia, with bold steps in deregulation planning with regard to pricing systems and exchange rates, progress in the organization of markets for capital, labour and services and the consolidation of public finance. There are, however, new complications for trade and financial flows within CMEA countries, with the almost abrupt pulling out of the German Democratic Republic and the opening to the West.

1403. Given the built-in trade imbalance of CMEA countries as a whole and considering the new trend to import more from countries outside the CMEA owing to a push towards modernization and a market system, generated by economic reforms, and considering that exporting to those countries is difficult owing to a lack of competitiveness, CMEA countries tend not to pay their debts within the area and to channel outside CMEA their financial resources, raw materials and marketable products. What that implies for countries like Hungary, which have a surplus in their balance of trade and need those receipts to honour the service of their external debt, is a lack of liquidity that affects their debt-servicing capability.

1404. More particularly, the financial crisis of the USSR is having negative repercussions on the CMEA countries, which could increase their exports to the Soviet Union while raising their competitiveness if they could be paid in cash or receive an equivalent amount in raw materials. The disruption of trade in CMEA countries is dangerous for Eastern Europe as well as for the Soviet Union. What is needed is a real integration of their economies, as they increasingly join the free market economy and trade systems, with increasing foreign exchange freedom.

1405. The task is still far from being easy because the medium-term goals of some of these countries are still unclear, and since they need to learn a great deal from the industrialized world, not so much in the area of basic technologies as specific techniques in order to improve quality, to bring products in line with market requirements, to raise the efficiency of the means of production, to reduce the need for working capital and to develop an effective business financial system, together with credit and savings institutions.

1406. On the other hand, the partial reforms implemented in some of the countries under examination during the 1970s and 1980s in certain cases made problems worse instead of solving them. They eliminated wage constraints and the overall rigidity of the plan but did not provide incentives and autonomy for the promotion of efficiency and competition. The effect was an inflationary process, whose nature is completely different from the one resulting from bringing controlled prices in line with costs and the exchange rate in line with the purchasing power of the domestic currency. In the latter case, inflation is part of the adjustment process and leads to equilibrium. It is a temporary cost that has to be met in order to gain a permanent benefit. In the former, it is the result of a misunderstanding of the adjustment process and leads further away from equilibrium. In the transition strategy, it is fundamental to make a distinction between the two cases. Debt reduction strategies for the countries in question and the flows of new money towards them must be carried out without letting them repeat the mistakes of the previous period.

Table XX.1 Growth of labour, total factor productivity and the capital stock in the USSR and selected countries, 1951-1984
(Annual percentage changes)

	Labour productivity a/		Capital stock		Total factor productivity	
	1951-1973	1974-1984	1951-1973	1974-1984	1951-1973	1974-1984
USSR	3.6	1.0	8.6	6.7	0.5	-1.4
Industrial countries b/	4.8	2.7	4.7	3.2	3.4	1.3
Latin America c/	3.2	0.2	4.7	5.0	1.8	-1.3
Republic of Korea	4.2	4.8	5.9	10.8	2.8	1.4
Taiwan, Province of China	4.9	4.1	7.7	10.0	3.5	1.2

Source: IMF World Economic Outlook, 1990.

a/ GDP per hour worked (Latin America: GDP per employed person).

b/ Weighted average of 16 industrial countries.

c/ Weighted average of Argentina, Brazil, Chile and Mexico.

Table XX.2 Performance indicators, by developing region, selected periods

	Growth of real per capita GDP (%)			Gross domestic investment / GDP (%)		
	1965-73	1973-80	1980-89	1965-73	1973 80	1980-89 a/
Sub-Saharan Africa	3.2	0.1	-2.2	16.2	20.8	16.1
East Asia	5.1	4.7	6.7	24.2	29.7	30.0
South Asia	1.2	1.7	3.2	17.1	19.9	22.3
Eastern Europe b/	4.8	5.3	0.8	28.3	33.8	29.4
Middle East, North Africa and other Europe	5.5	2.1	0.8	23.4	29.2	25.9
Latin America and the Caribbean	3.7	2.6	-0.6	20.7	23.9	20.1

Source: World Bank, World Development Report, 1990.

a/ Data for 1989 are preliminary.

b/ Estimates.

Table XX.3 Sectoral developments in Eastern Europe, the USSR and industrialized countries, 1961-1988
(In percentages)

	Sectoral growth rates a/				Employment shares b/					
	Agriculture		Industry c/		Agriculture			Industry c/		
	1961-80	1981-88	1961-80	1981-1988	1960	1908	1988	1960	1980	1988
Eastern Europe	1.0	2.3	4.9	1.3	43.0	22.9	21.5	25.7	32.9	32.4
Bulgaria	0.6	-0.6	7.0	1.6	54.5	23.9	19.5	19.4	31.4	33.0
Czechoslovakia	1.3	1.3	3.5	1.2	23.8	12.5	12.1	36.3	37.3	36.6
German Democratic Republic	1.4	1.9	3.6	2.1	16.0	10.4	10.2	39.8	38.9	39.0
Hungary	2.3	2.7	4.0	1.3	35.7	19.6	18.4	29.7	32.9	33.0
Poland	..	2.2	5.2	0.5	49.6	29.5	28.2	22.4	29.1	25.9
Romania	1.6	5.1	7.9	1.4	65.6	30.1	28.5	13.2	32.2	33.7
U.S.S.R.	1.0	0.6	5.0	2.5	41.3	23.6	21.7	20.5	25.0	24.6
Industrial countries d/	1.4	2.6 e/	4.5	2.5 e/	18	6	5 f/	38	38	34 f/

Source: IMF, World Economic Outlook, 1990.

a/ Real average annual growth rate.

b/ Percentage of total labour force.

c/ Includes construction.

d/ Grouping based on World Bank, World Development Report, op.cit.

e/ 1981-1987.

f/ 1987.

1407. Hungary, which has the highest bank debt, does not consider the application of the Brady Plan to be necessary in its case, since the Plan is aimed at debt and/or debt service reduction. In their meetings in Budapest, the authors of the present report were told by the Governor of the Central Bank, the head of Government and the Ministers for Finance and Foreign Trade, that Hungary would not like to establish a negative precedent that could reduce its creditworthiness in the future, with adverse repercussions on the flows of new finance and on the related process of international integration.

1408. Hungary is asking for an extension of the reimbursement period of its debt, with particular reference to the consolidation of short-term debts into medium-term debts and the setting up for CMEA countries of an Eastern European Payments Union, on the basis of what was done in Western Europe after the Second World War. The Union should eventually bring about full convertibility of all the currencies participating in it. It should allow the conversion of a debt expressed in any of those currencies into any other of the participating ones, and even credited to external creditors. Even with limits to the amounts payable in non-CMEA foreign exchange to external creditors, the latter could at any rate expand their countertrade. On the other hand, the Union should have funds that would enable it to meet the demand for foreign exchange, at least as long as it had to undergo an outflow of financial resources in connection with debt service.

1409. The proposal appears very interesting, since it can support and encourage the development of a regional economic free trade area in Eastern Europe and the growth of trade between the area and Western Europe. However, the position of the USSR in the Union should be considered carefully, since the Soviet Union's volume of economic activities and its overall problems are greater and more numerous than those of the Eastern European countries.

1410. The Brady Plan seems to be applicable only to Yugoslavia and Poland. In the latter case, however, since most of its debt is with official institutions, an extension of the Toronto options should first be considered. Brady Plan policies could be misleading if applied to other countries, since what they need most of all is an extension of maturities and, especially, new money for enterprises to finance a rapid transition process. The public debt must be replaced with private debt and direct investments. It would be preferable to consider the innovative options of new finance, based on projects and joint ventures and commodity bonds for the exploitation of raw materials, together with other formulas of investments and trade co-operation linked to regional development policies.

1411. As noted above, since the current Eastern European debt is largely public, the burden of alleviating it is mostly an issue to be tackled by the Governments and institutions of the industrialized countries. This would help to solve the problems of debt restructuring and of improving the pattern of payments of these countries without undermining bank loans and the creditworthiness of enterprises. But it would also entail delicate ethical choices. Regimes that have been openly rejected by the new democratic Governments contracted the debts for objectives (including high military and police expenditures) which the new Governments do not share. Everyone has to do his part in solving the problems of financial recovery of these countries. Soft public loans cannot be regarded as a permanent tool for

these countries, which do not belong to the underdeveloped world and, in some cases, formed part of the industrialized West until the Second World War. By implementing major adjustment processes, these economies can regain the efficiency and the growth capacity that they possess and - as illustrated - they have wasted.

1412. The speed of transition must be measured by the ability of Governments and managers of public bodies, enterprises and financial institutions. Hence, there is a need to give the highest priority - in the framework of temporary policies of public aid by the industrialized countries - to the supply of technical and managerial services. Short- and medium-term concessional lending for the purchase of food supplies and technology, added to the free supply of some of the agricultural surpluses of EEC, can surely help in the transition phase by mitigating the social repercussions deriving from the liberalization of prices and trade, provided that these are bold steps towards new market systems and towards new entrepreneurial responsibilities, and not just ways of marking time.

1413. The course illustrated above would have two important positive effects: it would support the financial and managerial autonomy of enterprises, the flourishing of small- and medium-sized enterprises and the development of a free market system. It would prevent Eastern European Governments from giving birth to a new dangerous external debt burden that would give only temporary relief to the economy and would end up in damaging those countries' creditworthiness, thus hampering the spontaneous financial flows from the neighbouring industrialized countries that could step up the productivity of enterprises. Free-trade area transactions with EEC could be much more effective than large, Government-to-Government concessional loans.

Notes

1/ According to the Morgan Guaranty Trust bulletin, World Financial Markets, 1989, per capita GDP in Czechoslovakia is 15 per cent higher than in Hungary.

2/ M. Calasun and D. Rodrik, "Turkish experience with debt: macro-economic policy and performance" in J. Sachs (ed.), Developing country debt and the world economy, National Bureau of Economic Research, Washington, D.C. 1989.

Annex I

SUMMARY OF THE SEMINAR OF THE STUDY GROUP ASSISTING FORMER PRESIDENT CRAXI IN HIS MISSION AS PERSONAL REPRESENTATIVE ON DEBT OF THE SECRETARY-GENERAL OF THE UNITED NATIONS HELD AT CERNOBBIO, ITALY, ON 19 AND 20 MAY 1990

PART ONE

Minutes of the meeting held on Saturday, 19 May 1990

Statement by A. B. Atkinson, Professor of Economics, London School of Economics

Professor Atkinson pointed out that he intended to look at the debt problem from two different angles: income distribution and public finance. The accumulation of debt and the rise of interest rates had resulted in a great deal of misspending by developing countries.

On the other hand, high interest rates and the fall of commodity prices had had a very adverse impact on the debt service capacity of developing countries. The worsening of the terms of trade was the result of the interplay of economic and other forces outside the control of the developing countries.

The situation had had also unwanted effects on the income distribution of developing countries, which, to start with, were poor because the large majority of the population was poor and there was an accumulation of wealth in the hands of the ruling classes.

Debt reduction might also have negative consequences on income distribution in developing countries and industrialized countries alike. In the latter the reduction might be achieved either by transferring the losses to the Governments and therefore to the taxpayers or by leaving such losses to the banks and therefore their wealthy shareholders.

Finally, debt reduction had also had an adverse impact on developing countries' government machinery. Prolonged negotiations were very costly and diverted scarce managerial talent away from other functions.

Statement by Victor Constancio, Professor of Economics, University of Lisbon

Professor Constancio pointed out the relevance of high interest rates in the context of developing countries' debt. He stressed the negative factors that contributed to the deterioration of the prospects of developing countries' economic growth.

Commercial banks had increased their reserves for losses and envisaged stopping lending to developing countries. Moreover in the next few years, the demand for capital in Eastern Europe was likely to grow because of German reunification and the integration of the remaining Eastern European countries in the Western European economy.

As a consequence of the negative factors that continued to affect the debt situation, more than 50 developing countries had developed arrears on debt. In fact, the Brady Plan encouraged arrears. Besides debt with commercial banks, something must be done with official public debt; too little had been done by the creditor Governments, as could be seen for instance from the attitude of those Governments in the case of the debts of Poland and Egypt.

So far as remedies were concerned, according to Professor Constancio debt-equity swaps were difficult to handle. Bonds were too rigid an instrument to be widely used. The use of exit bonds indicated the willingness of too many banks to take their losses and get away, while new resources were needed.

Appropriate steps should therefore be taken to encourage both creditor Governments and commercial banks to increase their commitments to developing countries. In that regard appropriate tax incentives should be considered by creditor Governments, and commercial credit guarantees should be explored by the international financial institutions.

Statement by R. Devlin, Economic Commission for Latin America and the Caribbean

Mr. Devlin insisted that elimination of the debt overhang was a necessary condition for promoting growth and socially efficient adjustment. In that regard the Brady Plan was a positive step forward. However, it was often overlooked that debt reduction must pass through a critical threshold before it could transmit significant benefits to the debtors in the form of adequate cash flow relief and the normalization of medium-term private risk premium.

The Brady Plan was not achieving those critical levels of debt reduction. As long as the Plan formally operated in a voluntary setting, the achievable volume of debt reduction would be heavily conditioned by the amount of available public funding; hence the urgent need for a very large increase in the public resource commitment to finance debt reduction. The only alternative way to achieve a quick settlement of excessive bank claims was through a fully coercive debt reduction scheme. However, the emergence of a coercive scheme in the highly consensual societies of the North seemed even more implausible than a significant rise in funding for the current Plan.

Notwithstanding the above, if it was to succeed, the Brady Plan could not be truly voluntary. Even with improved funding there would be a need for transparent and systematic institutional pressure on the banks to ensure their full participation in debt reduction. In this regard IMF could play a constructive role by helping countries to define - in the context of reasonable rates of growth - their sustainable levels of debt service and by tolerating protracted arrears to those banks that might be uncooperative. The Brady plan also would be more efficient if the administration of the debt reduction exercises were placed in a specialized multilateral facility.

The Brady Plan additionally must expand its scope to include the reduction of the middle-income countries' Paris Club debt, as well as to incorporate new concessional refinancing mechanisms to alleviate the burden of debt service to multilateral agencies. To reverse the negative transfer of resource from the latter creditors, it would be necessary to make conditionality more flexible and link it more closely with formulas for immediate restoration of growth.

The prospects of quickly reinforcing the Brady Plan along the lines mentioned above were not at all good. Therefore countries inevitably would find it necessary to relieve their debt burden through protracted arrears and the introduction of unilateral repayment formulas.

Statement by Peter Nunnenkamp, Institut für Weltwirtschaft, Kiel

Mr. Nunnenkamp felt that IMF conditionality was not excessive: it was insufficient. Debtor countries were not constructive enough in that regard. An increase of resources by itself would not solve the problem. Additional resources could be useful only to the extent that they were well employed and only if the indebted countries' Governments adopted the necessary internal reforms.

There was a conflict between the measures aimed at debt reduction and the ones aimed at the inflow of new resources. As for the middle-income countries he felt that the so-called letters of intent were not adequate. Governments should have adopted policies of structural adjustment (and not only show good intentions) before debt relief measures were carried out. However, also for lower-income countries efforts to restructure their economies were needed, and debt relief should be given only as a reward for the efforts made.

Statement by Giorgio Ragazzi, Associate Professor of Economics, University of Bergamo

According to Professor Ragazzi, only a realistic approach could encourage commercial banks to keep staying in the indebted countries. Banks were likely to be ready to adopt limited measures to cancel their credits if they had reasonable expectations that the balance would be paid. Also, if the banks continued trusting the indebted countries, there would be an inflow of new resources.

However, that attitude was not likely to prevail if capital flight was not prevented: to act in that field the indebted countries should adopt fiscal and income distribution measures.

Statement by David Knox, Former Vice-President, World Bank

Mr. Knox based his remarks on his long experience at the top of the World Bank. With regard to the Brady Plan, he noticed that voluntary debt reduction methods did not work. The financial incentives were too costly, and without them the banks did not move. One would need not the carrot but the stick to force the

creditors into an agreement. On the other hand the position of the debtors became better as debts increased.

The likelihood of defaults was growing stronger; if it could not be avoided, then conciliatory methods must be found between debtors and creditors. The unilateral decision of Peru to suspend debt payments had ensured the country a couple of years of boom. However, the lack of control on the nature of imports, which consisted mostly of luxury goods and very few investment goods, had brought the country back into chaos.

Besides the debt question, the developing countries' problem was to put their economies into order. Capital flight was the consequence of financial and economic internal chaos. In the case of Mexico there was beginning to be some repatriation of capital, which was encouraging.

Statement by Nora Lustig, Visiting Fellow, Brookings Institute, Washington, D.C.

According to Ms. Lustig the Brady Plan would have limited impact on the growth prospects of the large debtor countries. The positive aspect of the plan was the acceptance that some - though limited - debt cancellation was warranted. The agreement reached on Mexico, however, showed that negotiations were too time-consuming; they had started in April 1989 and concluded in February 1990.

On the other hand, as a consequence of the debt situation and of the adjustment efforts of the indebted countries the poverty area had increased by 10 per cent in Mexico and Guatemala and by 20 per cent in Argentina. The most affected part of the population was the middle classes.

The major problems, however, were still tax evasion and capital flight. They put a big question mark on the economic prospects of the largest Latin American country, Brazil, which was also the one that had the strongest economic growth potential.

Statement by Mansour Khalid, President, Centre for Our Common Future, Geneva

Mr. Khalid focused attention on Africa's reality. IMF did not want to admit that its prescription for the whole of that continent had failed. IMF conditionality did not take into consideration the existing political realities. The economic reforms sponsored by the international financial institutions hit the weakest social groups in particular.

He drew the attention of the meeting to the fundamental role that public institutions played in African countries. The weakness of infrastructure had caused the failure of many development co-operation programmes. Often there was a lack of roads, power lines and technical personnel needed for the success of any economic reform programme.

In the developing countries, moreover, people behaved as if they were living in rich countries and had adopted the wrong development models. In most of these countries health expenditures were one third of defence expenditures.

It was in those countries where environment was most under attack. Examples were the destruction of the rain forests in Brazil and Indonesia. Environmental problems should be taken into account in tackling the debt issue.

Statement by David Cohen, Economist, CEPRAMAP, Paris

Mr. Cohen mainly dealt with buy-back operations. He pointed out that the funds provided by international financial institutions were worth much more than moneys provided by commercial banks (at least three times) as the latter made fresh funds available mainly to refinance unpaid interest or defaulted capital.

He also stressed that the cancellation of up to 30 per cent of developing countries' debt could not be considered a gift. In fact on secondary market terms, debt reduction of 25 to 30 per cent was not likely to have any impact on the market quotations of debt.

On the other hand, the instability of the secondary market made buy-back operations very difficult to handle. Only by introducing an element of secrecy might the fluctuations on the value of the debt be kept under control.

Statement by Arturo O'Connell, Former Professor of Economics, University of Buenos Aires

Mr. O'Connell stressed the fact that Latin American debt reduction would also be profitable for industrialized countries; in fact it would increase substantially Latin America's import capacity. With that point in mind the taxpayer opposition would become a much less important argument.

Multilateral debt should be rescheduled. In fact, most Latin American Governments used bilateral funds to pay back multilateral debt. He felt that the inflow of new resources could not take place unless capital flight was brought under control; however, such flight would continue unless there were good prospects for economic growth.

On the other hand, capital repatriation did not provide any kind of debt relief to the country, as the capital was in private hands, while the debt was public. That circumstance raised the issue of tax reforms in developing countries, as a means to provide Governments with enough funds to pay their foreign debt. That was the case of most Latin American countries where also export proceeds were usually in private hands; only Chile was in a different situation, as the Government still owned the copper mines, i.e. is the main foreign exchange earner of the country.

Mr. O'Connell felt that the Brady Plan was far too expensive for the debtor countries. In fact although on paper Costa Rica paid 16 cents to the dollar, he felt that the actual cost for the country was 70 to 75 cents.

Industrialized countries would also have to come to terms with their growing protectionism if they wanted to help developing countries out of the debt crisis. Even if he felt that in most countries trade restrictions were deeply entrenched with the ruling classes, a financial solution might be easier to attain.

Statement by Riccardo Faini, Associate Professor of Economics, Johns Hopkins University, Bologna, Centro Luca, D'Agliano, Turin

Professor Faini examined the structural adjustment programmes. Not even the new generation of development-oriented programmes was adequate to give a fresh start to economic growth. Too little attention was being given to developing countries capacity to carry out such programmes in reality. Actually, he had some doubts whether they could be carried out at all.

The net result of the programmes so far enforced had been a lowering of investment, first of all public investment. Public finance was the most unstable sector of developing countries economies. Little was known about income distribution and the influence on it of structural adjustment programmes.

There was no need for a separate international agency to deal with debt. The main problems were rather theoretical, namely to define the most appropriate methods of intervention in developing countries economies.

Statement by Roger Lawrence, Director, Resources for Development Programmes, United Nations Conference on Trade and Development, Geneva

According to Mr. Lawrence there was a need not only to proceed to some debt reduction but also to strengthen the conditionality criteria. As for the Brady Plan, he pointed out that there had been a transition from a strategy of new loans to a strategy of debt reduction; that fact ended up discouraging the flow of new resources, which was still the main problem.

The United States had budget problems; it was not certain that European countries were willing to step in. Even the countries that were of most interest to Europe, i.e. Mediterranean, sub-Saharan and Eastern European countries, had not benefited enough from the Brady Plan or the Toronto agreements. European initiatives could, however, take advantage of Japanese support.

The idea of a new agency on debt, within IMF or the World Bank, was an initiative that was likely to be very unpopular in Washington. However, in his opinion international financial institutions should go back to their traditional role.

PART TWO

Minutes of the meeting held on Sunday, 20 May 1990

Senator Forte opened the second day of the meeting, asking that the discussion be limited to the following two subjects: new sources of financing and conditionality.

He said that the first item should not be necessarily confined to the traditional kind of financing but it could cover commodity trade, private investment, etc.

As for the second subject, he invited those present to focus on whether such conditionality should be ex ante or ex post. He envisaged a more selective conditionality based on ratios geared to economic development, income distribution and poverty alleviation. Some form of conditionality was necessary but it should concentrate in those priority areas.

The next problem tied to conditionality was how to enforce it. In particular he expressed some doubts as to whether the World Bank or IMF could interfere in a country's domestic policies, especially when they were tied to regional elements.

Mr. Ruffini stressed the fact that World Bank-IMF conditionality, as it was currently designed, entailed an infringement of a country's sovereignty. Although recognizing that the international financial institutions had the duty to suggest, or even to demand, that countries manage their economies properly, they should by no means interfere with the political basis upon which those countries' economic systems were built.

In fact the international financial institutions based their conditionality upon four dogmas: devaluation, deflation, liberalization and privatization. It could not be denied that often currencies were overvalued. However, devaluation as a way to expand exports made sense in a Ricardian model; in a world in which developing countries' trade was controlled by multinationals, that measure was of little help to the devaluing country, and even less so when prices of the main export commodities were in dollars. In fact the measure ended up with inflationary effects, lowering real wages; similar results could be achieved by raising custom duties, which would also increase government revenues.

Deflation was a correct measure to take when, by limiting domestic demand, more goods were made available for export. But in the case of tropical crops it could hardly be argued that domestic consumption was the factor limiting export expansion.

If borrowing countries wanted money from international financial institutions they were asked to lower, if not to eliminate, their tariff barriers. The industrialized countries were not asked to act symmetrically. That fact decreased the bargaining power of developing countries in the Uruguay Round.

Privatization should be undertaken carefully in specific fields only, as it often meant exploitation. It was surprising to note that the World Bank had suggested the privatization of low-income housing in countries where dwellers of slum shacks paid more per square metre than people living in medium-income areas.

Therefore the way international financial institutions approached those measures should be reviewed and the use of the conditions monitored, to avoid both distortionary effects in the recipient country's economy and qualifications as to the credibility of international financial institutions themselves.

Mr. Draghi, in responding to the list of questions in the questionnaire, suggested that the adjustment policies suggested by IMF had been satisfactory after 1986, changing from deflation- to development-oriented. IMF had ceased looking at the short term to recommend policies with a longer-term outlook. In particular it had been giving emphasis to improvements in tax collection systems of middle-income countries, as constraints on their budgets caused first of all cuts in the social services. In poor countries, particularly Africa, institutional development measures were recommended.

As to the second point, the Brady Plan, he suggested, was on the right track. However, there were constraints as to the financial resources. Moreover, international financial institutions should be given more of leadership role to compel both sides to reach an agreement.

The financing should come from the commercial banks' balance sheets (i.e. defaults on the debt), from industrialized countries' budgets and from foreign capital. In particular he suggested the repatriation of funds channelled abroad. To achieve the latter it would be necessary to restore the confidence of local investors and to achieve an appropriate exchange rate of the local currency.

He felt that, in the short term, aid programmes did not need to detract priority away from developing countries and in favour of Eastern Europe. Only in the medium term might priorities need to be redesigned. As for the debt reduction techniques, he suggested that it would be a mistake to leave countries and banks free to choose; it would give no certainty to negotiations.

His assessment of the Toronto programme was positive in general. For the lowest-income countries he suggested total debt cancellation. He also suggested that international financial institutions should get more involved in the process of negotiations. However, that fact may not be good for them as it would increase their responsibilities and potential liabilities.

As for the new sources of finance, Professor Atkinson pointed out that, if industrialized countries increased their transfers from the current 0.4 of GNP to the 0.7 target, about $40 billion would be made available, which might be a good enough level. However, industrialized countries might face internal political problems in trying to achieve such results.

Professor Constancio stated that developing countries had spent too large sums of money in debt conversion exercises, in providing guarantees and in capitalizing

past due interest. Therefore they should concentrate on improving the strategy of arrears management. Controlled default on existing debt might be in the interest of developing countries.

As for the sources of finance he supported the idea of money creation at the international level. In the past he had proposed on several instances an increase of SDRs to finance developing countries' debt. The case for that approach was now stronger, because of the developments in Eastern Europe and the likelihood of an increase in capital outlays following the unification of Germany.

As for conditionality, he pointed out that developments were on balance positive, even if there was still large room for improvement of existing techniques, in particular the need to have a longer-term outlook and to pay more attention to the supply-side effects of the measures proposed. Sometimes growth was limited by lagging infrastructure. Often in budget adjustment efforts it might be wrong to look at the budget deficit per se. Devaluations often did not work because developing countries went wrong in other directions, but they sometimes were necessary. Liberalization might be necessary, but only in trade between developing countries. Privatization was fashionable but justified only in a few cases.

Mr. Nunnenkamp stressed that, with regard to conditionality, two points must be stressed: timing and priority. The experience in that field was rather poor. Hundreds of letters of intent had failed because they were not enforceable, as sovereign risks were at stake. He was very skeptical on ex post relief, since the measures to implement adjustments should be in place ex ante, i.e. before debt relief was implemented.

So far as priorities were concerned, he agreed that equity and income distribution were very significant. However, improving existing efficiency should come first.

With regard to new sources, he felt that the initiative should be left first to private sources. Banks and private investors were very quick in reacting positively to positive action on the side of debtor countries. However in the case of sovereign risks, some time may be needed to restore the credibility which had been lost as a consequence of past bad performance. Voluntary debt reduction and injection of new money happened normally in private business life. There were no reasons why it should not take place in the international arena. The main obstacle was only the uncertainty about the behaviour of the debtor countries.

According to Mr. Nunnenkamp, international financial institutions should keep to their traditional role. He would be hesitant to recommend that they get involved in debt relief operations, as they would suffer from an administrative point of view and their financial viability might be jeopardized.

Mr. Draghi suggested that to remove the debt overhang new financing might not prove necessary. What was needed were reforms without a high level of debt.

Mr. Ruffini supported the opinion that no new debt should be incurred. In fact from the Brazilian case it could be observed that, over more than 30 years, in 1987 the national debt dollars had increased at a rate 24 times higher than the growth of the per capita income. That clearly showed that either the Brazilian Government had mismanaged its foreign debts, that growth should not be financed with debt alone or that, if a country became involved into a debt spiral, debt was self-generating.

He also pointed out that developing countries spent more that 100 billion dollars a year in military expenditures, without taking into account the expenses for police force maintenance. A cut of half would mean that resources would become available for development in excess of four and a half times the average yearly lending of the World Bank over the last 10 years.

Mr. Knox considered it difficult to persuade industrialized Governments to put up more funds to solve the debt issue, as they had doubts that such funds would be used wisely. The debt overhang could be absorbed through controlled default by developing countries on their bank debts as well as on their debt with official institutions. He recommended that in future discussions priority be given not to the idea of putting up more money, but to accepting partial default. New lending would not take place unless prospects for developing countries improved.

From experience he stated that conditionality could be imposed. Countries might only be persuaded to take some measures. Unless they agreed to take some steps, they might give the impression that they accepted the lenders' conditions, however, by and large those conditions were not applied. Therefore the whole matter became an exercise of self-delusion. Conditions were therefore applied only when there was a political will and consensus to enforce them.

Exports were mostly in the hands of the private sector; when foreign exchange was generated by those exports, external debt, which was mostly public, might be honoured only if the Government had the resources necessary to make the payments on such debt. The political will to increase these resources through taxation or similar measures still needed to be forged.

Mr. Mansour said that, with regard to the new resources necessary to tackle the debt problem, there was strong evidence that there was a case for reverting to multilateralism. More funds should be committed to Africa's priority programmes not based on acceptance of the international financial institutions' recipes, as targets could only seldom be met. There was a strong need for people in the industrialized contries to push their Governments to act. After all it was the people who pressed for the relief aid to Africa and, in the case of Italy, for the setting up of a special fund (FAI).

Some of the money released from disarmament in the first and third worlds alike should be used for debt relief and development purposes. However, in doing so, much more attention should be given to the environmental impact of such action. It was about time to stop the talking and to start funding specific projects aimed at environmental conservation.

Mr. Cohen recalled that one dollar of new money made available by multilateral institutions was worth much more than a new dollar made available by commercial banks. In fact the latter entailed some rescheduling and interest financing on a debt whose market value was lower than its face value.

International financial institutions loans should take precedence over the ones extended by commercial banks. Transforming bank loans into bonds de facto gave precedence to the latter. Since bonds had little flexibility, if they were not serviced at maturity, international financial institutions would have to provide funds to service them. That fact by itself meant that their lending had lost seniority. However, that did not mean that he was against transforming bank loans into bonds. It meant only that the bonds should be rightly priced, at an appropriate discount on the face value of the loans. Technically, there were many options for solving the debt issue; the problem however could not be tackled unless prior agreement was reached on the right price.

As for conditionality, he felt that the main condition that should be sought was an increase in government revenues. In the indebted countries the foreign exchange resources were there, but what was lacking were the transfers to the Governments to allow them to make payments.

Professor Dornbusch felt that there were several issues at stake:

(a) How much write-off could be encouraged? Many countries could pay all their debt, for instance Brazil. It was just a question of providing new funds to bring about the necessary improvements in the situation of the country. Banks should provide those funds and should be encouraged to do so;

(b) Public debt was far more important than the debt with commercial banks. However, simple rolling over of the public debt was not the answer; some write-off and cancellation should also take place, particularly in the poorest countries. Moreover there were no reasons why the commercial banks should be the only ones to suffer;

(c) The World Bank should be pushed to take action parallel to the state of development of the real world. It should therefore gear the repayment schedules of its loans to the change of prices of the main export commodities of the debtor country. The World Bank had a portfolio diversified enough to accommodate a decrease in repayments by some countries, to be offset by an increase by others;

(d) Some debtors, like Mexico, had done everything necessary to redress their economies. Now they were on the threshold of a boom if a large standby credit was forthcoming. In fact, it was very likely that the capital which had fled the country would go back when good policies were implemented and if new funds were invested thus contributing a quick recovery and growth. The developments in Mexico indicated that the conditionality might have a positive impact;

(e) With its trade surplus, Brazil could pay back every penny of its debt. All the Government needed to do was to increase its tax revenues, and to lay the ground for reactivating the financial market;

(f) The cases of Argentina and Peru were quite different. In those, and in similar cases, interest should be capitalized and added to the outstanding principal. The total money due should be tendered at auction and repurchased by the debtor countries at a large discount each time they matured;

(g) The new debt should be tied to an inflow of foreign investment. There was much room for growth in productivity as a vehicle for economic expansion.

So far as conditionality was concerned, he felt that a serious adjustment process brought some countries to the verge of a boom, because they did the things they had to do.

On item (f) he specified that any interest due should be capitalized, automatically added to the outstanding principal and amortized by annual reductions at auctions, in which the maturities should be redeemed at secondary market prices for several years (five to six).

Currently, however, the banks' position was quite the opposite. It was recognized that there might be a need to change the accounting rules. Bank auditors should look at capitalized interests as income, otherwise loans could not be considered as performing assets, but only tax-deductible loss.

The problem would be how to convince Brazil that it was able to pay and not receive a debt reduction if others did. Countries could not be forced into the Brady Plan. a/

Professor O'Connell stressed the fact that there was an element of asymmetry in the conditionality of the international financial institutions. It was imposed only on developing countries while nothing was done with industrialized countries. After all the current debt situation was much the consequence of the trade imbalances of the rich countries, which led to the decline in commodity prices as well to their fiscal imbalances, which caused a growth of interest rates. In other words the industrialized countries were the main cause of the historical plunge of developing countries' terms of trade.

A simulated shadow balance of payments for Latin America at normal conditions showed an enormous surplus. In spite of that, compensatory financing had received only insignificant funding. The oil facility scheme, which was financed by the oil surplus countries which provided sufficient funds, has not been carried over to other commodities. What was needed would have been a contingent financing mechanism to compensate for changes in commodity prices and interest rate levels. That scheme should have been funded by the countries in surplus; it had never been put into place by IMF, in spite of the offers made by Japan. Now the solution would be too late, as the situation had become chronic.

He felt that it would be difficult to persuade developing countries to put order in their accounts, when the situation was a consequence of a major confusion in the budgets of industrialized countries. As for the former, he recognized that tax reforms were needed to increase income to pay for the subsidies needed to carry out economic reforms.

Mexico's adjustment measures had caused a decrease in real wages. The same actions in Argentina would cause a fall of real wages of the order of 35 per cent. He felt that some steps were needed to correct developing countries' strategies and performance; however, the necessary conditions must be into place and a few ideas on conditionality must be corrected.

He agreed that several countries were able to pay. What was lacking was the mechanism to allow repayments (i.e. compensatory financing) since debt reduction, as an up-front operation, could be the only answer.

Notes

a/ For the specific case of Brazil, see Professor Dornbusch's paper in annex III.

Annex II

SOCIAL AND ENVIRONMENTAL IMPLICATIONS OF AFRICA'S EXTERNAL DEBT

by

M. KHALID

Both internal and external factors have been responsible for the African debt crisis. Internally, the tendency of allocating resources to consumption rather than investment, the low return to public sector investments and policy weaknesses, including inadequate fiscal discipline and price and capital market distortions contributed to a situation where savings and investment levels have fallen far below those of other developing countries, thereby constricting the ability to service debt. Thus, unlike in some Latin American countries such as Brazil, debts became the single major issue in Africa's economic life. Brazil, although heavily indebted, was not destroyed by its heavy debts because the money it borrowed was used wisely. For example, and taken as a whole, while the ratio of the external debt to the gross domestic product (GDP) was almost identical in both Latin America and sub-Saharan Africa in 1980 (37 per cent and 30 per cent respectively), by 1988, the ratio had galloped to 111 per cent in the case of Africa, while it had increased only to 54 per cent in the Latin American case.

Externally, the boom years of the 1970s fostered by a surplus of petrodollars had encouraged large-scale borrowings to sustain levels of spending that were difficult to retrench after the boom collapsed. The overhang of export credit, which was contracted on commercial terms during this period, remains among the most intractable of the current problems. The weakness of commodity markets in the 1980s greatly reduced returns on African investment in primary commodity exports. Combined with rapidly increasing prices for imports, they contributed to a serious decline in sub-Saharan Africa's terms of trade. The draining effect of the worsening terms of trade was exacerbated by declining export volumes, relative even to other low-income countries.

According to the United Nations Economic Commission for Africa (ECA) Africa lost $US 50 billion in the last three years of the 1980s in the potential earnings of only three crops: coffee, cotton and cocoa. This grim situation was not helped by the severe droughts of 1972 and 1984. In actuality, according to estimates of the United Nations Conference on Trade and Development (UNCTAD), debt-service ratios would have been from 30 per cent to 40 per cent lower had sub-Saharan Africa maintained its share of world markets.

In addition to the foregoing, there were increasingly adverse trends in world capital movements. After 1981, net capital flows to sub-Saharan Africa declined substantially in real terms, with a 30 per cent fall in 1984-1985 alone, owing in part to the virtual cessation of commercial lending. Global aid levels were also stagnant, although some donors have marginally increased the share of their aid to sub-Saharan Africa. Significantly, United States aid to Africa has dwindled in this period. Only 11 per cent of total United States aid went to that region, which is much below the average for other donors and even down from the United States' own 15 per cent in 1984-1985. In reality despite all the talk about alleviating Africa's debt burden, the situation on the development assistance front has, if anything, worsened. According to the last annual report of the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD), the net disbursement of official development assistance (ODA) by its 18 members amounted to $46.5 billion in 1989, compared with $48.1 billion in the preceding year.

Africa's debt, in overall world terms, is not noteworthy solely on account of its magnitude. In 1988, the continent's external debt amounted to $230 billion and the combined totals for 44 sub-Saharan countries only equalled the current amount owed by one Latin American country, Brazil. Furthermore, according to 1988 figures, only eight African countries have debts averaging or exceeding $5 billion: Côte d'Ivoire, $14.1 billion; Sudan, $11.85 billion; Zaire, $8.47 billion; Zambia, $6.49 billion; Kenya, $6 billion; Mozambique, $5 billion; Cameroon, $5 billion and Nigeria, over $30 billion.

Although the African debt problem has attracted considerable interest by policy makers, suggested remedial measures have been unable to alleviate the crisis significantly. Many countries remain unable to meet their debt servicing commitments and their minimal operating requirements of foreign exchange. It is suggested therefore that the starting point must be a correct assessment of the structural characteristics of African debt, rather than theoretical responses to, and over generalizations about, the crisis. In this respect, the following points concerning the situation of the low-income, debt-distressed countries of sub-Saharan Africa can be made:

(a) Total debt is small compared to global figures, and poses no threat to the viability of the international financial system as opposed to the debt of the highly indebted countries;

(b) Ninety-eight per cent of the debt is public or publicly guaranteed and 86.3 per cent is owed to official creditors;

(c) Relative to exports and economic activity, sub-Saharan Africa's debt problem is extremely serious, with debt ratios well above those of the highly indebted countries, in spite of the fact that debt servicing ratios may seem to be lower owing to concessional rates and extensive reschedulings;

(d) Although the total debt is small in absolute terms, it is the worst in the world compared with income. Africa's debt, given the weakness of its economic base, is superior to the continent's GDP. (Africa, with its 550 million people, has a GDP of $288 billion, compared with $142.3 billion for Belgium, with 10 million inhabitants.);

(e) Since the emergence of the problem, debt and debt-service ratios have continued to rise. In fact, they rose faster in the 1980s for sub-Saharan Africa than for any other group of countries in the 1980s. During the period 1980-1985 developing countries' debts rose by almost 60 per cent; in Africa the growth was 77 per cent. Annual growth rates of the debts of the former countries during 1980-1988 was 8.5 per cent whereas in Africa it was 11.2 per cent. Debt relief has so far been unable to reverse this perilous tide.

In view of all those factors a high proportion of African countries, according to the Wass report, face large debt difficulties, which include: mounting arrears on trade payments and debt servicing; gross international reserves well below those required for commerce (negative net reserves); and frequent recourse to Paris Club and London Club reschedulings. And despite this inherently combustible situation,

all strategies designed by creditor nations have failed because they were not envisaged as a co-ordinated assault on the debt front; the problem of debt was treated as an issue isolated from other economic internal and external factors. On the other hand, the debt issue has been the major preoccupation of African Governments since 1980, to the point that it was placed at the top of Africa's economic agenda. In 1984, the African Ministers of Finance adopted the Addis Ababa Declaration on Africa's external indebtedness, which was subsequently endorsed by the Assembly of Heads of State and Government of the Organization of African Unity (OAU) at an extraordinary session, in a document known as "Africa's common position on debt". According to that document, the debt problem can neither be approached by African countries individually (hence the call for a common African approach), nor can it be resolved by the African countries alone.

To the African Heads of State and Government the "debt crisis of Africa will only be solved by an overall and equitable approach within the framework of an integrated, co-operative development based on a strategy that takes into account the particular characteristics of the debt crisis in Africa. The strategy for the solution of Africa's debt problem should be based on co-operation, continuous dialogue and shared responsibility, and should be implemented with flexibility in an environment of strengthened international co-operation, bearing in mind the United Nations General Assembly and UNCTAD resolutions adopted in that respect". Africa was, virtually, drawing the attention of creditors to the interrelatedness between debts and the asymmetries of international trade. Africa, together with other developing countries, has been calling within UNCTAD for an integrated programme for commodities based on a regime of international interventions to stabilize commodity markets and supported with enough funds.

Creditors, however, are yet to recognize those exogenous factors of the crisis; instead they offered temporary relief through debt rescheduling. Thus, between 1970 and 1982, African countries asked for and gained 83 reschedulings, which only aggravated the pain; according to ECA reports debt rescheduling adds annually over $1 billion to total African debt. That debt, at the time of the OAU summit, stood at $200 billion, representing 45 per cent of the continent's GDP and 293 per cent of its export earnings. Despite reschedulings, debt service payments continued their upward surge unabated and faster than actual disbursements; the net transfer of financial resources to Africa plummeted from $20 billion in 1979 to $3 billion on the eve of the African debt summit.

What is more alarming is that international financial institutions (Africa's main partners in development) became the most exacting of all Africa's creditors. For example the International Monetary Fund (IMF) became a net recipient of flows from Africa each year since 1986. Sub-Saharan Africa, in this respect, fared worse than any other region in its relations with the Bretton Woods institutions, especially IMF; 24 per cent of Africa's debts, as opposed to 11 per cent in Latin America, is owed to those institutions. Since rescheduling is not available to IMF under the terms of its inception, what resulted was net reverse flows from the African countries to that institution. In 1986-1987 alone, $1 billion went from Africa to IMF. Whatever the justifications or explanations given to this situation, the existence of the negative flow means that there is a problem to be addressed, particularly by institutions whose role is to spur growth rather than

procure profit. In this respect any strategy for debt relief in sub-Saharan Africa must start with putting an end to the negative transfer of resources from the rich to the poor. In relative terms, the total expenditure of the World Bank and the International Development Association (IDA) on Africa in 1989 totalling $3.9 billion was less than the Bank spent on its three major recipients (Mexico $2.2 billion, India $2.1 billion and Indonesia $1.6 billion). In effect, Africa represents only 20 per cent of the International Bank for Reconstruction and Development (IBRD)/IDA engagements.

In the circumstances, debt service payments should be limited to a ratio of the region's annual earnings that is linked to the availability of resources to enable continued annual growth of GDP and per capita income.

Despite Africa's cri de coeur, the selective and fragmented approach by creditors to the debt problem continued to be the order of the day. Debtor countries were dealt with on a country-by-country basis. Debt relief was also tied to stringent programmes of structural adjustment such as the World Bank Special Programme of Assistance (co-financed with donors) and the IMF Enhanced Structural Adjustment Facility (ESAF). Prompted by IMF, the Paris Club has also stretched repayments to 15-20 years. All those are palliatives which only delay the day of reckoning. As far as low-income Africa is concerned, probably the most significant measure was the decision of some donor countries to convert partially their official debts into grants. This write-off of bilateral official debt should be total and generalized. It is because of this selective approach by the creditors that the OAU Assembly of Heads of State and Government, at the African debt summit, called for an international debt conference in which all creditors, debtors and financial institutions would participate and whose decisions should be binding to all.

For a long time creditor nations were, understandably, more concerned with Latin America's debts; the very notion of a debt crisis received more publicity in the industrialized world, eight years ago, in the wake of Mexico's announcement that it could no longer honour its obligations. But while Latin American debts are largely owed to commercial institutions, African debts are mostly owed to international financial institutions and official bilateral creditors and thus have no direct bearing on international financial markets as in the case of Latin America. Also by its sheer size, the Latin American debt is of greater concern to private commercial institutions and their Governments than the African debt.

Consequently, all the major plans to tackle the debt problem were basically addressing the Latin American debt. Both the Brady Plan, launched by the United States Treasury Secretary in 1989, and the moribund Baker Plan (initiated by his predecessor) barely scratched the surface of, indeed were of little relevance to, the African debt. Forty per cent of the annual service payments in Africa are related to non-concessional debts and paid (or supposed to be paid) to the Bretton Woods institutions, not to commercial creditors. Even within the Latin American context those plans have virtually collapsed not only because of underfunding, but also because of the mistaken belief that private creditors would voluntarily agree to debt and debt service reduction. This view is now shared even by the Bank of International Settlements (BIS); in its most recent report (June 1990), BIS

concluded that the likelihood that debtor countries and creditor banks would make significant progress without a mediator who was prepared to be more than just a mediator seemed, if anything, to have diminished. BIS was also sceptical about the usefulness of rescheduling commercial debts and extending new loans on commercial terms. According to BIS, it was not even clear whether, except for self-liquidating trade finance, the extension of further loans at market terms would be in the interest of the debtor countries themselves. The issue, therefore, is not new money but the terms and conditions on which this money is given and the manner in which it is being used by the recipients. Within the present scheme of things rescheduling only aggravates the problem. In 1989-1990 alone Africa, as a result of rescheduling, has taken on an additional debt burden of $5 billion, bringing its total debt to $114 billion.

Environmental impact of African indebtedness

Sub-Saharan Africa has suffered a grave deterioration in per capita income and consumption during the 1980s, when the standard of living continued to fall by 1.2 per cent annually. The impact of this decline has been most felt by the least privileged sectors of society. Although many factors have contributed to this situation, the debt burden is still an extremely important one. Most seriously, this has reduced the amount of foreign exchange available to purchase imports, leading to a very severe import strangulation depriving industry and agriculture of needed inputs. That, in turn, held back new investment and curtailed efforts to maintain existing capital stock, further reducing consumption standards and incentives for greater work efforts. Debt servicing has also absorbed resources that could otherwise have been devoted to investment. Those pressures, as well as the pressures ensuing from adjustment policies supposedly needed to address the debt problem, led to the degeneration of social welfare in the areas of health, education and the well-being of vulnerable groups.

A variety of these factors interact to create a vicious circle. Import strangulation holds back export growth, thus perpetuating import shortages. The uncertainties created by the debt situation and the rescheduling process further depress investment, which, in turn, holds back the restructuring necessary if the economies are to recover. Depressed export earnings and import capacities reduce government revenues, thereby increasing budget deficits and weakening Governments' abilities to improve the balance of the economy. It will take a huge effort if these vicious circles are to be broken.

In addition to the economic impact, the onerous burden imposed by the debt crisis and responses to it by international lending agencies have taken their toll on the environment. Poor people denied opportunities to engage in economic activity in the formal sector are driven to marginal activities, often with harmful effects on the environment. Landless rural labourers without employment start scratching a precarious living by farming on fragile lands without being provided with basic inputs, thus causing accelerated soil erosion and environmental stress. Thus deforestation, overgrazing and overcultivation became endemic in many areas in sub-Saharan Africa. Plans initiated by the United Nations to rehabilitate degraded land such as the 1977 United Nations Plan of Action to Combat Desertification was

an unqualified failure simply because it was denied the needed resources. For one thing the Plan does not promise immediate economic returns but long-term benefits; and donors are in a hurry to see the results of their intervention.

Examples from other parts of the world show that environmental degradation may even be accelerated by economic adjustment policies imposed by IMF and the World Bank. For example, the disastrous environmental effects of Chile's export-led growth are only now becoming apparent and the "Maquiladora" export processing plants on the Mexican-United States border are creating a wasteland as chemical wastes are indiscriminately dumped in neighbouring areas, or recycled in plants not equipped to deal with them. Thus, pressures from international agencies on debtor countries to increase exports so as to service foreign debts may be, in the absence of any environmental safeguards, injurious to the development and environmental integrity of those countries. To add insult to injury, there is now evidence to suggest that some multinationals, in order to evade stringent environmental measures in industrialized countries, are increasingly locating in developing countries where such measures can be ignored.

In view of the above, the design and implementation of any economic corrective measures have to be based on an understanding of the concrete realities and stark choices facing Africa rather than on stylized economic models and theoretical constructs that may have little bearing on reality. Any attempts to deal with the African crisis should have as a point of departure an understanding of the continent's political economy context, based on the recognition of the direct relationship of the environment to sustainability in that the natural resources base on which the sustainability of future development depends has been significantly and consistently undermined by natural and anthropogenic factors.

It should also not lose sight of the human dimension in all its manifestations. Indeed, this perception has led some commentators to conclude that macro-economic management initiatives have done more in the recent past to damage the environment than the sum total of all the environmentally damaging projects. It is, therefore, necessary to set aside doctrinaire approaches to the problem and to adopt a pragmatic problem-solving approach.

The structure of the sub-Saharan African economy is characterized by manifestations that include:

(a) The predominance of subsistence and exchange activities;

(b) A narrow industrial base with little or no indigenous technical capability;

(c) An urban bias;

(d) A fragmented economy;

(e) External dependency and vulnerability to external shocks;

(f) Weak economic institutions;

(g) Widespread environmental degradation;

(h) Low popular participation in the decision-making process and political marginalization of the majority.

This situation poses a grave challenge to those involved in African development. But there is more to development than quantitative growth; an increase in GDP alone is not necessarily development and certainly not sustainable development. The response to Africa's economic crisis, therefore, should go beyond econometrics. African people need to be set free to realize their individual and collective potential. The top-down development processes of the past three decades have kept people as bystanders and to integrate them in the development process there must be social and political motivation, not only economic incentives as IMF would want to make us believe. Thus, any structural readjustment measures of the region's economy should go beyond generalized models and should be inspired by endogenously conceived strategies.

There has recently been considerable debate on the effects of World Bank/IMF structural adjustment programmes (SAPs) as they were applied in the recent past. Reported successes in the effects of SAPs have been severely contested, not least by African economists of ECA. Nevertheless, the fact remains that aspects of economic policy management such as public enterprise efficiency, better targeted subsidies, improved agricultural incentives, marketing systems and supportive infrastructure. The implementation of those measures has considerably improved the managerial and institutional capability of many African Governments to implement reform programmes.

The debate, therefore, is centred on what is perceived to be the doctrinaire approach of SAPs, as they have been so far implemented in Africa. It is felt that the imposition of the orthodoxy of Western industrial economies on a continent characterized by institutional weaknesses and gaps, fragmented economies and dependency on the international capitalist market was inappropriate. Conventional SAPs have not taken into account those specificities of African economy, particularly when it comes to trade, monetary policies and economic management. In this connection ECA economists have raised the following objections to SAPs as they were applied to Africa:

(a) Exchange-rate polices advocated in SAPs invariably involve substantial devaluations and do not take adequate account of the dependence on monocultures and primary commodity exports, which are subject to quotas and market fluctuations owing to factors outside the control of developing countries;

(b) In view of protectionist policies, widespread heavy subsidization of agriculture in developed countries and the adverse effects of foreign competition on trade liberalization SAPs may be an inappropriate policy response;

(c) Privatization initiatives have been based on the incorrect assumption that the indigenous private sector is competitive or strong enough to take over State enterprises;

(d) Tight credit policies usually lead to contraction in output. A sustained policy of tight credit could in fact reduce existing capital stock that could not be replaced and undermine future growth;

(e) Although high-interest rates may increase savings levels, highly imperfect capital markets encourage speculative and short-term activities and fuel inflation;

(f) Pricing policies are based on the false assumption that markets are competitive. Widespread and consistent market failure has in fact seriously undermined the basis of orthodox SAPs.

The IMF conditionality relating to trade liberalization applied to the poor countries would have made sense if it were accompanied by similar measures to correct structural imbalances in the economies of the rich, e.g., imbalances caused by higher rates of interest, low commodity prices induced by subsidies to agriculture, etc.

Such measures, to have any meaning, would have to be supported by a system of compensatory financing to help to remove the imbalances, as was the case with the oil facility introduced in the 1970s to help the poor countries to face the impact of the sudden meteoric rise in oil prices. The surplus countries of the 1980s and 1990s (Germany and Japan) should be called upon to undertake such a role as the surplus countries of the 1970s (the oil producers) were constrained to do.

Equally, while IMF urges the developing countries to engage in liberalization, it has become tight-fisted towards the farm policies of the industrial countries, which represent one of the greatest barriers towards international free trade. The 24 countries of OECD alone spend $270 billion annually in subsidies to agriculture. According to the OECD report on agricultural policies, markets and trade (June 1989), few Governments within the organization have introduced programme changes in line with the long-term objective of letting market mechanism influence agricultural production. This policy is doubly damaging to Africa. For one thing the artificially depressed prices of agricultural commodities elbow African producers out of the market and secondly those producers are constrained to produce more in order to maintain the same levels of real income, which results in more use and abuse of natural resources.

However, there is now increasing realignment of positions, although not consensus, between contending points of view; for example, all parties now recognize that there are important roles for the State and important roles for markets and prices and those roles vary from country to country. In the words of President Gorbachev, "the market came with the dawn of civilization and it is not an invention of capitalism. And if it leads to improving the well-being of the people, then there is no contradiction with socialism". But while the arch-enemies of market economy have, at long last, undemonized the market, the supporters of market economy are yet to demythologize it; to them the market is the answer to all economic ills. What Africa needs, above all, is the development of its physical and social infrastructure, and this is hardly a job for the market or private initiative to undertake.

In effect, the private sector, which is so dear to the ideologues of IMF, can only assume its proposed leading role if it is armed with the needed skills. In this respect what Africa lacks is not entrepreneurship but advanced skills among its entrepreneurs. Even in its primitive form, it is the entrepreneurship of Africa's informal sector that has kept the continent alive in spite of, and not because of, government policies. With the onslaught of drought and famines and the ravages of civil wars and inter-State conflicts, the African people still survived thanks to the resourcefulness of the informal sector, both within and across the borders of African States.

However, for this sector to develop in a continent where levels of illiteracy reach 80 per cent, attention must first and foremost be given to education. That attention can only come from the public sector. The Indian miracle, to a large extent, is the result of the two-pronged policy of expansion in education and self-sufficiency in food. As regards the former, India today boasts of having the third largest pool of trained manpower in the world after the United States and the Union of Soviet Socialist Republics.

Equally, divergencies exist between, on the one hand, IMF, which has advocated orthodox SAPs with little variation, and on the other, agencies such as ECA and the United Nations Children's Fund (UNICEF), which have, primarily, given concern to the human dimensions and socio-political foundations on which adjustment has to be built. Some of the conclusions in the World Bank/UNDP report, Africa's Adjustment and Growth in the 1980s were described by ECA as both arbitrary and misleading. However, in 1989 the World Bank's report on Africa began to take a more refreshingly objective view of the real nature of the obstacles facing African growth. Basic factors impeding development, the Bank admitted, will have to be removed; e.g., absurdly high levels of imports, export dependency on monocultures at the expense of domestic food security, the relative failure of governance, high defence expenditures and the unsustainable Western lifestyles of the élite. Other major issues that need to be addressed with some urgency concomitant to the above are the issues of debt, environmental degradation and democratization. The World Bank's 1990 report has gone a step further and called for a fight against poverty through new policies that promote the productive use of human resources.

Thus, international financial institutions are increasingly accepting the fact that strategies devised to alleviate the debt burden are barely scratching the surface and that without radical solutions African economies face tremendous economic dislocation and will increasingly default. What Africa needs is a complete political and socio-economic transformation, not only adjustments that are primarily concerned with changing the structure of price, production, ownership, employment and the rate of exchange. This transformation, to be effective, should be envisaged within a reformed international economic order that is more equitable, more humane and more enlightened in its self-interestedness.

The World Bank in particular seems to have come to the realization that the provision of fast disbursing structural adjustment loans were in effect providing debtor countries with foreign exchange only in order to pay their creditors, thereby diverting precious resources that should have been going to education,

health and the infrastructural development in those countries. In a report in May 1990, the World Bank President said that sub-Saharan Africa's 32 low-income debtors were receiving minimal assuagement from the more liberal terms of Government-to-Government debt relief agreed at the Toronto summit of the seven industrialized countries. The Toronto meeting has also given the green light to the Paris Club to write down export credit loans and extend rescheduling periods with lower rates of interest. As a result, savings of $50 million annually were registered by African countries, which amounts to only 2 per cent of the foreign debt bill of the countries in question.

This situation is not helped by the fitful fluctuations of the international money market; according to a briefing paper recently presented by the Overseas Development Institute to the UK Government, the 2 to 3 per cent rise in interest rates in 1988-1989 has cancelled out the impact of much of the debt relief given to Africa in the years before. Over all, the World Bank has calculated that Africa's share of relief would be no more than 11 per cent and that its debt of $17 billion in 1982, which had risen to $35 billion in 1988, would continue to spiral despite having paid $5 billion in the intervening years. Owing to the extreme poverty of the African countries and the marginality of the debt relief measures, they must continuously reschedule their debts, thereby paying interest upon interest. Barber B. Conable, Jr., President of the World Bank, has, thus urged more flexible use of Bank and IMF money and the provision of additional resources from rich countries, which, however, are not responding. This call from the World Bank must be urgently heeded if a lasting solution is to be found for the African crisis.

Environment is the second field for urgent action. Poverty is forcing growing populations to undertake activities that result in environmental devastation. On the other hand export growth, the primary goal of IMF and World Bank adjustment programmes, is taking its toll on the developing countries. Those countries have little to export but timber from their forests, cash crops from their fragile soil and non-renewable mineral resources.

Thus in the absence of policies for environmental regeneration and where those policies exist, resources to implement them, export-led growth becomes a disaster. The United Nations Conference on Environment and Development scheduled to take place in 1992 might be a turning point. It provides the last chance in this century for a return to multilateralism, a pre-condition for global action to maintain the environmental integrity of our planet.

In the case of Africa, the success of that conference and the seriousness of the rich countries can only be gauged by their ability to identify the means of providing new, additional and automatic financial resources for already existing United Nations programmes for environmental rehabilitation, particularly in the areas of desertification, fresh water resources, deforestation and soil. Funding for the environment is now more influenced by the Western emphasis on dealing with climate change and ozone depletion than by the pressing need to control land degradation in developing countries. In this respect what is needed is not only some switching of assistance to environment projects, but also significant additional assistance, particularly for problems of a global nature such as desertification, depletion of tropical forests and fresh water pollution.

The need for developing countries to protect their environment is more urgent than it was for industrial countries at the advent of industrialization. Tropical ecosystems such as these of sub-Saharan Africa are more fragile and less capable of rejuvenation than those of temperate regions. Often, damage to a fragile and complex tropical ecosystem is irreversible even if the resources are available. Governments and economists have to be educated in natural resource management since there is often more environmental damage from macro-economic policy than individual projects. Research is also essential; for if the negative aspects are known, mitigation is possible by adopting, for example, agricultural practices appropriate to fragile environments, installation of pollution abatement technology or setting taxes and prices that reflect the real economic value of the environment. Rational tradeoffs between consumption and growth, on the one hand, and preservation and improvement of the environment, on the other, can only be made if the environment is treated like any other form of capital. In this respect, methods have to be developed to include environment in national accountancy.

Africa's problems are not only fiscal and managerial, they are also conceptual at both the economic and political levels. At the economic level, development plans were on the one hand based on the statist models of Eastern Europe with all their rigidities and inefficiencies, and on the other, they sought to emulate the capitalist models of Western Europe, with all its wasteful styles.

In both cases, the experiences failed, the former by its commitment to distributive justice with complete oblivion to the factors that spur production and growth in Africa. The latter produced an urban-centred development pattern that led to the collapse of the rural economy, the mainstay of the continent's economy. President Nyerere has aptly described this predicament by saying: "there will be pain and sacrifice especially by those of us who have grown accustomed to living in the economic South as if they were citizens, of the economic North".

However, Africa is increasingly coming of age; the master plans of African economic development, e.g., the Lagos Plan of Action and the African Priority Programme of Action for African Economic Recovery and Development, have set the pace for an endogenous pattern of development that is both self-sustaining and self-reliant. In this respect Africa can learn a lot from the Asian experience, particularly that of India. India, a country ravaged by famines in the 1960s, was dismissed by IMF as a basket case, particularly when it chose to part ways with that agency. India then gave priority to self-sufficiency in food and the building of physical and human infrastructures and not to export-led growth as IMF had advised. By the end of the 1980s, India was not only able to feed itself, it had also become a member of the league of the top 10 industrial Powers of the world, the country with the largest pool of technical expertise after the United States and Soviet Union and the only country in the south that was almost totally reliant on its own domestic savings for development (95 per cent); foreign aid represents only 5 per cent of the investment on development.

Equally, when India was faced in 1989 with its worst drought in the twentieth century, it did not have to ask for food aid since, despite its population growth, its own buffer stocks were enough to meet the crisis. By contrast, Africa, whose population doubled between the 1960s and the 1980s witnessed a reduction in food production per inhabitant, at an annual rate of 3.7 per cent between 1980 and 1985.

Economic and environmental issues cannot be separated from political ones. An effective reorientation of development demands greater accountability, dedication in public sector management and grass-roots participation in the development process. Lack of democracy militates against mobilization and effective accountability. The tremors that shook Eastern Europe had their resonance in Africa, and those countries that failed to be affected by them did so at their cost. The impact of those tremors is now being felt across the continent and many Governments are learning the necessary lessons. In February 1990, Africa, spurred by ECA, organized an international conference on popular participation in the recovery and development process in Africa. That meeting was attended by representatives of various African non-governmental grass-roots organizations and small-scale entrepreneurs. The conference, whose theme was "Putting the people first", adopted an all-encompassing African Magna Carta that was adopted in July 1990 by the African Heads of State and Government. As a charter, it was a document not only of citizens' rights, but also of duties.

It spelled out duties for Governments, popular organizations for women, labour and youth, the media and international community. It also asserted the role of people in monitoring popular participation in development on the basis of certain indicators. Those include:

(a) The literacy rate, which is an index of the capacity for mass participation in public debate, decision-making and general development processes;

(b) Freedom of association, especially of political association, and presence of democratic institutions, such as political parties, trade unions, people's grass-roots organizations and professional associations, and the guarantee of constitutional rights;

(c) Representation of the people and their organizations in national bodies;

(d) The rule of law and social and economic justice, including equitable distribution of income and the creation of full employment opportunities;

(e) Protection of the ecological, human and legal environment;

(f) Freedom of the press and media to facilitate public debate on major issues;

(g) The number and scope of grass-roots organizations with effective participation in development activities, producers and consumers co-operatives and community projects;

(h) The extent of implementation of the Abuja Declaration on Women (1989) in each country;

(i) The political accountability of leadership at all levels measured by the use of checks and balances;

(j) The decentralization of decision-making processes and institutions.

Obviously democracy alone cannot solve Africa's economic problems but it is a prerequisite for development since political marginalization makes people lethargic and indifferent. Carried to extremes, it leads to civil strife and social disruptions, which are the antithesis of development.

Annex III

BRAZILIAN DEBT AND ECONOMIC RECONSTRUCTION

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"In retrospect, we find that Brazil always paid on its foreign obligations when it was able to do so."

Barron's, April 1942

In the past five years, Brazilian macro-economic policy has been deplorable: hyperinflation, a worsening of income distribution and significant capital flight are only some of the highly visible signs of deterioration. Yet, rightly or wrongly, Brazilian optimism remains unbroken. The perception is widespread that it takes little to move the economy back to growth and investment, resuming one of the outstanding performances in world economic history. This is all the more striking since the current stabilization makes up in vigour what it lacks in sense, fulfilling altogether President Collor's prediction that his policies would leave the right speechless and the left perplexed.

The stabilization effort, from the freeze of financial assets and the suspension of subsidies to tax collection and enforcement, from industrial policy to import liberalization, has touched raw nerves in Brazil's economy. It remains to be seen whether the programme increasingly gains a foothold and achieves a transition towards market-oriented policies or whether Brazil reverts, increasingly, to a command economy. At this stage, there is little question that President Collor will succeed, the question is at what? He is by far the strongest political personality Brazil has seen in decades, with a powerful base in popular support. He is determined to transform Brazil and there is no question that he will shape events in the next decade; it is not certain today that all this implies a shift towards financial stability and sustainable growth. President Collor's enthusiasm for a market economy and for turning Brazil into a first-world country is less apparent today than during the campaign; his political base supports more nearly economic popularism and regimentation more than free enterprise. The business community so far has been victimized by the programme and has not been given a voice in the management of stabilization and reform. Thus, there is genuine uncertainty as to the course of Brazil's economy.

External debt is not a central problem of the Brazilian economy; it is a headache, but not a decisive affliction. The chief reason is that Brazil is large, inward-looking and substantially impervious to world opinion or sanctions by creditors. There is no link whatsoever between capital flight and the success or failure of debt politics, quite unlike the situation in Mexico. If anything, the strong nationalism of the Brazilian business community contrasts sharply with the insecurity seen in Mexico.

In Brazil, a tough stand on debt is popular not only with the left but also with the Sao Paulo business community. As a consequence, reaching a debt agreement is neither a pre-condition nor even a particularly favourable event in the context

of domestic stabilization. Even the threat of a suspension of trade credit, so effective in other countries, has left Brazil largely unimpressed. There is simply no lobby to support debt service either among industrialists or financiers, exporters or the man in the street. And this has always been so in the history of Brazil's external debt.

Against this background, poor debt policies can evolve easily; debt can become even more of a political issue, it can become a vehicle for corruption (as it did in the Sarney period), or it can simply be neglected for lack of interest and priority. It is unlikely that at this time policy makers have much idea what goals they will pursue. Domestic priorities are totally dominant and the talent is spread very thin. Debt can wait.

The main objective for Brazil is to reconstruct and move ahead so that by the year 2010 the country can claim the status of member of the Organisation for Economic Co-operation and Development (OECD). In the past decade, Brazil receded from the threshold of that status while competitors like the Republic of Korea pushed ahead, at least on the economic front. That gap can be made up, but it requires a substantial reconstruction. Debt issues are part of that reconstruction, although of course only in a minor way.

I. PRIORITIES

The 1980s were a lost decade, far more so than suggested by the zero growth of per capita output. Brazil is in crisis, the economic horizon has shrunk to a week or less, social and economic stability continues to weaken, even only two months into stabilization. But, unlike Argentina or Peru, Brazil has the means to support an outstanding economic performance. These possibilities of reconstruction and ultimate progress are the motive for support of a dramatic adjustment effort to put financial stability in place so that economic activity can return to normal.

Although Brazil did not suffer a decline in real income per capita in the 1980s, unlike virtually all other Latin American countries, stagnation is not an enviable performance compared with that of Asian competitors (see figure 1). Moreover, per capita income is a poor measure of the institutional deterioration and the setback in investment in human capital, technology and world competitiveness.

Until that task of reconstruction is accomplished, the horizon of the productive sector is no longer than the maturity of the domestic debt, and that is a week at most. The economic reconstruction programme must target three objectives:

(a) An immediate and lasting end to inflation and instability;

(b) Economic and institutional reconstruction;

(c) Creating an economic environment that shifts Brazil over the next two decades into the group of advanced countries.

Figure 1



Table AIII.1

Long term trends
(average annual growth)

	1950-59	1960-69	1970-79	1980-89
Real per capita GDP	3.3	2.7	6.0	0.0
Inflation	18.8	45.2	31.1	258.0
Noninterest C.A. a/		-2.3	2.3 b/	

a/ Noninterest current account, % of GDP.

b/ 1980-88.

Source: Brazil, Planning Ministry, unpublished data

The current task is to put an end to inflation, adopt policies that promote reconstruction and develop the institutions that induce strong, long-term economic development. The immediate priority continues to be the control of inflation. Fiscal austerity is at the centre of the programme and provides the guarantee for ultimate success. Incomes policy has lost its appeal; after the poor experience with heterodoxy, in an overreaction, de-indexation and recession are now the tools for disinflation. Although inflation is no longer at extreme levels, substantial uncertainty continues. It is essential to push further budget balancing while at the same time avoiding a growing overvaluation of the exchange rate and a sharp, possibly cumulative, decline in economic activity.

Zero inflation is desirable, but 20 per cent inflation per year, or even 50 per cent, can be accepted. The lesson of past experience is to abandon sharp disinflation and overvaluation before they become a political and economic problem. Mexico, which now has an inflation rate of 15 to 20 per cent per year, offers a good example. An even better example is Chile, where inflation has been 20 per cent in the past five years without in any way detracting from the impression of an "economic miracle".

After stabilization, the next step is institutional reform:

(a) Deregulation should allow the formation of companies without tedious and cumbersome approval procedures. The need to absorb labour released by the Government and the financial industry makes this an important priority. The deregulation should include the unlimited access of foreign direct investment subject to Brazilian law;

(b) The success at disinflation and fiscal stabilization should be cemented, once it has been demonstrated by the creation of an independent central bank and the removal of exchange controls for commercial transactions;

(c) The legal system is to be reinforced to make contracts more enforceable and therefore provide more room for economic activity and reduce illegal activity and the underground economy;

(d) Reform of the banking system. Restoration of financial stability invariably involves excess capacity in the banking system. Reform is therefore appropriate and should, conveniently, include the Banco do Brasil.

Once the crisis is over and institutions are created or rebuilt to support economic activity without inefficient or arbitrary government intervention three more steps remain in the development strategy:

(a) The Government must engage in a major effort at fostering education. The lesson from Asia is that education provides social mobility and hence social justice. It is also the most powerful ingredient for a country to absorb the knowledge available world-wide, thus facilitating the catching-up process. Brazil cannot become an advanced country without a fundamental reassessment of its approach to education;

(b) Infrastructure investment was neglected in the 1980s. The Government must make these investments. A cost-effective approach must avoid waste and a sensible tax system must facilitate the financing, but the work must be done. The overall level of investment brings with it growth in productivity. Capital accumulation is not the only source of economic development, but countries that have invested at high rates show the most decisive economic modernization and advance;

(c) Critical attention to income distribution is essential if political radicalization and resulting economic deterioration are to be avoided. Brazil's income distribution is one of the worst in the world. High inflation and disinflation based on real wage cutting have made the situation much worse. In the past year, real wages declined by 20 per cent. Without sustained growth there is a good probability of political instability, which, of course, has very adverse effects on economic performance.

Table AIII.2

Comparative Per Capita Growth and Investment
(Percent per year)

	1970-79		1980-88	
	Inv./GDP	Growth	Inv./GDP	Growth
Brazil	26.8	5.2	21.0	0.2
Korea	27.6	7.7	29.4	6.2

Table AIII.3

Income Distribution
(% of Income)

Households	1980	1988
Bottom 20%	2.9	2.2
Top 10 %	46.8	49.5

II. EXTERNAL DEBT

Much of the problem with the external debt today reflects the disastrous state of domestic macro-economics and an unwillingness to pay. The objective ability to service debts, in the long run, is much less in question than the willingness of the Government to perpetuate the political and economic mistake of continuing the strategy of muddling through.

Table AIII.4

Brazilian External Debt: 1988
(Billion US $)

	1985	1988
Total external	104.6	114.6
Long term debt	90.7	101.4
Official creditors	15.4	24.6
Commercial banks	67.3	67.6

In Brazil's case, debt service is largely a question of willingness, not of ability to pay. The external debt can be paid as the economy is rebuilt, and it should. But external debt service should not become an obstacle to reconstruction. Nothing short of time and performance can bring about this improvement. In this respect history will repeat itself and creditors cannot expect faster results than in the 1930s and 1940s (see figure 2). Before turning to specific debt strategies, we review here the economic and political context in which Brazil's debt strategy is formulated. The point of this discussion is to highlight that Brazil is in a very different situation from Mexico.

Figure 2.A

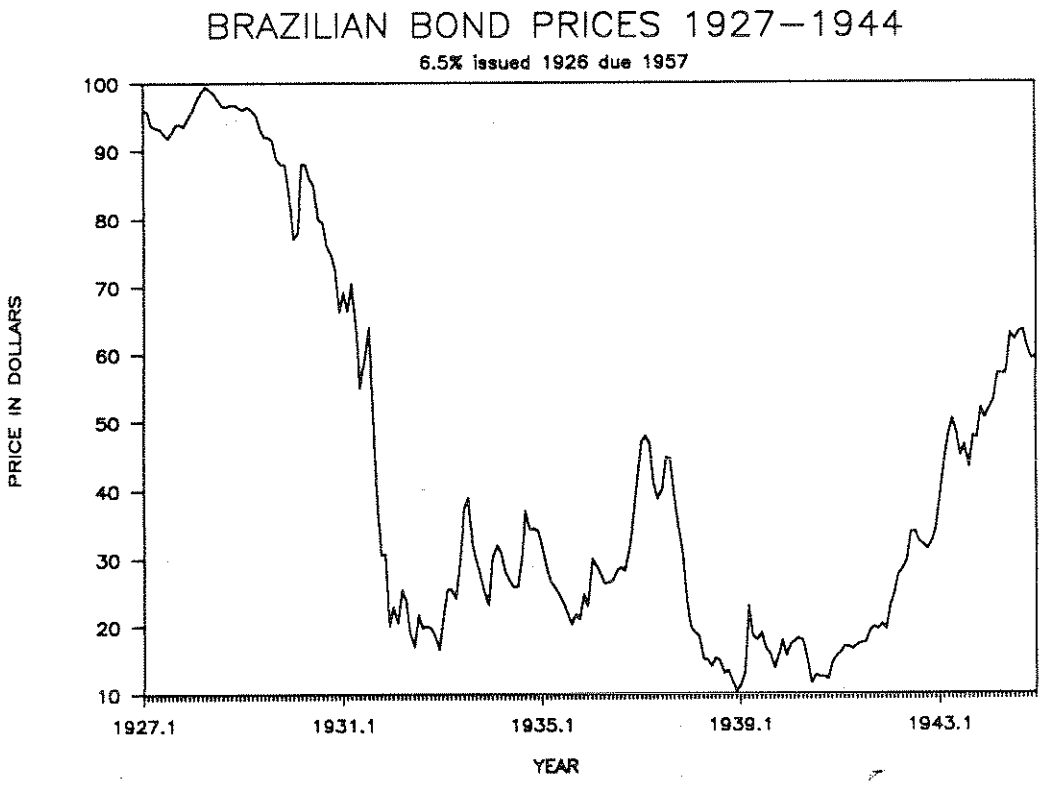
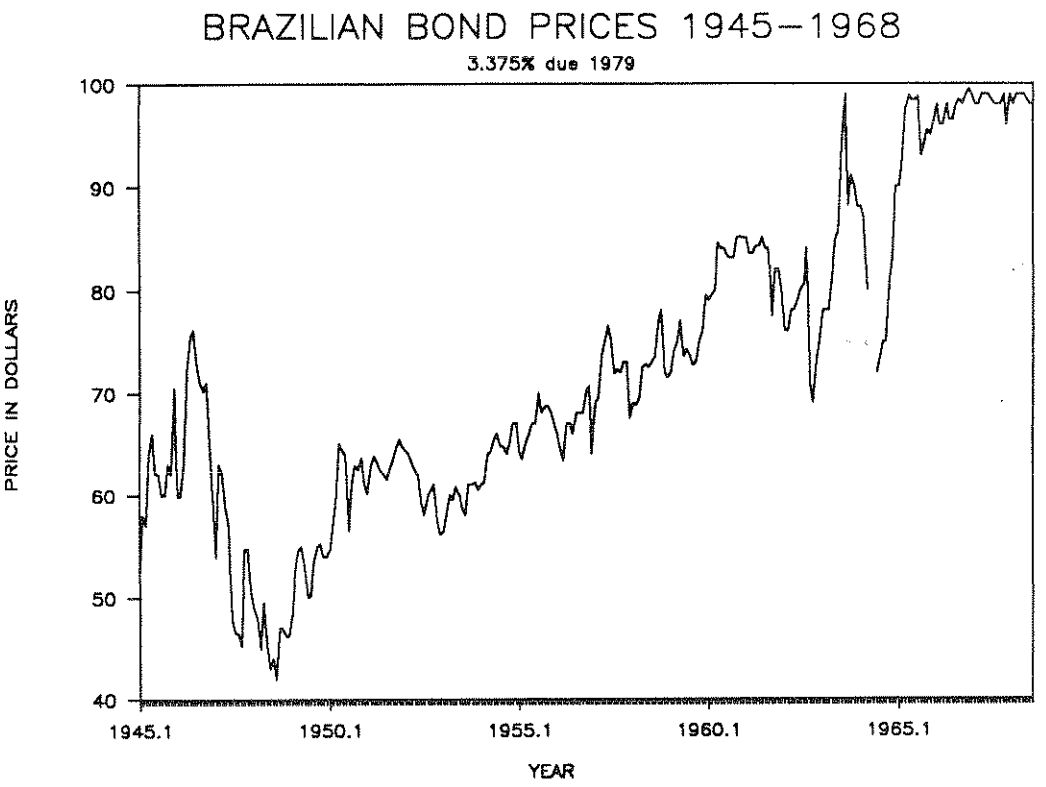


Figure 2.B



A. Attitudes

Brazil's attitude towards debt today is not much different from the view expressed by Getulio Vargas in 1937:

> "We stopped the service of the external debt, moved by circumstances beyond our control. This does not mean the rejection of earlier commitments. All we need is time to resolve difficulties that we did not create and to readjust our economy, transforming potential wealth in resources that will permit us to repay, without sacrifices, our creditors. Gone are the days when our obligations were written abroad, at the discretion of banks and intermediaries." a/

Some of the features of that Brazilian attitude towards debt, and the Brazilian perception of external constraints, are worth spelling out in the impressionistic way in which they are felt;

(a) Brazil is an inward-looking, nationalistic country. Brazilians are unimpressed with what happens in New York (and certainly Washington). Their frame of reference is domestic and they have no feeling of vulnerability in the way that is seen so conspicuously in Mexico;

(b) Brazil has a basic decency about paying debts, but there is no deep commitment to exact timetables; there is certainly a recognition that domestic priorities must be attended to first;

(c) Brazilians do not understand much about the debt issue; this applies to ministers and to the man in the street. There is an increasing question whether the money is in fact owed, whether it has already been repaid, whether sums owed are the result of United States policies rather than Brazilian use of resources. In sum, the legitimacy of the debt, in toto, is questioned. Making some deal is therefore indispensable;

(d) The lessons from the moratorium are not clear; many doubt that it in fact cost Brazil much. Sanctions against Brazil are altogether implausible. Brazil controls too many assets of the major corporations of industrial countries;

(e) There is a widespread perception that in 1988-1989 commercial banks and Brazilian financial market participants got by with an extraordinary amount of debt liquidation, at great social costs. Financing of debt conversions was responsible for a significant portion of money creation in 1988-1989 and thus for the hyperinflation;

(f) Brazil cannot count on as much foreign political support as Mexico. In the opinion of the outside world, mismanagement has been far more significant and the country's resources stand up much better to debt servicing. Given the little external support that can be expected, Brazil would be better served by structuring a solution that meets its own needs. If such a solution were to offer the prospect that ultimately the debt would be paid, then creditors, too, should be satisfied;

(g) There is no way of providing an assurance or guarantee of future debt service. Therefore, the country would best be served by a solution that was economically and politically viable while having the ability to lead ultimately to full debt service;

(h) Where Mexico had to undo a legacy of inefficiency and poor management, under the strain of reduced oil prices and active capital flight, Brazil had used the debt wisely for investment, had not experienced capital flight and had fallen into severe mismanagement only quite recently. Better policies could therefore go much further in servicing debt without undue strain domestically. However, Brazil should not rush payments and should not allow its creditors to impose a premature effective debt liquidation;

(i) Unlike in the case of Mexico, a good debt settlement has little effect; it certainly could not be relied on to mobilize a massive reflow of flight capital which in turn could serve as a pillar for stabilization and debt service. In fact, a debt agreement would have only minor impact on domestic financial stability. Unlike in Mexico, it would certainly not lower the rate at which the government could borrow in the domestic capital market;

(j) Getting ahead in the world economy involves primarily the ability to attract direct foreign investment and technology and to be able to penetrate foreign markets. Neither has much, if anything, to do with debt service. In fact, the more severe the burden of debt service a country undertakes, the more reduced prosperity and the less the attraction for foreign investors to come in. Severe commitments to service debt prejudice the liquidity of foreign investment;

(k) Commercial bank creditors have lost much of the legitimacy for priority treatment; their active involvement in mobilizing capital flight has given them a bad name. World public opinion (though not the Governments of industrial countries) favours radical debt reduction;

(l) The history of Brazilian debt shows that foreign money is irresistibly attracted to the country and that sooner or later it will come back. Debt policy can do little to speed up this process. In the meantime, emphasis on foreign direct investment, and a credible policy in this respect, has a more serious payoff than a major debt settlement that undertakes important front-end debt service;

(m) External debt service was an important part of the fiscal problems of the past five years. If fiscal consolidation is now the rule, a parallel treatment of domestic and foreign debt is only fair;

(n) External debt is never amortized, except by mistake. Finance Minister Rivadavia Correa noted this already in 1911:

> "In finance the essential fact is that debts are paid with funds obtained from new loans. This has been the rule for us already many years. What is new is that this time the loan is made by the same people to whom we owe the overdue interest." b/

Delfim Neto re-emphasized the point when he remarked that debt is rolled, not paid.

Debt problems are not new; in the past 100 years Brazil has experienced four or five crises. Sooner or later credit reopens. For example, following the suspension of interest payments in the 1930s, in 1943 Brazil implemented a unilateral exchange offer to consolidate debt service in a manner that is highly suggestive of possibilities today.

The 1943 plan consolidated the entire Brazilian debt, stretched the maturities by 40 to 60 years, and adjusted down both principal and interest. Creditors were offered a choice between two plans:

(a) No reduction of principal, but interest rates were reduced from more than 6.5 per cent to 3.375 per cent (and less), with a provision for a sinking fund. Debt service (interest plus sinking fund) amounted to between 2.9 to 5.1 per cent;

(b) For every $1,000 of original bonds, bond holders would receive a cash payment of between $75 and $175, a new bond with a face value of $800 (and $500 in some cases), and a coupon reduced to 3.75 per cent. The bonds had no fixed maturity but were entitled to a sinking fund. Interest plus sinking fund amounted to a combined debt service rate of 6.4 per cent.

The country must recognize and exploit two facts: commercial bank credit at LIBOR plus 13/16th is the cheapest credit Brazil can get today, either at home or abroad. It is therefore a mistake to pay off prematurely these cheap loans. Moreover, the secondary market offers substantial discounts and any debt arrangement should exploit this possibility for more effective amortization.

Table AIII.5

The Discount in the Secondary Market for Brazilian Debt
(Cents per dollar, offer price)

7/85	7/86	7/87	7/88	7/89	7/90
75	73	57	52	30	24

Source: Salomon Brothers.

The external balance supports some debt service; Brazil does have trade surpluses. But it would be a mistake to use all the slack that is available for debt servicing rather than for the purpose of a more dramatic reconstruction. Investment has lagged in the past years and trade liberalization will mean a loss in foreign exchange. Therefore any debt arrangement should rely mostly on the passage of time: with high growth rates of income (in dollars) reducing the debt-income ratio, rather than rapid amortization.

Table AIII.6

Current Account
(Billion US $)

	1986	1987	1988	1989
Current account	-5.3	-1.4	4.9	1.4
Noninterest G.A.	4.0	7.4	14.7	11.2
Interest	-9.3	-8.8	-9.8	-9.8
Trade balance	8.3	11.1	19.1	16.1

Source: Conjunctura, March 1990.

Fiscal reform, a solution to domestic debt and vigorous privatization will ultimately move the budget to a more sustainable situation and thus contribute to financial stability.

Much of the problem of the past few years is the complete collapse of a good tax system; unlike in Argentina, for example, where taxation has always been awful, Brazil did have in place a well-functioning, productive tax structure. It only needs to be rebuilt with accompanying improvements on the side of public spending, subsidy elimination and pervasive privatization.

Table AIII.7

Gross Tax Burden
(% of GDP)

1970	1975	1980	1985	1988
26.0	25.2	24.7	22.0	19.8

Even though one can be optimistic about the possibilities of budget improvement one must not overlook the serious need for social capital formation. There is a repressed need for investment in the public sector that is only partially met by the proceeds from privatization or by shifting public sector companies to the private sector. Government investment requires resources and one obvious and cost effective way to obtain these is by lengthening the low-cost foreign debt.

Table AIII.8

Brazilian Real Gross Investment
(Percent of GDP, 1980 prices)

1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
22.9	21.0	19.5	16.9	16.1	16.7	19.0	18.1	17.3	17.9

Source: R. Bonelli and E. Landau, "Brazil in the 1980s: Facts and Figures", INPES/IPEA, Rio de Janeiro, 1990

Summary:

There is ample room to rephrase and sharpen these impressionist statements, but the basic point is that they do capture the political and economic situation of Brazil correctly. Brazil is very different from Mexico: Brady style deals promise less and are less justified, rapid debt service cannot be imposed and should not be accepted. The appropriate solution is a debt settlement that stretches the debt far out while at the same time offering a plausible scheme of liquidation over time. Debt redemption can only be contemplated in the sense that the debt-income ratio falls off significantly over time.

B. Alternatives

There are a number of alternative approaches worth considering: a moratorium, unorthodox debt settlement, swaps and the Brady Plan. None of them offers the potential of the preferred mechanism already sketched above.

Swaps:

Debt equity swaps and debt-debt swaps need little comment. It is by now well-established that they rarely serve the interests of the debtor. The reasons include the following four considerations:

(a) Conversions rarely present additional resources; conversions apply frequently to projects that would have taken place even without a discount. As a result the Central Bank loses foreign exchange that could have been used for debt reduction or other priority assignments;

(b) Conversions have to be financed. A country in debt difficulties typically faces far higher borrowing costs on new debt than on captive debt. As a result, the implied refinancing raises the debt service cost dramatically.

(c) Conversions, because they convey the right to remit earnings and principal within a few years, liquefy the external debt. With a conversion, a debtor loses the ability to control the outflow of foreign exchange and thus becomes more vulnerable;

(d) Conversions are a one-way street. If resources are committed, because of credit rationing, they are irretrievably lost.

These arguments against debt swaps have been accepted in the aftermath of a few years of bad experience. The results of Brazil's extravagant, unjustifiable and excessive swapping of 1988-1989 have no doubt provided the most conclusive evidence.

The Chilean case remains the possible exception. The chief reason is that domestic interest rates were not much higher than in New York so that a refinancing, capturing part of the discount, could be profitable. But even in Chile the liquefication of the external debt will present a major difficulty for the democratic Government. In fact, in 1993-1995 there will be major pressure on the balance of payments from the possibility of repatriation of funds under the conversion programmes of the Pinochet Government. This makes the point that conversion programmes in fact liquefy the external debt.

Debt-equity swaps are primarily a balance sheet operation, not a net resource transfer. One might argue that the government could target deals to make them less a transaction in existing assets and instead be directed towards new, additional investment. Thus, debt-equity swaps will finance investment, but they finance at the budget cost of a subsidy investment that would have taken place anyway.

Balance sheet tricks are not a substitute for gaining extra real resources for investment. Improved government budgets in the debtor countries, increased private saving, increased efficiency in the public sector and net resource transfers from abroad are the only way for investment and growth to return. Of course, Brazil (and other debtors) should open all doors to foreign direct investment - the sooner and wider, the better. But there is no justification for subsidizing such investment.

Unorthodox mechanisms:

Brazilian citizens hold assets abroad. In part these represent legal holdings, but in large measure they are the result of capital flight in violation of tax laws. The exact size of these assets is unknown, but data for bank accounts give some idea.

Table AIII.9

External Deposits of Brazil
(Billion US $)

1985	1986	1987	1988
9.8	12.0	11.3	14.4

Source: IMF

A politically attractive option is to enact domestic Brazilian legislation that allows foreign creditors to claim these assets as an offset against their claims. The chief problem is that there is not enough to go around - bank claims exceed recorded deposits by nearly $50 billion. Such a solution therefore would be more spectacular than effective.

Moratorium:

An indefinite suspension of interest payments is similarly ineffective. A country cannot really run away from its debt, it can only choose when to face up to it.

A moratorium is a needlessly messy solution; it hurts creditors whose ratings in the world capital market deteriorate and who as a result are less able to make concessions. At the same time it does not offer lasting relief. On the contrary, it leads to an accumulation of interest and ill will. As a medium term strategy it does not pay, although as a negotiation device it is plausible. But even in the latter context, because it reduces the ability of creditors to offer a good settlement, debtors must recognize that they may be cutting into their own flesh.

Brady Plan:

In the aftermath of the United States Treasury initiative, it seems plausible to put a Brady Plan solution high on the list. Brazil would develop, in the context of an IMF and World Bank programme, a list of debt reduction options: interest reduction, principal reduction and new money commitments. Support from the multilateral agencies and possibly some industrial countries might offer enhancements as incentives.

The political argument for a Brady Plan solution is strong: any country that proposes to service its debt without any recourse to debt reduction schemes would seem to be letting banks off too easily, failing to take advantage of the Treasury invitation to shed some of the burden. Yet, it seems implausible to expect that Brazil would really emerge with a particularly good deal. The country is too well placed to service its debt and the argument for important external support and debt reduction is not overwhelming.

Going the Brady route might in the end turn out to be politically frustrating, with too little control of events and a messy moratorium as an expression of the ultimate failure of that strategy. Brazil is too large to accept playing Washington's games, accepting tutelage and the Treasury definition of what is or is not an acceptable arrangement. The country therefore should define its own debt settlement outside the parameters of the Brady Plan.

C. A good debt strategy

There are five ingredients for a good debt strategy:

(a) It should be simple;

(b) Over time the debt should become less and less of a problem until it literally disappears;

(c) The debt settlement should not interfere with financial reconstruction, leaving room in the budget and in the external balance;

(d) The burden that is assumed can in fact be carried so that full compliance, year after year, ultimately builds up a record that enhances credit worthiness and the value of the claims;

(e) Creditors who are willing to wait should be paid the full amount they are owed.

A plan:

A specific proposal assures that the entire debt is paid ultimately and that creditors who want early retirement can exercise the option. A straightforward, effective scheme works as follows:

(a) The external debt is restructured as a long term instrument with automatic capitalization at Libor plus 13/16th;

(b) Every month the Government devotes $250 million to repurchase debt from anyone who presents a tender at auction.

The proposal assures that banks will suffer less and less from a very depressed secondary market price, which reflects the random uncertainties of Brazilian policy that has been criticized so much by the international community and is so expensive the country, without greatly offsetting benefits. At the same time the amortization schedule does not put unreasonable cash flow pressure in the capital market, the exchange market or on the country's reconstruction. Over time, as Brazil performs and debt is retired through redemption at auction and through growth, secondary market prices will come to reflect, increasingly, Brazil's ability and willingness to pay.

This proposal satisfies the above criteria. First, it is radically simple. An effective proposal needs to imply a falling debt/income ratio over time. The retirement of debt at auction with a specified payment assures significant principal reduction while the discounts last. These principal reductions make room for interest capitalization without the risk of a rising debt-income ratio. As a result, creditors who hold out and do not surrender their claims at auction can in fact participate in a rising secondary market price and cumulative full payment of their claim.

The attraction of the arrangement is that it is entirely voluntary: anyone who wants to receive in full can hold out for 20 years, anyone who wants to leave can do so, at a loss, and thus enhances the credibility of the debt settlement for those who remain. A decade or two later the country can look back and assert that it honoured its debt fully!

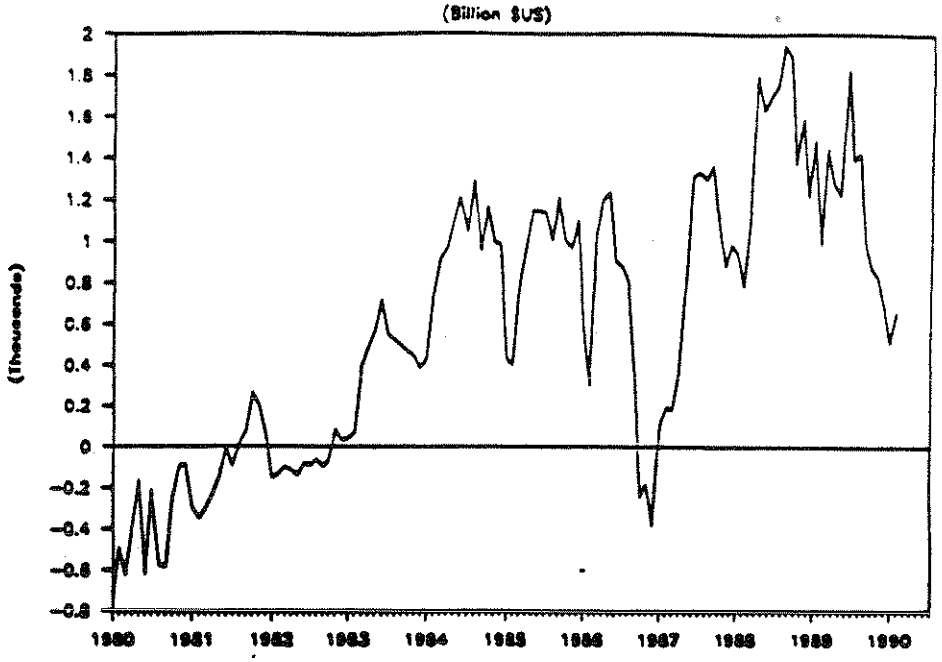
Two questions must be asked. First, can the country in fact plausibly commit annual debt service of $3 billion to be spent on repurchases? Here the trade statistics (see figure 3) leave absolutely no question. The trade balance is strong and easily supports the expenditure. In fact, one can go further to argue that in good years there should be extra allocations for repurchase so that creditors can share in the strong performance of the Brazilian economy.

The second question concerns the creditors: what will the banks say? It is not clear whether banks like the arrangement; but it is clear that banks do not really know what is good for them, at least not in the herd of 500.

Brazil can and will pay ultimately; accordingly, creditors should be eager to collaborate in a plan that has three features: it ultimately pays their loans (in which case they would, of course, not want their money back); it is politically acceptable in Brazil and therefore forestalls other schemes that have punitive connotations; and it makes a maximum contribution to Brazilian economic and financial reconstruction. This latter feature is the only real basis on which debt service can ultimately be expected.

Banks have a poor record in debt negotiations, having too eagerly accepted debt reduction. In Brazil's case, looking beyond the immediate troubles of the Collor Plan, write offs are totally unwarranted. Brazil and its creditors can agree on a plan of capitalization and regular redemption at auction which, once it has become a monthly routine, will soon be reflected in an improving secondary market valuation.

Figure 3. Brazil trade surplus



Rhetoric:

While Brazil can afford basically to disregard the interests of its creditors, it is not clear that this is the best strategy. In an optimistic scenario, the Brazilian economy will stabilize over the next year and resume growth. The stabilization will feed the latent optimism and strong growth will resume. On such a trajectory, Brazil will want to have a good working relationship with the world capital market. Specifically, there is little merit in a gratuitous confrontation with the creditors.

Creditors will be in a better position to accommodate Brazil's favourite debt service plan if they are not handicapped by unnecessary regulatory conflicts and by noisy debt rhetoric that worsens the creditors' rating in the financial markets. Whatever is done, it should be handled professionally in a manner that makes the outcome look as promising of a commitment to long term debt service as possible. That advice, of course, applies on both sides of the bargaining table; when banks threaten debtors with a trade credit embargo there is little reason to expect that the debtor will not respond with an equal noise level.

Notes

a/ Quoted by Valentim Boucas, Historia da Divida Externa, Rio de Janeiro, 1950.

b/ See Claudionor de Souza Campos, Divida Externa, Rio de Janeiro, 1946.

Annex IV

A NOTE ON THE EXTERNAL DEBT OF THE MEMBERS OF THE ECONOMIC AND SOCIAL COMMISSION FOR WESTERN ASIA

I. THE GLOBAL SITUATION BEFORE THE GULF CRISIS*

The external debt of the countries members of the Economic and Social Commission for Western Asia (ESCWA) rose during the 1980s, with some of the highly indebted countries in the region rescheduling part of their debt and some others building up arrears.

The total external debt of the ESCWA countries jumped from around $48 billion in 1980 to over $127 billion in 1988, representing an increase of around 165 per cent in just eight years (see table A.IV.1). This debt constitutes around 8.8 per cent of the total external debt of all developing countries.

Considering the ESCWA a external debt on country-by-country basis, the debt situation can be judged as serious, and in some cases critical, especially for ESCWA non-oil-exporting countries such as Egypt, Jordan, the Syrian Arab Republic and Yemen, where debt repayments and debt service are on the rise and their adverse repercussions are as severe as those in highly distressed economies of other developing regions.

Owing to the drop in foreign exchange resources caused by the decrease of workers' remittances, aid and grants from ESCWA oil-exporting countries, the indebted ESCWA non-oil-exporting countries during the second half of the 1980s found themselves unable to meet payment schedules without further restructuring their debt. Some of these countries, such as Jordan and Egypt, have resorted to unpopular socio-economic measures as a result of their external debt.

While the ESCWA oil-exporting countries have financed economic development from national savings, and were able to accumulate significant foreign surpluses, the ESCWA non-oil-exporting countries, which during most of the 1980s suffered an increasing savings/investment gap, have had to resort to foreign borrowing.

The oil boom of the 1970s and early 1980s, which tempted the ESCWA non-oil-exporting countries in particular to borrow instead of establishing a rationale for economic and financial planning policy, has contributed largely to the increase of external debt of this group of countries. In fact, an estimated 80 per cent of the external debt of these countries originated during that era.

The oil boom era revealed the importance of spillovers from the ESCWA oil-exporting countries to the ESCWA non-oil-exporting countries and their interdependence. It in particular brought forward the susceptibility of the economies of the ESCWA non-oil-exporting countries to the level of oil revenues, rendering their overall economic performance highly dependent on the economic fortunes of the ESCWA oil-exporting countries.

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* Based on information supplied by ESCWA, at a meeting held at Rome on 5 March 1990 with the Executive Secretaries of the regional commissions of the United Nations.

ESCWA non-oil-exporting countries have faced many economic and financial difficulties, reflected, among other things, in high inflation, currency devaluation, unemployment, capital flight and trade and budget deficits.

The sharp fall in the exchange rate of the United States dollar relative to major international currencies during the second half of the 1980s increased the portion of ESCWA external debt denominated in non-dollar currencies and consequently the total external debt of the ESCWA region.

Large-scale capital outflows have also been an important factor in worsening the problem of external debt of certain ESCWA countries. As the case in many developing countries, capital flight from the ESCWA region has been associated with overvalued exchange rates, high inflation, low or negative real interest rates, and, in general, lack of suitable domestic financial assets at attractive rates. With sizeable private financial resources being invested abroad, many ESCWA non-oil-exporting countries resorted to foreign borrowing to supplement domestic savings and finance widening deficits.

Other factors that have contributed to the rise in ESCWA external debt are seen in the short-term availability of financial surpluses of the ESCWA oil-exporting countries in relation to the long-term requirements of the economies of the ESCWA non-oil-exporting countries.

The financial surpluses during the oil-boom era were a one-time historical experience. Owing to the absence of institutional preparedness on the part of both groups of ESCWA countries, a large part of these surpluses could not be invested rationally in the region and has drifted abroad.

With the Government being the main actor in the economies of almost all ESCWA countries, the drop in the oil revenues of the ESCWA oil-exporting countries and in the spillovers of the ESCWA non-oil-exporting countries has resulted in a slowdown of economic activities in all countries of the region.

While the ESCWA oil-exporting countries could draw on their foreign surpluses to finance budget deficits, the ESCWA non-oil-exporting countries do not have such assets to draw on. ESCWA non-oil-exporting countries have been forced to postpone or cancel development expenditures aimed at the establishment of productive projects that could generate foreign exchange for, among other things, debt repayments.

The maturity structure of the external debt of the individual countries in the ESCWA region differs from one country to another. It is determined by whether the country has borrowed for purposes of trade finance or for purposes of financing development.

Establishing such a difference is important in that the external debt of the ESCWA oil-exporting countries, which can be grouped in a trade category of ESCWA countries, is generally a trade-related debt of the private sector and consists mostly of short-term bank and non-bank debt, while the external debt of the ESCWA non-oil-exporting countries, which can be grouped in a development category of

ESCWA countries, is generally a development finance-related debt with long-term maturities and different categories of creditors.

Since a significant portion of the external debt of the ESCWA non-oil-exporting countries is official, there exists no secondary market for this debt. Despite the soft-term nature of slightly less than two thirds of this debt, however, the debt has been posing a major burden on the economy and finance of these countries.

The external debt of the ESCWA non-oil-exporting countries has assumed serious proportions, with some of these countries, such as Egypt, Jordan and the Syrian Arab Republic, approaching insolvency, while the remedies proposed by international financial institutions are threatening their stability as well as infringing on their sovereignty. Since external debt is concentrated in the most populous countries, such as Egypt and the Syrian Arab Republic, and thus affecting the majority of the population, external debt problems of the ESCWA non-oil-exporting countries have become an integral part of external debt problems in the developing countries.

In the last few years, a new sense of realism to tackle the debt problems has emerged in the ESCWA non-oil-exporting countries, with the imposition of debt management strategies aimed at improving the debt service profile in the face of a shrinking supply of funds. Import restrictions, fiscal restraints and economic reforms have been introduced in an effort to tackle external imbalances and restructure fiscal accounts.

Also in the last few years, many ESCWA debtor countries have had to resort to stand-by facilities of the International Monetary Fund (IMF), with some of these countries also undergoing rescheduling of major parts of their debt. Some ESCWA non-oil-exporting countries have also had to subject their economies to structural adjustments and stabilization programmes associated with some debt relief.

The continued IMF stand-by facilities and rescheduling of debt repayments have provided considerable debt relief for few of the highly indebted ESCWA non-oil-exporting countries over the next few years. The impact of the reduced interest payments bill has reflected positively on the invisible balances of these countries. Continued restrictions on imports, liberalization of prices through the elimination of subsidies, the establishment of more competitive exchange rates, the institution of more rational fiscal policies embracing not only austerity but new priorities of development are all measures designed to correct these countries' external imbalances.

During the oil boom of the 1970s and early 1980s, the ESCWA oil-exporting countries responded positively to the demands concerning recycling oil revenue surpluses. The ESCWA oil-exporting countries have also been very generous in financial aids and grants to less fortunate developing countries. Their assistance to these countries has been many times the target of 0.7 per cent of gross domestic product (GDP) set in the International Development Strategy of the United Nations.

The developed countries have benefited most from the fall in oil prices. Primary benefits are estimated to be as much as a 2 per cent reduction in inflation and an increase of at least 0.8 per cent in real disposable income. Secondary benefits have been around $110 billion in 1985, $240 billion in 1986 and $280 billion in 1988. b/

So far, the ESCWA indebted countries have not benefited from recent debt reduction initiatives.

The distressed economic, financial and social conditions of indebted the ESCWA non-oil-exporting countries should be taken fully into consideration in all efforts concerning solving the debt problems. The GDP growth rate for all of these countries is becoming less than that of their population.

II

Jordan after the Gulf crisis*

Jordan appears to be in extreme difficulties following the Gulf crisis, the embargo and the war operations in that area. Alarming documents have been submitted to the authors of the present report by the Crown Prince of the Hashemite Kingdom of Jordan. The following description of the deterioration of Jordan's situation is chiefly based on those documents.

With its 4 million inhabitants, Jordan, before the Gulf crisis, had a GDP of $5 billion, i.e. $1,250 per capita, while exports of goods and services were $3.4 billion as against $4.3 billion for imports. In 1991 the foreign debt amounts to $8.4 billion. The balance-of-payments deficit, which was about 20 per cent of GDP before the Gulf crisis, was also a very delicate problem.

Foreign aid - even before this crisis - was showing a declining trend, from nearly $600 million in 1986 and 1987 to $414 million in 1988 to only $280 million in 1989, in relation to the diminished oil price which has caused a reduction of the Arab funds' aid flows. Even before the Gulf crisis, the international reserves of Jordan were at a minimum level (about $100 million in 1988).

Half of Jordan's foreign debt is official and only 30 per cent is concessional. The debt service - around $950 billion - was in 1988 about 30 per cent of the export flow and 20 per cent of GNP.

Arrears are not important for Jordan, because most of its debt, apart from that with bilateral and multilateral institutions, consists of bonds.

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* Based on documents submitted by the Crown Prince of the Hashemite Kingdom of Jordan on 26 November 1990.

Jordan's agriculture accounts for only 10 per cent of its GDP. However, exports of fruits and vegetables to nearby countries are an important component of its balance of payments. These exports have been practically wiped out by the embargo. Sixty-five per cent of Jordan's GDP consists of services and, among them, international tourism and transportation are paramount. Since the embargo they have also been wiped out. Remittances provided an important revenue to Jordan, both from the point of view of the balance of payments and from that of family income; but hundreds of thousands of skilled Jordanian workers who were in Kuwait and Saudi Arabia have been obliged to repatriate with a loss of $350 million in remittances per year and the cost for the Government of providing assistance to the returnees.

Finally, Jordan in 1989 received aid of $185 million from Iraq and Kuwait, which has now disappeared, while the oil for domestic consumption that Iraq was giving on credit is no longer available.

Total losses of income to Jordan due to the Gulf crisis have been assessed at $730 million at the end of 1990 and $200 million per month in 1991. Pledges for grants are $165 million and for loans $380 million.

The foreign debt service, in these conditions, clearly appears unbearable.

> "With our declining revenues and with evaporating foreign aid, the economic future of this nation - once given the prospect of becoming the Singapore of the Middle East - is bleak". c/

If this statement was true before the war in the Gulf, it is even more so after the war broke out.

Notes

a/ ESCWA consists of two groups of countries: the first is ESCWA non-oil-exporting countries, which include Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen, although some of these countries export oil without relying on it as a substantial source of foreign exchange. The second group is ESCWA oil-exporting countries, which include Bahrain, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

b/ Compiled from Quarterly Reports of the Bank of England, Bank for International Settlements (BIS), Organisation for Economic Co-operation and Development (OECD) publications, various issues of World Financial Markets (Morgan Guaranty Trust Company) and AMEX Bank Review (American Express Bank International) and others.

c/ Hassan Bin Talal, "Does the world want Jordan to vanish?", Christian Science Monitor, 28 November 1990.

Table AIV.1

Total External Debt of ESCWA Countries a/ 1974-1988
(in million of US dollars)

	1974	1975	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987 b/	1988 c/
.Oil-exporting countries													
Bahrain			80	112	289	300	612	772	840	913	982	911	954
Kuwait	286	421	864	1,753	3,226	2,629	4,321	7,623	8,950	9,253	10,025	10,559	10,321
Oman	276	306	322	415	826	401	723	1,222	1,923	2,225	2,960	3,252	3,513
Qatar		45	60	87	116	200	510	540	600	870	976	823	625
Saudi-Arabia	4,003	6,421	5,762	6,321	10,623	12,667	13,210	13,721	14,259	16,290	19,723	20,864	20,123
U.A.E.	409	1,201	2,232	2,869	3,523	6,232	9,212	9,823	10,221	12,031	14,968	15,632	13,568
Total	4,974	8,394	9,320	11,557	18,601	22,429	28,558	33,701	36,793	41,580	49,634	52,041	49,104
% in total ESCWA debt	28.3	29.4	34.0	33.0	38.6	39.4	41.6	43.7	43.6	43.0	42.6	42.1	38.5
.Other ESCWA countries													
Egypt	10,702	11,653	13,253	17,625	22,623	25,378	29,621	31,233	33,650	38,925	46,125	49,523	53,554
Jordan	458	623	965	1,121	1,778	2,021	2,267	3,123	3,534	3,692	3,885	3,988	4,987
Lebanon	452	723	980	1,213	1,310	1,621	1,823	2,201	2,655	3,041	3,952	4,321	4,678
Syrian Arab Rep.	866	1,331	1,728	2,167	2,322	3,121	3,523	3,867	4,297	5,560	7,892	8,500	9,723
Yemen Arab Rep.	121	136	188	254	334	623	875	1,002	1,270	1,292	1,623	1,698	1,723
Yemen Democratic Rep.		863	967	1,051	1,252	1,723	1,978	2,012	2,212	2,673	3,424	3,551	3,725
Total	12,599	15,329	18,081	23,431	29,619	34,487	40,087	43,438	47,618	55,183	66,901	71,581	78,420
% of total ESCWA debt	71.7	70.6	66.0	67.0	61.4	60.6	58.4	56.3	56.4	57.0	57.4	57.9	61.5
.Total ESCWA debt	17,573	21,723	27,401	34,988	48,220	56,916	68,645	77,139	84,411	96,763	116,535	123,622	127,524
.Memoranda													
Egypt / other ESCWA countries	84.9	76.0	73.3	75.0	76.3	73.6	73.9	71.9	70.7	70.5	68.9	69.2	68.3
Egypt / total ESCWA debt	60.9	53.6	48.4	50.4	46.9	44.6	43.2	40.4	39.9	40.2	39.6	40.0	42.0

a/ Excluding Iraq for lack of information. b/ Estimates c/ Preliminary estimates.

Note: . External debt of GCC-countries, excluding Oman, includes private debt only.
. External debt of other ESCWA countries includes private as public debt.
. External debt of the Syrian Arab Republic and Yemen Democratic Republic excludes military debt. Military debt of the Syrian Arab Republic to the former socialist (East-Block) countries is estimated at around $12 billion.
. External debt of Jordan as announced by the Central Bank of Jordan in July 1989 amounts to over US$ 8.5 billion, excluding debt service.

Source: ESCWA calculation based on BIS/OECD, World Bank Debt Tables, Institute of International Finance (IIF) and other international banking and sources.

Table AIV.2

Analysis of External Debt of ESCWA Countries a/
1980-1988
(in US billion dollars)

	1980	1981	1982	1983	1984	1985	1986	1987b/	1988c/
Total external debt (TED)	48,220	56,916	68,645	77,139	84,411	96,763	116,535	123,622	127,524
Debt/GDP (%) d/	18.0	18.6	23.5	32.6	38.7	51.9	69.3	68.2	69.4
Debt/current balance (%)	151.0	162.3	184.9	205.6	211.7	236.8	415.8	402.4	442.0
Total debt service (TDS)	6.4	7.3	8.5	9.6	9.9	10.4	10.8	11.5	11.6
Debt service ratio (%)	10.6	11.3	13.3	14.2	12.1	13.7	24.9	25.3	26.7
TDS/TED (%)	13.3	12.8	12.4	12.4	11.7	10.7	9.3	9.3	9.1
Long term debt e/	23.6	27.9	35.5	39.0	40.2	50.9	59.8	63.6	67.0
.. as % of TED f/	79.7	81.0	88.6	90.0	84.4	92.2	89.3	88.9	85.5
Short-term debt	4.8	5.6	3.5	3.9	6.6	3.4	6.1	6.9	6.1
.. as % of TED f/	16.2	16.2	8.7	9.0	13.9	6.2	9.1	9.6	7.8
Use of IMF credit	1.3	1.0	1.1	0.5	0.8	0.9	1.0	1.1	1.2
.. as % of TED f/	4.1	2.8	2.7	1.0	1.7	1.6	1.6	1.5	1.5
Total public long-term debt c/	22.5	25.8	36.1	37.2	39.0	48.2	58.1	60.3	65.4
Multilateral	2.7	3.4	5.1	4.1	4.7	6.2	5.8	6.6	7.4
.. as % of total	12.0	13.2	14.1	11.0	12.1	12.9	10.0	10.9	11.3
Bilateral	10.4	12.1	17.7	18.2	17.9	23.6	28.4	28.3	30.7
.. as % of total	46.0	46.9	49.0	48.9	45.9	49.0	48.9	46.9	47.0
Private	9.4	10.3	13.3	14.9	16.4	18.4	23.9	25.4	27.3
.. as % of total	42.0	40.0	36.8	40.1	42.0	38.1	41.1	42.1	41.7

a/ Excluding Iraq for lack of information. b/ Estimates. c/ Preliminary estimates.

d/ Excluding Lebanon and People Democratic Republic of Yemen.

e/ Excluding ESCWA GCC-countries. f/ TED of ESCWA non-GCC countries.

Source: ESCWA calculation based on BIS/OECD, World Bank Debt Tables, Institute of International Finance (IIF) and other international banking and sources.