THE DEBT CRISIS AND THE WORLD ECONOMY

Report by a Commonwealth Group of Experts

Lord Lever of Manchester

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Commonwealth Secretariat,
Marlborough House, London SW1.

Foreword by the Commonwealth Secretary-General

The decision of Commonwealth Heads of Government at their New Delhi Meeting in November 1983 to establish an expert group on the debt problem was a perceptive one. There were signs of economic recovery, interest rates were coming down and, although the debt burdens of developing countries remained severe, conventional opinion was still that the problem was manageable.

Now, nine months later, the international banking system obviously faces great danger. One major American bank has had to be rescued by the public authorities. The pace of the recovery has remained slow outside the US. Interest rates have again begun to rise from levels already high in real terms. Commodity prices have fallen to levels which could suggest future recession. Protectionist pressures show no signs of easing. All of this raises serious doubts whether developing countries can reasonably be expected to service their debt and, therefore, whether the banking system, already weakened, can avoid major injury if not collapse.

Patched-up arrangements—rescheduling of bank debts, new lending to help pay interest on outstanding debt, IMF loans on conditions of severe austerity for debtor countries—have, for the moment, bought time. But the source of instability remains and some of the short-term solutions may have deepened it. One of the worst features of the situation is that many developing countries are not experiencing debt relief commensurate with the painful austerity measures they have been forced to adopt. Renewed external pressures through higher interest rates and lower commodity prices are taking place at a time when severe adjustment strains are becoming economically and socially unbearable. The capacity of developing countries to comply with demands by the IMF and banks for austerity measures has political limits. In the final analysis, these limits are represented by unrest and the threat of revolution. Before that point is reached, debtor countries will obviously refuse to meet the terms and conditions of contraction demanded of them; there is growing evidence that that point is fast approaching. In some areas of direct and immediate concern to individual major industrialised countries, consciousness of this threat of instability has led to more imaginative policy. Such vision is now needed over a wider international field.

In many quarters, among bankers and Governments, a greater realism is emerging: recognition that current ad hoc policies are inadequate; assurances that 'the problem is manageable' not only sound unconvincing but also risk being counterproductive. Actions such as interest 'capping' and multi-year rescheduling are now being contemplated. Frankly, these 'solutions' are not commensurate with the scale of the problem. Moreover, the international community has been almost wholly indifferent to the difficulties of the poorest countries, especially those in Africa—many in the Commonwealth—for whom indebtedness is superimposed on already disastrous economic circumstances. Some have reached the stage where access to credit even for the most essential imports is being denied. These low-income countries do not individually have a major impact on the world economy or the banking system; that is why the response of the rich to their debt problem has been one of such benign neglect. Collectively, however, their weakness and poverty is an inescapable problem for the international community no less than for themselves.

In the end, action will have to be based on the reality of interdependence between developed and developing countries. This interdependence is currently being underlined by the effect on jobs and production in industrial countries of import cuts in indebted countries, imposed by forced adjustment. The current fragility of the whole Western banking system and the risk it poses for the whole international financial system are other strong reminders of this interdependence. So is the threat of political instability. There is a collective task, in the collective interest.

In approaching this important mandate from Heads of Government, I am pleased to have been able to bring together a most distinguished Commonwealth Expert Group whose members have all had close involvement intellectually and practically with the debt problem and related international financial affairs. Its Chairman, Lord Lever of Manchester, is a world authority on these matters. I am most grateful to them all.

The Expert Group sets as a major short-term objective the resumption of positive net transfers of resources to seriously indebted developing countries to permit orderly debt service and a resumption of growth. Its members do not believe that present measures are adequate to achieve this objective. In the light of this, and taking into account the special financing problems faced by the poorer countries and the systemic need for larger, more stable and better balanced capital flows to developing countries, the Expert Group calls for international cooperative action and recommends specific measures which form the basis of a programme of action.

It is my hope that this Report will make a significant contribution to policy discussions on the debt problem. It is to be considered first by Commonwealth Finance Ministers at their Meeting in Toronto in September 1984. In its topicality and coverage, however, the Report has relevance beyond the Commonwealth. I take this opportunity, therefore, to commend it to a wider international community.

SHRIDATH S. RAMPHAL

Letter of Presentation

Marlborough House,
London, SW1.

27 July 1984

H. E. Mr. S. S. Ramphal,
Commonwealth Secretary-General,
Marlborough House,
Pall Mall,
London, SW1.

Dear Secretary-General,

You appointed us as a group of independent experts from Commonwealth countries to examine the developing country debt problem in all its aspects, in accordance with the request by Commonwealth Heads of Government when they met last November in New Delhi. We herewith present our Report, which we have signed in our personal capacities, and not as representatives of the governments, organisations, or countries to which we belong.

We are firmly of the view that measures taken to-date to deal with the debt problem are not adequate. Substantive action is now required and we trust that our Report sufficiently emphasises the urgency of this need.

We are grateful to you for giving us the opportunity to make this contribution. We would like to express our thanks to your staff for their ready administrative and technical support.

Yours sincerely,

Lord Lever of Manchester

Alhaji Abubakar Alhaji

Horace Barber

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Introduction

Commonwealth Heads of Government, when they met in New Delhi in November 1983, surveyed the world economic situation and expressed concern over the serious crisis confronting developing countries because of the debt problem. They therefore asked the Secretariat, with the aid of a group of experts, to examine the developing country debt problem in all its aspects and to report to the Toronto meeting of Commonwealth Finance Ministers.

The Secretary-General constituted our Group in early 1984 and we met on three occasions before finalising this Report. We have seen our task primarily as one of drawing attention to the central features of a fast moving and deteriorating situation. In doing this we have endeavoured to take into account the work that has already been carried out in order to ensure that our recommendations are of the maximum practical use. The issues are immensely detailed. We have not thought it necessary to attempt to reach full agreement on all of them as a group. Our main purpose has been to stimulate action. In Part I of our Report we first put the debt issue in perspective. We then go on to explain the need for a more systematic and long-term strategy involving as its core a sustainable combination of public and private finance. We then set out our recommendations which cover the management of commercial debt, special measures for low-income countries, the role of the international financial institutions and the policies of the industrial countries.

Part II of the Report contains the background analysis which has served as a basis for our discussion and recommendations. Chapter I presents a survey of the debt problem. Chapter 2 reviews current policies on developing countries' commercial bank debt. Chapter 3 discusses the debt crisis as it affects the low-income developing countries. Chapter 4 deals with the international financial institutions and the debt crisis. Chapter 5 discusses future prospects for debt and resource flows.

Part I

Making Developing Country Debt Manageable

The Debt Problem in Perspective

1. Until 1974, governments and public institutions were the main providers of foreign capital to the developing countries. It was generally accepted that finance was required on terms which explicitly recognised the special economic and political problems of the developing countries and that many of them would be unable to meet interest obligations, or repay principal, within a commercial time horizon. The increase in oil price in 1973–74, while obviously diminishing the creditworthiness of the oil-importing developing countries, produced an urgent need for increased finance. The commercial banks, with ample deposits from the OPEC payments surpluses, were anxious to find opportunities to deploy them profitably and responded readily. Industrial country governments approved and welcomed the banks' willingness to respond. They recognised that major political and economic interests would be endangered if finance was not made available. And they were anxious to avoid additional budgetary obligations themselves.

2. The mainstay of the lending throughout was the assumption on the part of governments, banks and borrowers that the debts could be serviced indefinitely through expanded borrowing on the capital markets. The analogy was drawn between this type of international borrowing and the domestic debt of the richest countries in the world, which in any case did not require service in foreign exchange. Although global economic and political interests of the greatest importance were at stake, the lending was not underpinned by the resources of the developed world as a whole but only by a small and vulnerable part of those resources—the capital and reserves of its principal commercial banks. The banks

were not in a position to make appropriate decisions on the aggregate amount to be lent or on its apportionment between the developing countries; nor could they stipulate appropriate controls on borrower governments, who were very ready to accept the funds being offered to them on a larger scale and on more lenient terms than were available from the international institutions.

3. In the years after 1974, the borrowing countries increased their current account deficits and the lending, for a time, continued to cover them. The period between borrowing and the servicing of debt can be bridged by further commercial borrowing—but only as long as service in real terms seems a credible prospect. Unfortunately this prospect did not grow to match the great increase in debt obligation, particularly after 1980.

4. It was inevitable that lending and its servicing could not be sustained. The second oil shock, the prolonged recession and high interest rates speeded up this recognition, and over the past two years commercial bank lending to developing countries has dried up. The debtor countries' financial and economic programmes have been badly disrupted, with consequent serious political difficulties. Their considerable contribution to the expansion of world trade, itself one of the great dynamos of world economic expansion, has been abruptly reduced by reason of shortage of funds. At the same time the leading banks of the developed world are faced with potential defaults on debts which greatly exceed their capital and reserves.

5. The experience of the last ten years has, however, led us to the conclusion that a substantial contribution from the funds of commercial banks will be required in providing finance for developing countries in the years ahead. But this in turn requires much greater involvement by governments, and particularly by the multilateral financial institutions, than has been the case since 1974.

Prospects for servicing debt

6. The view of the industrial countries and the international institutions has tended to be that the soundness of the developing countries' debts can be restored if the present industrial country economic recovery is extended and if the debtor countries continue to pursue sound adjustment policies, through IMF programmes to support rescheduling and new lending. The assumption is that in the years immediately ahead the debtor countries can generate and sustain trading surpluses to service a substantial proportion of their debts and that, while so doing, they should and would be given further bridging loans, mainly from the commercial banks.

7. If this view is correct and substantial servicing of developing country debt in real terms is manageable in the years immediately ahead, this would certainly be a fortuitous outcome to lending founded on wholly different expectations. In our view, it is neither feasible nor desirable for the debtor countries in aggregate, at their present stage of development, to generate the large and sustained trading surpluses which would be required. Such surpluses could be obtained, if at all, in this period only at the cost of frustrating economic advance. Any sustained attempt to achieve what we believe would be a premature transfer of resources from the debtors to their creditors would face continuous political difficulties.

8. Moreover, the sustained export surpluses the debtors would require, if present policies are to succeed, would raise new and formidable structural problems for the developed world. Industrial countries have not yet succeeded in reversing the growing protectionist trends which have been prompted by their existing problems of structural adjustment. The obvious connection between export earnings and debt-servicing capacity has so far received insufficient attention.

9. Non-oil developing countries have sharply reduced their current account deficit—in aggregate from $109 billion in 1981 to $56 billion in 1983—partly because its financing became difficult. Some major debtors, under the pressure of IMF adjustment programmes, have moved from large deficits to large surpluses in their trade account. But these gains have been due mainly to reductions in their imports, abruptly brought about by a shortage of funds. They have been bought at the cost of economic setback, injury to world trade and grave risk to the political stability of the debtor countries. At present the international community is giving inadequate attention to the implications of the very large United States trade deficit. While it continues, it makes an important contribution to the export earnings of other countries, including, of course, major developing country debtors. But as it declines in future, the exports of these countries are likely to be adversely affected. We are thus in no doubt that developing country adjustment will continue to face considerable difficulties for some time ahead.

10. We do not question the need for firm adjustment programmes in the debtor countries. But these should be related to the achievement of sustainable economic growth and not to the attempt to secure early balance of payments 'gains' at the cost of inhibiting investment and growth. Such gains are too small to restore the debtors' market credit but large enough to do serious economic and social damage. The pressure for a premature reverse transfer of resources has arisen not because judgements about the economic and political conditions of the

developing countries have changed but because of the difficulties that have arisen since the assumption of readily available finance proved false. Present policies are, in our view, not policies of choice but a reflection of the failure of governments to overcome the difficulties of organising the coordinated action required for creative alternatives.

Dangerous instability in the system

11. We are not dealing with the isolated difficulties of one or two debtor countries or of one or two creditor banks. Rather we are faced with a dangerously unstable system in which the financial safety of the developing countries is involved and to which the leading banks have committed sums amounting to twice their capital and reserves. The point of greatest vulnerability for both debtors and creditors is in ensuring service of the interest on outstanding debts to the banks. If interest is not paid, the debts will be classed as non-performing and will have to be sharply written down in the balance sheets of the banks. If a substantial proportion of the debts become non-performing, we will be faced with the open insolvency of the indebted countries and of their bank creditors. The repercussions of this would be very damaging not only to the debtors and their creditors but to the world economy and to world politics. Clearly the first requirement of any sound policy must be to insure against this grave danger.

12. At present, formal default has been avoided by what appears to be payment in full of interest on almost all of these debts. These interest payments by major debtors are currently derived largely from three sources. First, the debtors have been able to borrow new funds from the IMF, roughly $9½ billion in 1983. Secondly, in the same year, the debtors have made a substantial contribution by their aggregate trade surpluses and the drawing down of their reserves. Thirdly, the balance of interest not covered by these two sources—about $15–16 billion in 1983—has been found by rescheduling. This means that the banks had little choice but to lend their debtors the money to make good the shortfall in their interest obligations so as to avoid open default.

13. Of these three sources of contribution to the vital task of ensuring that the debts remain performing, the most reliable is the IMF. It is by no means certain that this lending can be sustained even at present levels in the years ahead without substantial further infusions of funds. It is in the nature of the IMF that its ability to maintain its lending depends on its being repaid on time. As regards the second source, it would be very dangerous to found policy on the assumption that the current account gains of the debtors can be maintained. Thirdly, the rescheduling contribution to interest payments is rapidly losing credibility. Rescheduling is a valid and credible mechanism for granting

time to the occasional debtor in temporary difficulties. When, in conditions of vast and growing indebtedness, it is applied nearly universally and semi-permanently, it must increasingly be seen as purely cosmetic, that is to say, as a means to avoid the acknowledgement of default. For the creditors it produces balance-sheet assertions which are ever more obviously in conflict with market reality. In our opinion, we are dangerously near the time when these arrangements will no longer serve to permit the banks to treat these defaulted debts as performing assets. The debtors for their part are left with a sense of ever mounting debt.

14. The financial strength of the debtors and the bankers is now firmly interlocked. The questionable value of the banks' claims upon the developing countries represents a challenge to their solvency. Lightning rescues of the banks and emergency rescheduling, however massive, merely improve liquidity. They make neither borrower nor creditor stronger. The only way to strengthen the banks is to improve the quality of their assets. That means strengthening the economies and the finances of the debtor countries. The minimum required for safety is to ensure that the debtors are in a position to pay their interest in the years immediately ahead.

15. In short, at this crucial point of vulnerability, present policies provide only a most precarious protection. The world's financial safety is balanced on a knife-edge.

The Need for a More Systematic Approach: Public Purpose and Private Finance

16. Our analysis underlines the following conclusions:

- The debt crisis threatens not only development in developing countries but also the stability of the banking system of industrial countries.
- Debtor nations are being required by their debt-servicing obligations to engineer a net flow of resources to industrial countries for the foreseeable future.
- The bank debt crisis has been allowed to obscure another crisis in which indebtedness has been superimposed on other serious problems: namely, that of many low-income developing countries, especially in Sub-Saharan Africa, whose situation arouses the deepest anxieties. For many countries the position is very grave and calls for urgent responses to alleviate the situation.

17. Although the origins of the developing country debt problem in its present form can be traced to a particular set of historical circum-

stances, the problem has now become so intertwined with world economic relations that it has to be attacked simultaneously on a number of different fronts. We have therefore ranged widely in our discussion of policy measures, the remedial effect of which, on the debt problem, may in some cases be indirect rather than direct. But our prime concern is not with the detail of these various measures, important as they are individually. What really matters is that the aggregate impact of the measures taken should be on a scale which matches the size of the problem. We recognise the difficulties in mobilising the degree of intergovernmental cooperation required to frame and execute the necessary policies. But the issues at stake call for no less.

Recommendations

A. *Commercial indebtedness*

18. Any satisfactory solution to the present situation must in our view respect the following criteria:

(a) There should be an equitable distribution of responsibility and costs between debtor countries, creditor country governments and the private banks, having regard to the history of the lending and the contribution it has made to the growth of the world economy whatever its defects may have been.

(b) It is a matter of urgency to put an end to the premature outflows of resources from developing countries. Austerity which produces growth is acceptable. But austerity which attempts to secure premature balance of payments adjustments at the expense of investment and growth is not.

(c) Policies to bring about a positive transfer of resources to developing countries must be soundly based—that is, both regulated and designed to produce growth—and of mutual advantage to industrial and developing countries.

(d) Creditor countries must cooperate to assist the debtors, by guarantees or other means, to raise the funds to meet the interest on existing debt obligations and to ensure the flow of new funds referred to in (c) above.

(e) The efficient functioning of the banking system both domestically and internationally must be preserved and insolvencies avoided. The banks must not, however, be bailed out. They must bear an equitable share of the burdens involved and must be given adequate time to make this manageable.

19. Proper arrangements must therefore be made to keep loans performing and to permit higher levels of growth, and imports, in the

debtor countries. This requires a level of additional financing sufficient to enable the debtors to pay the interest on their outstanding debt, while removing the pressures for achieving premature trade surpluses. Since the market will not provide this additional amount without guarantee, the industrial countries will have to take steps to ensure the availability of this additional financing. This would come from a combination of:

- commercial bank lending underpinned by a scheme of insurance;
- bilateral official lending, including export credits; and
- multilateral lending via the IMF, the World Bank and the regional development banks.

20. In parallel with the additional financing, rescheduling arrangements should be enlarged in scope along the following lines to give greater stability to the 'overhang' of debt and to reduce the debt-servicing burden:

- longer maturities and grace periods will be necessary in most cases;
- mechanisms should be established to provide at least temporary relief in respect of interest when it is at exceptionally high levels;
- multi-year rescheduling should be the norm rather than the exception; and
- the possibility should be considered of granting temporary relief by arrangements which would permit debt service in local currency to cover periods of foreign exchange difficulty.

21. In this way the debtors would be enabled to pay the interest and the banks would be in a position to make realistic write-downs of the debts to sustainable levels over a long period of years. This would bring about that combination of public purpose and private finance that ought always to have been in place. The exposure of governments in respect of the guarantee would be reduced in size over time as the banks write down their debts. Debtor countries would be able to end negative transfers and to finance balance of payments deficits on a basis compatible with the resumption of growth—the only way in which a satisfactory long-term solution of these problems can be achieved.

22. In addition to the combination of commercial bank lending, bilateral official lending and multilateral lending from the international financial institutions, there is need for action on other fronts. Steps should be taken to create a larger role for direct foreign investment in developing countries, many of which are now actively seeking such investment. The necessary encouragement must be provided by both

developing and industrial countries in a mutually acceptable framework. An expansionary economic environment for developing countries is an important element in this scenario and it can scarcely be fostered by the current deflationary approach to solving balance of payments problems. The principle of guarantees or insurance can be applied not only to bank lending as advocated above but also to expand private foreign investment, and to encourage new types of commercial flows such as bond financing.

23. By giving the necessary help to prevent the insolvency of the debtors the developed world will in the best and most economical way protect the banking system. Though the sums involved are large in relation to the resources of the banks and of the borrowing countries, they are small in relation to the world economy. The OECD annual income is around $8,000 billion; by contrast the whole of developing country debt to the banks is some $400 billion—little more than one year's potential growth of the world economy. And a great deal more than one year's growth of the world economy is at stake.

B. *Special measures to assist low-income countries*

24. A distinction needs to be made between middle-income developing countries, mainly in Latin America, whose external debt is primarily owed to the commercial banks, and low-income developing countries, mainly in Africa and South Asia, which have relatively little bank debt, but where debt arises from export credits and past official development assistance (ODA).

25. The serious debt-servicing problems facing many low-income countries have not received adequate recognition from the international community. The combination of declining ODA in real terms and rising debt-service obligations has sharply reduced net transfers to low-income countries, particularly in Sub-Saharan Africa. This contraction occurred during a period in which the prices of primary commodities collapsed to the lowest levels since the 1930s and market access has been reduced. The drought in Africa has aggravated the difficulties of a decade of declining living standards. Even countries pursuing appropriate adjustment policies have been forced, in these circumstances, to renegotiate their debt.

26. The terms of official finance—IMF and World Bank loans and officially guaranteed export credits—have hardened in response to increases in interest rates.

27. We are greatly concerned at the danger that emergency solutions for the big debtors could result in a crowding out of the poorest

countries from official financing when in fact their problems are the most difficult and urgently in need of attention.

28. Priority must be given to a special set of measures for assisting low-income developing countries, especially in Africa:

- reactivation of the IMF Trust Fund and interest subsidy account to promote medium-term, low-interest balance of payments finance for low-income countries which have great difficulty in using high-conditionality short-term IMF finance at normal interest rates;
- recognition that while IMF lending of an appropriate kind is desirable, the essentially long-term, structural nature of adjustment required in most low-income countries calls for the central role in external financing for adjustment to be played by the World Bank, in conjunction with regional banks;
- substantial real increases in ODA with a larger proportion going to poorer countries, and a greater role for programme lending. In this connection, attention must urgently be given to providing supplementary resources to IDA, to avert a significant reduction in multilateral flows to low-income countries;
- full implementation of the commitment to ODA debt write-offs for the poorest countries and substantial relief for other low-income developing countries;
- substantial relief, through longer maturities and grace periods, lower interest and multi-year rescheduling in Paris Club restructuring of the official debt of low-income countries;
- a reform of the official debt rescheduling procedures to give greater attention to new financial flows; in particular a coordinated approach to support rescheduling with new concessional flows and to ensure that insurance cover for export credit is promptly restored;
- improvement of domestic management and in particular debt management; international agencies can play a useful role by providing technical assistance to develop debt management systems in low-income countries.

C. *International financial institutions*

29. The international financial institutions need to play a much more active role in resolving the debt problem and in meeting the financing needs of developing countries. To carry out this role they need substantially revised terms of reference to deal with economic adjustment in a long-term framework, and adequate resources to carry out this mandate.

The IMF

— adjustment programmes should be designed with an emphasis on investment and growth;

— longer periods should be granted for adjustment, particularly in the case of low-income countries. This would entail a consistent joint approach by the Fund, the World Bank and the debtor countries' governments to financing structural adjustment, along the lines envisaged by the Report of the Commonwealth Study Group, *Towards a New Bretton Woods*;[1]

— the present facilities with regard to compensatory financing should be enlarged; and

— the IMF should have substantial increases in its resources mainly through an increase in quotas. A substantial further allocation of SDRs is also necessary.

The World Bank and regional development banks

— a significantly higher fraction of World Bank loans should be in the form of programme lending to countries with balance of payments financing difficulties; in particular, the proportion of programme lending should be raised to over 30 per cent;

— the World Bank's lending resources should be increased by a further substantial general capital increase and by relaxing the gearing ratio;

— lending by IDA, which under present policies would decline even in nominal terms, should at least be maintained;

— the World Bank and regional banks should undertake a larger role in supporting private lending (for example, via co-financing) and equity investment;

— the World Bank and regional banks should play a more central role in drawing up adjustment programmes, especially for low-income countries;

— the regional banks have a useful role in development financing in addition to that played by the World Bank; to perform this they need greater resources and more flexibility to respond to the need for programme loans.

D. *Industrial country policies*

30. Our recommendations have been framed in the context of uncertain and uneven economic recovery in industrial countries, high interest

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1. Commonwealth Secretariat, *Towards a New Bretton Woods: Challenges for the World Financial and Trading System*, Report by a Commonwealth Study Group, July 1983.

rates and protectionist resistance to increased imports from developing countries. The scenario for the future, sketched out in Chapter 5 of Part II, highlights the dangers in the debt situation if any, let alone all, of these problems continue. Although the improved economic climate in industrial countries is not in itself enough to avert the recurrence of serious debt problems, the dangers and difficulties would be lessened considerably by:

— the resumption of sustained economic growth at higher rates than in the past decade;

— a significantly lower level of real and nominal interest rates; and

— a 'roll back' of protectionist measures, particularly those affecting developing countries in such sectors as agriculture, textiles and clothing, and steel.

Conclusions

31. We observed at the outset that we saw our basic task as one of drawing attention to the central features of a fast-moving and deteriorating situation.

32. The message is clear. The present situation is not sustainable. The world's financial safety is balanced on a knife-edge. The greatest immediate danger of disruption is posed by the risk that interest will not be paid on the existing debts of the major developing country borrowers. The erosion in the living standards of developing countries has pushed their peoples to the margin of tolerance. There is thus an urgent need to organise an adequate and collective response to the situation. There must be an end to premature negative transfers of resources and the quest for developing country trading surpluses. The needs of the poorest and most seriously disadvantaged developing countries must receive greater collective attention. The international community must find again the balance between public purpose and private finance which was at the heart of the Bretton Woods arrangements and which is indispensable to the sustained growth and stability of an interdependent world.

33. There is no room for complacency. We sense rather that a recognition of the gravity of the issues and of the dangers posed by the debt crisis in an interdependent world is growing. Full expression is not always given to this recognition, perhaps because of fear of seeming to aggravate matters. But the situation has now been reached where collective determination to take action is imperative. The knowledge that such determination has been mustered will itself be a factor for greater stability.

The Scope of the Developing Country Debt Problem

* Total debt of developing countries at the end of 1983 was about $800 billion, long- and short-term, and was of the order of one and a half times their export earnings.
* Half of all developing country long-term debt is owed to private markets, compared to one-quarter a decade ago.
* The annual debt service payments of the non-oil developing countries increased from less than $20 billion in 1973 to more than $100 billion by 1983.
* Interest payments on external debt by the non-oil developing countries reached a level of $60 billion by 1982–83, absorbing 13–14 per cent of their export earnings. Between 1980 and 1983, these countries' export earnings did no more than keep pace with the increase in their interest payments.
* In respect of some acutely indebted countries, interest payments absorbed between one-third and half their export earnings.
* The debt-service payments of low-income countries (i.e. countries with per capita incomes of not more than $350 at 1978 prices), absorbed more than a fifth of their export earnings in 1983.
* 40 per cent of all non-oil developing country debt, as against 5 per cent a decade ago, is at variable interest rates.
* Each one percentage point rise in the rate of interest is estimated to cost the developing countries at least $3 billion per year in increased interest payments.
* During 1983, developing countries experienced a negative net inflow of funds (i.e. gross borrowing minus debt-service payments) of $11 billion.
* Developing countries reduced their imports by $60 billion between 1981 and 1983, $40 billion of which was in respect of imports from industrial countries.

PART II

Chapter 1

Survey of the Debt Problem

Origins of the Problem

Banks and the recycling process

1.1 The immediate causes of the present debt crisis lie in the onset of the recession from 1980 onwards in the industrial countries and the associated rise in interest rates. The seeds of the problem were already present, however, in the events following the first oil price rise of 1973–4, the explosion in the current account deficits of the non-oil developing countries and the financing of these deficits by private banks. The main burden of the counterpart deficits to the surpluses of the oil-exporting countries was shifted quickly from the industrial countries which were the major oil importers, to the non-oil developing countries. The recycling by the banks of the surpluses of the oil exporters was facilitated by the softening of the costs of borrowing by inflation and the rapid expansion of international banking; the Eurocurrency market increased from US$300 billion in 1973 to over $2,000 billion in 1983. The second oil price increase in 1979 and the impact of restrictive fiscal and monetary policies in the industrial countries, adopted to control inflation, together resulted in a stagnation of world trade and a sharp rise in nominal and real interest rates. The result was a substantial increase in debt-service obligations leading to arrears which precipitated a sudden reduction in net lending by banks. Debt obligations, contracted under what seemed to be favourable circumstances, ceased to be viable. The intermediation role played by the banks—which made finance easily available at low real rates of interest during the 1970s—also encouraged some debtor countries to adopt expansionary policies, albeit for investment rather than consumption,[1] thus contributing to their large budget deficits and to the accumulation of debt.

1.2 This broad pattern of events can be encapsulated with the aid of a few aggregate statistics. The total long-term external debt of developing countries at the end of 1983 was around \$600–650 billion, with \$125–150 billion of short-term debt; and some 85 per cent of the total was accounted for by non-oil developing countries. The debt increased five-fold after 1973 in nominal terms, and more than doubled in real terms. It mainly accumulated over the period 1974–82 when a total deficit (and reserve increase) of \$587 billion for non-oil developing countries was financed as follows: 29 per cent by non-debt-creating flows, foreign direct investment and grants; 22 per cent by long-term capital from official sources, mainly export credits and from international institutions; and the remainder (49 per cent) by borrowing from private markets, almost all from banks (see Table 1.1). Consequently, by 1983, about half of all the long-term debt of non-oil developing countries, together with almost all the short-term debt and the rapidly increasing debt of some of the oil exporters, was owed to banks.

1.3 Various features of this private bank lending explain why serious problems arose subsequently:

— the maturities of Eurodollar loans have been typically around 8 years, which are long in relation to the liquidity of the banks' deposits but short in relation to the time periods appropriate to development financing. By contrast, the World Bank lends for over 50 years under its soft-loan International Development Association (IDA) facility and 15–20 years in its IBRD lending to middle-income countries. In the absence of well-defined measures for refinancing the Eurodollar loans as they fall due, the international financial system has operated on a false assumption that the debt would be repaid in the unrealistic time-frame of medium-term bank finance;

— much of the debt was contracted at variable interest rates; the proportion of such (non-oil) developing country debt increased from 5 per cent in 1972 to 40 per cent in 1982, and to over 75 per cent for some major debtors. This has made borrowers highly vulnerable to short-term increases in interest rates which raise the cost not only of new borrowing but of past debt too. It has been estimated that a 1 per cent rise in interest rates adds at least \$3 billion per year to interest charges on all developing countries' debt;

1. The IMF, on the basis of an econometric investigation, concluded that 'in general—it appears that increases in the indebtedness of the non-oil developing countries have reflected primarily an exchange of debt instruments for additional physical capital'. *World Economic Outlook*, 1983, p. 144.

— there has been a rise in the significance of short-term debt with an original maturity of less than one year. Countries have commonly relied on 90-day credit to finance many of their imports, but the big increases in short-term debt for some major debtors cannot be explained in terms of trade credit requirements. The increased proportion of short-term debt in total debt reflected the interest of individual banks in protecting themselves in periods of impending crisis by further reducing the maturity period of loans. But when all banks have acted together in a concerted way the effect has been to make the position of the debtors, and the system as a whole, more vulnerable.

Table 1.1: Non-Oil Developing Countries: Financing of Current Account Deficits 1974–82 Cumulative Totals

	$ billion	per cent
Current Account Deficits	531	90.5
Increase in Official Reserves	56	9.5
Total	587	100.0
Financed by:		
(a) Non-debt-creating flows (net)	172	29.3
(b) Long-term capital from official sources, net	128	21.8
(c) Borrowing through private markets	278	47.3
Of which: Banking	255	43.4
(d) Others	9	1.5

Source: Computed from IMF, *World Economic Outlook,* 1984 and *International Capital Markets, Developments and Prospects,* 1983.

1.4 It will be clear from the above that we regard the current debt crisis as having largely originated in the weakness of the financing mechanism itself which evolved to meet developing country external deficits in the 1970s. The recession and the rise in real interest rates precipitated the crisis in 1982, but the inherent vulnerability of the system would have been exposed sooner or later.

The impact of recession

1.5 The first major impact of recession was on developing country export earnings. Between 1973 and 1980 the export earnings of the non-oil developing countries roughly kept pace with the growth of debt. But between 1980 and 1983, the total debt of the non-oil developing countries increased by an amount close to $200 billion, while their total export earnings increased by only about $20 billion. The weakness in export earnings has arisen from the low volume of growth and the depressed prices of commodities, and also from difficulties in exporting manufactures because of protectionism and slow market growth. While the tentative recovery in growth in the industrial countries in 1983 began to suggest that a revival in commodity prices was under way, these have dropped again in 1984. At mid-July, the dollar index for all items had fallen by 3 per cent from a year earlier and by 17 per cent from 1980 levels; for non-food agricultural items the falls were 19 and 22 per cent and for metals 16 and 33 per cent, respectively.

1.6 The second influence has been that of high interest rates. For example, the six-month Eurodollar rate payable on variable debt rose from an average of 8.3 per cent in the period 1972–78 to 17.2 per cent in 1981, descending again to 9.8 per cent in 1983. The trend this year is, once again, upward, with the rate reaching 12.8 per cent in mid-July 1984.

1.7 Annual interest payments for all non-oil developing countries have risen from $13 billion in 1977 to over $60 billion since 1982. Between 1980 and 1983 the increase in annual interest payments on outstanding debt was about $20 billion, absorbing the entire increase in export earnings. For the 25 major debtor countries, interest payments now absorb over a fifth of all export earnings, and for some individual countries the position is considerably worse (see Table 1.2).

1.8 Although nominal interest rates are now at lower levels than in 1981, real interest rates remain high. If rates of interest are adjusted for changes in the export unit values of developing countries, it becomes clear that the real interest rate, which remained largely negative in the 1970s, rose to over 20 per cent in 1981–82 in respect of the non-oil developing countries, and has not fallen significantly since.

1.9 High international interest rates have another, negative, impact which exacerbates the liquidity problem faced by debtors. They precipitate outflows of private capital. The opportunity of earning high real rates of return on dollar deposits in overseas accounts encourages capital flight from developing countries, thus forcing governments, in effect, to choose between debilitating capital outflows and domestic interest rates which are at a level that chokes off investment.

1.10 We shall pursue in Chapter 5 the future implications of the debt problem based on different assumptions about growth and interest rates

Table 1.2: Developing Countries: Debt-Service Payments as per cent of Export Earnings, 1973–83

	Interest Payments Ratio				Debt Service Ratio			
	1973[a]	1977	1980	1983	1973[a]	1977	1980	1983
(1) All Developing Countries[b]	n.a.	5.7	9.1	13.2	n.a.	15.3	17.1	22.5
— 25 Major Borrowers[c]	n.a	7.2	11.9	18.6	n.a	19.1	21.5	29.9
(2) Non-Oil Developing Countries	6.1	5.7	9.1	13.2	15.9	14.8	17.2	21.6
— Low-Income Countries	6.1	4.7	4.4	5.4	14.6	12.1	10.3	13.3
— Excluding China and India	n.a	5.1	6.1	9.3	n.a	13.2	14.3	22.4
(3) By region								
— Africa	2.9	5.0	8.1	10.8	8.8	11.9	17.4	25.1
— Asia	3.9	3.1	4.4	5.9	9.6	7.9	8.4	10.8
— W. Hemisphere	11.1	10.0	18.9	32.2	29.3	28.2	34.1	44.0

Notes: [a] Figures for 1973 do not include China in any category and are not strictly comparable with the figures for later years. Regional figures for 1973 refer to non-oil developing countries only.

[b] Excluding eight oil-exporting countries: Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia and United Arab Emirates.

[c] The 25 developing countries with the largest total external debt at the end of 1982. In order of the amount of debt, they are: Brazil, Mexico, Argentina, Korea, Indonesia, Venezuela, Israel, India, Chile, Egypt, Yugoslavia, Turkey, Algeria, Philippines, South Africa, Portugal, Nigeria, Thailand, Malaysia, Peru, Pakistan, Morocco, Romania, Colombia and Hungary.

Source: IMF, *World Economic Outlook,* 1983 and 1984.

in the industrial countries. Suffice it to say here that since work on this report was initiated the prospects for both now look considerably less promising.

Major debtors and other developing countries

1.11 Up to now we have dealt with the developing country debt problem as an undifferentiated whole. There is, however, an important distinction to be made between the small number of major debtor countries which are critical to the viability of the international banking system and the many small debtors for whom the burden of external debt is also a serious problem but who are less central to the system as a whole.

1.12 As far as the international financial system is concerned, the debt problem would appear to centre on a handful of countries. Brazil, Mexico, Argentina and South Korea account for more than 45 per cent of total non-oil developing country debt, about two-thirds of the debt owed to private creditors, and 62 per cent of the gross exposure of banks to the non-oil developing countries. If we take account of the deposits of these countries with the banks, and exclude officially guaranteed export credits, they account for nearly 95 per cent of the net exposure of banks to all developing countries.

1.13 By contrast, low-income developing countries (on the IMF definition)[2] account for a total of $88 billion, short- and long-term, 13 per cent of the total for all non-oil developing countries. Their outstanding debt to all private creditors is $15.4 billion, under 5 per cent of the total of such debt for all non-oil developing countries (most low-income developing country debt being official rather than private). Yet these countries have collectively experienced serious problems of indebtedness. Between 1980 and 1983, their total debt (excluding India and China) increased by about $14 billion, while their annual export earnings declined by $1 billion. At the same time, their debt-service payments increased by about 50 per cent over a period of three years. Over a fifth of their export earnings are now absorbed in debt-service payments; for Africa, the share is over a quarter.

1.14 The distinction between the problems of major middle-income debtors and those of the low-income countries is sufficiently important for us to treat them separately in Chapters 2 and 3. In Appendix 1.1 we show for a range of mainly Commonwealth countries how the debt problem varies in scale and type.

2. See Annex for country groupings.

Implications of the Debt Problem for Developing Countries

Economic impact of negative resource flows

1.15 The main impact of the debt crisis on the major debtors has been the rapid forced transition from trade deficits financed by net capital inflows to net capital outflows made possible by running trade surpluses. The process by which growing interest charges are being met through surpluses elsewhere on the current account is shown in Table 1.3.

1.16 Gross new medium- and long-term Eurocurrency bank credits to developing countries fell from an average of over $40 billion in the five years 1978–82, to $33 billion in 1983 and $18.8 billion in the first six months of 1984 (against $23.1 billion a year earlier). As a result of the mounting debt-service payments on the one hand and reduced loan disbursements on the other, all medium- and long-term loans (net of repayments) to all developing countries declined by $41 billion between 1981 and 1983 and by $38 billion for the thirteen major borrowers.[3] During 1983, these thirteen suffered a net outflow of resources of $21 billion as compared with $11 billion for developing countries as a whole. This outflow was augmented by private capital flight, amounting to an estimated $45–70 billion from four Latin American countries in 1982 alone.

1.17 Developing countries have been required, as a consequence of lack of financing sufficient to pay the interest charges, to achieve surpluses on trade in goods and services. Deflationary policies have been the main instrument used to create these surpluses. As a consequence, their imports fell by some $60 billion between 1981 and 1983, much of this being concentrated on the major borrowers. In order to achieve this degree of import contraction, the ensuing deflation has been sufficiently large to induce not merely lower growth but also cuts in per capita income. In Latin America there was a decline in real per capita incomes in 1983 of 5.6 per cent, a fall for the third year in succession. Of developing countries as a whole, the IMF has commented: 'in 1982 and 1983 the entire GDP growth of 1½ per cent in the non-oil developing countries was needed to improve the foreign balance. Thus, real domestic demand in these countries in 1982 and 1983 was at best stagnant in aggregate terms and declined by a wide margin in per capita terms'[4]. The cutback has affected not just personal consumption but also investment, with adverse implications for future growth.

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3. These are countries with disbursed and outstanding long-term debt of over $13.5 billion in 1982 (World Bank classificaton).

4. IMF, *World Economic Outlook,* 1984, p.3.

1.18 In this report, we have endeavoured, with the help of a linear model of the world economy, to demonstrate the costs of trying to achieve trade surpluses by demand-reducing measures.[5] Our estimates are that for Latin America as a whole to generate $1 of additional foreign exchange it is necessary for it to reduce its GDP by $8; for Africa and Asia the reductions are respectively $5–6 and $6–7. Using the same model we also estimate that if growth rates are held back by the need to achieve trade balance (or a small positive resource transfer), then, even if growth in industrial countries averages 3 per cent (which was the average for the period 1970–81), growth in Latin America will average only 1.4 per cent, in Africa 2.1 per cent and in Asia 3.2 per cent. Except in Asia, per capita incomes will fall continuously.

1.19 The impact of the enforced contraction of incomes in developing countries has been felt in industrial countries also. In the case of the United States, for example, the drop in exports to Latin America

Table 1.3: Non-Oil Developing Countries: Balance on Current Account and Interest Payments, 1973–84 ($ billion)

Year	Balance on Current Account Excluding Interest Payments on External Debt and Official Transfers (1)	Interest Payments on External Debt (2)
1973	− 4.4	6.9
1974	−27.7	9.3
1975	−35.8	10.5
1976	−21.7	10.9
1977	−17.7	12.7
1978	−24.2	18.1
1979	−36.1	25.9
1980	−48.7	39.0
1981	−54.4	54.7
1982	−19.2	63.0
1983	+ 2.8	59.2
1984[a]	+13.7	63.7

Notes: China is not included in the years up to 1977.
[a] Projections.
Source: IMF, *World Economic Outlook*, 1983 and 1984.

5. This exercise was carried out in collaboration with Martin Weale of the Cambridge University Department of Applied Economics. The model is described in 'Quantity and Price Effects in an Analysis of World Trade Based on the Accounting Matrix', *Review of Income and Wealth*, March 1984.

accounted for almost half of the $33 billion decline in total exports between 1981 and 1983, and may have cost the American economy some 400,000 jobs. Clearly, the debt problem has affected industrial country growth. It is estimated that 3 per cent growth would have been achieved in 1983, instead of the 2.3 per cent actually achieved, if the developing countries had been able to continue importing at 1982 levels—which were already below those of 1981. This linkage is especially important for industrial countries which have a high share of their exports directed to developing countries: the US (40 per cent), Japan (43 per cent), the UK (29 per cent) and West Germany (22 per cent).

Export growth prospects

1.20 Negative net transfers entail trade surpluses on goods and non-factor services. These will be achieved either by further suppressing imports through low levels of domestic activity or by rapid export growth, which will in turn permit faster growth of imports and of the domestic market. Improved trade performance can come in part by removing any bias against traded goods and services, and in particular exports, which exists at present in some of the seriously indebted countries. But it will also be necessary for developing countries to achieve improved returns from their traditional commodity exports and better market access in industrial countries for an expansion of non-traditional exports, mainly manufactures.

1.21 Improved access to industrial country markets requires a reversal of protectionism. At present about a third of the exports to industrial countries of six of the most heavily indebted countries consist of highly sensitive items (meat; dairy products; cereals; animal feedstuffs; fats and oils; textiles and clothing; footwear; ships; and steel). Ever since the onset of the debt crisis, additional restrictions have been imposed on steel and textiles, and on many lesser items.

1.22 While the issue of protectionism is crucially important, it should not be forgotten that half the exports of non-oil developing countries—and a much higher proportion of those of the low-income developing countries—are primary commodities whose earnings have been depressed in respect of both price and volume since the start of recession in 1980. Indeed, in 1982, commodity prices achieved a post-war low in terms of manufacturing prices. Little progress has been made on the various proposals to improve developing country terms of trade, a consequence of which has been a weakened ability to service debt.

Implications for the Banking System

1.23 We have already argued that bank lending was an inherently unsatisfactory vehicle to carry the main burden of recycling financial surpluses. The consequences of this disproportionately larger role can be seen in the banks' current asset structures. In relation to their capital base, the main banks have a high degree of exposure to a small number of developing countries. The nine largest banks in the United States, for example, have a combined exposure to developing countries of over 200 per cent of bank capital and this excludes OPEC members and also offshore banking centres, many of whose funds are on-lent to developing countries. Of this figure the four major Latin American borrowers accounted for 128 per cent in December 1983. Particular banks face a much higher degree of exposure, the leaders being two British banks, Lloyds (228 per cent of shareholders' funds exposed to Latin America excluding Mexico at the end of 1983), and Midland (213 per cent), followed by Manufacturers Hanover (165 per cent) and Chase Manhattan (148 per cent). This high level of exposure in relation to capital has arisen in part because the banks, which were already insufficiently capitalised, sought in the 1970s to maximise the size of their assets and the return on shareholders' equity by gearing up with more and more marginally profitable international loans. The average capital to assets ratio for the world's leading 100 banks dropped from 4.5 per cent in the early 1970s to under 3.5 per cent at present, and of the top 34 from 5.3 per cent to just over 3.5 per cent.

1.24 Default by a small number of debtors could induce insolvency. Moreover, loans to these debtors are being kept in performance by the expedient of additional, 'involuntary', lending to maintain interest payments which in turn adds to bank exposure. Over half the $33 billion in new credits to developing countries in 1983 was involuntary, including almost all the $15.4 billion to Latin America, and two-thirds of the $18.8 billion new lending in the first six months of 1984.

1.25 Vulnerability in respect of developing country lending has added to the difficulties already being experienced by banks on account of the effects of the recession and high interest rates on domestic borrowers. In the United States, 45 banks failed in 1983, a post-war record, followed by 25 up to mid-May 1984, culminating in the near collapse, and subsequent rescue, of Continental Illinois. The weakness of the banks' balance sheets is reflected in a variety of financial market indicators. Almost all the major US and European banks have lost their former triple A credit rating assessed by recognised US agencies. The recent fall in US bank share prices in the aftermath of the Continental Illinois crisis has led to some major banks being valued by the market at significantly less than their book value.

1.26 For the banks to achieve greater security will not be easy and will take time. Under pressure from the authorities they are being urged to reduce exposure to developing countries (while at the same time being encouraged to increase 'involuntary' lending, which has the opposite effect). They are endeavouring to rebuild their capital base but against a background of market uncertainty which makes it difficult for them to raise additional finance. A crucial task to avoid the risk of insolvency is to make greater provision for losses in developing country loans. Yet the process of making such provision eats heavily into bank profits. It is estimated, for example, that if the nine largest US banks had set aside reserves equivalent to a mere 5 per cent of their outstanding loans to six of their major debtors, it would have eliminated 45 per cent of their reported 1983 earnings. A 10 per cent reserve would virtually wipe out profits. If in this year the major US banks were to miss interest payments from Argentina alone, and, in addition, if they were to set aside 10 per cent of their loans to Argentina as reserves against loss, it would cut their expected 1984 earnings by up to 40 per cent. A strong possibility is that precisely this eventuality could occur. If banks' profits were to be suddenly and severely squeezed in this way, they would seek to raise lending rates, thereby making debt-servicing problems even more acute for domestic and developing country borrowers.

1.27 Time appears to be running short. Within the last few months one major bank has come close to collapse. The experience of Continental Illinois (whose losses were domestic in origin) suggested that, at least in the United States, a damaging run on deposits could quickly be precipitated by market perceptions of impending insolvency. On that occasion, a $5.3 billion rescue operation was launched by other banks, plus a $1.5 billion injection to the bank's capital base by the Federal Deposit Insurance Corporation. The combination of Federal intervention as 'lender of last resort' and mutual self-help between the banks avoided a collapse. But doubts remain over the ability of the system to weather a more powerful storm. And, in the event that international lending were involved on any scale in any future crisis, there are major 'grey' areas of responsibility, notably the offshore banking centres, which could make the traditional Central Bank role of 'lender of last resort' difficult to perform.

1.28 If banks do not have time to adjust gradually to losses and to restore their capital base, then they will need large-scale long-term loans from the authorities, as has already occurred in the case of Continental Illinois. And this, in turn, raises major questions about government control over the banking system and about the scale of macro-economic management. The main point, however, is clear: the banks can only cope with the developing country problem if they are given time to adjust.

Chapter 2

Developing Country Bank Debt, Rescheduling and the Major Debtors

2.1 In this chapter we review and evaluate the way in which the debt crisis has been managed so far as it affects the banks. There is a description and evaluation of the process of debt renegotiation as it has evolved in relation to the major debtors, and a discussion of various proposals for changing the procedures and terms of renegotiation. The chapter is concerned with the process by which the crisis has been handled in general, rather than with particular cases, but Appendix 2.1 gives a summary of the agreements negotiated since January 1983.

2.2 Thirty countries have rescheduled their bank debt since then and other agreements (for example, with Venezuela) are being negotiated at the time of writing. Five Commonwealth countries have been involved: Jamaica, Guyana, Nigeria, Malawi and Zambia. The thirty countries account for half of the total debt of developing countries and the rescheduled amounts have totalled $56 billion (in the calendar year 1983). These represent a dramatic increase from $1.5 billion during the years 1978 to 1981 to $5 billion in 1982.[1] Rescheduling reduced debt-service payments in 1983 by $19 billion, equivalent to 4 per cent of exports. For 25 major debtors, debt service including amortisation accounted for 30 per cent of all export earnings in 1983, and the figure would have been 36 per cent had there been no rescheduling. In 1984 it is expected, on the basis of progress so far, that equivalent, or larger, sums will be rescheduled involving comparable numbers of countries.

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1. All of these figures include some official, as well as bank, debt.

The Process and Procedures

2.3 Debt renegotiation takes place on a case-by-case basis with no over-riding rules or guidelines. But in practice there is considerable uniformity in the process adopted and the terms agreed. The essential features are:

- rescheduling of maturing principal on existing loans;
- debtor country adjustment within an IMF programme;
- new finance from the IMF and from the banks (usually in the form of 'involuntary lending' to meet interest payments) and, on some occasions, bridging finance.

2.4 It is not necessary to give an extended description of the various rescheduling packages but the following are the main recurring elements:

The IMF: The Fund has proved crucial to rescheduling packages not simply because of its own financial input but also for its catalytic role. From the point of view of the debtor, it has been necessary to have a high conditionality, upper tranche, programme with the Fund in order to reach agreement with the banks. For the banks, the IMF's role is not merely one of giving a 'seal of approval', but also of tying the package to additional new ('involuntary') bank lending. This role is described further below and in Chapter 4.

Interest: Banks have generally been unwilling (barring a few exceptional cases) to reschedule their interest in arrears or future interest. Rescheduling payments have been at market interest rates. To meet interest payments banks have provided the major debtors with new medium-term financing.

Maturities: Maturities have generally been close to those of the loans they have replaced: seven to eight years with two or three years' grace.

Coverage: The agreements essentially cover principal payments on medium- or long-term debt contracted by the public sector. Only in a few instances has non-guaranteed private debt been included in the restructuring (Mexico and Chile, for example) and then as a result of the debtor governments assuming liability.

Short-term debt: Short-term debt is traditionally not covered but is increasingly included in practice. When short-term debt is not formally rescheduled, it has been rolled over on an informal basis and its level maintained over time.

Consolidation and Coverage: Normally rescheduling has been restricted to debt due within 12 months from the onset of negotiations, and has covered at least 80 per cent of the principal payments due. Total rescheduled amounts have generally represented between 15 and 30 per cent of the disbursed debt owed to banks, but sometimes more.

Spreads: The spreads applied to the basic rate have generally ranged from $1\frac{3}{4}$ per cent to $2\frac{1}{4}$ per cent. Fees have generally amounted to an additional 1 per cent of the amounts restructured.

Evaluation

2.5 Current rescheduling packages have essentially deferred rather than reduced the burden of bank debt servicing. But various positive results have flowed from this. They have eased debt service inasmuch as, for the eight largest bank reschedulings in 1983, the average debt-service ratio (including short-term debt) declined in that year from over 80 per cent to 50 per cent. They have thus created time for the system to evolve more stable financial mechanisms while helping to prevent default. They have also maintained creditor-debtor relations, preventing a complete breakdown in legal obligations and confidence.

2.6 None the less, a system which may have sufficed for a small number of special cases in exceptional circumstances, is inadequate when applied over a longer period to an increasing number of major borrowers, and many minor ones. Moreover, according to the IMF, even with rescheduling, arrears continue to mount, reaching $27 billion at the end of 1983 compared with $25 billion at the beginning of the year. Concern has been expressed about the present arrangements, regarding the following points:

— problems have been deferred only briefly. Consolidation periods are short—usually one year—and grace periods are only about two years. Hence there are significantly increased debt-servicing obligations after the grace period expires, involving a heavy 'bunching' of amortisation payments due on rescheduled loans. In the case of major debtors this will fall due in 1986/87;

— the system of annual negotiations on a case-by-case basis has introduced a strong element of brinkmanship and uncertainty on each occasion that a major debtor has been involved. This makes it impossible for the debtor countries themselves to undertake medium- and long-term policy reforms, since there is no predictable profile for debt service and new financial flows. Brinkmanship also creates uncertainty in already unsettled financial markets. The disadvantages in terms of instability substantially outweigh whatever advantages there are in keeping debtors 'on a short leash' in order to ensure observance of short-term financial policy objectives;

— rescheduling is concerned with loan principal, yet the success of the whole package hinges on the ability of debtors to meet interest payments. As interest rates have risen in recent months the deficiencies of using negotiated new 'involuntary' loans as the mechanism for ensuring interest payments have become more obvious. First, 'involuntary' lending was inadequate to cover interest payments even in 1983 when rates were 2–3 percentage points lower than they are in 1984. Second, at each renewed attempt to renegotiate a round of 'involuntary' lending the exercise becomes more difficult as a few more marginal banks decide to withdraw and major banks run up against exposure limits. Third, the small- and medium-sized debtor countries have great difficulties since their debt does not represent a high proportion of the banks' portfolio; in the final analysis, creditors could cope with a default on the part of a small debtor without endangering their own solvency. Thus, even if current arrangements can accommodate the problems of major debtors—which is doubtful—they are wholly inadequate for most of the remainder;

— banks have frequently adopted a policy of seeking to maximise short-term returns on rescheduled debt by charging high penalty lending margins and arrangement fees for debt rescheduling. The practice followed is the opposite of that in many domestic restructuring arrangements, which provide for somewhat reduced lending rates to help a borrower back on to his feet. The Group of Thirty has suggested that banks may be earning as much as an extra $1.75 billion a year on international debt recently renegotiated or being renegotiated. Thus, rescheduling has often been good business—creating a paradoxical situation where, in the midst of a serious deterioration in their international loan portfolio, some private banks are reporting to their shareholders surprisingly high rates of profits. Some bankers have come to see that what may be lucrative in the short run is unwise in the long run, as is reflected in reduced spreads recently;

— in general, rescheduling terms have been fixed almost regardless of different capacities to pay. The smaller and economically weaker debtor countries, in particular, have had little opportunity to moderate demands for high interest rates, fees and other commissions on rescheduled debt and have rarely been accorded long-term grace and repayment periods more appropriate to their capacity to pay.

Underlying these specific points of criticism is a judgment that the present ad hoc arrangements simply do not represent a feasible way of operating for any length of time. This point has been strongly made by the major debtors, but it is a view shared by many bankers. Thus *Amex Review*, September 1983, wrote:

> the present financing and adjustment effort is just keeping the boat afloat. The effort has succeeded in that no collapse of the international banking system has occurred. Yet it has failed insofar as the debt problem still looks a long way from solution . . . . observers and participants must surely still admit to a degree of unease as to the durability of the patched-up system.

And in April 1984, the bankers' journal *Euromoney* noted:

> there is a feeling among a growing number of bankers that the present muddle-through approach to the ldc debt crisis will not suffice for much longer, that more radical solutions will have to be considered.

2.7 In looking at some of the possible remedies various ideas can be considered, but a distinction can most usefully be drawn between measures which involve adaptations to existing approaches and those which involve more far-reaching changes, requiring action at a multilateral level and more direct involvement by creditor country governments. There is clearly a good deal of overlap but, from a policy standpoint, the distinction is worth making.

Adaptations to the Current System

2.8 A variety of proposals for making rescheduling smoother, more equitable and more sustainable are currently under discussion.

Multi-year rescheduling

2.9 Multi-year rescheduling covering debt maturing in 3 to 5 years was one of the main policy recommendations of the 1984 Western Economic Summit meeting in London:

> in cases where debtor countries are themselves making successful efforts to improve their position, encouraging more extended multi-year rescheduling of commercial debts and standing ready where appropriate to negotiate similarly in respect of debts to governments and government agencies.

2.10 There are two main arguments in favour of multi-year rescheduling. The first is that it reduces considerably the uncertainty and ineffectiveness associated with annual negotiations. The second is that it anticipates debt-servicing difficulties associated with a 'hump' of future repayments and seeks to create a smoother repayment profile. However, it would be an exaggeration to interpret multi-year rescheduling as representing a significant concession to debtors; the advantages lie primarily in administrative simplicity and improved financial management. Moreover, to treat the proposal as a reward for 'good behaviour' in terms of short-term adjustment performance has the effect of forcing countries which need a longer time to develop successful adjustment programmes to operate entirely in a framework of short-term policy objectives. It is reported that many banks are still reluctant to agree to multi-year rescheduling, even for the most highly favoured debtors, because of the lack of an accompanying multi-year IMF programme. This points to the need for a greater emphasis on medium-term extended facilities as the basis for debtor adjustment programmes—a point pursued in more detail in Chapter 4.

Maturities

2.11 From the point of view of the banks it is the regular payment of interest at market rates which is the source of profitability, and solvency; principal can always be rolled over into new loans without loss.

2.12 At a time when even some moderate Latin American negotiators are demanding repayment over 20 to 25 years including the grace period, it seems realistic to rethink the current approach to rescheduling. A systematic approach would frankly recognise that much longer maturities are realistic, that the maturities should correspond to countries' stages of development (defined in terms of relatively low per capita income and/or structural weaknesses stemming from, say, highly concentrated exports), and that concessions on maturities may help debtors to service interest by not overburdening them with amortisation payments.

Interest rate proposals

2.13 Clearly there is need for action that, to quote the consensus reached at the meeting of Latin American debtors in Cartagena, Colombia, in June 1984, 'leads to a sharp and immediate reduction of nominal and real interest rates in international markets'. A narrower but more manageable issue is whether developing country debtors can be insulated from some of the effects of high international market interest rates.

2.14 One approach is to find ways of postponing, or rescheduling, part of the interest payments in a more effective way than via 'involuntary' lending. The main device being considered by bankers is 'capping'. 'Capping' means different things to different people, and there are many variants. The essential idea is that capitalisation should apply to interest above a certain maximum level, or 'cap'. In one version, if interest rates rise above the 'cap', the balance could be debited to a form of 'escrow' or 'rainy day' fund which could be paid off when interest rates fall below the 'cap' rate. Alternatively, 'capped' interest would be rolled up into a payment at the end of the repayment period, and could, then, if necessary, be rescheduled again. Or, if interest rates rise above the 'cap', the loan maturity could be extended with the regular agreed payments of interest and principal remaining the same, and, if they fall below the 'cap', the maturity could then contract. There are technical problems, notably in establishing an underlying trend in real interest rates which could form the basis of the 'cap'. However, the main difficulty with 'capping' is not that it is too radical, but rather the opposite, that by postponing interest it piles up future problems which, in the case of some countries at least, should be met by interest relief.

2.15 Another idea, advocated by *The Economist*, is that the IMF's compensatory financing facility (CFF) could provide loans to offset fluctuations in interest payments. It has merit as being a mechanism which meets directly the debtors' concern about unpredictable surges in interest rates, with a minimum of new institution-building and of government intervention in capital markets. The scale of resources required would be considerable. If the facility were to cover the full range of fluctuations up to 4 per cent on each side of a base rate, the CFF would require something of the order of $12 billion additionally and individual debtors would require much larger access limits. There is attraction in the scheme to the extent that it recognises that interest payments by debtor countries can be financed only by official, or officially guaranteed, flows on a very much larger scale than is available at present. But its value is limited by its treatment of the problem as one of instability rather than of the high level of interest rates, and because of the fact that it would require debtors to pay interest on the deferred interest payments and to repay their CFF loans when interest rates are still historically high and debt problems are still severe.

2.16 A third approach, which was given some prominence in the Cartagena consensus, is to limit debt-servicing payments to a fixed percentage of export earnings compatible with the debtors' productive potential and needs. The idea has some similarity with one put forward by various individuals from the US National Security Council (see Appendix 2.2) as part of a more far-reaching proposal for dealing with the debt problem. There are also precedents—within government loans which incorporate a 'bisque' clause deferring repayment instalments, because of changed conditions, to be repaid when the original maturity of the loan expires.[2] This idea is attractive inasmuch as it gives to what was previously a fixed debt obligation an element of risk-sharing; the greater the earnings, the more the service and vice versa. Moreover, by providing a form of compensatory financing, it has particular relevance

2. Anglo-American Financial Agreement of 1946.

and appeal to countries with highly unstable export earnings. But the mechanics of determining 'ability to pay' and obtaining agreement between debtors and creditors would present some problems.

2.17 Finally, going further than any of the above is the possibility of an element of concessionality in the interest rate, converting past debt into debt serviceable at below current market rates. This could be acceptable to the banks in some cases if the loan were to be at a fixed rate which is high by historic if not current standards—say 3–4 percentage points below the current market rate. However, if we introduce concessionality on a large scale we make explicit the need for bank losses or official subsidy to help with these losses; and this raises more fundamental issues about whether the debtor and the banks should be treated as having a liquidity problem rather than one of basic solvency.

Internalising obligations

2.18 Some debtor countries have the capacity to generate surpluses to service their debt obligations but, because of structural weaknesses, are not—in the short term—able to convert the surpluses into foreign exchange. In several cases, private debt has been rescheduled in such a way as to create assets which are freely negotiable domestically but not, except after a period of time, internationally. The technique may have wider application.

2.19 One possibility is counter-trading arrangements where an importing country links payment to reciprocal exports. There is some countertrade in existence involving repayment of commercial bank debt in kind.

2.20 Another option is for the creditor to convert its debt into a local equity holding or even into real estate. Many developing countries will resist this encroachment on local ownership, though others are more relaxed. The more open the country's attitude to foreign investment and the more developed the local capital market, the more attractive this type of approach is likely to be; another factor is the degree of currency convertibility which can be offered for earnings and, eventually, repatriation of capital. Where there is a mutual interest between debtors and creditors, agencies such as the International Finance Corporation may have a role to play as intermediaries.

2.21 A third option is to convert commercial bank loans into long-term government bonds issued in local currency. To prevent a huge interest liability these bonds would be issued at a deep discount (possibly even with a zero coupon). But banks would need guarantees concerning exchange rates, a time period for their redemption, and exchange conversion as well as free tradeability so as to enable the bonds to be regarded as performing.

More Fundamental Reforms

2.22 The further the above adaptations depart from current rescheduling practice, and the greater the crisis, the more likely are banks and creditor governments to look at various radical reform proposals which have been canvassed. While we cannot do full justice here to a large number of often very complex proposals, Appendix 2.2 sketches out some of the better known ones. They have two main generic components: first, mechanisms for shifting some or all of the accumulated stocks of 'non-performing' (or potentially non-performing) loans from the books of the banks in exchange for more marketable assets, thus giving banks time to write down loans; second, an easing of the developing country debt burden through a combination of principal or interest relief or an extension of repayments on the one hand, or through large-scale new lending on the other.

2.23 Without going too far into particular schemes, it is perhaps useful to distinguish the various kinds of options. The *restructuring* proposals attack the problem by trying to reduce the debt 'overhang'. Debtors benefit from debt relief on a scale in excess of what is being negotiated through rescheduling. Banks acquire marketable bonds in lieu of debt, but at a loss. Most critics have concentrated on the likely impact of a large-scale involuntary writing-down of bank debt on bankers' willingness to lend again in future (though net lending for a given gross flow would be higher because of reduced repayment). Banks also are reluctant at present to accept that, except in a few cases of obviously 'insolvent' nations, loans should be written down. Reflecting different views on both technical issues and questions of principle, the schemes vary greatly in their main features: scale; the form and extent of debt relief; the type of new asset offered to banks; the type of liability acquired by debtors; the degree of involvement by existing international institutions or by a new agency; the distribution of losses between debtors, creditor governments and banks.

2.24 The *lending guarantee* proposals attack the problem from the opposite direction by giving security to banks to continue to make new loans. They emphasise the need for substantial increases in resource flows to developing countries in order to enable them to resume acceptable rates of growth; and they do not require banks to absorb sudden losses. Safeguards would be built into the schemes to prevent overlending: linking guarantees to an IMF programme; limiting guarantees to less than 100 per cent. A large-scale guarantee scheme would, however, involve industrial country governments in assuming a large additional contingent liability when their existing guarantee schemes—for export credit—are already in financial difficulty.

2.25 In addition to these proposals there are others, which we do not review here but which are more generally concerned with strengthening the banking system. Some envisage the Central Banks rediscounting banks' developing country loans, if necessary at a loss. The aim is to ensure that the banks have adequate liquidity to continue their lending operations. Others envisage an extension or clarification of Central Banks' existing lender of last resort role as it affects international loans. At present, there is considerable doubt over who exercises it. There are also 'grey areas' of ambiguous jurisdiction, such as off-shore banks. Essentially, it is assumed that the function would be exercised by Central Banks coordinating on an emergency basis. The ambiguity reflects in part the understandable traditional reluctance of lenders of last resort to specify in advance the extent and nature of the support they are prepared to offer under particular circumstances. There is clearly a difficult balance to be struck. Several critics of existing arrangements have argued that a reasonable price for greater security in this area could be tighter control over the direction and magnitude of international bank lending.

2.26 In practice, any workable set of arrangements is likely to be *eclectic* in character combining several of the more attractive features of the prototype schemes, by dealing simultaneously with the debt 'overhang', new lending and strengthening the banking system against the possibility of major shocks.

Chapter 3

The Debt Crisis and the Low-Income Developing Countries

Features of Low-income Country Debt

3.1 According to the IMF, over 40 low-income developing countries have a combined debt of $88 billion, just over one-eighth of all developing country debt. Eighty per cent of it is official, owed to the governments of industrial countries and multilateral institutions, and arising from past official development assistance (ODA) and guaranteed export credits. As can be seen from Table 3.1, there is a strong correlation between the share of official debt, and per capita income. While the debt of low-income countries is small in global terms, it is large in relation to the capacity of many of them to service it. The 'least developed' group of countries are particularly badly affected: their debt-service payments on long-term debt increased from 16 per cent in 1975 to 26 per cent in 1982.

3.2 Among the low-income countries there has been a somewhat different experience in Asia and Africa. Some low-income Asian countries have had worsening debt-service ratios, for example, Burma and Pakistan. However, for low-income Asia as a whole, the situation is not critical, since most debt is in the form of highly concessional long-term credits, such as IDA loans. By contrast, low-income African countries have seen their total external debt increase as a proportion of export earnings from about 90 per cent in 1970-73 to almost 250 per cent in 1983. Debt-service payments on the long-term debt of low-income Africa, which stood at around 7 per cent of their export of goods and services during 1970–73, are estimated to have reached a quarter of their export earnings by 1983. The wider African picture can be seen from Table 3.2, which shows a five-fold increase in total debt over the last decade and a trebling in overall debt-service ratios.

Table 3.1: Classification of Developing Countries by Per Capita Income and Importance of Official Creditors (1982)

	Value of Medium-term Official Debt	Share of Official Disbursed Debt in Total Debt	Per Capita Income
	$ billion	%	$
I. *Countries with under $400 per capita income and over 60% Official Debt*			
Bangladesh	4.21	93	140
India	18.37	91	260
Uganda	0.55	91	230
Tanzania	1.55	89	280
Malawi	0.49	69	210
Ghana	0.95	69	360
Sri Lanka	1.42	66	320
Sierra Leone	0.23	65	390
Kenya	1.57	60	390
II. *'Hybrid' Cases*			
Guyana	0.48	69	720
Jamaica	1.05	67	1180
Mauritius	0.22	55	1270
Indonesia	8.33	52	530
Zambia	1.73	36	600
III. *Countries with over $750 per capita income and over 60% Commercial Debt*			
Costa Rica	1.10	37	1430
Colombia	2.99	33	1460
Ivory Coast	1.34	27	950
Korea	8.33	27	1910
Philippines	3.85	23	820
Algeria	2.90	20	2350
Malaysia	1.77	20	1860
Nigeria	1.14	15	860
Chile	1.31	15	2210
Brazil	8.18	13	2240
Mexico	7.10	10	2270
Argentina	1.99	8	2320
Venezuela	0.30	2	4140

Note: Total debt used to calculate ratios excludes private unguaranteed debt.
Source: World Bank Tables and BIS.

Table 3.2: Features of Low-income Developing Country, and African, External Public Debt[a]

	1973	1980	1981	1982	1983
1. *Total Outstanding Debt* ($bn)					
Low-income countries	25.4	71.4	75.2	81.8	87.8
Africa	14.2	50.9	55.5	62.5	66.3
2. *Ratio of External Debt to Exports*					
Low-income countries	227.9	134.8	133.3	146.5	148.9
Africa	71.5	143.2	168.6	204.5	223.5
3. *Share of Official Creditors in Long-term Total Debt*					
Low-income countries	84.5	76.0	79.0	81.1	82.3
Africa	47.8	45.2	46.5	46.8	48.7
4. *Share of Short-term Debt in Total Debt*					
Low-income countries	2.3	5.9	4.3	3.3	2.6
Africa	2.7	8.4	11.1	12.6	11.0
5. *Debt Service Ratio*[b]					
Low-income countries	14.6	10.3	12.6	14.6	13.3
Africa	8.8	17.4	19.7	23.7	25.1
6. *Interest Payments Ratio*					
Low-income countries	6.1	4.4	5.1	5.4	5.4
Africa	5.9	8.1	9.2	11.0	10.8

Source: Derived from IMF, *World Economic Outlook*, 1983 and 1984.

Notes: [a] Low-income countries exclude China for 1973. Africa includes some middle-income countries and excludes South Africa for years 1980 onwards. All ratios are given in percentages.

[b] Payments (interest, amortisation or both) as percentages of exports of goods and services.

3.3 One consequence of the rise in debt-service payments has been a decline in net transfers to low-income countries since 1980. Total net transfers to low-income Africa, after reaching a peak of $2.7 billion in 1980 in nominal terms, declined to $1.1 billion in 1983; and net transfers to low-income Asia have also fallen since 1980, though not as sharply as to Africa. In Africa, 16 countries registered negative transfers at some time in the period 1971–81. Completing the picture of net resource transfers, official grants to low-income Africa have also declined since 1980.

3.4 As payments difficulties have intensified and other sources of finance have dried up, there has been a growing reliance on short-term debt, particularly in countries which have significant arrears on revolving credits to commercial banks and on imports from foreign suppliers. For many Sub-Saharan African countries, it is believed that short-term debt and trade arrears may have reached a quarter of the total debt outstanding, and in some cases—for example, Tanzania and Zambia—they may equal annual export earnings. A consequence of this accumulation of arrears is that fresh trade credit has dried up for many countries. Many low-income countries are importing food and oil, two essential items, largely on a cash basis. In the instances where finance is available, rates of interest have reportedly reached 30 per cent or more.

Factors Affecting Low-income Country Debt

3.5 A variety of factors have contributed to the deteriorating debt situation of low-income developing countries, especially in Africa.

(i) *Terms of trade*

3.6 They suffered a serious deterioration in their current external balance with the decline in their terms of trade, and specifically with the increases in oil prices. Between 1973 and 1982, low-income African countries lost as much as 20 per cent in the purchasing power of their exports. This, together with a decline in the volume of exports, contributed to a trebling or quadrupling of their current account deficits in real terms. Low-income Asia lost about 10 per cent in the purchasing power of its exports but was able, in part, to counteract the adverse price movements through a diversification of exports, particularly through expanded exports to the Middle Eastern oil exporting countries and through remittances from migrant workers.

Table 3.3: Terms of Trade (% annual change)

	1965–73 (annual average)	1973–80 (annual average)	1981	1982	1983
Low-income Asia	−0.5	−1.4	−0.1	−1.6	−0.6
Low-income Africa	−0.1	−1.5	−9.9	−0.9	4.6

Source: World Bank, *World Development Report, 1984.*

(ii) *Reduced aid*

3.7 In seeking to meet current account deficits by capital flows, low-income countries have relied mainly on aid, but ODA has also declined in real terms. Gross disbursements of ODA rose by 54 per cent between 1975 and 1982, and nominal net transfers, after deducting repayment and interest, by 37 per cent. But net transfers declined by 5 per cent in real terms, and by 30 per cent for the four major ODA recipients (Egypt, India, Indonesia and Pakistan), when account is taken of changes in exchange rates and prices of goods procured through ODA. Looking to the future the prospects are no better. With a Seventh Replenishment of IDA fixed at $9 billion, it is predicted that Africa will suffer a 21 per cent reduction in real terms compared with commitments in the IDA-6 period; and so will 13 other countries outside Africa.

(iii) *Increased use of private markets*

3.8 Increased current account deficits in real terms, combined with declining aid, led low-income countries to rely more and more on non-concessional export credits and private capital markets. They were attracted by negative real interest rates and the absence of strings. The upswing in commodity earnings in the late 1970s also engendered confidence in some countries that they could service commercial debt. Two-fifths of the increase in the total long-term debt of the low-income countries between 1975 and 1983 was accounted for by non-concessional flows; as a result, the share of concessional debt fell from 71 per cent of the total in 1975 to 60 per cent in 1983.

3.9 A consequence of increased reliance on private markets has been a hardening of terms. This was most evident for variable interest rate commercial debt, but was also true for ODA debt, in respect of its declining grant element. Multilateral loans—for example, from the IMF—have also become more costly. In Africa, average interest rates on loans of all kinds rose from 4.2 per cent in 1971 to 10.1 per cent in 1981. Parallel with this, loan maturities on African debt fell from 22 years in 1971 to 15 years in 1982; and the average grace period from six to four years.

(iv) *Internal factors*

3.10 While external factors have played a major role in explaining the rise in indebtedness and debt service in low-income countries, internal factors were also important. These include natural hazards such as drought which led countries to buy food through external borrowing; and policy deficiencies in the areas of production, savings incentives and debt management.

Prospects for the future

3.11 In the absence of ameliorative action, the factors which have contributed to the current crisis seem likely to perpetuate it in future. Both the IMF and the World Bank expect low-income countries to have significantly lower growth rates in their export earnings than other non-oil developing countries, and their terms of trade can be expected to deteriorate further. The IMF's projections suggest that the debt-service ratio of low-income countries is unlikely to improve before 1990, even if the growth in imports is compressed to a rate lower than the rate of increase in exports, which is itself projected to be low, and even if there is a substantial decline in interest rates. In the projections made by the World Bank, the debt-service ratio of low-income Africa is projected to fall from about 25 per cent in 1983 to about 19–21 per cent by 1995, but only with a decline in per capita incomes. In fact, the implied growth rate of GDP, corresponding to the modest projected improvement in the debt situation, entails a decline in per capita real incomes at rates of up to 0.7 per cent a year in the decade 1985–95. This comes on top of steadily declining per capita incomes over the last decade (see Table 3.4) and underlines the sacrifice in terms of development and living standards which is being demanded of some of the world's poorest countries in order to keep debt serviced.

Table 3.4: Trends in Per Capita Income (% annual change)

	1960–73	1973–79	1980	1981	1982	1983
Low-income countries (including China)	3.0	2.9	4.0	2.9	3.3	2.8
Low-income Africa	1.0	−1.0	−1.4	−1.5	−2.3	−2.8

Source: World Bank, *World Development Report, 1984.*

Policy Framework

3.12 During the period 1976–83, out of 31 cases of official debt rescheduling, 21 involved low-income African countries; Africa accounted for half of all reschedulings, including commercial bank loans, in this period. Several of these countries were obliged to reschedule their debts repeatedly, with Zaire, Togo and Liberia accounting for 15 reschedulings between them. A further eight countries which had not yet rescheduled were listed by the IMF as being in arrears in 1983.

3.13 There are some important variations in the ways in which the international community has treated the debt of low-income countries as compared with that of major and middle-income debtors. *First*, since a large proportion of the debt is official, the institutional framework for renegotiation is different, involving the Paris Club and aid consortia. Paris Club procedures are reviewed below.

3.14 *Second*, the principle of writing off debt for low-income countries has been accepted by creditor countries. However, a distinction is made between ODA debt which is eligible for write-offs and official debt negotiated in the Paris Club, which is not.

3.15 *Third*, there is acceptance by the international community of the need for special action in relation to the poorest countries including action on debt as part of a wider programme. This acceptance was given expression by the New Programme of Action for the Least Developed Countries (UN Conference, 1981) and, more recently, by the proposal of the Development Committee of the World Bank and the IMF for a special action programme for Sub-Saharan Africa. As drafted, this latter programme lays emphasis on more effective donor aid coordination, supported by a special fund for Africa, and embracing Paris Club official debt renegotiation for the countries concerned.

3.16 While these important differences exist, there are also common features. There is the central role of the IMF which we shall briefly refer to here and also in Chapter 4. There is also the same distinction to be made between new money flows from aid donors and official creditors, and the stock of outstanding debt. As with commercial bank debt, increased new flows make it easier to manage the stock or 'overhang'. While the emphasis here is on the stock of outstanding debt, we would stress the obvious point that if new inflows of ODA to low-income developing countries were to be substantially increased, the seriousness of their debt problems would diminish since there would be less need to borrow on hard terms—as also would the frequency of arrears and rescheduling.

ODA Debt and Debt Relief

Objectives and experience

3.17 Some Asian countries (India, Pakistan, Bangladesh) have carried out official debt renegotiation within the context of aid consortia under the chairmanship of the World Bank. Debt relief was linked to new aid in the context of a general commitment by donors to the countries' development objectives. This approach appears to have worked well and has helped to keep South Asia relatively free from debt-servicing problems, without the stigma of 'loss of creditworthiness' associated with default and forced renegotiation.

3.18 The principle that debt relief should be treated as a legitimate form of aid was given a good deal of attention by the Pearson Commission in its 1969 Report.[1] However, it failed to achieve much headway by adopting a bilateral case-by-case approach in the case of the overwhelming majority of low-income countries which lacked the coordinated aid consortium framework of the major South Asian ODA recipients.

3.19 Generalised debt relief was called for by the developing countries but this was resisted on the grounds that inequities might be generated by generalised solutions. A compromise agreement was reached in 1978, embodied in UNCTAD Resolution 165, under which donors undertook to adjust the terms of bilateral ODA retro-actively as a means of improving net flows. From the viewpoint of developing countries, the resolution had several deficiencies. *First*, it did not specify eligible countries. Eligibility came to be interpreted as referring to the 'least developed' countries, but each donor was left to decide for itself. *Secondly*, retro-active terms adjustment (RTA) is equivalent to debt cancellation only where a country receives its aid in grant form. Of the 17 countries which are members of the OECD Development Assistance Committee (DAC) only ten provide aid to the 'least developed'—let alone to other developing countries—entirely in grant form. And, *thirdly*, the resolution entailed no binding commitment; as a result the United States has not implemented RTA and other donors have varied in their commitment and methods.

Impact

3.20 The UNCTAD Secretariat estimates the total nominal value of debt relief granted as $5.7 billion, of which $3.3 billion was in the form of debt cancellation. About half the debt was owed by 'least developed' countries. In the case of a few specific countries, the proposed action has had a substantial impact. Eight 'least developed' countries had more than half their total debt written off and, for seven others, the proportion was over 20 per cent. In the case of all other countries, however, the impact on their outstanding debt was almost negligible. Even for the major beneficiaries, the gain has been limited by the fact that ODA debt relief has not been treated as additional money but has been taken from elsewhere in aid budgets. None the less, what debt relief has achieved, even in these cases, is to increase the availability to the recipient of untied foreign exchange.

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1. *Partners in Development: Report of the Commission on International Development*. London: Pall Mall Press, 1969.

Future initiatives

3.21 One way of giving quick and helpful relief to a substantial number of the poorest countries would be a commitment by donors to a complete ODA debt write-off (by converting past loans to grants) for the category of 'least developed' countries. This could save them approximately $100 million in debt service annually, a trivial sum for the donors but an important sum for some very poor countries.

3.22 For the remaining low-income countries (defined as those eligible for IDA financing) there could be a concessional arrangement which falls a little short of the proposal for the 'least developed countries'. One element could be the acceptance by donors of the remainder of loan payments in local currency rather than in foreign exchange; the local currency balances could be used for the local costs of future aid programmes.

3.23 It should, of course, be made explicit that the donor initiative is in the context of enlarged ODA flows rather than merely a different means of providing existing aid.

Rescheduling of Official Debt: The Paris Club

3.24 The Paris Club is the forum within which countries negotiate the rescheduling of public sector debt owed to the 17 governments of the DAC. It does not operate in the context of low-income countries alone; in fact, the largest absolute amounts of official debt rescheduled have been of guaranteed export credits and official loans of some major debtors—Brazil, Mexico, Poland. But the rules followed in the rescheduling of official debt are of particular relevance to low-income countries, as it has constituted a major component of their total debt.

3.25 The Paris Club was initially seen by creditors as a way of establishing common terms and conditions for debt rescheduling applications. While the Club has no written rules, a clear set of procedures and common features has evolved which will be discussed and evaluated below. Inevitably, we shall generalise, and country-level detail is briefly summarised in Appendix 3.1.

Procedures

(i) *The IMF*

3.26 For members of the IMF, it is a precondition of Paris Club rescheduling that the debtor has an upper credit tranche agreement with the Fund (no exceptions have been made since 1977). Also, in most cases, the continued validity of the Paris Club agreement has been made dependent on the debtor maintaining a satisfactory arrangement with the Fund.

(ii) *Interest*

3.27 A central principle of the Club is that interest rates on restructured loans are at commercial rates, and that interest payments are maintained throughout. The precise determination of interest rates is made bilaterally.

(iii) *Consolidation*

3.28 As in the case of bank debt, consolidation periods are short, with usually only a year's repayment to be considered at a time. But there have been several instances of 18-month or 24-month consolidation periods. In other cases, there is 'conditional further rescheduling' (i.e. an extension of the consolidation period subject to the fulfilment of specified IMF conditions) or a 'goodwill clause' which makes a somewhat vaguer commitment to future rescheduling.

(iv) *Maturities*

3.29 To a greater extent than with bank rescheduling, terms have been generally a little easier for low-income countries than for others. For example, the maturity of rescheduled loans has never been less than 8 years, and in three cases it was between 11 and 16 years. This compares with an overall average of 6½ to 10 years maturity.

(v) *Coverage*

3.30 The coverage of the rescheduling agreements has traditionally been restricted to principal on medium-term loans, amounting to an average of 85 per cent of the principal due. Interest is now regularly included and so are arrears outstanding at the beginning of the consolidation period (but on less generous terms than the payments falling due). Previously rescheduled debt has, however, invariably been excluded, as has debt owed to multilateral institutions.

(vi) *Special cases*

3.31 There has been some sensitivity to particularly acute balance of payments problems. A major departure was made in the case of Sudan in February 1983. The rescheduling covered 100 per cent of arrears on principal and interest payments resulting from previous consolidations as well as 100 per cent of payments due in 1983 on short-, medium- and long-term debt. In addition, half the interest due in 1983 on the amount rescheduled was capitalised and consolidated along with the other payments, and provision was made for considering similar treatment in the second year at an annual review meeting. Finally, the repayment period (16 years) follows a six-year grace period during which no payments, except interest, will be made. Attempts to treat this as a precedent have, however, been resisted.

Evaluation

3.32 Several major deficiencies have become apparent in the existing arrangements as they affect low-income countries. They are, if anything, more serious than in the case of bank loans and major debtors. *First*, the experience of rescheduling reveals that official creditors are less sensitive than private creditors to the implications of their negotiations for new financial flows. Within the bank rescheduling context there is at least an implicit understanding that new loans will be provided to help service interest. However, the main export credit agencies respond to impending renegotiation by withdrawing cover, and there are often long delays, even after agreement is reached bilaterally, before cover is restored.

3.33 The central involvement of the IMF should in principle help inasmuch as it is a catalyst to encourage new lending. In practice, however, it has been conspicuously less active in orchestrating new official lending for low-income countries than in working with the banks to ensure new 'involuntary' lending to major debtors. Indeed, its own methods have often aggravated the situation. The insistence on brief consolidation periods is linked to the IMF's preference for short-term standby arrangements. This, in turn, leads to frequent, rather than once-and-for-all, rescheduling operations and to repeated loss of export credit insurance cover.

3.34 More generally, and not only in relation to export credit agencies, there has been little coordinated effort during rescheduling exercises to increase the supply of additional finance. Yet lack of support in the form of new money can undermine the whole credibility of the Fund's approach to adjustment programmes which require working assumptions to be made on capital flows. The Fund has now started to play a more direct role in this context. Thus, in the case of Sudan, it was decided that although an IMF arrangement was approved in principle it would not go into effect until the necessary private and official finance was forthcoming. The Fund has also recently taken the initiative in several cases, in calling a parallel meeting of aid donors so that the needs of the debtor country can be more adequately addressed.

3.35 A *second*, and related, point is that the Paris Club format has led to an insistence on short-term—usually one-year—Fund programmes, and on the conditionality associated with such programmes which is largely inappropriate to the circumstances of low-income countries. We shall pursue these arguments in more detail in Chapter 4. Suffice it to say here that most low-income countries have structural problems which need medium- to long-term programmes to increase the supply of tradeable goods and services. New investment may have a high short-term import content which requires sustained and consistent external financial support over a number of years. Moreover, the need to build up infrastructure and human capital may well necessitate higher outlays on 'non-tradeable' activities in the short run, which generate no foreign exchange directly. The short-term nature of Fund programmes is, as we have noted, linked to short consolidation periods. A recent departure to ease this problem slightly has been the extended consolidation period offered to Cuba; but it is scarcely over-generous (2 years 4 months).

3.36 *Third*, the terms of rescheduling have caused concern, particularly in respect of interest rates. There is no consistency between creditors in relation to the interest charged. In general, there has been a movement reflecting higher international interest rates and the withdrawal of the subsidy element from export credits. In some recorded cases, there has been an increase in rates from 6 to 12 per cent consequent upon rescheduling. The overall result has been to increase the present value of future debt-service obligations over those of earlier loans—an extraordinary imposition on low-income countries in current circumstances.

3.37 *Fourth*, there has been only a modest attempt to relate maturities and grace periods to the circumstances of low-income countries. The terms for Sudan were generous and have been partially replicated for a handful of other cases (for example, Madagascar) but there is a reluctance to generalise the treatment.

Future adaptation

3.38 It follows from the above that the changes required in the operation of the Paris Club, as it affects low-income countries, are fundamental rather than minor. The main point is that the distinction between rescheduling one form of official debt (ODA) on concessional terms, involving debt write-offs, and another (official loans including export credits) on commercial terms is artificial and unhelpful to low-income countries. There are several implications:

— in an ideal world in which ODA flows were much larger and rapidly increasing, the optimal and most equitable solution to the external financing problems of low-income countries would be achieved by new flows rather than relieving the most heavily indebted countries of their loan obligations. However, in a situation of declining new concessional flows in real terms and chronic problems of low-income country indebtedness, it makes little sense for one set of official creditors to demand commercial debt rescheduling terms. Greater concessionality and write-offs in the context of the Paris Club are inevitable, as some individual cases have already demonstrated;

— insistence on treating official debt in the Paris Club independently of the activities of aid donors, results in the imposition of a short-term framework for economic management which is inadequate and may undermine medium-term development programmes. A better approach is that adopted in the case of Sudan, and mooted in the proposed special action programme for Sub-Saharan Africa, which links aid donors and official creditors in a coordinated approach to existing debt and new lending, in the context of a medium-term programme;

— once the above approach has been accepted in general terms, a variety of specific implications follow, including the adoption of multi-year rescheduling—i.e. much longer consolidation periods—linked to medium-term IMF loans or World Bank programme loans; increased grace periods and maturities; concessional interest rates; and a coordinated approach by export credit agencies involving firm commitments to a prompt restoration of cover in the case of agreed reschedulings and programmes.

Domestic Policies and Debt Management

3.39 Internal economic management plays a crucial role in preventing and resolving debt crises. Low-income countries, no less than others, need to pursue disciplined fiscal policies and to adopt realistic exchange rates, as well as offering adequate incentives to producers of food and exports.

3.40 One issue of particular importance in low-income countries is the absence of proper machinery for debt management, since many governments lack trained personnel. Many debt problems have been made worse because governments have not known, even approximately, the extent of the national external debt and future debt-servicing obligations. This has made their debt more expensive and burdensome by incurring penalties for late payment and by reducing further their ability to obtain new credit; and it has greatly hampered their negotiations for further finance with the IMF and others.

3.41 Many governments do not have a full picture of their external debts primarily because of an inability to monitor and control borrowing by parastatal institutions, which is generally government guaranteed but in many of the countries has been largely uncontrolled, and by the private sector. This needs to be overcome by establishing appropriate institutional machinery to manage debt and its repayment, both public and private.

3.42 The essential elements of a debt management system are:

(i) the appointment of a central agency to monitor the contracting, utilisation and payment of all external loans;

(ii) the establishment and regular updating by this agency of a full inventory of external debt and debt-service obligations;

(iii) the management and analysis of these data in order to provide information on payment of interest and principal due, on currency of payment, and on other key variables;

(iv) balance of payment forecasts which can be used in conjunction with debt projections to formulate an appropriate borrowing policy.

At present low-income developing countries make use of banks to advise them. International agencies can also assist governments which lack the manpower or experience to operate systems of this kind, and the Commonwealth Secretariat is among those seeking to extend its operations in this area.

3.43 While no amount of good debt management will avoid the acute problems of countries which have been faced with stagnating or declining revenues from one or two export commodities and with a massive increase in their import bill for oil, it should be possible for them to incur expenditure obligations which are appropriate not to the revenue peaks in the commodity price cycle of their exports but to some rough and ready mid-point of the cycle. This should at least minimise debt-servicing difficulties.

Chapter 4

The International Financial Institutions and the Debt Crisis

Changing Problems and Changing Roles

Original mandate

4.1 The current role being played by the IMF and the World Bank in relation to the debt crisis cannot be understood without reference to their original terms of reference and the way these have been interpreted in practice.

4.2 The IMF's principal mandate (Article I of its Charter) related to the provision of international monetary stability. The IMF provided 'machinery for consultation and collaboration on international monetary problems'; it sought to promote greater exchange stability; and 'by the provision of *temporary* finance, to discourage resort to measures destructive of national and international prosperity' in response to payments imbalances. The World Bank, on the other hand, although initially seen as concerned with post-war reconstruction, has been concerned with long-term developmental objectives and has provided project finance for this purpose. The establishment of its soft-loan affiliate, the International Development Association, made explicit the need for finance 'in the less developed areas' which would be 'more flexible and bear less heavily on the balance of payments than those of conventional loans'. A clear distinction was seen between the roles of the Bank and the Fund.

The oil shocks and the debt crisis

4.3 The events of the early 1970s revealed the need for a different kind of financing: medium-term financing for structural balance of payments deficits. The IMF responded in a variety of ways:

— a two-year Oil Facility was set up in 1974 incorporating a Subsidy Account for concessional lending to low-income countries;

— the Extended Fund Facility (1974) provided multi-year programmes in the form of three-year credits repayable over eight to ten years;

— a Trust Fund (1976), financed out of profits from gold sales, provided concessional balance of payments loans to low-income countries;

— another relevant institutional change was the introduction of the Supplementary Financing Facility in 1979. Since the repayment periods were longer than for stand-bys, this might have been expected to be of particular help to developing countries. Further, a concessionary element was provided to low-income countries by a two-tier Subsidy Account designed to reduce the associated interest rate;

— the Compensatory Financing Facility was liberalised or extended in scope on three occasions between 1975 and 1981;

— cumulative access was enlarged to 600 per cent which has now, after the eighth quota review, been reduced to 408 per cent or 500 per cent, depending on the seriousness of balance of payments needs and the strength of the adjustment effort.

4.4 For its part, the World Bank endeavoured to step up the scale of its lending and, in 1980, introduced Structural Adjustment Lending (SAL) to provide medium-term credits.

4.5 The consequences of these actions, particularly in relation to the Fund, were substantial, quantitatively and qualitatively, but essentially short-lived. As can be seen from Table 4.1, there was an upsurge in Fund lending between 1974 and 1976, but this fell to negligible levels, and indeed turned into negative net flows, during 1977 and 1978. Qualitatively, there was a movement towards medium-term programmes and special facilities for low-income countries; but this was reversed after 1976. These diminishing attributes partly explain why the Fund was called on to play virtually no role from 1977 to 1979 in financing non-oil developing countries' deficits, which remained large. Another major reason was the large percentage of high conditionality lending—three-quarters of the total by 1980. This change was brought about by increasing the percentage of quotas that could be drawn rather than increasing the quotas themselves (thus, first credit tranche conditionality continued to apply to 25 per cent of a quota even though much larger cumulative quotas could be drawn). There was a brief relaxation of attitude to conditionality at the end of the 1970s, involving easier availability of waivers, longer programme periods and modified policy objectives, but this proved short-lived. Those countries which were able to do so, preferred to make maximum use of commercial bank credit.

4.6 The reaction of the Fund to the second oil shock of 1979 and the resultant debt crisis (or at least the reaction of its principal members) was substantially different from its reaction to the events of 1973–74. There was, to be sure, a major increase in resources and lending; but it was primarily in relation to what was seen as a short-term liquidity crisis on the part of the major debtors. It has not been directed towards the longer-term structural problems of the countries concerned or to the particular problems of low-income countries. For its part, the World Bank increased its lending but this never exceeded planned levels, even during crisis situations, because of the constraint of remaining within sustainable lending limits. Each of these points merits some further discussion, which we undertake below.

The IMF and Major Commercial Bank Debtors

The IMF as lender

4.7 As can be seen from Tables 4.1 and 4.2, there was a major increase in Fund lending to non-oil developing countries after 1980, and this was almost totally accounted for by the 25 countries with the largest external indebtedness in 1982 (other than India, Pakistan and Indonesia, all are middle-income countries).

4.8 The resources to finance this upsurge in new lending were raised in several stages. After 1979, with the help of borrowing under the Supplementary Financing Facility, a review of quotas, and further borrowing from Saudi Arabia and the industrial countries, the Fund was able to enlarge its resources under the standby and extended arrangements. Two further important decisions were taken in early 1983 to increase IMF resources. Under the Eighth General Review, aggregate quotas were increased by 47.5 per cent from SDR 61 billion to SDR 90 billion—ahead of schedule. Secondly, the General Arrangements to Borrow (GAB) were expanded and extended by the members of the Group of Ten, whereby maximum credit lines available to the Fund were increased from SDR 6.4 billion to SDR 17 billion and access extended beyond the Group to provide 'additional financing for other countries with balance of payments problems . . . that could pose a threat to the stability of the international system'.

4.9 With these resources (and increased access limits), net commitments under agreed programmes with developing countries were raised to SDR 6.6 billion in 1980 (roughly equivalent to the total commitments over the whole period 1974–79), rising further to an average of SDR 7.3 billion in the following two years and SDR 10.6 billion in 1983 (double that of the previous year and of the five-year period 1976–80).

Table 4.1: Bank/Fund Lending to Non-Oil Developing Countries ($ bn.)

	Current Account Deficits	Gross Fund Disbursements	Net Use of Fund Credit	World Bank Gross Disbursements (IDA in brackets)	Net Fund Disbursements
1973	11.3	0.4	0.1	2.2 (0.7)	2.1
1974	37.0	1.9	1.5	3.0 (1.0)	2.9
1975	46.3	2.7	2.1	3.8 (1.3)	3.1
1976	32.6	4.1	3.2	3.9 (1.3)	n.a.
1977	30.4	1.4	– 0.2	3.9 (1.1)	3.2
1978	42.3	2.3	– 0.3	4.8 (1.2)	4.2
1979	62.0	2.8	0.2	5.8 (1.4)	4.8
1980	87.7	6.0	1.5	7.0 (1.9)	5.6
1981	109.1	8.4	6.1	8.4 (2.1)	7.0
1982	82.2	8.1	7.1	9.4 (2.6)	4.5
1983	56.4	13.5	10.2		

Note: World Bank figures are for July/June financial year (thus, 1982/3 for 1982).

Table 4.2: Use of Fund Credit 1977–83 ($ bn.)

	1977	1978	1979	1980	1981	1982	1983
Developing Countries	−0.2	−0.3	0.2	1.5	6.1	7.1	11.7
of which —major borrowers	−0.2	−0.5	−0.5	1.2	3.4	5.7	9.3
—low-income countries	−0.3	−0.2	0.2	0.6	2.1	2.7	1.8
—low-income countries excluding China and India	0.1	–	0.2	0.3	1.3	1.1	0.8
—Africa	0.1	0.3	0.4	0.5	1.6	1.2	1.4

Source: IMF, *World Economic Outlook.*

At the end of 1983, 43 countries had arrangements with the Fund involving a total amounting to SDR 22.9 billion. Of these, 20 countries—including nine in Latin America—with arrangements totalling SDR 14 billion, had undertaken at least one debt rescheduling over the period 1981–83. In terms of the current account deficit (admittedly much reduced as a result of IMF supervised programmes) the Fund financed 20 per cent in 1983 compared with 6 per cent in 1981 and 3 per cent over the period 1976–80. For nine Latin American countries with Fund programmes, the level of Fund support rose from less than 1 per cent of the current account deficit in 1981 to more than 50 per cent in 1983.

4.10 Two further features should be recorded regarding the big increase in Fund lending to meet the needs of the major debtors. First, while low conditionality lending increased (to a record SDR 3.4 billion in 1983), the proportion fell sharply from about a half of disbursements in the late 1970s (and 80 per cent in 1976) to a little over a quarter in 1983. Second, the new lending was dominated by one-year standby loans. The EFFs, symbol of the Fund's attempt to adapt its approach towards longer-term and more structurally oriented programmes, now account for a much lower proportion of Fund arrangements than earlier—only 10 out of 43 developing country programmes in 1983 and only 4 out of 37 in mid-1984. Thus we can see a marked change in response to developing country needs since the first oil shock.

The IMF as catalyst

4.11 Apart from the absolute amounts of finance provided by the IMF, it has played a role quantitatively even more important than is indicated by the scale of its own lending. It has extracted 'involuntary' lending from banks, making it conditional before its own resources were committed in the period ahead. Taking the four countries Argentina, Brazil, Mexico and Yugoslavia, the effect of this joint approach has been that the $12 billion provided by the IMF over a three-year period was matched by a rescheduling, over a 7–8 year period, of some $45 billion of bank loan repayments together with $10 billion in new medium- to long-term loans.

4.12 This degree of involvement in the case of the major debtors has made the Fund central to the successful resolution of debt rescheduling problems. As a corollary of increased Fund involvement in debt rescheduling cases, creditors have made almost all debt rescheduling arrangements, including the disbursement of new money, conditional upon compliance with performance criteria under arrangements with the Fund (the same applies also to official creditors under the Paris Club, but here the Fund's catalytic role is less in evidence). For a debtor country, therefore, non-compliance means the suspension not only of Fund lending but also of lending by the commercial banks and other creditors.

Conditions and performance criteria

4.13 The main feature of IMF conditionality as applied to the major debtors is the emphasis on demand management and a programme of monetary and fiscal measures which can be monitored within the short-term programmes consistent with standby loans. The principal instrument for achieving the objectives envisaged in these programmes has been a sharp reduction in public sector deficits; for example, a reduction in the case of Mexico from 16.5 per cent of GDP in 1982 to 3.5 per cent of GDP in 1983, and in the case of Brazil from 16.9 per cent of GDP in 1982 to 4 per cent of GDP in 1983.

4.14 The main achievement of debtor adjustment policies, as we have described in Chapter 1, was to produce a remarkable swing in their trade balance. If we take ten countries with the largest bank debt[1] and which have recently experienced bank debt reschedulings, their merchandise trade has achieved an estimated $25–30 billion surplus in 1983 from a deficit of $45 billion in 1981. This swing was largely accomplished by a reduction in imports; in 1983 imports were almost halved compared to the level reached in 1981.

4.15 There has been considerable criticism of the damaging consequences for development of this type and scale of adjustment. We shall briefly reiterate only two major points here. The first relates to the very high economic and social costs in terms of output, employment and personal incomes. The implications for GDP growth were summarised in Chapter 1. In terms of employment, in Peru, for example, about 900,000 jobs have been lost since 1980, pushing the level of those without a full-time job to an estimated 60 per cent of the 6 million work-force. Industrial employment fell by 8½ per cent during October 1983 in Brazil. Real wages are reported to have fallen by about 25 per cent in Brazil during 1983, as envisaged in the IMF programme. In Yugoslavia, where an IMF programme was pursued from May 1979 to the end of 1983, real wages showed a decline of 15–20 per cent between 1979 and mid-1983.

4.16 The second criticism is that short-term adjustment programmes are not directed to the need for measures to increase the output of tradeable goods and services—exports and import substitutes. Indeed, they may hinder necessary structural changes inasmuch as they inhibit new investment. In any case, new investments may well be import-

1. These are: Mexico, Brazil, Venezuela, Argentina, Chile, Yugoslavia, Nigeria, Peru, Ecuador and Turkey.

intensive, requiring increased, rather than reduced, trade deficits in the short term. The main mechanism used by the Fund to encourage improvements on the supply side is the use of exchange-rate devaluation. Between 1981 and mid-1983 the real exchange rate of Mexico depreciated by one-third; of Brazil by one-sixth; of Argentina by two-fifths; of Yugoslavia by three-fifths; of Ecuador by two-fifths. Results in terms of growth are meagre so far, which is not surprising since there is a longer time-lag between price signals and resource allocation than between income changes and demand for goods. There are inevitable gestation periods between investment decisions and production and marketing of production, and these lags are more evident where export markets have to be established. This underlines the need for adjustment to be seen in a longer time-frame.

The IMF and the Low-income Countries

4.17 The experience of seriously indebted low-income countries in relation to the Fund is in general much less satisfactory than for other developing countries, both in respect of the quantity and quality of lending.

4.18 As regards quantity, it can be seen from Table 4.2 that, while there has been an increase in the total use of Fund credit by low-income countries from the very low levels of the late 1970s, a large part of the increase is accounted for by China and India, particularly the latter, and the increase is small in relation to the overall increase in developing country borrowing from the Fund. One major problem is the limitation on access. Even where access is adequate, high interest rates and the short repayment periods on Fund loans are a deterrent to potential borrowers (and also to the Fund which needs to be persuaded that repayment is likely). The cut-back in special IMF provisions for low-income countries—the Subsidy Account and the Trust Fund—are a major impediment. Moreover, the Fund performs virtually no catalytic role; as explained in Chapter 3, it does not actively encourage new official lending and may inadvertently turn off sources of export credit.

4.19 IMF programmes present problems for the low-income countries for several related reasons. First, a traditional short-term Fund programme which calls for immediate cuts in expenditure leading to cuts in imports presents particular difficulties for these countries. Levels of incomes are initially lower and imports have usually been compressed to the minimum already. And, as we have seen, many African countries have had experience of long periods of falling per capita incomes and falling imports. Second, the time period required for achieving structural adjustment is likely to be long: this arises from the fact that low-income countries tend to have much less diversified production structures, so that a change in relative prices brings about a reallocation of resources more slowly. The existence of large non-monetised sectors also tends to limit the role of the price mechanism.

4.20 Yet a review of the Fund programmes in the context of Sub-Saharan Africa suggests that there is an even greater predominance of short-term, one-year, standby arrangements rather than three-year EFF loans, as compared with arrangements for middle-income countries.[2] While the Fund does, on occasion, operate in terms of a medium-term framework, even in formulating standby arrangements, the failure to conclude straight medium-term arrangements suggests that the performance criteria are formulated unduly in terms of variables related to short-term improvements, for example, variables related to demand management rather than to supply-side measures.

4.21 Taken as a group, low-income countries, especially in Africa, have left a sizeable trail of failed and aborted Fund programmes. In addition to the inherent difficulties in achieving meaningful adjustment with short-term deflationary programmes, most low-income countries are more vulnerable to exogenous shocks than are other countries. They are also subject to a greater seasonality in the tempo of their economic activity. Essentially, the requirements of these countries are for a higher proportion of low conditionality loans, particularly under the CFF which offsets external shocks; and for more medium-term loans under which performance targets are monitored less inflexibly and with more attention to possible social and political consequences.

The World Bank and the Debt Crisis

4.22 As we have pointed out above, the World Bank has so far made only a modest contribution to the balance of payments financing of developing countries. Out of an estimated gross lending commitment of $14.5 billion in 1983 (excluding the IFC), the net transfer was only $4.5 billion ($11 billion and $2 billion respectively for the IBRD alone, i.e. excluding IDA). In the case of low-income Africa, net transfers from the Bank have steadily declined since 1978 and have been negative for the last two years (the negative transfer was $42.6 million in 1982). In Zambia, to take an extreme case, transfers have been negative since 1979.

4.23 The Bank's role has been inhibited so far by two constraints. First, it is being held back from expanding its lending activities by a combination of its restricted capital base, its capital-lending ratio (a very conservative one-to-one) and its cautious policy of remaining

2. In mid-1984, 19 out of the Fund's 37 developing country programmes were with Sub-Saharan Africa and only one (Malawi) was an extended arrangement.

within its sustainable lending limit.[3] Second, the overwhelming emphasis on project lending imposes serious limitations on the absorptive capacity of many recipients. When output and consumption are being cut back as a result of forced balance of payments adjustment, it is difficult for governments to maintain the momentum of new projects. The Bank has evolved two mechanisms to help it play a larger role: SALs and co-financing.

Structural adjustment loans

4.24 Structural adjustment lending was introduced by the Bank in early 1980 with the objective of providing quick disbursing finance to support measures aimed at strengthening countries' balance of payments without severely constraining demand in a manner that sets back economic and social development. The loans are designed to assist governments to adopt policy and institutional reforms intended to improve the efficiency of resource use, thereby ensuring a more sustainable balance of payments and acting as a catalyst for the inflow of other external capital to help ease the balance of payments situation. Adjustment is anticipated over a period of five to ten years. The loans themselves are for disbursement within 12 to 18 months, but the Bank normally expects to undertake a succession of such loans over a 4–5 year period.

4.25 While the idea is attractive, the quantitative significance of SALs has so far been very small. Loan commitments in 1983 amounted to $1.5 billion and disbursements were considerably smaller. Moreover, there is a low ceiling on finance available for programme lending: 10 per cent of Bank lending and no more than 30 per cent of total lending for any one country. SALs also compete with other uses of the Bank's resources, and do not represent any net addition to total lending.

Co-financing

4.26 A second contribution on the part of the Bank is the encouragement of commercial bank lending to developing countries by means of co-financing. The rationale behind co-financing is that it provides the commercial banks with greater security because borrowers are less likely to default on a project in which the Bank is involved. To date, the scheme has had limited success in attracting commercial funds. Co-financing amounts to only 1 or 2 per cent of all commercial bank lending to developing countries. Moreover, it is questionable how much

3. Under the Bank's Articles, disbursements cannot exceed capital plus reserves. The 'sustainable lending limit' is that level of commitments that can be sustained indefinitely without requiring another capital increase. The limit varies and can be exceeded temporarily, but the commitment rate must then be reduced so that subsequent disbursements do not exceed capital plus reserves.

of the private funds are, in fact, new money which would not have been forthcoming otherwise.

A Future Role for the Institutions

A new mandate

4.27 It has been argued above that the IMF's role cannot simply be evaluated in quantitative terms, though the amount of resources is clearly very important. What is primarily lacking at present is adequate finance for medium-term structural adjustment lending, a deficiency related to developing countries in general but relevant to low-income countries in particular. The vehicle for this type of lending is already available in the Extended Fund Facility.

4.28 Were the IMF to move in this direction, it would mean increased overlap with the structural adjustment lending activities of the World Bank. There are important issues of policy and procedure in this area which will not be pursued here; they were covered in depth in the Helleiner Report, *Towards a New Bretton Woods*.[4] But there are two specific practical implications which should be underlined. First, if there is to be a consistent approach to structural adjustment there will need to be a coordinated approach by the two institutions (together with bilateral donors and credit agencies, and the recipient governments). This could eventually lead to a merged lending body. Second, in many cases, where the Bank plays the dominant role in coordinating external development finance, the Bank rather than the Fund should assume the lead role in any adjustment package, and its conditionality, rather than the Fund's, should be predominant. This in turn calls for additional Bank resources particularly for structural adjustment lending.

4.29 The other major element in a revised approach to external financing by the Fund would be recognition of the greater need for low conditionality compensatory financing to help developing countries withstand externally-induced instability. The case for an enlarged CFF rests on the following grounds: first, the particular vulnerability to external shocks of many low-income countries dependent on only one or two primary commodity exports and the absence at present of appropriate facilities on an adequate scale; second, the absence of any other satisfactory international arrangements to help developing countries deal with earnings instability; third, the desirability of incorporating interest rate fluctuations, together with export earnings, and import prices (at least for essential items), as variable elements which can be a basis of CFF eligibility; fourth, the inappropriateness of

4. Commonwealth Secretariat, *Towards a New Bretton Woods: Challenges for the World Financial and Trading System*, Report by a Commonwealth Study Group, July 1983.

conditionality and access limits for dealing with external shocks which are not permanent but reversible.

4.30 It is also necessary to stress that low-income countries find it difficult to have access to Fund facilities because of the high cost of its borrowing. A reactivation of the Interest Subsidy Account and/or the Trust Fund might therefore be considered.

Resources of the Fund

4.31 The required level of the Fund's resources depends in part on the extent to which its role remains the traditional one or is adapted along the lines sketched out above. It also depends on the extent to which the Fund's own analysis of the debt crisis is correct, namely, that existing major debtors require less external borrowing and are restored to a position where market borrowing becomes easier. If, however, their position does not improve in the medium term—as our analysis in Chapter 5 leads us to believe—they will have to roll over their loans and this will add substantially to resource requirements.

4.32 Rough calculations have been made on what could happen in a scenario in which the debt crisis will not be quickly resolved and in which the major borrowers will require programmes in place for the next three years or so, and will need continuing support at least over this period, if not longer. To provide further loans up to the present access limits would call for around SDR 15 billion over the next three years (SDR 19 billion on higher access limits). In addition, there are several other major debtors who are currently rescheduling and may well elect to make use of Fund programmes. This could involve calls on Fund lending of up to SDR 10–12 billion. These are, it should be stressed, notional figures and could in practice be substantially greater if countries with large quotas seek assistance, or substantially less if loans are not actually sought or if lending is constrained well within quota limits. We have, further, made out a case above for an enlargement of CFF low-conditionality support. Even if the same level of low conditionality support were provided as during 1981–83, the amount required could be an additional SDR 7 billion over the three-year period 1984–86. It is, therefore, not too difficult to envisage circumstances in which the Fund could face a demand on its resources of the order of some SDR 34–40 billion over the period 1984–86, and the demand could be much larger if low conditionality lending was substantially enlarged.

4.33 Looking now at the supply of finance, the Fund estimates that the Eighth Quota increase of around SDR 30 billion will provide an addition to useable resources of about SDR 15 billion from January 1984 and taken together with GAB enlargement will almost double the size of the IMF's resources. However, since access to the GAB is in practice severely limited by special criteria, GAB resources cannot be considered as a normal addition to the Fund's resources. Even allowing for repurchases under the existing arrangements which could amount to about SDR 10 billion over the three-year period, the Fund faces a short-fall of resources of some SDR 9–15 billion over the three-year period without allowing for a significantly increased CFF. Moreover, our analysis of the longer period to 1990, in Chapter 5, suggests that on most realistic assumptions there will be a call on the IMF for the rest of the decade for resources at least as large in real terms as in 1983.

The role of the World Bank

4.34 Consideration is at present being given by the Bank to the different ways in which it could play a more central role in developing countries in the light of the debt crisis, the decline in commercial lending and the particular problems of low-income countries, especially in Africa. A set of different instruments would be necessary to meet different objectives in the main groups of clients: the major debtors; low-income Sub-Saharan Africa; other low-income countries.

4.35 The Bank's effectiveness in low-income countries depends in large measure on its success in obtaining supplementary financing for IDA, at least to maintain in real terms the volume of its lending. Without adequate IDA resources, the Bank will not only be forced to make a relatively smaller contribution to seriously indebted low-income countries but will be unable to continue its valuable preventive role, which helps to keep the major Asian aid recipients from acquiring serious debt-servicing problems. Moreover, it is only with adequate resources to back it up that the Bank will be able to take a central part in formulating programmes, influencing and coordinating donors and creating a medium- to long-term perspective in joint operations with the IMF.

4.36 If the Bank is to perform this central role in medium-term structural adjustment in low-income countries and elsewhere, it will need a substantially higher percentage of resources for general programme lending. An immediate step along this road would be a significantly increased fraction of World Bank lending available for SALs, within the context of larger Bank lending in general.

4.37 Where the Bank's project orientation would be valuable is in maximising private flows not otherwise forthcoming. It is primarily in this way that the Bank will assist the major debtors as well as those not already considered creditworthy. This could be achieved through a combination of:

(i) a more flexible and larger co-financing scheme. Bankers argue that co-financing could be raised to much higher levels. The principle of cross-default should be made more explicit (linking default to private creditors with new Bank loans) and procedures made faster;

(ii) use of the scarcely invoked clause in the Bank's charter which permits it to offer loan guarantees;

(iii) continuing expansion of the International Finance Corporation. The IFC's resources are to be increased from $1.9 billion in the period 1979–84 to $6.4 billion over 1985–89 to permit substantially increased investment, mainly in equity form;

(iv) a World Bank banking subsidiary raising commercial finance and jointly participating with commercial lenders in lending to developing countries.

Regional development banks

4.38 In many respects the comments applied to the World Bank are relevant to regional banks too. However, they enjoy certain advantages over the World Bank: they have a greater knowledge of their respective areas and the developing countries themselves play a relatively larger role in their operations and decision-making. And where the role of the World Bank and/or the IMF becomes too dominant, the regional banks can provide an independent source of advice as well as finance. Moreover, they have in general managed to speed up commitments and disbursements in order to make an effective contribution when it has been most needed. In 1983, the three regional development banks made a net transfer of $2.5 billion from loan disbursements of $3 billion and commitments of $4.8 billion. Except on a small scale by the Asian Development Bank, there is no programme lending and, as with the World Bank, this represents a significant limitation on the role of the banks in the present context. They are also severely constrained financially in their ability to promote soft loan assistance through IDA-type facilities and equity financing. If these constraints were to be lifted the three regional banks could help to promote a better balanced range of multilateral financing.

Chapter 5

Debt and Resource Flows: Future Prospects

5.1 A view widely held in Western governments, international agencies and banks is that, while the debt crisis has assumed serious dimensions in the last few years, the policies developed in response to it—as reviewed in Chapters 2–4—coupled with economic recovery in the industrial countries, should restore the debt situation to a manageable level. This view is well articulated by the IMF. In the 1984 issue of *World Economic Outlook*, it said (p.68):

> Assuming moderate rates of growth in the industrial countries, some fall in real interest rates, and unchanged terms of trade, and assuming also that the non-oil developing countries continue their present adjustment policies, the conclusion is reached that most groups of these countries can achieve adequate rates of growth of GDP (although somewhat below the rates attained during the 1960s and 1970s), while restoring a manageable position with respect to their current accounts and debt-service burden.

In this chapter we shall review the plausibility of this scenario over the rest of the 1980s.

Debt Situation: Some Projections

The aggregate picture

5.2 In order to appreciate the precariousness of the prospects for an improved debt situation, it is important to understand the assumptions on which an improvement is predicated in the medium term:

(i) the industrial countries will grow at a rate of 3 to 4 per cent per year, and, as a result, developing countries will be able to increase their export earnings significantly as in the past;

(ii) the real rates of interest will decline substantially compared to the present levels;

(iii) the price of oil will remain stable; and

(iv) a significant number of developing countries will continue to generate trade surpluses.

Based on these assumptions, most exercises on the debt situation project an improvement in the medium term. (See Appendix 5.1 for a summary of various projections and the assumptions underlying them.) There are, however, some difficulties with such an assessment. First, the underlying assumptions seem optimistic, particularly when we consider that all of them must be realised simultaneously. Second, even if all the assumptions were to be realised, the picture is much less reassuring when we look at the debt profile for some individual countries or sub-groups of countries. Further, it is assumed that adequate financial flows, including new bank lending, will be forthcoming in the rest of the decade to meet the financing needs of the developing countries—an assumption that may not be easily fulfilled even if the debt situation were to improve as projected. We discuss these themes below.

Fallible Assumptions

(i) *Growth in industrial countries*

5.3 The projected improvement in the debt situation is highly sensitive to the industrial countries attaining a modest recovery, achieving a growth rate of 3–4 per cent in the rest of the decade.

5.4 A point of agreement among all the projections is that, if the industrial countries were not to attain the assumed growth rates, the debt situation could deteriorate seriously. According to the IMF, if the industrial country growth rates were to be one percentage point less than the assumed rate in the base case projections (i.e. 2.25 per cent instead of 3.25 per cent), the debt-service ratio of the non-oil developing countries would rise all through the rest of the decade compared to the levels in 1983, which were already high. Professor Cline (1983) concludes that a fall of one percentage point in industrial country growth could be seven times more important, in terms of its impact on the debt situation of developing countries, than a one percentage point rise in interest rates, serious though the latter would be.

5.5 The assumed growth rate of 3–4 per cent for industrial countries for the rest of the decade, while low by historical standards, is predicated upon a continuation and improvement in an economic recovery which is so far both uncertain and uneven. Growth has been strong in the United States and, to some extent, in Japan; but in Western Europe it remains weak. In the current year, 1984, the growth rate of GNP in the European economies is projected at less than 2.5 per cent, compared to 6 per cent in the US and 4.75 per cent in Japan (averaging 4.25 per cent overall as against 2.4 per cent in 1983). Moreover, most analysts forecast a decline in industrial country growth in 1985; the OECD forecasts a decline in the US to 2.5 per cent and in Japan to 3.75 per cent. The growth rate in industrial countries, on average, is expected to decline from 4.25 per cent in 1984 to 2.75 per cent in 1985.

5.6 The idea of higher and steady growth runs wholly counter to the reality of a world characterised by cyclical booms and slumps and by periodic shocks. Even if the industrial countries achieve a growth rate of 3–4 per cent on average in the rest of the decade but characterised by booms and slumps, it is doubtful whether the debt situation will improve, particularly if the next phase of the cycle is a 'slump' rather than a 'boom'. As noted above, the growth rate of industrial countries is generally expected to decelerate markedly in the coming one to two years; and if this deceleration in growth were to be as pronounced as that of 1981–82, the debt situation would worsen markedly.

(ii) *Developing country exports*

5.7 There is also some uncertainty as to whether the industrial country growth would continue to have the same degree of impact on developing country exports as in the past. In the short term, in spite of the recovery in industrial country growth in 1983–84, commodity prices have tended to decline. Between mid-July 1983 and mid-July 1984, the dollar prices of non-food agricultural commodities fell by 19 per cent and of metals by 16 per cent. In view of the expected decline in industrial country growth in the coming one to two years, it is doubtful whether these falls will be reversed in any significant manner. In the medium term, there are two other factors which cast doubt on the ability of the developing countries to increase their export earnings. First, during the 1970s developing country exports came to be diversified away from industrial countries, with a greater proportion going to other developing countries—oil exporters and others. Immigrant remittances from workers employed in the oil-exporting countries were also a strong component of exchange earnings for some developing countries during the decade. Therefore, if the revival in growth is confined to industrial countries—with growth in oil-exporting and other developing countries somewhat muted—the exports of developing countries might not revive as strongly as one might be led to believe from the past evidence. Secondly, there is evidence that, in spite of the avowed desire to reduce protectionism, the industrial countries, in fact, intensified protectionist measures in 1983, at a time when recovery was under way. Furthermore, at the margin, the additional exports produced as a result of developing country adjustment measures, in particular from more competitive real exchange rates, are likely to be price-sensitive manufactures which face the maximum protectionist stance. In the absence of a liberalisation of trade, therefore, developing country exports may not revive as strongly as past trends might suggest.

(iii) *Interest rates*

5.8 The projected global improvement in the debt situation assumes a decline in interest rates. The IMF, for example, assumes that interest rates on commercial credits, after continuing at the 1983 levels up to the end of 1985, will decline by three percentage points during the rest of the decade. If interest rates were not to fall at all, compared to 1983 levels, the results would be much worse.

5.9 So far, the experience has been far from encouraging. We have seen the demolition of hopes, widely held when we began this study, that there could be a speedy return to manageable levels of interest rates. Instead, they have risen—in the case of Euro-dollar rates from below 9 per cent at the low point in 1983 to 12.25 per cent in July 1984. Some analysts believe that they will continue to rise further. No less an authority than Dr. Martin Feldstein, in his capacity as Chairman of President Reagan's Council of Economic Advisers, recently warned that short-term rates would rise further, and continue high throughout 1985, even if ameliorative action were taken on the US budget deficit. An improvement in the debt situation of developing countries projected on the assumption of a fall—or even a constancy—in interest rates should, therefore, be viewed with scepticism.

5.10 In the absence of a fall in interest rates from the current levels during the rest of the decade, the chances are that the real rates of interest on commercial debt will either equal or exceed the projected rates of growth in real export earnings of the non-oil developing countries. These are projected at less than 5.5 per cent per year for the rest of the decade, compared to about 5–7 per cent real rates of interest at present. The projected rate of growth in real export earnings for the net oil exporters, whose commercial borrowing is significant, is, in fact, less than 3 per cent per year for the rest of the decade. The rate of growth in real export earnings of the low-income countries is also projected at less than the average for non-oil developing countries as a whole. The full significance of this comparison lies in the fact that a country whose export earnings growth consistently falls behind the real rate of interest must be, realistically, treated as 'insolvent' rather than merely 'illiquid'. For a country with balanced trade, an excess of interest rate on external debt over the rate of growth in exports leads to deeper debt-servicing difficulties. But we do not start from a balanced position.

(iv) *Price of oil*

5.11 A further uncertainty is the future price of oil. The oil supply situation, however, is dependent not only on the balance between the demand for and supply of oil, arising out of normal economic growth and production trends, but also on a continuation of political stability in the few major oil-supplying countries of the world.

5.12 The impact of a change in the price of oil cannot be viewed entirely in terms of the net debt situation at the global level. A fall in the oil price would threaten the more indebted oil-exporting countries,[1] while a rise in the price would worsen the debt situation of the oil-importing countries; but the gains and losses of countries arising from a change in the price of oil are not transferable, and the strains arising from such a change may not be accommodated evenly by a redirection of the financial flows. A big change in the oil price in either direction could have disturbing consequences for the debt situation.

(v) *Continued adjustment by developing countries*

5.13 The projected improvement in the debt situation also assumes that many of the developing countries will continue to generate export surpluses, as they have started doing at the behest of the IMF. As noted in earlier chapters, the adjustment effort has entailed a severe cut in imports and in GDP; in the projections made by the IMF, the volumes of imports of the major borrowers are not expected to exceed their 1981 levels until 1987, and in respect of the net oil exporters, until 1988. In the case of Sub-Saharan Africa, adjustment is called for on top of a decade-long decline in per capita incomes.

5.14 It is clear that an adjustment effort of this order would be extremely difficult to sustain. As two observers of the Latin American situation have put it:[2]

> In most [Latin American] countries, stabilisation plans have been sold as a short, necessary operation, soon to result in a new burst of growth. In some they are being instituted by technicians without

1. As Sir Jeremy Morse put it in evidence to the UK Parliament: 'Obviously, if there was a sharp break in the oil price that could create a secondary, at any rate, problem, perhaps at worst a crisis in the position of some of the oil countries. I think that is one danger. The other danger, of course, is recession deepening into depression, meaning that the arithmetic generally fails. I suppose those are the two which in my bank we have at the back of our minds.'
(*House of Commons Select Committee on International Monetary Arrangements,* Vol II, Q 1496.)

2. Thomas O. Enders and Richard P. Mattione, *Latin America: The Crisis of Debt and Growth.* (Washington D.C.: The Brookings Institution, 1984, p.56.)

broad political consent. When the crisis in some countries drags on with per capita incomes below 1980 levels, as they may be for much of this decade, and without credible promise of relief, it is easy to imagine resentment and frustration exploding and turning against governments when they fail to persuade the United States and other industrial countries of the need for more generous terms. Not only would the current broad but weak trend towards democracy falter, but public order and national security could also be at risk.

It is interesting, in this context, to note the projections made by the Inter-American Development Bank for Latin America, which are based on two alternative assumptions: (a) that per capita consumption remains constant; and (b) that unemployment does not rise. The projections show that the debt-service ratios of seven selected Latin American countries would continue to be above 40 per cent through the rest of the decade under the assumption of constant per capita consumption, and above 50 per cent if unemployment were not to rise further. This illustrates the difficulty of the task involved.

5.15 The projected improvement in the debt situation is thus predicated on the fulfilment of a number of crucial assumptions simultaneously. Moreover, even on this optimistic scenario, the developing countries are expected to face a rise in their debt-service ratios in the immediate future, due to the substantial rise in amortisation payments expected around 1986–87. The picture is also worrying when we look at the prospects for some individual countries or sub-groups of countries.

5.16 As we noted earlier in Chapter 3, the improvement projected in the overall debt: exports ratio does not apply to low-income countries. The IMF projects that the debt of low-income countries, excluding India and China, in relation to their export earnings will be roughly at the same level in 1990 as in 1983—i.e. at more than three times export earnings. In the meantime, it is projected that they will face a worsening in the debt-service ratio in the immediate future, in common with the rest of the non-oil developing countries. The projected interest payments ratio also shows hardly any improvement; it is expected to stay at about a tenth of their export earnings to the end of the decade.

5.17 There are some major borrowers whose debt situation is not expected to improve. Professor Cline's study, for example, indicates that the debt ratio is likely to rise in respect of seven countries out of the 21 studied. Oil exporters are particularly likely to see worsening ratios. Of the most important debtors, interest payments are projected to remain above half of export earnings to the end of the decade for Argentina, and in respect of Brazil they are projected not to fall below a fifth of export earnings. For Mexico and Brazil, debt-service ratios through the rest of the decade are not expected to change significantly from the levels which led to debt-service payments difficulties in 1982 and 1983.

5.18 The significance of a worsening of the debt situation—or lack of a substantial improvement—even in respect of a few major borrowers is that a sense of crisis can be expected to hang around the international banking system and severely test the stamina of current ad hoc arrangements.

Forecasts of the 'Financing Gap'

5.19 We turn now to the future level and pattern of financing flows. In its optimistic scenario, the IMF, for example, projects a current account deficit of some $63 billion by 1987 and $86 billion by 1990 for the non-oil developing countries. If we assume that these countries will need to increase their reserves by $12–15 billion annually, their financing needs would be in the order of some $75 billion by 1987 and $100 billion by 1990 (see Table 5.1).

5.20 This financing gap could be met, if we assume, as the Fund does, that in the medium term (i) official development assistance (ODA), other official flows including export credits, and the exposure of commercial banks will remain constant in real terms, and (ii) direct foreign investment will rise in real terms; and if we make the further assumption that (iii) the net use of Fund credit will be of the order of some $8 to $10 billion. The plausibility of such an outcome is in doubt, however. The above assumptions on financing flows imply a substantial departure from the trends in the immediate past. We shall now review the prospects for new flows individually.

(i) *Official development assistance (ODA)*

5.21 The background as far as ODA to developing countries is concerned is one of a fall in nominal as well as real terms between 1981 and 1983; ODA in real terms fell from $36.5 billion in 1981 to $33.8 billion in 1983 (at constant 1982 prices and exchange rates). Most of this fall was due to a reduction in disbursements by non-DAC countries, particularly OPEC, whose ODA has been affected by declining oil revenues and by the war between Iran and Iraq. ODA from DAC countries remained constant at about $27½ billion in 1982 and 1983, in spite of a recovery in the GNP of these countries. As the export revenues of OPEC countries remain uncertain the prospect of a recovery in OPEC aid is not promising. Indeed, the chances are that it may further decline, with the result that total ODA flows may stagnate in spite of any possible upturn in the assistance from DAC countries.

Table 5.1: Non-Oil Developing Countries: Financing Gap, and the Financing Flows: Some Projections ($ bn)

	1983[a]	1984[c]	1987	1990
I. Financing needs:	62	63	75 (100)[b]	100 (120)[b]
Of which:				
(a) Current Account Deficit	56	50	63[c]	86[c]
(b) Change in Reserves	6	13	12[d]	14[d]
II. Financed by:				
(i) Official sources[e]	36	37	42	47
(a) Transfers	13	14	–	–
(b) Long-term borrowing (net)	23	23	–	–
(ii) Direct investment (net)[f]	8	9	12	16
(iii) Borrowing from commercial banks (net)[g]	20	21	24	28
(iv) Use of Fund credit[h]	10	7	8	10
(v) Others[i]	–12	–11	–7	–5
III. Residual (Unmet Financing Gap) (I – II)	–	–	(21)[j]	(24)[j]

Notes: [a] Actual (IMF)
[b] Assumed (see text)
[c] IMF projections
[d] Figures assumed (see text)
[e] Projected for 1987 and 1990 on the assumption that they remain constant in real terms (corresponds to IMF's assumptions)
[f] Assumed to grow at 9½ per cent per year between 1984 and 1990 (corresponds to IMF's assumptions)
[g] Derived by assuming that bank lending will increase at 5 per cent a year during 1985 to 1990
[h] Figures for 1987 and 1990 are assumptions
[i] Includes, among other things, unrecorded capital outflow; this is assumed to decline by the end of the decade
[j] On the assumption that the financing needs will equal $100 billion in 1987 and $120 billion in 1990.

5.22 ODA channelled through multilateral institutions has been declining in recent years, relative to bilateral aid. Bilateral aid, which is directed towards middle-income countries to a greater degree than multilateral aid, is being increasingly made subject to commercial and strategic interests. An implication of this is that the aid flows to low-income countries could suffer in the future.

5.23 In discussing ODA, it is necessary to stress that the issue is not merely one of quantity. ODA is primarily of concern to low-income developing countries since these countries are unable to service commercial loans on any significant scale.

(ii) *Fund credit*

5.24 As explained in Chapter 4, the Fund, with an increased scale of commitments, is in danger of running ahead of its available resources—which it has met temporarily from increased borrowing. The assumptions nevertheless imply levels of financing from the Fund at $8 to $10 billion (net) per year over the next few years. This, it should be stressed, is considerably higher than in the past and more than the Fund's present resources could sustain.

(iii) *Export credits*

5.25 A major component of official financing is guaranteed export credit (medium- and long-term). Yet this source of finance has also fallen. According to the OECD, total medium-term export credit fell in 1982, the first year of the debt crisis, to $33.8 billion from $36.1 billion in 1981, with a particularly sharp cutback for the 'least developed' countries (by 40 per cent over a two-year period). These reductions partly reflect reduced demand in developing countries, faced with the need to cut back on imports. But a further factor is the refusal of export credit agencies to maintain guarantee cover for seriously indebted countries.

5.26 The prospects for increased export credit availability are adversely affected by the current difficulties of the export credit agencies consequent upon the debt crisis and the downturn in world trade. For example, the British ECGD, which covers 35 per cent of UK exports, has three-quarters of its exposure in the two riskiest categories of four. Claims on ECGD virtually doubled between 1981/82 and 1982/83. The response has been to place countries with debt problems 'off cover' until creditworthiness is established. In addition, premia have been raised substantially (by 50 per cent in the two riskiest categories), and this, combined with the effect of an agreement to reduce the subsidy element in lending, has pushed up borrowing costs. The Japanese agency has restricted or suspended cover to 60 countries; and premia were recently increased by 20 per cent. The West German Hermes agency made heavy premia increases in April 1984. The cumulative effect has been to cut export credit availability overall, to raise the price, and to remove from cover those highly indebted countries in greatest need of external financing.

(iv) *Foreign investment*

5.27 Net direct investment in all developing countries from industrial countries rose by an estimated 6 per cent annually in real terms during the period 1970–82, though there was a sharp drop in direct investment from 1981 to 1983. The IMF hopes, and projects, that there will be a considerable revival and that it will increase at a real rate of some 4–5 per cent per year during the rest of the decade. Indeed, industrial countries in general attach great importance to increased direct investment flows.

5.28 There is, however, considerable danger in creating exaggerated expectations of what is possible. The experience of the last few years has been one of cutbacks in direct investment in developing countries from $15.4 billion in 1981 to $11 billion in 1983 according to UNCTAD ($13.9 billion to $10.9 billion according to the IMF). The main reason is that direct investment is deterred by low growth, and this is likely to continue for some time in most of the heavily indebted countries. Moreover, foreign investment is unlikely to play a major role in poorer developing countries which lack strong domestic markets and well developed infrastructures. It is more likely to follow directions already favoured by commercial lenders, notably to the Far East. The experience of countries which have radically altered their foreign investment policies in favour of overseas companies suggests that, while foreign companies welcome incentives and guarantees, they are slow to respond on any substantial scale. The deflationary policies currently pursued by the debtor countries imply a contraction of domestic markets, providing little incentive for fresh investment including foreign investment. Moreover, while equity financing has the advantage of locating risk in the investor rather than the capital-importing country, it is not necessarily a cheap form of financing—as might become clearly apparent if real interest rates on borrowed capital fall back to more normal levels. Thus, while direct investment could become a factor of major importance—within a five to ten year time horizon—it is unlikely to be so in the next few years when growth could be slow, erratic and heavily skewed toward countries without debt problems.

(v) *Bank lending*

5.29 Very little new bank lending is taking place at present. Net bank lending has declined sharply since 1981; in 1983–84 it is less than one-third of the peak reached in 1981. Moreover, a significant portion of even this reduced flow is involuntary. The banks' own current assessments are that under present conditions they are unlikely to increase exposure to developing countries over the next few years by, at best, more than 5 per cent a year in nominal terms. There are several reasons over and above the perception of major debtors as risky borrowers for the general switch from international to domestic lending, especially in the United States: the absence of new banking institutions willing to be drawn in—like OPEC and Japanese bankers some years ago—to international lending; the pressure of bank supervision and regulation. Our assessment is that without a greater element of official support there is no way in which a substantial increase in flows will be forthcoming from the banks.

(vi) *Other commercial lending*

5.30 It is possible that new forms of commercial lending could arise replacing bank lending and involving other financial institutions not so heavily exposed as the banks. One source is bond finance. Overall, in 1983, bonds overtook commercial bank lending in importance in international capital markets but developing countries remain peripheral ($2.5 billion out of $76 billion in 1983), and lending is largely restricted to 'low risk' economies which have little difficulty raising bank credits (for example, Malaysia, South Korea, Thailand). Without government guarantees it seems unlikely that bank financing or other types of non-bank commercial lending will provide new flows on any scale.

The Overall Picture

5.31 The prospects for financial flows, then, do not suggest that the financing needs of the non-oil developing countries can be met, even if their current account deficits remain at a restrained level. But the current account deficits of these countries would be large if many of them were not to run trade surpluses. We believe that their annual financing needs could be at least $20–25 billion larger through the rest of the decade, were they not to run trade surpluses—which implies that their total financing needs might be in the order of some $100 billion by 1987 and $120 billion by 1990. At such levels of need for financial flows, even under optimistic assumptions for ODA, bank lending, direct investment, and use of Fund credit, a gap of some $20–25 billion per year arises for which there is no obvious source of financing. If the above assumptions were to prove to be unrealistic, and if, in addition, the industrial country growth were to falter and interest rates fail to decline, the gap would be much larger.

5.32 It follows from the above that unless action is taken to supplement official flows and support private flows at a higher level, developing countries will not be able to resume even modest growth for the rest of the decade and the servicing of debt will, in all probability, be unsustainable. It is also important that the composition of the financial flows should be right—for an expansion in commercial flows alone would not be of great benefit to low-income countries which are not in a position to bear the high costs of them. From their point of view, there is a need for an expansion in official flows as well.

Annex

Note on Country Groupings

1. IMF's Classification

I. Industrial Countries:

Australia	Japan
Austria	Luxembourg
Belgium	Netherlands
Canada	New Zealand
Denmark	Norway
Finland	Spain
France	Sweden
Germany, Fed. Rep. of	Switzerland
Iceland	United Kingdom
Ireland	United States
Italy	

II. Developing Countries:

A. Oil Exporting Developing Countries:
Defined as those whose oil exports (net of any crude oil imports) in 1978–80 amounted to at least two-thirds of the value of total exports, and were at least 100 million barrels a year.

Algeria	Nigeria
Indonesia	Oman
Iran, Islamic Republic of	Qatar
Iraq	Saudi Arabia
Kuwait	United Arab Emirates
Libyan Arab Jamahiriya	Venezuela

B. Non-Oil Developing Countries:
Includes all Fund members except those listed above in I and IIA.

(i) Net Oil Exporters:
Those developing countries that export more oil than they import but which are outside the group defined at A.

Bahrain
Bolivia
Congo, People's Republic of the
Ecuador
Egypt
Gabon
Malaysia
Mexico
Peru
Syrian Arab Republic
Trinidad and Tobago
Tunisia

(ii) Net Importers of Oil:
All developing countries except those listed at A and B(i).

(a) Major Exporters of Manufactures
All middle-income (see below) net oil importers having relatively large exports of manufactures.

Argentina
Brazil
Greece
Hong Kong
Israel
Korea
Portugal
Singapore
South Africa
Yugoslavia

(b) Low-income Countries:
43 countries whose per capita GDP did not exceed the equivalent of $350 in 1978.

Afghanistan
Bangladesh
Benin
Bhutan
Burma
Burundi
Cape Verde
Central African Republic
Chad
China, People's Republic of
Comoros
Ethiopia
The Gambia
Guinea
Guinea-Bissau
Haiti
India
Democratic Kampuchea
Kenya
Lao People's Democratic Republic
Lesotho
Madagascar
Malawi
Maldives
Mali
Mauritania
Nepal
Niger
Pakistan
Rwanda
Senegal
Sierra Leone
Solomon Islands
Somalia
Sri Lanka
Sudan
Tanzania

Togo	Vanuatu
Uganda	Viet Nam
Upper Volta	Zaire

(c) Other Net Oil Importers:

All other developing countries which are not included in any category above. These are middle-income countries which export mainly primary commodities. They include:

Botswana	Fiji
Cameroon	Papua New Guinea
Djibouti	Philippines
Ghana	Thailand
Ivory Coast	W. Samoa
Liberia	
Mauritius	Cyprus
Morocco	Hungary
Sao Tome & Principe	Malta
Seychelles	Romania
Swaziland	Turkey
Zambia	
Zimbabwe	Jordan
	Lebanon
	Yemen Arab Republic
	Yemen P.D. Republic
Antigua & Barbuda	Guatemala
Bahamas	Guyana
Barbados	Honduras
Belize	Jamaica
Chile	Nicaragua
Colombia	Panama
Costa Rica	Paraguay
Dominica	St. Lucia
Dominican Republic	St. Vincent
El Salvador	Suriname
Grenada	Uruguay

C. Major Borrowers:

Countries with the largest outstanding external indebtedness in 1982.

Algeria	India
Argentina	Indonesia
Brazil	Israel
Chile	Korea
Colombia	Malaysia
Egypt	Mexico
Hungary	Morocco

Nigeria
Pakistan
Peru
Philippines
Portugal
Romania
South Africa
Thailand
Turkey
Venezuela
Yugoslavia

2. World Bank's Classification

* Developing countries are divided into: low-income economies, with 1982 gross national product (GNP) per person of less than $410; and middle-income economies, with 1982 GNP per person of $410 or more. Middle-income countries are also divided into oil exporters and oil importers, identified below.
* Middle-income oil exporters comprise Algeria, Angola, Cameroon, Congo, Ecuador, Egypt, Gabon, Indonesia, Islamic Republic of Iran, Iraq, Malaysia, Mexico, Nigeria, Peru, Syria, Trinidad and Tobago, Tunisia, and Venezuela.
* Middle-income oil importers comprise all other middle-income developing countries not classified as oil exporters. A subset, major exporters of manufactures, comprises Argentina, Brazil, Greece, Hong Kong, Israel, Republic of Korea, Philippines, Portugal, Singapore, South Africa, Thailand, and Yugoslavia.
* High-income oil exporters (not included in developing countries) comprise Bahrain, Brunei Darussalam, Kuwait, Libya, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

3. UN Classification

The Least Developed Countries are those identified as least developed on the basis of their very low per capita income, very low literacy rate and low contribution of manufacturing industries to GDP. There are 36 countries currently classified as Least Developed: Afghanistan, Bangladesh, Benin, Bhutan, Botswana, Burundi, Cape Verde, Central African Republic, Chad, Comoros, Democratic Yemen, Djibouti, Equatorial Guinea, Ethiopia, Gambia, Guinea, Guinea Bissau, Haiti, Lao People's Democratic Republic, Lesotho, Malawi, Maldives, Mali, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Sierra Leone, Somalia, Sudan, Togo, Uganda, Tanzania, Upper Volta, Yemen.

4. **OECD** comprises: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom and United States.

Appendices

Appendix 1.1: Debt Servicing Capacity of Some Developing Countries

Countries	Total External Debt ($bn.): Total: 'Best' estimate 1983 (1)	Medium and Long Term: 1982 (2)	Short Term 1983 (3)	Measures of Total Debt Servicing: Debt (medium & long) ÷ GNP (in per cent) 1973 (4)	1982 (4)	Basic Debt Service Ratio (in per cent) 1973 (5)	1982 (5)	All Interest ÷ Exports of Goods and Services (in per cent) 1983 (6)	Liquidity Measures: Reserves: months supply of imports mid-1983 (7)	Cash Flow Ratio (in per cent) (8)	Undis-bursed Bank Credit ($ million) (9)
Middle-income NICs											
Argentina	43.6	15.8	11.0 (8.7)	7.4	25.8	17.7	28.8	32.1	7.1	173.6	1,600 (6.2)
Brazil	93.0	47.6 (70.7)	16.8 (8.5)	9.1	16.9	13.4	39.1	42.6	3.2 (end-1982)	149.2	5,500 (9.1)
Colombia	11.8	6.2 (7.4)	2.84 (0.4)	19.3	15.9	13.1	26.7	20.2	8.1	100.7	940 (15.0)
Korea	40.1	20.1 (21.5)	12.6 (–)	26.8	30.4	15.1	14.5	13.0	1.3	70.6	3,200 (14.0)
Malaysia	12.4	7.67	1.33 (–)	9.7	31.0	2.6	8.2	6.4	3.3	17.7	1,900 (23.8)
Mexico	90.0	50.41	25.2 (21.2)	10.2	32.7	22.2	55.8	27.9	1.5	141.1	4,300 (6.5)
Philippines	24.6	8.84 (12.0)	7.55 (3.5)	7.8	22.5	8.6	17.7	27.6	2.5	131.3	1,900 (14.4)
Thailand	11.0	6.21 (8.5)	2.40 (–)	4.2	17.1	2.5	12.9	10.6	1.9	47.0	1,400 (29.2)

Appendix 1.1—*continued*

Countries	Total External Debt ($bn.): Total: 'Best' estimate 1983 (1)	Medium and Long Term: 1982 (2)	Short Term 1983 (3)	Measures of Total Debt Servicing: Debt (medium & long) ÷ GNP (in per cent) 1973 (4)	1982 (4)	Basic Debt Service Ratio (in per cent) 1973 (5)	1982 (5)	All Interest ÷ Exports of Goods and Services (in per cent) 1983 (6)	Liquidity Measures: Reserves: months supply of imports mid-1983 (7)	Cash Flow Ratio (in per cent) (8)	Undis-bursed Bank Credit ($ million) (9)
Middle-income Primary Product Exporters											
Chile	17.9	5.24 (14.0)	3.66 (2.3)	27.5	23.7	10.6	15.4	28.1	8.0	100.7	820 (7.5)
Costa Rica	4.1	2.47	0.52 (–)	16.8	100.2	10.3	34.3	20.7	2.9	91.2	65 (5.3)
Guyana	..	0.61	0.03 (–)	59.6	126.5	7.0	46.4[a]	12.7[b]	neg.	57.5[c]	17 (15.2)
Mauritius	..	0.37 (0.38)	0.02 (–)	8.6	35.0	1.3	15.0[a]	8.0[b]	0.5	19.2[c]	27 (15.8)
Jamaica	..	1.51	0.09 (–)	18.9	49.3	5.4	30.5[a]	9.1[b]	0.5	34.8[c]	50 (9.2)
Ivory Coast	7.0	4.54	0.07 (–)	25.1	63.4	7.2	45.6	13.0	neg.	77.8	350 (11.2)
Zambia	..	2.38	0.03 (–)	31.4	82.7	30.6	34.5[a]	12.9[b]	0.5	40.8[c]	35 (4.4)
Low-income Countries											
Bangladesh	..	4.35	0.05 (–)	6.3	38.3	2.4	16.5[a]	7.7[b]	2.0	21.3[c]	38 (34.3)
Ghana	..	1.12	0.17 (–)	23.5	3.6	3.5	8.3[a]	4.9[b]	0.9	26.6[c]	14 (3.9)
Malawi	..	0.69	0.06 (–)	45.2	48.0	7.7	38.6[a]	14.5[b]	1.3	61.5[c]	4 (2.0)
Kenya	..	2.4	0.13 (–)	18.7	30.9	4.8	21.8[a]	9.7[b]	2.3	30.0[c]	170 (23.5)
India	..	19.6 (19.8)	0.09 (–)	13.8	12.1	18.7	11.2[a]	5.3[b]	5.3	12.3[c]	2,300 (95.8)
Sierra Leone	..	0.3	0.05 (–)	19.0	24.6	8.7	21.3[a]	9.1[b]	0.3	59.0[c]	12 (10.6)
Sri Lanka	..	1.84	0.41 (–)	22.4	38.9	12.0	11.2[a]	8.8[b]	1.8	14.3[c]	209 (28.5)
Tanzania	..	1.63	0.06 (–)	24.9	30.4	7.0	13.1[a]	5.7[b]	neg.	19.3[c]	64 (20.3)
Uganda	..	0.59	0.02 (–)	9.6	6.8	8.5	58.8[a]	9.9[b]	neg.	68.7[c]	10 (22.1)

Appendix 1.1—*continued*

Countries	Total External Debt ($bn.)			Measures of Total Debt Servicing					Liquidity Measures		
	Total: 'Best' estimate	Medium and Long Term:	Short Term	Debt (medium & long) ÷ GNP (in per cent)		Basic Debt Service Ratio (in per cent)		All Interest ÷ Exports of Goods and Services (in per cent)	Reserves: months supply of imports	Cash Flow Ratio (in per cent)	Undisbursed Bank Credit ($ million)
	1983	1982	1983	1973	1982	1973	1982	1983	mid-1983		
	(1)	(2)	(3)	(4)		(5)		(6)	(7)	(8)	(9)
OPEC											
Algeria	15.4	13.6	0.64 (–)	32.6	32.5	12.2	28.8	9.5	2.8	34.2	2,570 (36.0)
Indonesia	28.8	18.4	3.24 (–)	33.5	22.1	6.3	17.4	9.7	2.2	77.8	3,180 (29.5)
Nigeria	12.0	6.1	2.77 (–)	7.0	8.5	4.0	18.3	9.4	2.1	41.5	2,840 (37.2)
Venezuela	34.0	12.1	14.2 (11.4)	9.4	17.8	5.8	25.3	18.3	7.3	107.1	1,290 (4.8)

Notes: (1) 'Best' estimate is the most comprehensive available; this is conspicuously in excess of World Bank (medium-term) plus BIS (short-term) estimates. Mostly, figures are 'market' estimates supplied by Amex.

(2) World Bank estimates relate to medium and long-term debt at end 1982 (inclusive of private debtors unguaranteed debt in brackets).

(3) Short-term estimates for 1983 from BIS. 'Excess' short-term debt is in brackets. 'Excess' is in excess of six months import requirements–a proxy for nominal trade credit.

(4) From World Bank, *World Debt Tables,* 1983–84.

(5) Basic debt service ratio is medium-term debt service over exports and services.
Derived from World Bank (1973) or Amex (1984) or in cases indexed 'a' was calculated indirectly from World Bank estimated 1983 debt service and 1982 export figures.

(6) From Amex or elsewhere, in cases indexed 'b', calculated as in (5) plus interest on short-term debt calculated at 10% of short-term debt.

(7) IMF figures for mid-1983 (there are considerable month-to-month variations, and import figures not always up to date).

(8) Debt service including short-term debt, interest and principal divided by exports of goods and services. These indexed 'c' calculated as in (5) and (6).

(9) Bank for International Settlements (mid-1984)–(Undisbursed bank credit as a per cent of bank claims in total is given in brackets).

Appendix 2.1: Recent Bank Debt Reschedulings, 1983 – April 1984

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms* *Maturity/ grace* period (in years)	*Interest (in per cent; spread over Libor/US prime)*	*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement* *In Place/*	*Conditional Upon Rescheduling*
Argentina	January 1983	Public and publicly-guaranteed, public sector, due in 1983 and short-term public	5,500	7/3	$2\frac{1}{8}$–2	1,500	1,100 from creditor banks and 500 from BIS	Yes	Yes
	March 1984						500 emergency package to clear interest arrears: 300 from Mexico, Brazil, Colombia and Venezuela, guaranteed by the US Government 100 from banks (at spread of $\frac{1}{8}$ over Libor) and 100 from Argentina's reserves		

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place/*	*Conditional Upon Rescheduling*
Bolivia	March 1983	Public sector	205	within Sept. 1983	$2\frac{1}{4}$	No	No	No	Yes
	May 1983 (informal agreement: extension of 1981 re-scheduling).		416	5/2	$2\frac{1}{4}$	No	No	No	Yes
	(Reschedul-ing of 1983, 1984, 1985 maturities)		225	7/3	$2\frac{1}{4}$	No	No		

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/ grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place/*	*Conditional Upon Rescheduling*
Brazil	February 1983	Public and publicly-guaranteed, public sector, private, due in 1983, and short-term public and private	4,800	$8/2\frac{1}{2}$	$2\frac{1}{8}-1\frac{7}{8}$	4,400	1,230 from US Treasury and 1,200 from BIS	Yes	Yes
	January 1984	Public and publicly-guaranteed, public sector, private, due in 1984, and short-term public and private	5,350	9/5	$2-1\frac{3}{4}$	6,500	No	Yes	Yes
Chile	July 1983 (agreement in principle)	Public and publicly-guaranteed, private, due in 1983 and 1984 and short-term public and private	3,400	7/4	$2\frac{1}{4}-2\frac{1}{8}$	1,300	350 from BIS and 180 from creditor banks	Yes	Yes
	February 1984			$9/5\frac{1}{2}$	$1\frac{3}{4}-1\frac{1}{2}$	780		Yes	Yes
Costa Rica	September 1983	Public and publicly-guaranteed, due in 1983/84, short-term public	615	8/4	$2\frac{1}{4}-2\frac{1}{8}$	225	No	Yes	Yes

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/ grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place/*	*Conditional Upon Rescheduling*
Cuba	January 1984	Public sector due between September 1982 and December 1983	128	$7\frac{1}{2}/3$	$2\frac{1}{4}$	No	No	–	–
Dominican Republic	September 1983	Public and publicly-guaranteed, private, due in 1983 and short-term public and private	568	5/1	$2\frac{1}{4}–2\frac{1}{8}$	No	No	Yes	Yes
Ecuador	October 1983	Public and publicly-guaranteed, private, public, due in 1983, and short-term public and private	1,970	7/1	$2\frac{1}{4}–2\frac{1}{8}$	431	No	Yes	Yes
	April 1984 (agreement in principle)	Public and publicly-guaranteed, private, public, due in 1984	600	8/4	$1\frac{3}{4}–1\frac{1}{2}$	350–400 (requested)	No		

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*: *Maturity/ grace period* (in years)	*Terms*: *Interest (in per cent; spread over Libor/US prime)*	*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*: *In Place/*	*IMF arrangement*: *Conditional Upon Rescheduling*
Guyana	July 1983 (deferment agreement)	Public and publicly-guaranteed, deferred in June 1982 (covering 1982 and 1983 maturities) and amounts due until January 1984	38.5	Until January 1984	$2\frac{1}{2}$	No	No	No	Yes
Honduras	In process (requested by auth-orities in January 1982)	Public and publicly-guaranteed and public due between 1981 and 1984	120	6/between 3 to 15 months	$2\frac{1}{4}$	40.0 trade facility	No	Yes	Yes
Ivory Coast	In process (requested by auth-orities in December 1983)	Public sector, due between December 1983 and December 1984	900				No	Yes	Yes
Jamaica	June 1983 (agreement in principle)	Public sector, due between July 1983 and March 1985	166	5/2	$2\frac{1}{2}$–$2\frac{3}{8}$	18.0 under negotiation	No	Yes	Yes

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*: *Maturity/grace* period (in years)	*Terms*: *Interest (in per cent; spread over Libor/US prime)*	*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*: *In Place/*	*IMF arrangement*: *Conditional Upon Rescheduling*
Liberia	In process	Public and publicly-guaranteed, due between July 1983 and June 1984	14	6/3	–	No	No	Yes	Yes
Madagascar	September 1983 tentative[a] agreement	Public and publicly-guaranteed and short-term public – restructuring of total stock of outstanding debt	195.3	8/2	2	12.0 revolving trade facility equivalent to principal repayment due in 1983 or a one year grace period on that amount	No	Yes	Yes
Malawi	March 1983	Public sector, due from September 1982 to August 1984	57.0	$6\frac{1}{2}/3$	$1\frac{7}{8}$	No	No	Yes	Yes
Mexico	August 1983	Public and publicly-[b] guaranteed and public sector, due from August 1982 to December 1984	20,000	8/4	$1\frac{7}{8}$–$1\frac{3}{4}$	5,000 (for 6 years/3 years' grace and spreads of $2\frac{1}{4}$–$2\frac{1}{8}$)	2,000 from US Treasury and 1,850 from BIS	Yes	Yes

a. The agreement is subject to Madagascar being current on interest payments.
b. Mexico's private sector debt was renegotiated under separate schemes.

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place/*	*Conditional Upon Rescheduling*
Mexico cont'd	January 1984					3,800 (for 10 years/$5\frac{1}{2}$ years' grace and spreads of $1\frac{1}{2}$–1)		Yes	–
Morocco	April 1984 (agreement in principle)	Public and publicly-guaranteed and public sector, due from September 1983 to December 1984	500	7/4	$1\frac{3}{4}$	No	No	Yes	Yes
Nicaragua	In process (requested by authorities in June 1983)	Public sector and short-term public due between June 1983 and June 1984	–	–	–	150	No	No	No

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage* (*Medium- and Long-term and short-term debt*)	*Amounts restructured* (US $million)	*Terms*: *Maturity/ grace* period (in years)	*Terms*: *Interest* (*in per cent; spread over Libor/US prime*)	*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*: *In Place/*	*IMF arrangement*: *Conditional Upon Rescheduling*
Nigeria	July and September 1983	100 per cent of arrears on letters of credit owed by private sector, due July 31, 1983	1,350	3/5$\frac{1}{2}$ months	1$\frac{1}{2}$–1$\frac{3}{8}$	1,000 revolving trade facility	–	No	No*
			480	3/3$\frac{1}{2}$ months	1$\frac{1}{2}$–1$\frac{3}{8}$				
	April 1984	Uninsured trade arrears	3,000	6 year promissory notes/2$\frac{1}{2}$ years grace	1	–	–	negotiations in process	
Panama	October 1983	Public and publicly-guaranteed, due between July 1983 and December 1984	180	6/3	2$\frac{1}{4}$–2$\frac{1}{8}$	98	No	Yes	Yes
Peru	July 1983	Public and publicly-guaranteed, due between March 7, 1983 and March 7, 1984	380	8/3	2$\frac{1}{4}$–2$\frac{1}{8}$	450	200 from banks – part of the new money facility of 450	Yes	Yes
	February 1984 (agreement in principle)	Public and publicly-guaranteed, due in 1984 and first half of 1985, and short-term	600	9/5	1$\frac{3}{4}$–1$\frac{1}{2}$	780 requested	–	Yes	Yes
			950	,,	,,				

* A good faith effort to reach a stand-by arrangement with the Fund was required by the banks.

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/ grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place/*	*Conditional Upon Rescheduling*
Philippines	In process (requested by authorities in October, 1983)	Medium- and short-term, due from October 14, 1983 to December 31, 1985	–	–	–	1,650	500 from US Treasury	No	Yes
Poland	November 1983	Public sector, due during 1983	2,600	10/5	$1\frac{7}{8}$	65 per cent of $1.1 billion interest due relent as three-year trade credits	No	–	–
	April 1984 (agreement in principle)	Public sector, due from 1984 to 1987	1,600	10/5	$1\frac{3}{4}$	700: 350 as six-year revolving trade credits and remainder as five-year renewal of 1982 trade credits which expire in 1985	No	–	–
Romania	June 1983	Public sector, due in 1983	572	$6\frac{1}{2}/3\frac{1}{2}$	$1\frac{3}{4}$	No	No	Yes	Yes

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/ grace period (in years)	*Interest (in per cent; spread over Libor/US prime)*			*In Place*	*Conditional Upon*
Senegal	March 1984	Public and publicly-guaranteed, due from May 1981 to June 1984	97	6/3	2	No	No	Yes	Yes
Sudan	April 1983 (modification of 1981 agreement)	Public and publicly-guaranteed, short-term private – arrears as of April 1983	646	6/2	$1\frac{3}{4}$	No	No	Yes	Yes
Togo	October 1983	Public and publicly-guaranteed, due in 1983 and 1984 and arrears as of end-1982	83.5	$7\frac{1}{4}$	2	No	No	Yes	Yes
Uruguay	July 1983	Public sector, due in 1983 and 1984 and short-term private	693	6/2	$2\frac{1}{4}$–$2\frac{1}{8}$	240	No	Yes	Yes

Appendix 2.1—*continued*

Country	*Date of Agreement*	*Coverage (Medium- and Long-term and short-term debt)*	*Amounts restructured* (US $million)	*Terms*		*New Medium-term loan* (US $million)	*Bridge loan* (US $million)	*IMF arrangement*	
				Maturity/ grace period (in years)	*Interest* (*in per cent; spread over Libor/US prime*)			*In Place*	*Conditional Upon*
Yugoslavia	September 1983	Public and publicly-guaranteed, private and public sector, due in 1983, short-term private and public	1,020	6/3	$1\frac{7}{8}$–$1\frac{3}{4}$	600	1 300 from Western governments and 500 million from BIS	Yes	Yes
	March 1984 (agreement in principle)	Medium- and long-term, due in 1984	1,400	7/4	$1\frac{5}{8}$–$1\frac{1}{2}$	No	No	Yes	Yes
Zambia	August 1983 (agreement in principle)	Public and publicly-guaranteed, due between March 1983 and February 1985	75	7/3	$2\frac{1}{4}$–2	No	No	Yes	Yes

Source: Derived from IMF, *Recent Multilateral Debt Restructuring with Official and Bank Creditors*, Occasional Paper 25, December 1983.

Appendix 2.2: Reform Proposals for the International Banking Crisis

(1) Restructuring of Debt Overhang

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Kenen (Princeton University) *New York Times* March 6, 1983	1. Modest debt relief for some borrowers as agency would purchase debt from banks at discount which would enable it as new creditor to grant some reduction in interest rate payable. 2. Agency would renegotiate debt to longer maturities. 3. Participating banks reduce risk but accept losses.	1. Agency (IDDC) buys ldc debts at discount (10%) in exchange for long-term bonds. 2. Uniform discount applied to a uniform proportion of eligible loans. 3. IDDC lends to ldc at lower interest and over longer-term (10/20 years) with modest debt relief. 4. Limited period within which banks would have to decide whether or not to discount their assets with IDDC.	Banks carry losses for reduced risk.	1. Creation of International Debt Discount Corporation (IDDC) by OECD governments. 2. IMF programme defines eligible debtor countries.	Restricted in bank and debtor coverage. Estimated $30 to $40 billion. Subscription for guarantees (but no cash outlay).
Rohatyn (Lazard Frères) Testimony before Committee on Foreign Relations, US Senate, January 17, 1983 *Business Week* February 28, 1983	1. Debt stretched out to long-term maturities and interest reduced. 2. Substantial debt relief for borrowers as debt service cut to 25%–30% of exports. 3. Major risk transfer from banks who share losses. 4. Allows for secondary market to attract non-bank contributions.	1. Agency (MAC) buys bank loans in exchange for low-interest bearing long-term bonds. 2. Agency (MAC) lends to ldcs at 6% interest over 15/30 years (ldcs save interest of $15 to $20 billion p.a. 3. Comprehensive and most radical of all schemes for ldc debts.	Large losses subject to negotiation between debtor countries, tax payers and bank stockholders, while still leaving assets frozen until a reasonable secondary market is established.	1. Creation of global Municipal Assistance Corporation (MAC). – Subsidiary of World Bank or IMF or new agency 2. IMF to oversee rescheduled loans.	Estimated $300 billion in guarantees. Across-the-board mandatory buy out.

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Bailey (US National Security Council) et al. *Business Week* January 10, 1983 and Georgetown University Centre for Strategic Studies – paper 1983	1. Repayments linked to capacity to pay. 2. No risk transfer 3. No debt relief	1. Debtor Central Banks issue new asset – EPNs to replace principal obligations on bank debt. 2. Principal repayment based on agreed percentage of foreign exchange earnings. 3. Interest continues as before but priority to EPN notes.	None – or not explicit. Banks could make losses from sale of Exchange Participation Notes (EPNs) in secondary market.	No new institution. Debtor Central Banks issue notes.	Suggested limitations in terms of degree of country insolvency and type of loans (suggested $50–60 billion). Scale depends on market response to EPNs.
Weinert (*Foreign Policy* 1983 Spring)	Features of Rohatyn and Kenen – debt relief – stretch out restructured debt – banks reduce risk and accept losses – developing countries acquire new form of liability	1. World Bank swaps bonds for bank loans at a rate below market rates and set as a function of countries' ability to pay. 2. In theory, voluntary bank participation: to relieve threatened banks of all ldc exposure. 3. Agency would restructure debt for borrowers.	A minimum rate would be set to satisfy banks' income needs (at the level needed to "stay sound"), the World Bank making up any difference between this rate and ldcs' payment capacity.	World Bank.	Probably large scale of voluntary operation would be such as to drastically affect market value of loans of non-participating banks or creditworthiness of non-participating countries.
Lindbeck Chatham House Lecture (*Financial Times*, 1984)	1. Restructure debt into long-term claims via bond issues. 2. Risk transfer without debt relief. 3. Mechanism for new flows.	1. Old debt transformed into long-term bonds or consols which are marketable. 2. Voluntary for banks; Central Banks in creditor countries offer to buy part of bond issue. 3. Debtors issue 'priority bonds' for new money with precedence over old bonds.	Bank losses from market sale of claims (cushioned by Central Bank intervention).	IMF approves 'priority bonds'	Appears to depend on voluntary action at national (creditor) level.

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Congressman Schumer *Journal of Commerce* 13 April 1983 *New York Times* 10 March 1983.	1. Radical restructuring or loan concession by banks without new financial intermediary 2. Repayments set at manageable fraction of export earnings.	1. Banks remain creditors and restructure loans into long-term low-interest loans via bilateral negotiations with debtors. 2. IMF supervises restructuring arrangements. 3. Increased loan-loss reserve requirements for debts not paid on time. 4. Insurance fund with surcharges for renegotiated debt. 5. Country ceilings for short-term loans.	Losses appear to be borne by banks alone who also retain ldc debt commitments.	Crucial role of IMF to supervise and approve country restructuring (US veto to be used wherever necessary).	Unspecified: scheme has little to offer banks and would only be used by them under duress.
Gutentag and Herring (Pennsylvania University) Testimony before US Congress, House Committee on Banking, Finance and Urban Affairs, April 26, 1983 (Refs. in Cline monograph, *International Debt and the Stability of the World Economy*)	1. Banks forced to mark down foreign loans or opportunity to sell. 2. Risk transfer from banks. 3. Countries in difficulty convert debt to consols.	1. Agency (IMF, World Bank or new body), buys loans from banks at 'market' rate 2. Agency combines and re-issues loans. 3. Consols for countries with serious repayment problems – but commercial interest payable and any arrears automatically result in mark-down.	Losses appear to be borne by banks (but risk transfer)	New agency or existing bodies.	Probably large – since compulsory mark-down.
Morgan Grenfell	1. Rediscounting facility. Aim to assist banks by providing liquidity to permit new lending. 2. Shift risk from banks	1. Banks sell loans to new agency at face value, receive non-interest bearing bonds in return. 2. Bonds can be held or sold in a secondary market	Banks absorb losses to clear balance sheets.	New agency (perhaps IMF-backed)	Not specified. Depends on national governments of creditor countries.

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Leslie (Barclays) *The Banker*, April 1983	1. Aim to ensure bank assets are freed to support OECD exports (an incentive for OECD governments to back the idea). 2. Aim to ensure ldcs do pay but banks are not let off the hook.	1. Banks sell loans to Central Banks at a discount. 2. Central Banks buy loans on condition of new loans to worthy ldc borrowers of export credit, guaranteed by national export credit agency.	Banks absorb losses to clear balance sheets.	Central Banks	Not specified. Depends on national governments of creditor countries.
		(2) **Incentives for New Commercial Lending**			
Lever (former Financial Secretary, UK Government) (*The Economist* July 1983)	1. First of proposals has central banks discounting banks' ldc assets on condition that banks increase loan-loss reserves. Aim to give banks time to provide for loans 'without calling their liquidity or solvency into question.' 2. Second scheme aims to insure new lending to ensure additional net flows to meet ldc current account deficits and maintain world trade.	1. Export credit agencies insure new commercial bank lending. 2. Central international agency advises country limits for credit to cover trade deficits and interest payments. 3. Rescheduling of loan principal – part of agreed IMF package.	Contingent liability for public sector. Some risk borne by banks.	IMF advises country credit limits. National agencies operate with IMF/World Bank support.	Estimated $40 to 60 billion of *additional* lending. (declining over time)
Bolin and Canto (Bank of America) (formerly IMF) *Foreign Affairs* Summer, 1983.	Like Lever's second proposal.	1. New Agency makes (and/or guarantees) new loans of 8 to 15 years maturities to support industrial countries' capital goods exports. 2. Agency raises funds by placing 8 to 14 year floating rate notes with investors in European markets.	Contingent liability for public sector. Some risk borne by banks.	New multilateral body – Export Development Fund allied to World Bank and backed by national export credit agencies.	Not specified.

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Zombanakis (Financier) *The Economist* April 30, 1983.	Like Lever's second proposal.	1. 13-year IMF country loan agreements. 2. After 10 years, countries which despite adhering to agreements could not pay the banks have new loans guaranteed by IMF under special Loan Guarantee Fund.	IMF makes longer loans and carries guarantees.	IMF	Not specified.
Witteveen (former Managing Director of IMF) (1983 Per Jacobsson lecture)	1. Like Lever's second proposal. 2. A specific area (political risk) tackled where banks have limited expertise and/or inability to negotiate in times of difficulty.	1. International Credit Guarantee Fund – an IMF backed political risk insurance facility for bank loans. 2. Premiums and percentage insured fixed according to need of borrower. 3. Parallel extension of supervisory requirements to prevent overlending in the future. (i) re-solvency; applied to sovereign loans (ii) re-liabilities; reserve requirements for Eurodollar deposits.	Premium paid by lender. At least 25% of risk borne by banks. Shareholders in Fund include Central Banks, governments and private banks.	IMF contains Fund; also fixes country lending limits subject to performance.	Depending on demand, IMF resources could expand in parallel (via government guarantees).
World Financial Markets (June 1983)	Aim to encourage banks to supply additional financing.	*Either* Insurance pool for loans to ldcs, backed by IMF. *or* Link between World Bank lending and bank lending. Guarantee lies in agreement that World Bank disbursements cease if other loan service ceases.	Ldcs pay insurance premium but get lower spread because of IMF guarantee. Ldc runs danger of compounding liquidity problems if falls behind with service.	IMF guarantee for loans based on Fund assets. World Bank implicit guarantee.	Not specified. Modest since linked to scale of World Bank lending (i.e. in effect an extension of co-financing).

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Mahbub ul Haq (Planning and Development Minister of Pakistan)	1. Aim to make immediate servicing of debt manageable. 2. Aim to create liquidity in banking system for new loans. 3. Aim for efficient domestic economic management in debtor country. 4. Aim to reverse declining net resource transfers.	IMF Debt Refinancing Subsidiary to provide resources for: (1) extending maturities (2) reducing interest payments to declining ceiling of export earnings (3) guarantees for new loans	Losses distributed among banks and debtors New resources from SDR issue	Establishment of IMF Debt Refinancing Subsidiary for middle income countries.	Not specified.
Deposit Insurance proposals (e.g. Grubel, *Princeton Essays on International Finance).*	1. Aim to prevent lack of confidence in banking system. 2. Aim to create liquidity for loan expansion.	1. International Deposit Insurance Corporation insures deposits not currently covered under existing national arrangements. 2. Not specifically geared to ldc lending.	Insurance partial (80 to 90%) Premiums vary by risk class	Major effort of international coordination required.	All countries (otherwise banks miss premium in uncovered territory).

Appendix 2.2—*continued*

Schemes	Main Objectives	Key Elements	Distribution of Losses	Institutional Vehicle	Scale of Operation
Soros (New York Fund manager)	Aim to evolve from debt crisis management to better lending system and smooth out interest rate fluctuations.	1. Existing debt converted into 25-year bonds paying fixed rate of interest, say 11%, and portion of margin's proceeds (e.g. 1%) placed into premium account; borrowers would contribute extra 1½% of margin into escrow account. The combined 3% return would form insurance fund – International Lending Agency (ILA) 2. ILA to act as straightforward lending agency at long-term rates and maturities with smoothed out interest rate arrangement (via an Interest Equalisation Account).	Losses distributed among banks and debtors	ILA with capital contributed by present bank lenders and by debtors (in an escrow account). Initial obligations of ILA to carry international guarantee and IMF to make contingent allocation of SDRs.	Not specified.
Wallich (Governor, Federal Reserve Board) *Insurance of Bank Lending*, Group of Thirty, 1984.	Aim to provide confidence in banking system and thereby encourage continued lending, although on more moderate scale	1. Insurance of banks' portfolio of assets (rather than of specific loans, and distinct from present insurance systems which support banks' deposits and/or provide liquidity support via lender of last resort function.) 2. Given historical rate of banking losses of well under 1%, insurance scheme to be only of modest size, i.e. 2% of banks' portfolio.	1. Contribution from banks 2. Contribution from borrowers via additional charges either as surcharge on loan or some fraction of spread 3. Contribution from governments (existing official agencies with insurance or guarantee powers) and private sources (insurance companies) *not* as permanent net contribution but as temporary facility to be repaid over time.	Coordination among banks, IMF, World Bank and existing insurance organizations.	Assuming $20 billion in new bank lending over next five years and 1% premium p.a., a total insurance pool of $3 billion over five years to meet defaults of principal or interest.

Appendix 3.1: Official Multilateral Debt Reschedulings, 1981–February 1984

(1) *Date*	(2) *Country*	(3) *Amount $m*	(4) *Consolidation Period* (months & years inclusive)	(5) *Maturity (grace period) years*	(6) *Debt covered*
January 81	Pakistan	250	1.81–7.82	25–30	ODA Debt only
February 81	Togo	232	1981–1982	9(5)	
April 81	Madagascar	140	1.81–6.82	9	
June 81	Cent.Af.Rep.	72	1981	9(5)	
July 81	Zaire	500	1981–1982	10	
October 81	Senegal	75	7.81–6.82	9(5)	
November 81	Uganda	30	7.81–6.82	8–10	
December 81	Liberia	30	1.82–6.83	9(5)	
	Poland	2,200			
March 82	Sudan	400	7.81–12.82	10	
July 82	Madagascar	107	7.81–6.82	9	
July 82	Romania	234	1982	6½(3)	80% of interest and principal, 1981 arrears and maturities.

Appendix 3.1—*continued*

(1) *Date*	(2) *Country*	(3) *Amount $m*	(4) *Consolidation Period* (months & years) inclusive)	(5) *Maturity (grace period) years*	(6) *Debt covered*
September 82	Malawi	25	7.82–6.83	8	
November 82	Senegal	74	7.82–6.83	9	
December 82	Uganda	19	7.82–6.83	10	
January 83	Costa Rica	200			
February 83	Sudan	550	1983	16(6)	100% of principal and arrears, including debt rescheduled in 1979.
April 83	Togo	300			
May 83	Zambia	375		10(5)	
May 83	Romania	195	1983		
June 83	Mexico	2,000	1983	6(3)*	Private sector maturities only, including short-term.
July 83	Cent.Af.Rep.	13			
July 83	Peru	400	5.83–4.84	8(3)	90% of principal and interest due, excluding previously rescheduled debt.

Appendix 3.1—*continued*

(1) *Date*	(2) *Country*	(3) *Amount $m*	(4) *Consolidation Period* (months & years) inclusive)	(5) *Maturity (grace period) years*	(6) *Debt covered*
July 83	Ecuador	200			
October 83	Malawi	30			
November 83	Morocco	600		8	
November 83	Niger	70	1984		
December 83	Senegal	75	7.83–6.84		
December 83	Zaire	1,600	1983–1984	11(5)	75% of principal due
	Brazil	3,800			
	Cuba	413	9.82–12.84	8($2\frac{3}{4}$)	1984 consolidation subject to conditions. 95% includes debt rescheduled in 1977 and 1980.
February 84	Sierra Leone	50			
	Peru	560	5.84–2.85	8(3)	

* 4 years for short-term debt.

Appendix 5.1: Summary of Assumptions and the Main Results of the William Cline, Morgan Guaranty, the Inter and Data

		Assumptions in Regard to:					
Institution/ Person	Projections period covered	Real Growth Rate of GDP in industrial countries	Rates of Interest	Oil Price	Terms of Trade of Non-oil Developing Countries	Rate of Inflation in industrial countries	Protectionism in industrial countries
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. IMF	Up to 1990	3.6% in 1984; 3¼% on average during 1985–90	Nominal rates to decline to 7% by 1988–90 from 10% in 1984	To remain constant in nominal terms until end of 1985 and then to remain constant in real terms until 1990	To remain constant in 1985–90 after slight improvement in 1983 and 1984	To decline to 4% in 1986–90	Will remain at the same levels until 1990
2. World Bank	Up to 1995	High Case: 4.3% Low Case: 2.5%	High Case 6.0% Low Case: 9.5%			High Case: 3.5% per year Low Case: 6% per year	No new protectionist measures
3. Cline	Up to 1986	1.5% in 1983 3.0% in 1984–86		$29 until 1985; rises to $34 in 1986	A 3% improvement for each one percentage point *change* in industrial country growth		

Projections on the Debt Situation by the IMF, the World Bank, American Development Bank Resources Inc.*

Assumptions in Regard to:				Main Results			
	Financial Flows to Developing Countries						
Growth of GDP for developing countries covered	ODA	Private Investment	Bank credit	Countries covered	Debt Ratio	Debt Service Ratio	Interest Payments Ratio
(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
4.6% in 1986–90 for all non oil developing countries; low income group to grow more slowly	Constant in real terms at 1984 levels (implies a fall as a ratio of industrial country GDP)	To rise faster than bank exposure (assumed to rise at 9½%)	Exposure to remain constant in real terms between 1985 and 1990	(a) All Non-oil developing countries	*1983:* 149.5 *1987:* 132.2 *1990:* 123.8	*1983:* 21.6 *1987:* 24.4 *1990:* 21.3	*1983:* 13.2 *1987:* 10.6 *1990:* 8.9
				(b) Low-income countries	*1983:* 308.7 *1987:* 298.2 *1990:* *307.7*	*1983:* 22.4 *1987:* 24.2 *1990:* *22.2*	*1983:* 13.1 *1987:* 14.2 *1990:* *12.3*
				(c) Major 25 borrowers	*1983:* 194.4 *1987:* 165.1 *1990:* 150.4	*1983:* 29.9 *1987:* 34.1 *1990:* 30.1	*1983:* 18.6 *1987:* 14.9 *1990:* 12.4
High Case: 3.5% a year Low Case 4.7% a year	Loan disbursements and official transfers to increase by 33% under the High Case and fall by 7% under the Low Case between 1983 and 1995			(a) All developing countries	*1983:* 121.4 *1995:* 80.3 (High Case) 71.3 (Low case)	*1983:* 20.5 *1995:* 12.7 (High Case) 13.7 (Low case)	N.A. N.A.
				(b) Low-income Africa	*1983:* 242.0 *1995:* 234.7 (High case) 224.1 (Low case)	*1983:* 24.8 *1995:* 19.1 (High case) 20.6 (Low case)	N.A. N.A.
2½% in 1983 3½% in 1984 4½% in 1985 and 1986				(a) 12 Oil importers	*1982:* 1.94 *1986:* 1.28	*1982:* 0.39 *1986:* 0.26	N.A. N.A.
				(b) Seven oil-exporting countries	*1982:* 1.77 *1982:* 2.36	*1982:* 0.34 *1982:* 0.41	N.A. N.A.

Appendix 5.1—*continued*

Institution/ Person	Projections period covered	Real Growth Rate of GDP in industrial countries	Rates of Interest	Oil Price	Terms of Trade of Non-oil Developing Countries	Rate of Inflation in industrial countries	Protectionism in industrial countries
		Assumptions in Regard to:					
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
4. Morgan Guaranty	Up to 1990	2.0% in 1983 3.5% in 1984–85 3.0% in 1986–90		$28 in 1983 $29 in 1984 $32 in 1985 Stays constant in real terms 1986–90	Terms of trade to deteriorate in 1983 and then improve between 1984 and 1990 between 1 and 2% per year		
5. Inter-American Development Bank	Up to 1990	US: 5% in 1984 3.1% in 1985 2.7% in 1986–90 Europe: 1% in 1984 1.4% in 1985 2.1% in 1986–90 Japan: 4.0% in 1984 3.5% in 1985 3.4% in 1986–90	Not known	Nominal prices to rise at 9% per year to reach 1981 level in real terms by 1990	Not Known	7% per year	Not Known
6. Data Resources Inc.	Up to 1987	US: 4.8% in 1984 3.8% in 1985 3.5% in 1986–87 Four major European countries: 3.0% in 1984–85 2.1% in 1986–87	Euro-dollar rates To rise from 10.2% in 1983 to 11.2% by 1986 and then fall to 10.6% in 1987; Long term rates to fall from 10.2% in 1983 to 9.1% in 1987	To stay below $31 per barrel up to 1985 and then increase by $4 per barrel per year thereafter	N.A.	N.A.	N.A.

Note: * The projections summarised here correspond to the 'base case' scenarios—i.e. scenarios which are considered to be plausible or central vis-a-vis other alternative projections by the respective authors.

Sources: (1) IMF, *World Economic Outlook,* April 1984.
(2) World Bank, *World Development Report,* 1984.
(3) W.R. Cline, *International Debt and Stability of the World Economy,* September 1983.

Appendix 5.1—*continued*

Assumptions in Regard to:					Main Results		
	Financial Flows to Developing Countries						
Growth of GDP for developing countries covered	ODA	Private Invest-ment	Bank credit	Countries covered	Debt Ratio	Debt Service Ratio	Interest Payments Ratio
(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Not Known				21 Major borrowers	*1982:* 178 *1985:* 166 *1990:* 123	*N.A.*	*N.A.*
Scenario A: per capita consumption to remain constant at 1983 levels during 1985–90 Scenario B: Total unemployment not to rise. GDP growth: Scenario A: 2.7% Scenario B: 5.4%	Nominal transfers to increase at the rate of 10–11% per year between 1983 and 1990 (implies a rise in real terms)	To rise at 4–5% per year in nominal terms between 1983 and 1990 (implies a decline in real terms)	N.A.	Seven Latin American countries	*1983:* 332.7 *1987:* 243.9 *1990:* 184.8 *1987:* 274.9 *1990:* 269.0	*1983:* 68.2 *Scenario A:* *1987:* 53.4 *1990:* 39.1 *Scenario B:* *1987:* 57.1 *1990:* 51.5	*1983:* 39.3 *1987:* 27.2 *1990:* 21.2 *1987:* 29.2 *1990:* 27.8
5.6	N.A.	N.A.	N.A.	Seven Latin American countries	*1982:* 290.0 *1987:* 252.3	N.A. N.A.	N.A. N.A.

(4) Morgan Guaranty Trust Company of New York, "Global Debt: Assessment and Long Term Strategy", *World Financial Markets,* June 1983.

(5) Inter-American Development Bank, *External Debt and Economic Development in Latin America,* January 1984.

(6) Data Resources Inc., quoted in Thomas O. Enders and Richard P. Mattione, Latin America: *The Crisis of Debt and Growth,* (Washington DC; Brookings Institution, 1984).

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