LDC EXTERNAL DEBT AND THE WORLD ECONOMY

MIGUEL S. WIONCZEK
(EDITOR)

El Colegio de México and
Centro de Estudios Económicos
y Sociales del Tercer Mundo

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Table of Contents

Preface

This volume contains the proceedings of a private international meeting of some 30 experts and practitioners in the field of North-South financial relations, organized at the end of October 1977 in Mexico City under the auspices of El Colegio de Mexico and the Center for Economic and Social Studies of the Third World. The purpose of the meeting was to discuss indebtedness of the LDCs which has recently given rise to increasing concern at the international level and in the creditor and the debtor countries as well.

The experts who participated in the Mexico City meeting in their exclusively private capacity represented a broad spectrum of personal, professional and institutional experiences, gathered respectively in international lending agencies, financial and monetary authorities of both creditor and borrower countries, international private banks and the academic institutions of the developed and the developing countries. The group included nationals of Latin America, the U.S., Canada, Western Europe, Japan, Africa and the OPEC countries.

As the final report reproduced at the end of this volume indicates, a consensus was reached at the meeting to the effect that the LDC debt problem should be viewed and treated in the more general framework of international economic relations and, specifically in the context of North-South economic relations and should *not* be separated from the wider range of issues including trade policies, flows of official development assistance and the uncertainty of the world economic recovery.

The reasons for such a broader approach were identified as follows:

a) the growing interdependence of the different national and regional segments of the world economy;
b) the objective need to expand the net flow of financial and real resources for the development of LDCs;
c) serious and growing political obstacles in the DCs against the expansion —in real terms— of the flows of official development assistance;
d) the presence on the international financial scene of new actors (oil surplus countries and international private financial intermediaries), whose future behavior as providers of loanable funds for the LDCs can only be predicated with difficulty under conditions of general economic uncertainty;
e) the gestation in the international economy of structural problems —not yet fully identified and understood— that seem to lead to more persistent balance-of-payments imbalances than previously posited by both the creditor and the debtor countries; and
f) interrelatedly, the concern about the short and medium prospects for the world economy which appear to be less encouraging than only a few months ago.

The position prevailed that while the aggregated LDC debt increased in the past 10 years at very high rates, the aggregate size of the debt —in nominal terms— was of very limited use as the yardstick for policy-oriented solutions. The key issue was the structure of the debt and the amount and the structure of the debt burden, reflecting the recent hardening of conditions and shortening of terms of LDC commercial borrowing which accounts at present for about one half of the total debt outstanding of some 80 LDCs.

The viewpoints presented at the meeting coincided on a number of important points, including:

a) the LDC external indebtedness problem must be treated within a larger framework recognising global interdependence and covering the balance-of-payments adjustment process, LDC development needs, official development assistance, DCs' problems of "stagflation" frustrating their attempts to stimulate domestic economies, international trade and world economic recovery;
b) the solution of the indebtedness problem was the joint responsibility of the LDC borrowers and the lenders;
c) the LDC external indebtedness problem represented only one face of the general problem of ensuring the LDC "acceptable" growth rates;

d) the problem of the indebtedness and the declining net financial flows to the LDCs has been treated until now in a piecemeal and haphazard *ex-post* way;
e) the LDC borrowing of 1974-76 could not be repeated not because of the aggregate size but because of the structure of the debt;
f) linking the problems of short-term stabilization and adjustment with those of long-term economic growth and development financing would make it possible to combine the generalized and the case-by-case approach;
g) the combination of the generalized and the case-by-case approach would have to take into consideration the different situations of the poor and the middle-income LDCs;
h) the balance-of-payments adjustment facilities available to the LDCs needed to be strengthened and expanded because the exclusive emphasis on short-term finance for adjustment purposes was not enough;
i) in addition to expanded adjustment facilities the poor LDCs needed the continuous increase of long-term official concessionary assistance.
j) only under the assumption of the speedy recovery of the world economy, the problem of the middle-income LDC debt might be taken care of by increased official lending at non-concessionary terms and by international private capital markets;
k) the solution of the middle-income LDC debt would be greatly helped if new mechanisms were devised that would allow for a greater re-cycling of OPEC surpluses into capital formation;
l) even if adjustment facilities were strengthened and development financing were increased, the trade policies of the developed countries particularly in respect to non-traditional (manufactured) LDC exports, would have to be liberalized; and
m) the satisfactory solution of the problem of LDC indebtedness and development financing depends greatly upon the pace of world economic recovery.

Participants identified the asymmetries and the discontinuities characterizing the situation and making the search for solutions particularly difficult: the asymmetry in the adjustment process for the deficit and the surplus countries that was putting the major burden of adjustment on the deficit and borrower LDCs; the asymmetry of the lending process where short to medium-term liabilities were being transformed into long-term assets; the asymmetry in the distribution of financial assistance flows that was serving clearly the middle-income LDCs, and, finally, the discontinuities in the terms of lending, i.e., the absence of medium-term resources. It was thought that any durable solution of the indebtedness problem would have to include policy measures aimed at the elimination (or alleviation) of these important asymmetries and discontinuities.

The following specific subjects were discussed at length:

a) the uncertain future of private commercial credits to LDCs;
b) the OPEC contribution to the flow of financial resources to LDCs;
c) the question of the lender of last resort;
d) domestic debt management in LDCs;
e) debt renegotiation experiences, and
f) the future of the LDC indebtedness in the light of the revival of protectionism.

A number of policy-oriented proposals were directed respectively to international financial agencies, the developed lender countries, the oil surplus countries, the international banking community and the LDC borrowers. Attempts were made by participants to integrate these proposals into a broad policy package that would reflect the major lines of their agreement on the nature of the LDC indebtedness problem. It was thought that in view of the general and deepening concern about the uncertain prospects for the world economic recovery in the near future, the forthcoming meeting of the UNCTAD Trade and Development Board at ministerial level might be a proper international forum, to discuss such a policy package.

It was agreed that the situation of the world economy called at least for contingency planning with respect to the LDC indebtedness. As a participant representing perhaps one of the most optimistic views on the future of that issue put it, "should there be a prolonged period of relative stagnation in the OECD economies, LDC export earnings would probably fall below the levels needed to maintain both tolerable growth rates and normal servicing of their external debt. It would be wise therefore for the international community to develop a consensus on policies and to put into place the institutional basis for such an eventuality".

Within the context of the agreement on the need for both the policy package and contingency planning, international multilateral agencies were advised to take measures that would help to increase the flow of official development assistance, with the highest priority being given to concessionary development assistance to the poor LDCs. It was considered that no alternative existed to an increasing role of multilateral official institutions in the provision of medium to long-term development finance.

For the purpose of adjustment it was recommended that international agencies strengthen the existing compensatory and supplementary financing facilities and assure unconditional access to them for those LDCs whose balance-of-payments difficulties are due to reasons beyond their control. These agencies should keep in mind at the same time that the lack of flexibility in the LDC adjustment process may have a very negative impact upon the world economic recovery.

For the purpose of establishing a link between short-term adjustment and stabilization and longer-term development finance it was recommended that medium-term balance-of-payment support facilities be established for LDCs similar to the General Agreement to Borrow scheme already available to the advanced countries.

It was also thought that given political difficulties about expanding the flows of official development assistance to LDCs in the short run, international financial agencies should consider establishing mechanisms that would assure the continuation of private lending to the LDCs in spite of increasing lending risks. Such mechanisms might include risk insurance and in the case of private lending to the poor LDCs perhaps some sort of subsidy for the spread in interest rates.

Many participants strongly felt that if no rapid recovery of the industrial economies takes place debt reorganization and relief may become unavoidable. There was therefore a great need to continue working multilaterally on mutually acceptable guidelines for possible cases of debt renegotiation and relief. International financial agencies should get involved in the work on such guidelines if only to disarm possible political frictions between the borrowing and the lending countries.

It was noted that a very considerable degree of agreement on such guidelines was reached by the UNCTAD Group of Governmental Experts, comprising experts from both the DCs and the LDCs in early 1975, and that some elements of agreement on the debt reorganization could be detected also in the respective positions of the Group of Eight and the Group of Nineteen at the Paris Conference.

There was a consensus that the developed lender countries must keep in mind that the problem of LDC indebtedness could be managed in the long-run only if LDCs are assured of the constant flow of development financing at terms and conditions that are in accordance with the goal of "acceptable" growth rates and with their repayment capacity. The LDC repayments capacity will depend not only on these terms and conditions but also on the conditions of world trade which, in turn, will depend to a great extent upon the growth rate of the advanced economies themselves.

Thus, the need was perceived for action by the developed lender countries in three fields at the same time: *a*) increasing bilateral (in addition to multilateral) official development assistance, *b*) opening the DC capital markets to the LDC borrowers and *c*) liberalizing trade. Given the recent rise of protectionism in the major DCs, it was urgently recommended to return within GATT to the standstill with respect to trade restrictions and to keep open the LDC manufactures' access to the DC markets under preferential schemes.

The contribution of the oil surplus countries to the orderly management of the problem of LDC indebtedness could be increased in three not mutually exclusive ways: *a*) through lengthening of the terms of their placement of funds in international capital markets which would encourage private banks to lend on longer maturities to all borrowers, including the LDC borrowers, *b*) through direct investments in the LDCs, and *c*) through increased placement of funds with international financial institutions that would guarantee the risk (partly or wholly) of the contributing countries.

While the meeting considered it unlikely that international private capital markets would provide LDCs in the future with more resources at more liberal terms and conditions, it was thought that there was a possibility of mobilizing more private funds in the DCs for long-term lending to LDCs by creating some incentives for buyers of the LDC bonds through exempting from taxes bonds purchased by institutional and private savers.

Since the responsability for solving the LDC indebtedness problem was the joint responsability of the LDC borrowers and the lenders it was recommended that the LDC borrowers dedicate more attention than in the past to the problems of debt management. The equating of sovereign rights with financial irresponsibility and the lack of interest in integrating financial planning with overall economic long-term planning was considered not only as weakening the LDC position in international negotiations for the lasting solutions of the LDC indebtedness problem, but highly damaging to the individual LDC borrowers themselves as some recent debt crises have widely demonstrated. It was further recommended that in the period of uncertainty characterizing world economic conditions LDCs should give serious thought to the possibility that they may be forced to rely more than in the past on better management and more efficient use of their own financial resources.

The report from the Mexico City meeting was made available to international lending agencies, the UNCTAD, major central banks of the developed and the developing countries and large international private credit institutions involved in lending to the LDCs. Contrary to expectations the findings and the recommendations of the Mexico City Meeting were not discussed, however, at the UNCTAD Trade and Development Board meeting at ministerial level, held in Geneva in February 1978.

That UNCTAD gathering which addressed itself exclusively to the external indebtedness of the LDCS made unfortunately little progress towards alleviating their heavy and growing debt burden. The publication of this volume may therefore be of help in the international search for the solution of that problem which casts dark shadows over the future of the world economy and North-South relations. Such a search is perhaps more urgent at present than ever given the persistent stagnation of the economies of the developed countries and of international trade.

Mexico, City, June 1978

External Indebtedness of the Developing Countries

A background report to the Mexico City meeting prepared by a Working Group composed of

Miguel S. Wionczek
(Coordinador)
Ariel Buira
Víctor García Moreno
Rosario Green
Carlos Juan Moneta
Pedro Paz
Jesús Silva-Herzog

During the last few years, the official external debt of developing countries has increased substantially, so rapidly that some observers consider it has reached dangerous proportions. Concern has mounted among the developing nations and has spread to some quarters in industrialized countries and to the world press. While the current situation given rise to wide-spread concern, the main worry is about the short and medium term.

It was this which motivated El Colegio de Mexico and the Center for Economic and Social Studies of the Third World to join in the debate to try to increase and disseminate knowledge of the subject, and work out specific proposals of use for developing countries.

This paper was originally written to provide a basis for discussion at a meeting in Mexico City in late October 1977, to which some 20 financial experts from several countries and international organizations were invited.

One of the chief conclusions of the paper is that the problem of the LDCs' external debt must be viewed within the broader framework of international economic relations. The document thus begins with a chapter on recent developments and prospects for the world economy, which emphasizes the interdependence between industrial countries and developing nations.

Next, the main reasons for foreign borrowing are discussed briefly, including those that reflect actions for which the users of the funds are responsible. Then, the controversial subjects of the debt-servicing capacity and solvency of debtor countries is briefly explored. In this section, the concept of the "effective cost" of the debt is introduced, a concept that seems to have been neglected in policy-making in the past.

A descriptive chapter is also included on LDC external debt in the period 1969-1976. Debt from official sources is discussed separately from that of private origin. Because of its new importance, the latter has greatly influenced current overall terms of borrowing. In this chapter, a discussion of the changes in the terms of borrowing is also included, together with some considerations about the end-use of the resources borrowed. In our view, the latter subject requires a more thorough discussion than is generally found in the literature on the subject.

LDCs have shown more and more interest in finding solutions to their debt problems via debt relief and rescheduling. A separate chapter is devoted to past experience in this field and to examining the value of existing practices for the future.

Finally, a chapter is devoted to analyzing the position LDCs have taken in various international forums, a position that has drawn much of its inspiration from the work of the UNCTAD Secretariat, and that has gradually been shaping what might be termed an LDC ideology about external indebtedness. Finally, the views put forward in recent months by the World Bank, the International Monetary Fund, the U.S. Government and the international private banking community, are given to complete the picture of the current debate.

The paper covers only the decade 1967-1977, except where otherwise indicated. Its quantitative data base is the product of the World Bank's excellent efforts to obtain, organize and disseminate the main available evidence about foreign indebtedness.

The World Economy: Recent Developments, Prospects, and the Debt Problem

During the last decade, world trade and finance have undergone dramatic changes and upheavals of a kind unknown since the thirties. These developments directly or indirectly influenced the volume of foreign official borrowing by non-oil developing countries, as well as the composition of their foreign debt by origin, by end-use, and by other characteristics. A review of international economic developments during the period 1967-1976 is therefore in order, as well as an overview of prospective trends in the world economy for the next few years.

The last decade covered the final phase of the longest period since the end of the nineteenth century when the industrial economies grew at a sustained pace, while price levels remained relatively stable and international trade expanded continuously in real terms. The process of sustained growth and relative stability that began towards the end of the Second World War was interrupted during 1973-74 by a worldwide recession of major proportions, which had not been completely overcome as the first half of 1977 drew to an end. This recession differs from previous cyclic downturns of the postwar period, not only because of the unusual severity of the slump but because of the strong concomitant inflationary pressures and the high levels of persistent unemployment in almost all industrial market economy countries.

Until very recently some observers insisted that the current world inflation reflected the increase in international oil prices during the fall of 1973, but available statistical evidence does not support this contention. The origins of both the recession and the accelerated inflation seem to pre-date the so-called oil crisis. While the oil-price hikes were a factor that deepened the recession by seriously disrupting the working of the international financial system, it is difficult to blame oil producers for everything that has happened in the world economy during recent years. Imputing to the oil producers the major difficulties that developing countries are going through currently is still less defensible.[1]

Among the principal causes of the present recession should be included such differing factors as the simultaneity of the cyclical fluctuations in the OECD economies, U.S. monetary policy, social conflicts in Western Europe, the speculative accumulation of basic commodities, exchange instability and many others.

The severity and persistence of the current inflation, however, have greatly hindered industrial economies in their attempts to reestablish conditions favorable to the achievement of sustained growth with price stability and a satisfactory level of employment. The inflation that went along with the fall in the levels of economic activity in industrial countries has also undercut the modest economic progress that developing regions had achieved during the postwar years.

By the end of the 60's the twin phenomena of slower growth in the industrial economies and accelerated inflationary pressures in the world as a whole began to be felt. While the economies of the industrial OECD countries as a whole grew at a real average rate of 4.9 per cent per year between 1965 and 1969, their domestic price level rose at an

[1] In May, 1977, H. J. Witteveen, the Managing Director of the International Monetary Fund, declared that "since the volume of energy imports (by non-oil developing countries) is relatively small, pointing to a relatively low level of development, the main change that the oil-price hike induced in the payments structure of those countries has not been the relative size of the deficit, but the fact that a new source is being tapped as a lender of last resort."

annual rate of 3.7 per cent. In spite of a short-lived boom during 1972-1973, the rate of growth of these economies fell during the period 1969-1973, to 4.7 per cent per year, while prices increased at an annual rate of 5.9 per cent. Between 1974 and mid-1977, i.e., from the beginning of the current recession up until now, the rate of growth of GDP in the OECD countries fell to 2.1 per cent per year on the average, while prices increased by an average of 9.3 per cent per year.

In order to appreciate the severity of the current recession it should be pointed out that in 1974 and 1975 the GDP of the OECD countries fell in real terms by 0.1 per cent and 1.1 per cent, respectively, while unemployment reached an average of 8 per cent of the labor force, and domestic prices increased by 11.6 per cent per year. This performance, together with the efforts of the developing countries to sustain rates of growth at any cost, was reflected clearly in the LDCs' growing external resource requirements.

International trade and financial relations were seriously disrupted. Although the role of international trade, during the current recession, in spreading the business cycle from industrial centers to the LDCs has not been studied in depth,[2] world trade figures support preliminary estimates of the impact of the current recession on the developing countries.

Available data show that between 1973 and 1975 both the volume and the unit values of world trade underwent changes of a size unknown since the thirties.[3] World trade grew at about 10 per cent in 1973; but the rate of growth then fell to a mere 5 per cent in 1974 and to 4.5 per cent in 1975. While the volume of trade showed some recovery in 1976 the new average yearly rates of expansion during the latter year (11 per cent) and the first half of 1977 (between 6 and 7 per cent, according to preliminary estimates) were well below the average of the twenty years that preceded the current recession. Moreover, forecasts indicate that this deceleration will continue during the next few years, unless vigorous economic recovery starts soon in the industrial countries.

Changes in the rate of growth of the volume of world trade during the recession were accompanied by equally sharp changes in unit values, albeit for different products. The average unit values of world trade

[2] The oil price increases make such a study doubly difficult.

[3] Whenever strong inflationary pressures coincide with sharp and disorderly changes in the prices of international commodities, it is illusory to base comparisons of international trade levels on simple value indices (recent annual GATT reports are full of warnings about this). It is much more instructive to focus on the volume of trade and on unit values. Moreover, changes in unit values of exports and imports can be combined to measure the changes in the terms of trade of various parts of the world economy, and therefore, to determine the distribution of the gains of world trade in conditions of great instability.

increased by 25 per cent in 1973, 41 per cent in 1974, 8.5 per cent in 1975 and only 2 per cent in 1976. While these aggregate data seem to point to a stabilizing trend, behind the average lies a mix of factors that had diverse incidence upon the various sectors of the world economy. For example, the continuous increases in the prices of manufactured products caused by inflation in the industrial countries; the steep increase in oil prices; the short-lived increase in the prices of raw materials during 1972-1973, the fall of these prices in 1974-1975, their recovery in 1976 and their decline again in the first eight months of 1977.

The figures for the volume of trade and price changes, together with the value indices of world trade by region, show that between 1974 and 1976 the growth of world trade was sustained by the oil-exporting countries, and, to a lesser extent, by the demand for imports by non-oil developing countries, non-industrial developed countries and the socialist bloc. What was missing during the trough of the recession in 1974 and 1975 was the growth of import demand in industrial countries, largely due to measures to check domestic demand. When internal restrictive policy measures started being liberalized in 1976-77, they were replaced by protectionist measures.

Imports of industrial countries, which in 1974 barely maintained the real level attained one year before, fell by 7.5 per cent in 1975. Since 1975 also witnessed a fall in the volume of imports by all the other sectors of the world economy, except the oil producers and the socialist countries, the overall value of world trade at constant prices fell during the year, for the first time in the postwar period. In all likelihood, the maintenance of import demand by oil-producers and non-oil producing developing countries during 1976 and 1977 —albeit at levels lower than before— together with a slight recovery of import demand in industrial countries, has saved the world from a repetition of a world-wide economic depression like that of the thirties. Yet, the stabilizing role of developing countries during the current world economic cycle has yet to be recognized by the industrial countries, not just in reports by international organizations, but through assistance and trade policy measures.

As shown in Table 1, during the current recession developing countries have suffered a deterioration in their terms of trade and, therefore, in their import capacity. While part of the loss was due to the increase in oil prices, available evidence indicates that the recent losses in the import capacity of non oil-exporting developing countries as a whole were caused chiefly by a sharp fall in the prices of raw materials after 1974 and acceleration of the secular growth of the international prices of manufactures. This deterioration in the capacity to import based on export earnings was barely compensated for by the inflow of borrowing from abroad. Put differently, the surplus countries supplied the developing countries with the resources the latter had lost because of the working of the international business cycle, and even enabled some of them to increase their international reserves slightly.

According to UNCTAD estimates presented at UNCTAD IV in Nairobi, up until the middle of 1972 the overall index of export prices for non-fuel raw materials fluctuated around a relatively stable trend throughout the postwar years. On the eve of the short-lived boom in the prices of raw materials (1973-1974), the index was still at its 1950-52 level. A number of developments (simultaneous expansion of economic growth in industrial countries, unexpected bad harvests in several important food-producing regions, and the emergence of inflation-related speculative demand in the international commodity market)

Table 1

FOREIGN TRADE OF NON OIL-EXPORTING DEVELOPING COUNTRIES, 1967-1977

(Percentage changes)

	Average 1967-1972	*1973*	*1974*	*1975*	*1976*	*1977 (Estimated)*
U.S. Dollar Value						
Exports	11.9	47.2	42.9	—2.3	18.5	15.5
Imports	11.4	40.1	60.9	4.1	4.4	13.3
Volume						
Exports	9.8	8.0	3.5	0.7	9.5	7.5
Imports	7.0	13.3	7.9	—5.0	1.5	6.4
Terms of Trade	—2.1	10.2	—7.4	—11.5	5.6	0.8

Source: International Monetary Fund.

combined to push the overall price index up during 1972/73, so that in a brief period of eighteen months it increased by 120 per cent. However, between the beginning of the recession and the end of 1975 the prices of raw materials fell by 40 per cent. While some recovery took place during 1976, commodity prices started declining again in the spring of 1977.

According to the same source, the prices of manufactures, on the other hand, as measured by the index of unit value of manufacturing exports of industrial countries, continued to increase throughout the postwar period, attaining by 1972 a level 50 per cent above that of the base period, 1950-52. As inflation accelerated, the index of the unit value of manufacturing exports from industrial countries rose, by 1975, to 130 per cent above the level of 1972. Thus, even if the long-term trends are neglected, the deterioration in the terms of trade between raw materials and manufactures has been considerable during the present decade. It is estimated at UNCTAD that between 1970 and 1975 the loss was of the order of 15 per cent.[4]

World trade conditions have been partly responsible for the profound change that has taken place in international financial relationships since the onset of the current recession. Up until the beginning of the seventies, the financial position of non-oil developing countries had been relatively manageable, without ever having been comfortable. The current account deficit of this group of countries, which in broad terms reflects the amount by which their exports are less than their imports and service payments for the use of foreign capital, had customarily been balanced by means of new net inflows of capital from official sources (financial assistance) and from private ones (private foreign investment, direct and portfolio). During the sixties and until the beginning of the current recession, the long-term capital inflow used to exceed current account deficits, so that developing countries as a whole were able to accumulate some international reserves. This in turn allowed them to confront mild cyclical fluctuations in world economy and commerce, comparable to those that had occurred several times during the first two decades of the postwar period.

The serious disruption of the international financial system caused by the current recession has changed the situation drastically. From one year to the next, developing countries faced a current account deficit twice as large as the year before. The deficit rose from US$10.9 billion in 1973 to $29.5 billion in 1974 and to $38.3 billion in 1975. Even in 1976, in spite of efforts to adjust to the new situation, the latter had a current deficit of $25.8 billion. Those international sources that look upon the situation of the developing countries with equanimity point out that their 1976 deficit in real terms was equal to those of 1968-70.

Since the current recession has affected all quarters of the world economy except the oil countries, the need for a set of measures to

[4] This affected those countries that are relatively underdeveloped, which produce and export only raw materials. In the case of middle-income developing countries, some diversification in exports had been attained, as the share of manufactured products in their exports went up. This somewhat lessened the deterioration in their terms of trade in more recent years. Their major problem at present arises from protectionist trade policies in the industrial countries.

bring about domestic and international adjustment and to provide financial assistance to the developing economies so as to eliminate serious disorder in international financial relations, and to ensure that growth with stability can be resumed, is more clearly visible than ever. The current account of the world balance of payments suggests that the form this disorder took on after 1974 was that two groups of countries emerged: the first included, most importantly, the oil-exporting countries, and countries with a current account surplus; the second included all the non-oil primary producers, regardless of their level of development, as well as a considerable number of industrial countries.

This picture of world financial imbalance has led many observers to conclude that if the world economy is to return to a phase of growth with relative stability, the financial assets of surplus countries must be recycled toward deficit countries, and the economic and financial policies of deficit countries adjusted. The same sources posit that progress toward the restoration of international equilibrium would be facilitated if certain developed countries that customarily generate surpluses showed more interest in adopting expansionary domestic policies; if the oil-producing countries would restrain their interest in piling up international reserves; and, finally, if developing countries were more willing to adjust their levels of economic activity to the requirements of equilibrium in their balance-of-payments and the availability of domestic savings. By putting a great deal of emphasis on the need for adjustment, insufficient attention is devoted to analysing the factors that led developing countries to a situation in which they are facing, simultaneously, decelerated growth rates, accelerated inflation and an external financial crisis. This analysis would have to take into account the fact that, while the industrial countries can perhaps face a prolonged and severe recession due to their income and welfare levels without major difficulties, the developing countries are much more vulnerable, given their low average income levels, income distribution patterns, rates of population growth, etc.

Consequently, the problem of development with relative stability, domestic as well as external, for non-oil producing developing countries —which are the weakest part of the world economy— cannot be reduced just to a simple matter of adjustment. Because of the structure of traditional relations with industrial countries, as well as the impact of the recession, developing countries have recently suffered both the effects of a fall in their export prices, a certain deterioration in their terms of trade, and the impact of the stagnation —in real terms— of external official financing of a non-compensatory type (i.e., financial assistance for development). The current account deficit is only an indicator of the difficulties such countries are going through. Other indicators include the substantial fall in their rate of growth, the greater efforts required to sustain that growth, and also the acceleration of inflation even beyond the pace in industrial countries.

According to the most recent IMF estimates, the average rate of growth of GDP for a hundred developing countries in Africa, Asia and Latin America over the period 1967-1972 was 6.1 per cent per year; it rose briefly to 6.7 per cent in 1973, fell to 5.2 per cent in 1974 and to 3.4 per cent in 1975, rising again in 1976-1977 to an average of 4.6 per cent. In view of the gap in income levels between industrial and developing countries, the demographic explosion and the magnitude of structural unemployment, these recent growth rates, which are lower than those in the previous two decades, cannot be considered satisfactory. Nor are they consistent with the longer-term interests of the industrial countries. For the latter, solving the twin problems of excess productive capacity and unemployment depends to a large extent upon the dynamism of the world economy as a whole.

In spite of the fall in their growth rates during the past few years, developing countries withstood a veritable explosion of inflation. The average rate of increase in consumer prices for non-oil developing countries was of the order of 10 per cent between 1967 and 1972, but in 1973 it rose to 21.7 per cent, and surpassed 30 per cent per year in 1974-1976. Inflationary pressures were particularly acute and persistent in Latin America and in the non-oil countries of the Middle East. The rate of increase of consumer prices for Latin America rose from 31.6 per cent in 1974 to 68.4 per cent in 1976, while in the Middle East the average annual increase was of the order of 20 per cent. Only because of very strong deflation in Asia did the index of the price level for the developing countries as a whole increase by only 31.3 per cent in 1976.

During 1974-1976, the noticeable deceleration in growth rates and the accelerating inflation were accompanied by weakening of the balance of payments and a steep increase in the foreign indebtedness of the developing countries as a whole. Although this will be discussed in detail later on, is should be pointed out here that the need to increase the foreign debt was due as much to the political necessity to sustain positive rates of growth given deteriorating trade balances as it was to the growing burden of servicing the debt that kept piling up as they attempted to maintain their expansionary policies.

It should be pointed out here that, towards the end of the sixties, the large majority of industrial countries accepted the LDCs' thesis that the growing gap between the levels of development and welfare in different parts of the world made it urgent, as well as politically advisable and economically feasible, to set a minimum growth target of 6 per cent per year for the GDP of the developing countries as a whole for the current decade. To achieve this objective it was considered necessary first, to sustain a real growth rate of about 5 per cent per year for the industrial economies; second, to liberalize access to the markets of these economies for products from developing countries, by means of preferential tariff reductions and the progressive dismantling of quantitative barriers; and, third, to provide developing countries with net transfers of financial resources equivalent, as a whole, to 1 per cent, and (in terms of official development assistance) to 0.7 per cent (of the value) of the GNP of the industrial countries. It is worth remembering, however, that the three largest industrial countries —the U.S., West Germany and Japan— did not commit themselves to these global financial assistance targets.

Protectionist attitudes and opposition from public opinion in industrialized countries to more assistance, together with increasing conflicts between industrial and developing countries over the role of direct private investment made it impossible for those targets to be met, even before the onset of the current recession. While imports by industrial countries from developing countries grew substantially, the expansion was less than had been postulated in the mid-sixties, even before taking into account the negative effect of the slow deterioration in the terms of trade on the real import capacity of the developing countries. On the other hand the net flow of financial resources for development stagnated. In overall terms, net transfers did not even amount to 0.7 per cent of the GDP of industrial countries. And in terms of official assistance, they never exceeded half the original target (0.35 per cent of GDP).

Up until 1973 the industrial economies continued to maintain growth rates of about 5 per cent per year in real terms, but the problem of the LDCs' lack of external official resources for development continued to intensify, though without reaching its present dramatic proportions. The LDCs' current account deficits were balanced between 1965 and 1973 by means of official external assistance, direct private investment and modest public borrowing from foreign private sources. However, since grants were frozen, while the financial cost of direct investment and loans from the private sector substantially exceeded the cost of official transfers, a foreign debt burden began to pile up. The lack of financial discipline in many LDCs did not make the situation any easier.

The problem of external financial disequilibrium hit developing countries full force at the beginning of the recession. Domestic political and social factors led many developing countries to avoid measures to offset the fall in exports and the deterioration in their import capacity by means of adjustments in the import of goods and services. Almost all

LDCs were also unable to adjust their outlays for servicing financial obligations with the rest of the world, with the exception of payments to service foreign investment which fell owing to cyclical reasons. Only the compensatory financing facilities that have liberalized their len-

Table 2

FINANCING OF THE CURRENT ACCOUNT OF NON-OIL LDCS
1973-1976

(Billions of dollars)

	1973	*1974*	*1975*	*1976*
Current account deficit*	*—10.9*	*—29.5*	*—38.4*	*—25.8*
Financing via transactions with no effect on the net debt position	*8.2*	*10.8*	*11.1*	*10.4*
Grants to governments	4.6	6.2	6.2	6.0
Net flow of direct investment	3.6	4.6	4.9	4.4
Net borrowing and drawing on reserves	*2.7*	*18.7*	*27.2*	*15.4*
Fall (or increase) in reserves	— 7.7	— 2.4	0.1	—11.6
Net foreign borrowing	10.4	21.1	27.1	27.0
Long-term loans from official sources, net	5.6	7.8	10.6	11.7
Other external long-term loans, net	0.1	5.2	6.5	4.1
Loans from private foreign banks	4.1	6.3	8.0	8.4
Suppliers credits	0.3	0.5	0.7	1.2
Other sources	0.3	1.3	1.3	1.6
Reserve-related credit facilities	0.1	1.3	3.1	2.8
Net short-term borrowing from other sources	0.6	4.1	4.8	1.3
Residual errors and omissions	— 0.7	— 0.1	— 1.5	

* Net total balance of goods and services and of private transfers.
Source: IMF.

ding conditions in the recent past, and in particular the new IMF "oil facility", have offered some help to developing countries. At present, the rigidity of the volume of external official financial assistance, both multilateral and bilateral, together with the limited availability of multilateral compensatory financing, has forced the developing countries to choose between drastic deflationary programs or resources borrowed from private sources whose liquidity expanded greatly between the beginning of the recession and the present date.

It was relatively easy for developing countries with access to international capital markets to opt for increased indebtedness with private sources. The results can be seen in Table 2 (p. 10).

The current financial situation of the LDCs could be seen much more clearly if the figures in Table 2 were adjusted to constant prices. Nevertheless, the data show that in the period 1973-1976, the LDCs faced with sluggish concessional financial assistance and inflow of private investment, went into debt to try to sustain growth rates as close as possible to earlier rates and to accumulate reserves in expectation of future difficulties. In trying to achieve both objectives at the same time, the LDCs ran into steadily expanding deficits on current account and resorted more and more to net borrowing all types, repayable on short, medium and long terms. This reached an annual average of $25 billion during 1974-1976. Of this total, only $11 billion per year originated from official assistance, multilateral and bilateral (including multilateral compensatory financing), while the remaining $14 billion per year came from such sources as private foreign banks, suppliers' credits, short-term credits from non-official sources, etc.

Due to the private financing that became available as international liquidity swelled to an unprecedented level (i.e., as the oil-producing countries began to accumulate surpluses and Eurocurrency markets expanded), many developing countries were saved from a major domestic economic crisis. But this was achieved at a cost, a cost that has multiple dimensions. The magnitude of the financial cost will be discussed in the following parts of this study. The political cost consisted in the greater real dependence of the developing countries on a few world financial centers. This cost has to be compared with the domestic political cost of slowing down growth, a cost many LDCs consider higher than that of growing external financial dependency. Moreover a sizeable social cost was incurred, with two basic aspects. The relatively easy access to resources that could be tapped without any conditions seriously undermined the weak financial discipline characteristic of many developing countries; and it also led to postponing many politically difficult domestic reforms.

Some observers in industrial countries have severely criticized the developing countries for inefficient use of financial resources raised during the current recession. It is true that part of those resources have at times been used to support the achievements of long-term economic development, in line with social objectives, contrary to the principles of sound and efficient management of public finance. However, even with better management of domestic and borrowed external financial resources, developing countries would still have had growing requirements during the last few years, both for official development assistance and for financial resources for anticyclical purposes. Such resources were not available either in appropriate quantities or on the right conditions.

Consequently, it makes little sense to take the problem of the developing countries' debt out of the overall context of the economic and financial problems of the international community. Neither does it make sense to hope that the debt problem will be solved exclusively by adjustment measures or —in the more serious cases— by resorting to renegotiation of the outstanding debt. Overly harsh domestic adjusment measures entail two dangers: internally, that these will exacerbate social and political tensions; and externally, that an economic downturn will be fed back to the industrial countries through foreign trade. It would be particularly dangerous to ignore these potential effects of adjustments in LDC economies on the recovery of the world economy.

Prospects for the industrial economies over the next few years continue to be uncertain as of mid-1977. In a large number of OECD countries, concern about controlling inflation overshadowed an interest in accelerating growth. Only in the past few months have there been changes in attitude, not only in the U.S. but in West Germany and Japan as well. This is because levels of fixed productive investment in industrial economies as a whole are not only staying below those recorded in 1973, but no substantial recovery is expected at least until the beginning of 1979. Moreover, new investment is discouraged by the relatively low rates of utilization of available productive capacity, by lack of confidence in the recovery that started in 1976-1977 and by insecurity about inflationary pressures.

There are other factors, too. First, not only does the process of trade liberalization among OECD countries seem to have come to an end but new protectionist forces are emerging in practically all industrial countries. Second, inside the industrialized sector of the world economy, it does not seem sensible to expect a continuation of the process of shifting labor from agriculture to industry, which was one of the major factors that sustained the growth of the industrial economies between the early fifties and 1972. Hence, even in the best conditions, the industrialized sector of the world economy will grow at an annual rate of 4.5 per cent during the next few years (up until 1985). Moreover, the most recent projections suggest that a still lower rate of growth (on the order of 4 per cent per year) is possible. Such a rate, which is substantially lower than the 4.8 per cent recorded between 1965-1972, would immediately cause a slowdown in the growth of world trade.

These projections offer rather gloomy prospects for the LDCs. Bearing in mind that the rates of growth of developing economies have some impact on the economies of industrial countries, a strong argument emerges in favor of expanding and expediting the currently sluggish flows of official financial assistance for development. This is particularly important in view of the uncertain prospects facing the industrial economies and world trade in the medium term. Only expanded flows of official financial assistance can create a framework of serious discussion of the problems confronting the developing countries as a result of their external public indebtedness.

The Reasons for External Borrowing, the Capacity to Borrow and the Problem of Solvency

1. *The causes of external debt*

Foreign borrowing by developing countries is usually explained in terms of the financial requirements of their economic growth. While economic growth with diversification depends, to a large extent, on domestic capital accumulation in most developing countries there are severe limitations to this, owing to low productivity and growing demand for private and public consumption; these reflect, among other things, educational and technological backwardness and rapid population growth.

Economic growth demands considerable investments in infrastructure facilities and these, in turn, almost invariably involve sizable amounts of imports. Because of the structure of income distribution, the additional incomes that those investment expenditures generate stimulate new imports. Thus there is a dual requirement: domestic capital formation must be accelerated, and foreign exchange earnings through exports of goods and services must be increased.

Foreign borrowing makes it possible, in principle, to finance volumes of investment consistent with rates of growth above those that can be sustained with a given country's own resources ("natural" rates of growth), by adding to the capacity to import capital goods and other inputs including the necessary technical knowledge. Such imports could never be financed completely by export earnings since the growth of the latter is constrained by the structure of demand in the advanced countries, by tariffs and other barriers to international trade, and by the inelasticity of the supply of exports.

During the last few years these constraints have become more binding, as the rate of growth of the industrial sector of the world as a whole dropped substantially and official financial assistance for development slowed down. Hence the surge of external barrowing by developing countries, particularly from private sources. It may be in order to add that a good number of developing countries decided to resort to foreign borrowing in the recent past not only to cover the current account deficits in the balance-of-payments and their budget deficits, but also to postpone important reforms that might have increased their capacity to generate domestic savings and thus diminish their dependency on foreign savings.

While the total foreign debt of developing countries has grown recently because of the growing demand for resources the excess supply of money in world markets has also been an important reason for the growth in the debt. The conventional explanation of the debt problem, in terms of the trade gap and the domestic savings or public finance gap, must be supplemented by two additional considerations: that a long-term strategy for the role of domestic development finance has been lacking in developing countries, and that a bigger supply of idle savings in the international private capital market means a larger supply of resources for developing countries. Ample access to such resources, however, is open only to certain countries that are developed enough to be considered relatively credit-worthy by international private sources of credit.

Obviously, however, even if all developing countries did possess long-term strategies for financing their development, such strategies would be insufficient to overcome financial difficulties that are beyond their control. A great many of these difficulties originate in the tendency of the balance-of-payments of developing countries to be in permanent disequilibrium, as a result of both the loss of dynamism of their primary exports and the secular deterioration in the terms of trade.

Bearing in mind that any country requires at least some minimum holdings of international liquidity, it is clear that persistent trade deficits cannot be compensated for by drawing on international reserves, except in the case of countries with very large reserves. This is, and must be, only a temporary measure.

Alternative ways for developing countries to rectify persistent trade deficits are the on-going depreciation of their currency, or foreign borrowing, or a combination of both. With an excess supply of foreign money, external financing turns out to be politically more feasible. The characteristic features of developing economies (i.e., domestic structural barriers to the expansion of exportable output) and of international trade (i.e., especially instability in the demand for their exports by advanced countries, due to cyclical fluctuations and trade barriers) must also be considered. These make it futile to rely solely on exchange rate adjustments as a solution to difficulties in the current account of the balance of payments. Moreover, such adjustment may well make it impossible for development to proceed at acceptable rates, both from the political and the social point of view.

A sizable portion of the foreign indebtedness of developing countries originated in public sector borrowing. The growing dependency of the public sector on foreign borrowing cannot be explained solely in terms of the inability of the state to control expenditures and to increase the sources of revenue, or of the propensity of politicians to transfer to future generations the cost of present actions. The pattern of development that has been adopted by developing countries must also be taken into account, as well as their preference for conventional methods of public finance, the rigidity of the tax structure, and the institutional decentralization of the demand for foreign finance.

The governments of developing countries often resort to foreign financing in order to expand or maintain social programs (education, health, housing, employment), or infrastructure investments. While the former item is not the most important reason for foreign borrowing, demands for foreign financing for infrastructure projects do grow apace with the process of modernization and industrialization. When the inflexibilities in tax structures and in the rate of expansion of current public expenditure are put together with the much larger supply of external credit, the tendency to rely on foreign finance for infrastructure becomes even stronger.

The performance of official enterprises is another reason for the growth of foreign indebtedness. A number of factors explain the presence of such enterprises in developing countries, notably: first, general political considerations that cast the state in the role of sole promoter of strategic sectors of the economy (energy, large-scale mining, steel, petrochemicals, utilities, etc.); second, in some cases "national security" considerations are adduced; third, when the bankruptcy of medium-size or small private firms would create unemployment that might increase political tensions unless the state takes over; fourth, the political propensity to nationalize certain activities that used to be in the hands of foreign capital (railroads, petroleum, export minerals, certain banking and financial entities, etc.); and, fifth, considerations of regional development in extremely backward regions in which state or local governments are compelled to maintain or introduce certain activities, even if they are not economically profitable. Considerations of this sort explain why official firms spring into existence with such frequency in developing countries, almost independent of their level of development or industrialization, and why they so often become important recipients of foreign credit.

Because these enterprises are often in deficit, some observers attribute the deficits to inefficiency, red-tape, excess employment and corruption. Such arguments are often valid, yet a large share of the deficit of official firms can be traced to their price policies. The widespread practice of setting prices for their products (or tariffs for the services they supply) at levels below cost is part and parcel of policies to redistributive consumption, or benefit the private industrial sector, which is often the largest consumer of goods and services provided by the public sector. In other cases, the price policies of official firms are devised with the intention of slowing down or disguising inflation. Whenever the official firms fail to generate surpluses or to receive adequate transfers from the central government for investment purposes, they end up resorting more and more to foreign borrowing. Thus, the political framework as well as the structural conditions surrounding most such firms turn them into major and growing sources of borrowing from abroad.

Official foreign indebtedness is also generated whenever the private domestic sector borrows abroad, if the government acts as an underwriter. In the more industrialized developing countries, the structure of demand combined with the presence of transnational firms tend to deepen the dependency of domestic private entrepreneurs on imports of both capital goods and other inputs, physical and technological. Their growing foreign-exchange requirements for investment and operating capital create another source of foreign borrowing. These requirements grow even more whenever equipment is supplied together with medium or long-term financial services that are not available from domestic sources. Moreover, official financial entities charged with the function of favoring private investments frequently borrow abroad. The corresponding portion of external public indebtedness actually represents, therefore, private foreign indebtedness. In developing countries where income levels are lower and economic activity is little diversified, the pressure for borrowing from abroad that originates in the domestic private sector is not so heavy. Yet even in such countries debt pressure may be heavy whenever the importing sector has a strong influence on economic policy decisions.

The growth of the official foreign debt has affected a large number of developing countries because of the heavy burden of servicing this debt. In some countries the debt burden is so large that foreign borrowing has ended up virtually losing the original rationale for its existence, i.e., as a complement to domestic savings, and has become basically an exercise in obtaining external resources to repay existing debts.

This situation is made even more difficult by the strings attached to many credit operations both on a political level and concerning the utilization of resources (such as the obligation to purchase specific products from specific markets, to transport the products in ships of certain flags, to use the insurance companies of the lender country, etc.). Such practices are clearly visible in the case of a great many bilateral credits, particularly in the case of suppliers' credits, while in the case of the operations of some of the multilateral lending organizations, they occur in disguised forms.

2. *The capacity to borrow*

The question of the capacity to borrow must be viewed from the standpoint of both debtor countries and creditors. While the former tend to emphasize future capacity to borrow, the latter are often more concerned with whether commitments on existing debts can be met. From the standpoint of the debtor countries, the capacity to borrow depends on the efficiency with which borrowed resources are utilized, which in turn depends upon the allocation of overall resources between consumption and investment and of investment resources among programs and projects that may generate foreign exchange, as well as on economic policy as a whole. In the end, it is economic policy that can make it possible to convert resource surpluses created by projects financed with borrowed resources into foreign exchange. Thus, a borrowing country has a two-fold problem: it must find ways to satisfy domestic resource requirements, thus creating a surplus, by putting borrowed capital to productive uses and by applying policies that will increase the level of domestic saving; and it must discover how to improve the current account of the balance-of-payments sufficiently —e.g., by increasing exports— to be able to transfer abroad the amounts required to service the debt.

The capacity to generate sufficient funds to service the debt depends partly on the productivity of the activities financed with the aid of external capital. For instance, in the case of a loan that goes to finance an industrial or mining project, for which the technical feasibility as well as the economic and financial profitability have been accurately determined, the income from the new activities will be available to service the corresponding debt. Moreover, such income may itself take the form of an inflow of foreign exchange if the output of the project is exportable. Or the same income may mean savings of foreign exchange if the output replaces products that used to be imported. These savings, however, must be calculated with caution, since import substitution projects generally go together with some form of subsidy or tariff protection, the burden of which has to be borne by the rest of the economy, including export industries.

The growth process must be supported by an adequate infrastructure that must also be highly profitable —through in the much longer-term. Thus, if foreign loans are obtained for utilities (port authorities, transportation, electricity, communications), the tariffs charged to users should be high enough first, to cover the obligations incurred on the financing; and, second, to allow the accumulation of additional income to ensure that the program of utilities expansion will not be interrupted.

As for the ability of a country to convert the amounts saved into foreign exchange (required for repayment in the case of most of the external loans), the problem arises that foreign exchange has alternative and competitive uses. It can go to service foreign debt, or to purchase imported inputs that are crucial for the growth of the economy, or to other ends. The conflict over alternative uses can be resolved efficiently if the country has an adequate national planning system.

Borrowing capacity is determined to a large extent by the ability to increase foreign exchange inflows that depend more on conditions in export markets than on domestic policies of the developing countries. This differs from one productive structure to another. Countries that export raw materials and food are the most limited since international prices for these items change widely and the entry of close substitutes is easy, unlike countries that export goods with some degree of manufacturing. Countries without attraction for foreign visitors are also limited, compared with those with a relatively advanced tourist industry.

The possibilities of saving on foreign exchange by import substitution are rather limited. During the first stage, which may last a long time, import substitution may not produce foreign exchange savings but rather a reallocation of it, and the process may even generate increased foreign exchange outlays. The argument that import substitution may help to create a balance-of-trade surplus large enough to cover foreign repayment commitments is only valid in the long run. Moreover, such an argument assumes, first, that production processes are relatively simple and will not tend to stimulate a steady flow of imported equipment, raw materials and semi-processed goods; and, second, that certain efficiency criteria are applied —for example, a level of protection that will not produce an excessive burden on the economy, including export industries, or stimulate illegal imports.

3. *The question of solvency*

Creditor countries are concerned with the capacity to repay existing debts, rather than with the capacity to borrow further. Attempts have been made to set up a series of indicators of credit-worthiness or solvency and of the size of the debt-service ratio (the ratio of debt service to export earnings) and the debt-GNP ratio. Among other frequently used indicators are the proportion of the debt payable within terms of between one and fifteen years, which provides a measurement of the adjusted structure of the debt; and the variability of export earnings.

An opinion that is becoming widely accepted is that the measurement of a country's borrowing capacity, or its credit-worthiness, involves using a set of related variables, which should include at the very least:

a) the debt service ratio, since its increase entails a heavier burden of debt, which in turn increases the probability of default;
b) national income per capita, since the larger the income, the larger the probable degree of diversification of the economic structure, and the greater the flexibility of public policy over both savings and imports;
c) the ratio between the net inflow of foreign exchange and debt-service payments, which shows the extent to which foreign resources may be available to cover foreign exchange demands other than those stemming from the payment of obligations;
d) the rate of growth of GDP, which strengthens or weakens long-term borrowing capacity;
e) the secular growth of exports;
f) the ratio of imports to international reserves; and
g) the presence of important mineral deposits, oil and other non-renewable resources, which can be exploited relatively easily.

In evaluating the solvency of a country, borrowers usually look at a long list of additional economic variables that indicate the potential growth of national savings. Other indicators, such as the rate of inflation, the rate of growth of the money supply and the net budgetary position relate to the quality of financial management. Among the variables used relating to the foreign sector are the degree of diversification of exports, the structure of imports, the short-term changes in the net reserve position (including the IMF position), the current account balance, and the level of inflow of autonomous, non-compensatory capital. International creditors also take political alignment and stability into consideration as indicators of country's likely disposition to honor debt commitments. Since there is no single or well-defined criterion for determining the credit-worthiness of a given country, a general evaluation of economic policies and prospects is often used, with particular reference to balance-of-payments prospects.

In spite of its limited value, one of the most widely used indicators is the debt service ratio. The higher the ratio, the greater the rigidity of the balance of payments in the short run, and the stronger the pressures on debtor countries whenever their foreign exchange earnings fall. The debt service ratio has also been considered as a partial indicator of the risk of default. The value of this indicator must not be exaggerated, however. Debt service levels may have little bearing on the potential growth of exports, resource endowment or the capacity for economic management. While there exist well-known cases of countries, such as Israel, Brazil, or Canada, which had high debt-service ratios for years with no difficulty in honoring their obligations on existing debts, in other cases, in spite of much lower ratios, serious difficulties have occurred.

Nevertheless, it is correct to assume that the higher the debt service ratio, the narrower a country's room to maneuver. In effect, a country with a high debt service ratio is more vulnerable to changes in the prices of its chief exports, bad crops or adverse developments in the international economy. Thus, the debt service ratio can be useful as an indicator of the short-term problems of flow of funds caused by foreign indebtedness.

In order to determine the credit-worthiness of a country, creditors also analyze the structure of the official foreign debt outstanding, i.e., its size and terms, for the problem of solvency may arise not so much because of the size of the debt as because of the timing of servicing obligations. The annual debt service then can grow much faster than foreign exchange earnings. This may lead a country to face the alternative of decreasing imports drastically or of stopping payments on its debt, unless it enjoys a bargaining position that allows it to request a rescheduling.

4. *The cost of foreign resources*

The basic requirements for achieving satisfactory growth, while maintaining reasonable levels of indebtedness, is that output should grow faster than debt service, which in turn makes it possible for a country to finance a growing proportion of its own investment requirements. The growth of income must at the very least match that of the outlays going to repay the debt. This does not mean that whenever the interest on external loans is, say, 8 per cent, only countries growing at a rate faster than 8 per cent per year should request loans, but that the present value of the project chosen should be positive after discounting at the rate of 8 per cent, which is a much less restricting condition.

The basic rationale for using foreign credit to finance development is simple. Only when the cost of a loan is less than the increase in output financed with the borrowed resources will it be worthwhile applying for it. In effect, putting aside political considerations that might lead a country to limit its drawing on foreign credit in order to avoid excessive political dependency, a developing country should, in principle, apply for loans only up to the point that the (constant or increasing) cost of the additional or marginal loans will equal the (decreasing) marginal gain for the new investment. The cost of foreign capital is often underestimated because of a failure to compute the effective "cost".

Cost-benefit analysis for external credit operations turns out to be more complex than would seem at first. Moreover, distortions in domestic prices may make them misleading devices for computing the social marginal productivity of a given project. In such cases, accounting prices are called for in order to evaluate the investment projects adequately. This entails using accounting prices for the inputs (including labor) and the products in such a manner that the prices of the latter take into account externalities caused by an investment, notably the contribution to balance-of-payments equilibrium, regional development, improvement in income distribution, and other social objectives. The profit rate based on accounting prices measures the productivity of the marginal investment, and it must be compared with the "shadow" cost of capital for the borrowing countries.

A problem that arises because of the possibility of substitution between domestic and external savings must be pointed out here. Foreign borrowing may then not be transformed into increased resources for investment, but into higher levels of current expenditure financed in part by external borrowing.

Foreign capital is considered as a means to increase the rate of accumulation of capital and the rate of growth of the receiving countries; hence, the cost of capital is often computed in terms of an interest rate, or of interest plus other service charges. This cost could be labelled the nominal cost of capital.

Some recent studies have cast serious doubt on the widespread assumption that external financing, even when specifically destined to a specific project, must be considered as a net addition to capital formation in the borrowing country. The number of economists postulating the existence of an inverse relation between foreign investment and domestic savings is growing steadily.[5]

This suggests the need to differentiate between the concept of nominal and effective cost of external capital. The effective cost of external capital might be defined in principle as charges for interest and service (in foreign exchange) as a proportion of the net increase in capital formation. Whenever the increase in the foreign debt exceeds the resulting increase in capital formation, owing to failure to channel some part of the financial resources obtained into investment, the effective cost of the loan will be greater than the nominal cost.

As an example, the indirect increase in the cost of imported capital may be mentioned. This arises because a technology is embodied in the package of an investment project (and is therefore introduced into the economy along with the latter) that may entail a switch in factor proportions. Utilizing imported capital equipment along with the technology applied in the country of origin can be characterized as importing a technology that has factor intensities different from those that would be optimal in the receiving country, which results in a less than optimal use of capital. The ensuing loss in terms of the productivity of capital means that a given level of output can only be achieved by increasing the amount of capital by an extra amount, which brings about an increase in costs. Something comparable happens in the case of tied aid, which therefore has a cost higher than the nominal. When all these factors are added to the nominal cost of capital, the effective cost is obtained. Under reasonable assumptions for each of its components, the latter is larger —and it times substantially so— than the former (*see* technical appendix). Moreover, the definition of the effective cost of capital suggests that the larger the share of external capital in total capital formation, the higher the effective cost of capital.

Since the cost of external capital is substantially above its apparent level, it would seem that cost-benefit analysis, when applied to external

[5] See N. H. Leff, "Marginal Savings Rate in the Development Process: "The Brazilian Experience," *Economic Journal,* September 1968; Colin Clark, *Population Growth and Land Use,* p. 269; Keith Griffin, "Foreign Capital, Domestic Savings and Economic Development," *Bulletin of the Oxford University Institute of Economics and Statistics,* 1970; T. E. Weisskopf, "The Impact of Foreign-Capital Inflow on Domestic Savings in Underdeveloped Countries," *Journal of International Economics,* No. 2, 1972.

credit, as in the past (and this has been one of the most important considerations in handling the problem of external borrowing), was not appropriately formulated either by lenders or borrowers. A more careful evaluation of the costs and benefits of external finance would perhaps have resulted in lower levels of borrowings by some of the developing countries.

The benefits of external credit that are visible in the form of availability of foreign exchange show up immediately or in the short run, while the impact on the balance of payments and on other costs is only felt gradually and after some time —perhaps after a whole generation has gone by— which explains why there is a tendency on the part of politicians, who are usually in power for only a few years, to discount heavily the future costs in favor of the present benefits. Nevertheless, it is clear that whenever there is a reasonable expectation that national income will grow rapidly, using borrowed resources to maintain higher levels of consumption may be considered a rational decision.

Technical Appendix: The Effective Cost of Capital

The effective cost of external borrowing operations might be defined in percentage terms as:

$$C = \frac{i}{\Delta K}$$

where $\Delta K = K_f\,(1 - b)$
is the net increase in capital formation.

K_f = amount of external capital
i = interest and service charges, in dollars
b = elasticity of substitution of external savings for national savings.[6]

[6] The coefficient *b* can be estimated by means of a regression of the time series of savings, income and external credit, with:

Financing a new project often entails that the equipment be purchased from the creditor country. In these cases, we would adjust the original formula to include the cost of "tied aid", i.e., to find the difference between the actual cost of purchasing the equipment from, and using maintenance services supplied by the lender, on the one hand, and the lowest price of comparable items that is available elsewhere, on the other. The additional cost which results from the tying of aid may be represented by t.[7]

A foreign technology "package" can bring with it a switch in factor proportion. Often imported technology entails a more intensive utilization of capital than is justified by the conditions of the receiving country. This will induce a relatively "anti-economic" utilization of capital. Put differently, utilizing capital with too much intensivity will lower its productivity, which will result in a higher capital-output ratio, V.

$$\log \frac{S}{Y} = a - b \log \frac{(F)}{Y}$$

S = national savings
F = external credit
Y = GNP

If a given project financed with foreign funds brings about a capital-output ratio higher than the desirable level, V^*, then the loss of output and income for a given investment will be:

$$K \left(\frac{1}{V^*} - \frac{1}{V}\right)$$

In order to make up for this loss of output, additional investments will have to be made in the amount of:

$$V^* \left(\frac{K}{V^*} - \frac{K}{V}\right) \text{ or } K\left(1 - \frac{V^*}{V}\right)$$

which assumed to have a capital ratio of V^*). The effectiveness of foreign investment, therefore, will be measured as:

$$\frac{K - K\left(1 - \frac{V^*}{V}\right)}{K}$$

or more simply, $\frac{V^*}{V}$, a result that is intuitively obvious.

[7] The cost of tied aid can be as high as fifty percent above the lowest market price. See H. G. Johnson, *Economic Policies Towards Less Developed Countries*, pp. 81-84.

Ignoring tied aid, *t,* the overall effective cost may be expressed as:

$$C = \frac{i}{K_f\ (i - b)\ (\frac{V^*}{V})}$$

As for the cost of tied aid, it is usually measured as a percentage, *s,* measuring the excess payment over and above what would be paid if competitive conditions prevailed internationally. Again, it would seem reasonable to include this factor in the denominator of the following expression:

$$C = \frac{i}{K_f\ (1 - b)\ (1 - s)\ (\frac{V^*}{V})}$$

The effective cost will exceed the nominal cost since:

$$1 > b,s,y,\ \ (\frac{V^*}{V})\ O$$

$$C = \frac{i}{K_f\ (1 - b)\ (1 - s)\ (\frac{V^*}{V})} > \frac{i}{K_f}$$

The definition of effective cost suggests that it can be expected to increase for a number of reasons, as the share of external capital in total capital formation goes up.

The Foreign Debt of Developing Countries: A Quantitative Description

1. *The overall figures*

The increasing concern over the LDCs' foreign indebtedness reflects, to a large extent, the explosive growth of the debt during recent years.

In effect, the total figure measured in current prices has grown from US$34.3 billion in 1965 to $164.4 billion and $194.6 billion in 1974 and 1975, respectively, or by 480 per cent and 567 por cent. The average annual rate of growth accelerated from 14 per cent during 1965-69 to somewhat over 19 per cent during the last decade.

Because of the faster growth of debt from private sources (private banks and other financial institutions), its relative share has increased significantly in recent years. Table 3 shows how this share has risen steadily from 17.9 per cent of the total in 1967 to 43.0 per cent in 1976. During the last decade, this debt grew at an annual rate of 28 per cent in current prices and 17 per cent in constant prices, which compares with 14 per cent and 4.5 per cent, respectively, for official credit.

Access to private capital markets has obviously been unequal for the different groups of countries.[7a] Only those LDCs with middle and high-income levels or with oil resources have enjoyed such access. Figures published by the World Bank show that low-income countries raised only 17 per cent of their foreign resources from private creditors in 1975, or about the same share as in 1967. The opposite situation

Table 3

EXTERNAL DEBT, DISBURSED, BY TYPE OF CREDIT *
1967-1976

	Official Creditors		*Private Creditors*		*Private as per cent of total*
Year	*Billions of US$*	*% Annual Increase*	*Billions of US$*	*% Annual Increase*	
1967	23.8		9.2		27.9
1968	27.3	14.7	10.2	10.9	27.2
1969	30.7	12.5	12.2	17.6	28.1
1970	34.6	12.7	14.5	20.8	29.6
1971	39.8	15.0	17.3	19.3	30.3
1972	44.5	11.8	21.3	23.1	32.4
1973	52.1	17.1	27.1	27.2	34.2
1974	60.1	15.4	34.8	28.4	36.7
1975[a]	69.5	15.6	47.3	35.9	40.5
1976[a]	79.0	13.7	59.7	26.2	43.0

* Includes 81 developing countries.
[a] Preliminary.
Source: 1967-1974: World Bank, *World Debt Tables*, EC-167/76.
1975-1976: World Bank, Debtor Reporting System.

[7a] We use here the World Bank's familiar classification of countries by income levels.

was observed for intermediate-income level countries and for oil countries.

The two following sections show in greater detail that the foreign debt of LDCs is clearly undergoing a process of concentration towards a few creditor and debtor countries. For example, fifteen countries absorb over 80 per cent of the total debt, while on the creditors' side the importance of the US stands out very clearly and, to a lesser extent, that of the remaining DAC countries. As for the multilateral organizations, their relative share has fallen, with the World Bank consolidating its position as the most important institution supplying external finance to LDCs.

In fact, the overall figures for the LDCs' foreign debt conceal an enormous diversity among the various countries. The various sets of economic development patterns and prospects, levels of development and income, the behavior of the foreign sector, availability of natural resources, population, etc., differ very substantially from one country to another, as one goes down the list of countries in the consolidated foreign debt tables.

As the external indebtedness of the LDCs' has increased and become more "privatized", the financial terms of the debt have tended to harden; at the same time, the burden of servicing the debt has increased markedly for the vast majority of LDCs To a large extent, this explains the recent attempts to promote multilateral mechanisms to prevent or relieve possible future debt crises.

In 1976, according to preliminary World Bank figures, LDCs, had to pay the equivalent of US $ 16.5 billion for interest and repayment on

Table 4

AVERAGE INTEREST PAID[a] ON THE DEBT OF DEVELOPING COUNTRIES

(Percentages / Selected Years)

Years	*Private Sources*	*Official Sources*
1968	4.8	3.0
1970	6.3	3.0
1972	6.0	3.1
1973	7.1	3.4
1974	8.4	3.4
1976[b]	9.0	3.6

[a] Interest paid throughout the year, as a percentage of debt outstanding (disbursed) at the end of the previous year.
[b] Sample of 32 countries.
Source: World Bank, *World Debt Tables*, EC-167/76.

their debts, compared with US $ 3.6 billion in 1967. Between these two years, the service on foreign debt grew at an average rate of 18.5 per cent per year, several times faster than the average growth rate of export earnings, which are the ultimate source of revenue to cover service payments. Such a situation is untenable beyond the medium term and has precipitated one of the most serious conflicts over the question of the debt.

Table 4 shows the change in interest rates on the LDCs' foreign debt. The rates clearly differ between the two broad groups of sources of the funds.

One of the most striking features of the development of LDCs during the last few years was the emergence of the oil-exporting countries as important suppliers of external funds, especially after 1973-74. Not only did these countries provide a vital stimulus to the growth of the Eurodollar market, but, for the first time in history, a group of developing countries finds itself in possession of the capability to support substantially the economic development of other countries in the "same" category. Whatever solution is found to actualize potential, the issue is of great importance for the future.

Needless to say, the information about the LDCs' external debt, which has been briefly sketched above, cannot be evaluated in a vacuum. As with all economic variables, such information must be placed in a broader context and related to other indicators. Moreover, the absolute changes are measured it current prices, which tells us little about the true size of the problem, particularly in a world that has suffered sharp inflation during the last few years.

A great deal of the current debate over foreign debt is polarized between those who consider the problem an exceedingly serious one that threatens the economic development of LDCs and those who feel that the debt has kept reasonable pace with developments in the world economy, and therefore do not consider the problem to be so serious.

At the risk of over-simplifying, the debate between those who consider the debt question a major problem and those who do not is between those who employ global arguments, ignore the existence of a broader context and base their analysis on figures in current prices, on the one hand, and those who recognize the dangers of aggregation, place the debt figures in a wider context, and make allowance for the effect of inflation, on the other. An attempt will be made in what follows to place the foreign indebtedness of the LDCs within such a broader context, taking into account the growth of the world economy, in particular that of debtor countries, as well as the development of world trade, particularly the exports of the debtor countries and the behavior of international reserves, and, finally, the repercussions of inflation on the foreign debt.

Over the last decade the world economy maintained a high rate of growth, except during the last three years, when it plunged into a recession. The long-term rate of growth of domestic product in the industrial countries has been higher than that of the LDCs, continuing the tendency for the gap between the income and well-being of the two groups to widen.

In spite of the enormous statistical difficulties in trying to consolidate GDP figures, it can be said that the increase in the LDCs' foreign debt has been at least three times as large as the growth of their economies in real terms. These countries are clearly substantially more indebted now than ten years ago, and their prospects for the intermediate future are not bright.

World trade has expanded substantially during the last ten years. World exports were valued at US$ 906 billion for 1976, which compares with $ 192 billion for 1967, a rate of increase of over 30 per cent per year, if oil sales are included. The expansion, however, has been greater for sales by industrial countries, which means that the share of exports from LDCs has fallen somewhat. At the same time, trade among the industrial countries themselves has expanded significantly.

The prices of export products originating in the less developed regions, except the oil countries, have risen in general at a rate slightly below that of the prices of exports of industrial countries. Since the opposite occurred in the case of import prices, the terms of trade for the LDCs have generally deteriorated.

Total international reserves reached a level of SDR 222.1 billion in December 1976, compared with 74.4 billion for 1967 —of which the LDCs (excluding oil producers) accounted for 36.7 billion (16 per cent) and 9.7 billion (13 per cent), respectively. Thus, while in 1967 the LDCs' external debt was 3 times as large as their reserves, ten years later the proportion had risen to almost 6 times.

The previous paragraphs serve to substantiate the statement that the foreign debt is, without any doubt, a problem of greater importance today than it was only a few years ago.

As a rule, data about the LDCs' external debt are measured in current prices. If the effect of inflation were taken into account by estimating the figures in constant prices, the problem would appear less dramatic, although it would not, of course, disappear. The IBRD has pointed out that the rate of growth of the foreign debt, which was 19 per cent per year, during the last decade, could be adjusted to less than half that figure if the amounts were measured in real terms. Inflation generally benefits debtors, especially in the long run, and hurts creditors. Some have therefore concluded that the LDCs have benefited from world inflation during the last few years, as far as their foreign debt is concerned.

Leaving aside the serious distortions that price increases have caused in the productive apparatuses of the countries concerned, and recognizing that the countries themselves are ultimately co-responsible for their foreign indebtedness, the problem can be narrowed down to a large extent to selecting the most appropriate "deflator" for the effect of inflation. Different studies have used the prices of world exports and imports, consumer prices in different countries, and other indices.

Although some studies have concluded that the incidence of inflation on the burden of LDC debt has been favorable, this conclusion seems to be based on simplistic analysis. Actually, as UNCTAD points out in a recent study "... whether or not a debtor country will benefit from inflation will depend upon the relationship that exists between the rate of growth of the prices of her exports and the prices of her imports, and upon the debt-service ratio." [8] The widely accepted opinions may, therefore, be incorrect: "rather, the opposite might by the case"[9] for most of the countries.

Table 5

EXTERNAL DEBT DISBURSED BY TYPE OF CREDITORS
81 DEVELOPING COUNTRIES

	Official Creditors		*Private Creditors*			
Year	*Billions of US$*	*% Annual Increase*	*Billions of US$*	*% Annual Increase*	*Total Billions of US $*	*Official % of total*
1967	23.8		9.2		33.0	72.1
1968	27.3	14.7	10.2	10.9	37.5	72.8
1969	30.7	12.5	12.2	17.6	43.2	71.9
1970	34.6	12.7	14.5	20.8	43.3	70.4
1971	39.8	15.0	17.3	19.3	57.1	69.7
1972	44.5	11.8	21.3	23.1	65.8	67.6
1973	52.1	17.1	27.1	27.2	79.2	65.8
1974	60.1	15.4	34.8	28.4	94.9	63.3
1975[a]	69.5	15.6	47.3	35.9	116.8	59.5
1976[a]	79.0	13.7	59.7	26.2	138.7	56.9

[a] Preliminary.
Source: 1967-1974: World Bank, *World Debt Tables,* EC-167/76.
1967-1974: World Bank, Debtor Reporting System.

[8] UNCTAD, "The Foreign Debt of Developing Countries, Aspects of the Incidence of Inflation upon the Burden of the Debt of Developing Countries". TD/AC.2/4. June 30, 1977, p. 5.

[9] *Ibid.*, p. 6.

2. *External debt to official sources*

External public debt from official sources[10] rose from US$ 23.8 billion in 1967 to US$ 79 billion in 1976, according to preliminary figures; i.e., when measured in nominal terms, it grew more than three times during the last ten years. However, during this period, the proportion of debt to official sources fell relative to that contracted with private sources. Table 5 shows that in 1957 the former was 72.1 per cent of the total but that by 1975 it had fallen to 59.5 per cent and one year later had declined further to 56.9 per cent.

The proportion of debt originating in official sources fell during the period 1967-1976: it grew at an average annual rate of 14.3 per cent in current prices, while total foreign debt increased at rate of

Table 6

GROWTH OF EXTERNAL DEBT OF DEVELOPING COUNTRIES, 1967-1976

(Average percentage per year)

Creditors	*Current Prices*	*Constant Prices*
Official	14.3	4.5
Private	23.0	17.2
Total	17.3	8.9

Source: World Bank, *World Debt Tables*, EC-167/76.

17.3 per cent, and the average for debt originating in private sources grew at a rate of 23.0 per cent (Table 6).

Within the total debt from official sources, a trend can be discerned for bilateral financing to dominate over multilateral. This trend weakened slightly during the last few years (Table 7). In the sixties bilateral financing amounted to over three-quarters of the total originating in official sources; by 1974 the proportion had fallen below 70 per cent. This change, however, does not significantly alter the original picture. Again, if only disbursed amounts are taken as a basis for the calculation (Table 8), bilateral loans continued to predominate over multilateral ones. The changes in the last few years have reinforced this situation.

[10] External public debt from official sources includes all debt contracted and/or underwritten by the governments of Third World countries with international organizations, world-wide or regional, and governments, whether DAC members or others, including socialist countries and members of OPEC.

As a rule lower-income countries have relied more heavily on financing from official sources either because they were unable to gain access to private capital markets, or because they were barred from them, or, sometimes, because their own governments refrained from

Table 7

FOREIGN DEBT OF LDCs (INCLUDING UNDISBURSED) BY TYPE OF CREDITOR, 1967 - 1974

	1967		*1970*		*1974*	
	Amount	*%*	*Amount*	*%*	*Amount*	*%*
Official (total)	36 480.5	72.1	5 872.6	69.8	97 005.2	64.0
Bilateral	27 951.0	76.6	38 138.1	73.5	66 767.6	68.8
Multilateral	8 529.5	23.4	13 704.5	26.5	30 237.6	31.2

Source: World Bank, *Annual Report,* 1976, Table 4.

attempting to enter them. Table 9 shows that more then 80 per cent of the external debt of this group of countries originated from official sources. A large proportion of the total was official development assistance (ODA), which is of a highly concessional nature,[11] and consists of loans and grants in roughly similar proporitions.

Table 8

CHANGES IN THE STRUCTURE OF THE EXTERNAL DEBT, DISBURSED, ORIGINATING IN OFFICIAL SOURCES, 1967-1974

Creditor	*Debt originating in official sources (billions of US$)*		*Annual rate of growth (%)*	*Share in total official indebtedness (%)*	
	1967	*1974**	*1967-74*	*1967*	*1974*
Bilateral	18.8	44.8	13.3	77.3	74.4
Multilateral	5.4	15.2	15.8	22.7	25.3
Total	24.2	60.0	14.0	100.0	100.0

* The figures in this table differ from those in Table 7 which includes the undisbursed portion of the loans.
Source: World Bank, *World Debt Tables,* EC-167/76.

[11] The grant equivalent of a loan is defined as the face value of the loan commitment less the discounted present value of the future flow of amortization and payments of interest, using the customary discount rate of 10 per cent or the appropriate market rate. See *World Bank,* EC-167/76, p. 4.

In spite of the grant element in much of the official financing received by low income countries, the burden of their foreign debt turns out to be heavier than for any other group of countries. This is because in many cases domestic economic structures are inadequate, and their external sector lacks dynamism and is excessively dependent.

Table 9

LOANS ORIGINATING IN OFFICIAL SOURCES, COUNTRIES GROUPED BY INCOME LEVELS, 1967-1974

(Percentage of the total)

Countries	*1967*	*1974*
Low income	83.3	82.9
Medium income	51.4	43.5
Oil producers	57.5	39.1

Source: World Bank, *World Debt Tables*, EC-167/76.

It is possible to appreciate the situation better by looking at the secular trend towards a steady increase in the burden of external debt service for the low-income countries. Their position in this respect contrasts with that of other groups of LDCs which at some point received some debt relief or had smaller increases in their debt coefficient.

For low-income countries in general, the availability of concessional resources has helped them pursue some of their long-term goals, in spite of the political cost often involved, especially with bilateral assistance, and the burden of servicing the debt. At a multilateral level, the International Development Association of the World Bank Group has been the main channel, since it was set up for transfering official resources to these countries in view of their inability to tap private sources of finance. Projects to increase agricultural productivity or diversify exports are being launched to help these economies developed by expanding their savings and foreign exchange earnings. Yet, the prospects for some of these countries to consolidate as national entities continue to cause great concern to creditor governments and agencies, as well as international organizations.

According to UNCTAD, disbursements of loans and grants for this group of countries (broadened to include those with income levels below 300 dollars per year in 1973), rose from US$ 2.6 billion in 1965 to US$ 4.9 billion in 1973, an annual growth rate of only 8 per cent. Their debt-service payments, however, grew twice as fast, so that the

Table 10

EXTERNAL DEBT SERVICE OF DEVELOPING COUNTRIES AND DEBT-SERVICE RATIO FOR 1976, BY GROUPS OF INCOME[a]

	Low income	*Middle income*	*Oil producers*	*Total*
Debt service (billions of US$)				
Official	2.0	10.2	4.3	16.5
Private	0.3	4.6	1.6	6.5
Total	2.3	14.8	5.9	23.0
Debt service ratio (%)				
Official	23.3	9.7	6.7	9.1
Private	3.4	4.4	2.4	3.6
Total	26.7	14.1	9.1	12.7

[a] Estimates based on preliminary figures.
Source: World Bank, *World Debt Tables*, EC-167/76 and IMF, *International Financial Statistics*, Dec. 1975, Dec. 1976.

net transfer of resources to this group of countries expanded at only 6 per cent — a figure below even the rate of increase in the prices of the goods purchased by means of these resources. In 1973 the real value of the net transfers was therefore less than in 1965.[12] Since the situation is tending to deteriorate even further, this group of countries clearly faces a serious debt problem that demands urgent solution in order to forestall possible bankruptcies. The seriousness of the problem becomes more evident given the continued increase in their debt-service payments and the improbability that their borrowing from official sources (which forms the bulk of their disbursements) will increase substantially in real terms. This is especially so because of inflation and in spite of the announced expansion of the resources of some of the institutions, such as the IBRD and the IMF.

For the middle-income countries, the share of official financing in their foreign debt has fallen substantially, from 51.4 per cent in 1967 to 43.5 per cent in 1974. The same is true for oil-exporting countries: the proportions for them fell from 57.5 per cent in 1967 to 39.1 per cent in 1974. For both groups of countries this situation reflects the increasing role of foreign debt from private sources. The reasons for this must be sought beyond the supposed "coming of age" of some of the members of the group (meaning that they have become capable

[12] UNCTAD, *International Financial Cooperation for Development*, IV Session, Nairobi, 1976.

Table 11

EXTERNAL PUBLIC DEBT SERVICE OF THE DEVELOPING COUNTRIES AS PERCENTAGE OF THEIR EXPORTS

	External debt service of 81 LDCs (million US$)	*Low income countries (%)*	*Middle income countries (%)*	*Oil producers (%)*
1967	3 576	12.5	10.4	2.6
1972	7 618	15.1	11.0	10.4
1973	10 165	13.5	10.5	8.8
1974	12 225	13.1	8.5	4.8
1975[a]	14 000	20.5	8.5	5.9
1976[a]	16 500	23.3	9.7	6.7

[a] Estimates.
Soure: World Bank, *World Debt Tables*, 53-167/76, IMF, *International Financial Statistics*, Dec. 1975 and Dec. 1976. World Bank, *External Medium-and Long-Term Debt*, EC-156 (Dec. 1976).

of raising resources in private capital markets). A number of international financing organizations and governments are making a practice of granting loans to a country almost conditional upon the country's having a certain degree of poverty. But the required degree of poverty is not so clearly noticeable in the case of many of the middle income countries, much less among the oil producers.

For a number of countries in both groups, the debt burden is less than for the low-income countries, basically owing to the comparatively greater dynamism of exports in the former. The situation is not without difficulties, however. Some of the countries have been borrowing increasing amounts of resources in private capital markets, at rates of interests that are very high and with very short maturity periods. In addition, much of their foreign public debt payments are bunched up over the next few years and will fall due before the end of the decade. It is also expected that before the decade ends these countries' capital requirements for growth will have gone up rapidly. It has thus become apparent that disbursements will have to be speeded up in order to increase the net transfer of resources to these countries.

The preponderance of financing of official origin as a source of funds for low-income countries does not necessarily mean that these countries receive a large share of the aggregate portfolio of international organizations and governments. The opposite is true: Table 12 shows that during 1974-1976 the middle-income countries' proportion of the debt from official sources grew faster than that of the other two groups of countries.

Table 12

EXTERNAL DEBT OF 81 DEVELOPING COUNTRIES (DISBURSED), 1974-1976

(Millions of US$)

	1974	*1975*	*1976*
A. 73 non-oil producing countries			
1. Low income	22 611.2	25 264.4	28 884.0
Official	20 624.1	22 500.4	26 195.3
Private	2 347.1	2 753.0	2 688.7
2. Middle income	53 544.3	69 354.8	85 194.7
Official	28 755.5	34 867.1	40 250.6
Private	25 788.8	34 487.7	44 944.1
B. Oil producing countries (8)	17 677.0	22 200.0	24 700.0
Official	11 174.7	12 100.0[a]	12 100.0[a]
Private	6 592.3	10 100.0[a]	12 600.0[a]

[a] Figures based on incomplete information.
Source: 1974-1975: World Bank, Debtor Reporting System and IMF missions. 1976: estimates by IMF.

However, financial terms on the official component of the external debt of Third World countries have remained relatively stable during the last ten years: maturities have varied little, generally being long (18.1 years for official loans, compared with 7.4 years for loans from private sources, on the average). Interest payments on official debt, though rising, do not as a rule follow the pattern of interest on debts from private sources, as can be seen in Table 4. World inflation even caused those rates to become negative in real terms, but what might seem to be a favorable effect at first glance must be evaluated with caution, in the light of the increases inflation caused in the products that Third World countries import, as well as of the substantial disruptions inflation caused their productive apparatus.

Clearly, the issues noted here are not equally relevant for all countries in the Third World, or even for all the members of a given subgroup of countries. Even in the sub-group of the chief debtors, some countries raise a very high proportion of their external debt from official sources; in the case of India it is as high as 97.6 per cent (India thus absorbed 18 per cent of the world total in 1973). This contrasts with other countries such as Brazil and Mexico, whose official debt accounted for only 17.9 per cent and 19.0 per cent of their respective totals (see Table 13). In 1974 these two countries alone accounted for 44 per cent of the world total of external loans from private sources. There are indications that this situation has been reinforced in the case of both countries during the last two years.

Given the impossibility of doing a detailed study on each one of the principal LDC debtor countries, the countries will be grouped according to income levels and geographical regions, and the relevant peculiarities of individual cases will be highlighted. The behavior of the different sources of official financing will be discussed, and this will

Table 13

MAJOR DEBTOR COUNTRIES, DEC. 31/1974 IN MILLIONS OF US$

Country	*Total*	*Percentage*	*Official sources*	*Official as % of total*
Brazil	17 936	16	3 212	17.9
India	11 242	10	10 975	97.6
Mexico	10 514	9	2 005	19.0
Indonesia	5 897	5	4 698	79.6
Iran	5 135	5	3 386	69.4
Yugoslavia	4 966	4	1 578	31.7
Pakistan	4 635	4	4 384	94.5
Korea	4 442	4	2 112	47.5
Argentina	4 195	4	1 210	28.8
Chile	3 729	3	2 018	54.1
Algeria	3 325	3	1 004	30.1
Turkey	3 222	3	2 899	89.9
Colombia	2 422	2	1 609	66.4
Philippines	2 244	2	687	30.6
Peru	2 051	2	575	28.0
Egypt	1 811	2	1 440	79.5
Venezuela	1 468	1	414	28.2
Zaire	1 309	1	308	23.5
Total	90 543	80	44 714	49.3
81 developing countries[a]	112 916	100	60 070	53.1
Major debtors as % of total of 81 developing countries	80.2		74.4	

[a] The figure was derived as follows: External debt of 86 countries World Bank, *World Debt Tables*, EC-167/76, minus external debt of five Mediterranean countries: Greece, Israel, Malta, Portugal and Spain.

be complemented whenever possible with detailed information about individual organizations and governments.

Official sources basically means international organizations and governments. Among the former group it is customary to include world-wide organizations such as the International Bank for Reconstruction and Development and its two associated institutions: the International Financial Corporation and the International Development Association, and the "third window" of the World Bank.[13] There also exist regional institutions such as the Inter-American Development Bank (1961) and those of Africa (1964), Asia (1967), and the Caribbean (1969); and sub-regional organizations such as the Central American Bank for Economic Integration (1960), the Andean Development Corporation (1968) and the Bank of the Arab Countries.

As for bilateral resources from governments, these include assistance from member countries of the Development Assistance Committee, created in 1960 within the framework of the OECD: Australia, Austria, Belgium, Canada, Denmark, France, Germany (Federal Republic), Italy, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland, the United Kingdom and the United States. Others might be added, such as Western countries that are not members of the DAC like Finland and New Zealand, and socialist countries, mainly the Soviet Union. Finally, the assistance granted by OPEC countries to the rest of the LDCs should also be included, particularly that channeled through their Development Fund, established formally in 1976.

Table 14 shows the distribution of official financing by sources for 86 developing countries. The preponderance of bilateral over multilateral financing is clearly apparent. Loans from DAC countries form the bulk of the former category and World Bank Group loans stand out in the case of the second. In addition, it can be seen that little more than 50 per cent of bilateral financing is concessional, and that financial terms on this are much more favorable than those prevailing in the market. In the case of multilateral institutions, the concessional content reflects virtually entirely the loans from IDA, which contributes less than 25 per cent of the total loans granted by multilateral sources.

Bilateral loans are relatively flexible, in part at least to compensate for the relative inflexibility of the non-financial conditions attached to them, such as the tying of aid and other political considerations. Whether a balance is achieved can only be discerned for individual cases. It is significant, however, that a good many countries show a preference

[13] The International Monetary Fund is not included here as a lending organization, since most of its financing is basically of a compensatory nature. In Chapter VI, however, the increasingly important role of the Fund —which is certain to grow even more over the next few years, is noted with respect to the foreign debt problem.

Table 14

OFFICIAL FINANCING TO 86 DEVELOPING COUNTRIES BY TYPE OF LOAN AND BY SOURCE (COMMITMENTS)*

(Millions of US$)

	1969	*1970*	*1971*	*1972*	*1973*	*1974*
A. International Organizations:						
IBRD	1 195	1 535	1 757	2 028	2 352	3 268
IDA	369	588	717	924	1 576	1 520
World Bank Group	*1 564*	*2 123*	*2 474*	*2 852*	*3 938*	*4 788*
Others	404	719	675	817	992	1 805
Total International Organizations	1 968	2 842	3 149	3 769	4 920	6 593
B. Loans from governments:						
DAC members:	*3 165*	*3 574*	*4 865*	*5 974*	*7 342*	*7 156*
Concessional[a]	1 911	2 126	2 304	2 611	3 181	3 495
Others	1 254	1 448	2 561	3 363	4 161	3 661

Eastern Europe	*671*	*1 035*	*762*	*1 477*	*983*	*1 474*
Concessional[a]	529	870	431	1 159	553	1 189
Others	142	175	331	318	430	285
OPEC countries	*18*	*21*	*84*	*187*	*190*	*1 934*
Concessional[a]	1	12	51	169	62	1 285
Others	17	9	33	18	128	649
Other countries	*195*	*545*	*159*	*282*	*298*	*684*
Concessional[a]	73	64	17	48	6	22
Others	122	477	142	234	292	662
From governments	*4 049*	*5 175*	*5 870*	*7 920*	*8 813*	*11 248*
Concessional[a]	2 515	3 066	2 802	3 987	3 802	5 990
Others	1 534	2 109	3 068	3 933	5 011	5 258
C. Total Official[b]	6 017	8 017	9 019	11 689	13 733	17 841
D. Total of all sources	10 944	13 927	15 651	20 159	27 006	36 335
E. Official as % of Total	54.9%	57.5%	56.6%	57.9%	50.8%	49.1%

[a] Concessional credits are those with an interest rate of 3 per cent or less.
[b] Nationalizations are not included.
Source: World Bank, *World Debt Tables*, 53-167/76.
* This table covers 86 countries, including the 5 Mediterranean nations that are relatively advanced (Spain, Greece, Israel, Malta and Portugal) because it was impossible to obtain the breakdown by sources for 81 countries.

Table 15

EXTERNAL PUBLIC DEBT OUTSTANDING OF 81 DEVELOPING COUNTRIES BY TYPE OF CREDIT (DISBURSED)*

(Millions of US$)

Countries	Years 1967	1972	1973	1974
A. 81 Developing Countries	*30 579*	*61 709*	*74 461*	*89 679*
— International Organizations	4 951	9 734	11 660	14 207
— Government credits	17 001	31 329	35 392	42 799
— Concessional	9 837	21 058	22 991	66 899
— Others	7 164	10 271	12 401	15 900
Total official	21 952	41 063	49 415	55 593
B. Oil Producers	*4 242*	*12 023*	*15 641*	*17 709*
— International Organizations	552	980	1 190	1 456
— Governments	2 830	6 635	8 263	9 663
— Concessional	1 648	4 610	5 362	6 029
— Others	1 186	2 025	2 901	3 634
Total official	3 382	7 615	9 453	11 119
C. High and Middle Income Countries	*16 635*	*32 442*	*39 255*	*49 823*
— International Organizations	2 465	5 466	6 617	8 133
— Governments	7 252	12 213	14 259	16 297
— Concessional	3 635	7 140	8 049	8 760
— Others	3 617	5 073	6 210	7 537
Total official	9 681	17 699	21 596	24 430
D. *Low Income Countries*	*9 703*	*17 243*	*19 465*	*22 147*
— International Organizations	1 935	3 288	3 852	4 618
— Governments	6 956	12 480	13 870	15 426
— Concessional	4 554	9 308	10 580	12 173
— Others	2 402	3 172	3 290	3 253
Total official	8 891	15 768	17 722	20 044

Source: World Bank, *World Debt Tables*, EC-167/76.
* The 5 relatively advanced Mediterranean countries are excluded.

for multilateral financing. Yet, since many of these are middle-income countries that do not (or barely) meet certain criteria governing bilateral financing (such as the degree of poverty in their societies), it is difficult to generalize about this.

If the countries are grouped by categories, the distribution of official financing, both multilateral and bilateral, has tended to favor the group of middle and high-income levels (Table 15). For example, in 1974, this group received practically half the total official capital. The situation becomes clearer if the international organizations are singled out. For, as pointed out before, the grant element in their loans is generally less than in the case of government loans.

Table 16 gives a breakdown by type of international multilateral organizations. The picture is clearly dominated by the World Bank Group, and, within it, by the International Bank for Reconstruction and Development, which has granted over 50 per cent of the multilateral loans. A large part of the resources lent by the Bank to the LDCs have gone to finance specific projects, in order to create and strengthen the economic infrastructure. As a rule, the financial terms have consisted of maturities and interest rates that started from close to concessional levels, and, in the recent past, have approached the levels of commercial rates, reaching 8 per cent per year for some projects in middle income countries.

The flow of multilateral assistance is dominated by credits to high/middle income countries, with the single exception of loans from the International Development Association, owing to statutory restrictions. The IDA was created in 1960 to complement the activities of the IBRD just as four years before the International Finance Corporation (IFC) had been created to stimulate private investment in developing countries; the IDA's role is almost exclusively to handle the needs of relatively less-developed countries. Hence, the terms on its credits are more flexible: maturities up to 50 years, grace periods up to 10 years and interest rates between 1 and 3 per cent per year.

Low-income countries and the poorer middle-income countries have also been given some priority treatment by means of the "third window" of the World Bank. This is the international financial facility established in 1975 to provide assistance for development on financial terms somewhere between those applying to its ordinary resources and those attached to IDA loans. Countries eligible to obtain these resources are in principle those with per capital incomes below 375 dollars per year.

Table 16 gives the distribution of credits from the international organizations as a whole. Out of 86 developing countries, 26 absorb 80 per cent of the total resources —of which, again, the bulk was concentrated in the high and middle-income countries. Among the 26 countries, the ones that stand out if one looks at the totals for all

Table 16

DISTRIBUTION OF LOANS FROM INTERNATIONAL ORGANIZATIONS BY GROUPS OF COUNTRIES (INCLUDING UNDISBURSED)

(Millions of US$)

Organizations	*1967*	*1972*	*1973*	*1974*
IBRD	*5 613*	*11 577*	*13 473*	*16 283*
Oil producers	745	1 436	1 838	2 329
High income[a]	2980	7 156	8 272	9 616
Middle income[b]	644	1 741	2 133	2 860
Low income[c]	1 244	1 244	1 230	1 479
IDA	*1 711*	*4 765*	*6 426*	*7 946*
Oil producers	44	406	595	652
High income[a]	189	358	475	498
Middle income[b]	161	620	920	1 078
Low income[c]	1 318	3 382	4 436	5 717
Total World Bank group	*7 324*	*16 343*	*19 899*	*24 229*
Oil producers	789	1 842	2 433	2 981
High income[a]	3 169	7 514	8 747	10 114
Middle income[b]	805	2 361	3 053	3 938
Low income[c]	2 562	4 626	5 666	7 196
Other international organizations	*1 252*	*3 318*	*4 276*	*6 008*
Oil producers	69	241	360	470
High income[a]	1 132	2 324	2 870	3 747
Middle income[b]	50	571	763	1 216
Low income[c]	1	181	283	576
Total all[d]	*8 576*	*19 660*	*24 175*	*30 238*
Oil producers	858	2 083	2 793	3 452
High income[a]	4 301	9 838	11 617	13 860
Middle income[b]	855	2 932	3 816	5 154
Low income[c]	2 563	4 807	5 949	7 772

[a] Over 500 dollars per capita income per year. Includes the relatively advanced Mediterranean countries, which cannot be separated from the data base.
[b] 200 to 499 dollars per year.
[c] Less than 200 dollars per year.
[d] Includes regional organizations, etc., of a multilateral type.
Source: World Bank, *World Debt Tables*, EC-167/76.

international organizations are India, Brazil, Mexico, Turkey, Pakistan and Colombia, which together absorb about 50 per cent of the total. Brazil and Mexico are, in that order, the two principal debtors of the IBRD. India is the principal debtor of the IDA. The "third window" has concentrated resources on India, followed by Egypt, Pakistan and South Korea, Finally, taking the remaining international organizations, financing was again concentrated in Brazil and Mexico, this time followed by Argentina, reflecting the importance of the Inter-American Development Bank (IDB), which is the oldest of the regional development institutions.[14] Other major recipients of financing from these other international organizations were: Turkey, the Republic of Korea, the Philippines and Pakistan.

The DAC countries provide most of the assistance, supplied by governments, slightly over two-thirds of the total bilateral assistance received by developing countries in the form of loans or grants. However, it is mainly high/middle income countries that get this assistance (practically equal shares), while the oil-producing countries received a minor portion.

In spite of the importance of DAC financing within the total of foreign financial assistance, however, this group of countries as a whole falls far short of the goal that was set for the Second Development Decade of the United Nations: to allocate 0.7 per cent of GNP as official development assistance (ODA). DAC countries as a whole allotted only 0.36 per cent of their consolidated gross products to this purpose in 1975. Individual performance varied widely: Sweden devoted 0.82 per cent of GNP to ODA — the highest proportion for the group; while for the USA, the percentage was only 0.26 per cent, one of the lowest.[15]

The European socialist countries come next after the DAC in importance, but their total is much smaller, amounting to only a fourth of all bilateral assistance. As for the distribution by groups of LDCs, it seems to favor all three groups uniformly.

OPEC countries and some other countries allot much smaller amounts of resources in the form of bilateral assistance to the LDCs. Most of the OPEC countries assistance goes to low-income nations. The remaining countries favor the high/middle-income nations.

Within the DAC total, US Government assistance (of which more than 60 per cent consists of grants) accounts for a major part, although it fell from 50 per cent of the total during 1964-1965 to 30 per cent

[14] In 1974, 35.2 per cent of the loans authorized during the year by these other organizations (1.8 billion dollars) was from the IDB alone. Of the total loans outstanding from the same group of entities (6.0 billion) as of the end of 1974 more than 50 per cent came from the IDB. Source: IDB, *Annual Report 1974,* Tables 10 and 14.

[15] OECD, *Development Co-operation,* 1976.

Table 17

DISTRIBUTION OF LOANS FROM INTERNATIONAL ORGANIZATIONS TO THE 26 MAJOR LDC DEBTORS. AMOUNTS OUTSTANDING (INCLUDING UNDISBURSED), 1974

(Millions of US dollars)

	IBRD	*IDA*	*Others*	*Total*
Oil producers				
Algeria	186	—	4	190
Indonesia	138	574	189	900
Iran	936	—	—	936
Nigeria	534	40	6	580
Venezuela	595	—	151	446
Total	2 089	613	350	3 052
Total oil producers	2 329	652	470	3 452
High income countries				
Argentina	418	—	356	775
Brazil	1 625	—	805	2 430
Chile	144	22	149	315
Colombia	848	23	281	1 152
Greece	155	—	94	249
Israel	184	—	—	184
Malaysia	357	—	200	738
Mexico	1 572	—	649	2 221
Peru	225	—	55	280
Spain	375	—	72	447
Taiwan	265	15	85	366
Tunisia	216	71	16	303
Turkey	678	196	419	1 294
Yugoslavia	909	—	7	916
Total	8 151	327	3 191	11 669
Total high income	9 616	498	3 747	13 860
Middle income countries				
Egypt	85	186	6	277
Korea (Rep.)	429	115	325	933
Morocco	404	39	46	489
Philippines	504	32	240	777
Total	1 485	373	618	2 476
Total middle income	2 860	10 078	1 216	5 154

	IBRD	*IDA*	*Others*	*Total*
Low income countries				
India	668	3 543	—	4 211
Pakistan	391	603	204	1 198
Zaire	±	74	64	138
Total	1 060	4 220	268	5 547
Total low income	1 479	5 717	576	7 772
Total 26 developing countries	12 785	5 534	4 426	22 745
Total 86 developing countries	16 283	7 946	6 008	30 238

* Zaire qualified in previous years.
Source: World Bank, *World Debt Tables*, EC-167/76.

during 1973-1974. In view of the recovery of the US economy, it may be expected that this share will rise again. The allocation by countries can also be expected to change in view of the Carter Administration's policy of making both economic and military assistance conditional on respect for human rights. Because of political and strategic considerations, however, it is possible that certain countries will continue to receive an important share of this assistance, regardless of their stance on human rights. France, Germany and Japan are also important countries in view of their contribution to the total flow of bilateral finance (Table 19).

Among the Eastern European countries, the Soviet Union stands out, with more than half the total financing of that group (Table 20). Other countries which contribute an important part of the total (although much less than the USSR) are Romania (in spite of its relative poverty), Poland and Czechoslovakia.

Until the fall of 1973, assistance to Third World countries from OPEC members used to be small. Almost all this aid came from Kuwait, Libya and Saudi Arabia, and went mainly to other Arab countries. Outside the Arab group, long-term assistance for development used to be scarce, irregular and limited to some small African countries.[16] As can be seen in Table 21, assistance from OPEC countries expanded very rapidly after 1974.

[16] The Kuwait Fund for Arab Economic Development is the oldest and most active of the Arab development funds. In 1968, the Arab Fund for Economic and Social Development was set up, but it began operating only in 1972. In 1971, the Abu Dhabi Fund for Arab Economic Development was set up. Source: The OPEC Special Fund, *First Annual Report*, 1976.

Table 18

DISTRIBUTION OF LOANS FROM GOVERNMENTS BY GROUPS OF RECEIVING COUNTRIES (INCLUDED UNDISBURSED) TOTAL AND CONCESSIONAL

(Millions of dollars)

	1967		*1972*		*1973*		*1974*	
DAC Countries	*20 316*	*10 538*	*37 992*	*21 834*	*44 614*	*25 119*	*50 136*	*28 590*
Oil exporters	2 033	686	5 645	3 202	7 634	3 986	8 986	4 623
High income	8 468	3 970	14 692	6 650	16 644	7 202	18 890	7 796
Middle income	2 586	1 428	5 388	3 132	6 158	3 625	7 542	4 315
Low income	7 229	4 453	12 287	8 850	14 178	10 306	15 637	11 855
Eastern Europe	*6 185*	*5 772*	*9 848*	*9 288*	*10 480*	*9 935*	*11 822*	*11 027*
Oil exporters	2 021	1 648	3 748	3 259	3 634	3 528	3 663	3 554
High income	697	606	1 750	1 334	1 679	1 280	2 001	1 377
Middle income	957	893	1 279	1 259	1 542	1 518	1 829	1 803
Low income	2 510	2 510	3 071	3 066	3 226	3 222	3 936	3 904

OPEC Countries	*544*	*214*	*785*	*436*	*956*	*481*	*2 812*	*1 709*
Oil exporters	155	127	248	191	243	165	178	107
High income	46	8	69	16	106	52	384	102
Middle income	235	56	331	151	435	176	841	315
Low income	108	22	137	79	171	89	1 409	1 184
Other Countries	*1 089*	*589*	*1 171*	*529*	*1 429*	*413*	*1 997*	*385*
Oil exporters	244	201	317	203	335	108	390	96
High income	476	75	381	46	588	33	1 019	35
Middle income	146	110	287	163	301	163	309	159
Low income	223	202	186	117	206	109	280	94
Total all Countries	*28 134*	*17 112*	*49 796*	*32 087*	*57 478*	*35 949*	*66 768*	*41 711*
Oil exporters	4 454	2 779	9 959	7 220	12 246	8 171	12 690	8 766
High income	9 687	4 659	16 871	8 046	19 016	8 567	22 294	9 311
Middle income	3 923	2 487	7 285	4 705	8 436	5 481	10 522	6 592
Low income	10 070	17 188	15 681	12 112	17 781	13 726	21 262	17 037

Source: World Bank, *World Debt Tables*, EC-167/76.

Table 19

OFFICIAL DEVELOPMENT ASSISTANCE FROM DAC MEMBER COUNTRIES 1964-66 AND 1973-75

(In millions of dollars and annual averages)

Country	*Official Assistance*[b] *1964-66*	*1973-75*	*Grants*[a] *1964-66*	*1973-75*	*Grants as % of total*[c] *1964-66*	1973-75
Australia	114.9	407.7	108.4	381.1	94.3	93.5
Austria	10.0	54.7	3.7	13.4	37.0	24.5
Belgium	83.0	294.6	76.6	235.4	92.2	79.9
Canada	120.5	702.7	108.7	371.8	90.2	52.9
Denmark	14.7	168.4	10.4	112.6	70.7	66.9
Finland	n.a.	38.0	n.a.	21.7	n.a.	57.1
France	775.1	1 722.5	638.4	1 429.8	82.3	83.0
Germany	444.7	1 408.1	161.4	717.1	36.4	50.9
Italy	62.0	196.8	22.1	135.1	35.6	68.6
Japan	214.9	1 095.0	88.8	250.4	41.3	22.9
Netherlands	70.9	454.0	37.8	315.7	53.3	69.5
New Zealand	9.3	44.7	n.a.	39.0	n.a.	87.2
Norway	11.7	133.9	9.4	115.1	80.3	86.0
Sweden	42.6	414.3	28.8	299.2	67.6	72.2
Switzerland	11.3	78.9	9.1	52.7	80.5	66.8
UK	483.8	732.0	275.2	414.5	56.8	56.6
United States	3 453.0	3 471.3	2 357.6	1 966.3	68.2	56.6
DAC Total	5 913.0[c]	11 417.6	3 936.9	6 870.9	66.6	60.2
Without USA	2 460.0	7 946.3	1 579.3	4 904.6	64.2	61.7

[a] To countries and multilateral agencies.
[b] Including technical assistance.
[c] Excluding Finland and New Zealand.
Source: OECD, *Development Co-operation*, 1976.

Table 20

COMMITMENTS OF BILATERAL ASSISTANCE TO LDCs OF ASIA, AFRICA AND LATIN AMERICA FROM COUNTRIES OF EASTERN EUROPE, 1960-1974[a]

(Millions of dollars)

Country	*1960*	*1961*	*1962*	*1963*	*1964*	*1965*	*1966*	*1967*
Bulgaria	—	12	—	6	5	17	15	47
Czechoslovakia	115	146	1	20	118	43	192	88
Democratic Republic of Germany	27	46	—	—	71	132	—	231
Hungary	34	111	—	14	10	42	52	45
Poland	65	128	88	9	54	22	—	63
Romania[c]	—	100	—	—	70	—	—	14
USSR	582	302	214	205	608	330	1 033	333
Total	823	845	303	254	936	586	1 292	821

Country	*1968*	*1969*	*1970*	*1971*	*1972*	*1973*	*1974*[b]
Bulgaria	35	20	82	55	40	43	76
Czechoslovakia	200	37	55	14	100	303	100
Democratic Republic of Germany	8	134	125	25	23	...	46
Hungary	40	21	79	42	45	148	85
Poland	20	30	25	65	100	243	107
Romania[c]	45	132	10	141	385	36	330
USSR	368	402	197	677	921	1 236	904
Total	716	776	573	1 019	1 614	2 009	1 648

[a] Excludes commitments to Cuba and the Democratic Republic of Vietnam.
[b] Preliminary figures.
[c] Romania classifies itself as a developing country.
Source: Center for Development Planning, Projections and Policies of the Department of Economic and Social Affairs, United Nations Secretariat.

In 1976, OPEC member countries set up their own multilateral development fund, the OPEC Special Fund. This has a capital of 800 million dollars, and disburses loans under highly concessional terms.[17] Iran, Saudi Arabia, Venezuela and Kuwait are, in that order, the main suppliers of assistance among the OPEC countries. They contributed almost 80 per cent of the total allocated for 1976. Indonesia and Gabon gave the smallest amounts of assistance. In addition, Venezuela supplies increasing levels of assistance to Latin America through the IDB.

Table 21

LOAN COMMITMENTS BY OPEC MEMBERS TO OTHER LDCs

	Millions of US dollars		
Year	*Total amount*	*Disbursed*	*% granted in concessional terms*
1973	1 469	922	n.a.
1974	8 575	4 647	n.a.
1975	9 033	5 589	46.0

Source: World Bank, *Annual Report*, 1976.

The lending criteria of the OPEC Special Fund tend to favor low-income countries (those with less than 500 dollars per capita). The principal beneficiaries of its first program are: India, Pakistan, Egypt and Bangladesh, which absorbed a third of the commitments reported between December 1976 and May 1977. The rest of the nearly 200 million dollars allotted was distributed among 41 Third World countries.

High/middle income Third World countries were the major beneficiaries of assistance from Western governments, both members and non-members of the DAC. In this respect, the DAC and the Eastern European countries differ, since the latter allocated their financial assistance about equally to high/middle and lower income countries. For the OPEC countries, the basic priority was, as pointed out before, assisting the development of the relatively undeveloped countries.

For official bilateral assistance as a whole, the largest absolute amounts went to India, Indonesia, Pakistan and Turkey, which together absorbed 59.5 per cent of the total allocated to the 26 major Third World borrowers in 1974. Following closely were Egypt, Iran, Brazil and Korea. These eight countries together absorbed more than three-

17 Iraq has not as yet ratified its $ 40 million contribution to the OPEC Fund.

Table 22

DISTRIBUTION OF GOVERNMENT LOANS TO THE MAJOR DEBTOR LDCs (DEBT OUTSTANDING, INCLUDING DISBURSED), 1974

(Millions of dollars)

	DAC	*European Socialist Countries*	*OPEC Members*	*Other Countries*	*Total*
Oil producing countries					
Algeria	393	767	25	12	1 197
Indonesia	3 692	1 208	—	15	4 915
Iran	43	1 579	—	56	1 679
Nigeria	323	—	—	—	323
Venezuela	33	—	—	—	33
Total	4 448	3 584	25	84	8 147
Total oil producers	4 623	3 939	107	96	8 766
High income					
Argentina	51	—*	—	—*	51
Brazil	1 505	—*	—	—*	1 505
Chile	608	—	—	—*	699
Colombia	850	—*	—	—	850
Greece	55	1	—	—*	56
Israel	312	—	—	—*	312
Malaysia	115	—	—	6	121
Mexico	62	—	—	—*	62
Peru	198	22	—	6	226
Spain	74	—	—*	—*	74
Taiwan	37	—	—	—	37
Tunisia	591	53	82	2	729
Turkey	1 905	273	—	—*	2 179
Yugoslavia	415	312	—	15	741
Total	6 778	751	82	29	7 640
Total high income	7 796	1 377	102	35	9 311
Middle income					
Egypt	406	1 216	38	26	1 686
Korea (Rep.)	1 182	—	—	—*	1 182
Morocco	448	18	98	26	590
Philippines	220	—	—	—*	220
Total	2 256	1 234	136	52	3 678
Total middle income	4 315	1 803	315	159	6 592

	DAC	*Socialist European Countries*	*OPEC Members*	*Other Countries*	*Total*
Low income					
India	6 630	783	—	8	7 421
Pakistan	2 771	366	840	15	3 992
Zaire	112	108	—	—	220
Total	9 513	1 257	840	23	11 633
Total lower income	11 855	3 904	1 184	94	17 037
Total 26	23 031	6 796	1 083	188	31 098
Total 86	28 590	11 027	1 709	385	41 711

* Country that was included at some other period.
Source: World Bank, *World Debt Tables*, EC-167/76.

Table 23

DISTRIBUTION OF CONCESSIONAL BILATERAL ASSISTANCE TO 23 LDCs 1974, AND COMMITMENTS

(Millions of dollars)

	Total (1)	*Concesional (2)*	*(2)/(1) %*
Oil producers			
Algeria	168	85	50.6
Indonesia	682	585	85.8
Total	850	670	78.8
Total of 86 developing countries	898	709	79.0
High income			
Argentina	528	—	0
Brazil	333	56	16.8
Chile	279	17	6.1
Colombia	54	24	44.4
Greece	27	23	85.2
Israel	522	9	1.7
Malaysia	102	—	0
Mexico	129	—	0
Peru	213	17	8.0
Spain	122	—	0
Taiwan	254	—	0
Tunisia	64	57	89.0
Turkey	150	54	36.0
Yugoslavia	615	292	47.5

	Total (1)	*Concessional (2)*	*(2) (1) %*
Total	3 392	550	16.2
Total of 86 developing countries	3 945	754	19.1
Middle income			
Egypt	595	415	69.7
Korea (Rep.)	419	25	6.0
Morocco	294	123	41.8
Philippines	240	54	22.5
Total	1 548	617	39.9
Total of 86 developing countries	2 349	1 132	48.2
Low income			
India	771	678	88.0
Pakistan	1 176	1 124	96.0
Zaire	255	6	2.4
Total	2 202	1 807	82.1
Total of 86 developing countries	4 056	3 396	83.7
Total 23	7 992	3 644	45.6
Total 86	11 249	5 990	53.2

Source: World Bank, *World Debt Tables*, EC-167/76.

quarters of the total assistance, concessional and other, allocated by governments to 26 Third World countries.

The grant element in credits is larger than the loan element in the assistance of the Eastern European countries (over half the total), although these are subject to ties similar to those attached to assistance from Western countries. For the case of development assistance from the socialist countries, lack of information makes it impossible to go beyond the realm of conjecture. Approximately half the assistance from DAC countries is concessional. For other Western countries that are not DAC members, the grant element is slightly less. Finally, approximately one-half of the assistance from OPEC countries to other Third World countries was on concessional terms, but virtually all credits among the oil-exporting countries are granted on similar concessional terms.

As can be seen in Table 23, when the countries are grouped by income levels, those with the lowest income received almost half (45 per cent) of the total bilateral concessional assistance granted to 23 countries of the Third World. The proportion is larger (54 per cent) if all 86 countries are taken into account. The individual countries that received the largest share of concessional assistance were: Pakistan, Indonesia, India, Egypt and Yugoslavia, which as a group received 87.5 per cent of the total going to 23 Third World countries.

3. *External public debt from private sources**

A. *General overview*

The massive return of private banking to the international scene started in the mid-fifties. It mainly took the form of operations in the Eurocurrency market, which consists of a world-wide network of financial intermediaries that accept deposits on, borrow and lend Eurocurrencies.[18]

The Eurocurrency market grew naturally out of postwar domestic financial controls introduced by the United States, Western Europe and Japan. Trading in it is free from controls by monetary authorities or international financial agencies. Various attempts to set up some form of supranational control have failed because of divergent political and economic interests among the major capital-exporting countries.

Since its inception, the Euromarket has grown at rapid and sustained rates. In 1965 its size was estimated at US$ 15 billion; by 1969 it had trebled to $ 44 billion and it trebled again by 1973 to $ 132 billion. This spectacular growth has continued until the present. In September 1976, the Bank for International Settlements estimated the size of the Eurocurrency market at $ 230 billion. A Morgan Guaranty Trust analysis, that included estimates or liabilities in foreign countries of banks outside the BIS reporting area, put the net size of the Euromarket at $ 285 billion. At present, it is the second largest market after the United States.

Until 1969 US corporations and US banks were the most important users of Eurocurrencies. Subsequently, the public and private sectors of European industrial countries emerged as important users. LDCs appeared on the scene in the early seventies. A number of sources agree that the initiative for this came from lenders, rather than LDC potential borrowers.

* External public debt from private sources is defined here as financial obligations with more than one year maturity that have been contracted or guaranteed by the public sector. Privately incurred debt from private sources is not included.

[18] Currencies on deposit with banks anywhere in the world other than the country of origin.

Even now, when Eurocurrency lending to the LDCs has reached a magnitude that is worrying the governments of some major lenders, the LDCs as a group are net suppliers of funds to the Euromarket. It was estimated in September 1976 that out of the total of Eurocurrency funds, perhaps as much as US$ 75 billion originated in the LDCs: some $ 41.1 billion were Eurocurrency assets of oil exporters, close to $ 19 billion were assets of non-oil LDCs, and perhaps an additional $ 15 billion represented assets held elsewhere.

LDC borrowing in the Eurocurrency marnet is only a portion of their total debt from private sources, although an important and growing one. According to the most recent World Bank data, the privately-held outstanding public debt (disbursed only) of 81 LDCs expanded over the past ten years from less than $ 10 billion to nearly $ 60 billion. Even considering the recent inflation, the increase in real terms is enormous.

The growth rate of LDCs' borrowing from private sources was about twice as high during 1967-1976 as that of their borrowing from official multilateral and bilateral sources. At the same time, there were considerable shifts among the types of credit from private foreign sources. The most important shift was a drop in the share of suppliers' credits relative to that of all-purpose credits supplied by financial markets, mainly through banks. According to some estimates, while the share

Table 24

EXTERNAL PUBLIC DEBT TO PRIVATE SOURCES (DISBURSED), 1967-1976

(Millions of dollars)

	73 non-oil LDCS	*8 oil producers*	*81* LDCS	*Annual growth rate (%)*	*Share in total* LDC *outstanding debt (%)*
1967	8.3	0.9	9.2	—	27.9
1968	9.2	1.0	10.2	10.9	27.2
1969	10.5	1.5	12.0	17.6	28.1
1970	12.3	2.2	14.5	20.8	29.6
1971	14.2	3.1	17.3	19.3	30.3
1972	16.8	4.5	21.3	23.1	32.4
1973	20.9	6.2	27.1	27.2	34.2
1974	28.3	6.5	34.8	28.4	36.7
1975[e]	37.2	10.1	47.3	35.9	40.5
1976[e]	47.6	12.1	59.7	26.2	43.0

[e] Estimated.
Source: World Bank, *World Debt Tables,* EC-167/76.

of suppliers' credits in the LDCs' debt from private sources fell from 51 per cent to 30 per cent between 1967 and 1974, that of financial markets rose from 37 per cent to 66 per cent.

According to the World Bank, during 1967-1974 LDC borrowing from financial institutions, mostly commercial banks, accounted for about three-quarters of the total increase of US$ 25.6 billion in their debt from private sources, or nearly $ 20 billion. Assuming the same proportion was maintained during 1975 and 1976, the indebtedness of the LDCs to intermediaries operating in the Eurocurrency markets would amount to $ 40 billion. This sum does not include some $ 15 billion of outstanding balances arising from LDCs' direct borrowing from foreign financial institutions located in their home countries.

Figures for the LDCs' external debt in the Eurodollar market cannot be considered either complete or final for a number of reasons. First, they are based on private advertisements; there is no legal requirement anywhere that Eurocurrency transactions be disclosed or announced publicly. Moreover, there may be reasons why a borrower may not wish to publicize a particular transaction or its terms. The effective disbursements, amortization payments and total or partial cancellations are unknown. The figures revealed may mean amounts committed and not necessarily concrete obligations.

The estimates that the LDCs' outstanding debt in the Eurocurrency market amounted to some US$ 40 billion at the end of 1976 fit with available annual data on Eurocredits. According to Morgan Guaranty Trust, the LDCs contracted some US$ 45.7 billion in loans in the Euromarket between 1972 and 1976, or 45 per cent of the total.

While many sources, including the World Bank, maintain that the increase of Eurocredits granted to the LDCs does not yet create major

Table 25

EUROCURRENCY BANK CREDITS

(Millions of dollars)

	1972	*1973*	*1974*	*1975*	*1976*
Total	*6 857*	*21 851*	*29 263*	*20 992*	*28 602*
Industrial (including the socialist) countries	4 392	14 569	21 920	9 828	13 115
LDCS	2 465	7 282	7 343	11 164	15 487
Non-oil countries	1 532	4 531	6 276	8 264	11 332
Oil exporters	933	2 751	1 067	2 900	4 145

Source: Morgan Guaranty Trust.

repayment problems, the opposite case can be made, since the maturities for Eurocredits have shortened considerably, especially during the last two years, and also because of the increased costs of borrowing. American Express International Banking Group recently noted not only that 65 per cent of Eurocredits raised in 1973-76 carried maturities of less than 8 years, but also that in the last two years, such maturity periods applied to 88 per cent of Eurocurrency credits. Consequently, the burden of amortization, particularly in the case of non-oil exporting countries, will grow rapidly during the next five years: 95 per cent of the current Eurodebt of non-oil LDCs will be due for repayment by 1983. According to American Express estimates, by 1980 over half of the new gross Eurocurrency borrowed by LDCs will be needed to refinance maturing LDC bank debts. By 1985, for every three Eurodollars borrowed, 2 will be used for Eurodebt repayment.

B. *Who and why?*

According to the World Bank, while practically all LDCs have some obligations to private creditors of all sorts, five major borrowers were responsible for 62.8 per cent of total LDC debt to private sources at the end of 1974, ten major borrowers accounted for 78 per cent, and fifteen major borrowers for 85 per cent of the total.

In view of the importance of Eurocredits in private lending to the LDCs (75 per cent of the total), the list of major borrowers in the Euromarket by the end of 1975 looks very similar. During the period 1971-1975, fifty LDCs (including 8 oil-producing countries) raised US$ 29.6 million in Eurocredits: $ 985 million in 1971, $ 3.0 billion in 1972, $ 7.5 billion in 1973, $ 7.6 billion in 1974, and $ 10.4 billion in 1975. Out of this total, $ 7.4 billion (25 per cent) went to 8 oil-producers, $ 16.7 billion (56 per cent) to higher-income LDCs, $ 8 billion (10 per cent) to medium-income countries, and only $ 887 million dollars (3 per cent) to low-income countries. The remaining 5.5 per cent was committed to a few non-IBRD members.

The individual country figures suggest that a very limited number of LDCs, most of them oil-producers and larger semi-industrialized countries, made significant use of the private financial resources available in the Eurocurrency market. Only 15 LDCs borrowed more than $ 500 million each from the Eurocurrency market. In this group the volume of borrowing ranged from a high of $ 5.8 billion (Mexico) to a low of $ 523 million (Panama). The borrowing of 8 other LDCs ranged from $ 200 million to $ 500 million; that of another 4 was between $ 100 and $ 200 million each. The remaining LDCs raised marginal amounts in the Eurocurrency market.

Table 26

MAJOR LDC DEBTOR COUNTRIES TO PRIVATE CREDITORS AT THE END OF 1974

(Millions of dollars)

		Accumulative percentage of the total
1. Brazil[a]	14 724	
2. Mexico	8 509	
3. Argentina	2 985	
4. South Korea	2 330	
5. Algeria	2 321	62%
6. Chile	1 711	
7. Philippines	1 557	
8. Iran	1 549	
9. Peru	1 475	
10. Indonesia	1 199	78%
11. Venezuela	1 054	
12. Zaire	1 002	
13. Colombia	813	
14. Egypt	370	
15. India	267	85%
Major borrowers	41 866	
Total	49 126	

[a] Including private sector external debts without government guarantee.
Source: World Bank, *World Debt Tables,* EC-167/76.

Why have some countries that enjoy relatively easy access to the market made little use of the available resources, while some other countries have borrowed so heavily in Eurocurrencies?

One of the few detailed studies of the LDCs' borrowing in Euromarkets suggests that there are no simple answers to these apparently simple questions.[19] The volume of LDCs' private borrowing must be related to factors involving both borrowers and lenders. Large transactions took place, as expected, only when borrowers were willing and able to borrow, and lenders were interested in lending.

The OECD survey reviewed the record of 11 LDCs, ranging from Brazil, the second largest borrower in the private market, to marginal borrowers like India and Kenya, and accounting in all for over $ 10 billion of Eurocurrency credits — one third of total LDC borrowing in

[19] P. A. Wellons, *Borrowing by Developing Countries on the Eurocurrency Market,* OECD Development Center, Paris, 1977.

1971-1975. The survey, which included both oil-producers and non-oil LDCs of different *per capita* income levels, put the borrowers in three categories: eager borrowers (Brazil, Zaire, Ivory Coast and Panama), ambivalent borrowers, and reluctant borrowers.

A great variety of reasons underlie the different attitudes. Brazil opened its doors to Eurobanks for the purpose of furthering its industrialization program, while Zaïre went abroad for money to promote mining activities; the Ivory Coast borrowed extensively because of persistent balance-of-payments difficulties.

Among ambivalent borrowers there were many reasons for the ambivalence, chiefly of an economic or political nature. Among the reluctant countries, India, for example, believed that borrowing in private markets would have a negative effect on its access to concessional credits.

Leaving aside oil exporters, who are good risks anyway, international private lenders showed a clear preference for relatively large and growing "high-income" LDCs with stable political systems, diverse mineral resources (not heavily limited to oil), and well-established contacts with the international banking community. These factors are responsible for a country's image of credit-worthiness to a larger extent than refined economic indicators of the quality of domestic economic policy management. The businesslike, largely non-ideological attitude of private lenders, showing very little interest in the end-uses of their credits, often contrasts with ideological, moralistic or power-motivated attitudes of multilateral and bilateral official lenders.

The assertion that private lenders seem not to have a preference about the use of their funds, as long as the borrowing country fits their image of a "good risk", is supported by Table 27.

Table 27 should be looked at with some reservations, because of the deficiencies of the reporting system. While it shows that 90 per cent of Eurocredits were used by the public sectors of a limited number of LDCs, the actual proportion may perhaps be of the order of 80 per cent. It is highly significant that a large proportion of the resources were available for general purposes of balance-of-payments support, even if in principle they were supposed to go to finance specific projects.

The OECD study stresses that, at least between 1971 and 1974, the heavy borrowing by some LDCs in the Eurocurrency markets was not a consequence either of traditional multilateral and bilateral official sources of credits drying up nor of the decline in export earnings. While this appraisal may be debatable, it is quite likely that many LDCs found private capital markets attractive because they were a relatively easy alternative to internal political difficulties that would accompany such measures as tax reforms or better control of the public sector. The Euromarket also provided a way to neutralize the attempts at economic

Table 27

EUROCURRENCY CREDITS TO LDCs BY END-USE, 1971-1973

(Percentage)

Government	*36*
National	32
State	3
Municipal	1
Public Sector	*54*
General	3
Central and foreign exchange banks	12
Financial sector	12
Extractive and processing industries	17
Utilities	5
Transportation	5
Private Sector	*8*
General	2
Subsidiaries of foreign corporations	6
Unclassified	*2*

Source: Wellons, *op. cit.*, p. 11.

surveillance by international and official bilateral agencies. Finally, some LDC borrowers argue that private borrowings also became preferable because it way largely free from bureaucratic procedures on the lenders' side.

In many LDC the balance-of-payments and budgetary deficits in 1971-1975 occurred not only because export proceeds and fiscal revenues fell or stagnated but also because expenditures on imports and domestic public spending —capital and current— expanded substantially. Certainly, the availability of the Eurofunds made it easier to sustain levels of economic activity which would otherwise have been untenable. That the financial cost of such borrowing proved very high and financial mismanagement increased in some cases is another story.

The share of the LDCs in Euromarket borrowing grew from 35 per cent of the total in 1972 to 52 per cent in 1976. Again, this was accompanied by a growing concentration among borrowers. The explanation for this phenomenon, which has been responsible for increased worriers in major lending countries, is not difficult. First, only a small number of LDCs that established themselves as "good risks" in the private international capital markets could continue borrowing. Second, in some countries the accumulated borrowing reached such a level that additional lending, even with increasing risks, was perceived by lenders as the best, if not the only way to ensure repayment of the earlier debt. Third, many private lenders continued to believe that the political importance of individual large LDC borrowers, together with the high domestic political costs in the lending countries of a probable financial crisis if there were an LDC debt default, offered the assurance that their governments would bail out the unlucky lenders, in cooperation with multilateral lending agencies, in the case of such a crisis. A similar line of reasoning was followed by larger LDC borrowers, some of whom demonstrated a high degree of skill in discreet negotiations with major private lenders about rescheduling part of their debt.

C. *Terms and conditions of* LDC *Eurocurrency borrowing*

According to a sample of 17 LDCs that included all 12 major borrowers, a comparison of the terms and conditions of LDC Eurocredits shows a progressive hardening of terms that seems to be independent of the cost of Euromoney.

1973

In 1973, the first year of the great expansion in LDC Euro-borrowing, the average size of individual operations was of the order of US$ 25-30 million, most of the credits were extended by a single banking institution, and the terms followed rather closely those applied to borrowers in the advanced countries.

In many cases maturities were longer than 10 years, averaging between 8 and 10 years. Major borrowers were even able to arrange larger credits —exceeding $ 50 million each— for 12 and more years. Moreover, some of these included grace periods of 2-3 additional years. Consequently, the maturity structure of the LDCs' private borrowing in Eurocurrency markets in 1973 was even better than that of developed countries. Furthermore, the "spread" (the margin over the LIBOR,* charged to the borrowers by the intermediaries) paid by the LDCs, particularly by large borrowers that were well known in the market, was close to the spread paid by borrowers from advanced countries.

1974

1974 witnessed the beginning of the present economic recession and

* London Inter-Bank Offering Rate.

serious uncertainty about the future of the Eurocurrency markets in the wake of the bankruptcies of some lending banks. It also saw a steep increase in Eurocurrency interest rates, which reached the unprecedented level of 14 per cent and averaged 11 per cent for the year as a whole (compared with 9 per cent in 1974 and 7.5 per cent in 1975).

Table 28

EURODOLLAR 90 DAYS DEPOSIT RATES

(Prime banks' bid)

	January	*April*	*July*	*October*
1967	5.56	4.63	5.13	5.69
1968	5.38	6.56	6.19	6.63
1969	7.56	8.44	10.38	9.75
1970	9.56	8.56	8.38	7.63
1971	5.81	6.25	6.69	5.94
1972	4.94	5.00	5.63	6.00
1973	6.63	8.25	11.38	9.13
1974	8.94	11.69	13.44	10.06
1975	7.44	6.69	6.98	7.20
1976	5.51	5.40	5.77	5.45
1977	5.12	5.12	5.78*	

* June.
Source: Morgan Guaranty Trust, *World Financial Statistics.*

In 1974 the volume of LDC Euroborrowing increased by only US$ 1 billion, much less than in 1973 (over $ 5 billion) and 1975 ($ 3 billion), but the conditions of LDC borrowing changed drastically to the detriment of most borrowers. Maturities over 10 years became exceedingly rare, while those of 6 years or less increased considerably.

Spreads that averaged slightly less than 1 per cent at the beginning of 1974 rose to 1¾ per cent in the final months of the year, except for some oil-producers and particularly tough bargainers. Grace periods were practically eliminated and commission, management and participation fees, known in banking jargon as "the front load", appeared on the scene as the rule rather than the exception.

While detailed calculations are impossible, the actual cost of LDC borrowing in the Eurocurrency markets increased by the end of 1974 in comparison with 1973 by perhaps as much as 50 per cent, and was almost double that charged on "hard" loans by multilateral agencies and bilateral official sources. Private lending to the LDCs became very good business for the lenders.

1975

The trend towards shortening maturities and increasing costs of financial intermediation continued in 1975 in spite of the fact that the market became a borrower's market for the LDCs. Private lending to industrial countries declined sharply for the first time, from \$ 23 billion in 1974 to \$ 20.5 billion in 1975.

Total borrowing in international capital markets increased in 1975 due to the large expansion of credits both to LDCs and to European socialist countries. LDC borrowings increased by close to 3 billion dollars, or 30 per cent, to \$ 13.4 billion, while those of the European socialist bloc increased by \$ 1.6 billion —more than 100 per cent (to US\$ 2.8 billion).

In spite of the fact that it was an LDC borrowers' market, borrowing conditions for the LDCs deteriorated further. First, credits with over 10 years maturity disappeared completely and the bulk of borrowing (75 per cent) carried maturities not exceeding 6 years. Within just two years, 1973 to 1975, the average maturity for LDC borrowers shortened dramatically. Thus, for example, for Algeria it fell from 12 years to 7; for Argentina from 7½ to 5 years; and for Brazil from 12 years to 6½. The spread increased again, other fees increased and grace periods became almost completely forgotten.

It is not easy to explain the reasons for these developments. Some experts interpret them as the result of the Euromarket disturbances of mid-1974 and the increased concern over exposure to risk which emerged at that time. This simple explanation hardly seems satisfactory, however, given the fact that the hardening of terms took place in a borrowers' market and no established LDC borrowers was denied funds.

Eurocurrency lending to the LDCs not only continued growing in 1975, but underwent quantitative and qualitative changes. The size of the individual transactions increased greatly. While in 1973 only 14 credits amounting to \$ 100 million or more each were extended to the LDCs, the number of such credits increased to 20 in 1974 (including one single \$500 million loan to Mexico) and to 35 in 1975. All these big loans (jumbo loans) were extended by consortia of the largest US, European and Japanese banks. In these giant credit operations negotiated in 1975, the names of a small group of the largest US, Canadian and European banks reappear with considerably frequency. Many factors were responsible for the increased size of LDC Euroloans in 1975. among them inflationary pressures and the growth in the supply of oil funds.

The hardening of lending conditions was mainly due to two factors: first, high inflation rates in the principal economies, which provoked a general increase in interest rates and the shortening of maturities;

and second, the growing risk of lending to poor countries facing by payments disequilibria and considerable external debt.

The close uniformity of terms and conditions for these transactions, and the use made of the loans as general balance-of-payments support, suggest that perhaps they were not arrived at by bargaining between lenders and borrowers but rather by informal agreement among lenders. Because of the size of their borrowing in the previous years, the bargaining power of many LDCs over the cost of new money had been eroded. As long as the borrowers not only had no alternative access to official lenders but were also interested in having continued freedom to use borrowed funds in the way they saw fit, they were forced to pay for this freedom in financial terms. In this way, the community of interests among LDC public borrowers and international private lenders became cemented, while the underlying conflict of objectives between these two parties and multilateral and bilateral official lenders to the LDCs deepened. All this led to new discussions in 1976 at the governmental level in the lender countries about the need to strengthen multilateral lending agencies.

D. *Institutional framework*

The rapid expansion of international private lending to the LDCs was accompanied by the emergence of an elaborate network of financial institutions devoted fully or partly to these activities. At least 605 financial entities, located all over the world, but concentrated in the US, Western Europe and Japan, were involved in at least one Eurocurrency loan to an LDC during the 1971-1973 period.[20] If short-term Eurocurrency transactions involving the LDCs, which are rarely announced, were also counted, the number of financial intermediaries dealing with the LDCs would easily have supassed one thousand institutions.

The 605 financial institutions mentioned include banking consortia (both multinational and national), foreign branches and wholly-owned subsidiaries of individual banks, majority-controlled subsidiaries of foreign banks and joint ventures. In 1973 they operated in 56 countries —30 developed and 26 LDCs.

Most were located in the following OECD countries: the US —137; UK —107; France —51; Japan —31; and Luxembourg (a banking haven) —23. In the case of the US and Japan, the great majority of these banks were domestically controlled. In the UK and France, and obviously in Luxembourg, the majority were controlled from abroad,

[20] Wellons, *op. cit.*

mainly from the US. Most banks located in LDCs and engaged in lending to the LDCs were not only foreign-controlled but domiciled in banking and tax havens.

While illustrative of the size of the institutional network of international private intermediaries lending to LDCs, these figures reflect neither the relative involvement of intermediaries by country of origin nor the degree of concentration of the lending operations. According to the OECD study mentioned, there is no way to determine the amount of credits —in money terms— extended by individual banks. It is also impossible to establish the degree of domination of the market by a small number of international banking empires. This domination cannot be measured in terms of capital participation only. Moreover, nobody seems to know for sure not only who owns whom where, but who effectively controls whom by means other than capital participation.

There is enough evidence, however, that in spite of the large degree of intra-country and inter-country competition for the LDC end-users of international private credit, the degree of concentration on the lenders' side has been increasing rapidly over time. The evidence leads to the conclusion that both the US private banking system and the largest US banks play the dominant role in lending operations to the LDCs.[21]

Thus, according to Morgan Guaranty Trust, in 1976 US banks, whether operating directly from the US or through the network of Eurocurrency intermediaries abroad, accounted for some US$ 40.0 billion of the US$ 60.0 billion of international private bank debt of the non-oil producing LDCs. The Federal Reserve System has estimated that the 21 largest US banks had lent US$ 22.8 billion to the LDCs by the end of 1975, with US$ 14.5 billion, or nearly two-thirds, originating in the top six US banks.[22]

The dominant role of the US banks in international private lending to the LDCs is confirmed by the figures in the table 29.

This predominance of US based international private banking in lending to the LDCs reflects in part the circumstances in which the Euromarket was born in the fifties and changes which occurred in US com-

[21] It is due to the fact that, as one recent study put it, "within the past decade, the US financial system has undergone a historic transformation. Major banks no longer operate in a competitive market on a regional or national scale. Instead, they have become postmarket, transnational conglomerates, performing not only a vast array of financial operations throughout the world, but also participating in non-banking activities across more than two hundred industries in the US." Ronald E. Muller and Robert Cohen, "The Transformation of US Banking and Economic Instability: A Systemic Dilemma", *Executive,* Cornell University, Ithaca, N. Y., February, 1977. See also Andrew F. Brimmer and Frederick R. Dahl, "Growth of US Banking Activities Abroad", *Journal of Finance,* May, 1975.

[22] "Third world risks", *The Economist* (London), January 22, 1977.

Table 29

OUTSTANDING INTERNATIONAL PRIVATE DEBT OF THE PRINCIPAL LDC BORROWERS AT THE END OF 1975

(Millions of dollars)

	Total foreign private banks	*Top 20 US banks*	*Top 6 US banks*
High income LDCs			
Argentina	3 186	1 071	725
Brazil	14 847	5 540	3 734
Colombia	1 576	756	571
Mexico	13 465	5 810	3 573
Peru	2 302	2 066	665
Uruguay	161	54	54
Zambia	341	99	99
Middle income LDCs			
Egypt	914	177	162
Philippines	2 010	740	597
South Korea	3 309	1 473	972
Low income LDCs			
India	416	197	178
Zaire	783	162	123

Source: *The Economist* (Jan. 22, 1977), based upon Morgan Guaranty Trust data.

mercial banking legislation in the sixties. Moreover, the following additional factors should be mentioned:

a) The size of the US banking system as compared with those of its competitors in Europe and Japan; *b*) the overwhelming use of the dollar as the international lending currency; *c*) the global presence of the US banks, which covers not only the financial centers of the developed world but also the Middle East and the majority of LDCs; *d*) the business agressiveness of US bankers as compared with much more conservative attitudes towards lending abroad shared by European and Japanese bankers; and, finally, *e*) disappointing domestic profit performance in the US itself in recent years that has made profits from international operations particularly important (according to the US Comptroller of Currency, in 1976 some 75 per cent of US banks' profits came from foreign operations).

All these factors suggest that the leading position of US international financial intermediaries in lending to the LDCs is assured for the foreseeable future. The volume of their financial involvement in the LDCs, and the degree of concentration in terms of both borrowing countries and lending institutions, started to preoccupy seriously the US Congress and the Executive Branch in 1975-76. As well as the long-standing concern about the impact of unregulated foreign private lending through the Eurocurrency market on the effectiveness of US domestic monetary and financial policies, there was now the added fear of possible financial risks for the banks themselves.

The principal objective of private lenders to the LDCs, including obviously US lenders, is to maximize profits at what they consider "reasonable risks". The achievement of this private objective may, and in fact does clash with the major national objective of ensuring relative domestic monetary and financial stability. In the light of the continuing expansion of the international activities of the US banking system it is easy to understand why the US monetary authorities would like to see some degree of control over the foreign lending activities of US banks. Some Europeans would like to see similar controls over their international banks.

In view of the Euromarket's world-wide scope of operations, unilateral domestic controls seem to be impossible. Consequently, in the past two years the US and some European monetary authorities have come around to the position that attempts to institute controls over the source of funds should be replaced by control of the end-use of Eurocurrencies. This reasoning is behind recent Western initiatives at the World Bank and the IMF to increase their resources considerably, so that multilateral official lending may replace at least part of private lending to the LDCs, thus strengthening the position of the Bank and the Fund not only vis-a-vis poor borrowers but giant private lenders as well.

On the other hand, another factor related to the institutional structure of the Euromoney market, the high concentration of financial liabilities, also gives ground for concern. The extraordinary expansion in the availability of resources in the hands of a few oil-exporting countries has occurred in the very recent past. These resources are deposited in a relatively small number of banking institutions; this has led to a concentration of liabilities —mostly of a short-term nature— which constitutes a serious element of instability.[23] In this context, it is easier to understand the efforts made by the Bank of England and the Federal Reserve System, starting in the first quarter of 1975, to offer support

[23] At the end of 1976, the oil-exporting countries' deposits in international private banks reached almost 63,000 million dollars.

to banking institutions facing temporary liquidity problems due to withdrawals of petrodollars or other deposits. Given the concentration of assets in both lending institutions and borrowing countries, to get a complete view of the situation it is also necessary to consider the concentration of financial liabilities —a subject which requires more detailed analysis.

E. Difficulties with LDC bond issues

While the placing of foreign and international bonds represents a large part of international market operations involving borrowers from industrial countries and international organizations, one of the major characteristics of private lending to the LDC is the relatively small amount of transactions that take this form.[24]

Out of the total of US$ 60.7 billion borrowed from private sources by industrial countries in the 1973-1975 period, foreign and international bonds amounted to $ 26.6 billion, or 45 per cent. Moreover, in the total of over $ 14.6 billion borrowed during the same period by international organizations in international capital markets, all but $ 80 million were represented by bonds. On the other hand, out of the total of $ 25 billion borrowed by LDCs, bonds amounted only to $ 1 billion, or some 6 per cent, of total LDC borrowing.

When the LDCs first entered the Eurocurrency market in 1970-1971, some experts believed their borrowing would take the form of bond floating.[25] Yet not only did bonds become the exception rather than the rule, but the LDCs' share in new bond issues has continued to decline lately in both absolute and relative terms.

New foreign and international bond issues by LDCs between 1973 and 1975 were placed by 30 countries, including five oil exporters. Only one country placed bonds for over $ 500 million (Mexico), and three (Nigeria, Hong Kong and Brazil) for sums ranging between $ 100 and $ 200 million. Bond issues by the remaining LDCs were smaller; $ 810.9 million in bonds were placed in the Eurocurrency market, $ 704.4 million in the US, and only $ 78 million in European domestic markets.

The situation deteriorated further in the first half of 1976 when only 7 LDCs floated new bonds for a total of $ 447 million. Three of them (Mexico, Alegria and Brazil) were responsible for 85 per cent

[24] Foreign bonds are floated in the capital market of a foreign country; international bonds are issued in the Eurocurrency markets.

[25] Richard Cooper and Edwin M. Truman, "An Analysis of the Role of International Capital Markets in Providing Funds to Developing Countries", *Weltwirtschaftliches Archiv,* No. 106, 1971.

of the new issues. This would seem to indicate that by mid-1976 the possibilities for the LDCs to raise funds through issuing bonds in foreign and international markets were, for all practical purposes, exhausted.

In the spring of 1977 only 53 bond issues from the LDCs were quoted on the international market as compared —for straight bonds only— with 66 Australian, 161 Canadian and 65 Danish issues, not to mention hundreds of bonds floated by large private and public corporations from the UK and the US.

The average interest rate attached to these bonds was of the order of 8 to 8.5 per cent, and the net yields were of similar magnitude because bonds were quoted, on the average, very close to their nominal value. As for the few new LDC bond issues, their terms deteriorated considerably in 1976 in comparison with those of bonds offered by prime borrowers from the advanced countries. By mid-1977 for "prime" LDC bond issuers such as Brazil and Mexico, maturities were some 2 years shorter than those for bonds placed by the prime industrial borrowers (10 years on the average), while interest rates were 1.5 to 2 per cent higher.

In the case of the LDC Eurobonds, most probably the main obstacle is the lack of confidence of institutional and individual investors in LDC-originated securities and their preference for bonds issued by large, well-known private and public corporations located in the industrial countries.

Since bond floating was more attractive to the LDCs than Eurocredits, why were there so few LDC issues? The reasons are not only barriers to entry for the LDCs to the bond markets in both the domestic capital markets of the advanced countries and the Eurocurrency markets but also the fact that it is much easier technically to negotiate a commercial loan than to float a bond issue.

Most of the recent studies on the LDCs' access to international capital markets devote more attention to legal barriers than to operational problems of bonds placing. It was because these obstacles persisted that the Joint Development Committee of the World Bank and the IMF in 1976 recommended a phased program of action by the major capital exporters to:

a) Exempt LDC borrowers from the requirement of prior authorizations for issues of securities, or grant them such authorization automatically;

b) Modify laws to give larger scope to institutional investors to acquire LDC country securities; and

c) Simplify registration and disclosure requirements for LDC borrowers.

Under such conditions, improving LDC access to the securities markets of the developed world is unlikely to affect the borrowing possibilities of most LDCs. While those few who are at present issuing foreign and international bonds in small quantities might be able to continue to do so, bonds cannot help them more than marginally. Because of the volume of their overall public debt they should, in some cases, receive more grants and concessional long-term credits, and, in others, should mobilize more domestic savings and use them more efficiently if they are really interested in getting out of the vicious circle of increasing indebtedness.

4. *Financial terms and the end-use of international loans*

A. *Trends in financial terms*

The financial terms that private and official sources grant on loans to Third World countries differ widely. Moreover, in the case of official sources, the terms differ between concessional assistance granted by governments and some organizations to certain countries (mainly those with lower incomes, but also those with whom they maintain special links, for political or strategic reasons) and loans that are more like market operations.

Financial terms on loans granted by official sources as a whole to the LDCs as a whole deteriorated slightly between 1967 and 1974. The trend is more discernible if 1969 is taken as the base year. This deterioration, however, did not affect the length of the grace periods.

Table 30 shows that average interest rates rose from 4.3 per cent to 6.3 per cent. The average maturity of the credits shortened slightly, from 17.1 to 16.9 years; but if the 1968 average is taken as the basis it shortened from 19.0 to 16.9, i.e., by 12.5 per cent. The average grace period for these loans increased slightly, from 4.6 to 4.8 years, but if 1968 is taken as the base year it remained unchanged. The grant element fell considerably by 41.7 per cent, which illustrates the hardening of the terms applying to official development assistance.

The terms of financial assistance to governments by multilateral organizations and by governments differ, first, by income levels of the recipients. The higher a country is on the income scale, the harder the terms. This has to do basically with the policy of a number of official financial organizations, multilateral as well as bilateral, that prefer to lend their highly concessional resources to those developing countries that are relatively less developed. In fact, the grant element in assistance to the latter group of countries has been twice as high as that for the 86 developing countries as a whole.[26] From the geographical point of view, the terms applied to Latin America, the Caribbean and the more advanced Mediterranean countries are harder than those for Asia and Africa.

Table 31 shows that while the financial terms for official credits to Third World countries hardened between 1967-1968 and 1973-1974, the change was not uniform, but mainly hurt the oil-producing LDCs. Higher-income countries were especially affected; in these nations, there was a trend towards "privatization" of the external debt because of their easy access to private capital markets, where the terms are generally harder.[27]

Likewise, the terms of financial assistance to governments by multilateral organizations and other governments differ from one institution to another. For multilateral sources, the International Development Association, which lends to the poorest countries, applies very low rates of interest in comparison with market rates (1976: 3 per cent), as well as much longer maturity and grace periods (1976: 50 and 10 years, respectively). The International Bank for Reconstruction and Development as well as the regional development banks of Africa, Latin America and Asia, applied terms generally close to market standards (current interest rate: 8.5 per cent). The "third window" of the World Bank applies terms in between those of the World Bank and the IDA.

In the case of bilateral loans, the socialist countries of Eastern Europe give the largest grant element with their loans, through these are not very large as a whole. Only 50 per cent of the assistance provided by DAC countries is concessional, with the standards followed by the member countries differing widely. OPEC member countries lend to low-income countries and on highly concessional terms, especially since the establishment of their Special Fund in 1976.

Similarly, the financial terms on loans from private sources to developing countries (basically higher-income and oil-producing countries) have also deteriorated substantially in the last few years. This reflects both the inflationary trends in the world economy and the erosion of these countries' bargaining power which originates in the growth of their debt.

In the previous section, we gave a detailed comparison of the financial terms in the Eurodollar market. The financial intermediaries claim that the reasons the terms of lending in international markets

[26] 67 per cent grant element, as compared with 33 per cent for the average of the years 1967-68 and 1973-74.

[27] In 1974, the ratio of open market debt to overall debt was: for oil-exporting countries, 19 per cent; for higher medium-income countries, 34 per cent; for lower-income countries, 4 per cent.

Table 30

TRENDS IN FINANCIAL TERMS OF OFFICIAL LENDING TO DEVELOPING COUNTRIES, 1967-1974

		Creditors					
	Amount (million of US$)	*Maturity (years)*	*Grace period (years)*	*Interest rate (per cent)*	*Grant element (years)*	*Amount of grants (million of US$)*	*Grant element in loans and grants (per cent)*
1967	10 087.8	17.1	4.6	4.3	34	2 968.0	49
1968	9 998.2	19.0	4.8	4.4	34	2 794.2	49
1969	11 961.9	18.4	4.3	4.8	32	2 877.7	45
1970	13 788.2	19.1	5.0	4.9	32	2 830.7	44
1971	15 578.3	17.6	4.7	5.1	29	3.071.9	41
1972	20 191.0	17.5	4.7	5.3	29	3 616.8	40
1973	26 853.2	18.2	5.8	6.1	26	3 617.9	35
1974	36 259.7	16.9	4.8	6.3	24	4 397.7	32

Source: World Bank, *World Debt Tables*, EC-167/76.

Table 31

TRENDS IN FINANCIAL TERMS FOR OFFICIAL LOANS TO LDCs, BY GROUPS OF RECEIVING COUNTRIES, 1967-1968 AND 1973-1974

		Creditors					
	Amount (million of US$)	*Matu-rity (years)*	*Grace period (years)*	*Interest rate (per cent)*	*Grant element (years)*	*Amount of grants (million of US$)*	*Grant element in loans and grants (per cent)*
Oil-exporting countries							
1967-68	2 427.3	15.5	3.7	4.2	31	559.4	44
1973-74	11 044.1	16.2	4.6	5.7	24	778.5	31
High-income countries							
1967-68	11 030.8	15.5	4.3	5.0	28	1 070.3	34
1973-74	31 405.9	14.3	4.4	7.5	15	1 543.4	19
Middle-income countries							
1967-68	2 708.6	16.5	4.3	3.8	34	1 326.7	55
1973-74	9 617.0	19.1	5.1	5.6	29	1 898.2	42
Low-income countries							
1967-68	3 923.7	27.2	6.8	2.8	53	2 825.6	73
1973-74	10 264.1	26.4	6.8	3.2	49	3 780.6	63

Source: Averages calculated on the basis of World Bank, *World Debt Tables*, EC-167-/76.

Table 32

RATIO OF INTEREST PAID TO EXTERNAL DISBURSED PUBLIC DEBT OUTSTANDING — 81 LDCs, BY TYPE OF CREDITOR

(US$ thousands)

	1967			*1974*		
	Debt 1	*Interest* 2	*2/1* %	*Debt* 3	*Interest* 4	*4/3* %
Sources of credits:						
Private	*8 962 005*	*329 740*	*3.7*	*33 126 659*	*2 229 893*	*6.7*
Suppliers	4 446 572	160 134	3.6	10 130 737	534 084	5.3
Financial markets	4 515 433	169 606	3.8	22 995 922	1 695 809	7.4
Official:	*23 303 183*	*608 469*	*2.6*	*57 871 016*	*1 884 099*	*3.3*
Multilateral	5 200 288	196 201	3.8	15 551 217	733 785	4.7
DAC countries	15 024 623	384 484	2.6	35 226 442	1 059 762	3.0
Planned economies	3 078 272	27 784	0.9	7 093 357	90 552	1.3
Total	*32 265 188*	*938 209*	*2.9*	*90 997 675*	*4 113 992*	*4.5*

Source: Based on World Bank, *World Debt Tables*, EC-167-/76, tables with country aggregates.

Table 33

TRENDS IN INTEREST RATES PAID

(Per cent)

	1967	*1968*	*1969*	*1970*	*1971*	*1972*	*1973*	*1974*
1. *Low-income countries*								
1.1. Credits: private sources								
1.1.1. Suppliers	2.7	3.1	4.7	4.5	3.1	3.1	3.6	5.0
1.1.2. Financial market	5.1	5.3	6.0	5.0	5.3	5.5	5.5	6.8
1.2. Credits: official sources								
1.2.1. Multilateral organizations	2.7	2.7	2.7	2.7	2.7	2.5	2.6	2.2
1.2.2. Bilateral DAC credits	2.2							3.4
1.2.3. Socialist countries	1.4	1.7	1.7	1.7	1.5	1.3	1.4	1.1
2. *High-income countries*								
2.1. Credits: private sources								
2.1.1. Suppliers	3.8	4.1	4.2	4.8	5.1	5.2	4.9	5.5
2.1.2. Financial market	3.6	5.6	5.2	6.3	5.7	5.0	5.6	7.0
2.2. Credits: official sources								
2.2.1. Multilateral organizations	4.5	4.0	4.6	5.1	4.6	5.4	6.0	5.8
2.2.2. Bilateral DAC credits	3.1	2.9	3.2	2.7	2.5	2.6	2.7	2.7
2.2.3. Socialist countries	1.2	1.7	1.3	1.7	1.6	1.7	2.2	1.6
3. *Oil-producing countries*								
3.1. Credits: private sources								
3.1.1. Suppliers	2.6	2.9	2.9	3.0	3.2	4.6	5.5	4.8
3.1.2. Financial market	6.0	3.5	3.3	6.0	5.9	4.4	4.7	9.6
3.2. Credits: official sources								
3.2.1. Multilateral organizations	3.8							5.6
3.2.2. Bilateral DAC credits	1.7	2.2	2.5	2.1	2.3	2.7	2.6	2.9
3.2.3. Socialist countries	0.2	0.3	0.8	0.5	0.8	0.8	1.2	1.2

Source: Based on World Bank, *World Debt Tables*, EC-167/76.

—particularly the Euromarket— have hardened during the last few years are the problems that have plagued the world economy since the middle of 1974 and their own concern over increasing risk exposure. However, this explanation seems simplistic and incomplete, since the hardening of terms took place in a debtors' market from which not a single established LDC borrower was excluded, not even such doubtful cases as South Korea and Zaire. The increasing risk exposure alleged by the financial intermediaries was covered both by larger commissions on new loans and by shorter maturities. But these actions then had a negative influence on the solvency of the debtor countries in the short and the long run.

Although there are differences among the financial terms of different loans, by type of creditor and debtor country, and bearing in mind the more basic fact of the general hardening of terms, it is now in order to present an overall view. An indicator that is of use at this point is what is called the average interest cost on external debt. This is the ratio between interest payments and the balance of the (disbursed) debt outstanding. The average interest cost summarizes a great variety of interest rates, since interest payments reflect conditions in previous years. The indicator is, however, useful for medium and long-run trends.

Table 32 clearly shows that the average interest cost was higher for financing from private sources, and that during 1967-1974 this cost grew faster than the corresponding figure for loans from official sources, which resulted in a hardening of overall terms. Within the category of loans from private sources, the average interest cost of those contracted in the open market practically doubled as the share of this type of private financing rose relative to that from supplier credits. For official sources, the average cost increased faster in the case of multilateral organizations, reflecting a general hardening in the financial terms of multilateral credits (as the management of the World Bank itself pointed out). And even financial assistance for development from DAC countries and from the socialist countries of Eastern Europe has undergone increases in average cost, that is the financial terms have hardened, in the last few years.

Table 32 also shows the wide spread of average costs on funds from different sources. In 1974, the average interest cost on credits from the socialist countries and the DAC countries was 71 per cent and 33 per cent, respectively, below the general average, but still higher than in 1967. The average cost for loans raised in the open markets was 64 per cent above the general average, the reasons being that the latter are more influenced by market rates, whereas multilateral terms are somewhat insulated from them, and the credits from socialist countries are little influenced, if at all.[28]

The spread among the average costs becomes even larger if the data are disaggregated and the countries grouped by middle-income, low-income, and oil exporters (see particularly Table 5). From that table, two facts stand out that might seem to contradict the previous finding. First, the average interest paid by oil exporters in the financial market is significantly higher than that paid by the other two groups of countries, but this is due to the debt structure and terms of borrowing of two countries, Algeria and Venezuela.[29] Second, the DAC countries charge lower average interest rates to middle-income and oil-exporting countries.

B. *The end-use of the international loans*

Just as the financial terms of official and private resources differ, so does the end-use of the loans received by developing countries. However, since the allocation of the resources is decided in the end by the borrower (within the bounds set by the lending entities), there are also differences that reflect the degree of development of the individual borrower, and the demands of their individual debt situations.

Looking at the allocations made by different sources, private lenders do not seem to show any preference about the end-use of the funds they supply. As long as a borrower corresponds to their image of a "good risk" and its government is willing to guarantee the loan, the private lender is satisfied (see Table 27).

No specific criterion is discernible for the end-use of funds from private sources. These have gone to support objectives as diverse as industrialization programs, external current account deficits and public finance gap financing. Nevertheless, a pattern does show up insofar as the preference of creditors for a certain type of debtor is concerned. Leaving aside the oil-producing countries, which are considered "good risks", private lenders have shown a preference for the larger, expanding LDCs in the higher-income category.

For their part, developing countries that borrowed from private sources did so partly because their higher degree of development makes

[28] Most financial bilateral assistance is granted with some kind of ties, such as the obligation to purchase from the creditor country. Hence, such assistance, rather than following market conditions, is aimed at "sustaining" production and exports. Suppliers' credits play a comparable role. Assistance from socialist countries is tied to an even larger extent.

[29] These two countries entered the financial market in a big way in 1971. Apparently, they contracted mainly short-term loans, and so the average interest costs they paid during 1973 and 1974 turned out to be particularly high.

them ineligible to obtain sufficient resources from official lenders, but also because they seek greater freedom in allocating the resources they raise, as well as to avoid technical and political surveillance that is imposed by official lenders.

Official lenders clearly tend to prefer project loans to program loans. A project loan has a direct link with tangible investments that produce recognizable and concrete benefits. Such projects can be subjected to careful cost analysis, in particular as regards the foreign-exchange requirements for purchasing equipment, technical services and other inputs. Similarly, it is possible to evaluate the amount of local resources required to carry out the project. Such considerations, however, may also be subordinated to general political considerations as well as those of economic policy.

It has been asserted that project lending has obvious advantages for developing countries. In spite of these, it also has serious shortcomings —for example, projects must often be defined in terms that are too narrow, and a project does not reflect general economic trends that

Table 34

SECTORIAL DISTRIBUTION OF FINANCING BY THE WORLD BANK,* 1974-1976

(Millions of dollars)

Sector	*Amount*	%
Agriculture	1 627.6	24.54
Development finance corporations	761.1	11.48
Education	321.3	4.84
Electricity	949.3	14.31
Industry	606.0	9.14
Non-project	429.0[1]	6.47
Population and food	25.8	0.39
Technical assistance	32.0	0.48
Telecommunications	64.2	0.97
Tourism	31.0	0.47
Transportation	1 370.9	20.67
Urbanization	79.6	1.20
Water and sewage	334.6	5.04
Total[2]	6 632.4	100.00

* Including IBRD and IDA.
1 Includes 200 million dollars for "import maintenance".
2 Includes 477.8 million dollars lent under the terms of the "third window".
Source: World Bank, *Annual Report,* 1976, p. 19.

can be discerned in a program in which all the sectors of the national economy are coordinated and integrated.

As for the type of projects that are primarily financed with official resources, there is a certain degree of specialization by institutions: the IMF specializes in credits for exchange stabilization; the World Bank, in financing infrastructure; the Eximbank, in export credits, etc. The general aim is to strengthen the development of the borrowing country. When development used to be defined basically in economic terms, emphasis was laid on the economic infrastructure, *viz.*, electricity, transportation and communications projects. As the concept of development was broadened to incorporate a social component, financing was expanded to projects relating to housing, drinking water, education, and even land-settlement.

Similarly, when the emphasis used to be placed on industrial development, most infrastructure projects were linked to industry. As the need for agricultural development also came to be recognized, the financing of agriculture became more central.

As an example, Table 34 shows the sectorial distribution of loans to Third World countries by the World Bank Group, excluding the IFC, between 1974 and 1976. Two items (agriculture and transportation) clearly dominate, followed closely by electricity, development finance corporations and industry. Together these five uses represent 80 per cent of the total.

External Debt Renegotiations

The growth of the LDCs' external public debt, taken together with the deterioration in lending terms as well as in the economic prospects for the medium term during the last few years, has caused widespread and growing concern. At the same time, the debtor countries have intensified their search for new and improved international mechanisms for debt relief. Over the last two decades, ten countries[30] have on 33 occasions renegotiated their external debt, getting financial relief for some US$ 8.7 billion. As can be seen, some of these countries had to

[30] Argentina, Turkey, Brazil, Chile, Ghana, Indonesia, India, Peru, Pakistan and Zaire.

make use of these emergency mechanisms two, three or more times (see Table 35).

Hence, it was considered relevant to include a section describing the main features of the efforts made during the last few years to renegotiate external debts.[31] The objective here is to draw on past experience in order to offer a guide to the future.

1. *The institutional framework*

There is a general consensus that debt renegotiation is quite complex and therefore takes a good deal of time. The initiative for renegotiation always comes from a debtor country facing an emergency in its balance of payments. To forestall resorting to default, which is to be avoided at all costs, the country asks for renegotiation talks to be started through the offices of one of the principal creditors, or, at times, of some international financial organization.

Multilateral renegotiations have been conducted under the sponsorship of the several existing "clubs" (Paris, London, the Hague), or within the consultative or coordinating groups set up by the World Bank. The framework of the negotiations has been quite informal, and

Table 35

EXTERNAL DEBT RENEGOTIATIONS DURING 1955-1976

Countries[2]	*Amount of renegotiated debt*[1] *(million of US dollars)*
Argentina (3)[3]	816
Turkey (3)	734
Brazil (2)	500
Chile (4)	853
Ghana (4)	585
Indonesia (4)	2 517
India (7)	1 253
Peru (2)	128
Pakistan (3)	987
Zaire (1)	350
Total	8 723

[1] The amounts represent the total debt renegotiated at different times.
[2] Listed in chronological order by the date of the *first* renegotiations.
[3] Number of renegotiations.
Source: *Euromoney*, April, 1977.

[31] The period studied here is longer than for the rest of the document. The availability of information made such an extension advisable.

the conclusions have taken the form of recommendations made *ad-referendum* to the participants, pending ratification at the bilateral level. As a rule, the agreements specify the type of debt that will be consolidated and its amount, the schedule for the consolidation, and other terms, as well as the commitments made by the debtor country.[32]

Of course, the creditor countries' attitudes reflect the varying interests that link them to the country undergoing problems, and also considerations such as the danger of setting a precedent and, obviously, current domestic circumstances. It is worth emphasizing, however, that it has become possible to accord proportional treatment to all creditor parties, after some complaints at the outset.

Socialist creditor countries have not taken part in multilateral mechanisms of this sort. They have participated in bilateral negotiations, but infrequently and in more favorable conditions.[33]

Renegotiated debts have consisted almost exclusively of commercial loans, although government loans have at times been included, but never those granted by international organizations. Most renegotiations have taken a long time, sometimes almost two years. Repayment schedules on the newly consolidated debt have been short, limited to the medium term; while there has been great diversity in this respect, most terms have been around three to five years, although in exceptional cases they have stretched up to 30 years. The financial terms have been of a commercial character. The basic principle is that these operations are exceptional, only for an emergency and are not under any circumstances to be confused with the normal way of handling external financial loans.

Of the different types of arrangement (cancellations, moratorium, refinancing and repayment rescheduling), the last one has been most frequently used; it is the easiest for the creditors to implement, although its benefits to the debtors are less than some of the other options. Refinancing involves new resources to cover the previously acquired debt. Normally this creates difficulties of an administrative and/or legislative nature in industrial countries, which explain why this method has been so little used. A temporary moratorium on payments has been utilized quite seldom, and total cancellation has been allowed only on one occasion, and then only for a fraction of the debt.

The International Monetary Fund and, to a lesser extent, the World Bank, have taken part in all the talks so far. Their role has normally been that of providing the participants with a general overview of the problems and economic prospects of the country in question. Since the countries that have renegotiated were frequently going through a phase

[32] See International Bank for Reconstruction and Development, *Multilateral Debt Renegotiations: 1956-1968,* EC-170, April 11, 1969, p. 9.

[33] *Ibid.*, p. 30.

of overall reorientation of their economies and had entered into standby agreements with the IMF (frequently at the insistence of the creditors), the role of those institutions has been quite important, not only during the actual negotiations, but also throughout the phase of implementing the corrective measures.

Of course, political factors and the relationships between the principal creditor and debtor countries play a role that is sometimes critical both in how these institutional mechanisms of renegotiation work and in the results. One of the obvious objectives of these mechanisms has been the restoration of confidence, in order to prevent the flow of financial resources to the debtor countries from drying up.

2. *Conditions prior to the renegotiations*

In spite of the enormous diversity in economic, social and political conditions in the countries that have renegotiated their external debt, there are some basic characteristics common to all immediately prior to renegotiation. Some of these are:

a) a low rate of growth of *per capita* product;
b) political pressure to stimulate growth;
c) the predominant role of the public sector in shaping global strategy, which in turn requires high rates of capital formation;
d) the crucial character of the availability of external resources;
e) forced restrictions in imports by most countries;
f) substantial debt in the current account; and
g) a deterioration in the net transfer of resources from abroad, with immediate negative consequences.[34]

In several of the cases examined, conjunctural difficulties in the domestic economy were aggravated by a deterioration in the external sector, often through a fall in export earnings. In the majority of cases there were strong inflationary pressures as a result of excessively expansionary monetary policies that in turn originated from sizeable fiscal deficits.

Excess demand was a reflection of attempts by the governments to accelerate economic development and alleviate increasing social and political pressures by means of large public expenditures.[35] To a large extent, the explanation of the increase in the LDCs' external debt lies

[34] For more details, see UNCTAD, Ad-Hoc Group of Governmental Experts on Debt Problems of Developing Countries, *The External Debt Experience of Developing Countries: Economic Developments Following Multilateral Debt Renegotiations in Selected Developing Countries,* TC/B/C./3/A,C.8/9, 19 Nov., 1974.

[35] See International Monetary Fund, *Multilateral Debt Renegotiations: Experience of Fund Members,* August 5, 1972 and Sept. 20, 1974.

in this situation, one which does not signal a conjunctural or a temporary problem but, quite the contrary, one that is clearly becoming more permanent. This problem represents a structural element that will have a great influence on the future of the external debt in general.

It is also worth pointing out that in most countries, the mechanisms for the control and coordination of borrowing and allocating external debt resources are quite weak.

3. *The renegotiations*

In addition to some of the institutional aspects briefly discussed in previous paragraphs, there are certain indicators of the size and terms of the relief obtained through the renegotiations. The size of relief can be gauged in different ways: absolute amount, ratio to total debt, maturity, other terms, ratio to import capacity and to investment.

All these vary greatly among the different countries. Thus, the amount of annual relief has ranged from US$ 22 million (Ghana) to US$ 430 million (Indonesia). Likewise, the percentage of the originally scheduled payments that has been consolidated has ranged from 15 per cent (Chile, India) to up to 85 per cent (Indonesia). The time period covered by the relief has also varied greatly (in some cases it has been less than two years), and the same is true for the financial terms. The ratios of relief to the capacity to import and to investment have varied widely, from —0.6 per cent to 48 per cent for the former, and from —2.9 per cent to 300 per cent for the latter (for Chile and Indonesia, respectively, in both cases). Apart from a few minor exceptions, the contribution of relief to the capacity to import and to invest in the debtor countries has been "modest".[36] On the other hand, relief has had a substantial impact on the net transfer of resources.

It is important to stress the enormous diversity in the financial features of the renegotiation, which makes it exceedingly difficult to discern general guidelines for possible future application.

4. *Post-renegotiation period*

In the great majority of countries, the renegotiation process was part and parcel of a whole set of actions aimed at reorienting the economy and restoring a more adequate "balance"; it is difficult, therefore, to evaluate the effects of the renegotiations, since it is almost impossible to evaluate them independently from other economic and social measures taken at the same time.

Likewise, it is worth stressing that situations differ from one country to another, which makes it difficult to draw general conclusions. But

[36] UNCTAD, *op. cit.*, pp. 17 and 18.

it is important to point out that *all* the countries involved devalued their currencies at the time of renegotiation. Many of them also started stabilization programs with the support of the IMF, and almost all adopted important changes in their financial, monetary and foreign exchange policies, in what might be labeled "orthodox" fashion.[37] In addition, many experienced radical changes in their political regimes.

Some remarks about the performance of certain economic indicators in the post-renegotiation stage may be revealing. The rate of increase of prices slowed down and the public sector deficit decreased. The performance of imports and of the net transfer of external resources was quite varied, while the external accounts of all the countries improved, reflecting to a large extent higher rates of growth of export earnings. On the other hand, GNP growth in general slowed down.

Thus, the general effects of all renegotiation efforts can be considered beneficial, especially if the potential repercussions of failure to make such efforts are taken into account. This is especially true since efforts made it possible to obtain indispensable balance-of-payments support and to avoid a slowdown or a cessation in the flow of external capital; at the same time, they have served to support action aimed at economic reorientation.

Nevertheless, it must be recognized that "... in the majority of the countries, prevailing conditions that had made it necessary to renegotiate the external debt were not eliminated".[38] To a large extent, this explains why those countries that have renegotiated once have been forced to do so again a short time afterwards, and it also sheds some light on the essence of the problems of the LDCs' external debt.[39]

5. *Some preliminary conclusions*

Renegotiation is a measure devised to deal with a critical situation in the balance-of-payments and in the economic apparatus in general. The explanation for such crises basically lies (as experience reveals) in excessively expansionary policies. Severe conditions attached to the external debt, conditions not suited to the specific situation, have contributed to the failure to find a permanent solution to the problem.

The timely adoption of corrective measures is certainly preferable to renegotiation, which puts the debtor "against the wall"; but renego-

[37] The Pearson Report, published in the late sixties, had already drawn attention to these problems. See *Partners in Development*. Report of the Commission on International Development, Praeger Publishers, New York, 1969, pp. 156-160.

[38] UNCTAD, *op. cit.*, p. 19.

[39] At the end of August, 1977, according to reports in economic journals, Peru had once again started talks to request rescheduling repayments on its external debt (about US$ 4 billion), in view of the emergence of serious problems in the external sector of its economy and in the level of its international reserves.

tiation is better than default, the consequences of which would be highly detrimental.

The existing multilateral mechanisms for renegotiation are informal and relatively complex; they clearly reflect the interests of the creditor countries, and their "recommendations" generally take too long to implement.

The terms of the renegotiations are comparable to those prevailing in commercial market dealings. Creditor countries have stressed the exceptional nature of the mechanism, which is for emergency situations only. Although the amount of relief has varied widely, it has, as a rule, been beneficial, though relatively modest. The renegotiations have been part and parcel of broader economic reorientation programs aimed at achieving more "orthodox" policies.

In view of the extreme diversity of the countries involved, their situations on the eve of the renegotiations, and the size and conditions of the relief obtained, it is difficult to draw general conclusions about the impact of the renegotiations that might be of practical use for the future.

The difficulties in servicing the external public debt of the LDCs are, to a large extent, essentially of a long-term nature. Any international arrangement should reflect this, and the capital requirements and financial conditions should be set in an adequate way. In the renegotiations completed thus far, this fundamental fact has been neglected.

Given the LDCs' external debt prospects and the likely evolution of their economies, it is quite possible that out of necessity there will be more frequent attempts to get debts renegotiated in the future, and that these attempts will involve larger debts and a growing number of countries. In view of this, it is crucial to promote a basic change in attitudes towards renegotiation, which at present is considered a last resort or in some cases almost a catastrophe.

If the basic elements underlying present renegotiations —institutional difficulties, commercial treatment, limitation of coverage, short-term approach, etc.— persist, it is quite obvious that the potential relief will be as limited as it has been in the past. However, if new attitudes are adopted, which will only be possible with a fundamental policy change on the part of the creditors, and if the opportunities offered in principle by renegotiation are fully used, the new loans could be incorporated into the real context of development and subsequently long-term financial resources can flow in under better conditions. If all this were to take place, the LDCs could consider debt renegotiation an important contribution to reducing obstacles to economic and social development.

The External Debt of Developing Countries: A Survey of Viewpoints

For several decades, the problems relating to financial flows from industrial countries (ICS) to less developed countries (LDCS) have been prominent in economic literature, national and international economic circles and, of course, the banking community.

During the last few years, however, the extraordinary growth in the money value of the LDCS' external public debt has brought the problem to the forefront of the world's attention. But the recent debate no longer focuses narrowly on the effect of the debt upon the economic and financial situation of the LDCS. Increasing concern is developing in world financial centers about the possible negative repercussions for a number of creditor countries, as well as for the financial solvency of international banking institutions, particularly those operating in the Eurocurrency market.

Thus, a brief survey of the main viewpoints is in order. This will be undertaken in this final section. The analysis goes beyond the positions taken by the LDCS and the ICS, in that it also covers the viewpoints of some international organizations and of the international private banking community as well. Furthermore, the main features of a number of proposals for dealing with the problem of external debt (some of which are still in the preliminary stages of discussion) are also included.

1. *The* LDC's *position in international forums*

The external debt of developing countries has been debated at length within the institutional framework of the World Bank, the International Monetary Fund, the OECD's Development Assistance Committee, the United Nations Conference on Trade and Development and a wide variety of international meetings among Third World countries. The subject was at the center of the discussions at the Conference for International Cooperation which ended in early June 1977 without achieving substantive agreement on the vast majority of items on the agenda.

Until very recently, the developing countries had put forward very few proposals that were specific and feasible from the economic, financial and political viewpoints. It is also suprising that the industrial countries have lacked the political will to came up with anything but traditional attitudes towards the viewpoints of the majority of members of the United Nations, first at UNCTAD and then at the Paris Conference. The statement that the President of the World Bank made in 1965 is still valid: "if we continue to do what we are doing, this is in essence the same as doing nothing".

Over the last decade, the LDCs have strongly criticized the insufficient volume and excessively "burdensome" terms of external financial resources. This general view was complemented by demands for "relief" from the burden of servicing external debt; the elimination of tied loans; greater freedom in how external resources could be used to include local expenditures; and a shift in emphasis from project lending to program lending and from bilateral to multilateral financing. Gradually these tenets produced what might be termed an LDC "ideology" on the subject of external debt. An important part of this position. which to a large extent drew its inspiration from studies prepared by the UNCTAD Secretariat over more than a decade, is the growing recognition that external debt is only one dimension of international economic relations and must be considered together with international trade and overall financial flows between advanced countries and developing countries, rather than simply as a reflection of short-term disequilibria in the developing economies.

Developing countries have emphasized repeatedly that the volume of financing for development has failed to keep pace with their requirements, as well as with their absorptive capacity, not to mention the real potential of the industrial countries to transfer financial resources to the underdeveloped part of the world economy. Such viewpoints eventually formed an important political platform; and over ten years ago this platform served to exact a commitment from the industrial countries (one that has not been honored to this day)[40] to allocate one per cent of their GDP to financial assistance to the poor countries (0.7 per cent to be granted on "soft" terms).

Ten years ago, the President of the World Bank pointed out that "the volume of financial assistance for developing countries is inadequate, from any reasonable point of view". The same position was shared by the developing countries as a whole throughout the period. In 1967, for example, the countries in the Latin America Special Coordinating Commission (CECLA), which was important in the process that led to creating the Latin America Economic System (SELA), reiterated their "concern over the great problems caused by the insufficient availability of external financial resources".[41] Almost ten years

[40] It should be noted that the US, Germany and Japan did not commit themselves to this target.
[41] CECLA, *Carta de Tequendama*, Colombia, September, 1967.

later, on the eve of UNCTAD IV, the Group of 77 made an almost identical pronouncement during a coordinating meeting at the ministerial level in Manila in February, 1976.[42]

It has been mainly within the framework of UNCTAD that the subject of insufficient financial flows has received sustained attention. The UNCTAD Secretariat estimated in May, 1976, that "the current account deficit of those countries facing difficult situations may exceed that of the previous decade"[43] unless measures are taken by international agreement, with a view to increasing the volume and improving the terms of financial assistance.

Over the last ten years there has been unflagging insistence on the insufficent flow of external resources, though the extent to which these influence economic growth has perhaps been exaggerated. At the same time, a new concern emerged about the absolute level of the external public debt, its anual increase and the "critical proportions" of the borrowing capacity of a number of developing countries.

Together with an emphasis on the insufficiency of the volume of financial resources, LDCs, have maintained throughout the period that they wanted to "improve" the terms (maturities, interest rates and grace periods) of assistance, even though these had become more favorable. During the last few years as the overall nominal terms of external credits deteriorated, reflecting the increasing share of loans from private sources, demands for improvement in the terms have intensified. Yet, leaving aside the demands to the advanced countries to comply with their commitments about official development assistance (ODA), the schemes to improve the terms of financing have been exceedingly general and, on occasion, neglectful of the changing conditions in the international capital markets, as well as of inflationary processes.

It is therefore in order to recall what UNCTAD pointed out in 1967: "... the deterioration in the terms and conditions of the assistance has occurred at a time when the problem of external debt of a number of developing countries clearly demanded a substantial increase in the proportion of grants, and an improvement in the terms of the loans".[44] And, "... unless substantial improvement is achieved in the terms of financing in the near future, it will be difficult to avoid a fall in the net transfer to developing countries, which will entail a fall in the rates of economic development".[45]

[42] See UNCTAD, *Manila Declaration*, Febrary, 1976, item 7.

[43] UNCTAD Secretariat, *International Financial Cooperation for Development*, TD/188, Nairobi, May 1976, pp. 2-3.

[44] UNCTAD Secretariat, *The Terms, Quality and Effectiveness of Financial Flows* February 12, 1967, p. 3.
and Problems of Debt-Servicing. Trade and Development Board, TD/B/C. 3/1,

[45] *Ibid.*, p. 23.

Concrete proposals for liberalizing the terms of external financial flows as a whole, that have been formulated since 1971, were presented in consolidated form by the developing countries at the recent Conference on International Economic Cooperation. Loans to developing countries, according to these proposals, should bear interest rates of 2 per cent with maturities of 40 years and grace periods of 10 years;[46] or, somewhat less liberally "... all official loans for development should be supplied on the terms applicable to the funds of the International Development Association".[47]

The problems of servicing the external debt (paying interest and principal) has received a great deal of attention in all international financial debates of the last ten years. Concern has intensified in the light of the relative sluggishness of the flow of financial resources from official sources, and of developments in the LDCs, external sector during the recent international recession.

Different indicators are often employed to evaluate debt servicing: the radio of service costs to current account inflow, gross domestic product, per capita product, the total amount of the debt outstanding, etc. Most commonly used is the ratio of payments for interest and principal to export earnings. This ratio has generally tended to increase, although at levels below those projected from time to time by different international organizations.[48] Nevertheless, the LDCs' average debt-service ratio has risen from 10 per cent in 1976 to 18 per cent in 1976. Moreover, prospects for its continuing increase are such that, according to some studies, the ratio may reach 30 per cent by 1980. A debt-service ratio of such magnitude would mean a grave obstacle to the availability of foreign exchange for development. In addition, average figures conceal serious problems. For a number of countries, a fourth or more of their foreign exchange earnings are already committed for the payment of interest and principal on their external debt.[49]

Of course, the continued increase in the debt service ratio —although this concept is of limited value— is cause for increasing con-

[46] Interesting background is found in CEMLA, *Aspectos financieros del Programa Provisional sugerido para la III* UNCTAD *por la X Reunión Extraordinaria del* CECLA. Lima, October, 1971; in CEMLA, *Boletín Mensual*, Volume XVII, Nov., 1971. A similar position is presented by Angelos Angelopolus, "El Mito de la ayuda al Tercer Mundo", *Comercio Exterior*, (México), Sept. 1972.

[47] See CECLA, *Acuerdo de Lima*, Lima, Peru, Nov. 1971.

[48] See, for example UNCTAD, *Growth, Financing of Development and Aid* (Timing International and Domestic Policies: Problems and Proposals) TD/7 and supplement 5, Oct. 1967, pp. 2 and 35; *International Financial Cooperation, op. cit.*, Nairobi, May 1976; UNCTAD, *Trade Prospects and Capital Needs of Developing Countries 1976-80*, TD/B/C.3/134, Nairobi, April, 1976, p. 3.

[49] Interest and amortization payments derive from a contractual obligation and therefore have priority over other foreign exchange outlays.

cern,[50] especially if due attention is paid to other indicators. International debate on this issue for over a decade has clarified the need to place it in the perspective of the objectives of international financial cooperation.[51]

The difficulties of servicing the debt derive not only from its size and terms, but also from the end use to which the resources have been put. Many projects financed with external loans can make an important contribution to development, but they may not directly generate the foreign exchange required to service the corresponding debts. Occasionally, external loans that must be reimbursed in the short run are used to finance projects with long maturation periods. Also, the use of external resources has not always been as efficient as desirable. In such cases, pressure develops over the total capacity of the economy to translate increases in output into increased foreign exchange availabilities. In spite of all this, and granting that there is a risk of excessive generalization, there is a growing consensus that the "responsibility" for these problems belongs with the maladjustment of the world economy, that is to say, lies in causes beyond the control of the LDCs and not attributable to the absence of domestic adjustment policies by the debtor countries. The group of 77 has stressed that the debt problems largely reflect the fall in the net flow of external assistance and the hardening of terms; the ICs have reiterated that such problems originate in lack of planning and excessive reliance on expensive commercial credit.

The growth of debt service obligations at a rate faster than export earnings cannot be sustained indefinitely,[52] and is putting an increasing premium on the search for mechanisms for debt "renegotiation". While perhaps the "present level of indebtedness of developing countries will not provoke generalized *defaults* nor require massive debt renegotiations",[53] the problem of servicing the debt does not only arise in the extreme situation in which the ability of a country to honor its

[50] For debt contracted in the Eurocurrency markets, an estimate shows that by 1980, two out of every three dollars raised by debtor countries will go to service previous credits from the same source. See *The Amex Bank Review*, Vol. 4, No. 3, March 1977.

[51] *The Amex Bank Review*, Vol. 4, No. 3, March, 1977. See, for example, the Report by the Ad-Hoc group of Government Experts on Problems of External Debt of Developing Countries, UNCTAD, Trade and Development Board, TD/B/485 and TD/B/C.3/A 8/6. Geneva, May 1974.

[52] See Goran Ohlin, "Debts, Development and Default", in *A World Divided: The Less Developed Countries in the International Economy*, G. K. Helleiner (editor), London, Cambridge University Press, 1976.

[53] John H. Adler, "The External Debt Problem" in *The World Bank Group, Multilateral Aid and the 1970's,* John P. Lewis and Ickan Kapur (editors), Heath and Co., Lexington, Mass., 1973, p. 12.

obligations is in doubt. The problem also arises whenever the payments compress the net availability of external resources in such a manner that it becomes impossible to attain certain minimum objectives of economic and social development. This is why the experience of the years 1960-1970 led the developing countries to insist on both improving multilateral mechanisms and broadening the scope of renegotiations, so that they would not be restricted to the problems of debt from private sources and concessional terms, but also consider the need to forestall "crises" in advance, to avoid emergency measures that are not always constructive.

2. *The Paris Conference*

The solutions to the problems of debt-servicing that the LDCs have proposed have been improving in substance and in precision. The exceedingly general schemes presented at the beginning of the decade,[54] have been refined and made more specific. In January, 1976, a set of proposals was presented by the developing countries at the Conference on International Economic Cooperation, proposals inspired to a large extent by the work of the UNCTAD Secretariat. In fact, the subject of the external debt of developing countries was included in the agenda of the Paris Conference at the insistence of the Group of 19, only in the sense that the item would come up for consideration without the Group of 8 having accepted it as a part of the formal agenda.[55]

The chief proposals of the Group of LDCs for debt relief can be summarized in four points:

a) consolidate the commercial debts of the interested developing countries, and reschedule their payments to achieve maturities of no less than 25 years;
b) convert official debt, especially that of lower-income countries, into grants;

[54] See, for example, CECLA, *Carta de Tequendama*, Bogotá, September 1967: "...implementation of adequate methods for the long-term consolidation of the external debt of LDCs..." also, Group of 77, *Manila Declaration*, February 1976: "...taking immediate action... to mitigate the problems of increasing indebtedness of LDCs..."

[55] The developing countries' debt was also discussed at UNCTAD IV, which met in Nairobi in May, 1976. Given the impossibility of reaching resolutions that could be implemented immediately, developing countries demanded the convocation of a special international conference to deal with the debt question. The developed countries, showed a preference for dealing with debt questions within existing forums or institutions. The matter was turned back to the Paris Conference as the Group of 8 agreed that this was the appropriate forum.

c) establish a financial facility for refinancing short-term loans, under IBRD or IMF sponsorship;
d) supply more ample financial facilities to multilateral institutions.

Until recently, the UNCTAD Secretariat was of the opinion that none of these proposals had financial implications that were particularly burdensome for the creditor countries.

In addition, LDCs, represented by the Group of 19, had unanimously insisted on international action to deal with future problems.[56] The main items in the Group's position were: external debt has to be set in the context of medium-term economic development and international cooperation; efforts to restructure the debt must be speeded up; there must be internationally agreed guidelines and better conditions on new loans, and national sovereignty must be respected.

The developed countries, represented by the Group of 8,[57] refused to acknowledge the existence of a *general* external debt problem and insisted that individual extreme problem cases could be taken up, as a priority, by the existing mechanisms. According to the DCs, the problem of external debt is a balance-of-payments problem that does not necessarily represent financial or economic weakness; it is not a problem of insufficient transfer of resources for development, or a consequence of the nature of the prevailing international economic order. They also asserted that generalized "relief" would give the impression that there was a general loss of creditworthiness, which might result in a fall in the volume of resources. Given these opposing positions, there was no progress on the subject of external debt at the Paris Conference.

The assessment of the influential London *Economist* of these events was as follows:

"On the tricky issue of debt, the fact that the two sides agreed to disagree was, in itself, a welcome result for the industrial nations. The 19 had stubbornly insisted on tying this problem to progress in the other key areas of energy, finance and development aid. They asked for a moratorium on debts of the very poorest countries (estimated at close to $40 billion), and the rescheduling of debts incurred by others. But when the crunch came this week the 19 finally decided to back away. There were substantial disagreements between middle-income poor countries that want to continue to borrow from commercial banks and the rest."

56 In view of differences within the LDCs, the agreement on criteria created serious problems.

57 With the exception of Sweden, which suggested that the advanced countries accept "a general political commitment to provide additional resources for official development assistance" and that such assistance be devoted to "debt relief and measures".

"The industrial camp's $1 billion special action aid pledge was accepted by the 19 without much fuss, although it represents less than one year's debt servicing for the worst-hit third-world nations."[58]

3. *Latin American viewpoints*

Concern has increased recently in Latin America about external debt, an understandable reaction since Latin America is responsible for about 40 per cent of the external public debt of the LDCs. By the end of 1975, Latin America's external debt amounted to US$ 56.5 billion, compared with US$ 12.7 billion in 1966.[59] While debt service payments rose from almost US$ 2 billion to almost US$ 6 billion, the net transfer of external resources grew from US$ 642 million to US$ 8.8 billion.

The external debt burden has increased substantially. The ratio of external private debt to GDP grew from 13.9 per cent in 1966 to 21.8 per cent in 1975. The so-called "debt service ratio" remained stable at about 16.9 per cent, due to the increase in the value of exports.

The international recession that started in 1974 increased the external resource requirements for Latin America. The current account deficit (excepting Venezuela) increased from an average annual figure of US$ 4 billion in 1974 to US$ 16 billion in 1975. While a slight improvement in trade occurred in 1976, the external debt at current prices almost doubled between 1973 and 1976. Higher interest rates and shorter maturities, which reflected the larger share of borrowing from private sources, caused a marked fall in the size of the net transfer during 1976, the first time this has occurred in the modern history of Latin America.

The present situation and the prospects for the debt have recently been analyzed by ECLA and the IDB.[60] These studies suggest that, while the general situation is less dramatic than is felt in other circles, it does present certain signs that are reasons for serious concern. The current problem, as the IDB and ECLA see it, lies not so much in the size of the debt, but rather in the sluggishness of the flow of bilateral and multilateral assistance and in the difficulties of the World Bank and the IDB in mobilizing additional resources on concessional terms.

58 *The Economist* (London), "The North and the South are still on speaking terms — just", 4 June, 1977.

59 According to preliminary estimates from the IDB the 1976 figures for external debt, total and disbursed, were US$ 67.1 billion and US$ 49.1 billion, respectively.

60 For details see Inter-American Development Bank, *Latin America's External Indebtedness: Current Situation and Prospects,* Washington, D. C., May 1977; and Carlos Massad and Robert Zahler, *Financiamiento y endeudamiento externo de América Latina y propuestas de solución,* CEPAL-PNUD, Santiago, Chile, 1977.

The major worry centers about the thesis that Latin America, in view of its relatively high degree of development, may well rely on private sources to satisfy its financing needs.

These preoccupations were presented in a recent statement by the IDB President in favor of increased assistance to Latin America.[61] This points out that the external debt position of the region did not deteriorate in the last decade, in spite of the rapid increase in the total debt. Most of the debt was concentrated in three countries (Argentina, Brazil and Mexico) with diversified economies, vast natural resources and strong export capacity. The majority of the remaining Latin American countries have, according to the President of the IDB "capacity for a sizeable amount of additional indebtedness, while others are following policies aimed at allowing them to continue honoring their external financial obligations".

At an ECLA meeting of high government officials in Santo Domingo in March 1977, it was unanimously agreed that Latin America should obtain larger external resources for its development, not only because internal adjustment measures and a slowdown in the rate of growth might cause serious repercussions in the social and political spheres, but also because of the negative impact that such an adjustment world have upon the world economy, through the export of deflation. In addition, there is no reason for the developing countries to bear the brunt of the adjustment, given that the increase in the external debt comes, to a large extent, from causes outside their control.

The Santo Domingo meeting grouped countries into three categories as regards external financing. In the first group (Argentina, Brazil, Mexico and perhaps Venezuela) the problem lies in maintaining access to private capital markets and to the official financing of the World Bank and the IDB. For the second group, consisting of medium-size countries that have initiated expansion and export diversification, it will be necessary to increase official credits on better terms, and to gain access to capital markets, *before* their access to official sources becomes more difficult. For the poorest countries, they need systematic access to concessional funds.

The ECLA study reiterated its recent proposal to set up a mechanism for countries facing a potential debt crisis, along the lines of the IMF oil facility. From ECLA's point of view, establishing rules to deal with such problems in an overall context is preferable to the case-by-case approach that creditor countries support. The ECLA study also supports the proposals presented by the LDCs at UNCTAD IV and the Paris Conference, and refuses to accept that the region be dealt with as a group

[61] Speech by Antonio Ortiz Mena, President of the IDB, before the VIII Meetting of the Point Development Committee of the World Bank and the IMF, Washington, D. C., April 27, 1977 (IDB Press Release).

of "middle-income countries"; it argues that mechanisms for refinancing should exist (perhaps under the auspices of the IMF) and supports the idea of setting up a "financial safety net" for Latin America to reduce the sharp fluctuations in the flow of private resources.[62]

It is interesting to compare these positions adopted by the region as a whole with the attitude of the principal debtors, which on occasion conflict with those of the majority of LDCs and reflect a certain basic agreement with the theses of the industrial countries.

First, this small group of countries agrees with the rest that external debt cannot be isolated from international economic relations. Their own situation, however, makes them eager to avoid pressing the issue and entering into polemics about it. Their support for the unified position can be explained by solidarity towards the rest of the LDCs.

Their basic point is that the debt problem is neither of a general nature nor of a uniform intensity —that it has different peculiarities for each country. They disagree with the proposal for setting up global renegotiation schemes and worry that such efforts might hurt their access to international financial markets. Their bargaining capacity and credit-worthiness allow them to settle any problems individually.[63]

4. *Other recent viewpoints*

While the Paris Conference was unable to reach any agreement on the LDCs' external debt, the matter has perhaps been the subject of more debate in 1976-1977 than any other international economic issue, except world inflation and the short-term prospects of the ICs. The World Bank, the IMF, the OECD, the BIS, and the IDB, among other international organizations, as well as the United States Government, the oil-producing countries, and international private banking circles, have joined in this debate, publicly and privately. Moreover, an impressive number of proposals have been circulated, each one suggesting a partial solution to the problem.

A review of the debates and proposals suggests that, over and above the opposing attitudes of the ICs and the LDCs at the Paris Conference, there actually exist many positions. The current situation has been recently described in the following terms:

"People who believe that LDCs' indebtedness will continue indefinitely to rise faster than the debtor countries' capacity to service debts, advocate a general restructuring of existing public and private debt, under international auspices. Those who believe that the debt build-up was the result of banks' eagerness to expand foreign loans, propose

[62] These ECLA proposals have not been accepted in other Latin American financial meetings.

[63] See *Communiqué of the Group of 24*, Manila, 1976.

more official surveillance of bank lending abroad. Those who attribute a large part of the debt to a failure of balance-of-payments adjustment on the part of the LDCs want the International Monetary Fund to intervene more actively in the LDCs' economic policy-making. Some others also recommend a slow down of economic growth as a remedy for the LDCs' payments problems. There are those whose misgivings about the rationality of private lending decisions lead them to the extreme conclusion that private banks should withdraw from longer-term lending to LDCs, leaving that function to public agencies such as the World Bank."[64]

Other schools of thought exist as well. One of them, which is prevalent in major middle-income debtor countries, argues that these countries have enough bargaining power and expertise to manage their debt problems alone; it also suggests that their support for the LDCs' common front at the Paris Conference was a political concession for the sake of solidarity. Another, radical school, which is very vocal in some LDCs, is rather inconsistent, as it demands, on the one hand, the repudiation of the external debt, resulting from "imperialist exploitation" and, on the other, a larger transfer of resources to poor countries under unspecified conditions free of exploitative practices.

Of course, each of these currents of thought contains some truth, and each one is relevant to certain cases and certain countries.

5. *The World Bank Group*

The World Bank recognizes the existence of the problem and that its solution cannot be reduced to a mere balance-of-payments adjustment. However, it believes that the recent emphasis on short-term solutions (i.e., debt-relief action) is mistaken.

The Bank considers, first, that the growing indebtedness of the LDCs is the result of an inadequate flow of financial resources and not of the cyclical behavior of the world economy; second, it insists that the use of LDCs' external debt data in nominal terms and the consolidation of figures for almost one hundred individual countries with widely varying levels of development and income, as well as the inflationary effect of recent years, makes such data almost worthless for purposes of analysis and policy-making; third, that once debt figures are adjusted to real terms and a comparison is made with other indicators such as the debt-service ratio, GDP or GDP per capita, the debt problem looks more manageable; fourth, that considering the slight probability that the real transfer of resources will expand, two pressing issues arise: the debt

[64] Harold van Cleveland and Bruce W. H. Brittain, "Debt and the Banks: Are the LDCS over their Heads?", *Foreign Affairs*, July 1977, p. 748.

problem of the poorest LDCs, and the excessive indebtedness of a small number of middle-income nations, particularly to private lenders. The first problem is "a long-term one which cannot be solved merely by short-term rescheduling, and further relaxation of current soft terms. The critical issue here is the need for a substantial real increase in the net flow of capital to the poorest nations, from public sources, beyond the levels which now appear likely".[65]

The second problem, which faces a small group of middle-income LDCs, is the direct result, the Bank says, of the increasing role of private banks in international lending to LDCs. The problem is not so much the size of the debt as the deterioration of the debt structure of these countries, which contributes to a rapid and at times dangerous rise in the debt-service ratio. The situation of the largest LDC debtors has been described recently by the President of the World Bank as a dilemma:

"The sharp increase in their current account deficits has not been rolled back. Deficits at high levels are likely to continue for at least the next five to ten years if these countries are to generate GNP growth rates of 6 to 7 per cent, which are the very foundation of their creditworthiness. But continued heavy reliance on private sources for the financing of such deficits will require very large increases in the outstanding loans held by commercial banks and other financial institutions. To the extent that a large proportion of such debt is short-term, any temporary foreign exchange liquidity problem —or even the prospect of one— can too easily be turned into a crisis."[66] The World Bank considers that its role in relieving the debt burden of the major debtor countries should be marginal.

On the other hand, it is not easy to judge whether the Bank's evaluation of the "relative seriousness" of the global debt situations is completely objective or has been affected by its policy stands and institutional interests. While the Bank's statistics on the public indebtedness of the LDCs are probably the best available anywhere, they could be criticized on the grounds that they offer only a partial picture. For example, they do not include a short-term public debt, private sector debt or debt from military operations. It must also be kept in mind that the World Bank's appraisal of the overall or individual debt situation must lean towards a conservative posture, because of the Bank's need to avoid "fatalistic predictions" and maintain its financial prestige.[67]

Considering the World Bank's very limited involvement in debt re-

[65] Address to the Board of Governors by Robert S. McNamara, President of the World Group, Manila, Philippines, October 4, 1976.

[66] McNamara, *ibid.*, p. 19.

[67] Charles Frank, Jr., "Comment on Debt Adjustment: The Tyranny of the Bankers, Brokers and Bondholders," in Lewis and Kapur, *The World Bank Group, op. cit.*, p. 129.

negotiations, due to its dependence on international capital markets and its need to convey to its bond-holders the image of a conservative and sober organization, it is not suprising that, at least publicly, the Bank stays out of the present international controversy about the LDCs' debt crisis. On issues arising from the "privatization" of the LDCs' public debt, the Bank can hardly act as more than a collector and disseminator of debt data. Furthermore, these are now handled with increasing openess and greater coverage and depth.

6. *The International Monetary Fund*

In the recent past, the IMF has accounted for only a small part of the total financing of the LDCs' deficit, and in spite of the expansion of the IMF's overall financial resources in absolute terms, the volume of support provided by the Fund has continued to diminish in relative terms. In 1975 and 1976, credits from the IMF to the LDCs were US$3 and $2 billion, respectively, which represent less than 10 per cent of the overall deficits. From a quantitative point of view, the limited size of the IMF operations contrasts, for instance, with the growth of OPEC resources. When compared with the volume of private lending to LDCs, IMF activities look even smaller.

As some independent observers have pointed out,[68] the LDCs have shown a clear preference for the oil facility and the compensatory financial facility, rather than for the Fund's traditional stand-by arrangements. This shows a lack of enthusiasm for the surveillance and conditionality of the IMF.

The IMF's oil facility was established in mid-1974 for the purpose of recycling petrodollars to all countries (not only LDCs') affected by the increase in oil prices that occurred in late 1973. The conditions were slightly more attractive than market terms —interest rate 7 per cent; maturity 7 years; and 3 for the grace period. The automatic access formula made the oil facility very attractive for many LDCs. Under the oil facility, 55 countries borrowed close to SDR 7 billion in 1974-1975. About 45 per cent of the oil facility resources were used by three industrial countries and the rest went to more than 50 LDCs.[69]

The recent history of the compensatory financing facility is also instructive. During the first fifteen years of its existence LDCs hardly used it, but the liberalization of the terms of access agreed to by the Fund in December 1975 led to a very substantial increase in its use. In

68 *The Economist*, October 2, 1976.

69 For more details see Tom Cutler, "Recycling Petrodollars to the Third World. A Critique of the IMF Oil Facility" *World Affairs* (Washington), Vol. 139, No. 3, Winter 1976-77, pp. 189-205.

1976 SDR 2.4 billion were drawn under this facility by 48 countries, twice as much resources as during its entire previous existence.

The IMF has been engaged lately in negotiating various schemes to increase the range of its activities outside the traditional stand-by facilities. Along with the present discussions about a new increase in IMF quotas (the 33 per cent 1976 increases are in the process of ratification by the legislatures of the member countries), the Fund Interim Committee approved its new special lending facility in May 1977. This will strengthen the IMF considerably vis-a-vis both the LDCs and private lenders. The facility involves about US$ 9 billion,[70] half financed by the OPEC countries and the rest by the ICs. The interest rate will be somewhat higher than the 7 per cent charged by the oil facility, and the maturities will be longer; the size of loans will be related to the needs of the borrowing country, rather than to the IMF quotas. The most important characteristics of the new facility is its conditionality, which some observers feel is severe. It will operate with a "country by country approach" that will allow the IMF to intervene more in economic policy-making by member countries, particularly foreign exchange policy.

7. *US Government views*

Contrary to expectations, the recent change of Administration has not affected the US position on the LDCs' external public indebtedness. The policy described in the report of the outgoing President in January, 1977 continues to be valid:[71]

"The US believes that the problem of the debt in the developing countries is not resolvable by any one overall approach. The wide diversity of debt situations —even among the poorest countries— sometimes calls for different treatment for different situations . . . a case by case approach . . ." The President's report argues that the transfer of long-term resources should be left largely to private intermediaries and international financial organizations.

A similar position is put forward in the US Treasury's 1976 annual report on the debt situation of the LDCs.[72] The report notes a "dramatic" increase in net private borrowing by the LDCs and a "substantial increase in their debt service obligations". The report stresses the need for the debtor countries to adopt adjustment policies in order to avoid greater problems.

[70] Preliminary reports indicate that, the main contributors reached a general agreement on the basis of a sum of about SDR 8 billion in the first week of August 1977.

[71] *International Economic Report of the President to the Congress,* January, 1977, p. 31.

[72] Starting in 1975, the US Treasury has been required to present annual reports to the US Senate on the subject. This document's official name is *Report on Developing Countries' External Debt and Debt Relief by the US.*

Very recently the Foreign Relations Committee of the US Senate stressed the serious danger to "political and financial international stability" arising out of the growing external indebtedness of the LDCs; the Committee also emphasized the persistent nature of the debt problem.[73]

Within this general policy framework, the LDCs' growing external indebtedness has attracted more official attention in the US in the recent past. What follows is a composite picture of recent views expressed by high officials, mainly the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System:

a) Leaving aside the poorest countries, the indebtedness problem of the middle-income LDCs, consisting mainly of commercial debts, is manageable if they adopt the necessary adjustment policies.

b) In some specific cases, because of the "bunching" of interest and amortization payment obligations, the problem could be dealt with by renegotiating these debts or by new loans.

c) The involvement of the IMF is vital for an adequate mix of economic measures. However, adjustment through austerity programs, must, in a number of cases, be devised carefully to avoid provoking political crises. The IMF must be flexible in working out adjustment programs for individual countries.

d) The IMF's financial capability and its responsibilities for overseeing the international monetary system must be strengthened.

e) In view of the role of private banks as a source of loans to LDCs, new forms of cooperation are necessary between the IMF and the international banking community. Such cooperation should not be considered either as a take-over of international lending by the IMF nor as bailing out of private banks which made excessively risky loans to LDCs.

f) One way of diminishing the lending risks would be —as suggested by the Chairman of the Federal Reserve Board— to get agreement from the central banks of major capital exporters to require information about the economic situation and prospects of a potential borrower, which the borrowing country will be expected to supply. In a certain sense, providing such information would constitute the price of admission to private capital markets.

g) In view of the great importance of more cooperation between the Fund and the sources of private market financing, a number of alternatives should be studied, such as:

i) including in the Fund's reports about member countries an evaluation of their economic prospects for the use of private lenders.

ii) the IMF could publish reports based on its annual consultations

[73] *The New York Times*, September 18, 1977, Section III, pp. 1 and 4.

with borrowing countries, subject to approval of the countries in question. This is similar to the OECD practice with its member countries.

iii) the IMF could participate in the development of "mixed" financing packages featuring a combination of official and private funds that in some cases might involve some refinancing.

h) While such arrangements involve serious political and legal problems, arising from a possible conflict between the sovereignty of the individual countries and the private interests of lenders, they should be studied actively in order to diminish risks involved in LDC lending.

i) A return to protectionism in the DCs may have serious consequences for the external debt of LDCs.

j) There exist three ways to bring the world balance of payments into better equilibrium, *without* major US private banks acting as intermediaries:

i) increased direct lending by the oil countries to the LDCs;

ii) increased involvement of the oil-producing countries in IMF activities, and

iii) insulation of some of the banks, through the establishment of special facilities that would accept deposits from the surplus countries for the exclusive purpose of lending them to the LDCs.

This overall picture is not only similar to the traditional position of the US: it also reflects clearly the lenders' viewpoint rather than the development needs of the LDCs. For example, no consideration is given to expanding ODA, or using SDRs to relieve the debt burden, or to establishing a link between the creation of new reserve assets and the financial needs of the LDCs. The growing concern about the debt-repayment capacity of some middle-income LDCs leads, in the end, to proposals for more efficient policing of both the LDC public borrowers and the private lenders, under some "flexible" formula to be administered by the IMF.

8. *International private banking*

Concern about the external indebtedness of the LDCs reached a peak in 1976, two years after such spectacular bank failures as the Herstatt affair. For the first time, speculation in the exchange market caused a collapse in the confidence of the private financial intermediaries in the functioning of the Eurodollar market. Concern increased again during 1977 as the data about the increase in LDC public borrowing from private sources during 1975-1976 became available. The information provided by the Federal Reserve System concerning the involvement of major US banks in lending to the LDCs added to this concern.[74] The

[74] According to *The Economist* survey of US finance and banking, published

statements by Arthur F. Burns, the Chairman of the Board of Governors of the Federal Reserve System, whose point was less to criticize the banks for their past performance than to persuade them to be more cautious in future lending to the LDCs, had similar effects.

While international banks continue to maintain that all their lending to the LDCs follows the soundest banking practices, it is nevertheless possible to discern some anxiety among the US banking community.[75] The fears are three-fold: first, some banks seem to worry that some major LDC borrowers whose credit-worthiness looks suspect may be considerably under-reporting their debt obligations to private borrowers, and those of a short-term nature which would make them more vulnerable in a crisis. The second concern is related to the growing belief that in some cases certain banks may already be over-committed in certain countries. The third and the most significant worry is about the future. According to the Financial Times:

"While the US banks have been happy enough to step into the breach (and have so far earned good profits by so doing) they are less sure how they want to continue their involvement. They are well aware that they lack reliable information about the true state of affairs within many developing countries. They are wary of forecasts provided by their clients . . ."[76]

Independently of the degree of "rationality" of past private lending,[77] the situation by mid-1977 seemed to be as follows: first, the appraisal of lenders' risks in private lending to LDCs suddenly became a very fashionable topic in professional journals and world-wide surveys aimed at proving the adequacy of available appraisal techniques;[78] second, in addition to pressing potential borrowers for more information, large US banks increased their pleas for assistance from the World Bank and the IMF on this score.

Collaboration with these institutions would take two forms: first, drawing a common check list of minimum information that LDC borrowers should provide to potential private lenders; second, access to IMF information and analysis of the individual countries' economic situations and prospects. While the first demand does not seem to create major problems (except concerning the voluntary or mandatory char-

in early 1977, "The Third World loans by the American banks are still the most controversial and the most worrying part of the international business, even if their wilder feelings expressed earlier in 1976 had been discredited." "Third World risks —Survey of American Finance", Jan. 22, 1977, p. 25.

75 David Bell and Stewart Fleming, "The Banks and the bailiff; a new idea for the IMF," *The Financial Times,* London, June 15, 1977.

76 *Ibid.*

77 Though, as pointed out by *Euromoney* (March 1977), "logic is a scarce commodity in Eurodollar markets".

78 See a recent survey of such techniques by the EXIMBANK: *A Survey of Country Evaluation Systems in Use,* Washington, D. C., December 22, 1976.

acter of such a check-list), the second one runs into difficult legal problems, among others; IMF information, frequently obtained from confidential government sources, might be used in good faith for appraisal of a country's credit-worthiness, but it might also easily be abused for speculation in the currencies involved.

Another line taken by a number of private bankers, particularly in the US, is that they would like some sort of formal or informal guarantee for their operations, either from the World Bank or the IMF, or both. The informal proposals about this range from "parallel" lending to lending through the IMF, if and when the Fund could assure the bankers, a reasonable return on their money.[79]

Proposals to that effect were made recently by such important lenders to the LDCs as Manufacturers Hanover Trust, which in early June, 1977 called on the IMF to begin talks with commercial banks to develop new ways of "co-financing" the LDCs. In the opinion of the Chairman of Manufacturers Hanover, the Fund, being a sort of "world financial policeman" is almost the only institution with the power to attach binding conditions to its loan agreements that would enhance the creditworthiness of the borrowers in the eyes of private lenders.

Some observers believe that such proposals have been launched recently not only because of the private banks' interest in diminishing their risks, but also because of the IMF's interest in increasing its financial power.

The Fund is not particularly keen at this stage to enter into partnership with private international banks, because it is engaged in absorbing negotiations to increase its resources and is also interested in staying independent. However, some sources claim that it is

"... always possible that a final compromise already being tentatively broached in banking circles, would be for the banks to provide the Fund with direct finance funded through a debt issue. This might give the Fund extra liquidity and offer the banks high quality assets in the bargain".[80]

It is not at all clear, however, whether all international private banking giants are interested to the same degree in closer involvement with the IMF. A recent publication of Citicorp, the largest US lender to the LDCs, suggests that some of them prefer to keep the Fund at arm's length, without forgoing its seal of approval of the borrowers' creditworthiness.[81]

[79] The title of a recent article in *The Economist* reflects this attitude correctly: "IMF. Have the money but give facts", Sept. 3, 1977.

[80] Bell and Fleming, *op. cit.*

[81] Irving S. Friedman, *The Emergent Role of Private Banks in the Developing World,* Citicorp, New York, 1977.

9. *Some preliminary conclusions*[82]

The problem of the external public debt of the LDCs cannot be analyzed in an isolated manner, but must instead be set in the general context of international economic relations. The problem is not merely financial in character, but responds to the global problems of development and the trade flows between countries.

The maintenance of adequate rates of growth in the industrial economies has a special importance, because only then will the exports of the LDCs find an expanding market. In this context, the scarcely encouraging perspectives of the world economic evolution in the near future are worrisome, since such evolution can have a serious impact on the amount of the external indebtedness of the LDCs, on the fulfillment of their financial obligations, and on the achievement of "acceptable" rates of development, both from an economic and a social point of view.

The essential problem of the external debt of the LDCs is the structure of the payments-schedule. It is not so much a problem of the volume of the debt or the capacity to pay it; rather, the problem stems from a concentration of important payment commitments in the next few years as a consequence of the financial characteristics of the most recent resource flows, coming, as they do, from the private international banks. Moreover, the use of short or medium-term funds for longer-range objectives signifies an additional risk for the future economic growth of the LDCs.

As a consequence of the foregoing, it is necessary to struggle not only to increase the flow of financial resources from the industrial countries to the LDCs, if one wants to avoid a decrease in economic growth to levels that would be unacceptable in most regions of the world, but also, fundamentally, to assure more adequate payment-schedules for the credits, especially those of private origin. It is possible that, given the existing limitations on the flows of public funds, both bilateral and multilateral, it may be necessary to seek some kind of official intervention in the industrial countries or to establish a joint mechanism among the IMF and the IBRD, in order to attain a lengthening in the maturities of private loans.

The extraordinary growth of private international banking resources channeled toward the LDCs in the period 1974-76 played a fundamental role in the adjustment process of the world economy. Nevertheless, the worry that exists in various official circles, the possible increased de-

[82] After the experts meeting, a report will be elaborated on the principal aspects of the deliberations. In this part, some preliminary conclusions of this document are gathered, with an emphasis on those questions that could serve to orient the adoption of relevant policy measures.

mand for funds in the industrial countries themselves, and the present levels of external debt in the principal LDCs make it difficult to think that these countries will be able to count upon that important source of external resources in the coming years. That is to say, the events of 1974-76 cannot be repeated again in the next few years, at least not in the same magnitude and in the same ways.

It is unquestionable that in the future, the LDCs must intensify their efforts to base their economic development, to a greater extent, on their own internally generated savings. The need to improve external debt management and, above all, the use that is made of the resources coming from external indebtedness, is also clear.

The global focus on the external debt problem is not necessarily opposed to a case-by-case analysis. Although it is obvious that the situation and the external debt and economic problems of the various LDCs are very different, it is possible to find mechanisms that avoid their treatment in a disjointed manner and that recognize the generality of the problem.

Thus, while the global focus establishes the need for an increase in the flow of external resources to the LDCs, the solution to the present problems differs substantially among the types of countries. The least developed countries will require concessional assistance and the middle-income countries will need continued access to private capital markets and greater facilities for the interchange of goods.

The appearance of the petroleum-exporting countries on the international capital markets as important providers of funds, besides signifying the first time in history that a group of LDCs is providing resources to other nations of the same group (the essential characteristics of which differ fundamentally from the aid provided by the OECD countries), also has introduced fundamental changes in the structure of international financial relations. Nevertheless, notwithstanding the fact that their participation in the financial flows has been important, it is possible to conceive other alternatives that would increase the effective contribution of OPEC funds to the social and economic development of the LDCs. This is particularly important with respect to lengthening the amortization periods of loans.

The efforts to renegotiate the external debt made in the last few years have not been an adequate solution to the problems confronted. Their contribution has been, in reality, modest and merely a response to crisis situations. In the future, it will be necessary to introduce substantial modifications in the existing institutional mechanisms and, above all, to remove from renegotiations the stigma of being only a last resort. Future renegotiation efforts will have to respond in a clear and precise way to the long-term nature of the external debt problem and its inevitable interrelation with the broader aspects of economic development itself. In this respect, it is possible to find general guidelines that might serve in future debt renegotiations.

Recent years have seen a greater interest in improving the methodology and the statistical information utilized in evaluating the payment capacity and the solvency of the debtor countries. A general recognition exists of the dangers that are entailed in making judgments about these variables, supported only by one or several relations of a quantitative character. Therefore, the need to carry out a more complete analysis of the situation and prospects of the economy in question is recognized, with an emphasis on the external sector and on the aspects of administrative and financial capacity.

In spite of the significant advances made, principally by the IBRD, the BIS, and the major private banks, the data on the external debt of the LDCs still suffer from serious deficiencies, above all in their coverage and delayed availability.

External Debt of Developing Countries at the Paris Conference: Positions, Proposals and Conclusions

Jorge Eduardo Navarrete

This paper is designed to describe and analyze the manner in which one subject: the foreign indebtedness of developing countries, was handled at the Conference on International Economic Cooperation (CIEC), which was held in Paris for a year and a half and which ended at the beginning of June, 1977. The Paris Conference and, particularly, the sessions of the Development and Financial Affairs Commissions represent the first international effort to collectively review this problem, as well as the first time that concrete proposals to solve the problem, from both developing and developed countries, were studied; these proposals high-light the vast conceptual and political differences that still separate countries in regard to this matter. Thus, the description and analysis of the CIEC sessions concerning debt is considered as a good starting point for the organization of possible future international efforts in this field.

The first sections are primarily descriptive. In them, we examine the evolution of the two groups of countries' opinions as regards debt throughout the Conference's sessions, arriving finally at their final proposals. Then we critically analyze the contents of the final proposals presented at the ministerial meeting which closed the CIEC. This analysis reveals the points on which there is agreement on these proposals and those on which there is disagreement; this, in turn, leads us to the identification of issues which must be discussed in future negotiations.

THE APPEARANCE OF THE SUBJECT ON THE CIEC AGENDA

Nothing in the discussions held prior to the first ministerial meeting at the CIEC (Paris, December 1975) would have led one to presume that the foreign debt of developing nations would become one of the basic issues of the Conference which was then being organized. At the final preparatory meeting held in October, 1975, the schedules

The author was head of the Mexican delegation on the commissions meetings at the Conference on International Economic Cooperation throughout 1976, and also took part in other meetings at the Conference. The opinions expressed in this document are, however, strictly personal.

for the "four commissions" which would each cover one area at the Conference did not include any special mention of "foreign debt" but rather, seemed to automatically exclude the subject. Likewise, at this same meeting, a group of developing nations (Saudi Arabia, Algeria, Brazil, India, Iran, Venezuela, and Zaire) and the United States presented two tentative agendas of the subjects to be covered by the four commissions; these agendas also failed to specifically mention the issue of the foreign debt of developing countries, although the USA agenda, in its *item* "approaches to payments deficits of developing countries", did create, up to a point, the possibility of discussions concerning foreign debt.

At the ministerial meeting in December, 1975, which formally opened the CIEC sessions, some delegates from developing countries referred, in the general debate, to the following: the state of foreign debt in this group of countries; the extreme burden of debt servicing which many of these countries had to support; and the need for designing and implementing ways in which the burden could be mitigated. These first opinions expressed did not, in general terms, receive appreciable response in the statements of the representatives from advanced nations; therefore, it became evident that the advanced nations did not view this issue with the same sense of priority or urgency that the developing countries did.

The subject of indebtedness was formally proposed, however, by several of the 19 developing countries participating in the CIEC (G-19) at a meeting held in January, 1976; the purpose of this meeting was to define their own versions of the agendas to be covered by the Conference's commissions. The delegation from India, for instance, proposed that the Development Commission discuss "Debt Servicing Problems", sub-divided in the following manner:

> a) The burden of debt servicing in the context of the recent international economic events such as recession, high cost of manufactured goods, decline in ODA in real terms, etc.
>
> b) Recommendations of Sixth and Seventh Special Sessions of UN General Assembly on Debt Relief.
>
> c) Recommendations or examination of debt problems of individual countries at international level prior to debt renegotiation.
>
> d) New dimensions in debt relief. Fresh assistance on a larger scale and on highly concessional terms. Moratorium and rescheduling, particularly for the poorer and MSA countries. Debt cancellation in recognition of hardness of earlier loans. Debt cancellation related to infructous projects in developing countries. Relating debt burden to a fair proportion of export growth. Debt relief as an element of flexibility in foreign exchange management.

Other G-19 countries, among them Pakistan and Yugoslavia, also proposed, although in less detail, the inclusion of the debt subject in the Development Commission's agenda, as well as the creation of the means for this subject to be tied into the deliberations of the Financial Affairs Commission. Yugoslavia, for example, believed that this subject should be discussed by the latter commission and within the context of measures oriented toward the improvement of the developing countries' balance of payments.

These initial opinions high-lighted the fact that there was a real division among the G-19 countries. Some of these countries were interested in the discussion of general steps to be taken in debt servicing relief and, in a broader sense, the reconversion of credit into donations. However, other countries, with access to international capital markets, did not wish to be associated with this kind of project because they felt it could affect their international credit-worthiness. This objective difference in positions would be evident, either in deed or by omission, throughout the Conference, and the advanced countries took advantage of it.

In this way, the compromise finally obtained by the G-19 contained the following elements: a) no specific mention of debt should be included in the agenda proposed for the Development Commission, because the relatively more advanced countries feared that, within this general context, it would be easy to give the subject an overly-wide context, although they did feel that the problem could be covered under the general "transfer of resources" theme; b) the subject should be covered mainly in relation to the most seriously affected countries by the Financial Affairs Commission; and c) all mention of consolidation of debts and rescheduling of payments should refer directly to the "interested countries" or "requesting countries", in this way freeing countries with access to capital markets from this stance.

The text concerning debt proposed by the G-19 for inclusion in the Financial Affairs Commission's agenda reads as follows:

> 4.3 Problems of Foreign Debt Burden of Developing Countries - Measures by developed countries to mitigate the foreign debt burden of developing countries, with special attention to the situation of the most seriously affected countries, including the rescheduling of payments and/or cancellation of ODA (official development assistance) debts and the service payments of developing countries, especially the MSAC's (and more particularly the least developed, land-locked and island developing countries), consolidation of commercial debts and rescheduling of payments of developing countries at market related interest rates over a long period when requested and justified.

In the first period of sessions of the Development and Financial Affairs Commissions (February, 1976) the advanced countries (G-8) agreed to discuss, in both commissions, issues related to the foreign debt of developing countries; they did not agree, however to the agenda proposed by the R-19, which they, the G-8, felt predetermined the results of the discussions and included specific mention of measures whose very content had not yet been discussed. It was established that the first interchange of opinions concerning the issue would take place in the commissions' third period of sessions, in April.

Thus, because of the interest expressed by some of the G-19 countries, the foreign debt of developing nations was included as a subject in the broad area to be covered by the CIEC. However, the fact that it became one of the most important subjects of the Conference is due to events which took place at other international meetings.

THE GROUP OF 77'S POSITION: THE MANILA CHARTER

At the same time that the CIEC commissions' first deliberations were being held, the Group of 77 Developing Countries was preparing another international economic negotiation event: UNCTAD IV. The G-77, which held a ministerial meeting in February, 1977, approved the Manila Declaration and Action Plan; the contents of this Plan, which refers to the foreign debt of developing countries, greatly exceed the position adopted previously by the G-19 at the Paris Conference.

The Manila Charter really stresses the urgent necessity of taking measures to mitigate the burden of the official and commercial debt of developing countries. To that end, the following measures are proposed:

> Debt relief by bilateral creditors and donors in the form of waivers or postponement of interest payments and/or amortization, cancellation of principal, etc., of official debt to developing countries seeking such relief.
>
> Cancellation of the official debts of least developed, developing land-locked and developing island countries.
>
> Same treatment for other most seriously affected countries, or, as a minimum, waiver of their debt-service payments on official debts until they cease to be regarded by the UN as most seriously affected countries.
>
> Provision by multilateral development financial institutions of programme assistance to each developing country in an amount no less than its debt service payments to these institutions.
>
> Consolidation of the commercial debts of interested developing countries and payments rescheduling over a period of at least 25 years. (This would require the establishment of suitable financial arrangements or machinery, which might include, *inter alia,* a multilateral financial institution, such as a fund or a bank, designed to fund the short-term debts of interested developing countries.)
>
> Convening, under the auspices of UNCTAD in 1976, of a conference of major developed creditor countries and interested debtor countries, to determine appropriate ways of implementing the principles and guidelines on the renegotiation of official and commercial debts to be reached at UNCTAD IV.

The position adopted by the G-77 set a performance standard for the G-19 in Paris; it was politically inadvisable for the G-19 not to follow this standard. Because of this, rigid positions were take by the G-19 throughout the CIEC debates. It should be pointed out, however, that the same objective division observed among the G-19 countries was also to be found among the G-77 countries; due to this division, the Manila Charter also refers at all times to the "interested developing countries" or to those "that request" any given measures.

THE PARIS CONFERENCE: THE INITIAL PROPOSALS

As had been programmed, "transfer of resources" was first reviewed in the third period of sessions of the Development Commission of the CIEC, held in April; some aspects of foreign debt were included in this review. In this regard, the united G-19 document stressed that:

> adequate measures to improve the conditions of countries with the heaviest debt burdens; remission, or moratorium, of both capital debts and interest should be contemplated.

Among the most interesting reactions created by the first proposal were the following:

> The Swedish delegation expressed its opinion that a portion of the increase in the official assistance to development should be alloted to the most seriously affected cases of burden of debt servicing.
>
> The United States delegation pointed out that the problem did not really stem from the developing countries' insolvency or inability to pay, but, rather, was due to a temporary state of difficulties in balance of payments brought on by the increase in oil prices, by extended inflation, and by severe recession.
>
> The delegation from the European Economic Community felt that the debt problem should not be examined separately from the current state of international commerce nor from the flow of private capital and other related factors.
>
> Finally, the Japanese delegation stated its opinion: the creditor countries should take steps towards increasing the exports of the indebted countries in order to increase their ability to cover their debts.

However, the most important part of this first debate concerning debt was to be seen in the third period of sessions of the Financial Affairs Commission; both the developing and the advanced countries expressed their points of view, clearly and in detail, in these particular sessions.

The basic G-19 document ("Restructuring of Foreign Debts of the Developing Countries", April 23, 1976) considered the debt issue as a structural problem, because it had grown constantly worse in recent years and no relief from dependency on foreign capital was in sight. According to very complete statistical information concerning the level of debts and dates of payment, the document affirmed that it was absolutely necessary to design and apply measures which would provide immediate relief. Concretely, the G-19 document repeated the same objectives contained in the Manila Declaration and Action Plan.

The advanced countries, in answer to this, stated that they were opposed to adopting an automatic and general viewpoint for handling the debt problem. They insisted that the issue of debt burden must be examined within the context of the balance of payments, which meant that it must be subject to an appropriate policy of foreign payments and a steady flow of foreign resources. Nothing could be done to alleviate the debt burden except in special cases of acute crisis. They believed that the appropriate procedure would be to study each case individually in meetings held at creditor clubs; in these meetings, agreements regarding the rescheduling of payments could be reached — these agreements could be flexible and effective, and beneficial to both creditors and debtors, as had proven to be the case in the past.

The Swedish delegation expressed an opinion slightly different from that of the other G-8 countries; the Swedes believed that relief from debt burden should be provided to the most seriously affected and least developed countries by means of a single operation which would give them enough time to adopt adjustment measures. Concerning this opinion, the remaining G-8 countries pointed out that any general debt burden relief program would have a negative effect on developing countries because their credit status with private capital markets would be affected and because they would find that their position for receiving the private foreign capital so important for their balance of payments would be jeopardized. They also contended that, in reality, there are only a few developing countries with important servicing burdens and large debts and therefore a generalized attitude would be unfair and inconvenient.

Thus, it can be said that the positions adopted by the advanced countries and the developing countries in this first discussion concerning debt, in two of the CIEC's commissions, revealed the very different opinions held by each group. However, before this debate was carried any further, another event, unrelated to the Paris Conference, would condition the handling of the debt subject at the CIEC: UNCTAD VI.

THE UNCTAD IV MANDATE

The developing countries' opinion as regards debt, contained in the Manila Declaration and Action Plan, was expressed to the advanced countries at UNCTAD IV (Nairobi, May, 1976). After long debates, no consensus for action concerning the measures for the relief of the burden of debt servicing proposed by the G-77 was reached. A compromise, put forth by the President, was made, however in a text known as *94 (IV) Debt problems of developing countries*; the operative proposals of this compromise were the following:

> 1. *Welcomes* the fact that, at the fourth session of UNCTAD, the governments of the developed countries pledged themselves to respond in a multilateral framework by quick and constructive consideration of individual requests, with a view to taking prompt action to relieve developing countries suffering from debt service difficulties, in particular least developed countries and most seriously affected countries.
>
> 2. *Invites* appropriate existing international fora to determine, before the end of 1976, what features might usefully be discerned from past operations, together with others that might be identified in the light of the present situation of the least developed countries, the most seriously affected developing countries and other countries in need, which could provide guidance in future operations relating to debt problems as a basis for dealing flexibly with individual cases.
>
> 3. *Requests* the Trade and Development Board at its ministerial session, to be held in 1977, to review the action taken in pursuance of this resolution, and requests the Secretary-General of UNCTAD to convene an intergovernmental group of experts to assist as necessary in this task.

Everybody interpreted these resolutions as containing a mandate for the CIEC, which was considered the appropriate international forum for carrying on discussions about debt, as mentioned in resolution number two above. Thus, debt became one of the most important subjects if not *the* most important subject, to be covered at the CIEC. Unfortunately, in spite of the mandate contained in UNCTAD's 94 (IV) resolution, it would be plagued by general problems that, following both UNCTAD IV and other difficulties, would create an impasse in the CIEC proceedings, which persisted until September, 1976.

CIEC: IMPASSE AND THE FORMULATION OF WORK PROGRAMS

Once the initial debate on the agendas of each one of the CIEC commissions had concluded with the fourth session in June, the Conference started to define work programs for the second phase of its projects, "oriented towards action". In July, a meeting of senior officials was held, at which, because of the pronounced disagreements that had appeared, work programs could not be drawn up. It was then decided that this task would be finished by the present commissions in the fifth period of sessions, also in July. The commissions were also unable to come to an agreement; this situation led to an impasse which endangered the very continuation of the Conference.

The absence of consensus for the formulation of work programs was evident on two issues. The first issue was concerned with the protection of developing countries' incomes from exports by means of indexation or other equally effective measures, and was of interest to the Energy and Raw Materials Commissions. The second issue was related to the definition of the precise procedure for handling the debt subject and to the negotiation of concrete measures for immediate relief in cases of acute debt crisis; this issue was of interest to the Development and Financial Affairs Commissions. The positions held regarding debt can be summarized as follows:

> Both the G-8 and the G-19 recognized the CIEC as the appropriate "international forum" for applying the UNCTAD 94 (IV) resolution.
>
> The G-8, by means of the EEC, proposed that handling of the subject be divided between the Development and the Financial Affairs Commissions. The second commission would study the cases of acute debt crisis in order to "formulate proposals that include features which could provide orientation to creditors' clubs for future debt renegotiation operations". The first commission would examine cases of extreme dependency upon aid and severe structural financial problems in order to determine the features which, if needed, could be applied to make aid more effective, in this way avoiding the appearance of debt service difficulties and improving the transfer of resources process.
>
> The G-19 felt that the EEC proposal completely failed to take into account measures for inmediate relief in cases of acute debt crisis. They objected, moreover, to the concept of "avoidance of debt service difficulties".
>
> Therefore, the G-19 proposed that, on handling the debt subject, "the Commission on Financial Affairs will formulate proposals to guide future debt reorganization operations on both cases of acute debt crisis and structural debt problems of developing nations" and "the Commission on Development will deal with the other aspects of indebtedness of developing countries, including measures which will contribute to the alleviation of their existing debt burden, in particular least developed countries, most seriously affected developing countries and other countries in need".
>
> The advanced countries, through the United States and the EEC, responded to the G-19's remarks and proposal with another proposal which continued to exclude any consideration of immediate allevation and which strengthened even more the concept of avoidance of the appearance of debt service difficulties. In fact, the joint USA-EEC proposal said "the Commission on Financial Affairs will formulate proposals for features which could provide guidance for debt reorganization operations in creditor clubs in acute debt crisis situations" and "the Commission on Development will formulate proposals regarding features which might usefully be discerned on other aspects of indebtedness of developing countries, including measures of varying nature which could contribute to the prevention of debt service difficulties and to the alleviation of their external payments problems, in the case of developing countries depending largely upon aid and having serious structural financial problems and in particular

least developed countries, most seriously affected developing countries and other countries in need".

The G-19 felt that this second proposal from advanced countries was even further removed from their points of view than the first one they had formulated. Rather than oriented to the formulation of concrete proposals, it mentioned the identification of characteristics which could be useful on future occasions when renegotiations were held; it reiterated that the creditor clubs were the only forum where renegotiation operations could be conducted, even in cases of acute crisis, and insisted on the concept of prevention of future debt service difficulties.

Just as had been expressed at the initial debate on debt, the stances taken by the G-19 and the principal G-8 delegations concerning the contents and form of indebtedness negotiations high-lighted the extreme difference of opinions held by one group and the other as regards the nature and the objectives of an international negotiation of the problems of indebtness of developing countries.

Once the fifth period of sessions of the CIEC commissions had ended, the co-presidents of the Conference were asked to seek out some formula for facilitating agreement on purchasing power protection and indebtness, so that the Conference's efforts could continue in September.

The co-presidents proposed agreement formulas designed to overcome the impasse; these formulas were studied by the heads of delegations from both groups at an ad hoc meeting held on the 10th and the 11th of September. After discussions concerning the writing of the proposal had settled several points, a consensus of the 27 delegations was reached on indebtedness in the following words:

> CIEC is an appropiate forum for dealing with the problems of indebtedness of developing countries. It was recognized that debt problems of developing countries have both developmental and financial implications which require consideration during the second phase of the Conference with a view to facilitating agreement on concrete proposals to be submitted for approval to the Ministerial Conference.
>
> The Commission on Financial Affairs will formulate proposals for principles or features for debt reorganization operations. The Commission on Development will consider other aspects of or proposals on indebtedness of developing countries taking into acount their development needs and external payments problems, as well as proposals for measures which would contribute to the alleviation of the existing debt burden of developing countries depending largely upon aid and having serious structural financial problems. These would include in particular least developed countries, most seriously affected developing countries and other countries in need. These latter problems which may lead to difficulties in implementing their debt service constitute general problems of transfer of resources.

Some delegations felt, however, that the consensus reached had to be explained according to their particular points of view; they therefore formulated statements which were annexed to the commissions' work programs. Four of these statements make reference to indebtedness specifically and their basic contents are as follows:

> *European Economic Community*: "With reference to debt, the Community recognizes that the CIEC is an appropriate forum for handling developing countries' debt problems, in agreement with the 94th resolution of UNCTAD IV. It adopts a positive point of view concerning the issue of alleviation of the debt burden of developing countries. It would therefore be convenient to guide all future operations concerning debt problems so that each case can be handled in a flexible manner."
>
> *The United States*: "The United States believes that some developing countries have over-all financial and economic problems: debt forms part of these problems; the work program provides the opportunity for presenting different proposals concerning even wider issues which affect debt problems."
>
> *Mexico*: a) The reference to external payments problems contained in those points of the work program which cover indebtedness, "belong in all fitness to the subject of the financing of developing countries' balance of payments and does not belong, of course, to the subject of indebtness"; therefore, these problems should not be handled separately. b) As a country with access to international capital markets, "Mexico believes that indebtedness problems which may eventually arise can be solved by the normal mechanisms of these markets and, consequently, does not consider recourse to plans of moratoriums or over-all renegotiations of debt as appropriate". c) However, "Mexico recognizes that these plans can be useful to other developing countries with a different set of circumstances and whose needs must be fulfilled". d) The variety of economic and financial circumstances "leads Mexico to view with skepticism prevention plans which are rigid and for over-all application and which are based upon so-called objective economic indices and which are to be applied indiscriminately to all developing countries; therefore, Mexico disapproves the design and use of such procedures". e) Mexico "reiterates its hope that quick and constructive consideration be given, within a multilateral framework, to the applications submitted individually by developing countries with debt problems, particularly the least advanced and the most seriously affected countries".
>
> *Brazil*: Alluding to the theme of indebtedness mentioned in the work programs of the Development and Financial Affairs Commissions, "favors the suggestion that solutions to interested developing countries' debt problems be sought, particularly in the cases of the most seriously affected, the least developed, land-locked and island developing countries". Moreover, "the Brazilian delegation trusts that the application of the new measures to alleviate debt burden will not endanger the flow of net financial resources to developing countries that, as is Brazil's case, take advantage of currently existing international financial deals".

The agreement obtained regarding the formulation of the theme of indebtedness in the work programs of the Development and Financial Affairs Commissions, as well as the statements of some delegations concerning the matter, clearly high-lighted the fact that, in spite of the formal consensus reached, serious differences of opinion were still present as regards the approach to and the contents of the negotiations to be held and as regards the scope and nature of the measures which might eventually be recommended. The advanced countries continued to insist upon a case by case approach and also insisted that the problem be considered as part of the wider problem of general balance of payments difficulties, stressing the need for predicting these difficulties. Among the developing countries, the relatively more advanced ones with access to the international capital markets supported the less developed and the most seriously affected countries' claims on a political basis but clearly wished to dissociate themselves from the type of proposals that the latter countries were seeking.

Once the formal impasse had been overcome, however, the opportunity for presenting concrete proposals concerning indebtedness and its negotiation became possible.

THE PREPARATION AND BASIC CONTENTS OF THE PROPOSALS

In order to work up their concret eproposals concerning indebtedness, the Group of 19 developing countries decided to constitute a work group of government experts which met, in Geneva, from the 16th to the 27th of August, 1976; representatives from the delegations of Algeria, Egypt, India, Indonesia, Iran, Jamaica, Nigeria, Pakistan and Zaire participated. This work group presented its conclusions to the plenary G-19 meeting in September, 1976; at this meeting, the Group prepared proposals concerning indebtness, by means of a plenary work group.

According to the contents of the work programs, the G-19 divided its proposals into two parts: the one pertaining to the Commission on Development was limited to measures designed to alleviate the debt burden; the one pertaining to the Commission on Financial Affairs refers to future operations of reorganization of the debts of interested developing countries.

The essential contents of the G-19 proposal regarding the alleviation of debt burden are as follows:

1) The advanced countries should adopt generalized and immediate measures to alleviate the debt burden of the interested developing countries, particularly the most seriously affected, the least developed, the land-locked, islands and others with similar geographic difficulties, so that these countries can regain the rhythm of growth lost during the economic crisis and so that the objectives of the International Strategy for Development can be met.
2) These measures should include the following:

A. *Official debts*

1. *Bilateral debt owed to developed countries*

i) The least developed, developing land-locked and developing island countries should have their official debts converted into grants.
ii) Other most seriously affected countries should receive the same treatment as above, or as a minimum, should have their outstanding official debts recomputed at the present IDA terms with a minimum grant element of 90 percent.
iii) Debt relief should also be provided by developed bilateral creditors and donors to other developing countries seeking relief.

2. *Multilateral debts*

Multilateral development financial institutions should provide program assistance to each MSA, least developed, island and land-locked developing country in an amount not less than its debt service payments to these institutions. In the case of other interested developing countries, and to the extent sought by such countries, multilateral development finance institutions should provide program assistance to them in an amount not less than their service payments to these institutions.

B. *Commercial debts*

1. In general:

i) International agreement should be reached to consolidate debts of interested developing countries and to reschedule payments over a period of at least 25 years.
ii) The consolidation of commercial debts and the rescheduling of payments should be achieved by the funding of the commercial debts of the interested developing countries.
iii) A financial facility to refinance the burdensome short-term loans contracted in recent years should be established for the use of interested developing countries, perhaps under the aegis of the World Bank and the IMF.

2. In regard to the debts contracted through financial markets or credit institutions by developing countries seeking relief, two possible solutions may be applied:

i) The government of countries of origin of credit institutions should adopt measures to persuade these institutions to reschedule or refinance the total capital and interest due. This refinancing should be made at the lowest market rates. The amortization period should be the same as for the original operation refinanced at the time of such refinancing.
ii) The grant of a loan and interest subsidy by the governments of the developed creditor countries participating in the rescheduling of the official debt of the debtor country for refinancing of the private financial debts of the country. The amount of this loan should be equivalent to the capital and interest due and should be on the same conditions established for the rescheduling of the public debt.

On examining this first G-19 proposal it is apparent that:

a) Its basic contents are not essentially different from the positions contained in the Manila Declaration and Action Plan; in Paris, the developing nations once again presented the proposal that did not meet approval at UNCTAD IV. Of course, the hypothesis that this insistance reflected above all a strategical initial position for negotiation can be accepted. It also reflected, however, the fact that, in Paris, the G-19 could not, because of political circumstances, reduce or waive the negotiating positions of the G-77.

b) If we compare this proposal to that of the work group of government experts, we find that it contains, on one hand, a greater insistence on the fact that measures to alleviate the debt burden should only be applied to some developing countries (MSA, least developed, land-locked, island) and to those, belonging to any of the preceding categories, that specifically request them; in this manner, the relatively more advanced developing countries are not directly associated with this type of proposal, as has already been seen. On the other hand, the application for relief of the debt burden refers only to advanced creditor countries, which means that the developing creditor countries (mainly those exporting oil) are freed from relief of debt burden claims.

The basic contents of the G-19 proposal regarding future operations of renegotiation of debt of the interested developing nations are the following:

I. *General objectives of debt reorganization*

i) Policies with regard to debt reorganization should be considered in the overall context of internationally agreed development targets and national development objectives which call for an increased net transfer of resources to developing countries within the framework of international financial cooperation.

ii) Debt reorganization in certain circumstances, should be recognized as an appropriate means of increasing untied and quickly disbursable resource transfers to developing countries in order to meet their development needs and goals.

iii) It should be recognized that often debt problems indicate a need for augmented financial flows on appropiate terms in addition to debt reorganization.

iv) Debt relief should not be restricted to the cases of the so-called debt crisis since this penalizes countries that have been forced to forget about their development programs in order to service their external debts. Thus, ways and means must be found for developing countries to initiate international action at an early date of emerging difficulties.

v) Mitigation of debt service difficulties on terms and conditions which are consistent with an orderly development process in developing countries is in the interest of both debtor and creditor countries. It should contribute to increase the capacity of the debtor countries to discharge their debt service liabilities over the longer run consistent with their development objectives.

vi) Debt reorganization should be carried out within an institutional framework that would enhance the application and protect the interests of debtors and creditors equitably.

Debt reorganization should be carried out within the above mentioned framework of general objectives. Principles and procedure should be established to regulate the entire process of debt reorganization in all its stages.

II. *Procedure for the initiation of international action*

i) The procedure should confirm that it is the exclusive right of the debtor country to initiate the process of reorganization. It should not in any way open the possibility of international surveillance or *a priori* analysis.

ii) It should result in action at an early stage, well before the problems of the developing country have reached crisis proportions and have damaged its development plans.

iii) Whenever the developing country initiates the process for international action according to agreed principles and procedures developed creditor and donor countries will participate in the reorganization and commit themselves to contribute the necessary resources warranted by the economic analysis and the development objectives of the country. Multilateral development institutions participating in the reorganization operation would be invited to commit additional resources in an appropiate form to help meet those objectives.

It will be necessary to establish agreed principles that would entitle a country to initiate a reorganization operation within the framework outlined above.

III. *Procedure for analysis of the country's long-term economic situation*

Having initiated the reorganization operation the next step is the preparation of detailed analysis of the country's long-term economic situation (with a view to) the protection of the country's development goals and strategy (and respecting) the socio-economic objectives and the development priorities established by the country. Included in this analysis will be five key elements:

i) There will be estimates of long-term capital requirements and projected availabilities as well as debt projections.

ii) An examination will be made of the extent to which factors operating in the international economy may have contributed to the current developmental and financial problems of the country.

iii) A similar examination will be carried out of the extent to which changes in international policies may have contributed to the current and prospective situation.

iv) The analysis will also take into account the internal economic situation of the country including relevant policies within the context of the country's development plan.

v) Based on net capital flows required by the country in the pursuit of its development strategy within the context of internationally agreed targets, those combinations of additional development finance, debt reorganization and national and international policy will be indicated that would most quickly bring the country back to its development path and increase its long-term capacity to service its debt obligations.

IV. *Guidelines for reorganization operations*

... [They] should include inter alia, the following elements:

i) Creditor and debtor countries should ensure that reorganization will be completed expeditiously in order to reduce to the minimum any uncertainties associated with it.

ii) Measures to be adopted should be consistent with an accepted minimum rate of growth of *per capita* income.

iii) International and national policy actions to be adopted should be consistent with the socio-economic objectives and priorities of the country's development plan, and should be conducive to restoring the country to its development path as quickly as possible.

iv) The provision of new flows and the terms of debt renegotiation should be on a long-term basis consistent with the country's long-term financial and developmental needs as reflected in the analysis.

v) The terms and conditions of rescheduling the official and commercial debts should be no harsher than the softest terms prevailing for the same kind of loans at the time of reorganzation.

vi) Provisions should be included to facilitate additional flows or accelerated repayments if the analysis proved either too optimistic or too pessimistic with respect to the pace of the country's recovery.

V. *Institutional arrangements for reorganization operations*

An appropiate and permanent institutional machinery should be provided for, which will have the authority to convene, organize and supervise reorganization operations in accordance with internationally agreed principles and procedures.

VI. *Implementation of the agreement*

With a view to implementing the present agreement, and working out the necessary details with respect to the principles entitling a country to initiate the procedures outlined above and to propose the institutional machinery, the Joint Ministerial Committee of the Board of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries (Development Committee) in consultation with UNCTAD, is invited to present its recommendation by June 1977. The necessary institutional machinery should be established in the course of 1977.

On studying this second G-19 proposal, it can be seen that both the "work groups of government specialists" and the plenary G-19 ventured forth, by means of this text, into a new area, without the backing of previous valid experiences; all past experiences with activities of the so-called creditors' clubs had little bearing on the type of proposal that was to be formulated. For this reason, the proposal is of a clearly tentative nature, which the G-19 recognized on presenting it at the Conference's debates. It is, on occasion, unnecessarily repetitious and seems to be formulated from an extremely unilateral point of view, perhaps unavoidable due to its very nature.

The process of preparing proposals by the *advanced countries* was, of course, different. Not all the G-8 delegations seemed to be involved in the position-defining process, which focused mainly on the joint US-EEC proposals. The Swedish delegation, dissociating itself formally from these proposals, presented an independent proposal.

The joint US-EEC proposals stem from a common diagnosis of the external problems of the developing countries and eventually, distinguished two situations: the acute debt crisis and long-range problems. The proposal for handling debt crisis was presented to the Commision on Financial Affairs, and the proposal on long range problems was presented to the Commission on Development.

The basic contents of the joint USA-EEC proposals can be summarized as follows:

I. *The common diagnosis of both proposals*

The basic assumption was that indebtedness *per se* is not necessarily an indication of financial or economic weakness on the part of the debtor country.

On considering this issue, it is useful to distinguish between two different types of situation:

> The first is an acute debt crisis, involving default or imminent default on debt servicing, as well as serious balance-of-payments difficulties in which debt servicing payment plays a major role. This situation is characterized by the fact that it cannot be remedied, in the short term, by appropiate internal and external adjustment measures which the debtor countries can realistically be expected to take. Consequently, there is a need for recourse to debt-reorganization as a last resort.
>
> The second type of situation is of a longer-term nature, involving structural, financial and transfer of resources problems which constrain balance of payments and hamper development, [but] the country concerned is not facing default, or imminent default on external debt servicing. In this situation, there would be more scope for timely and appropriate internal and external adjustment measures including all those affecting the quantity, quality and use of external resource transfers.
>
> In examining both types of situation ,the structure and prospects at all times of the balance of payments have to be taken into account.

In any case, it is desirable that international financial institutions, donor countries and developing countries should continue to co-operate so that financial problems can be avoided by timely and efficient management of resources. In particular:

> Donor countries would assist the developing countries in managing their external financial problems, *inter alia,* assuring that their capital markets do not discriminate against them; offering them technical advise and assistance on debt management techniques, including the use of commercial-

ly-borrowed funds, and assuring that the assistance flows are compatible with the recipients development status.

Developing countries, on the other hand, "would pursue domestic and foreign monetary and financial policies to enhance the mobilization of domestic resources and avoid exernal financial obligations which could prove detrimental over the medium and longer-term to their financial situation, thereby impeding growth."

II. *Acute debt crisis situations*

These situations would be treated, on a case-by-case basis, in creditor clubs, at the request of the debtor concerned, whose problems would be discussed in a spirit of co-operation.

As guidance for debt reorganization in acute debt crisis situations, the following are some of the features which could characterize debt reorganization:

The debtor country would undertake a comprehensive economic program designed to strengthen its underlying balance of payments situation. The program would be, as a general rule, worked out with, and monitored by, the IMF.

Debt reorganization and the programme of economic measures would take into account the development prospects of the debtor country, thereby enabling it to continue debt service payments and restore its credit worthiness.

Debt reorganization modalities would be determined flexibly, on a case-by-case basis taking into account both the economic situation and prospects of the debtor country, its development prospects and the factors causing the debt service difficulties and the legitimate interests of the creditors.

Debt reorganization would cover official and officially guaranteed debt with a maturity of over one year.

Consolidation periods would normally be kept relatively short and generally would not extend, as to future maturities, beyond the year in which the reorganization is undertaken.

An essential feature in debt reorganization is equality and non-discrimination among all creditors, including those not participating in the creditor club. However, creditor countries with minor debts due, which frequently include developing countries, would generally be excluded from the multilateral debt reorganization.

It would be expected that the debtor country would negotiate debt reorganization of its private non-officially guaranteed debt with private creditors on terms similar to those agreed in the 'creditor club' for its official and officially guaranteed debts.

The arrangements of debt reorganization would provide for flexibility to review the situation at the end of the consolidation period to take account of unforeseen circumstances, and accelerated repayments in an agreed manner if the debtor's economic situation improves more rapidly than anticipated.

III. *Remedial measures to deal with situations of a longer-term nature*

These situations, in which the adverse structure of the balance of payments of developing countries depending largely on aid can hamper development, would be considered on an individual basis with a view to providing aid in forms better adapted to the balance of payments needs of the recipient country in the period of difficulties foreseen.

Nowadays there are some cases among MSA and least-developed countries in particular where development prospects have been seriousy reduced by external factors. Such problems which may lead to difficulties in implementing their debt service, constitute general problems of transfer of resources.

Taking into account features discerned from past operations and in the light of the present situation, as an effective way of identifying countries in these situations and assuring that appropriate action to assist them is taken, the following procedure is suggested:

i) A developing country which believes it has such a problem, of which debt is an element, would request an examination of its situation by the IBRD or another appropiate multilateral development financial institution mutually agreed upon. These requests should give reasons and contain all relevant data.

ii) The relevant institution would then examine the request, paying particular attention to the following elements:

—the relative poverty of the developing country concerned;
— the extent to which the country concerned depends on ODA;
— developments in and prospects for exports receipts and for the capacity of ensuring imports essential to the development process;
— composition and trends of debt service obligations and capacity for further borrowing upon non-concessional terms;
— impact which the situation has already exerted upon essential imports;
— appropiateness of the development plan for the relevant period and of the policies being pursued in that framework; and,
— extent of utilization of the IMF facilities.

iii) If in the light of such analysis further steps seem necessary, the relevant institution would then analyze the general economic situation of the country, incorporating the Fund's assessment of its balance of payments and exchange rate policies and prospects, including debt service and taking into account the level of ODA which is available in appropiate forms. The analysis should establish the effectiveness of the country's use of both domestic and external resources for safeguarding its development process, such as mobilization of domestic savings, priorities for new investment and export promotion policies, and its measures for monitoring external credits and other measures to avoid debt servicing difficulties.

iv) If the analysis reveals that the prospects of the country in question are seriously hampered, the said institution would contact the aid donors in order to discuss, by mutual agreement, the needs of the developing country, within the framework of consortia and consultative groups. The relevant institution can instead organize ad hoc meetings of donors or contact donors individually. The appropiate international institution would submit a report to the donor community and the recipient country on measures which they might take, including the use of IMF facilities by the recipient country, and invite all concerned to examine this report sympathetically.

v) If the donor countries find the requesting developing country in long-term financial difficulties which are unduly affecting its development progress, they would, to the best of their abilities, enhance assistance efforts in response to a developing country demonstrating its willingness to take corrective measures on its own behalf insofar as it is able. Normally, such an effort should be directed towards increasing the quantity of aid in appropiate forms and improving the quality so that terms are appropiate to the economic situation and development prospects of the recipient country.

vi) Program aid and any flexible forms of quickly disbursable aid would be considered preferable to ODA debt reorganization. Only in exceptional cases, a donor country might choose to use debt reorganization. In such a case the concessional element of reorganized credits would be as great as the average concessional element of comparable new credits provided by the donors concerned.

vii) The multilateral development financial institutions would consider commiting new resources in an appropriate form within their lending policies and practices.

viii) The debtor country would try to make equivalent arrangements with major [creditor] countries not taking part in the operation so that the increased balance of payments flexibility was not indirectly used to repay these other countries.

It would seem that the joint USA-EEC proposals are also of a preliminary and tentative nature. However, it is evident that they provide a certain type of answer to the indebtedness problems of the developing countries and they propose a range of measures completely different from those included by the debtor countries in their own proposals. The advanced countries' proposals are not tinged with the same sense of urgency that is to be felt in the developing countries' proposals: they seem to be designed in order to propose a methodology for the study of debt problems rather than to seek out concrete and practical action to solve them.

The independent proposal from the Swedish delegation was presented to the Development Commission. Its basic contents are as follows:

It recognizes the need to contribute to the alleviation of the existing debt burden of the least developed and most seriously affected developing countries.

It proposes that the advanced countries participating in the CIEC sign a general political commitment to provide additional ODA resources to the countries in those categories in the form of direct ODA debt relief and/or equivalent measures.

> The terms, conditions and modalities of such actions could vary from case to case. Developed countries not being in a position to grant direct ODA debt relief — due to technical or constitutional problems— could resort to equivalent measures: additional ODA in the form of untied program aid or import support.
>
> The implementation of this commitment could be left to each developed country on a bilateral basis. The establishment of an appropriate review mechanism in order to monitor the implementation, e.g. within a year after the commitment was made should be recommended.
>
> The Conference should urge all developed countries not participating in CIEC to undertake similar action.

The independent Swedish proposal seemed to be the result of a political decision intended to reveal an understanding attitude towards the needs and claims of developing countries rather than the result of a technically sound proposal to face the various aspects of the problem. The developing countries seem to have interpreted it this way.

THE DEBATE AND THE EVOLUTION OF THE PROPOSALS: SEPTEMBER, 1976-JUNE, 1977

The debates concerning the three proposals presented to the CIEC on indebtedness, the basic contents of which have been set forth in the preceding sections of this paper, were held in the period of sessions in September-November, 1976, and, subsequently, in the preparatory sessions for the final ministerial meeting of the Conference, in April and May, 1977. On both occasions the debates took place, not in plenary sessions of the Development and Financial Affairs Commissions or the very few joint plenary sessions of the two commissions that were summoned, but rather in an ad hoc group, called the "Joint informal contact group on indebtedness of the Development and Financial Affairs Commissions of the CIEC".

The members of this informal contact group were the delegations from Egypt, India and Pakistan, from the group of developing countries, and the EEC, the United States and Sweden, from the group of advanced countries. This group received a mandate from the commissions asking it to bring together the point of view contained in the three proposals and to start informal negotiations based upon them.

The first meetings of the informal contact group, as can be appreciated in the report of its mediator, the head of the Indian delegation, were spent in explaining more clearly the contents of the proposals that had been presented. Once the debate itself had started, the inflexibility of the manner in which the advanced countries view the developing countries' indebtedness problems became readily apparent; this was the case as regards the terms of immediate relief measures, which the advanced countries in general continued to oppose; and it was also the case as regards the characteristics and objectives of future reorganization operations, which, they continued to maintain, should be considered one by one rather than collectively, by means of a general viewpoint that could be applied to all interested developing countries, as was proposed by the G-19.

During the November sessions, and as a result of the interchange of revised opinions, both the G-19 and the EEC and the United States presented revised versions of their proposals. Morever, the informal contact group's moderator reported:

> "while some progress has been made by both G-19 and EEC-USA as compared with their previous positions, as yet there are no common conclusions to report".

In fact, the evolution in each one of the different proposals, after three series of the informal contact group's deliberations, is barely perceivable. This can be seen, for example, in the following points:

In answer to the advanced countries' objections, the G-19 modified its proposal in order to concede generalized and immediate official debt relief and, in exchange, requested an extraordinary and one shot operation of relief on official debt, clearly stating that only one operation was involved rather than a series of actions drawn out over time, as had been interpreted by some of the advanced countries.

In light of the fact that a substantial part of the resources available to international financial institutions is obtained from the payments of past loans, the G-19 retracted its request that these institutions grant, to the MSA, least developed, island and land-locked developing countries, as well as other interested developing countries, "programme assistance in an amount not less than its debt service payments". In return, they proposed that these institutions be invited to commit new resources in an appropriate form within their lending policies and practices which should continue to respond increasingly to the needs of the developing countries". It is to be noted that this new G-19 formulation coincides with that originally proposed by the EEC and the United States.

Similar reasoning led the G-19 to retract its proposals that the IDA financing terms should include a minimum grant element of 90 percent.

In light of the advanced countries' constant objections to the proposal that the field wherein possible relief operations were to be applied should also include "debts contracted through financial markets or credit institutions", the G-19 retracted that part of its proposal which refered to this type of debt.

The revised EEC-USA proposal contains some new minor features, introduced with the objective of bringing it closer to some of the G-19 positions. Among these new features, one finds the following:

i) Recognition, within the common proposal diagnosis of the avoidance of debt servicing difficulties under conditions that are generally consistent with an orderly development process in developing countries, is in the interest of both creditor and debtor countries, just as the G-19 had pointed out in its own proposal.

ii) On handling situations of acute debt crisis, it was established that creditor and debtor countries should ensure that renegotiations would be completed expeditiously in order to reduce to the minimum any uncertanties associated with them, just as the G-19 had proposed.

iii) Recognition, on discussing the remedial measures to deal with situations of longer-term nature, that these measures had to be adopted before the problems had reached crisis proportions; this coincided with the G-19 proposal.

After studying the modifications made in both groups' revised proposals, it is easy to conclude that, while the developing countries were willing to introduce significant omissions and alterations to their original proposals (which, on the other hand, reveals some lack of security as regards their concrete contents), the advanced countries held to their proposals inflexibly, except for modifications of a formal nature. In light of this situation, it had to be admitted, as was in fact admitted by the moderator of the informal contact group, that, in spite of all efforts to reach an agreement, no common conclusions were possible.

As is known, the Conference decided to postpone its final ministerial meeting, originally to be held in December, 1976; the initiative for this decision came from the United States and other advanced countries. It was felt that this postponement, which set the ministerial meeting for May-June, 1977, would lead to the creation of more positive political attitudes by some countries and would, moreover, give the advanced countries the opportunity of agreeing upon their final offers to the Conference, taking advantage of instances such as the London summit meeting, which could already be foreseen.

In this way, an additional negotiation period among contact groups was held between April 29th and May 14th, 1977. Although some results were obtained in certain cases at these meetings, none were obtained as regards indebtedness. No new agreements were reached; the proposals presented by the different groups were not modified; and not a single step was taken towards the drawing up of a common document.

The next negotiation stage was held on the 26th and the 27th of May, on the eve of the final ministerial meeting; on these dates the contact groups met once again, this time with senior officials present. However, as was reported by the co-presidents of the Development Commission, no change as regards the prevailing position was reached on indebtedness. And so, when the final ministerial meeting of the CIEC was opened on the 30th of May, 1977

a) there was no recommendation nor conclusion agreed upon by the participants in the Conference as regards indebtedness;

b) there were three sets of proposals, presented by the G-19, the EEC and the United States, and Sweden, which still contained substantially different points of view concerning the problem and the type and scope of measures suggested.

In the general debate of the final ministerial meeting of the CIEC, some heads of delegations made special mention of the problem of developing countries' external indebtedness. The mentions made by the developing countries' delegations generally revealed their disenchantment with the almost total lack of progress which had been made in this field. The interventions of some heads of advanced countries' delegations introduced some new elements, almost all of which were related to the Special Action Program, which does incude some offers related to the indebtedness of developing countries and its alleviation. As we know, the "Special Action Program" is the unilateral offer of the advanced countries participating in the CIEC to alleviate the burden of the outstanding debt in the form of quick-disbursing aid through multilateral channels, or through bilateral assistance, or debt relief, all of comparable quality. The promises of debt relief in the Special Action Program were the following:

> *Canada*: Approximately 35 million dollars from the immediate conversion to grants of all existing ODA loans extended by Canada to least developed countries. (The face value of these loans amounts to approximately 254 million.)
>
> *EEC*: The EEC will provide 385 million to a special account of the IDA to be allotted as additional quick-disbursing aid to those individual countries, in particular among LLDCs and MSAs, whose development prospects have been seriously reduced by external factors and which face general problems of resource transfers, a situation which may lead to difficulties in implementing their debt service.
>
> *Sweden*: Sweden's main contribution will consist of the cancellation of debt service for the five year period 1977-78 to 1981-82 with respect to development credits extended to least developed and most seriously affected countries.
>
> *Switzerland*: "The Swiss government will contribute, subject to parliamentary approval, 28 million dollars by converting outstanding official aid credits to lower income countries into grants."

It is understandable that the developing countries' reaction to this unilateral promise was not positive. After having objected (through all types of arguments) to the developing countries' proposal which sought a generalized conversion of official debts into donations, some of the advanced countries offered to do precisely this, not as a part of a coherent plan for debt burden relief of general application, but as a gracious concession. Speaking on behalf of the 19 developing countries, co-president Pérez Guerrero emphatically pointed out that what was needed was not this type of isolated gesture but rather, careful attention to the organic proposals that the developing countries had presented, in order to introduce structural changes in the international economic system. The head of the Mexican delegation pointed out the obvious disparity between the total resources proposed for the program and the increasing magnitude of the needs which are to be alleviated.

The negotiation efforts of the ministerial meeting focused on issues other than indebtedness. All participants were aware that the differences of opinion as regards indebtedness that separated one group from another, were so large that a valid last-minute negotiation was out of the question. For this reason, the issue was left at the point which it had reached when the informal contact group's deliberations ended. The Conference's final declaration, adopted on the 3rd of June, 1977, placed the subject of developing countries' indebtedness on a list of subjects for which no recommendations nor mutually agreed-upon conclusions were possible. The document annexed to the CIEC's final declaration included the texts of the G-19, the USA-EEC, and the Swedish proposals, in this way providing written evidence not only of the disagreement but also the concrete positions that created this disagreement.

These proposals are not only the end-result of an effort that lasted eighteen months at the CIEC, but, at the same time, can be considered as a starting point for any new efforts of international negotiation that may be undertaken.

Alternative Solutions to the Debt Problems of the Developing Countries

G. K. Helleiner

DEBT PROBLEM

It is a commonplace that there is no "problem" involved in borrowing for productive purposes. Indeed, in most orthodox discussions of direct foreign investment the continued flow of new investments (new loans) is taken as evidence of the healthy growth and sensible economic policy of the recipient countries, although they assuredly are increasing national liabilities to foreigners. (Nor are the payments obligations to foreign investors always more flexible than those on portfolio borrowing, as the conventional literature suggests). More to the point is the share which debt servicing obligations make up of freely available foreign exchange earnings, or of GNP or some such debt service measure. Despite international alarms being rung over the debt problem, the Third World's conventional debt service ratios have been remarkable in their stability. In 1976 while Third World debt weighed more heavily upon export earnings than in the past few years, its relative burden was still lighter than it had been in 1970-71. Worldwide inflation actually *reduced* the real debt for net debtor countries, providing, in some cases, very significant windfall gains. According to one estimate, inflation reduced the real present value of debt repayment obligations on end-1972 debt over the 1973-82 period by far more than it would have been reduced by a total forgiveness of interest obligations over the same period.

What then is "the problem"? It is necessary first to establish some of the facts which are new to the international financial scene: 1) the composition of Third World borrowing changed markedly as it expanded dramatically in the post-1973 period; far more capital was acquired on *non*concessional terms than before, particularly on hard and short terms, from the banks in the Eurocurrency market;

2) increased borrowing requirements associated with a sharp change in the Third World's terms of trade, originally assumed to be short-

The author, professor of economics at the University of Toronto, is grateful to the conference participants and to Göran Ohlin for comments on the original draft. In accordance with the instructions of the conference organisers, all debt statistics have been omitted since they are contained in a comprehensive background paper.

run in nature, can no longer be so viewed as the price for petroleum stays up, and the recession drags on; it now looks as if net borrowing requirements will not only continue but they may even increase unless growth is to be slowed to what are probably politically intolerable rates in the Third World.

The "problems" associated with the debt, then, have become the following:

1) The new commercial sources of finance for the Third World's continuing balance of payments deficits are not boundless in their willingness to lend. In the first place, some developing countries, while still requiring further credit, have already reached the point at which prudent lenders may be having doubts about the extension of further finance. Particularly may they slow further lending if the recovery in the world economy is slow, rendering these countries' debt servicing capacities more doubtful. Secondly, and on the other hand, *all* Third World borrowers are vulnerable to shifts in private lenders' preferences if and when the recovery in the developed countries resumes; many fear that, as inferior assets, loans to the Third World will be "crowded out" of bank portfolios by European, North American and Japanese investments when world economic expansion resumes. Thus *new* longer-term sources of finance are required to meet the Third World's capital requirements.

2) Much of the lending offered to Third World governments was offered on the assumption that their needs were short-term. Repayment on Eurocurrency loans was rarely longer than 5 to 7 years. As the need for net borrowing continued, repayment obligations in some countries have become inappropriately bunched in a short space of time in the next few years; to avoid an impending "liquidity" problem (too great a share of export earnings commited to debt servicing) they should have been spread over a much longer period. Short-term financing was unintentionally employed for medium- to long-run purposes; unless appropriately rescheduled, the affected economies may "seize" even though basically healthy. The rescheduling of this debt is clearly the appropriate remedy for this problem, with or without a reduction in the present value of repayments.

3) Some developing countries face short-term balance of payments problems so severe that, however they were caused, they may be forced or choose to postpone or even cancel debt servicing obligations in order to deal with them. The possible impact of developing countries' defaults upon the international financial system is a subject which has been rather nervously debated for the past two years; in no circumstances can it be viewed with equanimity. In the best circumstances, a rash of uncoordinated Third World defaults could destroy the rela-

tively easy access which a number of Third World countries have at last painfully re-acquired in the world's financial markets, and increase the difficulties for all future Third World financing. Unilateral and unplanned defaults are clearly to be avoided. From the standpoint of the private banking community, of course, the prospect of default *is* the major problem; their prime objective must be, in one way or another, to safeguard their assets. Gordon Smith has recently expressed "guarded optimism" as to the prospects of default: "no great rash of defaults and reschedulings is likely if recovery proceeds at reasonable rates in the industrial countries."[1] (He uses a discriminant function and logit analysis to identify countries nevertheless at present in a "danger zone".)

4) In the more alarmist discussions, the prospect of bank failures is raised together with ominous references to failure of the Kreditanstalt in 1931. There seems to be less concern about this now than there was two or three years ago. In a recent paper Kenen, for instance, argues: "Defaults by developing countries, even if widespread, are not serious threats to the stability of the international financial system, loose talk to that effect notwithstanding. Some banks and other private lenders would be hurt. A few might be mortally wounded. But there is little justification for fears that defaults would cause the Eurocurrency market to collapse or would do grave damage to national finance systems." A Federal Reserve survey estimated that total Third World debt accounted for no more than 6% of the consolidated assets of the top US banks (5½% for the top 21, 6% for the top 6), and no more than 1.5% was tied up in any one country.[2] It would nevertheless be prudent of the international financial community to have "lender of last resort" arrangements available in case of need; there is reason to believe that some national monetary authorities will, in fact, "bail out" the banks, if necessary.

5) The poorest of the developing countries have insufficient export prospects to finance their long-term development on conventional terms or even to service much of the (largely official) debt they have already accumulated. Their financing problems would not be much influenced one way or the other by world economic recovery since their problems are of a long-term nature. Much of the financing provided to these poorest countries in the past has been inadequate in volume and inappropriate in its terms. (In the post-1977 period, as previously, the major accumulations of new debt were not to be found in the

[1] Smith, Gordon W., *The External Debt Prospects of the Non-oil Exporting Developing Countries*, Overseas Development Council, Washington, D. C., 1977, p. 21.

[2] Quoted in *The Economist* (London), January 22, 1977.

poorest countries.) To maintain minimally acceptable rates of growth in these cases in the future, special longer term and softer financing will be necessary.

POSSIBLE SOURCES OF INITIATIVE

From where can one expect initiatives toward the resolution of debt problems? Let us consider the alternatives, one by one.

1. *Individual debtor countries*

Countries faced with heavy debt servicing obligations and without great hopes of attracting further foreign capital may rationally choose to repudiate their debt. (The case for doing so is essentially the same as that spelt out for the confiscation of foreign assets in Bronfenbrenner's classic article.) One may argue about the reactions of governments, international organisations and private traders and bankers to different types of default — on official *vs.* private obligations, on postponement of repayments *vs.* cancellation, on writing-down of obligations *vs.* postponement or cancellation. The seriousness of the consequences for the country concerned no doubt varies with the nature of the default. It is *not* true, as is sometimes implied, that *all* repudiations are necessarily followed by dire types of retaliation or even that capital necessarily ceases to flow to the repudiating country. Indeed unilateral action — whether the missing of a payment or two, or a dramatic announcement of repudiation (made most easily by a newly formed government, as in Ghana in 1972) — may be the quickest means of acquiring a creditor's meeting to negotiate rescheduling. It is the perception that many individual countries may already have reached the point at which a coldblooded calculation of the national advantage (allowing as well for what appears to be a recent decline in aversion to risk and uncertainty) could lead them to default which has generated the obviously widespread concern over the "debt problem" within the financial community.

The prime problem created by individual debtor country action is that, while default may be individually advantageous, it throws off negative externalities for the rest of the Third World. The reduced access and increased cost of private capital which could follow from individual defaults will affect other borrowers, including many who have scarcely entered international financial markets as yet. The bad feeling surrounding such repudiation of obligations could also result in reduced official development assistance to the Third World.

2. *Debtor countries jointly*

The case for a joint repudiation on the part of several countries, *all* of which calculate that there is advantage thereform, is essentially the same as that for individual countries. Joint action could conceivably strengthen individual countries' resolve and assist in the creation of a mood of legitimacy about the action. It might even limit the prospect of direct retaliation. On the other hand, the greater the number of countries participating in the default operation the more seriously will its effects be viewed by the international community and therefore the greater are the potential negative effects for non-defaulting Third World countries still searching for foreign capital.

In the aggregate, there can be little doubt the Third World as a whole would not gain from a universal repudiation of debt. There are many more potential losers from such action, because of the possibility of reduced capital flows to them, than there are winners. Joint "global" Third World unilateral initiatives in this sphere therefore seem unlikely, although for selected groups of Third World debtor countries, joint unilateral action cannot be ruled out.

3. *Individual creditors — private*

Private creditors can be divided into two groups: exporters and banks. Since its credit has usually been insured by an official agency the former group is unlikely to initiate any action to ease the debt servicing problems of its customer countries. If payments are not made, it has resort to the insurance agency of its own country, with which it is in any case probably preferable to deal, for equivalent payment so that it has no incentive to worry about the debtor's problems (either before or after sales). Only where trade credits are uninsured may anxiety as to the prospect of ever being paid lead developed country exporters to initiate debt relief arrangements.

Banks, on the other hand, are quite accustomed to negotiating revised payments schedules with clients who run into unforeseen difficulties. Moreover, their credits are backed not by insurance schemes but only by the law of averages. As far as Eurocurrency loans are concerned, the banks do not even have a lender of last resort or an established framework of rules, practices and expectations on which to depend in case of liquidity difficulties. Banks therefore can and do initiate rescheduling operations to rescue the funds they have already committed where the circumstances warrant, as recently, for instance, in Argentina, Zaire and Peru. They are unlikely to make proposals for substantial relief in terms of the present value of payment obligations; typically, it is a matter of stretching out repayment periods and/or the provision of more gross flows. (This sometimes appears to be throwing good money after bad.)

4. *Individual creditor countries*

In circumstances where one government is overwhelmingly the most important official creditor it may sensibly enter into bilateral debt arrangements with an individual debtor country in difficulties. In other circumstances, however, there is little incentive to do so since relief by one "soft" creditor will, in effect, simply bail out the "harder" ones. Private banks and exporters may press for action by their own home governments to assist at least in the refinancing of their own lending. The need for such bilateral debt relief has, of course, been anticipated by the creation of national export credit and foreign investment insurance programmes; in the spheres where these programmes are in operation, governments are unlikely to respond to the plaints of the uninsured. Where, as in the case of bank lending, the private creditors are highly exposed to the risk of default, they are emerging as important sources of pressure for government action. Even then, the difficulty of directing the gains from debt relief exclusively to one's own national banks is sufficiently great to discourage unilateral developed country action (although there are instances where it has occurred).

5. *Creditor countries jointly*

As in aid-untying, the reduction of trade barriers, and other international "public goods", there is much more reason for individual creditor countries to organise a debt relief operation if *other* creditors are also involved than if they are not. If the object is to assist the debtor countries and thus to forestall more widespread international problems, the impact of joint action is likely to be much greater, in both respects, if there is multi-lateral action than if it confined to the action of a single creditor. Moreover, joint approaches avoid the possible inter-creditor inequities, in consequence of the fact that some lenders, the tougher ones, may otherwise avoid their share of the burden of the relief exercise, while reaping the "public good" advantages of the overcoming of a difficult international financial problem, and so enjoy an international "free ride".

Agreements among the creditor countries could be negotiated among themselves within the Basle Club, or another economic summit, or the OECD. Alternatively, they could be still further multilateralized through the use of the IMF.

While there is scope for some unilateral initiatives on the part of creditors, particularly banks and individual developed country governments, and some prospect (danger) of unilateral debtor initiatives, there seems no way to escape the conclusion that reasonable solutions are likely to derive only from new comprehensive and multilateral intergovernmental agreements. In Peter Kenen's words, "... debt relief must be organized cooperatively and comprehensively. There is need for agreed international rules. There may be need for new multilateral institutions. Most importantly, there is need to regard debt relief as a form of development assistance, not as a device for protecting the integrity of the lenders' balance sheets".[3]

FORMS OF DEBT RELIEF

There are many possible means of providing relief through the alteration of the terms of existing debt:

1) the writing-off of loans
2) the writing-down of amortization obligations
3) the rescheduling (deferral) of amortization obligations
4) the lowering of interest payment obligations
5) the rescheduling (deferral) of interest payment obligations
6) the shift of repayment obligations to a system which renders them conditional e.g. on some measure of economic performance, e.g. exports, GNP, income terms of trade.
7) the simplification of debt arrangements through their consolidation.

The benefits of all but the last two of these may be expressed in terms of the effects upon the present value of repayment obligations and thus, provided one can agree upon a common rate of discount, the relative advantages of various alternative arrangements can be directly compared. (Similarly, one can compare the costs to the creditors of alternative debt relief measures by comparing the present values of their receipts at some agreed rate at which they discount the future. If, as in often assumed, the social rate of discount is lower in rich countries than in poor, debt relief may "cost" the creditor countries less than the value of the gains to the debtor countries. This consideration is unlikely to be of much interest, however, to commercial creditors.)

The last two types of debt relief listed above are more difficult to assess in these comparative terms. The advantages of a consolidation of the debt lie in economies of management and administration; they

[3] Kenen, Peter, "Debt Relief as Development Assistance", in Jagdish Bhagwati (ed.); *The New International Economic Order*, MIT Press, Cambridge, Mass. 1977.

are unlikely to involve severe costs to the creditors, except for the initial organizational inputs required, but in some debtor countries they could be quite useful.

Perhaps of greater interest is the possibility of shifting repayment obligation to some form of conditional arrangement in which payments fall due only in those years in which the debtor country in question is faring relatively well. There exist precedents for such arrangements at the international level. Under the Lome Convention, repayments on loans under the Stabex scheme are due only when the "trend of its export earnings permit", ie. when *both* price and volume of exports exceed the levels attained on average in the 4 years prior to the Stabex loan. Bisque clauses in loan contracts also have a long history. A further debt relief device for which there are some precedents is the authorization of debt servicing obligations to be paid, for specified periods, in the currency of the borrower. The articles of agreement of the World Bank permit this for a period up to three years, following which they must be repurchased in hard currencies. Governments might well authorize much longer periods for such provisions, as, for instance, in the case of the United States PL 480 grain sales. The present value of payments obligations under any such conditional arrangement is uncertain and depends, of course, upon economic performance; it could conceivably increase in consequence of such "relief". Yet the increased stability which such an arrangement would impart to "free" import purchasing power makes it an attractive relief possibility nonetheless.

It is also possible, of course, to provide official development assistance for the express purpose of easing debt servicing obligations, without altering existing debt obligations in any way. The right to employ gross bilateral development assistance for debt servicing can be of great value to a debtor country in that it converts tied aid to untied aid. The value of such changes in the provisions of gross financial flows can be assessed in conventional terms.

Whatever new facility is to be offered to Third World debtor countries can obviously not be imposed upon them. Resort to any new financing arrangements must be entirely at the option of individual governments.

APPROACHES TO THE DEBT PROBLEM

1. *General*

Broadly speaking, the orthodox OECD approach to the Third World's debt problems, which seems to be leading increasing numbers of ana-

[4] Art. IV; 4c., cited in Bitterman, H. J., *The Refunding of International Debt*, Duke University Press, Durham, N. C., 1963, p. 79.

lyst to dismiss them as relatively unimportant, is based on the following assessments:

1) there are no new *general* circumstances which have altered the "typical" Third World country's capacity to finance development;
2) private and public sources of finance for Third World development are generally at present available in quantities and at terms which are more or less as good as can be expected;
3) *individual* specific developing countries face "debt crises" in which debt servicing obligations have become major impediments to to the balanced management of their economies;
4) the causes of these individual and specific debt crises are varied — ranging from sharp and unexpected alterations in the terms of trade to irresponsible financial management — and solutions must therefore be found on a *case-by-case* basis, depending upon the specific circumstances of the country's problems;
5) finding case-by-case solutions to the problems of the relatively few countries facing "debt crises" will restore, quickly and automatically, the normal processes of development financing.
6) there exists an *immediate* balance of payments adjustment problem, created primarily by the increased price of petroleum, which calls for further efforts to recycle OPEC earnings efficiently to deficit countries.
7) special consideration must be granted by *governments* to a group of *very* poor countries whose development prospects are so bleak that they are unattractive to commercial lenders.

In the assessment of any individual debtor country's "case", it is necessary, it is therefore argued, to ascertain, as objectively as possible, what the specific debt problem of the country in question is. (It may be several at the same time.)

Is the problem one of:

1) extreme "bunching" of payments obligations which, whatever the reasons for it, are not themselves, when suitably scheduled, difficult to meet?
2) an unusually large deterioration in the terms of trade which is unlikely to be modified in the foreseeable future if ever, to which adjustment cannot easily be made in the short or even, in some cases, the medium run?
3) an unusually long, but basically *temporary,* period of recession which has rendered existing short-term financing arrangements insufficient, and resulted in the accumulation of short-term debt when it was medium-term financing which proved to be required?
4) extreme poverty and bleak development prospects such that debt

financing of long-term development, particularly at commercial rates of interest, was and is unsuitable?

5) sheer domestic mismanagement on the part of individual debtor governments?

Clearly, in this approach, one must consider each country's case as unique. Generalized approaches to the Third World's debt problems are therefore viewed with suspicion.

Two of these kinds of cases involve fewer disagreements and complexities than the remainder. These are the cases in which the problem is either that of a need to reschedule debt or that of extreme poverty.

2. *Rescheduling (and Consolidation)*

The refinancing of loans which have produced an undesirable and unnecessary "bunching" of repayment obligations (mainly in the 1978-82 period) is, in principle, an easy proposition. To some extent, the loans giving rise to the problem can simply be rolled over by willing creditors —banks, governments, IMF— without any "relief" (in the sense of reduced present value of repayment obligations) being granted whatsoever. Doubt as to the willingness of private creditors to refinance prior lending in full could sensibly lead governments and international institutions, notably the IMF, to take responsibility for the *entire* refinancing effort now, in anticipation of possible problems later. Consolidation of the relevant debts would then make evident sense too. The resulting decrease in private creditors' exposure in the developing countries could, paradoxically, improve the relevant debtors' creditworthiness and generate further provision of commercial credit which might not otherwise have been forthcoming.

3. *The Poorest Debtors*

It is generally recognized that the poorest of the less developed countries, however defined, require special treatment not only in the treatment of debt but also in all other aspects of their interrelationship with the international economy. In the sphere of financing, this recognition can be found in the creation of the IDA, the IMFS' Trust Fund, the special provisions for the poorest in the Stabex scheme under the Lomé Convention, the DAC agreement on aid terms for the least developed, and in recent reallocations within a number of bilateral official development assistance programs. A relatively high proportion of the financial flows to the poorest countries has always been in grant form or on concessional terms, so that their debt burden has typically not been so large, and such obligations as have been incurred are to governments and international institutions rather than to commercial lenders. The poorest countries have neverthless fared particularly bad-ly in the post-1973 years and their economic prospects in the medium-term future are also relatively poor. Some relief of their debt servicing obligations, small as they may be in total, is therefore important to assist them to meet even modest developmental targets.

There seems to be a wide measure of agreement both that they be granted relief from their existing debt servicing obligations, and that future finance be made available to them in greater volumes and in grant form or on very soft terms. A sensible procedure would seem to be to gear the provision of finance to these countries to longer-term capital requirements for agreed-upon macro-development targets (as was noted above). Debt relief would then constitute a part of the total increase in the financing package for these countries. Since there is, in any case, to be an expansion of grants or soft financing for their needs, the cancellation, writing down, or liberal refinancing of their debt — most of which is owed to governments and international institutions anyway — would seem an easy, modest, and sensible place to start. This development assistance has the special virtue of being untied.

But some specific problems remain. The distribution of the gains from debt relief, among the group of the poorest, may not be entirely fair. Those countries which previously borrowed the most will now receive the most. It is for this reason that debt relief for the poorest is best considered as part of an integrated program of increased and improved financing for these countries, in which overall equity of distribution can more readily be achieved. Thus there would be virtue in handling their present debt obligations through increased official *gross* resource flows (untied of course), some of which will be employed for debt servicing, rather than through special debt arrangements. This also, of course, reduces the complexity of the discussion of the distribution of the aid burden among donor countries, and eliminates any possible constitutional problems in debt cancellation.

There would also be an obvious logic —and no real inequity— in converting to those norms the terms of all prior official loans to the poorest countries which were made at lower grant-elements than the present DAC norms. The amounts involved would not, in any case, be very large and the beneficiaries few. Such action must obviously not be permitted to *substitute* for serious efforts to handle these countries' financing difficulties.

There remains the question of identifying which are to be the beneficiary countries, and of agreeing upon some kind of formula for the distribution of these resources. It may be that any attempt to produce a "formula" is utopian and impossible. On the other hand, such formulae —such as that governing quotas in the IMF— have been worked out before and undoubtedly could be again. (The alternative is a case-by-case assessment, with all its attendant dangers.)

There are 49 countries which had per capita incomes of under $ 300 in 1974, of which 29 have officially been designated "least developed". The latter designation unfortunately excluded such important poor countries as India and Pakistan. The per capita income cutoff, however, includes Nigeria and Indonesia, which are important members of the OPEC. A list of probably about 45 qualifying countries could probably be agreed upon. As a very imperfect starting point, one might assign quotas to each on the basis of the sizes of their IMF quotas.

RULES FOR DEBT RELIEF

The handling of the other kinds of debtor problem is in greater dispute. The principal concern of the governments of the developed countries, is that financial discipline and confidence should not suffer. The writing-off or rescheduling of debt must neither be, nor be seen to be, the rewarding of profligacy and mismanagement. The private financial system's strength and stability depends upon a modicum of mutual confidence and trust, which could be severely prejudiced by calculations, on the part of the borrower, as to whether he will ever be made to repay his debts in full or, on the part of the lender, as to whether the borrower may be harboring such thoughts. The developed countries do not therefore wish to provide relief for "the undeserving poor". To some degree, it is not in the interests of future "honest" Third World borrowers either that such undiscriminating debt relief be provided.

The Third World governments' well-founded fears that case-by-case approaches will minimise their individual bargaining strength must somehow be met by arrangements which at the same time cater to the developed countries' legitimate views that inappropriate incentives and inequities may be generated by overgeneralized solutions. The obvious meeting place for the two conflicting types of approach lies in a set of rules or principles or formulae sufficiently comprehensive and at the same time specific so that they cannot be significantly bent through the bargaining process— which are then, on the basis of prior agreement both by debtor and by creditor governments, *universally* applied. Individual countries will then indeed be treated differently depending upon their individual circumstances, but they will no longer be as vulnerable to collective creditor pressures.

What should meet with the approval of both sides in this North-South debate over debt is the proposition that there are certain *general* principles or criteria which should be employed in the assessment of specific country cases. Is it possible to express them in a manner which is not so general that their application becomes *de facto,* simply a matter of bargaining on a case-by-case basis? There *are* some possibilities, some of them suggested by schemes which are already in existence, others which have been proposed at the international level before, and still others of a more innovative kind. (Whatever is thought of the *specific* proposals which follow, it is hoped that the search for *some* set of rules will find broad assent).

Let me put them forward in terms of 3 headings:

1) "compensatory financing" principles
2) "supplementary financing" principles
3) "bad debt" principles

1. *Compensatory Financing*

Compensatory financing facilities have been available to primary-exporting members of the IMF for nearly 15 years. The provision of these credits above and beyond the normal IMF short-term facilities is in recognition of the extreme instability of export earnings believed to be characteristic of primary exporters. Judging from the experience of some of the semi-industrialized countries during this last recession, one does not have to be selling primary products to suffer from extreme instability in the export bill. For example, "fast growing exporters of manufactures" (those in which manufactures accounted for more than one-third of total exports and manufactured exports grew at an annual average rate higher than the world average of 16% during the 1967-72 period) suffered a 9% decline in export purchasing power in 1974-75.[5] Indeed there is still no firm econometric evidence that export instability is statistically correlated with the share of primary products in the export bill; that export instability is greater in the developing countries than in developed countries, however, is beyond dispute. The object of compensatory financing, then, is to finance the super-normal fluctuations in the balance of payments which are experienced by the *poorer* members of the IMF. As will be seen, these are by no means entirely attributable to fluctuations in export earnings (let alone, only the primary ones) although the present, still somewhat imperfect, compensatory financing facility is based upon the assumption that they are.

The rules governing access to this facility have been quite explicit. Subject to some upper limits, compensatory financing is available to make up the shortfall between current year export earnings and the five year average of export earnings, centered on the current year; this rule obviously requires a forecast of export earnings for two future years. The credits are designed for circumstances in which the shortfall from "average performance" is deemed to be temporary and attributable to

[5] Overseas Development Council, *Agenda for Action, 1977,* Washington, D. C., 1977, p. 209.

factors beyond the shortfall country's control. Liberalization of the administration of the compensatory financing facility through a December 1975 decision (the elimination of prior limits on forecast earnings, the increase in permitted drawings both within any 12-month period and in total, the creation of an early drawing procedure which permitted up to 6 months' exports of the current year to be estimated) led to unprecedented resort to it in 1976. The SDR 2.35 billion drawn by 48 countries (including 605 million by Australia, New Zealand, Iceland and South Africa) in 1976 was roughly twice the sum drawn under this facility in its entire prior existence.

The existence of certain explicit rules governing access to balance of payments loans creates a useful precedent for the handling of debt which has accumulated in consequence of stochastic influences upon the balance of payments. It remains to remedy certain obvious logical short-comings in the existing rules and, while applying them as possible to future borrowings, to employ them immediately to refinance some of the debt overhang which has resulted from the illogicality of the present rules.

The principal limitation of the compensatory financing facility's present rules is their failure to take account of import prices. Since the objects of foreign exchange reserves and balance of payments lending are to forestall the need for harmful cutbacks in the flow of imports, the exclusive focus of the present rules upon export earnings is illogical. In the context of the international crises of the past four years this anomalous rule has been particularly harmful to the oil-importing countries. The export shortfall calculation should clearly be undertaken in terms of the *purchasing power* of exports, rather than in terms only of export earnings; for the object *is* to stabilize imports.

A second limitation in this facility is its exclusive focus upon fluctuations in that part of (primary) production which is exported. As has again been demonstrated in the 1970s, domestic food production is also extremely vulnerable to influences which are beyond the control of governments. When drought (or other disturbance) strikes the primary-producing sector, there is a corresponding temporary increase in the need of imports; conversely, bumper crops reduce the import bill. If special provision is to be made for the peculiar balance of payments problems of poor and/or primary-producing countries, there are many in which these considerations are no less important than fluctuations in exports and the terms of trade.

Whatever the rules to be applied in the provision of balance of payments credits of a compensatory kind, they cannot adequately perform their function if there are low limits to the amount of credit to be made available. The 1975 liberalization of the IMF's compensatory financing rules has freed more credit for the use of the countries which most require it, but there are still limits to its use which bear no relationship to the real *need* for such credits. (The present limits are 50 per cent of quota within any 12-month period with the possibility of 75 per cent for disasters, and a maximum of 75 per cent of quota outstanding at any one time.) Had there been allowance for import price increases, and crop disasters, and had credits been available to meet (perhaps a stipulated percentage of) the obvious import stabilization needs as determined by a shortfall formula, rather than only up to certain arbitrary limits, it would not have been necessary for Third World borrowers to rely *so* heavily upon commercial credits on thoroughly hard terms. Short-term financing under this facility would have provided three to five-year loans at 4 to 6 per cent.

There is a strong case for a formula-based multilateral refinancing at IMF terms of short-term balance of payments loans which were obtained from commercial banks in the then absence of alternative sources of such credit. Since such short-term stabilization is in the *world's* interests (it constitutes the rationale for the IMF's existence), its cost should presumably be borne, in part, by the *world* community, rather than exclusively either by the borrowers or by the lending banks. The IMF is the obvious institution to arrange and fund this part of the debt refinancing effort.

2. *Supplementary Financing*

In the mid-1960s, the World Bank and others put forward schemes for the provision of so-called supplementary financing which would offer grants or credits not only to countries suffering temporary shortfalls from the five-year moving average of their revenues but also to those experiencing unexpected shortfalls from what were internationally agreed in advance to be reasonable forecasts of export earnings. The intention was to keep development plans more or less "on track" by guaranteeing that imports could still be financed despite unexpected trends (not just stochastic fluctuations about the trend) in exports. Again, logic would seem to require that the effects of unexpected changes in import prices and domestic crop experience should also have been included in such schemes. Such schemes were designed to offer the same kind of balance of payments protection as the compensatory financing one, except that the relevant shortfall period was now to be longer than a single year. Had such a supplementary financing scheme (particularly one incorporating the suggested adjustments for import prices and domestic production) been in place in recent years, the Third World again would not have been forced to resort to so much hard financing. Since no form of the supplementary financing scheme was ever in fact set into operation the case for basing debt relief upon the circumstances which would have occurred if it had been is perhaps not as strong as in the case of the compensatory financing principle. But the special oil facility (3 to 7 years) and the extended facility (4-8 years) created by the IMF constituted tacit recognition that there was (is?) a supplementary financing type of problem — a once-and-for-all change in medium-run balance of payments experience which had to be financed during the period in which adjustments were made and estimates of export prospects were revised downward.

Ohlin has also noted the gap in international credit facilities at the medium-term range.

> One of the obstacles to rational debt management by developing countries is the fragmentary character of the market for credit and capital to which they have access. As the structure of their debt shows, at the long end of the spectrum there are bilateral aid loans and IDA loans, at the short end export credits. Although the role of program lending is growing, these latter types of finance still dominate, and they are fairly inflexible and typically linked to the financing of imports of one specific kind or another. Even when there has been no excessive use of short term credits for long term purposes, there is no particular reason to think that the conventional time profiles of such loans will match those of project maturation, let alone of balance of payments developments. But apart from IMF facilities for very short-term balance of payments support, the system does not provide the range of untied medium and short-term credits that would be necessary for a flexible adjustment and management of the debt. The only recourse for most developing countries has been debt rescheduling, and it is in this light that many "debt crises" must be seen. In all their clumsiness, they are an integral part of the very imperfect international credit market rather than a sign of the breakdown of that market.[6]

The private banks have stepped into the breach during the past four years, using the unusual liquidity created by OPEC deposits, offering short-term program credit to supplement that provided by the IMF and medium-term credit (sometimes through the rolling over of short-term loans) which was elsewhere unavailable. As has been seen, the banks' willingness to continue this role is in some doubt. There is clearly a case for trying to fill this gap for the future, while "patching up" the damage which has been incurred from its absence in the past. Debt rescheduling, as Ohlin suggests, is one rather awkward way of doing this. The rules for such a comprehensive rescheduling effort might be related to those governing a new medium-term facility if one can be agreed upon.

The IMF's planned new "supplementary" Witteveen facility (replacing the oil facility and the extended facility) will help to fill the gap in the sphere of medium-term finance. It is intended to provide credit for

[6] Ohlin, Göran, "Debts, Development and Default", in G. K. Helleiner (ed.), *A World Divided, The Less Developed Countries in the World Economy*, Cambridge University Press, 1976, p. 218.

periods exceeding the 7 year maximum of the oil facility and to relate the provision to needs rather than to IMF quotas. Its principal drawbacks in descending order of importance are: the conditionality of the loans and IMF discretion over their availability which are far inferior to a set of rules of access and are bound to engender bad feeling and charges of interference; the reliance upon uncertain further OPEC and other contributions for financing; and the intention to charge commercial rates of interest to all borrowers. If the financing is truly to provide bridging finance for medium-term balance of payments problems, rather than development assistance *per se,* the proposed commercial rates of interest are, of course, quite appropriate. While the poorer countries would clearly benefit still further from subsidized interest rates, the possibility of which is still being explored, they at least gain access to credit which is at present often unavailable on *any* terms and are thus, even by the proposed less than ideal scheme, gaining an implicit subsidy.

The requirement that surplus countries be persuaded to finance this new facility has been a serious problem and obviously limits its size to the levels which these countries are prepared to provide (as was also the case in the IMF's oil facility of 1974-75). Assuming rates of return, liquidity and security are made roughly comparable (interest rates are to be "market-related" and creditors' claims "apropriately liquid"), the investing countries should be equally happy to turn over medium-term finance to the IMF as to alternative private financial institutions. To the extent that such a deflection of their resources is what is achieved, the total quantity of medium-term finance will not increase; all that will happen is that the IMF would replace what would probably otherwise be private banks. The result will be that IMF discretion and rules governing financial management of debtors' economies replace the private bankers' judgments as to "creditworthiness". The net effect will probably be to increase the availability of credit for the poorest and least creditworthy potential borrowers while increasing the degree of foreign policy "intrusions" into domestic economic and political affairs; better off countries may well prefer to continue to rely instead upon the relatively arms-length relations with private banks to which they are accustomed (although, with reduced bank liquidity, these may now only be available at increased interest cost).

The most serious pitfall in the new IMF facility is that which is also found in many other developed countries' proposals for creditor discretion and control. The desire of creditors to impose discipline upon debtors is perfectly understandable and, to a point, wholly reasonable. But the apparent neutrality of words like "surveillance", "sound management", and "conditionality" conceal the fact of substantial discretionary power both with respect to allocations between potential debtor countries and with respect to policies within any one such country. The potential for acrimonious dispute —charge and countercharge— is very great if some fairly specific set of rules and sanctions are not agreed upon *in advance* by both debtors and creditors. The effort invested in the development of at least certain guidelines as to the meaning of "need", circumstances justifying deferral of payments, maximum debt carrying capacity, and the nature of sanctions for failure to meet agreed payments on schedule, etc. is certain to be repaid in better international relations.

A "supplementary" medium-term financing facility, the modalities of which are clearly agreed in advance, should be a *permanent* and larger feature of the international financial system rather than a stop-gap to handle the period until the next IMF quota revision is put into place. The rules of access and the terms of such a new facility should then be applied retroactively so as to permit, at the debtor's option, the international refinancing of "hard" debts, taken on in recent years by countries, which that time had no other alternatives.

3. *Bad Debt*

Nurul Islam has suggested certain rules and/or conditions which might be employed to justify the writing-down of existing debt. He has noted that since the cost of procurement tying is now universally recognized, loans associated with tied aid could logically and equitably be written down by an amount (about 20%) which reflects this cost; alternatively, repayment in similarly tied form, in commodities, could achieve the same purpose. Food aid, which was also often notoriously overpriced, should be appropriately revalued to the then current world prices for the appropriate commodities for the purpose of meeting any associated debt.

Two other classes of loan are recommended by Islam for special treatment. In the first place, there are loans for projects which went bad.

> History is replete with examples of projects, in the developed countries, which have failed to yield any return and ended in failures and bankruptcies, owing to miscalculation of demand or of costs or of both. Such projects, when financed by private investors, were written off, if not formally then in fact, in so far as the investors, including foreigners, went bankrupt. In modern times, the creditor governments refuse to accept the phenomenon of bad debts or bankruptcies. Although the planning and preparation of projects is always done under conditions of great uncertainty, and despite the fact that the choice of aided projects or programmes was typically the result of joint decisions of the debtor and creditor countries, the creditors require the debtor countries to bear the full consequences of mistakes. Particularly in the case of projects financed by export credits, proper evaluations were frequently not conducted; for this, creditors and debtors were

> equally responsible. There were many instances where wrong specification of equipment, lack of proper balance in plant and equipment, and inappropiate choice of technique led to overcapitalization. There are many cases where the initial cost estimates of a project underwent, in the course of its implementation, substantial increases, either because there was underestimation to start with or because there was a subsequent rise in the price of equipment, aggravated by long delays in execution in a world of rising prices. Sometimes mistakes were the result not only of wrong analysis but also of careless and high pressure salesmanship on the part of foreign aid agencies and supplying firms, which are often interlinked. Unproductive projects could, therefore, legitimately be written off in the same way that wrongly chosen domestic projects undergo bankrupticies. Debtor and creditor countries could jointly examine individual projects to identify such unproductive, wrongly chosen projects and agree to scale down or write off debt relating to them.
>
> In many poor countries —he continues—, the results of other past investment financed by foreign credit were nullified by natural calamities like floods, cyclones or earthquakes, or by wars. There is an obvious rationale for writing off debts which financed investments, results of which are no longer available.[7]

Secondly, he suggests that loans which were made for the purpose either of increasing the utilization of existing capacity or of raising current consumption, rather than of increasing the stock of capital, should now be recognized as never having been intended to generate the capacity for future debt servicing. Development assistance in the form of food, raw materials and intermediate inputs has frequently been of this type. Such loans could sensibly now be scaled down or written off.

There is also a strong case, in logic and equity, for the rescheduling of debt for which repayments proved, through circumstances which could not have been foreseen, to be inappropriately timed. Delays in loan disbursements, usually associated with delays in the associated projects themselves, have frequently led to servicing obligations well in advance of any possible increase in production and servicing capacity. The convention that the timing of the repayment obligations of debtors is typically specified with much greater precision than is that of loan disbursements by creditors can thus produce severe servicing problems. In extreme cases, notes have even fallen due before there were *any* disbursements whatsoever under the loan.[8] These delays are found particularly frequently in official development assistance loans. One study of US project loans to Brazil found that, on average, only 49% of the face value had been disbursed three years after the loan agreements had been signed. In these instances, it should therefore be rela-

[7] Islam, Nurul, "The External Debt Problem of the Developing Countries with Special Reference to the Least Developed", in G. K. Helleiner (ed.), *A World Divided, op. cit.*

[8] Bitterman, *op. cit.*, p. 78.

tively easy for the governments or institutions concerned to reschedule the servicing obligations so as to reflect actual rather than anticipated disbursements.

FINANCING OF DEBT RELIEF - A PROPOSAL

How much financing would be required to provide debt relief in the manner suggested above depends on the specifics of the agreed rules and the precise forms of relief offered. There is certainly scope for innovative forms of relief such as the conditional repayments arrangements suggested in section III above. The possible size and distribution of the "burden" of debt relief arrangements is not a matter which will be pursued here. Only one major suggestion will be offered. There is one obvious source of finance for the handling of these debt problems around which people have tended so far to tiptoe. That is, of course, the possible issue of a new round of Special Drawing Rights. Rendered supersensitive to the unfair charge that they eventually wanted to create SDR's for the prime purpose of development assistance rather than only in amounts reflecting world monetary requirements (with merely their distribution affected by equity considerations), spokesmen for the Third World have refrained from suggesting that the present circumstances would seem to constitute a suitable occasion for a "special issue". (The Group of 24 *did* call for a new allocation of SDRS last October, and again in April but were careful to phrase their case in terms of the decline in the world reserves/imports ratio since 1970, the uneven distribution of increases in world liquidity in this period, and "the need to enhance the role of the SDR in the international monetary system, which is in the interest of the entire international financial comunity".) The funding of at least a portion of the Third World's debt would certainly seem to be a purpose, to use Professor Triffin's terminology, "collectively agreed by the international community". Now that there exists once again a plausible case for a planned expansion of world liquidity, there would be obvious advantage in pumping it into the system in such a way as to do the most good from the standpoint of balance of payments management. Clearly, the size of IMF quotas is unrelated to the present needs for balance of payments financing; for this reason, neither the (sixth) quota increase now being ratified by IMF members nor the proposed further (seventh) enlargement of IMF quotas will adequately address the current adjustment problem. An issue of SDRS to a debt relief and medium-term lending agency (perhaps the IMF itself, although the Third World would no doubt prefer some new institution in which their power is better represented) would direct the increased liquidity to those countries most in need of it, whereby to satisfy earlier critics of the link that by "need" is meant balance of payments medium-term financing "need" rather than, as in prior link proposals, "development needs". (Happily, the two frequently now coincide.) While a "permanent link" might well, as has frequently been argued, subject resource flows to developing countries to random and irrelevant shocks, here is a clear single instance in which two birds *could* be killed with one stone.

(It might be noted that the "older" case for the link still holds. None of the arguments which have been levelled against it detract from its basic logic. In John Williamson's words,

"The mere fact that reserve creation and resource transfer are different things does not . . . imply that it is improper to design a system that will promote both objectives, insofar as they are not competitive with one another."[9] That being so, there is also something to be said for relating the SDR debate once again to the financing problems of the poorest countries.)

CONCLUSIONS

The elements of the debt program here proposed are as follows:

1) the writing-off or major writing-down of the official debt of the poorest countries as *part* of a major gross increase in official development assistance to them;

2) the rescheduling of "bunched" debt repayment obligations by the governments of the developed countries and the IMF, without necessarily any debt "relief";

3) the provision of IMF (or other official international) credit, retroactively, to governments which would have qualified for it under a liberalized compensatory financing scheme and a supplementary financing scheme, both of which should be put into place as soon as possible;

4) the writing-off or scaling-down of "bad debts" associated with official tied aid, bad projects, "unproductive" loans, and delays in disbursements;

5) the financing of this debt "relief", at least partially, through a special issue of SDRS; and the use of more imaginative and conditional types of repayment obligation.

The principal innovation offered here is the resort to *rules or formulae* to break the deadlock between the advocates of the case-by-case approach and the global approach.

[9] Williamson, John, "SDRS: The Link", in Jagdish Bhagwati (ed.), *op. cit.*, p. 56.

The advantage of reliance upon formulae which are reasonable and equitable is that cases of economic mismanagement are then thrown more clearly into relief and the likelihood that profligacy will inadvertently be rewarded in debt relief operations is substantially reduced. While there may still exist "special cases" uncovered by the formulae, e.g. unwarranted capital flight or cessation of foreign capital inflow, creditors and debtors are substantially in agreement in advance as to what constitutes "unusual" circumstances beyond debtor control. Since any such agreed set of rules is unlikely to meet all contingencies or to generate as much debt relief as is frequently sought, we will have to live with the probability that both private and public creditors may themselves make additional special arrangements in what they perceive as special cases.

It should go without saying that in the longer-run, the likelihood of further Third World debt "problems" would be reduced by a whole variety of other international reforms — the easing of access to international bond markets, multilateral guarantees for Third World borrowings, the development of innovative new forms of cofinancing in which international institutions join with private creditors, etc. not to speak of all those falling under the general heading of the "new international economic order".

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Indebtedness of Developing Countries: Some Proposals for Action

G. D. Arsenis

The author is director of the Money, Finance and Development Division, (UNCTAD) United Nations Conference on Trade and Development. The views expressed in this paper do not necessarily reflect those of the UNCTAD secretariat.

Post-war debt re-organizations have been seen in the context of the economic conditions prevailing in individual debtor countries. The underlying assumption has been that unfulfilled expectations of the debtor country have given rise to domestic economic dislocations that made debt re-organizations inevitable. On the whole, post-war debt re-organizations have not distinguished between internal and external factors that have given rise to divergence between expected and realized values of key economic variables. In fact, since debt reorganizations have been undertaken as a last resort measure when the economy had ceased to function, the tendency has been to focus on domestic stabilization programmes and to neglect the impact of adverse external conditions which, in several instances, triggered the malfunctioning of the internal system.

A good part of the current debate on the debt problem is devoted to the question of whether the existing "system" of debt re-organization is adequate or whether it might be improved by the introduction of some common norms. It seems to me that this debate is of little value because the presènt conditions underlying the debt problems of developing countries are fundamentally different from those that prevailed until 1974.

The fundamental point that I wish to emphazise is that the debt problems of developing countries today cannot be seen in isolation. They must be seen as an integral and inevitable part of important and structural changes that have taken place in the world economy in recent years. The rapid increase in external indebtedness of developing countries is a reflection of the dramatic increases in their deficits on current account. These deficits, in turn, have been the result of external forces that have substantially altered the relative prices of internationally traded goods. There are two key points that must be made —

a) Developing countries, as a group, do not determine the level of their current account deficits.

These deficits are the mirror image of surpluses in the rest of the economy. The collective surpluses of both OECD countries and OPEC countries are likely to persist and even increase in size for several years to come. The reasons why a number of OPEC countries will continue to have large current account surpluses are well understood by now and need not be repeated here. What has not been fully appreciated, however, is that the OECD countries will not accept the continuation of a deficit position on current account. It follows, therefore, that the level of current account deficit of developing countries will be largely determined by structural current account surpluses of certain OPEC countries and balance-of-payments policy objectives of OECD countries.

b) Policies by individual developing countries aimed at reducing their current account deficit will not result in an overall reduction of collective deficits. They are likely, however, to lead to a redistribution of the overall deficit among them.

The conclusions that I draw from all this is that the problem at hand is an international one and cannot be separated from the broader problem of the adjustment process in the world economy. Seen in this context, the external indebtedness of developing countries is more directly linked to structural problems in the creditor countries rather than policies in the debtor countries.

To be sure, the fact that developing countries will have to be net capital importers of an order thought unmanageable a few years ago is not *per se* a matter of concern. What is of concern, however, is that the externally determined level of current account deficits may not come hand in hand with external financing on appropriate terms and conditions. In this connexion, a clear distinction should be made between low income developing countries, that receive most of their external financing in the form of aid, and other developing countries that have financed their deficits by resource to private capital markets.

In the past, the bulk of external financing was provided in the form of official loans and grants. The current situation is different, however, with private loans being the dominant component in total net flows to developing countries. The reversal in the relative shares of public and private flows is due partly to the failure of aid to increase *pari passu* with increases in the deficits of developing countries and partly to excess liquidity conditions in the private capital markets. These developments have resulted in widening the spread among developing countries. The economic development of low income countries has become increasingly dependent upon net transfer of official resources. On the other hand, middle income developing countries are being phased out of aid programmes and are becoming increasingly dependent upon access to private capital markets and demand conditions in the OECD economies. It seems useful therefore to consider the debt problems of the low income countries separately from those of the middle income developing countries.

THE CASE OF LOW INCOME DEVELOPING COUNTRIES

There is general agreement that the economic prospects of the low income countries are bleak. Projections indicate that income per capita may not increase substantially during the remainder of the decade and that, even under the most optimistic assumptions, the annual average rate of growth of income per capita over the period 1975/1985 may be no higher than 1.7 per cent.

There is also general agreement that the net transfer of assistance to these countries is grossly inadequate. It is estimated that if the net transfer of resources to these countries were to increase above the forecast levels by $1.5 billion per annum, the rate of growth of income per capita of these countries during the period 1975/1985 might reach the 3 per cent per annum mark.[1] It should be mentioned parenthetically that reverse transfer of resources from these countries in the form of amortization and interest payments on official loans is about $2 million per annum.

The case for writing off or writing down the official debts of these countries rests on the proposition that immediate debt relief will increase the net transfer of resources to these countries and will improve the quality of assistance.

The critics argue that debt relief across the board on official debts of low income developing countries may not necessarily lead to an increase in the overall transfer of resources and may, in fact, result in an unfavourable distribution of assistance among recipient countries. All this is, of course, nonsense. It can be easily seen that as long as the transfer of resources from each donor to each recipient country is to remain non-negative,[2] debt relief need not alter the distribution of assistance if the donor country does not so wish. Even if debt relief is not to result in an increase in the net transfer of resources, the fact still remains that this form of assistance (quickly dispersable, untied in respect of source of procurement or project) is considered preferable by debtor countries.

It may be asked, therefore, why major donor countries have been unwilling to even consider proposals for debt relief across the board.

[1] The projections also assume that the additional capital flows will help the debtor countries increase their own domestic savings rates.

[2] In the light of several declarations that net resource transfer to these countries should be increased, one should not expect negative transfer of resources to arise. If it does, debt relief will tend to reverse this abnormal situation.

I think that the reasons for the position taken so far by developed countries are basically of a political nature. Firstly, debt relief reduces the discretion of a donor country with regard to the form in which assistance is provided. Given the level of net transfer of assistance — which is entirely at the discretion of the donor country — acceptance of debt relief proposals will require that a certain proportion of the resource transfer be in the form of non-project aid. In many instances, this may not be consistent with the objectives of donor countries which, on the whole, consider project assistance as enhancing their own commercial interests and their leverage on shaping economic policies in debtor countries. Secondly, in some major donor countries, debt relief across the board may require direct or indirect parliamentary approval. It is argued that parliaments are more likely to approve additional aid in traditional forms rather than in the form of debt relief. One may doubt the validity of this argument which, in any event, is beside the point. Whether the final decisión is in the hands of the executive or the legislative branch of the government, opposition to debt relief proposals does not seem to relate to rational, economic reasoning but tends to unmask the fact that, in connexion with decisions affecting the form of assistance, a conflict exists between the welfare of the debtor country on the one hand and the interests of the donor countries on the other hand.

In all, the question of debt service payments by low income developing countries should be seen in the context of the agreed principle that net resource transfers to these countries should be increased. Thus, proposals for debt relief should be understood as mechanisms for increasing the transfer of resources and improving the quality of assistance.

THE CASE OF MIDDLE INCOME DEVELOPING COUNTRIES

The existence of surplus savings in the rest of the world has allowed this group of countries to finance their balance-of-payments deficits without serious difficulty. As was indicated earlier, the deficit of these countries will continue to grow not so much as a result of domestic policies but primarily because of the existence of persistent and structural surpluses elsewhere.

It may be argued that the willingness of developing countries to absorb the savings surplus of the rest of the world strengthens the interdependence of the economies and brings them together along a path of long-term growth and prosperity. While this argument is in principle correct, the actual situation is characterized by certain rigidities that may not allow the economy to evolve along that path.

For one thing, the international banks, which are involved in the intermediation of transferring excess savings from developed and OPEC countries to middle income developing countries, do not and cannot perceive this operation as involving net transfer of resources in perpetuity. They are naturally concerned about the medium-term capacity of a country to repay its loans to them. As a result, they tend to give special emphasis to short-term and medium-term debt service capacity indicators. The fact that world economic conditions have determined that this group of countries will continue to be net capital importers is of no relevance to the banker who is in the business of providing medium-term credits. The inconsistency is quite clear: while the stability of the world growth model requires increasing net resource transfers to these countries in the foreseeable future, the form of intermediation requires medium-term perception about the reversal of transfers. Those who have doubts as to whether such inconsistency exists, may seek a banker's opinion as to whether he would be prepared to continue lending in increasing amounts to a country whose debt service ratio over a period of 7 years is projected to increase from, say, 40 per cent to 75 per cent.

Another problem relates to the investment prospects in capital importing countries. Capital inflows will, of course, contribute to growth only if they are used productively. In the case of middle income developing countries, this means that capital inflows should generate net foreign exchange earnings in the long run. I myself do not see how this can be effected without dramatic expansion of exports from those countries to the OECD economies. This, however, will require a reversal of the current position of developed countries *vis à vis* access to their markets and commercial policy in general. And here we have another inconsistency: the current account surpluses in the rest of the world will make it possible for the middle income developing countries to accelerate the pace of their development; but this, in turn, will lead to a substantial vent for surplus in the developing countries which probably cannot be absorbed by developed countries without far-reaching structural changes.

The upshot of this discussion is that the growth-cum-debt model may, in fact, be unstable.[3] Market perceptions may turn out to be inconsistent with long-term resource transfer requirements; and trade policies in developed countries may make it increasingly difficult for developing countries to invest in areas where capital productivity can match the terms of external financing.

To leave these trends to take their own course is a clear prescrip-

[3] The Annex demonstrates the heroic assumptions that must be made to work out a "stable" solution for export-oriented-cum-debt growth paths.

tion for disaster. What is required is a new, official investment mechanism that will transfer resources from saving surplus to saving deficit countries in amounts, terms and conditions that are consistent with the global objectives of full employment and growth. Similarly, debt payments will have to be flexible and geared not only to the debt servicing capacity of individual debtors, but also to considerations relating to the world business cycle and trade conditions.

The establishment of an official investment facility to offset imperfections in the private capital markets is a necessary but not a sufficient condition. The international system of capital movements cannot be rendered stable without the co-existence of an open and dynamic trading system that permits debtor countries a rapid pace of expansion in their exports.

ANNEX. ILLUSTRATIVE CASE STUDIES OF DEBT SERVICE

In the numerical example, two quite different cases are considered to illustrate the difficulty of successfully managing high levels of indebtedness and the external factors necessary for a successful outcome (defined as stabilizing the debt service ratio).

Case I illustrates the situation of a country pursuing an export-oriented development strategy where exports of manufactures are the dynamic element constituting 25% of merchandise exports in the base period and growing at nearly 15 per cent per year from 1976 to 1985. Reflecting the import requirements of such a growth strategy, the import elasticity is assumed to be greater than one, 1.3 in this case, although much higher import elasticities ranging from 1.8 to 2.5 have been observed for sustained periods during the past decade and a half for countries pursuing this particular development strategy. Other assumptions may be found on the accompanying table.

Due to an accumulation of past indebtedness, the level of debt service payments in the base years is already fairly high, 32 per cent of exports and net non-factor services, while the net transfer required in the base period is of the same order of magnitude. With exports of goods and services growing faster than imports, the net resources transfer falls as a percentage of exports and, while debt service continues to rise faster than exports, the rate of increase slows and by 1985, the debt service ratio, while nearly 60 per cent of exports of goods and services, is approaching stability.

The "successful" outcome in this case depends upon a number of key elements. In the first place growth of demand in markets must be stable, which implies not only continued expansion of the economies of the importing countries, but also an absence of trade barriers. Secondly, creditors must continue to make additional funds available on a scale even somewhat larger than in the past. Thirdly, commodity prices must remain reasonably stable since primary products continue to constitute the larger, although declining, share of export earnings. Finally, domestic policies must be successful in moderating import growth so that a relatively low import elasticity is achieved.

Case II illustrates a somewhat different economy, where future increases in export earnings are expected from developing new mineral deposits. The opening up of new deposits is made possible by imports of capital goods and construction materials, financed by commercial loans. The base year reflects these higher than normal imports with the result that the net transfer required in the base year is more than twice the value of exports of goods and services. The debt service ratio is also high reflecting several years of such borrowing, standing at about 50 per cent in the base year. In the event that expectations of rapid export growth are well-founded, in this case, 12 per cent per year, and that import growth can be contained at about 3 per cent in real terms, the required net transfer immediately begins to decline and eventually becomes negative. The ratio of debt service to exports continues, nevertheless, to increase for several years before stabilizing. When the debt service ratio begins to fall, there will be greater scope for expanding imports. As in case I, neutral terms of trade have been assumed, as well as continued expansion at a reasonably rapid rate of the developed market economies constituting the largest export market.

Table 1

ASSUMPTIONS FOR ILLUSTRATIVE CASE STUDIES OF DEBT SERVICE

	Case I	Case II
Rate of growth of GDP in OECD	4.7	4.7
Rate of growth of GDP in developing country	6.0	6.0
Elasticity of country's exports of manufactures (5-9) with respect to GDP in OECD	3.0	3.0
Elasticity of country's exports of primary products (0-4) with respect to GDP in OECD	1.3	2.6
Elasticity of developing country's import demand with respect to own GDP	1.3	0.5
Elasticity of growth of net non-factor services with respect to GDP in OECD	1.1	0
Rate of growth of unit value of exports of manufactures	5.4	5.4
Rate of growth of unit value of exports of primary commodities	5.4	5.4
Rate of growth of unit value of imports	5.4	5.4
Initial values assumed for 1976		
Value of developing country's exports of 5-9 (fob)	2 532	10
Value of developing country's exports of 0-4 (fob)	7 596	1 235
Value of exports of non-factor services (net)	229	— 400
Value of imports (cif)	13 623	2 559
Balance on goods and non-factor services*	— 3 266	—1 714

Terms and structure of net transfer of resources

	Interest profits	*Grace*	*Maturity*	*Case I*	*Case II*
Official development assistance	3.0	7	33	.04	.02
Other official flows	7.0	1	5	.13	.06
Private commercial loans	8.5	1	7	.68	.72
Private direct investment	15.0	—	—	.15	.20

* Equals (with change of sign) net transfer of resources.

Table 2

ILLUSTRATIVE CASE STUDIES OF DEBT SERVICE

	1976	*1980*	*1985*
Case I			
Exports of goods & non-factor services	10 357	17 476	34 498
Imports of goods	13 623	22 704	42 994
Balance on goods & non-factor services	— 3 266	— 5 229	— 8 496
Debt service	3 264	7 306	20 311
Ratio of debt service to exports of goods & non-factor services (net)	0.32	0.42	0.59
Case II			
Exports of goods & non-factor services (net)	845	2 017	5 227
Imports of goods	2 559	2 572	3 879
Balance on goods & non-factor services (net)	— 1 714	— 556	1 348
Debt service	432	1 524	3 234
Ratio of debt service to exports of goods & non-factor services (net)	0.51	0.76	0.62

Debt Implication of International Resource Transfers to Developing Countries

Edgar Kröller

The author is Head of the Financial Policy Division in the Development Co-operation Directorate at OECD-DAC. The views expressed in this paper do not necessary reflects those of OECD.

INTRODUCTION

Debt problems of developing countries have been one of the most prominent topics of international discussions for several years. They were a central (and abortive) issue in the deliberations of the CIEC and will continue to engage the attention of both developed and developing countries at a number of forthcoming international meetings, notably within the framework of UNCTAD.

Consideration of external debt cannot be divorced from consideration of external resource flows. In fact, there exists the dilemma that developing countries continuously claim an increasing net volume of international capital, and at the same time express concern over their mounting debt service burden. However, one is only the mirror image of the other. Except for grants and direct investment, international capital consists of loans. Every additional net dollar of loans adds one dollar to the recipient's external debt. Demands for external resource flows, e.g. as embodied in international transfer targets, are thus tantamount to demands for more debt.

This relationship is inescapable but need not be the source of debt servicing problems. All depends on the volume and cost of external borrowing and the capacity of the borrowing country to manage its economy and external accounts so as to derive real net benefits from external capital without encountering serious servicing problems.

This is obviously easier said than done. The fact is that many developing countries are under great pressure to accelerate their economic development, pursue active social policies and preserve political stability at one and the same time. Given this pressure and the uncertainties prevailing as to domestic and international economic events, it is not surprising that several developing countries may have misjudged their debt servicing capacity and borrowed more and on harder terms than was prudent — thus mortgaging their future with payment obligations which they may be unable to meet without unreasonably cutting down their development objectives.

This is a situation which provides a challenge for the international community to maintain a healthy international economic environment which supports the export earnings of developing countries, to seek ways and means of helping them in their debt management, and to provide relief in cases which leave no other solution.

INTERNATIONAL CAPITAL FOR THE THIRD WORLD

External Resource Flows to Developing Countries

In the past few years, there have been enormous changes in the financial needs of various groups of developing countries and their access to different forms of external financing. Net resource flows to oil-importing developing countries rose from 31 billion dollars in 1973 to 59 billion in 1976.

With the onset of the world recession in 1974/1975, after the dramatic increase in oil prices, it was feared that lasting damage might be inflicted on the development prospects of oil-importing developing countries. An emergency program was set up to ease the difficulties of the most seriously affected countries, and individual developing countries were able, to different degrees, to tap world capital markets and to obtain access to part of the oil-exporting countries' surplus liquidity. In 1976, the non-oil countries' growth of GNP recovered in aggregate, from a 10-year low of 3.3 per cent in 1975, to an estimated 5.8 per cent. Their reserves stood $ 11 billion higher in December than a year earlier, and their real imports had begun to increase again.

This overall picture conceals major differences in the circumstances of individual countries and groups of countries. The forms, terms and geographical distribution of resource flows did not always correspond to needs. A simple perpetuation of the present pattern could face some countries with serious debt servicing difficulties.

With respect to the sources of international capital, three main types can be distinguished:

a) Official development assistance (ODA; grants and loans with at least 25 per cent grant elements);

b) Officially-supported or encouraged resource flows, such as officially-extended or guaranteed export credits, direct investment (partly guaranteed), equity participation (e.g. by Public Development Finance Corporations), band lending (requiring official authorization), etc;

c) Resource flows at market terms, essentially Eurocurrency and bank credits.

Of the total net flow to developing countries in 1976 (excluding Euro-currency flows), DAC countries provided 82 per cent (0.98 per cent of their GNP), OPEC countries 16 per cent (3.28 per cent of their

GNP), and countries with centrally-planned economies 2 per cent (about 0.03 per cent of their GNP).

The main trends in the recent evolution of external resource flows to developing countries can be summarized as follows:

a) The massive increase in the dollar value of the total resource flow;

b) The emergence of OPEC countries as an important source of financial resources after 1973;

c) The upsurge in developing countries' borrowing on non-concessional terms, especially through Euro-currency markets, which were, to a large extent, fed by surplus liquidity deposited by OPEC countries;[1]

d) The corresponding growth in the share of non-concessional flows in the resource receipts of developing countries, implying a rising burden of nominal debt service. This increase in the non-concessional share is observed for each separate group of developing countries;

e) The parallel decline in the share of ODA from DAC members and multilateral organizations, notwithstanding an increase in its amount in dollars. This is the consequence of the failure of DAC Members to increase their ODA/GNP ratio, which has oscillated between 0.30 per cent and 0.36 per cent in the 1970s, with 0.33 per cent in 1976;[2]

f) The increased use by developing countries of a widening range of IMF special instruments (oil facility, compensatory financing facility) established to meet their short-term balance-of-payments deficits.

Total External Resource Receipts of Developing Countries

The volume and composition of the net resource receipts of developing countries in 1976 is summarized below:

	$ billion
I. RECEIPTS OF NON-OIL DEVELOPING COUNTRIES IN 1976	
1. *Concessional*	*17.8*
a) DAC (ODA)	9.3
b) Multilateral (mainly IDA, UN, EEC, "soft windows")	3.5
c) Other (mainly OPEC)	5.0

[1] The oil-exporting countries' aggregate payments surplus is now estimated to be about the same in real terms as the surplus run earlier by the industrialized countries. The oil-importing countries' deficit in real terms, the necessary counterpart of their intake of real resources, has not changed greatly, although its amount in dollars and the source of the underlying savings have. The OPEC surplus was $ 67 billion in 1974, $ 35 billion in 1975 and $ 44 billion in 1976.

[2] OPEC Members have made substantial purchases of IBRD bonds, but provided little ODA to multilateral financial institutions until 1976.

2. *Non-Concessional*	*41.2*
a) DAC (export credits, direct and portfolio investment, bonds)	18.9
b) Multilateral (IBRD, "hard windows")	2.4
c) Other (mainly Euromarkets and OPEC)	19.9
3. *Total*	*59.0*
a) DAC	28.2
b) Multilateral	5.9
c) Other	24.9
II. RECEIPTS OF OPEC COUNTRIES (excluding Indonesia and Nigeria; mainly non-concessional)	*6.7*
III. GRAND TOTAL	*65.7*

By and large, and notwithstanding some significant deviations, the geographical pattern of resource allocation was reasonable in that:

a) The softest part of the international resource transfer (bilateral ODA and multilateral grants and IDA-type credits) was concentrated on the poorer developing countries;

b) Resource transfers at intermediate terms, i.e. semi-concessional, government-guaranteed or otherwise supported funds, went predominantly to the middle-income developing countries, but also to other recipients where investment conditions and trade opportunities encouraged such finance;

c) Resource transfers at market terms were concentrated on recipients in higher income brackets and with more dynamic economies, i.e. those which, in the perception of the lenders, had sufficient credit standing to absorb this type of finance.

Resources for the Poorer Developing Countries

The poorer developing countries (with per capita incomes of $ 265 and below in 1975) account for 60 per cent of total non-oil LDC population. They include 39 countries with 1.2 billion people which had, in 1975, an average income of $ 150. This group of countries received in 1973-75 one-half of the total volume of concessional finance, one-tenth of non-concessional funds, and one-quarter of the total international resource flow.

Seventy-eight per cent of their total external resource receipts consisted of concessional funds (against 80 per cent in the early 1970s).

These concessional receipts represented a lower per capital amount ($ 5.2) than for the other non-oil exporting countries, but a considerably higher share of the poorer countries' GNP (3.7 per cent), imports (31.7 per cent) and investment (around one-third; however, their investments were only 11 per cent of their GNP — against 11 per cent for the other non-oil LDCs).

The figures mentioned for the group of poorer developing countries are heavily influenced by the inclusion of India. Its exclusion would show significantly higher figures for ODA receipts per capita.

Resources for the Other Non-Oil Exporting Countries

Developing countries with per capita incomes of over $ 265 benefitted from rapidly-increased international resource flows in recent years, notably those with non-concessional terms — including private investment, Euro-currency and OPEC funds. This group of countries received one-half of the total concessional resource transfer, 89 per cent of non-concessional flows and three-quarters of the total volume of international finance.

Twenty-two per cent of their total external resource receipts consisted of concessional funds. They represented a higher per capita amount ($ 7.3) than for the poorer countries (somewhat due to large ODA receipts of countries with which certain donors have special relationships) but only 0.9 per cent of their GNP, 3.8 per cent of their imports, and 4 per cent of their investments.

DEBT IMPLICATIONS OF EXTERNAL RESOURCE FLOWS

The Analytical Framework

A country's external debt is the result of its external borrowing which it has undertaken to add to its domestic sources for the use of investment and consumption. The amount of outstanding debt is merely an expression of foreign loan resources which have not yet been repaid and are thus theoretically still available for domestic use.

Since developing countries will continue to receive substantial net additions of international loan capital, their external debt will continue to rise. This consequence is inescapable but analytically has no particular significance.

Whether external resource inflows result in debt servicing problems for the borrowing countries depends, on the one hand, on the amount and terms of the borrowed funds and, on the other hand, on the recipient countries' management of their economies, notably their investment and export promotion policies. In a wider balance-of-payments context, a number of other factors, such as the import demand of their trading partners and the terms of trade, are also relevant.

The nominal value of outstanding debt, in itself or even related to other economic variables, provides little economic insight into the actual or potential debt servicing problems of developing countries. The nominal value of debt outstanding is made up of different types of debt with different "grant elements" —ranging from zero to around 90 per cent. To make the different types of debt comparable and addable they must be discounted to their present value.

The discounted present value of the debt may be interpreted as that amount through the immediate payment of which the debtor country could theoretically rid itself of its future debt service obligations. The creditor would neither be better nor worse off than had he received the service payments on schedule: the underlying assumption is that the creditor can invest the money at the same interest rate —conventionally taken as 10 per cent— which was used in discounting the nominal debt to its present value.

For example, Euro-currency debt (with virtually no grant element) has the same nominal and discounted value, the present value of IDA debt (86 per cent grant element) is 14 per cent of its nominal value, the present value of DAC/ODA debt (around 60 per cent grant element) is 40 per cent of its nominal value, etc. Very soft debt, i.e. with a high grant element, is therefore not too dissimilar to the accumulated stock of grant assistance received.

Rather than debt in itself, the economically more relevant magnitude for debt management is the debt service, which is determined by the structure and terms of the outstanding debt. However, even regarding the debt service, an important analytical distinction is that between the current (interest) cost and the amortization (repayment on principal). As long as amortization payments are rolled over through new capital inflow, they do not constitute a net charge on the debtor's balance of payments.

While borrowers naturally repay individual loans, developing countries, both separately and as a group, are not expected to reduce their overall external debt by making net repayments for some time. On the contrary, they will continue to be net recipients of external loans which will add to their existing debt.

Whether foreign debt benefits or impoverishes the borrowing country depends fundamentally on the cost and uses of resources. If the borrower has used the foreign resources for investment and if the marginal cost of borrowings is less than the marginal productivity of the total investment program (in terms of foreign exchange), the recipient stands to benefit from the external capital inflow. This analysis also holds true with respect to the relationship between the current cost on accumulated debt and the productivity of investment. For developing countries on average, the current (interest) cost of their outstanding disbursed debt is still relatively low —some 6 per cent—, especially when considering inflation. For poorer developing countries the current interest cost of their debt is around 4 per cent.

Genuine debt servicing problems[3] will therefore arise if external resources are consumed (e.g. by displacing domestic savings or meeting current import needs) rather than invested, or if the recipient's investment program yields a marginal return which is less than the marginal cost of borrowing. In theory this means that the most expensive loan should have a lower interest rate than the rate of return of the least productive project. In practice, however, rates of return can usually not be precisely measured and considerations other than cost/benefit ones often determine borrowing decisions and investment programs.

Cost/benefit analyses rest, at least implicitly, on the assumption that external capital is invested, rather than consumed. What actually happens, however, is that many developing country borrowers —under economic, social or political pressure to meet basic needs of their populations, as well as possibly due to imprudent overall economic management— use, directly or indirectly, a substantial portion of their net external capital inflow for consumption, i.e. for purposes which have no immediate productive return out of which the future debt service could be paid.

Borrowing for consumption is, of course, quite legitimate for countries with important assets or a sure source of future earning power. In contrast, poor countries, with practically no possibility of compressing living standards, easily fall into a vicious circle: if, in the absence of sufficient grant assistance, they have to borrow for consumption, they may have to borrow later to service the debt.

Temporary (as distinct from fundamental cost/benefit) debt service problems may occur if the recipient is unable to roll over amortization payments through new borrowing (e.g. due to the creditors' perception of its creditworthiness, banks' exposure limits, crowding out by other borrowers, or shortage of loanable funds), or if very large gross borrowing is required to secure modest net loan inflows, or if debt service payments are "bunched" together in certain years.

The extent of roll-over problems can be measured by the share of the outstanding debt which a debtor country has to re-borrow each year just to maintain the level of its outstanding debt. This share is determined by the average maturity (m) of the outstanding debt and equals 2: (m+1). For example, if the outstanding debt is composed

[3] A typology of debt problems is contained in the OECD, *Debt Problems of Developing Countries,* Paris, 1974.

of five-year loans, the debtor must annually re-borrow 33 per cent of its debt just to stay in the same place; this share is 18.2 per cent for a ten-year debt, 12.5 per cent for a fifteen-year debt, 9.5 per cent for a twenty-year debt, etc.

For a growing number of developing countries, bunching and roll-over problems may indeed become a major source of temporary debt servicing difficulties. These kinds of problem are behind various proposals to encourage bilateral creditors to extend anticipatory debt relief by lengthening maturities or to establish a new refinancing facility to be funded by OECD and OPEC countries. Stretching out amortization periods would help debtor countries in their debt management during the coming years. However, interest rates charged on rescheduled debt service would have to be high enough to maintain the present value of future debt service payments, or creditors would lose money.

Although the international discussion is full of references to developing countries' debt problems, it is not possible to devise single or composite statistical indicators which can unequivocally indicate the presence or absence of an acute or approaching debt crisis. While such aspects, as a country's growth momentum, balance-of-payments position, debt service ratio and reserve level, provide useful pointers, all the relevant data are usually not available early and completely enough, and it is difficult to combine them in a coherent framework. Moreover, non-economic phenomena, which cannot be captured by statistical data, are often of decisive importance for a country's credit standing which, in turn, determines its possibility of attracting additional external resources to roll over its debt.

Much of what is currently referred to as "debt problems" are essentially balance-of-payments problems which are somewhat arbitrarily associated with debt service payments since these constitute a contractually-fixed and therefore rigid element in the balance of payments. To meet such balance-of-payments problems, the whole range of balance-of-payment management comes into play, including efforts to increase exports and repatriate export earnings, reduce non-essential imports, secure external resources, improve creditworthiness, etc. Only if a country has exhausted these possibilities does its debt service payments become a residual, on which its future import capacity and growth prospects may hinge. It is this link which developing countries emphasize when they seek debt relief. Some of them, especially when they become the victims of internal or external events beyond their control, may indeed face the predicament of either having to reduce their development objectives beneath minimum acceptable levels or recognizing their inability to service their debt on schedule.

The economic events after the rise in oil price provide a good example of such a predicament. Non-oil-exporting countries had to absorb the shock of higher import prices in a situation where the economic recession in OECD countries deprived them of adequate export earnings. Given their need to safeguard at least a minimum growth momentum and the relatively narrow scope for immediate internal adjustment measures,[4] these countries borrowed heavily from external sources to balance their external account. They are now saddled with high contractual debt servicing obligations (over $100 billion for the non-oil-exporting developing countries during the 1978-1980 period), a continued pressure to grow and to satisfy the basic needs of their people, uncertain export earnings, and, for some countries, protracted difficulties of economic adjustment to the changed international situation.

While developing countries must, of course, assume the prime responsibility of managing their economies and their debt, the international community must face up to the challenge to maintain a healthy international economic environment which supports the export earnings of developing countries, to provide external capital in adequate volumes and conditions, to seek ways and means of helping them in their debt management, and to provide debt relief in cases which leave no other solution.

The Present Debt Situation, Recent Evolution and Future Prospects

It must be stated at the outset that any analysis of the debt situation of developing countries in aggregate terms is of very limited use for policy guidance. Disaggregation at least by different groups of countries, and ideally on a country by country basis, is needed to do justice to the great diversity of different debt situations. Still, to gain an overall view, this section starts with a general description of the debt situation of developing countries as a group.

Taking all developing countries together, their disbursed debt grew from $48 billion to $207 billion during the period 1967 to 1976, and their debt service from $6 billion to $32 billion. The average annual growth rate of their debt service was around 15 per cent until 1972, it rose to around 25 per cent during the period 1973-1976, and is expected to return to about 15 per cent by 1978.[5]

For the non-oil-exporting developing countries, their total disbursed debt rose from $42 billion in 1967 to $172 billion in 1976, and their

[4] The adjustment process can be extremely painful and involve high political, economic and social costs. Examples include the riots in Cairo following the IMF's economic plan for Egypt in early 1977 and in Peru, following the announcement of the new economic plan which was to pave the way for further external borrowing.

[5] The debt figures in this section are drawn from the Report by the Chairman of the Development Assistance Committee of the OECD: *Development Cooperation 1977 Review,* Paris, 1977. This report also contains a note on sources and methods.

debt service from \$5.8 billion to \$25.6 billion. About two-thirds of the service was made up of amortization payments (which were more than rolled over through new borrowing), and one-third of interest payments.

The rise in the nominal value of developing countries' debt service, however, looks much less dramatic if seen in the light of inflation which has significantly eroded the real value of their debt and debt service (as it has, of course, also eroded the real value of their external reserves which have also risen rapidly in nominal terms). It must be kept in mind, on the other hand, that it is difficult to measure precisely the complex effect of inflation on the debt burden.

Still, the fact remains that the share of debt service in the GNP of non-oil-exporting developing countries has roughly doubled over the past ten years. In 1976, their ratio of debt service to GNP was about 3 per cent; it was 1.4 per cent for the poorer developing countries.

Since the mid-1960s, the total debt and debt service of developing countries has been highly concentrated on a relatively small number of debtors. In 1975 and 1976, about one-third of the total LDC debt service was concentrated on four countries (Brazil, Mexico, Iran, Yugoslavia), and over one-half on ten countries (in addition to those four countries: Algeria, Argentina, India, Spain, Korea and Israel). Detailed data on this pattern are provided in Table 1. Comparing, for these countries, the annual average rate of growth of their debt service and export earnings during the period 1972 (the last year before the oil crisis) to 1976, it will be seen that for these countries together (which capture over 70 percent of the total LDC debt service) the growth in their total export earnings was roughly the same as that of their debt service. In spite this pattern, for the 20 largest debtors, taken as a group, there are significant differences among the individual countries, as demonstrated by the various data and indicators shown in Table 1.

Especially in 1976, the debt evolution was also influenced by the fact that some of the developing countries with more dynamic economies borrowed more than was necessary to cover their current account deficits. The reason was that they wished to build up their reserves (which increased by \$11 billion for non-oil-exporting developing countries in 1976, of which Brazil alone accounted for \$2.5 billion). Apart from providing a cushion for future import needs, they wished to improve their creditworthiness for future access to foreign capital markets. Some of them also wished to protect themselves against possible difficulties in obtaining adequate volumes of private bank loans in case the banking community, due to high exposure and official warnings, might be unwilling to substantially increase new net

Table 1

DISBURSED DEBT AT END-1975 AND DEBT SERVICE DURING 1976 OF THE LARGEST DEBTOR COUNTRIES, AND RATES OF GROWTH OF RELATED ECONOMIC VARIABLES

Country	*Indebtedness*		*Average Annual Rate of Growth 1972-76*				
	Debt end 1975	*Debt service 1976 (p)*	*Debt service*	*Exports of goods and all services*	*Total net inflow*	*Inter-national reserves*	*GNP*
	$ billion		*%*				
1. Brazil	21.2	4.56	33.6	25.5	23.8	11.8	7.4
2. Mexico	14.3	2.72	22.9	16.8	35.1	9.1	4.6
3. Iran	5.9	1.76	14.9	50.0	9.8	74.2	15.9
4. Yugoslavia	5.5	1.39	51.9	22.7	28.5	29.4	5.9
5. Spain	4.5	1.19	31.2	16.3	23.9	1.3	4.1
6. Algeria	7.1	1.18	45.3	40.6	45.6	41.7	8.4
7. Argentina	4.0	1.16	19.2	19.1	23.6	36.4	2.0
8. Korea (Rep. of)	5.8	1.01	21.1	42.4	23.4	41.4	12.0
9. India	11.8	0.90	8.2	20.4	23.6	27.0	4.8
10. Israel	5.9	0.87	16.6	16.5	17.6	3.0	3.6
11. Chile	3.6	0.86	55.1	23.6	— 2.0	32.3	—3.0
12. Greece	3.6	0.78	31.9	21.0	87.7	— 2.7	3.6
13. Indonesia	8.9	0.78	48.5	47.9	42.2	27.1	6.1
14. Egypt	5.1	0.74	20.3	34.4	151.5	25.0	3.9
15. Peru	3.1	0.55	19.9	10.9	33.3	— 9.1	5.3
16. Philippines	2.7	0.52	35.1	21.7	46.2	31.3	7.0
17. Taiwan	2.4	0.47	28.8	28.3	— 0.1	11.5	6.5
18. Colombia	2.5	0.37	20.7	24.6	— 1.0	37.4	6.5
19. Turkey	3.5	0.37	9.9	17.9	15.8	— 5.4	7.2
20. Pakistan	5.5	0.34	19.3	21.7	21.3	17.3	4.9
Total 20 countries	126.9	22.52	26.3	27.1	28.7	19.4	6.1

lending in future years. Several countries also merely changed the structure of their total external liabilities by replacing foreign-held equity by debt or by replacing short-term debt (not covered by debt statistics) by longer-term debt.

With respect to the *creditor sources* of the developing countries' debt, there has been a decrease in the share of DAC countries in the LDC total debt service from 85 per cent in 1967 to about 70 per cent in 1976, while the share of international financial markets (essentially Euro-currency debt) rose from virtually zero to 16 per cent during this period (see Table 2).

Table 2

DEBT AND DEBT SERVICE BY CREDITOR SOURCES

Disbursed Debt	*$ billion* 1967	1970	1975	1976
— DAC countries	38.6	57.9	110.2	127.1
(ODA)	(15.9)	(22.6)	(33.8)	(37.1)
— International financial markets	—	0.5	24.2	33.5
— International organizations	5.8	8.1	19.8	23.6
— Other	4.0	6.4	18.7	22.6
Total	48.4	72.9	172.9	206.8

Debt Service	*$ billion* 1967	1970	1975	1976
— DAC countries	5.3	7.6	18.6	22.6
(ODA)	(1.0)	(1.3)	(1.9)	(2.1)
— International financial markets	—	—	3.6	5.0
— International organizations	0.6	0.8	1.6	1.8
— Other	0.3	0.6	2.2	2.6
Total	6.2	9.0	26.0	32.0

With regard to their *terms*, the developing countries' debt and debt service is composed of four main categories: (i) ODA and IDA-type debt; (ii) debt arising from non-concessional lending by multilateral institutions; (iii) export credit debt (partly subsidized); (iv) private debt (market terms). The evolution of these types of debt is shown in Table 3. The most striking change in the composition of the total debt service over the past ten years is the drop of ODA/IDA-type debt from 16 to 8 per cent and the increase in private debt from 23 to 43 per cent.

Table 3

DEBT AND SERVICE BY TERMS CATEGORIES

Disbursed Debt	*$ billion*			
	1967	*1970*	*1975*	*1976*
ODA/IDA-type	20	29	52	57
Other multilateral	4	5	12	13
Export credits	17	26	49	62
Private	7	13	60	75
Total	48	73	173	207

Debt Service	*$ billion*			
	1967	*1970*	*1975*	*1976*
ODA/IDA-type	1.0	1.4	2.2	2.6
Other multilateral	0.6	0.8	1.6	1.7
Export credits	3.2	4.9	11.3	14.0
Private	1.4	1.9	10.9	13.7
Total	6.2	9.0	26.0	32.0

As an intermediate step between showing debt figures for developing countries as a group and a country by country analysis, the distribution by income groups provides some initial insights. (See Table 4.)

Table 4

DEBT AND DEBT SERVICE BY INCOME GROUPS

Disbursed Debt	*$ billion*			
	1967	*1974*	*1975*	*1976*
LLDCS	2	5	7	10
Poorer LDCS	11	24	28	31
Non-oil LDCS	42	113	144	172
Total LDCS	48	137	173	207

Debt Service	*$ billion*			
	1967	*1974*	*1975*	*1976*
LLDCS	0.1	0.5	0.5	0.6
Poorer LDCS	0.8	1.7	2.1	2.3
Non-oil LDCS	5.8	15.8	20.8	25.6
Total LDCS	6.2	19.8	26.0	32.0

Generally speaking, debt and debt service is reasonably distributed geographically in that it shows a strong concentration on the relatively more advanced developing countries. This is particularly true for commercial debt, export credits, bank and bond lending, and the service on such debt. However, even for the poorer and poorest developing countries, the largest burden of servicing their debt stems from non-DAC/ODA lending.

Despite the shocks of the oil crisis and other international financial disturbances, the relative shares of the different income groups in the total LDC indebtedness have remained relatively stable. The recent major deviations from past distributional patterns have been a decrease of poorer countries' and an increase of OPEC countries' debt service in the total LDC debt servicing obligations.

The Role of Private Debt

The most noteworthy element in the recent debt evolution was the dramatic upsurge in commercial borrowing, especially of the middle-income developing countries, which has led to a drastic rise in the share of commercial debt and commercial debt service in the total developing countries' indebtedness. It has also resulted in a deterioration of the debt burden of a growing number of developing countries in terms of the maturity structure of their total external debt. However, the current cost of debt servicing in real terms has not increased, given the depressed level of interest rates in international commercial lending.

A significant number of developing countries have had recourse to substantial amounts of private bank borrowing, initially to meet the severe strains on their balance of payments, caused by the quantum jump in oil prices, world recession and deteriorated terms of trade, and, more recently, to refinance their commercial debt. Over 60 countries were able to attract Euro-currency credits, of which major borrowers were Brazil, Mexico, Spain, Iran, Algeria, Indonesia, etc.

Some of the borrowing countries have by now reached a situation in which they may be unable to secure major net additions to their already outstanding private debt. Moreover, some of the major international banks have reached what they consider reasonable, though quite flexible, exposure limits with respect to certain borrowers. In contrast to export credit institutions, private banks cannot, for non-export-related credits, have recourse to official guarantees from the government of the country in which they are domiciled, in case of default — a fact which sharpens their perception of the borrower's creditworthiness.

The precarious risk exposure of some international private banks has recently come to public notice as a result of a number of difficulties. Although these concerned mainly real estate, tankers, foreign exchange speculation and municipal financing and were thus unrelated to the banks' lending exposure to developing country borrowers, they have spread some nervousness in international banking circles and led to official warnings.

The international banking community has so far shown an effective response in acting as financial intermediaries between the OPEC surpluses and the borrowing needs of developing (and some developed) countries. Banks have found lending to developing countries generally more profitable than lending to developed countries, given the interest rate differentials, fees and commissions which they could charge. They have willingly assumed the risks of lending and credit evaluation which OPEC countries have shifted upon them. There is, however, a growing feeling among bankers who are already heavily involved in lending to developing countries that they cannot expand their role as financial intermediaries at an undiminished pace.

Banks themselves have taken measures to diversify their portfolios with increased concentration on borrowers with well-managed economies. Syndication through Euro-currency credits has also helped markedly to spread the lending risk among a large number of participating banks. Moreover, while individual banks may have a large exposure vis-à-vis individual developing countries, the banking community at large in OECD countries is only marginally involved in lending to developing countries. It should also be noted that developing country borrowers have so far exhibited an excellent debt servicing record vis-à-vis private bank. When difficulties arose, private bank debt was usually serviced on schedule, rather than renegotiated. In fact, the banks' loan loss experience for international lending has been considerably better than for domestic lending.

It is also interesting to note that several developing countries preferred to have recourse to private bank lending rather than availing themselves of the IMF facilities. While developing countries as a group drew more than half of their gold tranche, they drew only a small portion of their higher credit tranches and extended facilities. The reason for their preference for bank credits was mainly the relative ease with which they can be obtained and the intention to avoid the stringent conditions of IMF assistance. More recently, and in the future, however, banks are relying increasingly on IMF stand-by arrangements for their own refinancing operations. Such arrangements provide for specific domestic economic and external adjustment policies designed to strengthen the debtor's creditworthiness and debt servicing capacity.

Debt Reorganization

It is important to recall that in spite of the mounting debt of developing countries, their debt servicing record has on the whole been quite satisfactory. Notwithstanding this general pattern, from 1956 to date, twelve developing countries sought and received debt relief in an official multilateral context, involving 37 debt renegotiations and a total amount of over $ 9 billion of rescheduled debt service. In addition, some 60 developing countries benefitted from bilateral debt relief extended by DAC governments, involving a total amount of over $ 1.2 billion of renegotiated debt service, of which a quarter was cancelled and the remainder rescheduled, in roughly equal parts, at ODA and non-ODA conditions.

In relation to the total debt service paid on schedule by all developing country borrowers, the amount of rescheduled debt service was small and only a minor portion of this amount involved losses for the creditors. However, for those developing countries which did benefit from debt relief —notably the poorer ones— it constituted a significant alleviation of their debt service burden.

Future prospects of the debt situation of developing countries cannot be meaningfully addressed in aggregate terms. Notwithstanding certain similar features of countries within broad categories (not necessarily income groups), individual country positions are too different to permit generalizations about their future posture. Only a country by country analysis can lead to operationally useful policy formulations.

Future increases in debt of developing countries will critically depend on the evolution of their current account deficits and on the amount and type of external finance which they will be able to attract to meet their external capital needs.

To a very large extent, the debt servicing obligations of developing countries in the next few years are already determined by the level and composition of the presently outstanding debt. Assuming a modest increase in their current account deficits until 1980, the total debt of non-oil-exporting developing countries is projected to grow by 15 per cent annually during the period from 1977 to 1980. Their debt service is expected to rise by 20 per cent in 1977 and by 15 per cent per year until 1980.

The ability of developing countries to meet their increasing debt service obligations will depend critically on their general economic performance. While capital inflow is important to accelerate their economic growth and to cushion adjustment difficulties, it cannot, in the long run, substitute for export earnings.

The export earnings of developing countries depend, of course, on the total import demand of their trading partners: OECD, OPEC, developing and centrally-planned countries. Given this diversity of import markets, and their changing pattern, it is difficult to establish a direct link between the rate of OECD countries' economic growth and the rate of growth of developing countries' exports. OECD imports from non-oil-exporting developing countries are estimated to grow in 1977 by 11 per cent in volume and by over 20 per cent in value. These growth rates will be less in 1978.

It must also be kept in mind that the slow rate of expansion in the OECD area will continue to leave more capital available for LDC borrowing and depress the prices of OECD exports, thus contributing further to the recent improvement of the terms of trade of developing countries.

After the rapid increase in commercial borrowing during the last few years, it now seems that the basic debt structure of non-oil developing countries is tending to stabilize: the relative shares of (i) official bilateral and multilateral debt; (ii) private market debt; and (iii) total export credit debt, are now roughly equal. This pattern is expected to continue in the near future since the net lending by these three sources is also likely to continue in roughly equal amounts. Given the different terms of these three creditor sources, however, it is clear that private banks will continue to capture a higher share of the debt service of developing countries.

Most of the largest debtor countries are those with dynamic economies and rapid growth of GNP and exports. They have been able to attract increasing amounts of international capital and to use it productively for investment, thus maintaining their debt servicing capacity. It is expected that, on the whole, these countries will continue to maintain their growth and their credit standing. They should therefore be able, as in the past, to secure and absorb significant volumes of international capital at market terms.

While capital availability and its current cost are thus not likely to constitute a major constraint for these fast-growing countries, they —as indeed all developing country borrowers— need longer maturities to inject a suitable time horizon into their debt management policies.

Poorer developing countries face a radically different set of development problems: they are unable to produce rapid growth, some have little export growth potential, and all are under pressure to satisfy the basic human needs of their people.

Many of these countries are long-haul cases and depend essentially on aid for their external capital requirements. Donors are expected to increase their aid volume and concentrate it on the poorer countries. While more aid —whether in the form of new commitments or selective debt relief— is extremely important for these countries, for most of them it will not immediately result in significantly higher GNP growth rates. This would require an improvement in their ability to use resources more productively so that additional aid can be efficiently translated into investment and growth. This will only be possible if higher aid receipts are accompanied by sustained domestic efforts to raise savings and pursue effective economic policies.

The international banking community will continue to play a major role as capital suppliers for more dynamic developing countries, although their net exposure is likely to grow at a lower rate than in the past. In the years to come, banks will continue to be motivated in their lending operations essentially by profit and risk considerations.

It is expected that banks will continue to find loans to developing countries profitable, and in many cases more profitable than other lending because of interest rate differentials, fees and commissions which the borrowers are willing to pay.

On the other hand, banks are becoming increasingly aware of the lending risk which they are taking. While they have considerably improved the creditworthiness analysis of their potential borrowers, this is an area where much uncertainty still prevails. While such data, as the borrowing country's growth performance, savings record, reserve level, balance-of-payments position and debt servicing obligations are indispensable, judgmental factors and impressionistic elements inevitably enter into the picture. Private banks now also make more use of information which is being made available to them by the World Bank, the IMF and the regional development banks and will increasingly rely on stand-by arrangements between the IMF and their borrowers.

On the whole, there is every indication that international private banks will at least roll over the borrowers' repayments on past loans — short of a collapse in confidence, a political crisis or other severe disturbances. It is also expected that developing country borrowers with good credit standing will not be crowded out by other borrowers with respect to new net lending from banks to developing countries, both taken as a group. While some of the banks with heavy involvement in LDC lending may wish to curb their future exposure to them, other banks are appearing as new lenders. Similarly, some developing countries with large private debt may wish to curtail a further increase in such debt, but other developing countries are appearing as new borrowers.

Apart from bank lending, bonds are a growing source of private capital for developing countries. Increasingly, more dynamic developing countries seek a larger access to the bond market with the objective of gaining longer maturities. Their success in securing a larger amount of bond capital depends critically on their credit standing, given the fact that bond investors' perception of the borrowers' credit-worthiness is traditionally much more conservative than that of private banks.

BASIC ATTITUDES OF CREDITOR COUNTRIES TOWARDS DEBT PROBLEMS OF DEVELOPING COUNTRIES

In preparation for the UNCTAD Debt Group meetings in 1974 and 1975, OECD countries developed a consensus on their basic attitudes with respect to:

— the economic context in which the significance of debt service payments is to be evaluated;
— avoiding debt servicing difficulties;
— remedial measures.

Most of these attitudes have found their way into the agreed report by the UNCTAD Debt Group.[6] Creditor views were further elaborated at the CIEC. This section restates some of the main elements of creditors' attitudes regarding the avoidance and meeting of debt servicing problems.

Avoidance of Debt Servicing Difficulties

As part of their responsibility for their economic development in general, developing countries themselves have the prime role to play in pursuing financial and economic policies which avoid the emergence of acute debt servicing problems. In this task, they are assisted by bilateral donors and international financial agencies, notably the IMF.

On the other hand, creditor countries should also contribute to the avoidance of debt servicing difficulties by preserving a healthy international economic environment which permits a continued growth in developing countries' export earnings and access to long-term international capital. For poorer developing countries, they should provide increased aid inflows to help them achieve reasonable development objectives.

The key to sound debt management is to ensure consistency between the country's macro-economic growth objectives, the resulting current account deficit, and the amount and terms of capital inflow which is available to assure the servicing of old debt and provide the necessary net addition of foreign resources. This often means in practice the acceptance of quantitative limitations on new external borrowing in certain maturity brackets and interest levels and the adjustment of the related economic variables —in the last analysis the GNP growth rate— accordingly.

Effective debt management rests, of course, on the basic strength of

[6] *Debt Problems of Developing Countries,* Report of the Ad Hoc Group of Government Experts, UNCTAD, United Nations, 1975.

the debtor country's domestic economy, notably its ability to generate savings for investment, to use investment capital efficiently for growth,[7] to compress non-essential imports and to increase (and repatriate) export earnings. External factors —especially the availability of foreign capital and trade opportunities— also have a powerful influence on the countries's debt management policies.

Apart from pursuing effective economic and financial policies, developing countries can considerably strengthen their debt management by a number of measures directly designed to assure control and surveillance of their external debt. These measures include screening procedures to ascertain that foreign loans are only contracted for high priority projects, as well as prior authorization procedures for public, and at least central registration procedures for private, loans taken up. Such a system of central debt recording enables a country to run a continuous check of its overall indebtedness and service obligations. Knowledge of the amount and terms of its total debt also permits projections of future debt service payments and may indicate the need for corrective action to be taken before acute difficulties, e.g. due to "bunching", arise.

Meeting Debt Servicing Problems

The basic attitudes of creditor countries which have guided their past action towards debt relief, and will probably do so in the future, can be summarised as follows.

Balance-of-payments problems of developing countries should be met essentially by sound balance-of-payments policies as well as by the adequate provision of new resource inflows, including IMF facilities, rather than by debt relief. In the absence of fundamental remedies, debt relief may be no more than a palliative. Debt relief should therefore be a highly exceptional measure of last resort to enable the debtor country to continue its debt service payments without a serious disruption of its growth momentum.

Avoidance of debt renegotiation is in the interest of both creditor and debtor countries. Capital providers are averse to see the volume and allocation of their new resource flows determined by the accidental patterns of the debt structure of their recipients, and most donors do not view debt relief as a normal form of aid. For the developing countries, it is important to avoid debt renegotiation in order to safeguard their credit standing and the inflow of future external resources.

[7] With respect to effective project identification and preparation, developing countries rely heavily on the assistance of their bilateral donors, the World Bank and the regional development banks.

Given the wide diversity of debt situations among developing countries, even within the same income groups, calling for different types of remedial action, each case has to be examined on its merits, rather than on the basis of generally applicable criteria with respect to the eligibility and modality for debt relief.[8]

Debt reorganizations should be conducted in the existing multilateral fora[9] with the intention of concluding agreements as speedily as possible in order to avoid prolonged uncertainties regarding foreign exchange availabilities:

a) "Creditor Clubs" to meet acute debt crisis cases, involving default or imminent default on debt servicing, serious balance-of-payments difficulties in which debt servicing payments play a major role, and a situation which cannot be remedied, in the short term, by appropriate internal and external adjustment measures which the debtor country can reasonably be expected to take;

b) "Aid Groups" to meet a situation of a longer-term nature for countries not facing actual or imminent default but structural, financial and transfer of resources problems, with scope for timely and appropriate internal and external adjustment measures.

The modalities of debt relief (including the type of debt eligible for reorganization, the consolidation period, the cash quota, and the terms) should take into account the anticipated long-term debt servicing capacity of the debtor country and the legitimate interests of the creditors.

Debt relief should be accompanied by an effective stabilization program of the debtor country, preferably in the context of an IMF stand-by undertaking.

Debt relief should be based on the principle of non-discrimination and equality among all bilateral creditor countries; however, creditors with minor debts, which frequently include developing countries, would generally be excluded from multilateral debt renegotiations. Debt relief sought by the debtor country from its private creditors, notably banks, should be on a similar basis as official debt relief.

[8] Notwithstanding this case-by-case approach, a number of DAC Members have undertaken to cancel the ODA debt service of a group of the least-developed (and some poorer) countries — essentially with the objective of retroactively modifying their past terms of ODA lending to these countries.

[9] Described in UNCTAD "Present Institutional Arrangements for Debt Renegotiation", TD/B/C.3/AC.8/13; 26th February, 1975.

Causes of the External Indebtedness of the Third World Countries

Pedro Paz

The author is Professor of Economics at the Universidad Nacional Autónoma de México (Mexico City).

VARIOUS EXPLANATIONS OF THE EXTERNAL DEBT

The determination of the causes of external indebtedness is an arduous and complex task, and undoubtedly any attempt at an explanation will be subject to controversy. The problem can be examined from the most diverse angles, and from the resulting elucidation, a varied range of objectives can be pursued. Moreover, whatever approach is adopted will come laden with an underlying theoretical and ideological content.

It would be idle to insist upon the relevance and significance of this problem. Its repercussions grow sharper daily, and there is a growing consciousness, public and private, national and international, concerning the need to seek integral and profound solutions to the growing indebtedness; and that, furthermore, emergency solutions can only provide a breathing space. It is necessary to re-examine the usual measures taken in these cases, such as: *1*) renegotiations, the result of which is further indebtedness and greater financial cost; *2*) devaluations and recessionary policies in order to lessen the trade deficit; *3*) requests for credit that imply self-submission to financial disciplines which many times compromise the internal flexibility of economic policy; and, in general, a partial and short-term view of the problem, where all that is achieved is the postponement of the financial effects of a more complex process.

At the same time, finding a profound explanation of the growing debt of the Third World will permit us to think creatively in searching for solutions that not only are of interest to the poorest and most indebted countries of the planet, but also to the large creditor countries. The situation should be a source of preoccupation and of serious questioning of the customary credit practices used in the international financial markets. It would be appropriate to attempt a revision both of the ways in which, up to now, credit of all kinds has been granted, and of the perspectives and interpretations concerning this intricate problem.

Much has been written about the characteristics of the debt (volume, periods, financial cost, origin, destination, weight of the debt services on the balance of payments, evolution of the debt, etc.). A great part of this effort, which is in itself important, is carried out by the principal international organizations (the World Bank, IMF, IDB, etc.) and by the various specialized organizations of the United Nations (UNCTAD, ECLA, etc.). In general it can be maintained that the literature of these organizations adequately describes the nature and magnitude of the indebtedness problem, and consequently constitutes a good point of departure for research into the causes of the external debt. But, these are diagnoses which, in drawing attention to the debt problem, have always done so with a limited analytical perspective.

It is appropriate to indicate the differences of approach between the studies made by UNCTAD and ECLA, on the one hand, and those made by the IMF and the World Bank, on the other. In the documents issued by UNCTAD, one finds above all a continuous effort to relate the problem of external indebtedness to the problems of development within the debtor nations. The concern of this UN agency is directed towards finding solutions that result in benefits for the developing countries: proposing longer payment periods, longer grace periods, lower financial costs for credit and renegotiations of the debt in which the readjustments of the balance of payments problems do not necessarily imply recession or the postponement of investments oriented towards economic development.

Thus, for example, UNCTAD maintains that "... The perspectives for the developing countries are influenced by the course of economic events in the developed countries with a market economy. A slowing down of the rhythm of economic activity in these economies would probably cause a decrease in the prices of a great number of primary products which, in turn, would lower the income derived from exports in many of the developing countries. In such a situation the debt-servicing problem in many of the developing countries would be aggravated ...", and it repeats, "... The difficulties of debt-servicing must be examined in the context of the development objectives of the developing countries, at the same time protecting the legitimate interests of the creditor nations ...".[1]

In contrast, the studies of the World Bank and the IMF fundamentally reveal and express the views of the creditor nations. In general, the stabilization policies advocated by the IMF relegate the concern for development to second place. Furthermore, an unequal treatment for developed and developing countries can be perceived.[2]

[1] See UNCTAD, *Debt Problems of Developing Countries,* New York, TD/B/545/ Rev. 1 N. Y., 1975, and the list of documents included in Annex II of this work.

[2] Only as an example, we may recall the persistent balance of payments deficit of the United States, which was not considered a "fundamental disequilibrium" in its balance of payments; consequently, its process of adjustment did not follow the rules to which the IMF and the World Bank ask the developing countries to conform.

Likewise, in recent works by the World Bank, one notes an obvious effort to demonstrate that the problem of the growing indebtedness of the developing countries has not, in fact, become more acute, that the dead-lines for payment have not been appreciably cut, that the interest burden has not increased, that world inflation significantly reduces the real cost of the debt (which results in a redistribution of income from the creditor countries to the debtor nations), etc. Apart from the partial and biased treatment given to the figures in the detailing of the indicators, this approach expresses the views of the creditor or capital-exporting nations.[3]

In various of the studies mentioned it is argued that the increase in the debt reflects the expansion of international trade, the deficit of the trade and payments balance, the deterioration of the terms of trade, the loss of dynamism of the primary exports from the developing countries, the over-valuation of the currencies used, the fiscal deficit and inflationary pressures. These elements then would function as *the causes of the growing indebtedness.* From an analytical point of view, the fall in the growth rate of the demand for primary exports, the fiscal deficit lessened by external financing, the inflation and over-valuation of the currency used together with the deterioration in the terms of trade, would explain the tendency towards the growing trade and payments deficit; hence, this deficit would be the main explanatory factor in the increase of the external indebtedness. This type of explanation, although it reflects real factors that are behind the growing indebtedness, is insufficient to obtain a global understanding of the functioning of the underdeveloped economies which become indebted; at the same time, it leaves out other essential aspects of the explanation of the external indebtedness.

In the view of ECLA, the tendency to external disequilibrium and the deterioration in the terms of trade are articulated within the global concept of Center-Periphery. ECLA understands that between the center and the periphery there is a basic difference in economic structure which in turn creates a special type of trade between both parts of the world economy. In the center there exists a diversified and integrated economic structure, in contrast to a specialized and dual structure in the periphery. Thus, the center bases its exportations in a wide range of manufactured products and the periphery in just a few primary products (foodstuffs and raw materials).

Along with this, the fruits of technological progress are concentrated in the center owing to this structural difference; and in turn, the working of the mechanism of the deterioration of the terms of trade reinforces such concentration. In this context, the deterioration in the terms

[3] World Bank, *External Debt of Developing Countries,* February 28th, 1977.

of trade is explained by the wage-differential between the center and the periphery, by the productivity differences in both poles and by the difference in the income elasticity of demand for imports from the center and the periphery. Inserted in this center-periphery system, the peripheral countries do not manage to overcome their primary and dual character, and they are confronted with a tendency to external disequilibrium that impels upon them a spontaneous process of industrialization. This situation results in a growing differentiation in productivity and income levels between the center and the periphery and a concentration in the center of the fruits of technical progress.

As can be seen, in the ECLA conception the problems of the deficits in the trade and payments balance, and consequently those of external indebtedness, are conceptually integrated in an overall explanation and linked to a general interpretation of the problem of underdevelopment. It contrasts with other analyses, in which the external debt is examined in terms of monetary and financial variables, abstracting from the particular characteristics that the problem assumes in different countries in accordance with their insertion in, and role within, the world economy.

However, the various ECLA theses have not always been sufficiently close to reality. For example, ECLA postulates that the function of foreign capital is to remedy the shortage of internal savings, to decrease the external disequilibrium and to be, initially, only a dynamising element of the economy so as to guarantee a certain growth rate of the national product. In various Latin American countries, in recent years, it can be verified that the expansion of foreign capital fundamentally rests upon the use of internal savings, and that many times its activity is a significant factor in the commercial deficit and in the external strangulation of the economy. Further, its growing capacity to capture the internal market inhibits the expansion of private domestic investment.[4]

There also exists a literature that conceives the export of capital from the developed countries as "aid" in the development of the receiving countries. Although it is not relevant to discuss, in this paper, the theoretical and ideological implications of the very concept of "aid", it must be pointed out that in such a conception only the beneficial nature of capital exports is emphasized. Hence, the entrance of capital would signify an increase in the total saving and consequently in investment, the incorporation of technical progress, an acceleration in the rate of economic growth, a decrease in unemployment, an expansion

[4] This situation is partially recognized in studies which point out that external finance cannot be considered as a net addition to domestic saving or capital formation. But this analysis principally refers to the relations between domestic and external saving without going into the economic repercussions of the growing presence of foreign capital.

in the rate of economic growth, a decrease in unemployment, an expansion in the social services to the population, etc. In short, the incorporation of foreign capital would be the basic element in overcoming the problems of underdevelopment. This partial and biased view of the problem has lost its force.

This brief account of the approaches that attempt to explain the causes of the external debt suggests some of the obstacles to achieving a total view of the problem. From here on, therefore, an attempt will be made to reformulate the analysis of the external debt. This reformulation is based on the particular kind of commercial insertion imposed upon the Third World countries by the world market; in a characterization of the dependent functioning of these countries; in the tendency towards a growing availability of savings in the international financial markets; and in the absence, in the developing countries, of an adequate policy of internal and external financing.

This view implies analyzing the external debt in the context of the economic development of the debtor countries. Independently of the level of advance reached in the industrialization and modernization process, the debtor countries are principally underdeveloped and the creditor countries are basically developed. This perspective is also present in the works of the ECLA and principally of UNCTAD, and even in the measures that the World Bank takes for those countries with the lowest level of development.

The conventional explanation that the problem of the external debt is generated by the trade and public finance gap is incorporated in a scheme of analysis which views the trade gap as the result of the tendencies in the commercial relations between the developing and developed countries; and in turn, the public finance gap is the product of the functioning of an economic structure where the public sector is only a protagonist, although doubtless an important one, in a complex process of underdevelopment. To these two explanatory factors is added the "greater availability" of credit from the private international capital market for the developing countries with medium and high incomes. Finally, reference is made to the lack of a long-term strategy of external finance, in contrast to a short-run view which springs from the immediate financial problems that must be resolved when the balance of payments deficit becomes critical and urgent financial commitments cause relentless pressure.

EXTERNAL INDEBTEDNESS AND THE COMMERCIAL INSERTION OF THE THIRD WORLD IN THE WORLD MARKET

Unless a country can count on a growing positive flow of private external investment, the tendency to external disequilibrium and the consequent deficit in the trade balance that is generated, must be taken care of by the decrease of international reserves or by an increase in the net flow of credits (new disbursements less amortization payments, interest and other transfers that accompany the indebtedness process). Excluding the countries that possess large reserves and taking into consideration the minimum level of international liquidity that a country must maintain, the first expedient to deal with the trade deficit, i.e. the use of international reserves, cannot be maintained for a long period of time; it is, and must be, only a temporary mechanism. Therefore, there remains only the resort to external indebtedness to deal with the commercial deficit.

Given that the developing countries do not have large international reserves (with the exception of the petroleum exporting countries), and that the inflow of capital through direct private investment tends increasingly to be offset by the servicing of such investment (i.e. profit remittances, royalty payments, technical assistance, etc.) until in some cases it becomes negative (especially in the developing countries with high and medium per capita incomes), it is clear that the commercial deficit is one of the important elements in the analysis of the growing external indebtedness. Therefore, we must seek an explanation of the trade gap between the developing and the developed countries.

From a formal point of view, the trade gap is the result of the evolution of exports and of imports and of the effects of the modifications in the terms of trade. It is generally admitted that the conjunction of the loss of dynamism in the primary exports of the developing countries, the growing need to import by these countries in order to sustain their growth, and the deterioration in the terms of trade generate the growing trade deficit. This offers a first approximation to the problem of the debt, since the increasing deficit will lead to greater indebtedness. In the first moment of the analysis, the problem would consist in verifying if such hypotheses are manifested as fundamental tendencies in the evolution of international economic relations. But something more is required. It is essential to explain these tendencies, to identify their causes and so to deepen the analysis of this problem, one which is so important in the indebtedness of the Third World.

The growing disparity in levels of development, of productivity, of living standards, etc. between developed and developing countries continues to exist. The difference in economic structure and functioning between these two kinds of countries still exists and the forms of trade which the international division of labour generates are still a reality. Against this general background, important changes in the world economy have occurred in the post-war period, changes which must be taken into consideration to be able to grasp fully the present situation of the Third World economies. The diminished dynamism of the developing countries' exports flows from the nature of the insertion of these countries in world trade. Their very situation of underdevelopment has given rise to a particular economic structure, and an export sector that remains based, fundamentally, upon primary production.

In spite of the advances in industrialization made by the developing countries and the extraordinary expansion of world trade in the last two decades, Third World participation in this trade has declined and their financial problems are becoming more critical. Furthermore, these trends reflect long-term tendencies which are especially adverse for the developing countries. In fact, while exports from the developed countries rose 8.6% annually between 1948 and 1970, exports from the developing countries grew 5.3% a year, and those from Latin America only 3.8% per annum. This brought, as a result, the persistent fall of the share of exports from the developing countries in total world trade. This participation was 30% in 1948, 21% in 1960, and 17% in 1970. In Latin America the decline was even more pronounced, since its 11% participation in 1948 was reduced to 5% by 1970.

Part of the increase in trade of the developed countries is explained by the increase in trade flows among these countries themselves. Trade between developed countries constituted 64% of their total exports in 1948, and represented 77% in 1970. In contrast, trade between developing countries, which was only 29% of their export totals in 1948, fell to 19% in 1970.[5]

This situation is explained chiefly by the fact that trade expansion mainly occurs through the exchange of manufactured products. World manufacturing exports have grown at a 10% annual rate during the last two decades. The external sales of manufactured products of all the developed countries grew from 64% of total exports in 1955 to 76% in 1970. For the same period, the share of manufacturing exports in the total exports of the developing countries rose from 13% to 24%; in Latin America these percentages were 9% and 17%, respectively.[6]

[5] In this respect, Latin America, perhaps as a result of the existence of LAFTA, the Cartagena Agreement (Andean Pact), the Central American Common Market and CARIFTA, shows a slight growth in its inter-zonal trade: from 9% in 1948 to 11 in 1970. See Miguel S. Wionczek, "El crecimiento latinoamericano y las estrategias de comercio internacional de la Posguerra", en *Política económica en Centro y Periferia,* Lecturas No. 16 del FCE, México, 1976, pp. 234-274.

[6] It should be pointed out that these percentages are overestimated due to the method of registering them: certain export activities are shown as manufactures (sugar, minerals with a certain level of refining, etc.), although they are essentially primary in nature. Furthermore, some of these exports are a result of the strategy of the division of the market by transnational enterprises. Finally, many sales of manufactured products between underdeveloped countries are a result of purely conjunctural trade agreements and of sporadic sales of manufactured products which are unable to consolidate a tradition of export of manufactured goods.

Furthermore, in 1975, 75% of the exports of the developing countries were destined for the developed countries. In that same year, 77% of the total exports of the developing countries were primary products; in Latin America, this percentage was 83%.

This process operates *pari-passu* with the fall of imports that the developed countries obtain from the developing countries, in relation to their total imports. This percentage fell from 31% in 1948 to 18% in 1970, and for Latin America this decrease is even more pronounced; the relation declined from 13% to 5% in this period, far below the amount that it had before the Second World War. The economic structure of the developed countries leads to an absorption of primary imports that is incompatible with the necessities of the developing countries to increase their exports, in so far as these continue to be based on raw materials and foodstuffs.

The figures examined show that the tendency towards external disequilibrium, and consequently the trade deficit, of the developing countries, goes beyond merely conjunctural imbalances in their trade; rather, they are a reflection of the function that they carry out in the international division of labour as providers of raw materials and foodstuffs. These countries still have not overcome the primary nature of their export structure and therefore have confronted a significant decrease in their participation in world trade as a long-term tendency. Here is to be found one of the causes of the trade gap and consequently, part of the necessity of the external indebtedness of the Third World countries.

In relation to the growing import needs of the developing countries, it should be pointed out that these expanded significantly, at a rate higher than the growth of the gross domestic product, especially in high income countries. The developing countries which do not export petroleum saw a three-fold increase in the value of their imports between 1970 and 1975. The analysis of this phenomenon will be carried out in the following section, because the level and kind of imports are intimately linked to the characteristics of the internal functioning of the developing economies. Here it will only be said beforehand that it is this kind of functioning of the Third World economies which explains the fact that higher growth rates can only be achieved at the price of a significant increase in imports of raw materials and of capital goods. In these countries, the capital-goods producing industry is still nascent and a broad range of inputs for the industry, that require relatively complex technological processes, have not been sufficiently developed. This accounts for the fact that the dynamism of production does not provide greater internal stimuli and signifies greater imports from developed countries.

On the other hand, the phenomenon of deterioration of the terms of trade constitutes a mechanism for the transfer of real resources from the developing economies to the developed ones and is evidence of the concentration of the fruits of technical progress in the latter. Between 1951-55 and 1966-70, the trade relation for Latin America worsened 23%. The physical volume of its exports in the period increased 86% while the purchasing power of the exports (x px/pm) rose only 43%. This means, in terms of real resources, that half of the physical quantum of the Latin America exports was transferred to the developed economies. During the 1970's the trade relation between developing and developed countries became more complex due to the conjunction of a series of phenomena: the great increase in petroleum prices, the abrupt and conjunctural variations in the prices of other primary products, the increase in the price of capital goods and other manufactured products, and world inflation. Very careful work must be done to establish the real significance of the terms on trade in this very unstable period.

Other aspects as well should not be left aside. They concern an examination of the services that accompany trade (freight, insurance, suppliers' credits) which generally tend to make imports more expensive for the developing countries. These countries lack the minimum of external commercial infrastructure needed in order to achieve a more equal distribution of the economic surplus that is generated in this activity.

THE EXTERNAL INDEBTEDNESS AND THE DEPENDENT FUNCTIONING OF THE THIRD WORLD ECONOMIES

1. *Financial and Economic Repercussions of Foreign Capital in the Developing Economies*

It is quite difficult to characterize generally the internal functioning of the developing countries so as to be able to single out those aspects of this functioning which lead to an expansion of their external indebtedness. The diversity of economic structure, the different levels of industrialization and of internal economic articulation, the diverse geographic and economic dimensions, and the lesser or greater control that foreign capital has gained over their productive and financial apparatus, etc. reveal a multiplicity of situations in which any generalization is dangerous and clearly vulnerable to attack. But, in spite of this diversity it is necessary to identify those recurring aspects in these economies that are capable of explaining a functioning that leads to a growing external indebtedness.

In this respect, two hypotheses emerge. One deals with the manner in which the present development model and type of industrialization leads to a growth of imports tending to be greater than the structural possibilities of the growth of traditional exports. Another suggests how the dependent functioning of these economies is reflected in growing financial burdens deriving from the various services to foreign capital (amortization, interests and other financial costs arising from loan, profit remittances, interests and royalties which constitute the financial counterpart of direct foreign investment, and the sale of patents, licenses and trademarks). The two elements combined, along with the growing external financing of various public sector activities, form the basis of the disequilibrium in the balance of payments that leads to and reinforces the spiral of external indebtedness.

Though from different perspectives, most of the more recent studies concerning the functioning of the developing economies recognize the strategic role that the transnational companies have played in the expansion of the last two decades. This is certainly valid for the industrializing underdeveloped economies, where these companies control the most dynamic and key sectors and where they tend to promote and consolidate an oligopolistic structure in the main industrial branches. Also, in those countries where, because of their small size and low per capita income, the conditions do not exist for an industrialization directed towards the internal market, these companies tend to control the export sector, giving place to, in various countries, a type of rebirth of outward-directed growth in which they have a significant participation in the commercial and financial sector. This is not the place to evaluate the repercussions and implications of a greater control by foreign capital of the Third World economies, but simply to point out an existing situation which is not unrelated to the financial problems of these countries and consequently constitutes an element that cannot remain outside an explanation of the causes of the growing external indebtedness.

The economies of the developing countries which reached a higher level of industrialization and, in turn, are among the countries with a greater level of external indebtedness, expand in accordance with a pattern of dependent development. That development, together with the changes in commercial, financial and technological relations with the developed countries, manifests simultaneously various of the following phenomena:[7]

[7] See some empirical studies on dependence: Caputo, O., Pizarro, R. *Dependencia y relaciones internacionales,* Costa Rica, EDUCA, 1974; Fajnzylber, F., "La empresa internacional en la industrialización de América Latina", en *Lecturas* No. 6, FCE; Wionczek, M. S., *Inversión y tecnología extranjera en América Latina,* Ed. J. Mortiz, México, 1971 y *El nacionalismo mexicano y la inversión extranjera,* Ed. Siglo XXI, México, 1967; Vaitsos, C. V. "El poder, los conocimientos, y la política de desarrollo. Relaciones entre las empresas transnacionales y los

a) Greater foreign presence through direct investment or through the sale of licenses or trademarks in the dynamic sectors which direct their industrial production towards the internal market;

b) De-nationalization of parts of the pre-existent national industry through acquisition or an increasingly extensive take-over of the expanding domestic market by foreign interests;

c) Increasing utilization of national saving for the expansion of foreign investments (reinvestment of profits, access to credits of the domestic financial market, etc.);

d) Consolidation of consumer preferences incompatible with the level of development reached by underdeveloped countries, based on an exaggerated diversification of the consumption of the high and medium income groups;

e) Growing technological dependence not only in relation to productive processes but also with respect to forms of distribution;

f) Economic concentration and deepening of sectorial and regional disequilibria;

g) Accentuated unemployment, underemployment and marginality as an expression of the functioning of these economies.[8]

It is evident that each of the indicated phenomena has a different magnitude and meaning in each country; but the recurrence of these facts has been shown in various case studies, mainly in Latin America, and indicate some of the most important repercussions of the growing presence of foreign capital in these economies. Furthermore, it must be added that some attempts have been made to check several of these tendencies both through legal arrangements to control foreign capital and through certain aspects of economic policy that are adopted in some countries.

This general outline attempts to show some of the repercussions provoked by greater foreign influence on the economic decisions of the

países en desarrollo", *Trimestre Económico,* No. 168; Fajnzylber, F. y Martínez Tarragó, T. *Las empresas transnacionales (expansión a nivel mundial y proyección en la industria mexicana)*. México, FCE, 1976; Graciarena, J. *Tipos de concentración del ingreso y estilos políticos de América Latina,* CEPAL, abril de 1976 (mimeo); Lagos, G. *Empresas multinacionales. Aspectos socioeconómicos, jurídicos e institucionales,* BID, INTAL, 1968; Katz, J. M. *Oligopolio, firmas nacionales y empresas multinacionales. (La industria farmacéutica argentina)*, Siglo XXI Editores, Buenos Aires, 1974; Chudnovsky, D. *Empresas multinacionales y ganancias monopólicas en una economía latinoamericana,* Siglo XXI Editores, Buenos Aires, 1974; Karbusch, Ernest (ed.) *Cambios estructurales en el Perú, 1968-1975, Lima,* ILDIS, 1976, etc.

[8] See: Paz, Pedro, "Dependencia financiera y desnacionalización de la industria interna" en *Trimestre Económico,* No. 146, FCE, México, 1971: Quijano, Aníbal, "Redefinición de la dependencia y proceso de marginalización en América Latina" en *Populismo, marginalización y dependencia,* EDUCA, Costa Rica (2a. ed.), 1976.

developing countries, repercussions which are not commonly mentioned when the necessity for external investment and financing is considered as a measure to overcome the problems of underdevelopment. We maintain that one of the results of this dependent functioning is a growing external indebtedness.

When foreign investments are preferentially directed toward the internal market, financial requirements that are transformed into pressure on the balance of trade and the balance of payments are generated. This contrasts with the previous model in which foreign investment was linked to the export sector, and its dynamism implied a greater inflow of foreign exchange independent of the amount of profit remittances abroad, or of the level of imported inputs used. In the new scheme, in which the foreign companies operate inside the economic structure of the developing countries, they enjoy the advantages of the local activities (principally proteccionism) which increase their profits that, in turn, to a certain degree will be remitted abroad. But furthermore, a large part of the profits transferred abroad have nothing to do with the operation of capital contributed from abroad, but rather have to do with the surplus of capital generated in the developing countries themselves. The profits of the foreign companies reinvested in these countries are converted into "foreign capital" with the same category or status as that of resources which in fact, have their origin abroad. To these savings, which stem from domestic activities, we may add other local capital which is mobilized by or channeled through the foreign companies. This use of internal savings by, and in favor of, foreign companies can be seen in the increasing share of funds belonging to the subsidiaries and other local funds, in the total investment of US subsidiaries in Latin America. This share rose from 67% in 1957-59 to 91% 1963-65.[9] This means that only 9% of US investments in Latin America were financed in this period by *foreign exchange flows.* Thus, foreign capital operating in this way creates a situation in which, first, profit remittances and interest payments to foreign sources are greater than its contribution of foreign exchange,[10] and, second, foreign interests tend to control local savings. This is one factor which explains part of the growing need for foreign exchange, which causes pressure on the balance of payments and in the absence of adequate reserve levels, leads to a greater indebtedness.

If we examine the eight Latin American countries with the greatest

[9] ECLA, *Estudio económico de América Latina, 1970,* Pinto, Aníbal, "El sistema Centro-Periferia 20 años después" en *Inflación: Raíces Estructurales,* FCE, México.

[10] The difference between the net contribution of direct investment from the USA and the profit remittance to that country in the period 1960-68 was $ 6.7 billion; *ibid.*

external public debt, accounting for almost half of the total, and take into account the fact that two countries monopolized 44% of the private external debt of the Third World, we see that such countries are among those in which the industrialization process, of the nature described above, advanced furthest. Within this industrialization process, the production and sales of the transnational companies grow at considerably faster rates than those of the national companies. The growing foreign participation in the most dynamic areas of the productive structure in these countries leads to an increasing need to import inputs and capital goods. In various cases, the imported component is greater than that of the traditional industries. To this one should add that national capital, increasingly operating with foreign patents, licenses and trademarks, in order to be competitive given the new patterns of consumption, becomes technologically dependent, because import requirements from the country which possesses this technology are in large measure defined. Furthermore, certain "tied" credits are transformed in part into additional imports (whether they be credits extended to the public sector or to private activity). All these elements suggest that this kind of dependent functioning is translated into growing import needs which causes a tendency towards a trade deficit implying in turn either a decrease of international reserves or a greater external indebtedness.

On the other hand, the contribution of the transnational companies to the exports of the developing countries is totally different from the contribution they make in other phases of development, because now their activities are principally directed towards the internal market. The share of exports in the total sales of the manufacturing subsidiaries rose only from 4% in 1957 to 7% in 1965. We must add to this that partial studies show that the subsidiaries of the transnational companies over-price both their imports from the mother company and their payments for technical assistance. In turn, other partial studies indicated that a large part of the manufacturing exports from the transnational companies that operate in Latin America are undervalued.[11] The overpricing of imports and the under-pricing of exports are transformed into a mechanism for hiding profits and for remitting them by unconventional channels. This creates yet another pressure on the trade deficit which can lead to greater indebtedness.

With this brief review, we have tried to show which elements of the

[11] See Wionczek, Miguel S., "El crecimiento latinoamericano y las estrategias de comercio internacional en la posguerra", en *Lecturas* No. 16, FCE, 1976, where reference is made to a survey of more than 100 foreign manufacturing companies in Latin America, showing that their exports to Latin American countries and to the rest of the world are invoiced 50% below of the prices of the transnational Latin America companies exporting to the open market.

growing presence of foreign capital in the developing countries, when directed towards satisfying the internal market, generate increased needs for imports to sustain the growing levels of economic activity, as well as needs for foreign exchange to pay for servicing foreign capital. These elements aggravate the trade and balance of payments problem and form part of the explanation for the increase in external indebtedness.

2. *External Indebtedness of the Public Sector of the Third World Countries*

A large part of the external debt originates in the public sector of the developing countries. The reasons why the public sector tends to depend on external financing are complex and varied; external financing is used more and more both for investments and for the extension of social programs. The explanation does not lie completely in the incapacity to control expenditure, to increase sources of fiscal revenue, or in the tendency of politicians to pass on the future present costs. The problem consists of explaining why the public sector behaves in this way and how certain parameters in the functioning of the economies of these countries structurally constrain the possibilities of state action.

The analysis of the pressure on the public sector towards a greater external indebtedness will be made on the basis of three converging elements: the dispersion of the sources demanding external financing in the developing countries; the requirements on the state imposed by the industrialization model; and the continued use of conventional forms of financing together with the inflexibility of the tax structure. The significance and presence of each one of these elements will differ in the various developing countries given the diversity of their structure and policies.

With regard to the dispersion of the demand for external financing, it would be appropriate to examine separately the needs of the government, the public enterprises and the domestic private sector. In general, governments of the developing countries resort to external financing to maintain or extend certain social sector programs (education, health, housing, employment) or to expand and support their infrastructural investments. The public enterprises resort to external credit to finance a large part of their investments and in many cases to finance their current deficits. The domestic private sector tends to use external financing to meet the foreign exchange commitments resulting from its investments and/or its imported inputs.

Good reasons can be found for many of these external financing requirements, justifying their existence from a "micro" point view. However, considering that from a global perspective the developing countries suffer severe restrictions in terms of their foreign exchange revenues, their levels of reserve assets and their external financial commitments, one can conclude that some of these demands for external credits cannot be fully justified. Thus, it becomes necessary to look for new ways of internal financing in order to minimize the use of external indebtedness.

A. External Financing of Social Sector Programs

With regard to social sector programs which are partly supported by external financing, two considerations must be taken into account. First, various loans which are destined for this sector are official bilateral or multilateral loans, which means that they come accompanied by the criteria that interest the creditor nation or those countries that have greatest influence in the multilateral organizations. This creates a participation of the creditor country in the determination of the social policies of the debtor country. Second, the amount of external support needed for these programs depends on the level of development reached by these countries and the nature of the program to be implemented. In the majority of cases it is not justifiable to create foreign exchange commitments for programs that can be "genuinely" financed with local resources. In the case of education, external financing should be directed towards the support of certain specialist programs of a highly technico-scientific nature, scholarships for the completion of studies, projects with high levels of complexity that need imported apparatus, combined programs of scientific and technical cooperation, the purchase of educational technology inputs, etc. There are no good reasons for making primary, secondary and even university education programs dependent on external financing. In the case of housing plans and programs, there are no arguments to defend financing them by means of external credit. With regard to the health sector the situation is the same from the economic and financial viewpoint. One should add here that the programs implemented by external financing such as birth control and highly specialized medical research, in many cases leave untouched research and programs more closely related to the medical and health needs of developing countries.[12]

The preceding analysis must be adjusted for the cases of those low-income developing countries where various social programs, if financed with concessional credits, can contribute to improving the living standards of the lowest income sectors. This also applies to the more back-

[12] We are not considering here the political implications or the aspects of cultural dependence which external financing of programs directed towards the social sectors can carry; we are only considering the inconvenience of assuming foreign commitments for activities that can be financed by internal sources.

ward regions of medium-income developing countries. Nevertheless, these considerations are not the most important in external indebtedness, even though they are not without significance.

B. External Financing of Infrastructural Investments

With regard to the demands for external financing of infrastructural works, it is clear that these are growing significantly and that such growth is a function of the expansion needs of economies faced with a deformed infrastructure which arose to serve the export sectors of the developing countries. To the degree that the industrialization process advances in some Third World countries, and insofar as all lower income countries tend to modernize at least part of their economic structure, the need to change, extend and adapt the infrastructure will grow accordingly. A large part of the burden of this effort falls on the public sector even though the external economies generated principally benefit the private sector and, in various countries, especially benefit the transnational companies which, as indicated, are the central protagonists in industrial dynamism. Consequently, large investments in infrastructure are an objective necessity of development and industrial expansion in the developing countries. The problem consists of explaining why these investments tend to be undertaken totally by the state, and why they are increasingly financed with external credit.

Also, with respect to external financing of the infrastructure, it is appropriate to point out that the criteria that should govern the resort to external sources will be different according to the nature of the infrastructural investment to be carried out and the degree of development of the country.

In the high income developing countries and in some medium income countries, where the state already has a greater operational capacity and long experience in the carrying out and administering of infrastructural works, resorting to external credit is not justified, except in special cases. In the developed debtor countries, it is totally imprudent to contract foreign exchange obligations in order to finance social sector programs and infrastructural investments. When they resort to external credit in those situations, they only create problems in their balance of trade and payments or in reconstituting their international reserves. The socialist countries use external debts to transfer real resources (via trade) from other economies to their own. Even in certain developing countries, external financing is no longer used to create infrastructure or extend social programs. It is not the same thing to base railway expansion or the building of ports on external financing in early phases of development, as it is to resort to external credits to finance roads, bridges, urban infrastructure, extension of electricity networks, etc., once a certain level of industrial development has been reached and when there is a higher degree of operational capacity in the state apparatus.

Under these conditions, only the dependent nature of development and investment policy explains the increasing resort to external credit to carry out investments that do not mean an incorporation of technical progress, but do imply an increased use of imported inputs, and result in foreign exchange commitments which cause pressure on the balance of payments and lead to a growing external indebtedness.

These general theses which seek to reduce, as far as possible, the use of external credit, must be qualified for particular situations. In the first place, there exist infrastructural works which, because of their scale and technological complexity, require a commensurate financial and technological effort necessitating external financing. As examples, we may mention projects which link two countries by uniting the banks of a great river, the construction of long oil pipe lines, or great hydro-electric projects with a complex network of irrigation channels. In projects of this type, the long period both of the feasibility studies and of the maturing of the investment, the high cost of the project, its complexity and its technological challenges may involve a need to support these projects through foreign technical assistance and external financing. These projects emerge because they form an essential part of a long-term development policy or respond to a long term strategy of the transnational companies, or both. In the second case, an attempt should be made to distribute the costs among the parties benefitting most directly from the projects.

On the other hand, in the smaller countries, or in the low income countries, these kinds of works, and even projects of lesser scope, are not so common, and their presence can substantially transform the overall economic structure and functioning. In these cases, external financing and technical assistance take on a special meaning, given the limited operational capacity of the state, the almost nonexistent infrastructure, the isolation of vast regions of their territory, etc. In such situations, more roads or a hydro-electric project can produce important changes in the economies and create conditions for greater development. But also, given the greater external vulnerability of these economies, ways should be sought to utilize domestic financial resources for such works, insofar as this is possible.

The analysis carried out regarding the external financing of infrastructural investments suggests that there is a link between the size of such investments and the advance of the industrialization or modernization process. But the model of dependent industrialization leads to even greater levels of infrastructural needs. For example, the great expansion of the automobile industry, the incessant increase in automobile parking areas in the metropolitan areas, and the replacement or displacement of the railway as a means of transporting both goods and passengers provokes, in several developing countries, a growing demand for roads, highways and freeways which, soon after being put into use, are found to be insufficient; in this way demands for these works multiply. But furthermore, the automobile industry, and those which provide its inputs, must count on energy sources, lines of communications, supply of metals, etc., all of which, in these countries, tend to be provided by the state. It is clear that these needs signify an obvious material progress. It is only suggested that the model of industrialization which tends to prevail in some of the developing countries causes pressures on the public sector to continually increase its infrastructural investments. When there is a certain inflexibility of the tax structure, expanding current expenses, and the availability of external credit, the tendency to depend on external financing to extend infrastructural investments becomes almost a necessity.[13]

C. External Indebtedness of the Public Enterprises

Other sources of growing external indebtedness come from the activities of the public enterprises. It is also a difficult task to characterize these state enterprises in the developing countries. How great the share of state enterprises is in the economy depends on various factors, among which it is worthwhile to single out the following: *1*) The presence of key enterprises which, because of their size and strategic character, could only be undertaken by the state or by foreign capital (energy, large-scale mining, iron and steel works, petrochemicals, public services, etc.); *2*) The weakness of many medium or small enterprises that, if they should fall into a situation of bankruptcy, would create unemployment problems and sharpen political tension, thus forcing the state to take them over; *3*) political decisions that the state should participate in the strategic sectors of the economy as the axis of a national policy of development, or for reasons of "national security"; *4*) policies favoring nationalization of certain foreign-owned activities (railways, petroleum exploitation, export-oriented mining, certain banks or financial organizations, etc.); *5*) the need for activities in very backward zones or regions where a large part of the population is employed in only one productive activity which the state or provincial government considers necessary to maintain, etc. It is easy to

[13] Often, part of this financing pays the costs of the feasibility studies and project elaborations carried out by foreign consultant firms. This, in many cases, tends to limit the autonomous capacity of generating projects in the debtor country. This does not generally occur with the technical assistance which the United Nations offers to the developing countries through its specialized organizations.

appreciate how such dissimilar circumstances explain a very diverse situation with regard to the varying influence of the public enterprises in the developing economies, independently of the level of development reached or of the greater or lesser advance of the industrialization or modernization process.

Within the great heterogeneity which characterizes the role of the public enterprises within the developing economies reference will be made to the larger enterprises, which are those most directly involved in the external debt. Generally speaking, the operation of these enterprises results in financial deficits. Liberal thought, ideologically opposed to the presence of public enterprises in the economy, tends to explain such a deficit in terms of inefficiency, bureaucratic organization, and overemployment stemming from political demagogy and corruption. Several of these factors are indeed present in the operation of such enterprises, but they do not offer a complete explanation of the deficit phenomenon.

Generally, these enterprises sell their goods and services at prices and tariff levels that do not meet their own costs. In the case of tariffs for certain public utilities this under-pricing responds to redistributive policies in favor of domestic consumers and/or to policies which benefit the private sector, where industrial use is made of these services. The same occurs when private enterprise is supplied with low-priced goods produced by state enterprises. Whether or not one attributes a social function or a role of stimulus to private activity to these enterprises, in fact, not only do they usually operate with deficits, but in addition they do not receive financial support from the central government to expand their activities either. Under these circumstances, they must increasingly resort to external financial resources for financing their investment needs. In some cases public enterprises use foreign consultants informally linked to certain multinational or bilateral credit organizations, in order to obtain the financing needed. These practices tend to raise the costs of the project, to tie the buying of machinery, equipment and the inputs to imports of a specified origin, to weaken the internal project-generating capacity, to neglect domestic scientific and technological research, to forego advantages of world-market competition, to underutilize products of domestic origin, etc. As can be seen, such economic and financial conditions, to which a large number of public entreprises in developing countries are subject, constitute a growing source of external indebtedness.

D. The Public Debt which Originates in the Private Sector

The domestic private sector, when it contracts an external debt with state guarantees, generates yet another source of external indebtedness.

For the more industrially developed Third World countries, given the pattern of demand consolidated in the market, the private national entrepreneur tends to depend increasingly on foreign technology, and consequently to base his operations on imported capital goods and other inputs. This leads to his demand for foreign exchange for investment and working capital becoming a source of external indebtedness. This problem is accentuated when the purchase of equipment is accompanied by medium and long-term external financing because such financing cannot always be found on the domestic market. There are other situations; in inflationary conditions when the foreign exchange rates adjustments fall behind domestic inflation rates, additional incentives are created for external borrowing by the local entrepreneur.

In various countries, certain public enterprises created to foment private investment contract external debts to constitute or increase the working capital of private firms. In this case, the public debt increases merely to support a private debt. In the cases of the lower-income developing countries, the pressure towards external indebtedness originating in the domestic private sector is relatively mild, given the very limited diversification of economic activity. Nevertheless, when the import sector markedly influences economic policy decisions, it generates great pressures for external indebtedness because of its interest in financing imports on a large scale.

As can be seen, both the public sector and the private sector in the developing countries contribute to the growing demand for external financing and to the steadily expanding external debt, thus generating the so-called spiral of external public indebtedness.

3. *Global Effects on the Balance of Payments*

Finally, one should examine the global pressure on the balance of payments of the diverse elements which lead to the growing external indebtedness of the Third World countries. First, one must single out the tendency towards external inbalance derived from the nature of the commercial insertion of these countries in the international division of labour: the trading of raw materials and food-stuffs for manufactured products implies a deterioration in the terms of trade and the diminishing participation of the Third World in the expansion of global commerce. Second, one must keep in mind the absence of an adequate trade infrastructure and of those services which accompany international trade (merchant fleets, trade insurance companies, export financing, etc.), and also the practices of the transnational companies that overprice imports and under-price exports, Moreover, the growth of the trade deficit is accelerated during periods of recession. In recent years the deficit on the current account of the nonoil exporting developing countries rose from US dollars 9 billion to 11 billion in

1970-73, to 30 billion-in 1974 and to 38 billion in 1975, declining to 28 billion in 1976.[14] The trade deficit is the key factor which causes pressure on the balance of payments and leads to a greater external indebtedness.

The pressure on the balance of payments generated by the payment of profit remittances, interests and royalties, due to the growing participation of foreign capital in production for the domestic market, constitutes an additional element of demand for foreign exchange which, given the inadequacy of international reserves, results in indebtedness. Moreover, the functioning of the public sector, which increasingly resorts to external credits in order to support certain social program and its infrastructural investments, to keep up the functioning and expansion of the public entreprises, and to guarantee external credits for the domestic private sector, reveals the wide range of demands for external financing and explains, to a large degree, the spiral in the external indebtedness of the public sector. All these factors taken together, each one operating to a different degree in the different debtor countries, permit a global appreciation of the critical pressure on the balance of payments of Third World countries, and, consequently, their growing external public indebtedness. Similarly, the combination of external financial commitments which this indebtedness generates creates a need for further external credits which, in turn, further increase financial commitments and lead to a kind of *vicious circle* of external indebtedness. The overall financial effect of this vicious circle is reflected in the growing ratio of the services on foreign capital as compared with export income.

This process of indebtedness has its limits; if the LDC debt continues to grow, not only the Third World countries but the creditor nations as well will be seriously affected. Flows of goods and services and of capital should maintain a certain harmony or proportionality in order to avoid a situation in which the Third World countries face critical and growing disequilibria in their balance of payments, and, consequently, fall into a spiral of external indebtedness. In other words credits or indebtedness *per se* do not produce healthy or expansive effects on the Third World economies. The increase of both debt and direct foreign investment is only justified for certain very specific projects, in a context of increasing export revenue and improving terms and conditions of the external indebtedness. Only in this way can the financial commitments arising from the debt be met without lowering the imports needed for the development process, and without falling into recession as the only way of dealing with the balance-of-payments disequilibrium.

[14] In the deficit on current account, net payments for profits and interests on foreign capital are included.

LDC Debt and U. S. and World Economic Stagnation: Overcoming Contradictions in Global Interdependence

Ronald E. Müller
David Moore
and
Robert Cohen

Presented at the meeting by Ronald E. Müller, Professor of Economics and International Finance at the American University, Washington, D. C.

SUMMARY

There are two major problems confronting the world economy. One is that of growing levels and new forms of *external debt* of less developed countries (LDCs). The other is that of the slowdown and *stagnation* in the economic growth of the more developed countries (MDCs), the resolution of which is compounded by the relatively new phenomenon of simultaneous inflation and unemployment, popularly termed 'stagflation". The central thesis of this paper is that solutions to the LDC debt and MDC stagnation-cum-stagflation problems are in fact linked and cannot be forthcoming until their respective remedies are globally coordinated. Unless current policy is supplemented by new approaches that explicitly integrate the three major poles of global economic interdependence — OPEC, OECD, and non-oil exporting LDCs — in a coordinated fashion to attack these twin problems, our analysis concludes that the US and world economy will experience a major recession in the 1979-1980 time-frame.

Traditionally, observers have indeed understood the interdependence of LDC debt and the growth rates of MDCs. Yet, they have not had to deal with the question of *solutions to the* LDC *external debt problem in the context of the actual persistence of economic stagnation-cum-stagflation in the industrialized countries of the* OECD, simply because the latter's occurence during the post-World War II period has been only most recent. Past analyses, for example, have clearly demonstrated that LDC exports are a function of economic growth rates of the MDCs, and, therefore, that the levels of LDC debt and debt service capacity are a function of GNP expansion rates in the "center" countries of OECD. But, to repeat, policy makers in the post-World War II period have only recently had to face a situation of simultaneous and reforcing occurrence of mounting LDC debt with increasing symptoms and tendencies towards economic stagnation in the MDCs.

We argue in this paper that current approaches to resolving the LDC debt problem are inadequate particularly because they have failed to take into account the contemporary phenomenon of prolonged MDC economic stagnation compounded by stagflation. (The stagnation phe-

nomenon is similar to that of the 1930s, *except* that inflation was absent during that earlier period of economic decline.) Thus, we attempt to demonstrate that neither the IMF stabilization approaches towards LDC debt, nor the more fundamental structural approaches of the UNCTAD are adequate because they have not integrated into their policy-making proposals the new facts and behavioral modes of a recently transformed world economy.

The uniqueness of the present situation can only be understood by casting an analysis in both short-run and long-run dimensions. That is, we believe it essential to base our analysis on a historical framework that illuminates the fundamental structural transformation which the post-World War II world economy is undergoing. Historically viewed, the current transformation is complexifying conventional policy in much the same manner as that of the last great transformation of the industrialized economies which occurred during the late 1880's through a dramatic turning point in 1929-1930.

The salient characteristics of the post-World War II transformation are twofold. On the one hand, there are new levels and forms of global interdependence. While historically LDCs have been dependent upon the international economy via trade, today global interdependence is mirrored in much more than just trade flows. The new interdependence also reflects itself in the intensifying dependency of the MDCs upon the natural resources, labor and consumer markets, and novel forms of international financial flows of both OPEC and other LDC nations. On the other hand, the second fundamental characteristic of this transformation is the new levels and forms of economic concentration and their impacts on impairing the conventional functioning of world market mechanisms to assure appropriate and stabilizing investment decisions. The new concentrated economic actors include not only the transformed OECD private sector institutions of the multinational corporations and banks, but also OPEC and other regional and commodity blocs.

In section IV of this paper, we present an analytical diagnostic of the current situation of the US and world economy, concluding with a forecast of a heavy recesion occuring during the 1979-1980 period, unless new policy initiatives are undertaken. Our analysis proceeds by showing reinforcing vicious circles or feedback mechanisms between increasing LDC debt and further levels of economic stagnation in the industrialized nations. (This includes the compounding problem of stagflation: to wit that the inability of the MDC policy-makers to rid their economies of inflationary pressures, even in the face of high unemployment levels, has placed significant limitations on the US and other governments' conventional stimulation efforts to overcome stagnation forces.) Although we do not argue that the origins of either of these problems were necessarily the same, nor in fact were they necessarily linked, we do demonstrate that once set in motion, the two tendencies became linked and have the effect of further intensifying and reinforcing one another.

To overcome this reinforcing set of vicious circles between LDC debt and economic stagnation in the MDCs, and avoid the forecasted recession for 1979-1980, we argue the necessity of implementing policy initiatives which take explicitly into account constraints and limitations in each of the three major "poles" of economic activity which encompasses our globally interdependent world economy: that of the LDCs, the MDCs of the OECD, and the OPEC countries. Each of these poles has a set of economic and political conditions, as well as problems, which, when analyzed "holistically" in the context of a globally interdependent world economy, can be shown to have a unique set of simultaneous solutions.

We argue that this set of unique, simultaneous solutions towards meeting the constraints and problems of each of these three major respective economic spheres of activity can only be brought about by a globally coordinated policy package which involves initiatives for each of the three sets of poles. As such, in the final section of this paper, we sketch out the contours of a proposed "OPEC-OECD Marshall Plan-type" approach towards solving the problems of LDC debt and poverty while providing a needed form of non-inflationary stimulation to the US and other stagnating economies of the OECD. The proposal would target the LDCs as a "new growth frontier" for the world economy over the next five to ten years. The specific design of this approach would relieve the worrisome strain of Third World debt on the stability of international financial markets, mobilize uncommitted surplus funds of both OPEC countries and those of MDC private investors, and thereby reverse the dangerous deterioration in fixed investment and capital formation which is plaguing LDC and OECD nations alike.

The remainder of the paper is broken down into four other sections. Section II, which follows immediately, is a review of the quantitative dimensions of LDC debt with a specific focus on the lending of private multinational banks. (This section is a review which need be read only by those unfamiliar with this data.) Section III overviews the only two existing schemes in the international policy arena for dealing with the LDC debt problem: the proposals of the IMF versus those of UNCTAD. Section IV is an analysis and diagnostic of the twin problems of LDC debt and MDC stagnation-cum-stagflation. Secion V, as already noted, sketches out a proposal for dealing with these twin problems.

THE DIMENSIONS OF LDC: THE FINANCIAL BOTTLENECK TO TRANSFER OF REAL RESOURCES

The persistent problem of LDC external debt received once again major focus with the UN General Assembly's Declaration on the Establishment of the New International Economic Order (NIEO).[1] Commensurate with the goals of NIEO, the UN's Sixth Special Session emphasized the need to take the following pragmatic steps: (1) the exemption of the LDCs from import and capital outflow controls of developed nations; (2) promotion of foreign investment in developing nations; and (3) the mitigation of the debt burden of developing nations, whether by cancellation, moratorium, rescheduling, or interest subsidization.[2]

Later UN resolutions concerning LDC debt were even more insistent upon the need to liberalize the credit access of developing countries during the current period of dramatically increasing imbalances in international financial flows.[3] In response, the IMF expanded temporarily members' borrowing limits by 45 percent following the meeting of the ministers of the Group of 77 in Kingston. OPEC nations established a special $ 800 million to help finance LDC oil-related payments imbalances during 1976. Finally, in 1977, the IMF sent its member countries, for approval, the creation of a $10 billion supplementary lending facility, the so-called "Witteveen Facility". This proposed new facility is itself a testimony to the seriousness of the debt burden and repayments capacity in many LDCs (and a growing number of MDCs for that matter).

Most observers, however, find the longer-term outlook more worrisome. The OPEC special fund was to end after 1976. Private commercial banks, largely multinationals, which had begun to provide a large share of the financial needs for the more credit-worthy LDCs, were becoming more cautions about extending such loans. Finally, the traditional MDC major donors of bilateral foreign aid began to cut back in relative terms because of their own domestic problems of short-run instability in terms of simultaneous inflation and unemployment, combined with stagnant growth rates and secular deterioration in produc-

[1] United Nations, General Assembly, *Resolutions Adopted by the General Assembly During the Sixth Special Session*, 9 April - 2 May, 1974. In recognizing that the existing economic order did not provide for the "even and balanced development of the international community", the Declaration developed the following treatment of the LDC debt issue: (a) effective participation of LDCs in decisions about the world monetary system and the IMF; (b) additional allocations of special drawing rights (SDRS) to create more liquidity for LDCs; (c) establishment of an SDR link for new development financing; and, (d) promotion of the net resource transfers from MDCs to the LDCs.

[2] *Ibid.*, p. 8.

[3] United Nations, *Resolutions Adopted by the General Assembly During Its Seventh Special Session*, 1-16 September, 1975, pp. 4-6.

tivity increases. Thus, as the chairman of the OECD's Development Assistance Committee notes, "the prospects ahead for most developing countries are bleak".[4]

A. *Balance of Payments Overview:* OPEC, LDCS *and* MDCS

The most recent balance of payments figures available[5] show that between 1973 and 1976, members of the Organization of Petroleum Exporting Countries had a combined cumulative current account surplus of $143 billion.* Over the same three year period, the United States, Japan, and West Germany had a combined surplus of $26 billion, while the Benelux nations and Switzerland together had a surplus of $12 billion. Thus, OPEC and 7 MDCs had a cumulative current account surplus of over $180 billion for this period. This surplus, of course, had to correspond to deficits in other countries. The largest deficits were incurred by, first, the non-OPEC LDCs, with $78 billion, and second, the MDCs of France, Britain, Italy and Canada with a combined deficit of $50 billion. In addition, other MDCs had a deficit of $50 billion.

Using figures which do not include official transfers (of merely $27 billion for non-OPEC LDCs over the last three years), the current account of the non-oil exporting developing countries deteriorated by nearly $7.5 billion between 1974 and 1975, rising to a deficit of nearly $35 billion. The position of the developed nations improved by $27 billion over the same period, to attain a surplus of $16 billion in 1975.[6] Even though the current account position of the non-oil LDCs improved by $7.5 billion in the past year,[7] their deficits still pose a sizeable policy problem for their own governments and for the international financial system. (The relative improvement in many LDCs' balance of payments came at the cost of relatively austere reductions in domestic consumption and investment. These were initiated by some in 1975, by others in 1976 or 1977; and, for some, such anti-growth measures can hardly be expected to continue if political stability is to be maintained.)

[4] "Foreign Aid Flows: Needs Strain Availability", *International Finance* (Chase Manhattan Bank), February 23, 1976, p. 1.

[5] "Further Official Channels for Surplus Funds Seen Needed to Avoid Worldwide Slow-down", *American Banker*, February 24, 1977, p. 3.

* Balance of payments data are compiled both for transfers including official transfers and excluding official flows. The former figures are used here, although the latter figures are cited in some instances below.

[6] Studies of the World Bank and the International Monetary Fund cited in the statement by the Group of Twenty-Four, "Communique of 7 January, 1976, of the Intergovernmental Group of Twenty-Four on International Monetary Affairs".

[7] "Bank Lending to the Less Developed Countries", *International Finance* (Chase Manhattan Bank), February 21, 1977.

B. *Private Multinational Bank Loans: Causes and Composition by Origin and Recipient*

Whas has been new in the present situation is the growth of private bank lending to cover the mounting deficits of a number of nations, including the non-OPEC-LDCs. J. A. Kirbyshire, Chief Advisor to the Bank of England, has noted that private multinational banks financed yearly all of the deficits of industrialized countries and about 56% of the combined deficits of the non-OPEC LDCs over the past three years.[8] Economists at Morgan Guaranty Trust Company have taken note of this new role for the banks, citing the fact that the "new net financing requirements of these countries (LDCs) totalled an estimated $109 billion in 1974-76". Compared to the previous three year period, this represented nearly a 140% increase in private bank lending to public sectors.[9] With reference to non-OPED LDCs, commercial bank lending rose by an estimated $46 billion, accounting for more than 42% of the net new financing required by these nations, compared to 20% of the new financing over the 1971-73 period.[10]

One major reason for this dramatic increase in the multinational banks in public sector financing is due to the fact that official credit sources have not grown rapidly enough to meet the rising needs of LDC deficit nations. During 1971 to 1973, official sources provided two-thirds of deficit nations' needs for financing. During the last three years, however, they have met little over one-half of these national requirements.[11] The recent increase in private bank lending to non-OPEC LDCs took place last year *despite the fact* that there was a $7.5 billion reduction in these nations' current accounts deficits. Thus, economists at Chase Manhattan Bank have explained the actions of these LDCs by noting that they wish "to strengthen their cash position in a period when credit market conditions are relatively favorable to borrowers".[12] The global interdependence characterizing financial markets was demonstrated by reasons underlying this relative availability of credit to LDC governments. The world-wide recession of 1974-75 had strongly diminished the private demand for loanable funds in the advanced home nations of multinational banks, thereby freeing up monies and pushing the banks to search for new loan customers.

There are many other reasons, however, for the expansion of private international bank lending to the LDCs. Bank analyst Richard Weinert,

[8] "Further Official Channels...", *op. cit.*

[9] "Coping with the Imbalance in International Payments", *World Financial Markets* (Morgan Guaranty Trust Company of New York), January, 1977, p. 4.

[10] *Ibid.*

[11] *Ibid.*

[12] "Bank Lending to the Less Developing Countries", *International Finance* (Chase Manhattan Bank), February 21, 1977, p. 1.

for example, has identified four basic factors on the bank supply side of LDC lending. Weinert notes that LDC "loan demand certainly was there in the 1950s and early 1960s" and that "loan demand did not explode as dramatically during 1970-76 as did bank lending".[13] After the mid-1960s, the four factors which pushed banks to lend to LDCs included: (1) following their multinational corporate clients and, as private international lending competition increased, (2) defensive measures to keep these clients. Nevertheless, of total medium-term lending to LDCs, less than one-half appears to have gone to multinational corporations' subsidiaries. The majority of LDC loans, in fact, went to public sector borrowers.[14] In addition, there were the related factors of: (3) competitive pressure to generate international earnings given, and (4) the development of Eurobanking markets. Eurobanking is important particularly because after 1974, when loanable funds demand in the MDCs fell off, the lack of Eurocurrency reserve requirements added to the inflow of new deposits. This allowed for a high multiple of loans on an increasing deposit base (although a similar growth in banks' capital base did not occur). Given the intense competitive pressure among international banks to maintain and/or increase earnings, the flexibility of Eurobanking operations plus the recession in the MDCs pushed the banks to the LDCs as much as the latter's demand drew the banks into this relatively new market.

Obviously, the large oil and recession-related current accounts deficits of many countries has also been an overall factor responsible for the great acceleration in international private lending over the past year. The need for new funds to refinance maturing external debt and the fact that balance of payments needs have outstripped the funds available from international public institutions and official national sources have both contributed to the forces for expanding international private credit flows. As economists from Morgan Guaranty emphasized: "Gross new publicly announced credits arranged in the private international bond and Eurocurrency markets combined reached a new high of $58 billion, an increase of $17 billion or 42% from the previous record volume of 1975".[15] In total, identifiable private loans and credits to governments reached at least $7.8 billion. or nearly a third more than the $61 billion provided in 1975.[16]

Several factors have played a more important role in the recent private financing of international lending in the past. First, new interna-

[13] Richard S. Weinert, "Why Banks Lent to LDCs", unpublished mimeo, New York, 1977, pp. 14-15.
[14] *Ibid.*
[15] "Trends in International Lending", *World Financial Markets* (Morgan Guaranty Trust Company of New York), December, 1976, p. 1.
[16] *Ibid.*

tional bond issues grew even more rapidly (48%) between 1975 and 1976 than did Eurocurrency credits (36%). In part, this growth of the bond market was due to the increasing portion of the OPEC nations' surplus which has been directed into longer-term maturities. The use of bonds has also been supported by the secular rise in interest and amortización payments on past bond issues, such issues having accounted for $95 billion in new public sector debt, mostly held by LDCs, over the last ten years.[17] Secondly, banks in a number of industrialized nations have increased their lending to private-sector foreigners by at least $12 billion on a net basis with those in the United States providing nearly $5 billion, those in Germany contributing almost $4 billion, and banks in the United Kingdom, the Netherlands and Switzerland extending almost $3 billion.[18]

While most LDCs will continue to draw loans from the world banking system, and are viewed by the banks as having the capacity to service higher levels of debt than what they currently have outstanding, the rate of increase of bank credits to this group of nations appears to have slowed.[19] The non-OPEC LDCs have already used a large part of the borrowing capacity. In addition, there is now the likely failure of the 1977-79 economic recovery of MDCs to sustain (what until recently was assumed to be a safe target of) six percent per annum increases in real GNP. This prospect of economic stagnation in the MDCs, i.e., in the major export markets of the LDCs, has meant that, in 1977, banks are subjecting new requests by developing nations for funds to much greater scrutiny. This will force LDCs to give up their recent strategy of gradual adjustment to large deficits and, instead, resort to austerity measures.

The role of the US private bank loans to developing nations has been especially important in recent years. As of June, 1976, these banks accounted for nearly one-half of the total of outstanding loans to such nations, including loans in both Euro- and domestic currencies (see Table 1).[20] US banks were the major lenders of private funds to a number of non-OPEC countries in Latin America including Chile, Mexico, Argentina, Peru and Colombia. Banks from other MDCs were the chief lenders to the remainding countries in this hemisphere. In Asia and Africa, US banks had the large majority of the claims upon South Korea, Taiwan, the Phillipines and Thailand; while banks from other areas accounted for nearly half the claims on other Asian-African nations. Although much of the funds that US banks have provided go

[17] *Ibid.*
[18] *Ibid.*
[19] "Bank Lending . . .", *op. cit.*, p. 4.
[20] "Trends in International Lending", *op. cit.*, p. 4, based upon figures provided by the Bank for International Settlements.

Table 1

BANK CLAIMS[a] ON SELECTED COUNTRIES[b]

(End-June 1976, billions of dollars)

	All Banks[c]	*US Banks*[d]	*US Banks as percentage of all Banks*
Non-OPEC Countries	67.72	44.05	65.0
Latin America	49.93	31.77	63.6
Mexico	15.83	11.54	72.9
Brazil	17.37	11.04	63.6
Argentina	3.15	2.20	69.8
Colombia	1.52	1.26	82.9
Peru	2.50	1.25	50.0
Chile	0.90	0.67	74.4
Others	8.71	3.21	36.9
Asia and Africa	17.74	12.88	72.6
South Korea	3.71	3.01	81.1
Taiwan	2.27	2.15	94.7
Philippines	2.39	2.06	86.2
Thailand	1.26	0.82	65.1
Others	9.36	4.84	51.7
OPEC Countries	15.35	8.38	54.6
Venezuela	2.96	2.72	91.9
Indonesia	2.98	1.98	66.4
Others	9.41	3.68	39.1
Socialist Countries	27.10	3.33	12.3
USSR	9.16	1.07	11.7
Others	17.94	2.26	12.6
Total	110.17	55.76	50.6

[a] Includes gross claims in domestic and Eurocurrencies.
[b] Includes all countries that are not members of OECD (except Turkey), but excludes Israel, South Africa, Yugoslavia and offshore banking centers (Bahamas, Bermuda, Cayman Islands, Hong Kong, Lebanon, Liberia, Netherland Antilles, New Hebrides, Panama, Virgin Islands and West Indies).
[c] Includes banks in Belgium-Luxembourg, France, Germany, Italy, Netherlands, Sweden, Switzerland, United Kingdom, Canada, Japan, United States and foreign branches of US banks in the Bahamas, Cayman Islands, Panama, Hong Kong and Singapore.
[d] Banks in the United States (including US agencies, branches and subsidiaries of foreign banks), and foreign branches of US banks.
Source: *World Financial Markets* (Morgan Guaranty Trust Company), December 1976, p. 4.

Table 2

DISTRIBUTION OF PUBLISHED EUROCURRENCY CREDITS BY REGION
1971-1976

(Millions of US dollars)

Region *	*1971* [a]		*1972* [a]		*1973* [a]	
	Amount	*Percent*	*Amount*	*Percent*	*Amount*	*Percent*
Industrialized countries	2 645	64.2	3 771	48.0	11 125	55.0
Developing countries	1 475	35.8	4 080	52.0	9 116	45.0
Oil exporters	432		1 117		3 013	
Higher income	918		2 632		5 280	
Middle income	62		94		507	
Lower income	63		130		317	
Total: IBRD members	4 120	100.0	7 581	100.0	20 241	100.0

[a] Source: Organization for Economic Co-operation and Development, Development Assistance Committee, *Development Review*, 1973-74.

Region *	*1974* b***		*1975* b***		*1976* b** ***	
	Amount	*Percent*	*Amount*	*Percent*	*Amount*	*Percent*
Industrialized countries	17 243	60.3	5 090	24.8	1 679	26.6
Developing countries	9 741	34.0	12 429	60.2	2 923	46.3
Oil exporters	789	2.8	3 207	15.6	751	11.9
Higher income	7 041	24.7	7 860	38.2	1 373	21.8
Middle income	1 620	5.7	1 289	6.3	797	12.6
Lower income	291	1.0	71	0.3	—	—
Others	1 547	5.3	3 056	15.0	1 708	27.0
Total: IBRD members	28 532	100.0	20 575	100.0	6 310	100.0

[b] Source: IBRD, *Borrowing in International Capital Markets, First Quarter 1976.*
* IBR Members countries.
** First quarter 1976.
*** Details may not add up to totals due to rounding.

for extensive financing of public sector borrowings in these LDCs, it is in the nations where such US bank activity is most important that there is also located the heaviest investment by US transnational corporations.

The foregoing review gives an indication of the quantitative dimension of LDC debt as well as a highlighting of the supply and demand sides of the relatively new private transnational bank loanable funds market for developing nations. In the next section, our focus shifts to a review of the most recent analysis of LDC future debt payments burdens and debt servicing capacities, as well as certain differences among individual debtor nations.

C. *Differential Access to International Financing: By Type of* LDC

The access to international financing has differed greatly for various groups within the LDCs. In general, the higher income LDCs have had the greatest access to such funds and in recent years, OPEC nations have utilized international borrowing more extensively (see Table 2). The lower income LDCs have not been able to borrow much in international capital markets, *even though* their borrowing in Eurocurrency markets in the first years of this decade was not much different from the pattern of borrowing by middle income nations. The poorer LDCs have just not been as successful in increasing their access to such funds.

D. *Recent Changes in* LDCS' *Balance of Payments Position: Cumulative Surge in Indebtedness*

The balance of payments situation for the developing nations appeared to change for the better in 1972-73, when the rise in commodity prices and volume of manufactured exports from LDCs permitted these nations to expand their volume of imports substantially while upping their economic growth rates. However, any improvements in the terms of trade for these countries came to an abrupt halt in 1974. The recent changes in the commodity terms of trade (other than petroleum) in relation to manufactured goods did not offset the deterioration which had occurred over the previous two decades. The sharp decline in employment in MDCs was deeper and more precipitous than the upswing which preceeded it. In addition, MDCs have not regained earlier levels of employments, meaning downward pressure on growth rates in LDC exports to them. The result has been a general upward shift in the debt service ratios of LDCs[21] above what was assumed to be the

[21] See "Projected Debt Service Ratios for Argentina, Brazil, Mexico and Peru: Economic Estimates for 1978-82", prepared by Dixie Sakolowsky and Daniel Andrews under direction of Ronald E. Müller, Department of Economics Graduate Study Paper, The American University, Washington, D. C., June, 1977.

case at the time of, particularly, increased private bank lending to these nations was made.

Finally, the earlier improvements of the 1972-73 period had an uneven impact. For example, those nations with annual per capita incomes of $250 or less had only slight improvements in their terms of trade (accompanied by, in many cases, declines in the domestic production of foodstuffs). Thus, the current deterioration in the terms of trade among these LDCs results not only from the higher import prices for oil, but also from higher prices for fertilizer and manufactures, and the decline in the prices of other primary commodities. These events, in part, reflect the recession in the MDCs that reduce export volume from LDCs.[22]

While many of the LDCs were thus able to build up their official external revenues during the first years of the decade, this activity ended in 1974. After 1974, short-term borrowing and changes in the rate of reserve accumulation — operations not sustainable over the long run — were used to provide half of the additional financing required by the LDCs. The rest of the financing was accomplished by drawing on long-term credits. While many of the developing nations were able to finance their deficits in 1974, by drawing upon the available credits, they encountered increasing difficulty in 1975.[23]

If they hope to maintain their target for economic growth in the 1970s, non-oil exporting LDCs would have to achieve an annual growth rate of growth of GNP of 6.6 percent over the remainder of the decade. Yet, projections of the import requirements needed to attain this rate of expansion and of export prospects show that the annual current account deficit for these nations could increase to $70 billion by 1980. If interest payments and remittances are taken into account, the annual deficit could exceed $100 billion by 1980. Even these dismal projections are biased downwards since they are based upon two now unrealistic assumptions: (1) that MDC per annum growth rates would average 5%-6% through 1980 and thereby generate the necessary increases in demand for LDC exports; and (2) that targets for official development assistance by MDCs would be met. The recent past, however, has demonstrated the unreasonableness of both assumptions. Nevertheless, analyses based on them still project that the ratio of debt service payments and profits remittances to export earnings will rise from 15% in 1974 to 30% in 1980.[24]

Data compiled by the World Bank's Debtor Reporting System shows that gross disbursements to 86 LDCs grew at an average annual rate of

22 UNCTAD IV, TD/188, p. 2.
23 *Ibid.*
24 *Ibid.*, p. 4. For the LDC debt service ratio forecasts under lower MDC growth rates, see Sakolowsky and Andrews, *op. cit.*

13% over the 1965-1973 period; but, that debt service payments grew even more rapidly over the same years. As a result, the net transfer of financial resources for these nations, calculated in current dollars, increased by only 10% annually over this period. But, when the inflation in prices of goods and services is taken into account, the transfer growth rate in real net transfers was only three percent. During the same period, outstanding debt, including undisbursed debt, increased at an annual rate of 15%.[25]

The situation is even more serious among the 67 non-OPEC LDCs for which data is available. Differential access to disbursements and credit accounts for the bleak situation of these nations. As may be seen in Table 3, nations with a per capita GNP of $201-$300 had virtually no increase in their level of net transfers because of the great increase in their debt service payments over the 1965-1973 period. Nations in the next higher category obtained only a modest improvement in their

Table 3

GROSS DISBURSEMENTS, DEBT SERVICE AND NET TRANSFER FOR 67 NON-OIL-EXPORTING DEVELOPING COUNTRIES ACCORDING TO INCOME GROUP, 1965 AND 1973

(in millions of current dollars)

	Disbursements		*Debt Service*		*Net Financial Transfer*	
	1965	*1973*	*1965*	*1973*	*1965*	*1973*
Total (67 countries)	5 726	16 281	2 227	7 751	3 499	8 530
Countries with per capita GNP in 1972 of:						
Dls. 100 or below	287	1 422	8	156	279	1 266
Dls. 101 - 200	1 672	2 437	422	1 034	1 250	1 403
Dls. 201 - 300	618	1 019	119	503	499	516
Dls. 301 - 400	591	1 480	186	687	406	793
Dls. 401 - 800	1 209	4 235	360	1 948	849	2 287
Dls. 801 and above	1 350	5 689	1 134	3 424	216	2 265

Source: Annex table II-1 (TD/188/Supp.1/Add. 1)

* Defined as debt repayable to external creditors in foreign currency goods, or services, with an original or extended maturity of more than one year, which is a direct obligation of, or has repayment guaranteed by, a public body in a borrowing country (see UN Conference on Trade and Development, UNCTAD IV — item 11 — *Supporting Paper: Addendum*, for more details on coverage and definitions).

[25] UNCTAD, *op. cit.*, p. 13.

transfer because of a similar rapid increase in debt service payments. Only those nations with per capita GNPs of over $401, who received the greatest share of new private lending, had significant gains in net transfers, accounting for nearly half of the recorded net transfers in 1973.[26]

Thus, recent developments have exacerbated the problems facing the non-OPEC LDCs. Because of the short- and medium-term borrowing which occurred in the early 1970s, debt service payments will accelerate even more rapidly over the next few years. According to UNCTAD estimates, it is likely that the ratio of debt service on public and publicly guaranteed debt to exports will rise from 11% in 1974 to 21% in 1977. If estimated debt service on credits not covered by the data collected by the World Bank is taken into account, the ratio could reach nearly 30% by 1977.[27] But, these projections also assume a satisfactory recovery in MDCs, which will almost certainly not be the case. As a recent UNCTAD study concluded: "the external financial position of a large number of developing countries has been worsened by these events (of 1974 and 1975) and . . . difficulties in financing external debt have become acute and will become even more acute in the future. The question therefore arises whether new and/or intensified international strategies are required on a large scale to deal with a common problem afflicting a large number of developing countries".[28]

THE IMF VERSUS UNCTAD: ALTERNATIVE INTERNATIONAL POLICY TOWARD LDC DEBT

At the risk of overgeneralization, but nevertheless adequate as an assessment of current policy approaches, there are basically only two strategies which have thus far been proposed for dealing with the current crises in the international financial system. Each of these two alternative strategies is derived from a very different perception of the fundamental problems which have caused the present conditions.

A. *Alternative One: Maintain Lender Confidence through Traditional Approaches*

One position, favored by some of the largest bank lenders and a number of the biggest borrowers among the LDCs (Brazil, Mexico), is the traditional IMF stabilization strategy of maintenance of lender confidence through both: (1) domestic monetary, fiscal and balance of

[26] *Ibid.*, p. 33.
[27] *Ibid.*, p. 37.
[28] *Ibid.*

payments policies by large-deficit nations to restrain local demand and stimulate exports; and (2) the increased participation of official bodies in the resolution of the possible financial difficulties of some nations[29] so as to maintain, while expanding, the singular emphasis of the IMF stabilization approach. To some degree, steps taken by international organizations, since 1973, are seen as major devices for remedying the current problems. Included among these are the extension of the IMF regular credit branches, the liberalization of the IMF's Compensatory Financing Facility, the establishment of a Trust Fund for channeling part of the profits of the IMF gold sales to low-income LDCs and the proposed Witteven facility. Yet, these measures will have only modestly increased[30] the amounts of official sources of financing which were previously available.

B. *Alternative Two: A Structural Attack to Realign Real Terms of Trade*

An alternative approach, put forth by a number of nations at UNCTAD IV in Nairobi, in May of 1976, finds that the problems facing deficit nations, especially those which are non-oil exporters, must be remedied more by realigning terms of trade and production, than by adjusting imbalances in international payments. This structural view emphasizes the fact that sustained balance of payments insolvency is caused by real, not financial, problems. In short, the real terms of trade in goods and services must be realigned by LDCs before we can expect to see a permanent alleviation of their financial indebtedness. In part, this alternative route was an attempt to respond to the special needs of developing nations, who are often subject to great fluctuations in their export revenues. It also was a recognition of the inadequacies and limitations of present international facilities for balance of payments financing.

The UNCTAD proposals asked the IMF to supplement traditional policy and also engage in compensatory long-term financing linked to adjustments by deficit nations to help LDCs respond to major declines in the world economy. Beyond this proposal, many LDCs believe that additional IMF lending on long-term loans would require augmentation of Fund resources and that access to Fund resources needed to be

[29] On this strategy see: "Coping with the Imbalance...", *op. cit.*, pp. 1-2, 5-7, and Paul Lewis, " Nations Pressed to Bolster IMF Lending to Needy Countries", *New York Times*, March 10, 1977, p. 49, 57. This expansion would include, obviously, the proposed Witteveen Facility of the IMF.

[30] *Ibid.*, and Ronald Müller, "Testimony before the Senate Committee on Banking, Housing and Urban Affairs on the IMF Supplementary Financing Facility", First Session, in S.2152, Washington, D. C. Government Printing Office, 13 October, 1977.

expanded. To this was added the view that less demanding conditions should be attached to future funds provided by the IMF, particularly in the case of loans from the new Trust Fund established by the sale of IMF gold holdings.[31]

UNCTAD's focus on a realignment of terms of trade between LDCs and MDCs depends on more extensive lending by the IMF and other international organizations and upon a liberalization of the terms for obtaining funds. It also foresees the need for additional contributions by developed nations to official development assistance if LDCs are to meet their objectives for growth.[32] This strategy holds that "the international monetary system is not simply a monetary one but springs from the malfunctioning of the international financial and trading systems, and the international economic mechanism, generally."[33] Needless to say, the political feasibility of the UNCTAD (real) approach was predicated upon enactment in a world economic environment of normal MDC recovery to their pre-1974 economic growth rates.

The next section seeks to demonstrate that both the IMF and UNCTAD approaches are in and of themselves incomplete, and, therefore, inadequate. Their inadequacy stems largely, we feel, from the fact that each is a partial approach to what in fact is both a "financial" *and* a "real" set of problems which, concomittantly, also have both their short-run *and* long-run dimensions. In summary, the important question is whether simply increased short- and medium-term lending can alone enable LDCs to surmount their deficits and realign their terms of trade, or whether the current problems are indicative of a more widespread systemic dilemma. It is to this question that we now turn while taking due note of global interdependence by integrating into our analysis the role of US and other MDCs' domestic economic policies.

INADEQUACIES OF CURRENT DOMESTIC AND INTERNATIONAL POLICY: A DIAGNOSTIC OF THE US AND WORLD ECONOMY

Our diagnostic of the present situation derives the forecast that the cumulative effects of both secular and short-run forces will make the United States and world economy slip back into stagnation at major recessionary levels of unemployment by late 1979 or early 1980. This forecast, which we first made two years ago,[34] has a probability of

[31] *Ibid.*, pp. 9-13.

[32] It should be noted that few of the large industrialized nations are currently contributing 0.7 per cent of their GNP to such assistance, even though this amount was a goal for these nations. See UNCTAD IV TD/188/Supp. 1/Add. 1, pp. 1-27.

[33] UNCTAD, *International Monetary Issues: Problems of Reform*, p. 21.

[34] Ronald Müller, "Keynote Address before the International Advertizing Association", Annual Meetings, Geneva, Switzerland, September 18, 1975. For ana-

occurence of at least 65 per cent, and it is one with which a growing number of economists are now agreeing. The situation of a stagnant US and world economy by the end of the 1970s will occur in our opinion unless some fundamentally new policy initiatives are taken by the US and other nations to stimulate economic growth.

The return to a stagnant US and world economy by the end of the 1970s will not be avoided by the enactment of the IMF Supplementary Facility, the so-called "Witteveen Facility", or similar traditional IMF type of remedies. However, these intensified stabilization measures will reduce the probability of financial imbalances triggering a precipitous collapse of confidence in world money markets. For this specific reason, there is a need to support such measures as the Witteveen Facility. Nevertheless, it should be recognized that IMF activities have only a very limited role, i.e., like an insurance fund, reducing short-run uncertainty about imbalances in the international financial system. However, the IMF approach does not focus on the fundamental causes of that imbalance; rather, it seeks only to contain it. Excessive focus or reliance on mechanisms like the Witteveen Facility can detract attention from the crucial problem that US and the world community have still to devise an economic stimulation strategy for guaranteeing stable and acceptable rates of economic growth. IMF policies provide one, but only one, of the necessary (but not sufficient) conditions for economic growth, that of short-run financial stability. Operating in the absence of other policy tools and institutions —as has largely been the case in the early 1970s— the IMF approach has the unintended but nevertheless *de facto* effect of an anti-growth approach.

The IMF's strategy of austerity in national fiscal and credit policies and "belt-tightening" to correct balance of payments problems begins with the premise that economic contraction will return a financially unbalanced economy to an otherwise healthy, balanced and growing one. During the 1950s and 1960s, while such an approach had a salutory effect among the MDCs, it had only limited success in achieving its objective in the LDCs. As shown below, by the late 1970s, the post-World War II transformation of the US and the world economy had rendered obsolete stabilization policy approaches *operating in isolation* of other instruments. At best, the IMF fulfills the function of a band-aid: needed, but by no means in and of itself capable of healing the wound.

With regard to the UNCTAD-type approach towards LDC debt through

lytical details, see: Ronald E. Müller, "Stable National Growth in the Age of Multinationals: The Challenge of our Post-Market Economy", in Vol. 12 of *Future United States Economic Growth,* commissioned by the Joint Economic Committee of the US Congress, Washington, D. C., Government Printing Office, 23 May, 1977.

a (real) realignment of LDC/MDC terms of trade, we also support this as an essential objective. Unfortunately, however, implementation of this approach lacks a large dose of political realism because it assumes various extensions of compensatory and commodity stabilization types of financing as well as significant increases in development assistance flows from MDCs. The political unreality of these UNCTAD proposals stems from a failure to recognize the relatively new MDC problems (to be analyzed below) of economic stagnation compounded by the persistence of "stagflation" (simultaneous inflation and unemployment).

The existence of *stagnation* in the industrialized nations of OECD means that high unemployment and low growth rates make it domestically difficult to increase aid flows from MDC, and, worse yet, might accelerate even further reductions in imports from LDCs because of the likelihood of protectionist measures. Currently, the existence of *stagflation* means that the fear of triggering more inflation has made it difficult for MDCs to mount effective economic stimulation programs for reviving growth rates and lowering unemployment. Domestic stimulation through conventional monetary and fiscal policy now finds itself constrained by multiple new causes of inflation including market imperfections, structural bottlenecks like that in energy, and the effects of novel forms of international money flows. Like its international counterpart, current domestic policy was designed for the world of the 1950s and early 1960s. Until our policy approaches are modified and supplemented to take account of the relatively new reality of a transformed, globally interdependent economy of the 1970s, their further pursuit will produce unpredictable results.

A. *Transformation of the World Economy: New Levels and Forms of Global Interdependence*

On the one hand, the post-World War II transformation of the world economy is mirrored in the fact that we have come from a collection of national economies dealing with each other largely in the form only of trade, and at much lower relative levels than today, to a globally interdependent set of nations that are intertwined by a complex set of international commodity, investment, technology and money flows. On the other hand, the institutional side of the post-World War II transformation is seen in a sharp reduction in the number of actors in domestic and international markets. That is, a highly concentrated and smaller number of economic actors than ever before now dominate the contemporary world scene. These include, of course, not only OPEC but also the European Community, other commodity and regional blocs and a sharp reduction in the number of national private actors and their replacement by a much smaller number of large multinational corporations and banks. This new environment means that policy can no longer rely on natural forces of supply and demand, signalled through competitive markets, to generate stabilizing short-run changes in prices. Instead, short-run prices are now determined more by the negotiating power of concentrated economic actors than by market supply and demand conditions.[35] In short, both the level *and* the form of global economic interdependence has changed dramatically within the space of a short twenty-five years. Unfortunately, public policy, both national and international, has not kept pace with these changes.

B. *Three Poles of Global Interdependence: LDCs-OPEC-MDCs*

One basic message for policy-makers of this new global interdependence is that the problem of LDC debt is not isolated or closed off from other maladies that afflict our economies. Obviously, the rise of OPEC and the rapid increases in oil prices since 1973 have had a major role to play in explaining both the level of LDC debt as well as possible solutions to it. Yet, it would not only be incorrect, but also dangerously misleading to believe that OPEC is the sole cause of the world's financial imbalances.

Rather the causation (and therefore the remedy) of the LDC debt problem is also intimately linked with two major and relatively new problems of the US and other MDCs. First, there is the disturbing trend since the mid-1960s of a long term secular deterioration in US productivity and economic growth, i.e., the problem of secular stagnation. Superimposed upon this is the more recent problem of stagflation. Given global interdependence, what occurs in the "center" economies (the MDCs) will effect the "periphery" countries (the LDCs), and vice versa. To these two poles of traditional but heightened interdependence, that of the MDCs and the LDCs, we can now add a third pole, OPEC. A basic conclusion of our work[36] is that the international financial imbalances that beset the world today are a function of a *set of dynamics within and among all three of these poles.* In addition, the causes for our economic woes are to be found not only in short-term

[35] As Irma Adelman notes with reference to the private sector, "The emergence of strong multinational corporations, often established to facilitate foreign exchange transfers (that is, circumvent controls) has worked to much the same effect... a major result is de facto administered rather than market prices for major segments of LDC economies..., the major economic impact of the multinationals on the United States appears to be a reduction of control over the US balance of payments." From, "Interaction of US and Foreign Growth Rates and Patterns", Vol. 12 of *US Economic Growth from 1976 to 1986: Prospects, Problems and Patterns,* Joint Economic Committee of the US Congress, Washington, D. C., Government Printing Office, May 23, 1977, pp. 9-10; parentheses are the author's.

[36] See Ronald E. Müller, *Transcending the Past: Nations, Corporations and an Emerging New Order* (forthcoming, 1978).

but also long-term structural problems within each of these three poles. We shall, therefore, proceed by analyzing the respective problems of each of these major poles of global economics and the links among them.

C. *Misconceptions about the Causes of LDC Debt and OPEC*

It is often overlooked that the LDC debt problem is not new, nor does its origin have anything to do with OPEC. It is most unfortunate how fast economists in the MDCs have forgotten the burning issues of LDC debt and poverty that were discussed in the 1950s and 1960s well before the rise of OPEC. Even in the 1950s, although we were at lower levels of global economic interdependence, economists still had to search for the magic rates of growth in the MDCs which would permit the LDCs to expand fast enough to pay off the balance of payments obligations incurred in the past years.

Since World War II, the foreign trade interdependence between LDCs and MDCs created for the former an increasingly severe problem of deficit financing of their balance of payments. While LDCs exports to their more developed counterparts varied over the business cycle, the same was not true for the imports of the poor nations. They exhibited, to use the technical jargon, "structural rigidity", in that they entailed largely capital goods which were committed to fulfilling planned development targets. The reduction of such imports could only be carried out by sacrificing growth and employment goals. To reduce imports meant to further increase poverty, a politically difficult and undesirable action which in the short-run could be by-passed by resort to additional deficit financing. Thus with each subsequent business cycle, the LDC debt problem worsened. As early as the late 1950s and again in the late 1960s, many experts began to call for a re-evaluation of the whole question of debt renegotiation, and possible debt moratoria. *Already in 1969,* for example, the much-heralded Pearson Commission, sponsored by the World Bank, noted that there was "an explosive increase in public debt and debt service" in LDCs. The Commission went on record to this effect:

> The indebtedness of the developing countries imposes a large burden of debt service. There has already been a sequence of debt crises in the late 1950s and throughout the 1960s, and even a cursory inspection of the situation suggests that the debt servicing problem of the low income countries will become even more serious in the years ahead.[37]

This, of course, was very much in advance of the emergence of OPEC

[37] *Partners in Development: Report of the Commission of International Development,* New York, Praeger, 1969, pp. 153, 172.

and its subsequent raising of oil prices. OPEC intensified the situation, but did not create it.

We have already made reference to why, in the absence of other policies, IMF type stabilization measures cannot break, what developmental economists refer to as, "the vicious circle of LDC debt". The application of these austerity measures in LDCs means that unemployment increases, income distribution worsens, and economic growth slows by the terms of the contract required by the Fund as political-economic collateral for its financial support. Without other new international approaches to stimulate economic growth and to act in complementarity with purely stabilization measures, many debtor nations will have to devote an increasing portion of their future foreign exchange earnings to meet amortization and interest payments. In turn, heightened debt servicing will lower LDCs' capacity to import from MDCs the technology, capital goods, and food which are the essential inputs required to break the debt cycle through a sustained process of economic growth and development. Successive business cycles in the advanced nations fuel a worsening debt cycle in the LDCs. As this condition persists over time, austerity ironically becomes a necessary condition to attain some degree of short-run stability through financial assistance. But, the greater the degree of belt-tightening applied in the absence of long-run stimulation policies, the greater is the need for future financing, and the less resources are therefore available for stimulation policies, the greater is the need for future financing, and the less resources are therefore available for stimulating new economic growth. The vicious circle is complete and the apparent policy dilemma is seemingly profound.

D. *The Link between LDC Debt and Faltering US Economic Growth*

Another central message of global interdependence is that there is more than coincidence behind the fact at the very time when IMF policy-makers find their austerity measures increasingly ineffective in solving LDC balance of payments disequilibria, their national counterparts in the US, West Germany, and Japan are also finding traditional national stimulation policies crippled by the threat of double-digit inflation.

The dilemma of the LDC debt versus stimulation thus must be analized within the broader framework of an uncertain world dominated by OPEC petrodollar surpluses as well as by the stagflation prone economies of the MDCs. In the initial part of any given short-run period, external debt financing can temporarily bolster the LDCs' capacity to import from MDCs. But on a sustained basis, year in and year out, only through a widening and deepening of their domestic economies and their own internal growth can there be *a stable role for LDCs to serve as expand-*

ing markets for exports of the United States and other MDCs. For example, a recent report of the US Senate Budget Committee described the LDCs' contribution to MDC employment through purchases of exports as "heroic". With reference to the tremendous downturn in economic activity in the MDCs of 1974, the report noted that "had the smaller economies prudently abstained from borrowing and adopted policies to reduce their imports, the recession would have much worse for all countries".[38] We hasten to reiterate, however, that this anti-recessionary or stimulation role of the LDCs is short-lived in the absence of an underlying secular growth pattern in the MDCs. Thus, to illustrate, a large debtor nation such as Brazil, by borrowing heavily, was able to sustain an average annual growth rate in real GNP of almost 10 percent per year between 1973 and 1977. However, because of slackening MDC demand for its exports, Brazil is now going into deflationary measures and expects a sharp reduction in its growth rate in order to maintain its financial imbalance at an acceptable level.[39]

In breaking down these differential effects of the short-run of a few years versus a longer-run period, a strange irony emerges. In the short-run period that we are just now concluding —1973-1977— there was indeed a harmony of interests among LDCs, their expanded borrowings from the IMF and private multinational banks, and the resulting stimulation of jobs in the United States and other MDCs through relative maintenance of the latter's exports to poor nations. But, for the longer-run, the continued absence of other policy measures to generate economic growth in both the center and the periphery (and/or the presence of a "myopia" that only refinancing is necessary), make self-defeating the stabilization function of the IMF and private multinational banks. That is, over an initial period of application these stabilization approaches eventually have the effect of reducing imports from MDCs and lowering the latter's growth rates, while at the same time not providing a basis for stimulating growth in the LDCs. We are now at the beginning of a sharp period of reductions in LDC imports for the products of the US and other advanced nations' economies at the very time when the growth rates of these MDCs are more in need than ever for this external source of stimulation.

[38] V. D. Ooms and A. Packer, "The International Economy and the Federal Budget", Senate Budget Committee, December, 1976.

[39] We should therefore be wary of economists who use recent (1973-76) LDC growth rates to justify the argument that a continuing accumulation of LDC debt in the absence of other policies for the period of 1977-1980 is feasible and will not produce further strains and uncertainties on international financial markets. Cf., Robert Solomon, "Testimony before the Senate Committee on Banking, Housing, and Urban Affairs on the Supplementary Financing Facility", in s-2152, Washington, D. C., Government Printing Office, October 13, 1977.

E. *Prospects of US and World Economic Stagnation*

As already noted, we and an increasing number of other economists are forecasting for the US and world economy, by mid 1979 to early 1980, a substantial slow-down if not halt in the recovery now in progress. That is based, in part, upon the inability of MDC consumer spending to sustain the recovery beyond 1978. Nor, as we have just analized, can we rely on the increasing demand for LDCs to stimulate growth in the "center" countries of the OECD. Thus, most important of all is that investment demand obviously will have to play a crucial role in maintaining the recovery, particularly beyond the next year and a half. But it is not at all clear whether sufficient investment demand will be forthcoming due to four sets of both long- and short-run problems that are related to the transformation of the US and world economy alluded to earlier.

First, in the OECD nations a combination of long-run secular forces, including declining capital and labor productivity as well as the necessity to maintain deflationary corporate tax policies, have been putting downward pressure on the creation of new, long term fixed investment. In other words, there is an increasing tendency for non-OPEC investors, e.g., large corporations in the United States, Europe and Japan, to place their surplus funds into acquisitions and real estate or other types of non-productive investments which do not create new capital formation and therefore do not generate new capacity for real economic growth.

Since 1971, US investment for new capital formation (new plant and equipment) is some 30 percent below its average for the 1960s. Even more indicative is the fact that compared to the previous five post-war recessions, the 1974-77 rate of new fixed investment is down some 16 per cent. But even this figure disguises the magnitude of the problem. Eliminating food and service industries from the average and concentrating on the giant basic industries which are the mainstay of the US economy, like steel, computers, machine goods, textiles, rubber, etc., one finds almost zero growth in capital formation. The most apparent cause of the slump in capital formation slump is the significant decline in the rate of profitability on fixed investment. The real rate of return on fixed investment, for the 1970-76 period, is some 30 per cent below its 1960-69 average. The profitability problem is, however, in turn due primarily to a long term productivity decline which has been in motion since the mid-1960s, compounded by such factors as increasing costs of anti-pollution equipment, upwards shifts in natural resources costs like energy, and "work alienation" affecting labor output in large-scale, mass production line industries. During the past ten years, compared to the average annual increases for the 1950-65 period, the rate of increase in productivity is down by 40 per cent. In fact, for whatever period in the past is chosen, the decline is startling. For example, even during the 1929-'39 Great Depression, the decline in the rate of increase in productivity was only 20 per cent in contrast to the 40 per cent drop off in the past ten years.

The slump in capital formation, profitability and productivity is not isolated to the US, but is a phenomenon plaguing other industrial powers like Germany, Japan, etc. In Germany, real capital formation is down 30 per cent compared to any other recessionary period of the past 25 years; in Japan the decline is a dramatic 70 per cent. Given this secular problem, corporations are exhibiting an increasing tendency to place their investible funds into acquisitions and/or holding them in near-liquid assets, i.e., not targetting them for new capital formation.[40] In addition, short-run political uncertainties surrounding the so-called phenomenon of "Euro-Communism" have further reduced the rate of capital formation in the European Community. As a result investors are channelling more of their funds to the US, but, again, largely into real estate or acquisitions.

Second, in the OPEC nations short-run political and financial bottlenecks have made it difficult for them to recycle their surplus petro-dollars into long-term direcly productive investments.[41] Although data is scarce, we have made a detailed study, which under the most optimitic assumptions estimates that at the very minimum 72 per cent of OPEC's current account surpluses are *not* being channelled into productive long-term, fixed investments, i.e., are *not* going into capital formation.[42] Using more realistic assumptions, there is every reason to believe that of the 1973-76 cumulative current account surplus of $ 150 billion, no more than 16 per cent went into new capital formation in the world economy. In this regard, OPEC appears little different than investors in the MDCs who, as already noted, are increasingly unwilling to commit their funds to long term fixed investments in new capital formation. In addition, OPEC faces other economic and political problems that inhibit further their ability to commit funds into capital formation and which are unique to them as compared to MDC investors.

[40] Productivity figures from Michael Boretsky, "Trends in US Technology: A Political Economist's View", *American Scientist*, January-February, 1976; Profit and investment data from *Business Week*, "The Slow-Investment Economy", October 17, 1977.

[41] The OPEC surplus creates two types of recycling problems. The first, and the only one to receive attention, has been that of recycling from surplus to deficit nations. The other, and much more important for economic growth in the United States and other countries, is a recycling from short-term near-liquid assets in which the surplus is being held into long-term, *new* fixed investments.

[42] The details of these estimates are given in Ilena Porges, Hussein Pourmick and Roberto Bacquerizo, "The Recycling of OPEC Surpluses into Directly Productive Fixed Investments", Supervised Research Report of the Graduate Seminar in International Trade and Finance, Department of Economics. The American University, Washington, D. C., December 17, 1977.

For particularly the largest OPEC surplus nations, the Arab countries, oil is their only basis to assure their future progress from a situation of underdevelopment to that of self-sustaining economic growth. Their oil income is not really income, therefore, but productive wealth which must be invested at low risk and at a sufficiently high return to guarantee these nations' future growth. OPEC members also perceive a political risk in committing too much of their funds long term in the MDCs because of a continuing fear that such assets could be seized or threatened as an MDC instrument to diminish OPEC bargaining power vis-a-vis the industrialized countries. Numerous interviews with petro-dollar fund managers in the OPEC group indicate that their upper limit on fixed investments in the MDCs is no more than 5 to 10 per cent of their total monies. Their real desire is to commit long term funds to investment projects in developing nations, but not until they are given an increased say in the decision-making of the major international institutions like the IMF and World Bank which channel and guarantee the investment flows to the Third World. Here again we see the significant policy lag of the United States and other MDCs in their reluctance to create a new international political order commensurate with the fundamental transformation in world economic structures that have now made outdated the decision-making process and power relations within current international institutions.

Third, it is not at all clear that the proposed US government's $ 25 billion 1978-'79 tax stimulation, or the German package of some $ 5 billion, or the Japanese of some $ 8 billion will be adequate for overcoming the lack of investor confidence, and therefore, for investment commitments, that will be needed to put us back onto a five-six per cent per annum growth pattern.[43] Also feeding the investor confidence crisis is the obvious fear that inflation could be generated by such stimulation packages when aimed only at the national economies of respective MDCs. This fear, whether justifiable or not, acts as a further constraint on the size of these packages, and therefore, inhibits normal recovery.

Fourth and finally, we must superimpose on this picture of an unstable US and world economy the growing pressure throughout the MDCs for trade protectionism. It is easy to understand from whence this pressure comes. Here again we must view the role of the LDCs in the global economic interdependence of the US and other MDCs. LDCS account for over 45 per cent of Japan's total exports. In Western

[43] In Japan, for example, it is estimated that a stimulation package ten times greater than that proposed is needed to use up the economy's excess capacity. For Germany, some US $ 4 billion of the stimulation will be absorbed by increased value-added taxes (VAT) and social payments, leaving less than US$ 1 billion, and thus having little or no impact on growth. (From P. G. Juhl, Wirtschafts-institut, Kiel, Germany.)

Europe, the figure is lower but still very substantial particularly in the most dynamic industries which in recent years have made the largest contribution to overall economic growth. Even in the United States, some 26 per cent of all exports now go to the Third World, non-OPEC nations. As significant as these figures are, there is a further "multiplier effect" between US economic growth (or stagnation) and the LDCs. Also essential to grasp is that when LDC demand for the exports of Japan, *et. al.*, does slacken, the US market has increasingly become a sponge to absorb those exports no longer going to the LDCs. The loss of LDC markets, in other words, influences MDCs' attempts to sell their now excess inventories in the United States. (Whether or not one wishes to refer to this as "dumping" is another matter.) The result is a significant impact on US employment due to this *de facto* "absorption role" of the US economy for the excess export inventories of other MDCs in such key industries as steel, textiles, and electronics. In addition, the ever-increasing energy import bill feeding US balance of payments deficits, provides an additional drag on US recovery while further reinforcing the pressures for trade protectionism. Nor are protectionist pressures to be found only in the US. They are rapidly multiplying in all of the industrial nations of the OECD where unemployment persists.

Within this framework of global economic interdependence, we find that the cycle of LDC debt converges with an emerging international business cycle which is puntuated by recessions and pseudo-recoveries. Given their timing, the LDC debt cycle reinforces stagnation tendencies in the MDCs, and vice versa.

AN "OPEC-OECD MARSHALL PLAN" APPROACH TO THE LDC: TOWARD A SUSTAINED US AND WORLD ECONOMIC RECOVERY

It is crucial to an understanding of this present dilemma to recognize that economists and policy-makers have thus far focused on only a limited number of alternatives for dealing with the LDC debt problem. In evaluating both actual policy and proposed alternatives to date, it can be demonstrated that they are either politically undesirable, economically inadequate, and/or unlikely to occur. For example, one proposed alternative aims at reducing the price of oil by either a weakening or break-up of OPEC, an event which is neither politically desirable nor likely to occur. Another suggested alternative is to apply sharp reductions to the levels of deficits being incurred by the debtor nations. This is obviously inadequate in that it would mean an extreme anti-growth approach for the LDCs, while intensifying the dangers of a deep world economic recession, if not a depression. As for current policy, it is based on the IMF approach of moderate stabilization measures with supplementary facilities for refinancing and allowing a further accumulation of debt. It is viewed as the most feasible and least undesirable of policy alternatives. Unfortunately, as I have already noted, this approach has a moderate anti-growth effect and, although currently necessary, is leading us up the same blind alley as in the past.

One alternative, however, not yet seriously considered, is a comprehensive, internationally coordinated stimulation plan for world economic recovery which explicitly takes into account the political realities of the three respective poles of global interdependence, i.e., OPEC, the LDCs, and the MDCs. This approach recognizes explicitly that global interdependence among these three groups of nations means that stimulation of LDC growth not only alleviates the strains to the world system of the debt-poverty problem, *but also,* stimulates employment and growth in the US and other MDCs. Such a new initiative would act as a complement, not a substitute, to conventional national monetary and fiscal policy stimulation. Indeed, a joint "OPEC-OECD Marshall Plan-type" approach towards the Third World would provide a non-inflationary stimulus to MDCs —through increased exports of goods and technology to the LDCs— that would afford US, Japanese, and European policy-makers a needed degree of freedom in overcoming the dilemma of stagflation which currently compounds the difficulties of strictly national efforts. For national and international policy-making arenas, however, such a basic new policy approach, while previously mentioned or alluded to by a small number of experts,[44] has not until now been developed in detail and, therefore, has not yet been systematically evaluated.[45]

This "Marshall Plan-type" of global stimulation package could be initiated through an international accord, signed by all three groups of nations. It would be a basic commitment, and delineate the respective level *and* forms of financial participation of the OPEC and industrialized nations of the OECD to generate on a five-year sustained basis significantly increased development assistance funds *and* long term private

[44] One of these is James Grant, President of the Washington-based Overseas Development Council, who was quoted by the *Christian Science Monitor* (August 22, 1976) as seeing the need for what he called a "Third World Marshall Plan". Already in December, 1974, in a Trilateral Commission report by N. R. Gardner, S. Okita, and B. J. Udink there is a focus on a joint OPEC-"Trilateral World" development assistance effort to stimulate growth in LDCs and, *therefore,* in MDCs; in "OPEC, the Trilateral World, and the Developing Countries: New Arrangements for Cooperation, 1976-1980", *The Trilateral Papers: 7,* New York.

[45] The approach which follows was developed over the past half-year, with the encouragement of various US and foreign officials, among them Venezuelan President Carlos Andrés Pérez and his Foreign Minister, Simón Alberto Consalvi. On December 22, 1977, during the OPEC Ministerial Meetings in Caracas, President Pérez announced in a press conference one version of this approach for consideration by OECD, OPEC, and LDC nations.

investment flows for the LDCs. Taken together, this sustained commitment for development stimulation in the LDCs, given their global interdependence, could in fact lead to further stimulations in the US and other MDC economies through increasing exports of technology, food, capital and consumer goods, and thereby increase jobs. Here, of course, it is crucial that we see how global interdependence affords us a new basis for international relations: that a stimulation of the US and other MDC economies in the OECD countries can be obtained through a stimulation of other parts of the world economic system, in this case, the LDCs. In technical economic terms, the LDCs, if they received sustained stimulation, could in fact be a "new growth frontier" for a world economic recovery, for themselves and the MDCs. The LDC growth frontier would thus overcome a major problem underlying lagging capital formation, i.e., investors' perceptions of saturated demand levels for new goods and services.

Although the approach being suggested for the current situation would be radically different in many ways, sufficient discussion would confirm that there are three basic *messages* of the original Marshall Plan from which we should learn. First, because of the *sustained committed* effort, the original Marshall Plan was able to overcome the crisis in investor confidence which occurred in Europe after World War II. Given the absolute ruin and devastation of the Western European economies, investors were not willing to initiate massive investment projects because of what appeared to be a lack of sufficient demand future for goods and services. The riddle was: "Who starts first?" The "sustained commitment" aspect of the Marshall Plan original holds out a basic message of why a 1980s version for the LDC*s* can break the current vicious circle of the crisis in investor confidence.

A second lesson of the European recovery program was that it was the first time in the economic history of nations where recipient nations of internationally transferred funds were able to *participate* in the decision-making on the allocation and utilization of the transferred resources. This "participation aspect" applies directly to the contemporary area because without the increased participation of OPEC and the LDCs in world decision-making forums like the IMF and World Bank it is difficult to envisage either group's cooperation in initiating global economic coordination to deal with the MDCs' stagnation problems.

A third message of the original European program was how it demonstrated, given any form of basic interdependence among a group of nations, that it is possible to forge an international economic policy based on "enlightened self-interest". This is seen in the fact that although the Marshall Plan was initiated because of the national security situation of the world of the late 1940s, the economic program proved to be one of the most successful stimulations of US business and employment expansions ever facilitated by the US government. There is every reason to believe there would be equal benefits for US labor and business in this proposed 1980s approach to attack the interdependent (in this case, economic) problems of the North and South. To make feasible such a proposed international accord for a new "North-South Plan" viable, it would have to fulfill certain basic prerequisites in each of the three major poles of economic activity, i.e., OPEC, the MDCs of the OECD, and the LDCs.

For the OPEC countries, it is absolutely essential that their currently unused surplus, which is being held in short-term liquid assets, be recycled into long-term, new fixed investments. If this does not take place, then the world economy lacks the necessary investment funds for regenerating itself and for future growth processes. However, the OPEC countries will only put a very limited amount of their funds into new long-term fixed investment projects in the MDCs because of their fears of possible political implications (see prior section). However, with creation of the appropriate financial mechanisms described below, OPEC funds could be channelled into long-term LDC investment projects through both multilateral public *and* multinational private actors. This would allow the fulfillment of the OPEC countries' first and foremost condition of a participation in a new and long-term investment push in the world economy, i.e., that of being secure about the controlability over their investment assets. Of course, the particular form of OPEC financial participation would have to allow the fact that these nations themselves are overcoming severe problems of underdevelopment and in many ways have future programs that make their financing needs quite different from the rich countries in the MDC center. Nevertheless, OPEC financial participation, on both economic and political grounds, is absolutely essential if we are to overcome world economic stagnation.

Important, therefore, is that the *form* of the OPEC participation has to be different from that of the OECD nations. OPEC development assistance contributions to the Third World are already three to five times higher, on a per capita income basis relative to their GNPs, than those of MDCs, and only nominal future increases should be expected or demanded. As already noted, given OPEC's needs to overcome their own developmental problems, their major role should be through the private capital markets in a joint approach with international and regional development institutions like the World Bank, the Inter-American Development Bank, etc.

There are two major features of such an OPEC role. First, a cooperative effort through the private international bond markets could secure for OPEC nations acceptable rates of return which they must receive on the vast proportion of their surplus-investible funds and thus bring about the needed transfer of these funds into long-term fixed investments for capital formation in the LDCs. Second, the "OPEC Development Bond" effort being suggested here, with them acting as a guarantor along with cooperating international institutions and using the regular underwriting service of multinational banks and consortia, would mobilize surplus funds of private investors worldwide to also purchase these issues and further increase the rate of new fixed investments. Third, OPEC placement of the total funds raised by its Development Bond subscriptions could be through "Special OPEC Windows" at the World Bank, IFC, and their sister regional institutions for investment in the LDCs. In these limited areas where these investments do not yield a rate of return equal to the terms of the Development Bond subscriptions, the difference could be paid out of development assistance funds provided to the World Bank, etc., from the OECD industrialized nations. Fourth, another proportion of MDCs' public aid funds could be devoted to basic human needs projects, particularly, in the poorest of LDCs where most investment requirements are not suitable for private financing.[46]

In the MDCs, a number of conditions would also have to be met by such an international accord for this proposed "North-South Plan". First, the public and their elected officials in the MDCs would have to understand that OPEC financial participation would be subject to the MDCs' own increased contributions of new flows for development assistance to the LDCs. This condition, as noted in the previous paragraph, can indeed be met. A second and equally important condition is that stimulation in the LDCs would not result in putting US workers and their counterparts in other MDCs out of jobs. I am referring here to the problems of "structural dislocations" (such as that suffered by the US shoe industry) which result from the successful expansion of LDC export programs in manufactured products. However, the recent initiative of the "shoe plan" of the US Department of Commerce has established an important and necessary precedent for the US government to assist private enterprise and their employees while programming on a forward basis to make successful adjustments and/or conversions to rapid changes in import competition which are to be expected in today's highly globally interdependent world economy.[47] In our own personal experience, what will have to be done if the US and other MDCs wish to maintain and support the principles of free trade, is to initiate two to

[46] These four features overcome the deficiencies of the R. N. Gardner *et al.*, *Trilateral Report, op. cit.*, namely that their proposal relies almost singularly on OPEC as a source of "aid contributions".

[47] See remarks by Undersecretary of Commerce, Dr. Sidney Harman, designer of the US Shoe Initiative, as quoted in the *Wall Street Journal,* July 21, 1977, p. 24.

seven year sectoral and inter-sectoral policy coordination for structural adjustments, or, as the Europeans call it, "structural adaptations". This is in addition to the now obvious need to develop coordinated monetary and fiscal targets for meeting two to seven year macro goals as well as for facilitating sectoral adjustments.[48] Here, the US can learn from its European and Japanese counterparts. They have shown us that there is no basic contradiction between a viable private enterprise system and the use of government intermediation instruments to assist the private sector in making healthier and more rapid adjustments to changing competitive conditions. Market mechanisms alone, in an age of concentrated economic actors, cannot be relied upon to provide adequate signals for the needs of resource allocation. In this sense, we must transcend our past and transcend our ideological blinders.

A third set of conditions which must be met are those that would occur in the LDCs. Here the biggest problem is that which is called the "absorption problem". This refers to the difficulty of many LDCs to absorb large inflows of financial and technological resources because of a lack of basic human skills in management and planning, engineering, and in technical crafts for the emplacement and operation of these resources.

If and when the absorption problem can be overcome, and I have strong reasons to believe it can under this proposed scheme, then in fact the *LDCs hold out to the world economy a "new growth frontier", the investment in which would not have the same levels of inflationary bias that we now find in the MDCs when there is reliance on only national stimulation packages.* There are two basic sets of reasons which lead me to believe that the LDC absorption problem is manageable. The first set includes the selected, but expanded, use of multinational corporations from MDCs in the primary and manufacturing sectors of LDCs, but under new forms of interaction structures, controls, and guidelines that have already proven themselves to be highly successful and feasible for both the host countries and the corporations involved. In fact, the most "progressive" of the multinationals are rapidly "discovering" that, compared to the 1950s and 1960s, there are new ways of doing business with the Third World that are indeed opening up new growth opportunities for these corporations. Indeed, a most pivotal element of this new pattern of LDC-MNC interaction is that it is taking place in host countries that span a political/ideological spectrum from China, Algeria

[48] For details see: Müller, "National Economic Growth . . .", *op. cit.*, Part IV. On the need for systematic policies for sectoral-structural adjustments to stimulate MDC growth while maintaining free trade, see the major new study of GATT by Jan Tumlin and Richard Blackhurst, Geneva, December, 1977.

and Tanzania to Venezuela, Mexico and on to Brazil, the Philippines and South Korea.[49]

The second set of reasons concerns why the absorption problem has existed in the first place. Under this proposed massive, new sustained stimulation for LDCs (on the order of a three- to fourfold increase in investment flows, public and private), it will be possible to accelerate the rapid training and creation of the needed managerial and technical skills. In the past this has never been possible in most LDCs since there were never sufficient resources available for both: *1*) investment in industrial and other material projects, as well as funds for, *2*) investment in human resources. The formerly high levels of trade-offs between the two, given the significant increase in investment funding envisioned by this scheme, should no longer be constraining.

The idea of a sustained OPEC-OECD Marshall Plan-type effort for the LDCs is sure to be criticized by those of the extreme "right" and "left" of the political spectrum. The right will again offer its outmoded yell of "giveway" and preach its outdated *laissez-faire* doctrines. The left, in its turn, will cry, "new form of capitalist imperialism". The obvious contradiction between these two criticisms should make apparent their mutual invalidity. Yet, we speculate that there is now enough *new knowledge* of not only economics but also the sociological and political, to transcend the past on which both right and left rationalize their charges. Thus, as noted, we find that LDCs —regardless of ideological persuasion— are learning to control and structure multinational corporations. The result is that formerly negative impacts (e.g., in the area of balance of payments, employment and domestic technological development capacity) arising from multinational operations are now being changed into benefits for the host economy. A short ten years ago, such a process of change could not have occurred. In the same vein, a new and mutual awareness of the fragile global interdependence of the world economy, combined with a new knowledge of the control procedures on both donor and recipient ends, the will to experiment, and the necessity to respect an individual nation's choice of development style, should permit the execution of a broad-based Marshall Plan assistance program without subjecting LDCs to the abuses of the past.

There is one final advantage of such a new type of internationally coordinated initiative which, however obvious, we should make explicit at this time. A particular percentage of the increased funds could be devoted to basic human needs projects and, therefore, become the eco-

[49] For details, see Ronald E. Müller, *Transcending the Past . . .*, *op. cit.*; and R. Müller and D. Moore, "Successful LDC Cases of the Promotion, Structuring and Control of MNCs", Preliminary Report, prepared for the UN Centre on Transnational Corporations (January 15, 1978).

nomic component of "human rights". At the same time, the transfer of the total package of these funds would indeed, under proper financial management, go a long way to solve the "vicious circle" of LDC debt further feeding economic stagnation in rich and poor nations alike.

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Integrating Financial Planning with Macroeconomic Planning for Efficient Foreign Debt Management

Clark W. Reynolds

The author is Professor of Economics at Food Research Institute, Stanford University.

In this conference, attention has focused on ultimate borrowers among the developing countries, upon ultimate lenders in the industrialized countries and surplus third world economies, and particularly on the debt problems created by the rapid increase in international financial intermediation both public and private. However, there has been little discussion of the intemporal supply and demand structure of the economies concerned, which might provide the basis for net lending or net borrowing over sustained periods of time. It would seem that, for efficient global resource allocation, such issues should be raised. Moreover, to the extent that private international capital markets reflect responses to market signals, both prediction of future lending and borrowing trends, as well as more effective national and corporate capital budgeting are facilitated by such an approach.

Recent trends in private international lending have followed the historical pattern of financial transaction flows of public lending institutions from developed countries (and some of the resource-rent-rich developing countries) to the larger and more commercially dynamic middle-level developing countries such as South Korea, Taiwan, Brazil, and Mexico. This reflects a general consensus among creditors that the latter offer what might be called a "comparative advantage for growth". This refers to the fact that such countries are better-equipped in terms of natural resources, labor, capital and technology, to transform present capital and intermediate goods into future final goods for export and domestic consumption, *vis à vis* the smaller or less well endowed developing countries. Since such a determination tends to be subject to political and economic risk considerations, the type of economic system and geopolitical orientation of the countries concerned may of course affect the perception of their comparative advantage for growth.

Since voluntary international financial transactions, which permit real resource transfers eventually anticipate resource flows, it is not surprising that countries perceived to have comparative advantage for future growth and export capacity will be most attractive to lenders. This paper describes a number of instances in which "vent for surplus" economies received large initial resource transfers from other regions (international flows in large nation-states, international flows in other cases) which led to a substantial growth in export capacity. Exports led to rental income payments to owners of natural resources and related investments, some of which was saved. But those savings tended to be consumed or transferred out of the region to other locations more suitable for innovations in manufacturing, commerce, and services (and especially to those activities with the potential for generation of new economic rents). In many cases the eventual outflow of real resources substantially exceeded what might have been regarded as a handsome return on equity investment plus servicing of interest and principal on previous loans.

Indeed, it is the argument of this paper that for developing countries today the potential for loss of real income, through failure to mobilize, save and efficiently invest scarcity rents from domestic resources, represents a far greater opportunity cost than any failure to negotiate a major transfer of real resources from richer to poorer countries through international debt moratoria, stimulation of private international financial intermediation, or a global plan for future borrowing. This is not to minimize support for such programs. It is simply to urge developing countries which have significant rent-generating potential to engage in internal real and financial planning so that foreign borrowing will become consistent with the growth and savings potential. International financial institutions are also advised to expand the use of such an approach in their evaluations of country risk as a basis for future portfolio decisions. In later sections of this paper such planning techniques are discussed.

There is a fundamental constraint imposed by the political arithmetic of net resource transfer between lending and borrowing countries; namely that gross capital flows tend to become ever-higher, as a share of GDP, while net flows remain small and eventually reverse themselves. In few cases do net resource transfers represent more than 2 to 3 per cent of GDP for sustained periods of time; the most extreme cases of 5 to 10 per cent shares rarely last more than a few years. Hence, if growth is to require investment rates of 18 to 30 per cent of GDP, clearly the net resource transfer from foreign borrowing (net foreign savings) will fail to cover more than 10 per cent of total capital requirements. However that 10 per cent, if planned carefully so as to provide scarce technology and other resources not efficiently obtainable domestically, could have a disproportionately high impact on growth. Meanwhile the larger the gross transfer, the greater the constraints which they impose on the domestic policy of borrowing countries, regardless of the size of the net transfer, as has been pointed out so well by Pedro Malan, Rosario Green, and others at this conference. For this and the preceding reasons, it would seem worthwhile to draw attention to the internal mobilization of resources. Integrated real and financial sector planning is a step in that direction. External assistance in this area would serve to lessen the relative dependence of developing countries on international sources of gross borrowing, while simultaneously increasing internal rates of savings to finance growth and broadening the scope for domestic economic policy.

A MICROECONOMIC BASIS FOR CONSISTENT FINANCIAL POLICY

This section discusses the elements essential for a microeconomic foundation for the analysis of real resource transfers among major lending and borrowing sectors as they are related to financial flows. The framework of analysis is based upon a theory of surplus creation linked to the concept of economic rent applied at the level of production sector. This in turn is used to provide a basis for a theory of potential savings in which the rents generated by production activities may be used to provide savings for investment in new, rent-generating activities. The approach is extended to international resource transfers and financial flows, permitting domestic surpluses and deficits to be related to the level of external indebtedness. This permits one to determine whether the level of foreign debt is consistent with the projected growth of domestic production, savings, and investment. Hence it provides a sequence of conceptual links from domestic production and investment behavior to international financial transactions.

A. *The Nature and Significance of Economic Rents for Investment, Productivity and Growth*

Much contemporary Third World growth, as that of presently developed countries, has depended on the mobilization of natural resource rents from agriculture, mining, and petroleum. Scarcity rents, which accrue to inframarginal suppliers, have induced investments in new sectors of production which offer further potential for yields over and above a normal return on capital. The historical succession of investments which transmit themselves from sector to sector in search of scarcity rents has been cited from Marx to Schumpeter. Rent-generation in any economy takes three major forms:

Natural resource rent — the returns to natural resource endowments over and above the normal cost of capital, labor, and premium for risk and liquidity essential to permit the activity to occur (Ricardian rent)

Innovation rent — the returns to entrepreneurial combinations of innovations with financial capital, subject to natural or artificial barriers to entry essential to permit the activity to occur (Schumpeterian rent)

Protection rent — the returns to barriers to entry (legal, social, institutional, illegal) permitting monopoly and monopsony profits (Bain rent)

Each form of rent has different implications for the productivity and growth of the economy. Natural resource rents are common to developing countries whose exports of raw materials and primary products are leading sectors. Income from these activities and related production and demand linkages provide a potential surplus for further savings and investment. The rental incomes from resources accrue to the most productive suppliers, i.e. inframarginal producers to the left of the equilibrium point on the market supply schedule. "Productivity" in this sense is both a joint physical and value concept. In physical terms, in the case of agriculture, it refers to quality of the soil and climatic conditions which permit greater crop production per unit of land, labor and capital employed. In the extractive industries it refers to the quality of the ore mined, distance from port facilities and transport costs, accessibility of ore bodies to excavation, and other factors associated with the bounty of nature and location of the developing region. In either case, in value terms, the relative price of the commodity produced determines the value product of physical output. Value product and the rental income streams which it generates tend to be extremely volatile for natural resource-base activities. Demand fluctuations influence world prices. Climate influences the supply of crop production. Investments in research and development, exploration, infrastructure, technical training, and other inputs, may also affect supply, causing prices to fluctuate and providing productivity gains in the form of quasi-rents. In practice such rents are difficult to distinguish from pure resource rents. Because of induced productivity changes, even those economies with less-abundant initial resource endowments may ultimately obtain higher rental shares of unit value for the same commodities than producers in "more fortunate" regions. Indeed there are many historical instances of natural resource-abundant regions which eventually lost their relative position in the market through technological change, exploration, and development which permitted new regions to replace them as the "most productive" suppliers. In extreme cases, some older regions eventually became extramarginal suppliers dropping out of the market completely.

Innovation rents are those which accrue to entrepreneurs who combine new technology with financial capital in the pursuit of profit. These activities are described by Schumpeter and used to explain why an economy which has achieved an equilibrium level of production and productivity may suddenly shift to a higher level (what he terms "development"). In his theory of business cycles, economies are seen to be ever tending toward new levels of production in a dynamic process by which investment flows sequentially from innovation in search of profits. When such investment overshoots, profits in that sector will become negative causing the economy to fall back to a depressed level before eventually recovering and continuing the upward movement. One of the principal elements in this process is the tendency for leading sectors to borrow financial capital, in order to innovate and expand, so as to earn excess profits (innovation rents). These profits provide the potential for new savings which, in the form of financial capital, may be drawn into investment in additional innovation activities. Through the growth of competition and associated price declines in leading sectors, their innovation rents (in excess of a normal return on capital) will eventually decline and disappear. If the balance between net savings-generation in actual surplus sectors and net investment demand in potential deficit sectors is lost, the results would be inflationary (in the cases where ex ante investment demand exceeds savings) or deflationary where ex ante savings exceed investment demand).

Third world countries have had less success in generating innovation rents for reasons which are widely discussed in the literature, including lack of domestic research and development, a shortage of entrepreneurship, and reduced supplies of financial capital. Vicious circle theories have been used to "explain" why such countries, traditionally dependent upon high priced imported technology, have failed to develop their own innovation-based leading sectors. It is argued that they have had a tendency to replicate the techniques of leading sectors of the industrial countries in such a way that the innovation rents which do accrue revert to the latter in the form of payments on patents, royalties, transfer pricing, and other measures. In short those excess profits from industrialization which are retained in third world economies tend to reflect protection rents rather than innovation rents.

Protection rents provide little incentive for sustained growth in production and productivity. By their very nature they arise from barriers to entry into the market. They thrive on the exercise of monopoly and monopsony power. Hence they exist because of impediments to the evolution of competition in pursuit of profits, which Schumpeter saw as an essential element in the dynamic of development. Barriers to entry for import-substituting activities rely on "infant industry" arguments which depend upon the assumption that domestic competition will eventually thrive even though foreign competition is blocked. Since only the larger developing countries appear to have markets on a scale sufficient to permit vigorous internal competition, and since these countries tend toward oligopoly and collusion among suppliers, protection rents tend to be preserved. Moreover the potential size of these national markets is restricted by policies which favor inequality in income distribution. As a result inframarginal import substituting activities continue to earn significant protection rents and to produce at levels below competitive efficiency, wasting capital and other resources. (The capital share of value added in the protected industrial sector of developing countries in Latin America, which includes protection rents, averages 40 to 50 per cent, compared to 20 to 30 per cent in the industrial countries.)

Protection rents also accrue to those able to circumvent import restrictions, obtain rationed permits, violate exchange controls, avoid payment of minimum wages, and engage in black and grey market activities in economies subject to legal and institutional barriers to trade and production. The more the obstacles to trade, the greater the scope for such rents. While the dead weight cost of these barriers is significant, their dynamic consequences can be much more severe, since they attract scarce talent into activities which (while lucrative) have little to do with innovation, productivity growth, or the more efficient use of domestic resources. Hence they cause a great waste of potential entrepreneurship as able persons are led to pursue occupations in law, the military, politics, illicit commerce and other activities which exist because of the potential they provide for earning protection rents. Hence, such incomes do not lead to major growth in output and productivity as would resource rents and innovation rents, except in cases where the initial barriers to trade inhibit efficient resource allocation. Adam Smith described the many roadblocks in the economy of 18th century England imposed by the court and its retainers, guilds, and other possessors of privilege, criticizing their adverse consequences for the division of labor, productivity, and the general welfare. In many contemporary Third World countries the obstacles to the economic progress placed by both government and business are even more costly. Yet all too often the ostensible justification for these barriers is "social progress", protection of workers, or improved income distribution, when in fact their primary object may be to earn protection rents or to gain power for a privileged few.

B. *Stages in the Evolution of Economic Rents*

Historically those economic rents which we term productive have accrued to private investors in land and other natural resources and to innovating entrepreneurs. It is the thesis of this paper that such rents tend to elicit a historical cycle of sectoral deficits and surpluses. The first step in the generation of economic rents from resources or innovation is one of exploration, development, and investment in plant, equipment, and other physical infrastructure. This requires a net inflow of resources into the sector including physical capital, skilled labor, intermediate goods, and technology. Thus, the first phase will be one of net borrowing from other sectors. If the domestic economy does not have sufficient net savings to finance the initial borrowing, the requisite transfers will have to come from abroad. Whatever the source, they may take the form of direct or indirect finance or unilateral transfer. In the case of foreign transfer concessional lending would be one form of unilateral transfer.

When such flows occurred in the past, under the aegis of private enterprise, the finance of new rent-generating activities was often in the form of direct investment of firms which had accumulated rents elsewhere, plus their use of debt finance to "lever" equity participation and thereby increase the return on net worth. Stephen Hymer's now-classical doctoral dissertation analyzed the process of leverage by which investors borrow as much as possible, both at home and abroad, in order to retain access to profits and management control. In this way the "normal costs of capital" flow to indirect investors, while rents accrue to equity holders in the form of higher rates of return on sunk capital (as distinct from total assets). Wherever rents to resources, innovation, or protection are possible, leverage is likely to be employed. This holds as well for state enterprises, since the government should be expected to maximize its use of borrowing from the private sector to cover capital costs, thereby maximizing its share of rental income.

The second stage in the recent cycle is that of increasing production, during which rents may be expected to accrue in excess of reasonable operating expenses, depreciation, and a normal return to capital *if* (and only if) the enterprise has been successful.[1] What is often forgotten by developing countries which assume the role of owners and managers of such industries is that they are generally very risky. Mining and petroleum exploration are cases in point. For every mine or well that proves to be a bonanza, dozens are unable to cover the sunk costs of exploration and development. John D. Rockefeller recognized this problem when he concentrated his initial participation in the US petroleum

[1] The concept "economic rent" as used here represents that share of value added remaining after deducting the cost of all factor inputs valued at their productivity in the next best occupation. Capital costs including returns for risk and liquidity essential to elicit the initial investment should also be deducted before estimating rent. The residual includes "bid rent" for natural resources plus excess profits and wages over and above the social opportunity cost of labor. (Note that if the reservation price of labor exceeds its opportunity cost, the difference may be termed rent accruing to employees.)

industry at the less-risky processing stage, since Pennsylvania petroleum deposits were difficult to locate and expensive to drill. "Normal costs of capital" must include an element to cover such risks as well as those reflecting the volatility of world prices. Having absorbed these costs, if the investment is successful the second stage should permit the repayment of earlier borrowings and the gradual accumulation of positive net worth in the form of physical and financial assets.

This leads to the third stage of rent-generating activities, that of diversification through investment in new activities on the part of those with access to the rental income. It should be noted that future rental streams may be capitalized and sold in the form of financial assets to permit capital gains for the original investors which, in turn, may be saved and invested. In such cases subsequent rents accrue to new investors as a "normal return" on financial capital. The capitalization of future rents makes it difficult to identify such income as a "surplus". It is indeed a surplus in terms of sunk physical capital, labor inputs and other intermediate costs of production. But from the standpoint of the new owners, who have paid full value for capitalized rental income flows, a considerable capital loss would be experienced if these rents subsequently were to be taxed or otherwise diverted. This problem is less serious in cases where the state owns the rent-generating resources. But even then the opportunity cost of maintaining ownership of the resources is the return on capital which might be obtained from their disvestiture at capitalized rent or marginal future rents at rates which permitted substantial immediate gains, especially if long-term expectations were unduly favorable to the enterprises. On the other hand, governments have often given away rental income streams at prices far below any reasonable present value of concessions, though this situation appears to be diminishing with the increased answerability of government officials to the public. (The more democratic the system, the more likely that public officials will be held accountable for such transactions. This makes it more understandable that rent-rich export economies are often governed by dictatorships. The potential for personal enrichment in such cases is often compensation for the risks inherent in totalitarian rule.)

C. *The Role of Financial Planning in the Channeling of Economic Rents*

The rents from growth-initiating sectors permit net resource transfers to other regions and sectors. These transfers may be regarded as a kind of "export surplus" from the initiating sector to net deficit sectors. The surplus may reflect voluntary or involuntary transfers. Taxation of the initiating sector's income, or the "tax" of its financial assets through capital losses due to inflation (to the extent that this leads to replacement of real financial asset balances), will lead to involuntary transfers. Direct and indirect finance by the initiating sector or other sectors, reflected in the accumulation of financial assets by initial rent-income recipients, lead to voluntary transfers. Both operate in the same manner that an export surplus on current account of a nation's balance of payments reflects the net accumulation of financial claims on the rest-of-world. Within a given country, most intersectoral real and financial flows tend to be netted out in the national income and flow of funds accounts, unless they occur across institutional sectors (such as from households or owner-operated enterprises to the corporate sector, or from corporate enterprise to government).

Yet such flows cannot be ignored by those concerned with capital budgeting, especially in cases where the state has a major share in resource rents. The opportunity to generate and channel such rental income into further growth-inducing investments provides a windfall to those economies fortunate enough to possess abundant land and mineral resources. In addition to the availability of natural resources there is a need for entrepreneurial potential capable of establishing enterprises which can transform these resources into a "surplus" of rental income as well as access to financial capital which will make the enterprises possible. To assure the availability of such financial flows and to prevent them from destabilizing the economy or leading to undue external indebtedness or under-use of internal savings potential, the state is well advised to coordinate financial planning with the real planning of investment in rent-generating activities.

To be successful, financial planning ultimately depends upon the efficiency of real resource allocation. While this can be left solely to market forces, most of the now-developed countries have historically relied upon the state to provide assistance for infrastructure, legal rights to resources, access to financial capital at favorable rates, patents for new technology (rights to innovation rents), and even aid in marketing and distribution. Internationally the state has often intervened to secure the right of national enterprises to develop new rent-generating activities abroad, to extract profits, and to reinvest them elsewhere, making use of diplomatic, military, and security forces as well as economic pressure. In short government financial planning cannot efficiently take place in a real development vacuum. Hence, the capital budgeting of new rent-generating ventures both public or private should be a matter of concern for policymakers, however much market forces are utilized in the process of savings and investment.

Most current development goals require policies to maximize domestic participation in rental income flows and to channel the resources which they provide into new investment so as to permit sustained growth. This is especially important where a portion of the income flows reflects returns to depleting resources, such as in mining and the extractive industries. It is also important in manufacturing and other activities which are subject to rent "cycles" that may eventually lead to falling prices and rent shares due to the development of substitutes, changes in tastes, or the opening of new sources of supply. This process has been formalized in recent work by Magee and Robins (1977) on the "raw material product cycle". Also while this paper does not focus on income distribution, that goal also provides scope for integrated real and financial planning so as to influence the evolution of social claims on rental income. Finally it should be noted that the enclave character of many raw material-based industries, which have few direct linkages to the domestic economy, and which provide weak employment effects, increases the importance of fiscal and financial measures which will channel their rental income into development-generating expenditures.

To accomplish the multiple and frequently conflicting objectives of growth, efficiency, and distribution, policymakers require:

a) Measures to make production planning of the private and public sector consistent with the availability of domestic and foreign savings;

b) Instruments and guidelines for the mobilization of voluntary savings from actual or potential surplus sectors, through direct and indirect finance, and involuntary savings through taxation and other measures assessing possible tradeoffs between the two approaches;

c) Instruments and guidelines for the allocation of savings to investment in future rent-generating activities (down to the point where the return on capital reaches the social opportunity cost of savings);

d) A basis for projecting savings and investment behavior at the sectoral level for firms, households and government under conditions of alternative real and financial policies; these projections will provide a basis for alternative projections of external lending and borrowing;

e) A set of criteria for the determination of optimal degrees of foreign lending and borrowing so as to make internal and external financial management consistent with the capital budgeting requirements of real macroeconomic planning.

While most developing countries are engaged in all of these activities to some degree, an examination of the current external debt problems of many would suggest that insufficient attention has been given to links between real and financial planning. There is rarely a consistency framework for the matching of internal and external surpluses and deficits. To illustrate the consequences of this failure of policy, one may take the cases of two countries, one of which has borrowed abroad while maintaining an internal surplus, thus causing an increase in the monetary base (and inflation). The other country has borrowed abroad to cover an internal deficit with external savings, leading to inflation and devaluation of its currency.

If a mechanism such as that suggested above were adopted, and if social accounting techniques were used to project real and financial flows by major sector of economic activity, it would begin to be possible to determine whether planned investment could be financed out of anticipated savings. Where sectoral surpluses or deficits would result, one could determine the extent to which financial flows (and in extreme cases fiscal transfers) are required to bring about internal balance. Given investment requirements and domestic savings capability, the net foreign borrowing (or lending) needs would become clear under alternative expansion paths. Many cases exist in which the financial savings of some sectors are used to finance dissavings of others. In these cases the *net* financial savings could become much higher as a share of GDP if the use of funds were shifted from current to capital expenditures. Finally there is evidence from earlier work on flow of funds in Latin American countries that the financial savings potential of a given country may be quite flexible and responsive to a variety of financial policies. The implications of policies to increase domestic financial saving, in terms of foreign borrowing requirements, could also be derived from this approach.

DOMESTIC FINANCIAL PLANNING AND FOREIGN DEBT MANAGEMENT

It has been shown that a resource rent-generating export economy may be expected to pass sequentially through cycles of sectoral surpluses and deficits, much as the economies subject to innovation rents described by Schumpeter and others do. In the private sector savings and investment behavior of firms and households participating in resource rents may be expected to respond to market signals —including, and in particular, borrowing costs (when investment demand is dominant) and lending rates (when savings are paramount)— in decisions to consume or acquire physical or financial assets. The sum of domestic decisions will lead to the internal net financial surplus or deficit with respect to the rest of the world and hence to the net asset or liability position abroad. Exogenous external factors may of course influence financial price signals, such as major changes in international lending and borrowing costs. Since most developing countries are price-takers in the world capital market, domestic portfolios may be expected to respond to these changes as well as those introduced by internal policy and market conditions.

From the standpoint of foreign indebtedness, it should be possible to predict a variety of alternative foreign financial flows under different domestic production possibilities and intertemporal preference patterns (underlying market conditions) and subject to alternative fiscal, financial, and investment incentive programs (superimposed policy conditions). It is conceivable that one set of policies would lead to a pattern of foreign lending and borrowing, and resulting net resource flows, which would more closely approximate the country's ultimate development goals than another, given the underlying market supply and demand conditions in the economy. The objective of physical planning is to budget capital expenditures in such a way as to maximize the efficiency of resource allocation during the development process, subject to a specific set of objectives. This can be more or less dependent upon the use of market signals and private decision-making ("indicative planning" uses the market mechanism insofar as possible). However physical planning tends to leave financial decision-making of firms and households out of the picture, providing only the most aggregative reconciliation accounts between ex post saving and investment, with the foreign sector taking up the slack. It is perhaps for this reason that such models often lead to two gaps, the "savings gap" and the "foreign exchange gap" as though the resulting difference between domestic saving and investment (equalling net foreign saving) should differ from the current account deficit or surplus in real goods and services.

While such gap models are the logical result of a primary focus on real planning, they tend to obscure the process whereby forces are at work in the financial markets to *reconcile* the two gaps through international lending and borrowing. Thus if domestic savings tend to exceed investment demand (e.g. if resource rents predominate and new rent-generating activities fail to materialize) it would not make sense for the planners to seek to borrow abroad so as to provide a net inflow of foreign savings in the form of real resources. All this would do is depress internal lending rates and divert local savings abroad or into needless consumption. In the meantime the attempted forcing of foreign savings into the economy would lead to increased liquidity and inflation, encouraging an excessive expansion of imports by lowering the value of foreign exchange below its social opportunity cost. Moreover the foreign debt burden in such a case would grow, requiring future payments of exports to cover interest and principal on the debt. During this conference the case of Nigeria has been discussed. Its recent increase in foreign borrowing illustrates the points mentioned above.

On the other hand, an economy whose investment potential vastly exceeds savings supply would benefit considerably from access to international financial capital and resulting real resource transfer, provided that internal policies have maximized the mobilization of domestic savings. Both Brazil and Mexico are cases in point. Each country shows the capacity to increase future rents, but each has domestic savings which are far short of their potential. While in the 1960s they were both heralded for financial policies which tended to encourage voluntary financial savings, real interest rates have recently lagged behind world market levels (in the face or increased inflation and exchange risk). Their tax policies have failed to capture a share of growing economic rents comparable to most other economies in the world, and, in the case of Mexico, government expenditures on current operations have soared reducing the share of government savings in investment finance, though the opposite has held for Brazil. Hence, both countries have relied increasingly on foreign borrowing for the financing of domestic investment, and in both countries net foreign financial inflows have exceeded the real resource gap. While Brazil has had more apparent success at sterilizing the excess inflow of foreign funds (by accumulating offsetting official reserves of foreign exchange, and hence relending abroad), both reflect the internal inflationary consequences of attempting to force the external finance of investment beyond the absorptive capacity of the economy.

What is proposed in this paper is greater attention to links between real expenditure policies and capital budgeting. This attention would emphasize the responsiveness of domestic savings behavior to appropriate financial and fiscal measures. Such an approach would lead to policies that would facilitate the matching of net foreign borrowing to net import requirements and discourage attempts to use foreign savings to fund domestic resource gaps with inflationary consequences. This would improve the credit-worthiness of borrowers and lessen their vulnerability to external pressures. Failure to relate current foreign borrowing to medium-term planning goals tends to produce a succession of stop-and-go measures, as loans became due without the requisite foreign exchange to repay them. The "stop measures" lead to pressures on profits (credit squeeze) and labor income (wage freeze) exacerbating domestic uncertainty, social unrest, and reducing investment incentives. These conditions produce political pressures for "go measures" to increase the domestic deficit and return to the inflationary cycle. The cases of Argentina in the 1960s and Peru in the 1970s illustrate the consequences of such failures to coordinate internal and external balance. Resulting waves of inflation make such coordination even more difficult, as unexpected increases in costs and prices wreak havoc on budgetary planning in real terms in both business and government. Also inflation subjects financial flows to distorting capital gains and losses resulting from changes in the real value of financial assets and liabilities from period to period unrelated to underlying productivity conditions.

The next section introduces a framework for the reconciliation of real and financial flows permitting alternative projections of external borrowing. Such a framework is designed to reflect the evolution of rent-generating sectors through a "rent cycle" in which they are first net borrowers and subsequently net lenders. Economies characterized by a significant share of resource rents are particularly vulnerable to a loss of potential investment from those rents through failure of policies to channel the rents into savings in the form of physical and financial assets. The following analysis focuses on such cases in terms of their implication for foreign debt.

A SOCIAL ACCOUNTING FRAMEWORK FOR THE RECONCILIATION OF REAL AND FINANCIAL FLOWS

A. *Sectoring the Accounts*[2]

Sectoring of the flow of funds accounts should take into consideration the functional behavior of specific sectors as key factors in the national economy and should be consistent with the national income accounts. For a rent-generating export economy I suggest the following sectoring:[3]

Basic Flow of Funds Sectors (also for Capital Accounts of the National Income Accounts)

Nonfarm households and nonprofit institutions
Agriculture (including farm households)
Principal export industries
Other manufacturing
Other private non-financial corporations
Unincorporated enterprise
Central bank
Insurance and pension funds
Commercial banks
Nonbank financial intermediaries
Public enterprise
Government

[2] A detailed discussion of this and other aspects of flow of funds accounting for development analysis is contained in Reynolds and Spellman (1975). However, that study does not stress the real and financial accounting of rent-generating export economies.

[3] Note that this sectoring is essentially that of Rampersad (1962) and not that of the OAS flow of funds project, for which it was not possible to disaggregate further than households, business, government, non-financial sector, central bank, other financial institutions, and rest of world.

The objective is to provide sufficient detail for real production sectors so as to be able to estimate net savings and investment flows (net financial flows), and to provide sufficient detail of the financial institutional sectors so as to determine their role in the channeling of funds from net lenders to borrowers.

B. *A Complete Sectoral Source and Use of Funds Statement*

A complete statement of the source and use of funds of a given sector integrates information from both national income accounts and flow of funds accounts. The latter are customarily prepared from annual statements of financial assets and liabilities, using the first difference of year-to-year changes to determine specific financial "flows". These statements tend to be available in consolidated form for financial intermediaries and corporate enterprise. Sample surveys facilitate the preparation of flow of funds statements for households, unincorporated enterprise, and agricultural enterprises. Cross-references may be made to permit the disaggregation of both assets and liabilities of financial institutions with respect to non-financial sectors (e.g. business and households; government; rest-of-world). Since each financial asset has a corresponding liability entry with respect to a given sector, this permits gaps in the flow of funds accounts to be filled.

If balance sheet data are used for the estimation of net flows of financial assets and liabilities from year to year, income statements are helpful in preparing annual national income and product accounts. These in turn permit the estimation of sectoral savings ("real savings") and investment. The difference between the two is the "net financial surplus" (or deficit) of the sector. By definition the net financial surplus (or deficit) from the income and product accounts must equal the net financial surplus (or deficit) from the flow of funds accounts for the same sector. However, matching the respective net flows is frequently impossible owing to the use of separate accounting procedures for estimating the flows. (The problem of reconciliation of a sector's real and financial flows is analogous to that of the current and capital account in the balance of payments, in which an item for "errors and omissions" bridges the gap between the independently derived estimates.)

The Figure I shows a complete sector sources and uses of funds statement:

Figure I

A COMPLETE SECTOR SOURCES AND USES OF FUNDS STATEMENT

(Given time period)

	Uses	*Sources*
Income Statement	Current Expend. (c) Saving (s)	Current Receipts (γ) Net Fiscal Transfers (F)
Change in Balance Sheet	Investment (Δ RA) = (I)	Saving (Δ NW)
Flow of Funds	Lending (Δ FA) Accumulation of Cash balances (Δ M)	Borrowing (Δ L)
	Σ =	Σ

Above the solid line are real income and expenditure flows taken from the current account of the national income accounts. Below the solid line and above the dotted line are the real flows of investment and savings from the capital account of the national income accounts. Below the dotted line are the financial flows which correspond to those in the flow of funds account. "Net financial surplus" (or deficit) would be inclined as a balancing item in the flow of funds accounts and would be offset by the same item (S — I) in the capital account of the national income accounts. In Figure I it is left out of both accounts for consolidation purposes.

The "net fiscal transfers item" in the income statement refers to net subsidies (minus taxes) of the government with respect to the given sector. For most sectors this item will be negative. An offsetting item of opposite sign will be entered in the government sector.

C. *A Flow of Funds Matrix for the Whole Economy*

Having shown the complete source and use of funds statement for a given sector in Figure I, in Figure II the general source and use of funds statement for the economy as a whole (plus rest of world) appears below:

Figure II

FLOW OF FUNDS MATRIX FOR THE WHOLE ECONOMY

	Sector A		*Sector B*		*Sector C*		*All Sectors*	
	U	*S*	*U*	*S*	*U*	*S*	*U*	*S*
Saving (Δ NW)		s_a		s_b		s_c		S
Investment (Δ RA)	i_a		i_b		i_c		I	//
Borrowing (Δ L)		b_a		b_b		b_c		B
Lending (Δ FA)	l_a		l_b		l_c		L	//
Accumulation of cash							+	
balances (Δ M)	m_a		m_b		m_c		M	
	$\Sigma = \Sigma$		$\Sigma = \Sigma$		$\Sigma = \Sigma$		$\Sigma = \Sigma$	

Note: The small letters represent data on sector saving (s) investment (i), borrowing (b), lending (l), and accumulation of cash balances (m). The large letters represent the totals of each category for the whole economy. Thus

$s_a + s_b + s_c = S$; $i_a + i_b + i_c = I$, etc.

Ref. Ritter (1968).

As we have seen, for each sector:

$s + b = i + l + m$

but b need not $= l + m$
and s need not $= i$

However for the economy as a whole:

$$S + B = I + L + M$$

and: $B = L + M$
$S = I$

(where no net foreign borrowing or lending occurs).

Open Economies with Net Foreign Borrowing or Lending

If the economy is open to the rest of the world, it is reasonable to suppose that lending and borrowing will take place beyond its borders. This case could lead to a situation in which domestic savings (S_d) might not be equal to domestic investment (I_d) by the amount of the balance of payments surplus (or deficit) on current account. In this case if we let X represent exports and M imports for the economy as a whole:

$S_d = I_d + X - M$
or
$S_d + M = I_d + X.$

Since net foreign lending $(X - M)$ represents the net domestic accumulation of foreign monetary and non-monetary financial assets less liabilities to foreigners, the general flow of funds matrix for the whole economy presented in Figure II could be adapted to an open economy by allowing one of the sectors (such as Sector C) to represent the rest-of-the-world.

D. *Intersectoral Financial Flows*

Note that the balance of payments concept which relates the economy to the rest of the world in terms of real flows (current account of the balance of payments) and financial flows (capital account of the balance of payments) is analogous to intersectorial transactions within a given economy. Just as some countries are in surplus and other in deficit in their balance of payments on current account $(X \neq M)$, with associated and offsetting financial flows, so individual sectors, regions, or income groups within an economy may be in surplus or deficit with the rest of the economy. The flow of funds accounts can be designed to reveal such intersectoral real and financial flows. These flows may be as important in permitting accumulation and growth of the domestic economy as are real and financial flows between countries. Yet they are rarely considered by social accounting analysis, probably because of the difficulty of obtaining reliable flow data at the sectoral level. The application of such an approach to transfers between the agricultural and non-agricultural sectors in Taiwan is presented in T. H. Lee's pioneering work (Lee, 1971).

E. *Flow of Funds for a Resource Rent Generating Activity*

In the earlier part of the paper it was noted that sectors which have a large share of resource rent in their income stream may eventually be capable of providing net financial savings for investment in other sectors. Of course in their early stage they may be net borrowers from other domestic sectors and/or rest of world. This would hold for "vent for surplus" resource-intensive activities such as are described by Caves (1971). In the Figures below (Figures IIIa and IIIb) an example of a rent-generating activity is presented in terms of hypothetical real and financial flows in early and late stages of development:

Figure III

A Resource Intensive Activity's Real and Financial Flows During the Raw Material Product Cycle

a) Stage of exploration and development

	Sector A Mining		*Sector B Manufacturing*		*Sector C Government Development Bank*		*Sector D Rest of World*		*All Sectors*	
	U	*S*	*U*	*S*	*U*	*S*	*U*	*S* =	*U*	*S*
Saving (Δ NW)								100		100
Investment (Δ RA)	100								100	
Borrowing (Δ L)		100								100
Lending (Δ FA)							100		100	

b) Stage of maturity (before significant depletion)

	Sector A Mining		*Sector B Manufacturing*		*Sector C Government Development Bank*		*Sector D Rest of World*		*All Sectors*	
	U	*S*	*U*	*S*	*U*	*S*	*U*	*S* =	*U*	*S*
Savings (Δ NW)		60						—30		30
Investment (Δ RA)	10		20						30	
Borrowing (Δ L)		—30		20		20				10
Lending (Δ FA)	20				20		—30		10	

In the first phase, the mining sector is engaged in exploration and development. Since this requires imported inputs, it borrows abroad 100, increasing the external debt by that amount. If any of the 100 were not spent on imports (net savings of rest of world = M − X) then the economy would accumulate foreign exchange or other rest of world liabilities in the amount of the difference, reducing rest of world savings accordingly and increasing domestic savings for the sector holding the claims. During the process of development the mining sector will experience income growth. If it is successful, income will exceed expenditures permitting positive real savings (Figure IIIb). These savings of 60 are used in part for additional physical investment in the mining sector (10). Part are used to retire earlier debt (30). (Note that debt service payments as opposed to debt retirement appear as current transactions deducted from income before arriving at sectoral savings. Note also that savings of the production sector may be gross or net, depending upon whether depreciation allowances are included, and they should include retained earnings (undistributed profits)).

The remaining "net financial savings" are lent to the financial sector (government development bank) in the amount of 20. These funds are then relent to the manufacturing sector which has investment opportunities in excess of its savings capacity. Note that in developing countries such flows from resource rents to innovation or protection rents in manufacturing and commerce are facilitated by policies which encourage financial intermediation. If such intermediation possibilities did not exist, local savings and investment out of resource rents might well decline (McKinnon, 1973). An alternative means of mobilizing and channeling resource rents is through fiscal transfers whereby the export sector is taxed to provide funds for investment in new activities. The use of fiscal resources to provide loans subsidies at low or negative real rates of interest is common in the Latin American experience. A disadvantage of such an approach is that it tends to distort resource allocation, at times discouraging further investment in the rent-generating sector, while new investment subsidies lead to marginal yields which would be negative if the capital market and industry were competitive. Favored sectors also often enjoy protection rents through preferential subsidies, tariff barriers, and monopoly pricing. The shift from resource rents earned in efficient export production to protection rents of inefficient domestic manufacturing seldom favors productivity or sustained growth.

In the now-industrial countries of North America, Europe, and Japan, resource rents were often channeled into new innovation-rent generating activities. This Schumpeterian process gave rise to cycles of progressive evolution of manufacturing, as new inventions were mass-produced and marketed in connection with the creation of new tastes through advertising. The advantage of innovation rents is that they represent value derived from the net addition of new utility to consumers, whereas protection rents *ceteris paribus* substract utility by forcing up the price for commodities already available more cheaply elsewhere. However such "value" itself was sometimes created through the formation of tastes by advertising as Chamberlin and Joan Robinson stressed decades ago. While patents and other means of safeguarding intellectual property rights permit a form of "protection rent" to be incorporated in innovation rent, generally these rights are subject to legal limitations. The monopoly power which they bestow on the innovation should be restricted to permit the eventual emergence of competition which will ultimately cause the rents to disappear. For that reason industrial products have their own "rent cycles", as competition forces entrepreneurs to shift investment progressively from innovation to innovation. Financial capital flows are clearly essential to this process, since it is one of continual shifts of resources from deficit to surplus sectors, commodity by commodity.

The model presented in this section provides a framework for the examination of alternative paths of rent generation, savings, and reinvestment in further growth-activities. The reaction of such real and financial flows to specific policies is not spelled out in the accounts. Each flow may be regarded as responsive to a variety of market and policy-induced signals. Historical behavior can be used, in relation to changing market and policy conditions, to provide a set of parameters which will permit planners to predict the pattern of real and financial flows likely to result from alternative capital budgeting strategies and related financial policies. The model will permit the two approaches, real and financial, to be made consistent over time. The net flows resulting in the rest-of-the-world sector accordingly provide a basis for effective management of the foreign debt. It will then be possible for both government and interested private institutions to determine whether foreign debt projections are consistent with internal balance and hence with export and import capacity.

SUMMARY AND RECOMMENDATIONS

There has been much discussion at this conference about the obstacles to debt repayment from developing to industrial countries because of the recent slump in the OECD economies. Exports of the periphery are indeed hampered by malaise at the center. However the region which has the long-term comparative advantage for growth is not the center but the periphery. It is in a number of Third World countries that the majority of basic resources, both human and material, are located. For this reason I would not expect the objective conditions of the international economy to foster a major reverse resource flow from developing to developed countries, but rather a continuing pressure for voluntary net transfers to the Third World (and especially to its higher-income countries). Real resources of the rich countries are likely to follow financial capital flows to those regions where real yields are shifting from resource rents to returns to "surplus labor" which is the new vent-for-surplus factor attracting foreign capital and technology.

For an Adam Smith of today, the future wealth of nations lies in the Third World, even though the contemporary locus of education, science, and technology remains in the center. It will not be necessary to force major net capital flows to the Third World's leading countries. But what is necessary is that those countries expand their capacity to generate internal savings for investment in socially productive activities. To do this it is recommended that much greater attention be given to financial planning in connection with physical macroeconomic planning. This will provide a logical next step in the current trend of such economies to get their short-term financial houses in order by the adoption of more flexible interest rate and exchange rate policies and by working to stem the high and uncertain rates of inflation which have so-distorted them in the past. Policies are needed, *a*) to provide incentive for a much higher rate of voluntary financial savings than is currently observed in most countries, *b*) to tax scarcity rents but at rates which do not discourage productive rent-generating activities, *c*) to minimize the distortions implicit in protection rent-generating activities, *d*) to identify new investment possibilities and to encourage entrepreneurship, innovation, and financial capital for the generation of new ventures.

Research on the relation of real savings and investment flows to financial flows in Latin America indicates that at least in this "high income" developing region the potential for the mobilization of financial savings to increase real domestic savings and investment is much greater than was hitherto believed. This research also indicates that voluntary financial savings are highly responsive to sharp increases in real rates of return on financial assets of minimum risk and maximum liquidity. Where yields have been distorted to negative real rates of interest, such increases may be achieved without seriously distorting capital markets. What is also indicated, however, is that financial intermediaries are disinclined to place their funds in long-term loans for investment. Much scope remains for the "term transformation" problem to be improved in such countries by extending deposit insurance to financial institutions, providing government guarantees for longer-term credits, and other safeguards for short-term borrowers.

International financial institutions may play a role in the process of greater intra-Third World financial intermediation, by providing technical assistance and by participating in the creation of joint-ventures, local branch offices, and other activities which make use of their considerable expertise. They may also facilitate the identification of profitable investment opportunities for locally generated financial capital and local management in exchange for a reasonable charge on the provision for such financial intermediation services. In this way the institutions would be able to gradually shift their locus of operations away from the triangulation of financial flows from surplus to deficit countries through present OECD financial centers toward intermediation within the developing regions. This would permit these countries to retain a greater proportion of intermediation service income within their own economies, would permit vital financial investment decisions to shift to local and regional centers, and would encourage the mobilization of increased domestic financial savings for local investment. The integration of real and financial planning of developing countries would greatly facilitate the growth of inter-third world financial intermediation by reducing the risk of external borrowing through more efficient debt management.

It is recognized that the issues raised in this paper are primarily economic, while the decisions which affect them are essentially political. It has been pointed out in this conference that policymakers tend to discount the use of guidelines based on academic modelling or social accounting analysis, however rooted such work may be in the realities of the countries concerned. It is my belief that such analysis will increase the information base for policymakers, however much decisions must ultimately reflect political considerations. To facilitate the usefulness of the planning frameworks, they should be sufficiently broad in design to incorporate social and political consequences of economic and financial decisions, realistically reflecting the choices open to decisionmakers. The benefits from the use of such guidelines will cause the additional effort to more than compensate itself, not only for the goverments of developing countries but for the society which they purport to serve.

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Private Lending to LDCs by Great Britain in the Nineteenth Century: A Guide to the Future?

Anthony B. Greayer

The author is Director of Grindlay Brandts Ltd. (London).

While no literature exists on the methods used by British banks in analyzing the risks and rewards of LDC lending, our researches into this subject would indicate that, by and large, British banks lag behind the major US banks in using sophisticated analytical techniques. In part this reflects the fact that British banks' lending to LDCs is much smaller than their counterparts. In part it reflects the fact that UK banks rely more heavily on the experience brought about through over 150 years of doing international business — either as issuing houses for foreign loans or as pure overseas banks. They have, up until recently, relied on their feel for the markets.

What, therefore, I wish to do in this paper is to explore how they have developed this feel and pose the question: do we gain much from the detailed statistical analysis expounded today by some banks, or are the risk/reward criteria of yesterday as good a guide to what is an acceptable risk? In order to do this, we dwell for some time on the past; then skip quickly to today, assume that today's markets are well-known and then dwell again, but this time on the future and what may be a pragmatic solution to tomorrow's financing needs of LDCs, taking the criteria of the British investors of the 19th century as our guide.

We will spend some time looking back to the 19th century and the early years of this century when British banks dominated long-term lending to LDCs. It can be argued that, in real terms, the amount and type of lending during that period were at least as important as the lending we see by the private sector today. What is more, it involved to a very large degree —tapping a different type of saving— the private individual investor.

The author of this paper believes that it would be possible to develop once more this private investment. Further, it may be a far more desirable source than either the present commercial bank lending or the alternatives which so many commentators feel will have to be developed in order to mobilize the money required to continue financing the development of the LDCs.

This paper is divided into two main sections:

1) The historical perspective — Development finance for LDCs, 19th century to the present day.

2) Financing future needs — The possibility of the return of the private investor.

We will, in the first section, try and answer the question: on what criteria was the lending made, what were the dominating forces behind the decision to finance LDC development, rather than using the funds elsewhere? In the second section, we shall see if these historical lending criteria have a place in today's LDC analysis and in particular in future fund raising.

THE HISTORICAL PERSPECTIVE - DEVELOPMENT FINANCE FOR THE LDCS, 19th CENTURY TO THE PRESENT DAY

Although in recent years there has been a blurring at the edges, we had among the pure British banks three distinct breeds — the merchant bank, the commercial bank and the overseas bank. We must consider each of these banks' international activities in order to understand the scope of British bank involvement in LDC development.

1817-1825

Unquestionably the principal driving force in the 19th century, when international lending to the LDCs began, was the British merchant bank, and its sub-breeds, the various issuing houses. In 1817 Barings arranged a 100 million French Franc loan for France, bearing a rate of 5% and issued at 53 for a commission of 2½%. This marked the beginning of the issue of foreign loans by British houses. Barings, with the exclusive contract to raise further loans in order to assist the French Government meet its indemnity payment to the British had issued, by early 1819, some six loans with subscription coming to a large degree, initially at least, from London. Barings, it is estimated, made profits from them of more than £ 1½ million. Thus one of the great investment houses of England established its reputation, which it was to maintain throughout the next hundred years, as one of the foremost foreign bond issuing houses in the world. The Duc de Richelieu talked of the Six Powers in Europe in 1819 — the British Isles, France, Russia, Austria, Prussia and Baring Brothers.

N. M. Rothschild, arguably the other great merchant bank of the period, was not laggardly. In 1818 it issued the first sterling denominated bond issue. It was for Prussia and totalled £ 5 million. N. M. Rothschild was very much the chosen vehicle for this fund raising by the European powers. The reason was simple, Rothschilds had not only established a reputation for themselves in European financial wizardry, but also they were considered cosmopolitan and thus to a degree at least, independent of England —something thought to be desirable by many European governments. In 1822 N. M. Rothschild issued three loans, one each for Austria, Russia and Prussia— the Austrian loan outside London because of a previous loan default. Their success brought the Rothschild brothers baronetcies in Austria, as well as pre-eminence among the issuing houses for European issues.

Latin America and Iberia were not slow to tap this source of finance. Spain, faced with revenue deficits, raised, in 1820, a $ 10 million loan in Paris, but underwritten and subscribed in London. She repeated the exercise on a larger scale during the next three years, raising in total more than £ 16 million. The British investor was equally happy to support, as well, the armies fighting Spanish imperialism in Latin America. Colombia was first. She found herself indebted to England for the help given in the form of army expeditions, assisting Bolivar and other revolutionary armies. A loan for £ 2 million was issued by Herring, Powles and Graham in 1822. There followed others, including Chile, Peru, Argentina, Mexico, Brazil, Guatemala. In many cases more than one loan was issued. Both Barings and N. M. Rothschild were responsible for some of the issues —especially Brazil and Argentina— but they guarded their reputation well and left many of the lesser issues to houses that have long since disappeared. They were what one would call merchants, without the suffix 'bank', whose 'skill' we will return to later. In the three years up to the end of 1825 investors suscribed over £ 17.5 million for Latin American securities. Indeed, by 1830 something like £ 76 million has been invested in foreign securities.

Although a miniscule amount by today's standards, it was an encouraging start, which was discouraged from continuing by the collapse in England towards the end of 1825, with bank failures, merchant failures and with it a drying up of the appetite for foreign loans — something which had already happened to the issues of South American mining stocks which had proved to be in almost all cases abortive speculations. Many countries had over-extended themselves through borrowing. Now they found it impossible to raise money on the London market and had to suspend interest payments. In the two years 1825-1827 all the South American countries, with the sole exception of Brazil (N. M. Rothschild being their exclusive issuing house), defaulted. As indeed did Spain, Portugal and Greece.

1850-1876

Thus the first wave of foreign bond issues ended and it was not to be resurrected in any degree for many years. However, with memories never normally longer than a generation, we see the tentative beginnings with some new issues in the late 1850s. These continued to swell with one brief pause, until the collapse in the early 1870s, during which period a total of £ 712 million of foreign loans had been issued publicly in London. Additionally, it is estimated that almost all the foreign-owned debt of the US (which was not issued publicly in London) amounting to $ 1 billion, was owned by English investors.

Taking Latin America as an example, between 1862-1867 government loans for the area, issued in London, totalled some £ 40 million — principal among the borrowing nations were Peru, Brazil, Venezuela and Mexico. When Maximilian was shot in 1867 the new regime of Benito Juarez refused to recognise his debts; then Venezuela stopped paying interest. By 1867 some £ 10 million of issues were not being serviced. This did not stop all new issues. In 1866 Argentina raised £ 500 000 and Chile £ 1 million, followed by £ 2 million in 1867 for Chile and £ 1.9 million in 1868 for Argentina. Thereafter, we see the pace pick up for Latin America with Peru being the major borrower, together with Brazil. Once again, as fashion gained hold, others joined in until some countries allowed prudence to give way to recklessness. Of the £ 140 million plus raised for Latin America between 1869-1873, half was in default by 1876, Peru being the greatest disaster. Only Argentina, Brazil and Chile continued to meet all their payments — the smaller states such as Santo Domingo, Costa Rica, Bolivia, Guatemala, Uruguay and Honduras being in arrears. Latin America was not alone: Spain went into complete default in June 1873. Turkey and Egypt, which depended upon new borrowings to enable them to meet their obligations, also finally succumbed. The boom and bust in foreign security issues in the period 1860-1876 is well illustrated by the amount issued. In the peak years of 1871 and 1872 £ 60 million and £ 77 million were raised, while when the market finally dried up in 1876, only £ 17 million of bonds was issued, of which about 50% were Colonial and Indian loans.

1880-1914

The closing decades of the 19th century saw a shift away from continental loans issued in London, reflecting the self-sufficiency of France and Germany, as well as the defaults of Spain, Portugal and the Balkan Governments. Additionally, France and Germany became sources of foreign funds used to a great extent by East and South-East Europe, as well as becoming sources of capital equipment and engineers for developments in those regions.

The English market turned to India, South America, Canada, Australia and the United States, and even Africa. For example, in Africa in this period over £ 100 million was invested in gold mining ventures. Amazingly, South America continued to attract investors. *The Economist* of 1892 put it succinctly:

> South American investments have for half a century been a thorn in the flesh of British investors and it is perhaps, because we have become so accustomed to the infliction that the country has, time after time, shown its readiness to increase the sore.

The pace of investment accelerated in the first years of this century and it was South America that raised the largest amounts. Argentinian and Brazilian issues between 1907 and 1914 amounted to more than $ 1 billion. Likewise Canada, Australia, India and America all commanded large sums from British investors. Japan, which had first come to the market in 1870, came to the market for over £ 60 million by 1914. Finally, after 30 years of absence, the Anglo-Russian agreement of 1907 saw a return of Russian securities issued in London.

In 1914 came the third breakdown in major foreign capital raising by London. The first break was in the mid 1820s, by which time £ 76 million has been issued. The second in the early 1870s with £ 712 million outstanding. When this third break came, London periodically issued investments totalled almost £ 4 billion (with an annual issue rate of £ 200 million in the final years before 1914), of which £ 1.8 billion was to countries within the British Empire and a staggering £ 756 million in Latin America — (this, in fact, was led by Argentina £ 320 million, Brazil £ 150 million and Mexico £ 100 million), then came the United States £ 750 million and finally Europe with about £ 220 million, much the same as was in issue in 1870.

1920-1930

Thus ended the pre-eminence of London as the major centre for foreign fund raising, or at least, the pre-eminence of the British banks. While it is not the purpose of this paper to look closely at the US banks which to a large extent in the post World War I period, took over the mantle of the British banks as foreign security issuers, yet it is interesting to note that the rise of the United States as the major issuing centre in the decade 1920 to 1930 has many of the same marks as that of the three great issuing periods when London ruled supreme. Between 1920-1930, 43 countries borrowed in the United States $ 7 billion (of which $ 1.4 billion were Canadian issues). Of these issues, only 18% issued in 1920/1924 went into default in the 1930s, while 50% of those issued in 1925-1929 did go into default. Ilse Mintz made a detailed study of this period in a book entitled *Deterioration in the Quality of Foreign Bonds Issued in the United States 1920-1930* and came up with some interesting conclusions which we will touch on later when trying to decide whether the criteria used by British banks for analyzing risks of lending to LDCs in the 19th and 20th centuries were at fault. But before we do so, we must look at the other groups involved in international lending during the period up to World War I and the development of British banking thereafter.

The overseas banks

Besides being the center for long-term capital, London was also the center for financing the movements of goods. Through the merchant banks, the bill brokers and then later the Eastern Exchange banks and the Overseas banks (headquartered in London), London financed the vast proportion of international trade. This was not only British trade but third country trade as well. Clearly this experience in financing international trade gave the London financial community a continuous link with the principal countries which were tapping London for debts issues. This link was greatly strengthened with the development, in the second half of the 19th century, of the international banks. For, while the great commercial or joint-stock banks tended to remain "at home", there grew up a new type of bank that depended for its growth purely on its overseas branches and their business both within the countries in which they operated and for the international trade they financed. Indeed, some of them can rightly claim to have played an important role in developing a sound financial system locally to whatever extent was possible within the economic and political climate of each individual country. Thus, in 1914, British banks controlled about a third of the deposits of the Brazilian banking system and over a quarter in Argentina and Chile. Although these banks became powerful within the countries in which they operated, they did not try to play a direct role in the issue of foreign bonds. That said, it is worth noting that the Brazilian funding loan (£ 10 million) of 1898 was made at the initiative of the London and River Plate Bank, although, as always, N. M. Rothschild, Brazil's exclusive bond issuing house, led the issue. As a result of this loan the River Plate Bank decided that the retrenchment policy that accompanied it was such as to bring new stability to the economy and they opened two new branches in 1899.

In short, British international banks developed a strong overseas network rising from eleven branches in 1860 to 462 branches in 1933; their nearest rival being France with 207 in 1933 and the United States with 146 (26 in 1914).

Only the big domestic branch banks in England lagged behind, beginning on the tentative overseas expansion after the outbreak of World War I.

As we noted earlier, the US issuing houses took the lion's share of foreign issues in the 1920s. London still handled more than $ 3.5 billion during the period and really only stopped completely as depression set in and with it defaults and government restrictions imposed in 1932.

It can be safely said that since that time no capital market for long-term issues by LDCs has re-emerged. What has replaced it is a combination of sources of finance — bilateral, multilateral and, of greatest importance today, private commercial bank financing based on the dollar as the world's major trading currency.

The British bank's role is important as a medium-term lender, but it is dwarfed by the importance of the major US banks. This reflects a whole host of factors. To name a few: US banks are much larger than UK banks, not one UK bank appears in the top ten banks in the World; finance is provided to a large degree in dollars (in the 19th century and early 20th century sterling pre-dominated) while British banks' natural deposits and capital base are in sterling; world trade is no longer determined by the movement of goods to and from England; above all England is not the world's leading nation and has continuously slipped in terms of trade and power over the past century; finally, investing in foreign currency securities has been severely curtailed by government regulations.

All that said, London is still today arguably the major financial center of which pure banking plays a key role. There is still today a bigger concentration of knowledge and expertise on international trade and finance in London than anywhere alse, although New York must be close to overtaking that position.

Criteria used by LDC lenders in the 19th century

It is in the light of the short history outlined above and its present position, that it is worthwhile asking the question: what criteria do British banks use for judging lending to the LDCs?

The answer lies, I believe, in the answer to two further questions: how do British banks and investors profit from this lending and what risks do they run?

Let us turn to the history books again. Many writers when castigating the rampant speculation of the British investors of the 19th century use, as their evidence of the deceit and malpractice of the period, the Special Report by the Select Committee on Loans to Foreign States ordered by the British Government and issued in April 1875. It is indeed a damning document. It states *inter alia:*

i) In respect of all these loans, those who introduced them to the public seem to have been regardless of the financial resources of the borrowing state

ii) By means of exaggerated statements in the prospectus the public have been induced to believe that the material wealth of the contracting state formed sufficient security for the repayment of the money borrowed

iii) In the opinion of your Committee these transactions are deserving of much censure

and so on.

But what many commentators do seem to forget, or fail to point out, is that the Committee was investigating loans to but four countries — Honduras, Santo Domingo, Costa Rica and Paraguay; loans not representative of the majority of issues and certainly not loans issued by respected issuing houses.

What I am trying to highlight here is that, as pointed out about the foreign issues made in the US in the 1920-1930 period, there is a world of difference between foreign issues made by the most respected houses and those which were simply trying to cash in on the recurring bouts of euphoria for foreign bonds and greed by investors. Unquestionably greed, to put it crudely, was a dominating feature throughout. Greed represented by an interest yield of 5½% to 8% when consols were paying 3% to 4%. Indeed, in the case of Honduras, to give one example, the rate was 10% at an issue price of 80 when, in the same year, 1870, France paid 6% issued at 85. So, while one should, indeed must, censure some firms, one must also mitigate the censorship by pointing out that the investor too must have been aware of the risk if only because of the yield differential.

This is not to say that the practices used in issuing bonds were above criticism — far from it. There was much manufacturing of facts. The press too played an important role in certain issues, for should they not be advertised properly in journals such as the Money Market Review, then the Review would be less than kind in the commentary. Indeed, there was a moment in the late 19th century when the sublime went to the ridiculous. An issue was raised for the Kingdom of Poyais — a fictitious place. It was eagerly taken up.

One could go on writing up a myriad of examples of bad practice in the market. However, it really would not reflect the true facts. They are, I believe, that the majority of issues, and certainly those issued through the major houses —such as N. M. Rothschild, Barings, Hambros, Schroders, etc.— were well researched and well intentioned. Detailed analysis would seem to show —as did Ilse Mintz's of the 1920-1930s— that these houses issued bonds that suffered fewer defaults than those issued by other firms. Defaults certainly did occur. In bad cases, because the proceeds went to ill-thought out adventures, to projects where the security was inadequate or misapplied. In other cases, defaults occurred in spite of everything. Maybe external forces played the major role — such as the collapse in commodity prices. Maybe political forces caused economic collapse or prior-debt repudiation.

Above all else, it would appear that the major missing factor, which in today's analysis of sovereign risk we assume not to be a missing factor (although it may be), is a continuing source of funds in times of economic depression. The international capital market in the 19th century, and indeed in 1914 and in 1930, was not able to cope with major "hiccups", it was unable to provide the funds needed to tide over the LDCs.

While there was evidence of malpractice encouraged by investors' greed; while there can be no question but that the information available on individual risks simply could not have been as good as it is today, there does not seem to be any evidence that the bulk of borrowing for productive enterprises (and sometime non-productive war-like enterprises!) was misplaced lending through mal-analysis of the risks. Except, and this is vitally important, the investor and issuer continued to be content with long-term issues (20 years and more) in an environment which from past experience went through serious economic cycles, during which sufficient external funds were very often not available. This 'hole' in the analysis by the issuer and investor may in part be explained by the fact that the securities were traded and that the investor certainly could and did sell if there was a marked economic deterioration.

Obviously borrowers too benefitted from the anonymous mass of investors. The State was less concerned with ensuring (in some cases at least) an unbroken record of prompt payment. This weakness was in part dealt with by the formation of the Council of Foreign Bondholders, in 1868. While any country's bonds were in default, no new issues could be quoted on the London Stock Exchange. This penalty was normally sufficient to 'encourage' proper performance by issuers.

In short, the flow of British investment overseas in the 19th and early 20th centuries cannot be considered a vast speculation based on misinformation and bad analysis of the risks. Certainly it went into countries about which today we would demand to know much more than was known in those days. But it is difficult to say that had they been able to glean and analyze as well as we claim to be able to do today, the same funds would not have been forthcoming. The mood was different. Less than a third of the £ 4 billion outstanding in 1914 was straight government lending, the rest went into "project loans" such as railways, mines, utilities, etc. Often these were run by Britons with stakes in the ventures, the earnings of which secured the loans. What is staggering above all else was the volume. Between 1910 and 1914 just over 8% of the British national income was invested overseas. In American terms, the entire Marshall plan was being carried out twice a year!

Today the bankers, in a much more modest way, have taken over this role of provider of development capital for the developing world.

Today computers are used in an effort to monitor and, more importantly, to try and forecast the future development of the economies of the world. We have learned much from the past experience of the British investor. We have built up a system of regulation, a legal framework, which we hope will prevent the deception practiced in times of euphoria. The deception has, I believe, been prevented except for the self-deception of lenders in lending too much in times of economic boom (and particularly commodity price booms) and of borrowers in taking too much when the temptation has been too great. We have built up a system of bilateral and multilateral institutions which not only aid the neediest, but also have prevented to date the self-deception leading to disasters.

The danger we run today is that we will, as in the past, lull ourselves into thinking that it will always be all right. We must be on guard against the true calamities, which previously broke the system and caused a long period without the vital foreign investments. The crisis brought on by the commodity boom of 1972/73 and exacerbated by the oil-price increases at the end of 1973 has been ridden out. Both private and public sources of international funds played their part. They did so because we were able to foresee the dangers just in time, borrowers and lenders were able to get together and mutually work out the problems. Today, more than ever before, each party realizes the vital importance of the other. It is this fact more than anything else that has made the flow of investment into the developing world a continuing one, and has brought about the break from the past experience of stop-go.

FINANCING FUTURE NEEDS - THE POSSIBILITY OF THE RETURN OF THE PRIVATE INVESTOR

It is now some 45 years since the private investor has played an important role in development finance. And yet today more than ever in the past, the climate should be right for him to return. Certainly he has the money to invest. Certainly everybody is crying out for somebody to help alleviate the growing burden that is being placed on the commercial banking system. Certainly neither the bilateral nor the multilateral agencies have, as far as can be seen, the means to return to their former place as the leader in the field.

Although there is much talk of an expanded role in money (as well as qualitative) terms for the IMF, it is unlikely and many would think undesirable for them to expand their facilities too much. First, it could take them into the political field which would spell disaster, secondly, it would, in all probability, be inflationary.

Likewise, it is difficult to see bilateral aid expanding even to the

0.7% of GNP suggested by the UN in 1970. Today it is approximately half that figure ($ 14 billion).

While one can be perfectly confident that the commercial banks have the resources to meet the needs of the LDCs in the foreseeable future, it would benefit both the LDCs and the industrialized nations if the resources available were increased, and in particular, if the period of lending were stretched. This can be done if one believes that history can be repeated.

What we need to do is to convince today's private or non-bank institutional investor that the risks are not significantly greater than alternative investment forms and that the rewards are, at least during the "learning stage", significantly greater. The borrower likewise should not pay too high a price, otherwise the incentive to borrow or to switch away from commercial bank credits will not exist.

While, in practice, the above is a long, hard, educational struggle, with the help of the governments of industrialized countries (particularly the DAC members) it should be quite possible.

The argument goes as follows:

a) DAC members wish to help the LDCs. Politically, and, to a lesser extent, economically, they find it impossible to contribute in all but three cases —Sweden, Norway and the Netherlands— 0.7% of GNP to the LDCs.

b) While information on the majority of the LDCs —particularly the high and middle income LDCs— is good it could be improved, with the help of the IMF or an equivalent supra-national body lending assistance in compilation of statistical information on debt, trade movements, international money flows, etc.

c) While investors and non-bank financial institutions have money to lend

i) they are in certain cases very restricted in their ability to buy foreign currency denominated bonds (such as in the UK) or to buy foreign bonds (US) or foreign unquoted bonds (US), etc.;

ii) they are, in most cases, cautious of doing so because of a lack of knowledge, mis-conceptions over past experience in foreign bonds, a lack of a secondary market, and so on;

iii) they are not offered today a sufficient inducement to overcome *c*) i) and ii).

d) Foreign borrowers would welcome the opportunity to borrow at fixed rates especially for periods beyond 15 years, if the cost were not more than, say 2% above that which they would have to pay for shorter term commercial bank roll-over credits.

If the above points are accepted, then using the historical criteria of lending by British investors as a basis for a solution, long-term investors could be induced back into the market if:

a) DAC governments were willing to allow certain LDC loans to be bought by their national institutions with interest thereon tax exempt. Clearly the effect of this would be to allow the real yields to these institutions to increase substantially, in much the same way as yields were substantially higher on foreign investments in the last century. Indeed, it is worth noting here that, in 1900, the British Government directed British capital towards the Dominions and Colonies by the Colonial Stock Act. Previously only Indian Government loans had had privileged treatment: by this Act, securities which observed the applicable Treasure orders were made eligible for inclusion among "Trustee Securities", thus becoming purchasable by trust bodies and institutions. Various controls were placed on the issuer which ensured an extremely high "quality" of issue. The result was a strong market for Colonial and Dominion bonds.

b) In addition, investors would be allowed to invest in these securities, notwithstanding the normal national constraints placed upon them by their own governments, up to an amount determined by the government in order to ensure that capital flows were not such as to jeopardize the flow of funds for the internal development of individual industrialized countries, or to cause a drain on the foreign exchange resources of the country. Again it might well be deemed advisable in certain cases to allow issues in local currencies of the investing country (e.g. yen, French francs, Deutschmarks, sterling, etc.).

c) The issuer, in order to gain the tax-exempt status, should be willing to allow the IMF or some other supra-national body to do a "due-diligence" on the information supplied, without actually giving up sovereignty over the economic policies of the governments. Such "due-diligence" might be an annual event in order for the government to maintain the tax-exempt status.

This, I believe, is a viable and a preferred solution to the present problem of the pressures faced by commercial banks involved in international lending. It is not seen as a device for substituting their role, but rather as a means of mobilizing additional available funds from private sources, with the help and concurrence of governments of industrialized countries as well as the IMF. The links between the development of the OECD countries and the LDCs have been amply demonstrated. While, in the short run, some may argue that the industrialized countries will lose marginal revenue, their gain in new capital equipment exports and, in the long run, of new sources of basic resources will far outstrip such sacrifice. What we need to work towards is a body through which such co-operation between the governments and private sectors of the industrialized countries can be brought about for the good of world economic development. I believe past British experience has shown that the mobilization of long-term investible funds can help significantly in the development of major project developments in LDCs. The time has come to build on this past experience —a break of 45 years is too long.

Criteria Applied by Large Private Lenders in Credit Operations with Developing Countries

Elisabeth K. Rabitsch

The author is Consulting Economist at International Banking Group, Citybank, N. A. For the past two years she had the privilege of working as a consulting economist on the staff of Dr. Irving S. Friedman, senior vice president and senior adviser international operations, at Citibank in New York. The experience and knowledge gained while working at Citibank, and under the guidance of Dr. Friedman, who was formerly an official of the World Bank and the International Monetary Fund, make it possible for the author to present in this paper an overview of the criteria applied by large private banks in country risk assessment and credit operations with developing countries.

The remarks are mainly based on the approach taken by Citibank at the present time; they obviously reflect Dr. Friedman's direction of the country assessment work being done at Citibank, and his thoughts on the country assessment work carried out by the US banking community in general, and on the potential that exists for improving and refining the continuing efforts in this field.

During the past decade, large international banks have begun to play an increasingly significant role as private lenders in credit operations with developing countries. As private bank lending has become a major factor in international development finance, and in the on-going process of economic development around the world, many related questions and issues have been raised. One of the most frequently raised questions is: by which criteria should private lenders be guided in their overseas credit operations, and whether private lenders are adequately informed and sufficiently prudent in their foreign lending activities.

THE NEED OF PRIVATE LENDERS FOR FOREIGN CREDIT RISK CRITERIA AND COUNTRY RISK ASSESSMENT

Large private banks have specific objectives, and therefore also specific management criteria and mechanisms; these are distinctly different from those of the international non-profit organizations, such as the IMF and the World Bank, which in the past have been the principal multilateral lenders to developing countries. Private banks aim to make profits and avoid losses, and also have —in comparison with official multilateral lenders— a less stable resource base made up of largely short-term liabilities to the public at large. Some banking institutions are able to draw long-term funds from public markets, but this is the exception rather than the rule. Private banks must, therefore, place great emphasis on the protection of capital, assets and revenue streams, and on the ability to meet promptly and fully all outstanding liabilities. Maintaining adequate liquidity is a private bank's major concern.

With the growing involvement of large private banks in the international lending process, the need for clearly defined foreign credit risk criteria, and for country risk assessment, will make it necessary for banks to devote more and more resources and professional ingenuity to this activity.

[1] Dr. Irving S. Friedman, *The Emerging Role of Private Banks in the Developing World,* Citicorp, New York, April 1977.

One reason for the importance of foreign credit risk criteria and country risk assessment lies in the evolution of international banking — resulting in part from the continuing process of economic development and the accompanying changes that have occurred since the 1950's in the demand for international banking services. Many private banks initiated their international activities in a very limited way, for example by servicing the overseas financial needs of domestic transnational corporations. Many have not gone beyond this stage. Other banks, however, eventually began to concentrate on the buildup of a portfolio of high quality international loans. From this base, others proceeded to maintaining a foreign branch/affiliate network. In addition, a relatively small number of the more international banks have developed specialty market segments (ranging from geographic specialties to individual customer segments such as shipping, energy, project finance, correspondent and/or retail banking including consumer financing). Large private banks are thus at different stages of development. Nevertheless, this gradual evolution brings with it an increasing need to understand how national and international developments potentially affect the international activities of large private lenders, directly and indirectly.

Another aspect of this evolution has been the expanding role of governments as borrowers or as guarantors of international loans. To the extent to which governments assume these roles, the private lenders weighing these lending decisions face credit assessment needs which are no longer simply an analysis of an individual project and its anticipated cash flow, but are instead synonymous with an assessment of the borrowing country itself.

For the above reasons, sound country risk assessment must be a major aspect of sound private international banking. It should be mentioned, however, that country risk assessment work is not unique to private banking institutions. National governments perform country assessments, and so do official international financial institutions such as the IMF and the World Bank. As the purposes and goals of national governments and of official multilateral financial institutions differ from those of private banks (as pointed out above), the country risk assessment methods selected by each group will also differ fundamentally.

Although private bankers can, of course, benefit to some degree from the country risk assessment work carried out by other groups, it is essential for private lenders first of all to define clearly their own concerns, and then to find and adopt the assessment methodolgy best suited to their needs. This means that private banks should evolve a country risk assessment methodology in common and distinct from that employed by other groups.

A COUNTRY RISK ASSESSMENT METHODOLOGY FOR LARGE PRIVATE LENDERS

At this point in time, it seems that no standard approach to country risk assessment has yet evolved among the major private international banks. A recent study conducted by the US government[2] reported as follows: "... that in most banks the country evaluation is undertaken at headquarters by the bank's line personnel, without critical review by another group in the institution; that analytical approaches vary, with a small numbers of banks using quantitative techniques, generally together with more qualitative systems; that a number of banks use either a letter or numerical rating to summarize the results of their country evaluation; that a few banks use their results to help analyze the quality of their portfolio; and that none of the respondent banks use the results in fixing interest rates or fees ..."

The approach evolved at Citibank under the direction of Dr. Irving S. Friedman differs significantly from the pattern described above — although in some aspects it is consistent. This is really not surprising as international business activities also differ among large private banks. In short, one cannot generalize on the issue of which approach to country risk assessment is best suited for any one particular bank. *Each* bank must define its concerns in relation to its activities *both* among and within countries. Private bank concerns are, for example, potentially much more heterogenous than those of the IMF and the World Bank. Many of their activities are of only marginal concern to the IMF and the World Bank Group.

Each bank's own manner of carrying out its country risk assessments will be determined primarily by its own objectives, institutional structure, operating and lending policies, as well as by the stability of its resources. Many small banks, for example, may wish to supplement their own limited resources by making use of the assessments of larger institutions to which they have access either through correspondent bank relationships or participation in loan syndication. For each private bank, however, the identification of concerns must begin with the definition of "country risk".

WHAT IS COUNTRY RISK?

What is "country risk", and how does it differ from such terms as "credit risk", or "sovereign risk"? Country risk comprises the whole spec-

[2] Export-Import Bank of the US, *A Survey of Country Evaluation Systems in Use*, Washington, D. C., December 1976. See also Association of Reserve City Bankers, *Country Exposure Measurement and Reporting Practices of Member Banks*, New York, March 1977.

trum of risks arising from the economic, social and political environments of a given foreign country (including government policies framed in response to trends in these environments) having potentially favorable or adverse consequences for foreigners' debt or equity investments in that country. These may be events which potentially have a direct impact upon the profitability and/or recovery of foreigners' investments. A few examples are: confiscation, nationalization, branching limtiations, restrictions on earnings remittances, etc. They also include other developments, with more indirect impact, such as changing market conditions, exchange rate fluctuations, foreign exchange control, changes in fiscal and monetary policy, etc., affecting the liquidity of domestic borrowers and hence their ability to service domestic or external debt. As can be seen, this concept of country risk encompasses events both within and beyond the control of the government, and events both domestic and foreign to the borrower's country, as long as they have a potential impact upon a bank's investment, either directly or indirectly.

As is apparent from the above, the concept of "country risk" is much broader than that of a "credit risk" related to a given borrower's individual credit-worthiness. "Country risk" includes *all* those risks which are incurred by a private lender in the course of certain activities in the foreign *country* involved, as distinct from considerations relating to the individual borrower.

It should also be clear that "country risk" is a broader concept than "sovereign risk": Under "country risk" one should include not only those events under the control of the government (or the "sovereign"), but also a wide variety of further potential risks — both domestic and international — over which the borrower's government has no control. It includes risks which affect the customer base of the bank as well as the bank directly. An adverse change in the condition of a major group of borrowers may be the result of changes in the country's environment or governmental policies, rather than changes in an individual economic sector or a specific enterprise.

It is essential that a private lending institution include all *potential* risk in making its country risk assessment, and not simply confine itself to those which appear most likely or most imminent. The private lender should try to *anticipate* the way in which changes in country conditions will occur, and not simply react to the identification of today's events. It should be obvious to all bankers that this is a very demanding professional task. The abrupt worsening in the market evaluation of such countries as Italy in 1974 and Turkey in 1977 bears witness to the difficulty of anticipating changing conditions. It also takes constant professional monitoring to anticipate quick *favorable* changes such as occurred with the imposition of stabilization programs in some countries in the past years.

Not all observers might agree with the above definition and views on "country risk". In particular, different types of institutions having different goals will define these risks in terms consistent with their own institutional purposes This is why judgments of such widely respected bodies as the IMF or the World Bank, though useful, can only be of limited value to large private lenders in reaching the judgments upon which private banking decisions must rest.

Before devising a method for country risk analysis, a basic decision must be made: it is essential to determine just which assets are subject to "country risk" as decribed above.

DEFINITION OF CROSS-BORDER EXPOSURE

The determination of assets subject to "country risk" will again be different among various types of institutions. Transnational corporations with large fixed direct investment will differ fundamentally from international lenders as to the types of assets affected. For the private international lending institution the choice seems clear: the assets which should be monitored most closely are those which comprise the lender's "cross-border exposure". This exists when any subsidiary or branch of the holding company or bank, irrespective of location, lends to, invests in, places with, or otherwise extends any form of credit or credit commitment to any entity (including any other entity of the holding company or bank) that is located outside the booking unit's national borders, irrespective of currency.[3]

On the other hand, intra-country foreign currency exposure exists when a creditor lends, invests or otherwise extends credit to borrowers located in the same country but in a currency foreign to the country where the borrower or lender is located. For the most part, intra-country foreign currency asset acquisitions, like local currency assets, are funded by deposits gathered from third-party sources in the country. Both kinds of activities fall outside Citibank's definition of cross-border exposure for the following reasons; when a branch is confiscated, the government presumably takes over not only the assets but also the liabilities of the branch, and the resulting loss in such an event is limited to equity and reserves. By the same token if a country imposes restrictions affecting the manner and means of the repayment

[3] Private banks often find it useful to establish ceilings on the total amount of cross-border exposure they are prepared to have in any one country. The setting of such ceilings (and sub-ceilings) by maturities and/or borrowers is directly related to the country risk assessment.

of intra-country foreign currency assets, these same restrictions would generally apply to the intra-country foreign currency liabilities gathered from third parties. Again, the net effect is nil. (Note that if an intra-country foreign asset is funded with corporate resources from *outside* the country, the funding will *automatically* be caught and included in the cross-border exposure of that country.)

For such reasons, Citibank has chosen, for the time being, to focus on cross-border debt and equity investment. The state of the art of country risk assessment and cross-border exposure measurement is in an evolutionary stage. It is conceivable that many institutions will increasingly develop other methodology for assessing the specific types of country risk which make an impact on intracountry foreign currency and/or local asset acquisition activity.

COUNTRY RISK ASSESSMENT AT CITIBANK

The basic approach to country risk assessment is to gain a thorough knowledge of the individual borrowing country, its uniqueness, its vulnerabilities, its longer-term historical development and outlook as well as the most detailed data available on its past and present economic performance. Basically, it is essential to assess the economic management of the country, and its consequent conditions and outlook. This cannot be done simply in quantitative terms, as many of the key political and social indicators are actually not quantifiable. Among the major qualitative elements that should be examined are: global interdependencies, trade vulnerabilities, a country's proposals and agreements made in international forums, its social conditions and its political outlook as well as its government's domestic economic management and balance of payments management. Each qualitative aspect has many subdivisions.

In addition to the key qualitative indicators, there are also many quantitative indicators which must be taken into consideration, including such data as are available on a country's external debt structure, debt profile and debt servicing. Of importance are, of course, rates of growth of exports, diversification of exports, variability of export earnings, growth of per capita income and all information on the country's dependance on imports (imports in relation to GNP, substitutability and compressibility of imports, etc.). The country's savings rate, domestic capital formation, international capital flows and international reserve position are equally significant in the risk assessment process.

However, it should be pointed out that no one single indicator or ratio can be relied upon to provide a complete picture of the situation;

in fact, some indicators, when looked at in isolation, could be actually misleading without a thorough study of the reasons behind their behavior. It should be recognized that few indicators have the same meaning for any one country as they have for another. No effort should be spared to examine with great thoroughness each country individually and repeatedly (if not continuously) since significant changes in a country's economic and financial conditions can occur rapidly. It should be realized that the process of knowing a country take years to mature.

The sources of information required in country risk assessment are both in the field (the worldwide network of a bank's overseas operations and the expertise of its employees), and at head office.[4] These sources must be supplemented by a great deal of traveling on the part of the senior staff, in order to permit frequent consultation both with the bank's own personnel overseas and with knowledgeable local nationals, such as Central Bankers and key government officials.

At head office, Citicorp maintains a centralized data bank of major economic variables for each country of interest. The variables cover fiscal and monetary policy, inflation and real growth, the balance of payments, external debt, and the central bank's balance sheet. Latest data are incorporated as they become available, and the outlook is adjusted accordingly. Periodically, a world overview is prepared to insure the consistency of various projections. Citicorp has also explored econometric methods to sharpen the work on country risk assessment.

There are however two aspects of country evaluation, which deserve further comment. The first is the obvious difficulty one faces in trying to predict future actions on the part of national governments. All one can do is to assume a certain set of policy actions, and then try to simulate the economy's response to these policies. One can test, for example, the probable impact of a change in monetary targets or interest rates, or of a change in fiscal deficits financed by monetary expansion. However, government decisions actually taken may differ markedly from the assumptions used earlier in the country assessment work. The situation will always remain fluid as one is confronted with a dynamic interaction of economic aims and responses at the national level with international developments. The second aspect is, that one cannot rely on these responses being the most obvious or "logical" at all times. One can foresee the range of policy responses which are

[4] In practice, this means that country risk assessments are done in the field with the senior officer in a given foreign country recommending an overall limit for total cross-border exposure booked into that country by Citicorp and/or its affiliates. The Senior Adviser International Operations at Citicorp headquarters in New York reviews the evaluation and the recommendation, and his office gives the final approval.

more likely than others, but the range is very wide and encompasses many different options. In other words, when doing country evaluation work one should be prepared for surprises.

Obviously, large private lenders must react to these interminable series of uncertainties and difficulties with decisions and actions. There is a basis for reducing risk to acceptable proportions by using country evaluations which employ all sources of information, all known methodologies and analytical tools, and all feasible judgments based on experience and intuition.[5] Large private lenders will need to dedicate increased resources to country risk assessment work, which should be of a highly professional nature and be done on an increasingly sophisticated level so that opportunities and threats affecting the lender's future business can be anticipated and acted upon effectively.

POTENTIAL FOR IMPROVEMENT IN COUNTRY RISK ASSESSMENT

Citibank's approach to country risk assessment could be improved in a number of areas.

As far as the collection of information is concerned, there are available large masses of data, both qualitative and quantitative, on an individual country basis. A large part of the information is received from representatives stationed overseas and is supplemented by data obtained from national and international organizations in the United States. The information is evaluated on an individual country basis. Every effort is being made to insure that the information flow is continuous, reliable, updated, and as precise and detailed as possible. Efforts must continue to improve data upon which to base sound judgments regarding the international lending activities of private banks.

In addition, it is essential to continue work on the creation of a system which would provide the country analyst with a useful worldwide framework within which the performance of individual countries would be assessed. Citibank is making a very explicit effort to integrate economic and political situations into global criteria in order to improve policy making and/or lending decisions in the real world. It is not sufficient to know a country in isolation, it is also important to be aware of the exogenous factors which may have an impact on a country's credit-worthiness. For example, it is important to be aware of differences in inflation rates among countries on a worldwide basis and of the fluctuations in world trade, the rise in protectionist senti-

[5] It should be noted that in addition to the work described above, another essential aspect of dealing with country risk is the actuarial principle. It is imperative to avoid magnitudes of risk assets in any one country that are in violation of the actuarial principles of balance and dispersion.

ments in key countries, the changing magnitudes of bilateral assistance, and so on. All of these variables have a direct or indirect impact on any given country's performance.

The integration of individual country information into a much larger framework presents a number of problems. Basic among them is a lack a comparability of quantitative data collected in the more than 100 countries in which Citibank is operating. It is even more difficult to compress the multitude of information into a global framework of manageable proportions. Although it is considered important to integrate the information on individual countries into a global framework as an analytical tool, Citibank does not intend to rank countries by any type of numerical method. A rigid ranking system is considered to be arbitrary and unrealistic. It would not allow one to take into account the fundamental proposition, which is being adhered to at Citibank, that cross-border exposure in a given country is not homogeneous as to risk. The bank's client base is too diversified. Specific country risks vary from country to country, and no simple ranking system could cope with such a diversity of concerns.

Citibank's country reviews and assessments are not only based on historical data but also on projections of country performance. More formal procedures are now being instituted to assess the accuracy of past judgments and evaluations. The systems would have failed, if country risk assessments did not anticipate events which have potential adverse consequences for Citicorp activities in a given country. Only when events in a country are anticipated, then appropriate defensive action can be taken to protect Citicorp's concerns.

Furthermore, it is of great importance in risk assessment to refine continually the understanding of the linkages which exist between a country's projected overall performance and Citicorp's specific business interests and investments in that country. It is this link between the country's macroeconomic performance on the one land, and the outlook for specific economic sectors and individual public and private sector enterprises on the other. The knowledge of these linkages will provide the understanding which is necessary for lending decisions.

These remarks have obvious implications for Citicorp and other bank managements in the years ahead. It will be most important to refine the methods used in country assessment work and broaden the information which is required and applied in portfolio management. No large lending institution will be able to operate effectively without adequate country evaluation work.

LARGE PRIVATE LENDERS AND THE DEVELOPING WORLD

As pointed out before, the analyses of individual countries cannot be carried out without an examination of how each of these countries interacts with the world around it. However, it is also important to look at the worldwide environment in which large private lenders will operate in the foreseeable future. It now seems to be generally recognized that the expansion in developing countries' borrowing from private banks was not a temporary phenomenon stemming from the increases in oil prices and other economic developments of the past four years; private banks are going to be a permanent major factor in the development process.

The emerging role of private banks in the developing world has occurred for a number of reasons. Official capital sources are not adequate to sustain the capital requirements of the more rapidly expanding developing countries. Furthermore, the developing countries which can gain access to private capital markets find certain advantages to private borrowing. It is nonpolitical, not tied to purchases from any particular supplier country, available in the amounts needed, and often more quickly available than funds from official sources. Although the terms may be higher, the rate differential is often not of great significance.

However, it should be emphasized that private banks will *not* be equally important sources of financing for *all* developing countries. As private banks depend upon full and prompt servicing of their loans for their financial profitability and viability, they understandably tend to focus their activities upon the best managed countries and, within these countries, the best managed firms in the most advanced sectors of the economy. This is in contrast to the lending activities of the IFM and the World Bank Group.

The vast bulk of private lending to developing countries has been concentrated in the "higher income" countries not because of the per capita income level as such, but because these are countries with a larger number of relatively advanced sectors. These may be advanced manufacturing plants of highly modern facilities for producing or processing primary commodities for export. As these advanced sectors attract financing, their growth and the development of other sectors play a vital role in the structural transformation of the developing economy.

Even in the poorest developing countries, generally classified as "low income" countries, there are, at certain points, relatively advanced sectors, in particular modern facilities for producing or processing primary commodities for export. As more and more developing countries succeed in modernizing a growing number of sectors of their economy, these countries will increasingly depend on the access to new sources of financing. Private international financial institutions will play a crucial role in the international transmission of investible funds from the high income industrial countries to the developing world. With the continued expansion of international credit, borrowers and borrowing countries will be under strong pressure to be and remain credit-worthy.

The following guidelines, or cannons, are given for lending by private banks to developing countries. These guidelines are not intended to cover short-term borrowings for one year or less, or for trade related and inventory financing, as these do not constitute an important problem either from the viewpoint of the borrower or the lender.

Canons for Private Lenders to Developing Countries:[6]

1) Do not expect developing countries to be in balance-of-payments surplus on current account over time; assume that current-account deficits are normal for such countries;

2) Do not view the developing countries as a homogenous group for business decision-making purposes. Recognize their differences and judge the risks of doing business in these countries on a country-by-country basis;

3) Do not view any single developing country as a homogenous entity within itself. Disaggregate the country into its major sectors and components to judge country risk;

4) Evaluate most carefully the credit-worthiness of the individual borrower —whether it be a private or an official entity;

5) Avoid lending into developing countries which are regarded as not credit-worthy for private bank lending irrespective of potential earnings and avoid new lending to developing countries whose outlooks for maintaining their credit-worthiness are unfavorable;

6) Pay special attention to the actuarial principle both in subdividing global programs by countries and in lending into any developing country, for any particular purpose or to any one entity;

7) Give special attention to management of domestic economy and the balance of payments, including external debt management, in judging the country's credit-worthiness. Regard domestic growth, expansion of the modern sectors of the economy in agriculture and industry, institutional capability of encouraging and allocating available savings efficiently, and export performance in diversification and expansion —especially in manufactures— as primary indicators.

8) Do not be guided, however, by a small number of quantitative

[6] Irving S. Friedman, *op. cit.*, pp. 78-80.

indicators, but rely on in-depth knowledge of the country, preferably based on first-hand experience. Be aware of the danger of applying generalizations and approaches derived from the experience of different societies and economies to judging specific countries;

9) Do not forget that past measures of ability to use capital efficiently, as well as need for capital, have become completely anachronistic; do not assume that the historical experience of a country foretells its future;

10) Be guided by the principle that private banks must be regarded by borrower and lender alike as the most cautious source of international lending and that continued reliance on this source can only be assumed if countries are able to manage their economies in such a manner as to command the confidence of private international lenders;

11) No lending should be undertaken by private banks based on the assumption of rescheduling or refinancing as a way out of future difficulties;

12) Remember that the international environment must be continuously monitored in order to assess the possible impact on borrowing countries;

13) Recognize that a good credit to an individual borrower may be transformed into a bad credit with potential losses by adverse economic, social and political developments within a country subsequent to the original credit decision. Thus, countries must be continuously monitored in order to assess the impact of actual and potential country developments on a bank's portfolio of outstandings loans as well as prospective loans;

14) The size of a developing country's outstanding debt, or the size of its gross national product, or its natural resources do not determine its credit-worthiness. Rather, dynamic criteria such as rates of growth and progress in diversification in national product, domestic savings and exports are more indicative;

15) Private bank lending should be made for productive purposes directly, or to the governments which are demonstrating their management capability and, therefore, are pursuing policies which cause domestic savings and inflows of foreign capital to go into productive purposes;

16) Consider that lending abroad on a non-guaranteed basis cannot be "riskless". Potential country risk must be scrutinized and evaluated. Banks cannot avoid the full responsibility for their decisions on countries;

17) Avoid simplistic modeling of countries to anticipate or judge country risks. There is great danger in spurious precision;

18) Banks should not impose policy conditions relating to government economic management as part of loan contracts, but should judge economic performance and outlook carefully before making loan commitments. Such judgments should be made known to the borrowing country, if requested;

19) Banks should not make significant investments in countries without an adequate knowledge of the country, obtained directly by its own efforts or indirectly by its business relation with other banks;

20) The kind of mechanisms used to set country ceilings (if any), implement ceilings, report exposure, evaluate countries, assess country risk, etc., must be tailor-made to suit the individual bank. The main components are:

a) Size of operations abroad
b) Geographical spread
c) Business-segment spread
d) Field-driven US head-office management style — i.e., degree of decentralization and delegation of authority
e) Extent of physical presence abroad
f) Kind of presence — branches, subsidiaries, consortia, representative offices, visits, etc.
g) Professional capability in evaluating countries and international development
h) Head office management style —degree of differentiation of functions— marketing, credit evaluation, auditing, foreign exchange operation, funding or treasury operations, personnel policy, e.g., use of local talent abroad and at head office, etc.

If guided by these canons, the private banks can continue to be important lenders to a number of developing countries. The careful, productive use of the borrowed private bank funds, together with sound monetary, fiscal and exchange rate policies, will result in sufficient gains in output in the borrowing country and enough improvements in their export earnings to attract further private capital inflows which will more than offset the increased debt servicing burden. A rigorous analysis of both credit and country risks should ensure the sound investment of private capital, and the borrower's capability of servicing the borrowed funds.

Sources of Data on LDC External Debt

John A. Holsen

The author is Chief Economist, Latin America and the Caribbean Region World Bank.

Analysis of the external debt problems of the LDCs has been complicated by the inadequacies of the information available. Data tend to be incomplete, are often available only with long delays, and different sources may report information which seems to be inconsistent. Problems exist for the debtors and creditors themselves as well as for outside analysts. Most countries now have reasonably good records on loans to or guaranteed by public sector agencies, but data on non-guaranteed borrowing by the non-bank private sector is often either not available or seriously inadequate for the requirements of the country concerned. Lending institutions have sometimes found it difficult to obtain all the debt information they needed to make their creditworthiness assessments of borrowing countries. Practically all users of debt data have no doubt been confused by the differing definitions and concepts that are in use.

There is, for example, a great deal of confusion over the use of the words "public" and "private" because it is not always clear whether the user is referring to the lender or the borrower. To avoid adding to the confusion, in this note we will use "official" when referring to creditors and "public" when referring to debtors. When referring to "private" debt it is generally necessary to specify whether the reference is to creditors or debtors. Confusion may also arise because of the failure to indicate whether one is talking about all debt, regardless of maturity, or only medium and long-term debts (generally defined as loans with an original maturity of more than one year). When speaking of loans by commercial banks some additional distinctions are important; among these are Euro-currency lending as distinct from total foreign lending and gross claims as distinct from the net position (which takes into account the banks' liabilities to the LDC borrowers).

This note briefly surveys the external debt data which are generally available to the public and which also cover most, if not all, of the developing countries. The organizations which make debt data available have sought to respond to the demand for better information and thus there has been a steady improvement in both the quality of the information and the timeliness with which it is available. These comments refer to the situation as of the end of 1977. Three sources of specialized debt information are considered —Morgan Guaranty Trust Company (MGT), the Bank for International Settlements (BIS) and the World Bank's Capital Markets System (WB/CMS). Two more general sources are discussed— the Organization for Economic Cooperation and Development (OECD) and the World Bank's Debtor Reporting System (WB/DRS).

The Morgan Guaranty's monthly publication entitled *World Financial Markets* regularly publishes data on the volume of new international bond issues and new medium-term Euro-currency bank credits. The issue for May 1977 contains a "Note on statistics on international lending" which describes the coverage of MGT's reporting. In the case of bonds, the data cover both Euro-currency bonds (generally underwritten by an international syndicate and sold mainly in countries other than the country of the currency in which the bonds are denominated) and foreign bonds (generally underwritten by institutions from one country, sold principally in that country and issued in the currency of the same country). In the case of loans by commercial banks, however, the figures are limited to Euro-currency (i.e., they would include a loan in US dollars made by a European syndicate but not one made by a group of US banks).

The World Bank publishes a quarterly report on *Borrowing in International Capital Markets* which covers much the same ground as MGT's *World Financial Markets*. There are minor differences in coverage (e.g., MGT excludes and the WB/CMS includes direct placements of bonds with central banks, monetary authorities and governments), but the overall totals of the two sources present are relatively close. Thus MGT reported Euro-currency bank credits to developing countries of $ 15 093 million in 1976 while WB/CMS reported $ 17 465 million. Both sources provide a breakdown by country; the WB/CMS also provides available details on individual loans including the lender, the borrower and the terms. In the case of international bonds issued by developing countries in 1976, the figures are $ 1 761 million as reported by MGT and $ 1 829 million as reported by the WB/CMS.

Both MGT and WB/CMS rely upon public announcements of bond issues and Euro-currency loans, but supplement these by their contacts within the international financial community. Coverage can be considered good but certainly not perfect in both cases. The main advantage of these two sources is the promptness with which they make data available on what has been the most rapidly growing source of credit for the developing countries, the Euro-currency market. The main shortcomings are the exclusion of commercial bank loans made in the currency of the lender (as distinct from Euro-currencies) and the fact that the data are limited to commitments (rather than the full range of detail which would include debt outstanding, disbursements, principal repayments and interest payments). As time passes, and repayments of prior years loans become increasingly important, the fact that MGT and WB/CMS only provide data on new commitments becomes a greater limitation on the usefulness of these sources.

The statistics on commercial bank assets and liabilities published by the Bank for International Settlements are the most important source for information on lending by commercial banks. The BIS not only publishes data on the Euro-currency market but also on total international bank lending — which is normally of greater interest to one looking at the indebtedness of the developing countries. Its reports provide a listing by developing country of their assets with and liabilities to banks in the Group of Ten countries[1] and Switzerland plus the foreign branches of US banks in the Caribbean and the Far East. In 1976 the reporting banks' claims on non-oil developing countries rose by $ 17.9 billion to a total of $ 80.9 billion. It is important to note, however, that at the same time their liabilities to these same countries increased by $ 12.7 billion to $ 49.4 billion. The borrowings of the developing countries were thus in substantial measure offset by their own deposits. Indeed, Brazil and Mexico were both the largest depositors and the largest borrowers during the year. A summary of the BIS data on the external position of reporting banks is shown in Table 1; details on the country are published in the Annual Report and are also issued in the form of press releases.

Important advantages of the BIS data are the inclusion of lending in national as well as Euro-currencies and the provision of both asset and liability information. By comparing figures of different years one can derive a figure on net disbursements as well as debt outstanding and disbursed. However one cannot obtain information on commitments, gross disbursements or debt service payments. Because some countries do not provide a complete breakdown per country in their reporting to the BIS, the data are incomplete for many of the smaller countries. Another disadvantage of these data is that they include both short-term as well as medium and long-term claims, but make no distinction between the two. (During 1977 the BIS conducted a special survey which provided some information on the maturity as well as the amounts of reporting bank claims on the developing countries; this survey indicated that about 46% of the claims by the reporting banks were for loans with maturities of up to and including one year.)

The most comprehensive estimates of LDC indebtedness are those prepared and published by the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD/

[1] The Group of Ten includes Belgium-Luxembourg, France, Germany, Italy, the Netherlands, Sweden, United Kingdom, Canada, Japan and the United States.

DAC). More detailed but less comprehensive (both in country coverage and in the kinds of debt included) data are collected and published by the World Bank Debtor Reporting System (WB/DRS). These two debt data systems are consistent insofar as their coverages overlap since the OECD/DAC in effect begins with the data provided by the WB/DRS reports and then adds data from other sources on debt not included in the former.

The WB/DRS data cover external medium and long-term debts repayable in foreign currencies which are either obligations of governments or are guaranteed by these governments. These are generally referred to as "public" debts. The most recent annual report, *World Debt Tables* (publication EC-167/77), includes over 400 pages of analysis and detailed tables of the public debt of the 84 countries covered by the DRS. These data are based on detailed reports supplied to the World Bank by member governments participating in the DRS. These governments report all new public loans commitments, including data on the source and terms, and then subsequently report all flows —disbursements, interest payments and cancellations— for each loan, on an annual basis. This detailed information is tabulated and summarized by the WB/DRS. To improve the reliability of the information the World Bank both provides technical assistance to participating governments in establishing and maintaining their own debt reporting system and, insofar as is practicable, checks the information received with creditor sources.

The reports published by the WB/DRS provide details by source-official lenders subdivided into multilateral and bilateral organizations and private lenders subdivided into suppliers, financial institutions and other private lenders. In each case data are published on debt outstanding (both including and excluding undisbursed loans), commitments, disbursements, principal repayments and interest payments. The most recent annual report provides data for each year from 1969 to 1975. It also shows projected debt service obligations based on existing debt, broken down by official and private sources and by interest and principal payments, for the years 1976-1982. Data are provided for individual countries, for regions and for groups of countries based upon per capita GNP. Supplementary tables cover factors such as external public debt as a percentage of GNP, debt service ratios and average terms of loan commitments.

The WB/DRS reports are excellent for the areas they cover. The data on projected service payments are particularly important since developing countries have borrowed on widely varying terms and the amount of debt is, by itself, often a poor indicator of the "debt burden". Their main disadvantages arise from the fact that coverage is limited to loans to governments or guaranteed by the government in the debtor country, that not all countries participate in the DRS, and that considerable time passes before country data are submitted, processed and finally published in the WB/DRS reports. Efforts are being made, however, to improve the system in all of these reports. The World Bank is expanding the DRS to request summary reporting on loans taken out by private borrowers. However, the extent to which participating governments will be able to respond is not yet clear; in countries without effective systems of foreign exchange control the government may simply not know much about foreign borrowing by its private sector and it may not be practicable to collect all of the desired information through special surveys. The lags in publication of the debt data are being overcome by issuing supplementary reports (seven were issued in 1977) which make available one page summaries of each country's debt situation almost as soon as the data have been processed. Finally, some additional countries are participating in the Debtor Reporting System.

The OECD/DAC debt statistics are published in the Statistical Appendix to the annual report of the Chairman of the Development Assistance Committee. (*See OECD, Development Cooperation, 1977 Review* published in November 1977 for the most recent data.) The OECD/DAC tables are concerned primarily with the flow of resources from DAC members to the developing countries, but in recent years the DAC has devoted substantial effort to estimating total external liabilities of the developing countries. With respect to debt, the OECD/DAC supplements the WB/DRS with information from the Expanded Reporting System (ERS) operated jointly by the OECD and the World Bank and from other sources such as the BIS reports discussed earlier. The ERS is based upon reports by DAC member creditor countries on officially extended or guaranteed loans to some 140 developing countries. It thus includes data on loans to private borrowers which fall outside the WB/DRS tabulations and, of course, data on loans to many countries which do not participate in the WB/DRS.

For an individual country covered by both OECD/DAC and WB/DRS, the estimate of the former will be equal to or larger than that of the latter (except in the rare case where the WB/DRS has made a substantial revision in its figures which have not yet been reflected in the annual report of OECD/DAC). The accompanying Table 2 shows the latest OECD/DAC and WB/DRS estimates (available in December 1977) of total external debt outstanding and disbursed. The former cover total external medium and long-term debt as of the end of 1975 while the latter cover public medium and long-term debt as of the end of 1975, and for 58 countries, as of the end of 1976.

The advantages of the OECD/DAC debt data are clearly their extensive coverage. The main disadvantage is the long lapse of time before they

Table 1

EXTERNAL POSITIONS, IN DOMESTIC AND FOREIGN CURRENCY, OF BANKS IN THE GROUP OF TEN COUNTRIES AND SWITZERLAND

(In billions of US$)

	1975	*1976*			
	Dec.	*March*	*June*	*Sept.*	*Dec.*
Banks' claim on:					
Group of the Ten countries and Switzerland	235.1	239.7	241.0	248.8	270.2
Offshore banking centers[1]	61.9	67.2	72.5	76.8	83.7
Other countries in Western Europe	31.8	32.6	35.0	38.3	42.7
Australia, New Zealand and South Africa	9.0	10.0	10.7	11.4	11.8
Eastern Europe	21.6	23.6	25.1	26.8	29.0
Oil-exporting countries	14.3	15.5	17.3	20.0	24.1
Non-oil developing countries of which:	63.0	65.7	70.2	73.5	80.9
Latin America[2]	43.5	46.1	49.6	51.8	57.4
Middle East	3.3	3.0	3.2	3.5	4.4
Other Asian countries	12.9	13.2	13.9	14.3	14.7
Other African countries	3.3	3.4	3.5	3.9	4.4
Unallocated[3]	5.0	5.0	4.9	4.5	5.2
Total	441.7	459.3	476.7	500.1	547.6

Banks' liabilities to:					
Group of the Ten countries and Switzerland	270.1	277.8	284.3	294.4	320.5
Offshore banking centers[3]	40.8	44.8	49.4	51.5	56.2
Other countries in Western Europe	31.1	30.3	29.4	31.1	32.6
Australia, New Zealand and South Africa	2.1	2.6	2.2	2.1	2.4
Eastern Europe	6.3	5.7	6.2	6.1	7.7
Oil-exporting countries	51.8	52.4	54.6	59.1	64.2
Non-oil developing countries of which:	36.7	37.8	41.4	43.1	49.4
Latin America[2]	16.3	16.5	17.6	17.7	22.3
Middle East	5.9	6.2	6.7	6.7	7.1
Other Asian countries	10.4	10.8	12.4	13.5	14.7
Other African countries	4.1	4.3	4.7	5.2	5.3
Unallocated[3]	8.2	8.1	9.2	8.7	10.6
Total	447.1	459.5	476.7	496.1	543.6

Note: The figures in this table are partly based on estimates by the BIS. Foreign branches of US banks in the Bahamas, Cayman Islands, Panama, Hong Kong and Singapore.

1 Bahamas, Barbados, Bermuda, Cayman Islands, Hong Kong, Lebanon, Liberia, Netherlands Antilles, New Hebrides, Panama, Singapore, West Indies.

2 Including those countries in the Caribbean area which cannot be considered as offshore banking centers.

3 Including international institutions.

are published. Since the OECD/DAC tabulations depend upon combining the results of several other debt reporting systems, it is inevitable that they will lag behind these other sources. An additional concern of some is the possibility of double counting, and hence of over-estimating debt, in the OECD/DAC statistics. The approach used involves choosing the larger of available estimates for particular categories of lending and debt; because of differences in classification between debtors and creditors and other reporting problems, it is likely that double counting cannot be entirely avoided.

Debt reporting organizations have been making major efforts to improve the quality and the timeliness of their reporting; the results are reflected in the greatly improved flows of information now becoming available. With the exception of information for some countries on borrowing by private debtors (where one needs projections of future debt service obligations as well as better data on the debt presently outstanding), the flow of information available at present on medium and long-term external debt now seems reasonably adequate for most analytical purposes. Debt data become meaningful primarily as they are analyzed in the light of the overall balance of payments prospects and economic outlook for a particular country. There is sufficient uncertainty about the future, because of changes in the international economic climate as well as developments within the individual developing countries, that the remaining short-comings of the external debt data (with the sometimes important exception noted above) are, comparatively speaking, minor problems.

Table 2

OECD AND WORLD BANK ESTIMATES OF EXTERNAL INDEBTEDNESS

(In millions of US$)

	Outstanding and Disbursed at End 1975		*World Bank/ DRS Public Debt O&D at End 1976*
	OECD/DAC Total Debt	*World Bank/ DRS Public Debt*	
Afganistan	787	802	911
Algeria	7 110	4 475	5 853
Angola	193	*	*
Antilles (Netherlands)	213	*	*
Argentina	3 973	2 902	4 251

	Outstanding and Disbursed at End 1975		World Bank/ DRS Public Debt O & D at End 1976
	OECD/DAC Total Debt	World Bank/ DRS Public Debt	
Bahamas	189	*	*
Bangladesh	1 622	1 624	1 943
Benin	99	94	n.a.
Bermuda	231	*	*
Bolivia	879	778	1 001
Botswana	263	143	161
Brazil	21 171	11 459	n.a.
Burma	279	279	321
Burundi	15	22	24
Cameroon	413	362	n.a.
Central African Empire	92	63	n.a.
Chad	70	70	n.a.
Chile	3 594	3 679	3 527
Colombia	2 473	2 351	2 449
Congo	373	336	n.a.
Costa Rica	433	420	534
Cuba	715	*	*
Cyprus	83	76	94
Dominican Republic	479	440	n.a.
Ecuador	508	454	639
Egypt	5 135	3 640	n.a.
El Salvador	268	204	272
Ethiopia	387	381	431
Fiji Islands	58	49	57
Gabon	619	454	n.a.
Gambia (The)	14	13	14
Ghana	742	604	n.a.
Greece	3 608	2 552	2 377
Guadeloupe	128	*	*
Guatemala	207	166	212
Guinea	211	*	*
Guyana	261	238	n.a.
Honduras	278	264	335
Hong Kong	1 347	21	62
India	11 766	11 539	n.a.

	Outstanding and Disbursed at End 1975		
	OECD/DAC Total Debt	*World Bank/ DRS Public Debt*	*World Bank/ DRS Public Debt O&D at End 1976*
Indonesia	8 917	8 124	10,141
Iran	5 911	3 827	4 271
Iraq	1 265	596	n.a.
Israel	5 897	*	*
Ivory Coast	984	963	1 183
Jamaica	706	661	855
Jordan	348	333	n.a.
Kenya	626	520	n.a.
Korea (Republic of)	5 762	5 227	n.a.
Kuwait	253	*	*
Lebanon	169	46	40
Lesotho	13	13	n.a.
Liberia	1 981	170	n.a.
Libyan Arab Republic	264	*	*
Madagascar	180	171	181
Malawi	262	242	258
Malaysia	1 610	1 258	1 530
Mali	327	327	n.a.
Malta	36	32	48
Martinique	104	*	*
Mauritania	173	170	354
Mauritius	56	43	46
Mexico	14 305	11 252	15 547
Morocco	1 814	1 593	n.a.
Nepal	37	34	44
New Caledonia	153	*	*
Nicaragua	619	598	642
Niger	114	106	n.a.
Nigeria	1 253	1 102	954
Oman	365	346	284
Pakistan	5 459	5 088	5 968
Panama	1 166	768	1 091
Papua New-Guinea	327	276	289
Paraguay	176	174	222
Peru	3 074	2 664	3 379

	Outstanding and Disbursed at End 1975		
	OECD/DAC Total Debt	*World Bank/ DRS Public Debt*	*World Bank/ DRS Public Debt O&D at End 1976*
Philippines	2 724	1 362	2 126
Portugal	686	967	n.a.
Qatar	173	*	*
Reunion	139	*	*
Rwanda	22	21	n.a.
Saudi Arabia	380	*	*
Senegal	294	289	n.a.
Sierra Leone	182	163	n.a.
Singapore	809	521	670
Somalia	257	220	277
Spain	4 544	3 403	4 761
Sri Lanka	620	598	682
Sudan	1 191	942	n.a.
Surinam	186	*	*
Swaziland	46	47	46
Syrian Arab Republic	696	661	968
Taiwan	2 370	1 650	2 234
Tanzania	839	794	914
Thailand	924	699	895
Togo	140	103	n.a.
Trinidad & Tobago	174	150	99
Tunisia	1 153	1 072	n.a.
Turkey	3 499	3 181	n.a.
Uganda	209	188	212
United Arab Emirates	730	*	*
Upper Volta	63	63	84
Uruguay	633	616	688
Venezuela	1 614	1 272	2 970
Vietnam (Rep. of)	209	*	*
West Indies	177	*	*
Yemen (Arab Republic of)	243	*	*
Yemen (People's Dem. Rep. of)	101	*	*

	Outstanding and Disbursed at End 1975		World Bank/ DRS public Debt O&D at End 1976
	OECD/DAC Total Debt	*World Bank/ DRS public Debt*	
Yugoslavia	5 476	2 273	n.a.
Zaire	2 233	1 684	n.a.
Zambia	1 132	957	1 184

Notes: Countries outside the WB/DRS for which the OECD/DAC estimate of external debt is less than $ 100 million are excluded from the list. These countries include Bahrain, Barbados, Belize, Brunei, Comoro Islands, Gibraltar, Equatorial Guinea, French Guinea, Haiti, Kampuchea, Laos, Macao, Maldives, Mozambique, New Hebrides, French Polynesia, Rhodesia, Seychelles, Solomon Islands, St. Pierre and Miquelon, Territory of Afars and Issas, Tonga and Western Samoa.

n.a. = WB/DRS data not yet available for 12/31/76.

* = country not covered by WB/DRS.

The OPEC Aid Record

Ibrahim F. Shihata

The author is Director-General, OPEC Special Fund. The paper has been written with the assistance of Mr. Robert Mabro, St Anthony's College, Oxford. Opinions expressed in this paper are solely the author's and do not necessarily reflect the views of the OPEC Special Fund.

Financial aid from OPEC Member Countries to the other countries of the Third World is a novel historical phenomenon which differs, in many of its characteristics, from aid extended either by Western industrialized economies or by the Soviet Bloc. OPEC financial co-operation with the Third World represents a transfer of resources from some developing to other developing countries. The main donors among oil exporting economies are admittedly endowed with large financial assets; yet their wealth is derived from a depletable natural resource, not from industrial power. There are central facts with interesting implications for both donors and recipients.

The aid burden is heavier on an OPEC donor than is apparent at first. This is due to the fact that the immediate future (the period during which revenues from oil and the accumulation of net financial assets tend to increase) has a higher discount rate than the distant future (when revenues and financial accumulation begin to decrease as oil resources become depleted). Furthermore, aid is given from oil revenues which are in fact part income and part capital, as they merely represent, to a large extent, a monetary form of a capital asset. The benefits from aid to recipients are also greater than apparent because OPEC grants and loans, for evident reasons, are rarely, if ever, tied to source.

Most OPEC Members are small developing countries. None of them is a super power with world-wide strategic interests, or an ex-colonial power, with political and economic commitments to former dependencies. This raises the issue of motives. The difference between them and the motivations of other donors is that they involve, in the case of OPEC, the relationships of Third World countries with each other and the mutuality of their interests.

OPEC aid has been considerably influenced, both in scope and in scale, by the oil revolution of 1973. Further questions arise here. Do increases in the export prices of a certain commodity create a case for aid giving? Should the beneficiaries of price increases compensate in some way those who carry the burden of the additional import bill?

The subject tackled in this paper is important. OPEC aid is not a minor phenomenon. The flows of financial assistance from oil exporting countries in recent years have become very substantial. Commitments of funds and amounts actually disbursed represent an unusually high proportion of the gross national product of major OPEC donors. The share of OPEC member countries in the total flow of official assistance to the Third World is large. Many an important developing country critically depends today on OPEC aid. Major international development institutions have also come to depend on oil-exporting countries for substantial borrowings. More interesting perhaps than these indications of quantitative significance, is the fact that OPEC aid has taken a variety of forms, some newly conceived or hitherto untried.

The purposes of this paper are to establish and to evaluate the record of OPEC aid. The analysis, it is hoped, will try to capture what is original in the phenomenon: the novel elements and the specific features. Another purpose is to draw some tentative lessons from the experience and to assess the prospects of OPEC aid in the coming years. The history of OPEC aid is perhaps now sufficiently long to justify the attempt to appraise; and yet far too short for any appraisal undertaken at this stage to be anything but tentative in nature.

THE RECORD

A. *OPEC aid before the oil revolution*

The history of financial co-operation between member countries of OPEC and other developing nations began soon after the foundation of that organization in 1960. This history started with the creation, in 1961, of the Kuwait Fund for Arab Economic Development. The chronological coincidence of these events may be considered as accidental; there was no necessary link between the actions of the five oil-exporting countries which decided, in 1960, to join together in order to defend vital economic interests threatened by the erosion of petroleum prices, and the separate decision of Kuwait, in 1961, to establish a Fund for external development aid. Yet, in a subtle sense, one may now recognize in these diverse actions the features of a new and important phenomenon: the emergence of effective solidarity in the Third World both within a group of countries with similar economic interests and between members of this group and other developing nations. The point of interest in the context of this paper is the birth, as early as 1961, of a new concept in foreign aid in which both donor and recipient are developing countries.

The Kuwait Fund during the 1960s was, by present standards, a fairly modest aid institution. Yet, Kuwait was in this period transferring every year, in foreign aid, a percentage of its Gross National Product higher than that of any other donor country. Cumulative disbursements from the Kuwait Fund between 1962/1963, the first year of operation, and 1970/1971 were of the order of KD 60 million or approximately US$ 200 million. Other aid institutions sprang up in OPEC member countries early in the 1970s, prior to the oil events of 1973. The Abu Dhabi Fund for Arab Economic Development was launched in 1971, and the Arab Fund for Social and Economic Development, established in 1968, became operational in 1972. The Abu Dhabi Fund, like the Kuwait Fund, is a national institution owned by one OPEC member country. The Arab Fund is a regional institution founded by a group of countries, not all of which are members of OPEC. These funds were mainly concerned with the granting of project loans on concessional terms to Arab countries.

Aid from OPEC member countries before 1973 was not uniquely channelled through development finance institutions. Late in the 1960s, three Arab oil-exporting countries, Kuwait, Libya and Saudi Arabia, began to extend substantial grants to Egypt, Jordan and Syria. There were considerable differences between this particular type of aid and that provided by the Funds. The payments were in the form of grants, not loans. They were not tied to projects nor to plans but given as straight budgetary support. They were benefitting only three Arab countries while the Funds had, from the beginning, a much wider vocation. They were motivated by a strong political imperative: the need to support the states who had been victim of the Israeli armed attack of June 1967 and the military occupation which resulted from it.

Estimates of actual disbursements of OPEC members in the years 1970 to 1973 are as follows (US$ million):

1970	*1971*	*1972*	*1973*
443.5	630.9	688.9	1 740.0

Sources: 1970-1972, World Bank; 1973, OECD.

The data suggest that OPEC aid was already substantial before 1973. The oil events of that year enabled OPEC countries to inaugurate a new chapter in their aid record, but they did not mark an absolute beginning. Institutions with proven capabilities in the provision of financial assistance were already in existence before 1973. Governments had already recognized the need to express solidarity with other developing countries, beginning with immediate neighbours, through foreign aid. Large disbursements in the form of grants and soft loans for budgetary support were being made from 1968 on. And the scope of aid in terms of objectives, spread and scale of disbursements had broadened significantly in 1971.

B. *OPEC aid after the oil revolution*

There are at present two sets of comprehensive data on flows of resources from OPEC members to developing countries. One set is compiled by OECD and the second by UNCTAD. The two sets display significant differences in both aggregates and detail; yet these sources are not totally independent of each other. There is now a greater exchange of information between researchers in these two international organizations than was the case in the past, and all rely to a large extent on the same sources. Differences in estimates of aggregate flows seem to arise primarily because of definitional issues. OECD applies criteria evolved for DAC flows and has less contact with primary sources than UNCTAD in the identification of OPEC aid flows.

The main data recently collected by both sources are summarized and compared in the table below.

Estimates of net disbursements of concessional aid (multilateral as well as bilateral), made by UNCTAD and OECD, are basically very similar for all years except 1976.[1] The major difference between the two sources seems to lie in estimates of non-concessional multilateral flows. OECD does not consider payments to the IMF oil facility as part of the relevant flows, while UNCTAD does.[2] The OECD argument is essentially that these payments did not constitute long-term financial flows, but rather short-to medium-term balance of payments assistance and did not diminish the donors' resources since they were able to draw on them whenever their own payments position so warranted. The UNCTAD argument holds that OPEC flows to the IMF oil facility exceed by far the facility's flows to developing countries which could be considered as exclusively financed by the OPEC donors, and that the duration of the facility's loans (up to seven years) constituted as much relief for the recipients' balance of payments as any bilateral non-concessional loan subject to similar terms. The IMF oil facility was indeed conceived by OPEC countries as a form of assistance to other developing countries. Flows may have been diverted to other recipients by the intermediary in ways that did not necessarily correspond to the donor's

[1] The difference in that year relates mainly to multilateral concessional aid. UNCTAD figures are US$ 330 m. higher than OECD, and this is largely due to a difference of judgement on the timing of a single transaction as well as to a more extensive coverage by UNCTAD of non-budgetary contributions to UN agencies.

[2] In fact, if the contributions to the IMF oil facility are added to the OECD figures for non-concessional multilateral disbursements, the discrepancies with UNCTAD become insignificant.

NET DISBURSEMENTS OF OPEC AID 1973-1976 ESTIMATES BY UNCTAD AND OECD US$ MILLIONS

	1973		1974		1975		1976	
	UNCTAD	*OECD*	*UNCTAD*	*OECD*	*UNCTAD*	*OECD*	*UNCTAD*	*OECD*
Disbursements								
Concessional:	1 145.5	1 307.6	3 504.2	3 445.6	5 472.8	5 571.9	5 239.4	5 182.0
Bilateral	1 043.0	1 208.0	3 038.3	3 015.1	4 920.9	4 947.1	4 405.5	4 386.5
Multilateral	102.5	99.6	465.9	430.5	552.0	564.8	833.9	795.5
Non-Concessional:	445.9	432.4	4 057.0	2 506.3	5 984.3	2 651.6	3 738.6	2 773.2
Bilateral	142.2	138.3	688.9	981.5	1 486.7	1 497.3	1 106.2	1 592.5
Multilateral	303.7	294.1	3 368.1	1 524.8	4 497.6	1 154.3	2 632.5	1 180.7
Total	1 591.4	1 740.0	7 561.3	5 951.9	11 457.1	8 163.5	8 978.1	7 955.2

Source: UNCTAD, statistical tables dated 4 November 1977 (mimeographed).
OECD, statistical tables dated 4 November 1977 (mimeographed). The OECD figures will appear in the 1977 DAC Annual Review and reflect a revision of the data published in earlier DAC reports.

intention. This, of course, is an inherent feature of multilateral aid, especially when little control is exerted by donors on the final allocation. To distinguish disbursements from receipts becomes legitimate when there is such diversion of flows. Disbursements are an indicator of the donor's effort; receipts a measure of development aid. Such an argument implies that the UNCTAD figures correspond to a meaningful concept (disbursements) while the OECD data may underestimate both outflows from OPEC and inflows to developing countries.

Having interpreted the conceptual differences of the sources, we may now turn to the figures. The picture, however looked at, is clear: net disbursements from OPEC countries increased manifold in 1974 and 1975 above the high levels achieved in 1973. There is a dip in 1976, much more marked by the UNCTAD than the OECD figures. Once again, the IMF oil facility is the main cause of the apparent difference in behavior. Interpreting the data in terms of disbursements and receipts, it would be fair to say that outflows from OPEC member countries declined in 1976, if compared to 1975, but that receipts by developing countries attributable to OPEC bilateral and multilateral contributions decreased much less in this period than the figure of the decline in outflows would indicate.[3]

The magnitude of OPEC aid can be assessed in different ways. First, the comparison with the official development assistance of the industrialized DAC countries, though uncalled-for because of the structural differences between the two groups of donors, yields striking results in favour of the OPEC group. OPEC aid, according to the lower estimate, represented 44% of DAC official disbursements in 1974. In the peak year, 1975, the low OECD estimate corresponds to a ratio of 49%, the higher UNCTAD figures indicate a ratio of 67%. Two OPEC countries, Saudi Arabia and UAE, ranked in 1976 among the six largest bilateral aid donors in absolute terms, Saudi Arabia being second only to the United States.

NET DISBURSEMENTS, OPEC & DAC, 1974-76*

(Concessional and non-concessional official flows US$ m.)

	1974	*1975*	*1976*
DAC	13 500	16 609	17 030
OPEC			
(OECD estimate)	5 952	8 163	7 955
(UNCTAD estimate)	7 561	11 457	8 978

* Official flows only; excluding flows to Southern European recipients, but including contributions to IMF Oil Facility.

[3] According to UNCTAD estimates, receipts between 1975 and 1976 decreased by some $ 1.5 billion, of which $ 1 billion is attributed to the IMF oil facility.

Comparison of disbursements to the GNP of the donors is even more revealing. In 1974-1976, official development assistance from DAC countries to developing countries was equivalent to 0.33-0.35% of their collective GNP. In these years, Sweden and the Netherlands shared the best record, reaching on occasions the 0.82% mark. The comparable OPEC averages[4] in 1974-1976 (net disbursements of concessional aid, using OECD estimates) range between 2.0 and 2.7% of the collective GNP. In 1976, OPEC countries occupied the top six ranks among all donor countries of the world as regards the proportion of aid to GNP. In the peak year of 1975, OECD sources record a 15.6% of the GNP figure for Qatar and an 11.8% for the UAE. If non-concessional official flows are added, net disbursements (excluding for IMF oil facility) represent 3.4 to 4% of GNP in 1974-1976, according to OECD estimates. In none of these three years, did the total disbursements of Kuwait, Qatar and the UAE, fall below ten per cent of GNP. These percentages are the lowest possible estimates, being based on the OECD figures and on a definition of OPEC donors which include countries such as Algeria and Nigeria which, while doing their best in aid giving, have per capita incomes lower than in many an "assisted" developing country. To illustrate the differences in results, if alternative definitions are adopted, the following calculations were made for 1975:

	As Percentage of GNP
Net disbursement of OPEC countries according to OECD estimates (total official)	4.01%*
Net disbursements of OPEC countries (excluding Algeria and Nigeria)	7.21%
Net disbursements of four OPEC countries making the highest disbursement/GNP ratio (Kuwait, Qatar, Saudi Arabia and UAE)	12.30%

* Of these averages, country percentages are: 16.9% for Qatar, 13.59% for UAE, 11.44% for Kuwait, 7.42% for Saudi Arabia, 2.96% for Libya, 1.9% for Iraq, 1.8% for Venezuela, 1.74% for Iran, 1.37% for Nigeria, and 0.31% for Algeria.

In 1975, if contributions to the IMF oil facility are included, the net disbursement/GNP ratio would rise from 7.4 to 10.9% for Saudi Arabia and from 11.4 to 14% for Kuwait.

These percentages, already higher than any aid ratios previously known, would become even higher if the nature of oil revenues, as

[4] OPEC in this paper always means ten members (Ecuador, Gabon and Indonesia are excluded). For a fairer comparison with DAC one should also exclude Algeria and Nigeria which are themselves capital-importing countries with a relatively modest per capita income.

basically a new form of capital wealth and not a net income, is taken into consideration. Even at the low 30% "depletion factor" suggested for the GNP of the major oil-exporting countries by Mr. McNamara in his September 1974 adress to the World Bank Board of Governors, the 10.9% disbursement/GNP ratio for Saudi Arabia would become 16% and the 11.5% for Kuwait would become 17.4%, etc. Such ratios become much higher of course if we take the UNCTAD figures as a basis of calculation.[5] In all cases, including the most conservative estimates, the ratio for OPEC aid exceeds by several times the target long sought by developing countries and interested international organizations.

From the beneficiary point of view what matters most, however, are the amounts received and the terms on which aid is extended. The OECD estimates the overall grant element in the concessional commitments of OPEC countries to be as follows:[6]

1974	*1975*	*1976*
79.0%	72.3%	79.3%

The OECD/DAC practice in measuring the grant-equivalent of official development assistance is to use a rate of discount of 10%. But no allowance is made for factors other than the specified terms of grants and loans. Yet the value of a loan to the recipient does not depend only on the rate of interest, the maturity and the grace period of the loans. Aid which is not tied to source has greater value to the beneficiary than aid given for purchases of goods and services from the donor country. Similarly, aid tied to a project may be (though the issue is extremely complex in this case) of less real value, in terms of volume, than the same amount given for balance-of-payment support. The World Bank calculates a "commitment deflator" on project loans, which is an index designed to take into account the fact that commitments in a given year will be disbursed over a number of years, five on average, thus sharply reducing their real value in a period of rapid inflation. Professor Henderson, among others, argued also that an allowance should be made when measuring the grant element of aid for the factor mentioned above, as well as for such other factors as "the quality of technical assistance provided, the continuity and predictability of funds and the administrative efficiency of the agency which handles the aid

[5] According to UNCTAD estimates, the disbursement/GNP ratio for Saudi Arabia amounts in 1975 to 11.65% which, with the addition of the depletion factor, would become 16.6%. The corresponding figures for Kuwait would be 14.1% and over 20% respectively.

[6] UNCTAD estimates are somewhat higher: 81.3% for 1974; 73.6% for 1975 and 78.87%for 1976.

programme in the donor country . . .".[7] However, all recognize that it may be difficult in practice to make even the roughest allowance for such qualitative factors.

When comparing the grant element of OPEC with DAC aid, figures for DAC should thus be reduced to allow for the costs of tying to source and probably, to a lesser, extent, because of tying its use. Comparability calls for further adjustments, as well. The grant element is calculated for commitments, not disbursements. There is a larger discrepancy between volume committed and amounts disbursed in the case of OPEC (because of the sudden increase in OPEC aid in 1974) than in the case of DAC. Terms of the total OPEC committed aid tend, in fact, to be harder than the terms of the aid actually disbursed because recipients cash straight grants and budget support aid with greater ease than they draw on allocated loans for projects or other purposes.[8] In short, the grant element in OPEC aid is probably greater, in fact, than it may seem to be if one considers the commitments figures only.

The grant element in official development assistance (commitments) of DAC countries is estimated by OECD as follows:

1974	*1975*	*1976*
86.0%	88.6%	88.9%

If the suggested adjustments were made it would probably appear that by 1976 the terms of OPEC aid had become at least as favourable to developing countries as those of DAC countries' official assistance.

Let us finally note on this issue of the terms of aid that official non-concessional flows represent a much larger proportion of OPEC than of official DAC aid. The concessionality element involved in some forms of OPEC financial assistance (such as direct deposits from the donor's to the recipient's Central Bank) tend to be grossly understated. The value of these deposits are greater than apparent from their terms because, in most cases, their effective duration is much longer in practice than their formal maturities, thus allowing recipients to avoid the tough liquidity problems which arise in connexion with short-term commercial loans.

The geographic distributional characteristics of the OPEC aid record after 1973 are of interest. There was an increase in the number of both

[7] P. D. Henderson, "The Distribution of Official Development Assistance Commitments by Recipient Countries and by Sources", *Bulletin of the Oxford Institute of Economics and Statistics*, 33(1), 1971, p. 2.

[8] On a disbursement basis, general support assistance accounted for half of OPEC bilateral concessional aid in 1975; on a commitment basis it only accounted for 32% of the comparable category.

donors and recipients immediately after the oil price adjustment. Before 1973, OPEC donors numbered three to four. Today, ten OPEC members have become international donors of some significance, and all thirteen members have contributed to the OPEC Special Fund. Some of the new donors have fairly low per capita incomes; several experience balance-of-payments difficulties, and a few are regular borrowers of foreign exchange on non-concessional terms in international financial markets.

The total number of recipients of OPEC concessional disbursements in the period 1970-1973 was 23 developing countries, including three low-income OPEC members. This number is estimated by UNCTAD at 42 in 1974, 55 in 1975 and 63 in 1976. Recipients of assistance from the OPEC Special Fund alone have so far been 60 developing countries. The high concentration on recipients neighboring the major donors is now giving way to a larger geographic distribution, as shown in the following figures on bilateral concessional disbursements measured in terms of the proportion of funds received by Arab countries to the total:

	1973	*1974*	*1975*	*1976*
OECD	96.3%	73.9%	81.9%	64.5%
UNCTAD	96.6%	74.5%	80.5%	63.1%

A clear example of this trend to widen the geographic distribution of OPEC bilateral aid is manifested in the spheres of operation of the Kuwait Fund and the Abu Dhabi Fund which, restricted before 1974 to Arab League Members, have been extended since that year to cover all developing countries. The Saudi Fund for Development, the Iraqi Fund for External Development and the Iran Organization for Investment and Foreign Assistance have, from their inception, included all developing countries.

In addition, after 1973 there was, a considerable expansion of financial flows from OPEC countries to multilateral institutions which no doubt have also broadened, indirectly, the geographical spread of OPEC aid.

The second distributional characteristics of OPEC aid worth commenting upon is the allocation by purpose. Understandably, the share of technical assistance is very small. The equivalent for OPEC countries to commodity aid extended by DAC countries would be concessional credits for the sale of oil. Some OPEC countries also have arrangements to supply oil at reduced prices (e.g. Venezuela's part-financing of oil sales to Central American countries), but this form of aid is very limited in scale. There are also some examples of support for the stabilization of the export earnings of recipient countries through such mechanisms as the special fund considered by Venezuela to finance the stockpiling of Central American coffee beans. The distinguishing feature of OPEC aid is, however, the very large share of budget or balance-of-payments support assistance. In bilateral concessional aid half of the disbursements in 1975 and one third in 1976 was for general support assistance, compared with DAC's 11 per cent share in 1975.

The third, and perhaps most remarkable, characteristic is the diversification of channels and modes of financial co-operation between OPEC members and other developing countries since 1973. The institutional channels for the granting and distribution of funds are now comprised of the following:

a) National funds created for the purpose of providing external assistance, such as the Abu Dhabi, the Kuwait, the Saudi and the Iraqi Development Funds, and similar agencies which combine the task of foreign aid with investment at home, such as the Iran Organization for Investment and Foreign Assistance and the Venezuelan Investment Fund.

b) The OPEC collective aid facility, namely, the OPEC Special Fund.

c) Multilateral institutions established by some OPEC members and other developing countries such as the Arab Fund, the Arab Bank for Economic Development in Africa (ABEDA) and the Islamic Development Bank.

d) Nationally financed trust funds administered by multilateral institutions.

e) New multilateral institutions involving other developing and developed countries in the creation of which OPEC countries played a leading role, such as the International Fund for Agricultural Development (IFAD) and the projected Common Fund for Commodities.

f) Existing multilateral institutions such as the World Bank, the IMF, UNDP and others, in receipt of contributions, grants or loans from OPEC member countries.

g) Central banks and national treasuries.

OPEC aid, through these channels, is taking a variety of forms. Bilateral aid includes long-term and medium-term balance-of-payments support grants and loans, project aid, central bank to central bank deposits, and banking guarantees under-writing commercial loans to developing countries. Multilateral aid involves straight contributions to international development agencies, as well as the creation of new multilateral institutions. Financial co-operation between OPEC and other developing countries has led to the establishment of joint companies for financial placements and direct investment in the Third World. Such bilateral arrangements have often involved third parties from the developed countries, thus widening the scope of the much talked of "trilateral cooperation".

THE EXPERIENCE

Four years have elapsed since the dramatic events of October 1973, which inaugurated a new and important chapter in the history of OPEC aid. The time may have come to appraise, and to attempt to formulate the questions raised by this short but fruitful experience.

One —perhaps the more important— issue relates to the donors. What is prompting them to give aid? What are the motives, the justification, the legitimate interests? An explanation of the origins of OPEC aid may provide some useful clues. The first chapter of the history of OPEC aid is the emergence of Kuwait as a donor in the 1960s. In those early days Kuwait was already accumulating part of its oil reserves in the form of liquid assets and thus had the means to engage in financial co-operation with other developing countries. Yet the availability of funds is just an enabling factor. The motivation, surely, must involve interests in the international relations of the state. Kuwait was a small country which was rapidly achieving economic prosperity and which had just acquired full political independence. The granting of aid was probably perceived as the instrument of an enlightened foreign policy allowing the state to play a positive role in the area surrounding it and to achieve a measure of international recognition for the prosperous, peaceful and newly independent nation.

A second chapter opened in 1967, at Khartoum, when Arab oil-exporting countries pledged to provide Egypt, Syria and Jordan with substantial annual grants. The motivation here is readily understandable: the need to consolidate the Arab front in the context of a violent and highly damaging regional conflict. Aid in this situation is a necessary act of solidarity, linking a small group of neighbors sharing a vital common interest and a deeply rooted sense of community.

The third and major chapter in the history of OPEC aid begins, as shown in earlier sections of this paper, after the oil events of October 1973. The various sets of objectives and motivations which inspired earlier acts of financial co-operation continued to operate, acquiring, indeed, greater significance. A large component of OPEC aid, after 1973, is accounted for by the support given to Egypt and Syria by Arab oil exporting countries. And it could be argued that a number of the smaller oil exporting countries today find themselves in a similar situation to that of Kuwait in 1961, seeking through aid to play an international role commensurate to their new status as holders of oil power and wealth.

Aid could also be an effective instrument in creating a vested interest for the recipient countries in the continued prosperity of the donors. This factor has been strengthened by the responsible feeling of many OPEC governments of the need to strengthen the hand of developing countries during a period of immense economic stresses, where solidarity among all developing countries becomes all the more necessary if they aspire to achieve more favourable deals in their relationships with the developed world. Indeed, the oil revolution has introduced new elements in this respect. One such element is that OPEC success in raising the price of oil in such a dramatic and significant manner have put petroleum exporting countries in the position of the vanguard of other developing nations. The price of primary product exports is not simply an important economic issue for the Third World; it is a political issue which relates historically to the colonial past and the struggle for independence. Consciously or unwillingly, OPEC, by raising oil prices, has acquired a leading role in the demand for and the attempts to build a new international economic order. This role involves acts of solidarity within the Third World and the building up of networks of cooperation. Financial aid, given the availability of liquid assets in some OPEC countries, has been the natural way of expressing this solidarity. A further consideration may have enhanced the need to express this solidarity: the fact that the higher oil prices represent a financial burden on oil-importing countries of the Third World. The OPEC position is that oil price increases do not create a case for compensation through aid. However, OPEC countries have been mindful of the special financial difficulties experienced by many developing countries in recent years. It would be paradoxical indeed if successful actions on the part of a group of developing countries, which correspond to deep aspirations of the Third World and which help to build up solidarity, were allowed to develop damaging side-effects on those who are supposed to benefit. There is no case for sellers to compensate buyers for every significant price rise (at the limit, this would mean that prices should remain indefinitely fixed, which is absurd), but there is a case for alleviating burdens in the context of Third World solidarity to the extent that such a role could be played without appreciable harm to the donors.

Further, the emergence of substantial foreign exchange balances in the hands of a number of oil-exporting countries introduces an economic dimension in the donor's objectives. The difference between an OPEC and say, a Western world, donor is that the former has liquid assets in search of locations for placements, while the latter may be in search of markets for goods and services and outlets for foreign private investments. Oil producing countries with financial surpluses have limited outlets for placements, and non-concessional flows to developing nations have come to be considered as an additional option in this area. The large component of non-concessional flows in total OPEC contributions to the Third World is largely explained by this phenomenon.

One could look at the question of objectives and motivations in a different way. Three main cases can be made to justify aid-giving: ethical, economic and political. *Ethical* considerations, however important, have in the past only explained a relatively small portion of aid-giving activities in the world. They apply in cases of emergencies, natural catastrophes (such as famines and earthquakes) and similar distress situations (help to refugees, etc.). Ethical considerations also have begun to influence the allocation of aid as distinguished from its volume; hence, the concern recently displayed by some multilateral agencies for the plight of the absolute poor and for the problems of the Sahel countries. OPEC may, in this respect, be different from most DAC and Eastern bloc donors in that a good part of its aid is made in response to ethical and religious factors. Other motives could not explain most of the aid provided by the small members in the OPEC group to areas outside the region of direct political interest to them.

The case for aid made in terms of the donors' *economic* interest usually involves such arguments as the need to create commercial goodwill in Third World countries, or the need to strengthen and develop existing economic and trade ties and to create a favourable environment for foreign investment. It is sometimes argued, by the supporters of foreign aid in industrialized countries, that to foster economic growth in the Third World is enlightened self-interest, because advanced countries benefit more from economic progress than from economic stagnation in the rest of the world. OPEC donors do not, however, have an immediate interest in promoting crude oil exports — the major items of their merchandise trade. The promotion of other exports for most of them is indeed a premature exercise. As argued earlier, aid provides an opportunity for placement of funds not always very attractive on commercial terms. The trade-off here is between diversification and returns. Financial co-operation between OPEC and other developing countries makes much economic sense in the area of joint ventures and investment in the productive sectors of developing economies. Some of that is taking place, but, unfortunatelly, not yet enough.

There are two *political* cases for aid. The first seems to apply exclusively to Western countries. It has been argued that foreign aid is the least costly course of action for governments faced with demands to help the Third World from lobbies within the donor countries. It is easier and politically more expedient to launch an aid programme than to remove trade barriers, allow inmigrants in, facilitate movements of capital, etc. Whatever the relevance of that argument, it does not readily apply to OPEC aid. The second political case for aid is that its justification lies in foreign policy objectives. Broadly speaking, OPEC aid may be attributed in part to foreign policy, that is to the national interest, in areas which involve other countries. This accounts in part for the large share of OPEC aid that is allocated to the donors' close neighbors. But foreign policy may be enlightened and, in seeking its national goals, the donor can be helping the building up of mutual interests. If financial co-operation between OPEC Members and other countries, for example, contributes to the creation of a new international order, mutual interests are well served.

The experience of OPEC aid not only raises issues about objectives but about instruments and means. Though the experience is short, it is possible to seek some lessons from the ways in which aid was conceived and managed and the ways in which it evolved.

There is no doubt that the suddenness with which the oil price adjustment took place, and which allowed for a substantial increase in OPEC aid, caught most donors by surprise. They simply lacked the time to elaborate an aid philosophy, to design elaborate sets of policies, establish procedures and organize all the efficient channels that the unexpected scale of aid operations required. It is remarkable that they managed what they did, but there were inevitable defects. The major drawback in such a situation is the temptation to respond fairly passively to the demands of the potential recipients, whether they be governments or international institutions, rather than to initiate the aid program and implement it according to one's own priorities. The oil revolution seems to have fostered much impatience about immediate action. However, as time passes the OPEC countries are developing their own thinking on this matter through new institutions, methods and techniques.

However, the creation of a large number of new institutions for financial co-operation after 1973, necessary as it was, also raises problems. There is a danger of duplication and manpower difficulties are often experienced. The pool of available talent is still so small in relation to the new demands for its services.

In its short experience OPEC aid faced the perennial problem of balancing the advantages of project and general support aid. The emphasis on project loans as a mode of financial assistance has encountered advantages and drawbacks. Project aid often involves long administrative processes with feasibility studies, economic appraisals and the drawing-up of elaborate contracts. Donors may become victims of some illusion about the quality of the investment funded as the project-tied aid often releases other funds to finance different expenditures. The poorer and less developed countries, which are perhaps in the greatest need of aid are often least able to identify projects useful to the country and attractive to the donor. Project aid may, inadvertently, favor countries which have the specialized manpower resources for identifying projects and for promoting them to the donors. Donors may thus find that they are committing and disbursing for project financing much smaller amounts than intended and that the distribution of their aid does not correspond to their preferred allocation. The advantages, however, are that project aid involves an element of technical assistance to the recipient; it ensures that certain standards are applied in the scrutiny and selection of projects; and it contributes, in a certain way, to an increase in the rate of investment in the recipient country. It also provides the donor with psychological and sometimes political rewards by associating him and identifying him to some extent with a concrete achievement. However, disbursement flows in such a type of aid, whatever the volume of funds allocated or committed, tend to be very constrained. Hence, the significant recourse to general support grants and loans, which form a very large proportion of OPEC aid. But support aid which sometimes turns out to be very beneficial to recipients often carries the unpleasant connotation to the donor of "money being given away".

OPEC aid includes considerable contributions to the major international financial agencies. One could argue that the contributors should have insisted from the outset on acquiring a role in the management of these agencies commensurate with their importance as contributors. Here again restraint was displayed, suggesting that aid has not been fully used by OPEC members as a tool of foreign policy. Many developing countries are calling upon OPEC members to adopt a more agressive policy in this respect for the promotion of Third World interests in the agencies hitherto dominated by the developed industrialized countries.

Finally, OPEC members have not yet resolved, in this short time, the important issue of how much aid should be given on a bilateral basis and how much on a joint basis from OPEC members as a group. At present, aid from OPEC as a group is provided through the OPEC Special Fund, an international account to which all member countries contribute. In this area, what matters most is not the size of the collective facilities but the concerted action of member countries, which ensures a greater degree of effectiveness. Recent experience revealed the advantages of collective and concerted efforts, especially in international fora where coordination among OPEC member countries was effected through the OPEC Special Fund.

THE PROSPECTS

What are the likely prospects of OPEC aid in the immediate future and the medium-term?

The volume of OPEC aid is not only large but has expanded in a sudden manner at a very fast rate in 1974-1975. The events in the oil sector, which were associated with this expansion of aid efforts, were fairly unique and are unlikely to be repeated in the near future in the same way. Barring unforeseeable events, one should not, therefore, expect much growth in the gross volume of OPEC aid in the years to come.

It is likely, however, that the level of aid will remain high in the immediate future. Many of the forces and interests which motivated a large part of OPEC aid in recent years are not likely to disappear overnight. True, data on aid for 1976 show that commitments have declined, but this does not imply that disbursements will automatically decrease in the coming two or three years, as gross disbursements are yet to catch up with the abrupt and significant increases in commitments in 1974-1975. Since repayments are still many years ahead in most cases, the figure of net disbursements will remain close to that of gross disbursements for some years to come.[9]

The prospects of OPEC aid beyond the short-term will be influenced by two factors. That part of aid which is channelled through the many institutions created by member countries will continue over time, as these institutions have their own capital endowments and are thus able to survive, even if confined to their present resources. That part of aid which is financed directly by governments may well be strongly influenced by developments related to oil prices and oil revenues. Though oil revenues and financial surpluses do not necessarily provide a case for aid-giving, they are obviously the enabling factor. There is no need to indulge here in forecasts of future oil prices, as the main point is simply that stagnation or decline in revenues (if they take place) would inevitably affect the volume of aid that OPEC member countries could afford.

A further consideration is that the development needs of OPEC countries themselves are increasing. "Absorptive capacity", that is the ability to spend domestically on economic development, has a tendency to increase with time. As oil is a depletable asset, the priority given to domestic economic objetives becomes more, rather than less, important with the passage of time. Oil exporting countries are increas-

[9] In this respect, OPEC aid differs again from DAC flows. In the latter case, gross official flows totalling $ 21.2 billion in 1975 exceeded net flows by $ 4.6 billion, the latter amount representing amortization of existing debt of aid recipients.

ingly aware that the surplus funds at their disposal are not income but paper assets which they have acquired in exchange for a natural asset on terms which are not, from their viewpoint, as favorable as suggested in the outside world. They crucially depend on these assets — whether financial or natural — for their economic future, and they have an important duty towards future generations in their own countries, particularly since many have few or no other resources than depletable oil. The crude pressures sometimes exerted in 1974 and 1975, which suggested that "oil revenues are in surplus, hence, superfluous, and must be shared" have obviously failed and are likely to remain ineffective, if repeated. Estimates of the accumulation of liquid assets of OPEC member countries as a group indicate, at any rate, a rapidly declining trend, and several OPEC countries have already switched from a net surplus to a net deficit position.

The medium-term may thus involve a decline in the volume of concessional flows for all the reasons mentioned, unless revenues grow significantly. This decline, if it occurs, may, however, be partially offset by an increase in the volume of OPEC investments in other developing countries. Investments with adequate returns to both the OPEC investor and the host developing country may present, at any rate, a more balanced pattern of cooperation in the context of Third World solidarity, in view of the special nature of oil revenues and the future needs of OPEC countries. The slow pace of such investments which, by definition, require a long period of time to materialize, may eventually accelerate, paving the way for greater cooperation in this field. The trilateral venture formula which involves cooperation of third parties from the developed countries could help advance such a process especially when the legitimate interests of all parties are secured.

The level of sophistication of financial cooperation extended by OPEC countries, the modes of assistance and the patterns of allocation (irrespective of what happens to volumes) will also inevitably improve as the aid donors progress on the road to economic development. As there are gains to donors when the recipients' economies grow and progress, there may be gains to recipients when the donors become more developed, even if in the process, they lose some of the false appearances of wealth.

Annex I

Total net flows from OPEC members to Developing Countries OECD and UNCTAD Statistics dated 4 Nov., 1977

Donor Country		1973	1974	1975	1976
		$ million			
Algeria	OECD	29.7	51.4	42.2	(66.6)
	UNCTAD	30	52	42	75
Iran	OECD	4.9	739.4	936.1	795.4
	UNCTAD	5	1 182	1 595	820
Iraq	OECD	11.1	440.2	(251.4)	(119.7)
	UNCTAD	11	436	288	91
Kuwait	OECD	550.0	1 250.1	1 711.2	1 874.8
	UNCTAD	581	1 369	2 112	1 807
Libya	OECD	403.7	263.2	362.8	373.2
	UNCTAD	414	218	367	262
Nigeria	OECD	5.7	134.8	347.5	176.7
	UNCTAD	7	135	545	337
Qatar	OECD	93.7	217.9	366.7	245.4
	UNCTAD	94	253	366	445
Saudi Arabia	OECD	334.9	1 622.1	2 466.7	2 826.0
	UNCTAD	342	2 372	3 870	3 625
UAE	OECD	288.6	749.4	1 206.6	1 143.8
	UNCTAD	90	765	1 375	1 221
Venezuela	OECD	17.7	483.4	472.3	333.6
	UNCTAD	18	779	899	296
Total	OECD	1 740.0	5 951.9	8 163.5	7 955.2
	UNCTAD	1 591	7 561	11 457	8 978

Donor Country		1973	1974	1975	1976
		As per cent of GNP			
Algeria	OECD	0.36	0.43	0.31	(0.43)
	UNCTAD	0.36	0.43	0.30	0.48

Donor Country		As per cent of GNP 1973	1974	1975	1976
Iran	OECD	0.02	1.59	1.74	1.20
	UNCTAD	0.02	2.54	2.97	1.24
Iraq	OECD	0.21	4.16	(1.91)	(0.75)
	UNCTAD	0.21	4.12	2.18	0.57
Kuwait	OECD	9.17	11.46	11.44	11.50
	UNCTAD	9.69	12.56	14.12	11.08
Libya	OECD	6.25	2.21	2.96	2.43
	UNCTAD	6.41	1.83	2.99	1.71
Nigeria	OECD	0.04	0.60	1.37	0.61
	UNCTAD	0.05	0.60	2.15	1.15
Qatar	OECD	15.62	10.90	16.90	10.37
	UNCTAD	15.64	12.67	16.88	18.81
Saudi Arabia	OECD	4.12	7.19	7.42	7.04
	UNCTAD	4.21	10.51	11.65	9.03
UAE	OECD	12.03	9.78	13.59	11.45
	UNCTAD	3.76	9.99	15.49	12.22
Venezuela	OECD	0.11	1.93	1.80	1.06
	UNCTAD	0.11	3.10	3.43	0.94
Total	OECD	1.88	3.47	4.01	3.28
	UNCTAD	1.72	4.40	5.62	3.70

Annex II

Concessional Assistance by OPEC members 1973-1976. OECD and UNCTAD statistics dated Nov. 4, 1977

Donor Country		Commitments - $ million 1973	1974	1975	1976
Algeria	OECD	23.0	63.7	59.6	77.9
	UNCTAD	36	78	74	84
Iran	OECD	8.8	805.5	1 448.5	402.2
	UNCTAD	9	814	1 452	408

Donor Country		Commitments - $ million 1973	1974	1975	1976
Iraq	OECD	115.7	497.7	370.8	181.3
	UNCTAD	139	547	406	86
Kuwait	OECD	378.8	838.9	1 190.0	755.5
	UNCTAD	469	1 038	1 137	679
Libya	OECD	238.4	266.9	291.6	217.2
	UNCTAD	800	286	387	133
Nigeria	OECD	4.6	15.7	35.8	136.4
	UNCTAD	6	27	26	151
Qatar	OECD	93.1	227.7	369.1	138.3
	UNCTAD	96	254	372	191
Saudi Arabia	OECD	568.2	1 287.6	2 790.1	2 802.6
	UNCTAD	577	1 363	2 957	2 679
UAE	OECD	318.1	676.6	1 123.3	1 181.4
	UNCTAD	125	740	1 218	1 134
Venezuela	OECD	18.1	112.4	11.6	145.2
	UNCTAD	18	111	32	218
Total	OECD	1 766.8	4 792.7	7 690.4	6 038.0
	UNCTAD	2 273	5 260	8 061	5 764

Donor Country		Net Disbursements - $ million 1973	1974	1975	1976
Algeria	OECD	25.3	46.9	40.7	53.6
	UNCTAD	26	51	41	64
Iran	OECD	1.9	408.3	593.6	740.6
	UNCTAD	2	402	560	748
Iraq	OECD	11.1	422.9	(215.4)	96.7
	UNCTAD	11	418	235	85
Kuwait	OECD	345.3	621.5	975.1	526.9
	UNCTAD	371	627	907	500
Libya	OECD	214.4	147.0	261.1	103.6
	UNCTAD	218	147	212	135

Donor Country		Net Disbursements - $ million 1973	1974	1975	1976
Nigeria	OECD	4.7	15.3	13.9	82.8
	UNCTAD	6	15	14	82
Qatar	OECD	93.7	185.2	338.9	175.1
	UNCTAD	94	220	297	244
Saudi	OECD	304.9	1 029.1	1 997.4	2 315.8
Arabia	UNCTAD	312	1 049	2 068	2 296
UAE	OECD	288.6	510.6	1 046.1	1 021.9
	UNCTAD	88	523	1 066	1 019
Venezuela	OECD	17.7	58.8	30.0	65.0
	UNCTAD	18	51	33	65
Total	OECD	1 307.6	3 445.6	5 511.7	5 182.0
	UNCTAD	1 145	3 504	5 473.0	5 239.0

Donor Country		Net Disbursements - As per cent of GNP 1973	1974	1975	1976
Algeria	OECD	0.31	0.39	0.30	0.34
	UNCTAD	0.31	0.43	0.30	0.41
Iran	EOCD	0.01	0.88	1.10	1.12
	UNCTAD	0.01	0.86	1.12	1.13
Iraq	OECD	0.21	3.99	(1.63)	(0.60)
	UNCTAD	0.21	3.95	1.78	0.53
Kuwait	OECD	5.76	5.70	6.52	3.23
	UNCTAD	6.19	5.75	6.06	3.07
Libya	OECD	3.32	1.23	2.13	0.67
	UNCTAD	3.38	1.23	1.73	0.88
Nigeria	OECD	0.04	0.07	0.05	0.28
	UNCTAD	0.04	0.07	0.06	0.28
Qatar	OECD	15.62	9.26	15.62	7.40
	UNCTAD	15.64	11.02	13.70	10.30

Donor Country		Net Disbursements - As per cent of GNP 1973	1974	1975	1976
Saudi	OECD	3.75	4.56	6.01	5.77
Arabia	UNCTAD	3.84	4.65	6.22	5.72
UAE	OECD	12.03	6.66	11.79	(10.23)
	UNCTAD	3.66	6.83	12.01	10.20
Venezuela	OECD	0.11	0.23	0.11	0.21
	UNCTAD	0.11	0.20	0.13	0.21
Total	OECD	1.41	2.01	2.70	2.14
	UNCTAD	1.24	2.04	2.69	2.16

Latin America: Foreign Debt and Financial Cooperation

Carlos Massad

The author is former President of Banco Central de Chile, consultant to UN Economic Commission for Latin America (ECLA).

GENERAL BACKGROUND

The Latin America non-oil-exporting countries have traditionally been net demanders of foreign savings, which has resulted in persistent deficits in their balance of payments on current account. During the period 1965-70 such deficits reached an annual average of approximately two billion dollars. This imbalance in the current account contributed to the economic growth of the region by adequately complementing the internal savings so as to assure satisfactory volumes of investment. The magnitudes involved were not very high. Actually, the average annual deficit in the current balance of payments made up no more than 8% of the financing of the gross investment during that period.

Nor did this deficit reach a magnitude of any importance in the field of foreign economic relations; it comprised less than 15% of the value of exports of goods and services, which were growing rapidly. Furthermore, the financing of the imbalance on the current account came equally from direct investments and donations, loans from official sources and loans from private sources. Thus, the way in which the contribution made by foreign savings to the growth of the region was financed implied the combination of these three ingredients, in proportions such that any future period would not be excessively taxed and that the profile of the foreign debt of the region would not show too heavy a concentration on any particular period.

It was during those years that Latin America strengthened its foreign trade relations to the point of making the issue of the substitution of imports, so important in the 50's, obsolete in national politics. The substitution issue was replaced in the majority of the countries by a persistent effort to open their economies and expand their exports on the world as well as the regional and subregional levels. This was the period of greatest vitality for projects aimed at economic integration of the area and of the largest number of innovations in the changing policies of various countries, which began to favor small but frequent modifications in the exchange rates over more drastic types of changes. These tendencies were fortified by the almost continual growth of the world economy, by the relative stability of international prices (on the whole) and by improvements in the terms of exchange. For the latter, the index, with base 100, indicated 97.1 in 1970 for the five-year period 1965-69, and reached 144.7 in 1973.

In the course of expanding their economic relations with the exterior, the larger Latin American countries obtained growing access to financing by private foreign bank sources without official guarantees. This was made possible by the improved trade relations between Latin America and the rest of the world, as well as by the steady expansion of the market for Euro-currency. The latter was stimulated by certain banking and tax dispositions put into effect by the United States, particularly by the prohibition of the payment of interest on bank deposits of less than 30 days and the tax which equalized interest.

During the first few years of the decade of the 70's, the seventies, it became increasingly clear that the existing international monetary system was incapable of successfully handling the tasks of adjusting the world economy and systematically creating liquidity. The beginning of a new period of readjustments in world economy was marked by the generalized floating of the exchange rates of the most important countries of the world, caused by the impossibility of regulating violent short-term movements of capital. World inflationary pressures, which had begun to be felt toward the end of the previous decade, became much stronger; and anti-inflationary efforts began to appear with increasing priority among the objectives of the economic policies of the industrial countries.

Nevertheless, such efforts did not achieve the expected success. The inflationary pressure turned out to be more stubborn and rebellious than in the past, and anti-inflationary efforts, instead of producing relief from the rapid increase in prices, brought decrease in the rate of world-wide economic growth.

The sudden increase in the prices of petroleum toward the end of 1973 worsened the situation and modified the traditional structure of the balance of payments throughout the world. The deficit on current account of Latin American non-oil-exporting countries, which during the period 1970-73 had already reached four billion dollars (a little more than twice the amount recorded for the second half of the decade of the 60's), rose substantially in 1974 and 1975, exceeding 13 and 16 billion dollars respectively.

Likewise, industrial countries which had traditionally shown a surplus on their current account with the exterior registered considerable deficits in 1974, stimulating even more the application of restrictive domestic economic measures.

As a consequence of this set of factors, the expansion of Latin America's external gap was accompanied by a drastic reduction of direct foreign investment and official loans as sources of financial resources, while financing provided by foreign commercial banks increased. This financing multiplied more than 27 times between the second half of the 60's and the second half of the 70's; during the same period 1965-1975 the average conditions for officially guaranteed loans reduced the average terms of credit to almost half in Latin America.

Table 1

EXTERNAL FINANCING OF LATIN AMERICAN NON-OIL EXPORTING COUNTRIES

(Billions of dollars)

	1966-70	*1974*	*1975*	*1976*
Deficit on Current Acount[a]	—2.0	—13.4	—16.2	—11.2
Reserves[b]	0.4	— 0.7	— 2.2	4.8
Utilization of external financing	2.4	12.7	14.0	16.0
Net external financing[c]	2.5	14.3	15.4	
Direct investment	0.7	2.1	2.2	(2.3)
Donations	0.1	0.1	0.1	(0.1)
Net loans[d]	1.7	12.1	13.1	
Loans from Official sources	0.9	2.0	2.5	2.4
Multilateral	0.4	1.1	1.4	1.4
Bilateral	0.5	0.9	1.1	1.0[e]
Loans from Private sources	0.8	10.1	10.6	
Suppliers	0.4	0.7	1.1	1.3[f]
Commercial Banks	0.3	8.2	8.2	7.5
Unassigned balance	0.1	1.2	1.3	

Source: IMF, *Balance of Payments Yearbook*; BID, *External Financing of Latin American Countries*; BIS Annual Report, 1976, and ECLA estimates.

Note: The flow of loans from commercial banks was estimated on the basis of the annual variation of the net external position (assets less liabilities) of the region in foreign commercial banks.

[a] Excluding official donations.

[b] A positive sign corresponds to an increase in reserves.

[c] Excluding Bolivia, Ecuador, Venezuela, Trinidad and Tobago for being oil exporters, as well as Panama, for being a financial center.

[d] Including compensatory and autonomous loans of long, medium and short-terms.

[e] Estimated on the basis of the growth of the total bilateral loans granted by the DAC to developing countries.

[f] This figure was calculated according to the increase in credit of the suppliers granted by the DAC to developing non-oil-exporting countries.

The widening of the foreign imbalance on current account in Latin American non-oil-exporting countries forced the adoption of adjustment policies aimed at reducing the disequibrium, while at the same time impelling these countries to increase their access to foreign financial resources in order to rapidly overcome their difficulties without having to resort to exaggerated sacrifices in terms of domestic growth. These policies began to show their effectiveness in 1976 when the deficit on current account was reduced to approximately 11.2 billion dollars.

Table 2

AVERAGE CONDITIONS OF THE OFFICIALLY-GUARANTEED LOAN COMMITMENTS AND THE CONCESSIONARY FACTOR OF THE LOANS BY REGION

		Loan commitments			
Region	*Year*	*Expiration (years)*	*Grace period (years)*	*Interest rates (%)*	*Concessionary factor on loans*
Latin América	1969	14.0	3.6	6.7	18
	1974	12.4	3.5	7.6	12
	1975	10.4	3.1	7.6	10
Mediterranean countries	1969	16.0	3.8	5.6	25
	1974	13.8	4.7	7.9	14
	1975	11.0	3.6	8.3	8
Africa south of the Sahara	1969	24.2	6.5	4.0	42
	1974	20.4	5.9	5.4	33
	1975	22.1	5.4	5.5	32
East Asia and the Pacific	1969	19.4	5.3	5.5	29
	1974	15.9	5.1	7.5	16
	1975	12.7	3.9	8.1	10
North Africa and the Middle East	1969	13.0	2.8	5.5	22
	1974	16.9	4.7	5.7	25
	1975	15.3	5.2	5.8	23
South Asia	1969	30.5	7.4	2.8	55
	1974	27.7	7.3	2.6	54
	1975	37.4	8.8	2.4	64

Source: World Bank, *Annual Report, 1977,* p. 117.

Besides using foreign resources to confront the deficit on current account, these countries also had to reduce their international reserves in 1974-75; these, however, were recovered in 1976. In this way this group of countries was able to maintain rates of growth in their economies, which, although considerably inferior to rates registered for the immediately preceding years, proved more satisfactory than those of other areas of the world. Moreover, it can be said that Latin America thus contributed to the restraint of the weakening of the world economy, as will be discussed below. The region was also able to maintain high rates of investment, thus assuring a sustained growth for the future which in turn makes possible an increase in their debt capacity.

In spite of the decrease in the rate of growth of the product recorded in 1975-76, the investment rates were higher than any registered since 1966. That is to say, the adjustment policy applied in the Latin American countries tended to sacrifice consumption rather than investment, and therefore to maintain the dynamics of the economy in the medium-term.

In the financial field, the characteristics of the different countries of Latin America are not identical. There are important differences in the degree of diversification of exports and access to foreign financial markets, as well as in the degree of diversification of domestic production.

Toward the end of 1975, 90% of the guaranteed foreign debt and 97% of the total bank debt of the region was concentrated in six non-oil-exporting countries of the region. Sixty-two percent of the guaranteed foreign debt and 75% of the total bank debt corresponded to Brazil and Mexico. Argentina showed a situation similar to that of these countries, which stand out because of their industrial expansion. In 1974-75 the total of the deficit on current account plus the payments

Table 3

RATE OF GROWTH OF THE REAL GROSS DOMESTIC PRODUCT AND COEFFICIENT OF THE GROSS INVESTMENT OF THE LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES

Years	*1965-70*	*1971*	*1972*	*1973*	*1974*	*1975*	*1976*
Gross domestic product	6.0	6.1	7.1	7.2	7.1	2.4	4.0
Investment coefficient	19.0	19.1	19.7	20.8	21.1	22.0	21.6

Source: ECLA.

toward the amortization of foreign credits in these three countries was just slightly less than 75% of the total for all of the Latin American non-oil-exporting countries. We must bear in mind, however, that what appears to be a strong concentration of indebtedness is not exactly so from the viewpoint of the debtor countries. Actually, the Gross Domestic Product of Argentina, Brazil and Mexico made up 76% of the total of the non-oil-exporting Latin American countries.

At the same time, Colombia, Chile, Peru and Uruguay form a second group of countries which, without having reached the levels of the first three countries, has progressed in the same direction. These four countries together accounted for 15% of the deficit of the balance on current account in 1974-75 plus the amortization of the debts of the group formed by the region, while the rest of the countries, which make up a third group, together reached 11% (See Table 4).

As for the total debt of the region, the first three countries held 50% in 1975, their participation in the increase in indebtedness being greater than their average participation, which tends to make the latter grow. Information for 1976 indicates that this average increased to nearly

Table 4

DEFICIT[1] OF BALANCE OF PAYMENTS ON CURRENT ACCOUNT AND AMORTIZATION OF DEBTS[2] IN THE LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES

	1965-70		*1971-73*		*1974-75*[3]	
	US$ nillions	(%)	*US$ millions*	(%)	*US$ millions*	(%)
Argentina, Brazil and Mexico	2 119	(62)	5 044	(67)	14 213	(74)
Colombia, Chile, Peru and Uruguay	706	(21)	1 595	(21)	2 838	(15)
Other countries	567	(17)	901	(12)	2 043	(11)
Total	3 392	(100)	7 540	(100)	19 094	(100)

Source: Constructed on the basis of the official figures for the balance of payments of the different countries. The figures correspond to annual averages for the indicated periods.

1 Excluding official donations.

2 Refers to non-compensatory medium and long-term debts.

3 For 1974 and 1975 the 1974 figures for debt amortization were used.

Table 5

ESTIMATE OF THE TOTAL DEBT OF THE LATIN AMERICAN NON-OIL-EXPORTING COUNTRIES

(Billions of dollars)

	1974			*1975*			*1976*		
	Officialy guaranteed debt	*Unguaranteed bank debt*	*Total debt*	*Officialy guaranteed debt*	*Unguaranteed bank debt*	*Total debt*	*Officialy guaranteed debt*	*Unguaranteed bank debt*	*Total debt*
Argentina	3.14	2.37	5.51	2.97	3.05	6.02	4.25	2.26	6.51
Brazil	8.99	9.62	18.61	11.46	10.51	21.97	(14.00)	15.75	29.75
Mexico	8.07	6.01	14.08	11.25	8.54	19.79	(15.90)	12.08	27.98
Subtotal	*20.20*	*18.00*	*38.20*	*25.68*	*22.10*	*47.78*	*34.15*	*30.09*	*64.24*
Chile	3.64	0.57	4.21	3.56	0.53	4.09	4.26	0.73	4.99
Colombia	2.12	1.33	3.45	2.36	1.39	3.75	(2.60)	1.36	3.96
Peru	2.07	0.93	3.00	2.67	1.19	3.86	(3.40)	1.25	4.65
Uruguay	0.52	0.08	0.60	0.61	0.09	0.70	0.69	0.05	0.74
Subtotal	*8.35*	*2.91*	*11.26*	*9.20*	*3.20*	*12.40*	*10.95*	*3.39*	*14.34*
The remaining countries[a]	2.43	0.02	2.45	3.16	0.40	4.22	3.83	0.65	4.48
Total[a]	*30.98*	*20.93*	*51.91*	*38.04*	*25.70*	*63.74*	*48.93*	*34.13*	*83.06*

Source: World Bank, *World Debt Tables*, IV-VI-VII-1977; BIS, *Annual Reports* and Press Review, March, 1977 and estimates of the ECLA.

Note: All figures refer to debts payed at the close of each year. The officially guaranteed debts include only medium and long-term debts. The unguaranteed bank debt is the debt not backed by official guarantee incurred with foreign commercial banks operating in the following countlies: Belgium, Luxemburg, France, Germany, Italy, Holland, Sweden, the United Kingdom, Canada, Japan, the United States, Switzerland and branches of US banks in the Caribbean and the Middle East. It is believed that these figures are underestimated in that they only include partial information on the operations of extranational financial centers. Furthermore, the estimates for the total debt do not include unofficially guaranteed debts to suppliers nor loans from the IMF.

[a] Panama is excluded for being a financial center.

60% in these countries. Likewise, the second group held approximately 12% of the total debt incurred in 1974-75 by the non-oil-exporting countries of the region, which figure was raised to 14% in 1976 (See Table 5).

From the viewpoint of the creditors, on the other hand, there was a concentration of credit in a few countries, since these, the deepest in debt, represented a not inconsiderable proportion of the total composition of their portfolios.

DEFICIT, AND SURPLUSES, FINANCIAL FLOWS AND THE NEED FOR ADJUSTMENT

As has been mentioned, after 1974 a change in the balance of payments was produced which was more rapid and difficult to reverse. During the seven years prior to 1974, the total of the deficits on current account of the countries which are members of the International Monetary Fund, reached an annual average of 13 000 million dollars, while during the next three years this yearly average grew to 67 000 million dollars. It is expected that the deficit for 1977 will be approximately 62 000 million. Obviously the same amount appeared in the total of the surpluses. These figures have their counterpart in the surpluses of the other countries, whose annual average reaches similar levels.

Thus, there was a dramatic increase in the need for the transfer of financial resources from the countries with surpluses to those with deficits, thereby putting the financial system to the test.

In the past, international financial flows went from the industrial countries to the rest of the world, and were primarily based upon internal savings in the former. At present, however, the industrial countries are playing a new role as intermediaries, receiving the savings of the petroleum exporting countries and transferring them to the rest of the world (including to the socialist countries).

Two important consequences have resulted: first, the world financial system must exert an uncommon degree of effort. Second, this effort is being undertaken in difficult conditions, conditions which are no more than the inevitable result of a situation of increasing indebtedness.

Floating exchanges rates have not resolved the problem of the demand for international reserves in the industrial countries. Monetary authorities have maintained an important degree of intervention, which requires the maintenance of a relatively high level of international reserves. At the same time, the fact that their current accounts sometimes show a deficit instead of a surplus, makes their situation more unstable. Capital moves with great rapidity, while the current account is much slower to adjust. These two elements, sustained intervention and the deficit on current account, point toward an increased demand for reserves, in terms of both stock and flow.

As a result, the industrial countries utilize part of the resources which they receive from the petroleum exporting countries and recycle only what remains. Probably, recycling among industrial countries is of greater importance than recycling between the industrial countries and the rest of the world. "Outward" recycling is marginal and can, as a result, lack stability, as it can be seen, in part, in the table on the following page.

The developing countries face this situation with a growing external debt. If the rest of the world, taken as a whole, maintains a surplus on current account, these countries cannot help but have a deficit regardless of any effort they are prepared to make to avoid it. Some individual countries maybe successful in eliminating the deficit, but really they will only be transferring it to other countries in the group, since it is impossible for all of them to eliminate their deficit unless the other countries in the world are willing to eliminate their surplus.

This is a very important point which, while theoretically accepted, is forgotten in practice when *all* of the developing countries with a deficit are asked to eliminate their deficits.

Table 6

ESTIMATE OF THE DESTINATION OF THE NET CONTRIBUTION OF RESOURCES OF THE OPEC COUNTRIES TO THE EUROCURRENCY MARKET

(Percentages)

	1975	*1976*	*(March) 1977*
Developing countries	11	10	4
Eastern European countries	36	30	39
Industrialized countries and the rest of the world[1]	53	60	57
Net contribution of the OPEC	100	100	100
(Thousand million dollars)	29	36	37

[1] The rest of the world corresponds to the extra-national centers and in the degree to which they recycle resources to the developing countries, the percentage will decrease.

Source: BIS, *47th Annual Report,* 1977 and *Review,* June, 1977.

If the developing countries must live with their deficits on current account, it ought then be expected that their indebtedness, in any of its forms, must also grow. This is a *necessary* conclusion of the above analysis.

This analysis does not, however, tell us anything about the structure of the new debt as far as its terms and costs are concerned. In order to obtain some idea of these aspects it is necessary to turn to other elements of analysis, in particular, to the characteristics of the supply of loan resources which face the developing countries and, in particular, Latin America.

The various sources of financing have been analyzed in many studies and thus will not be examined here. It has also been made clear that Latin America is losing its access to official sources of financing which provide longer term credits with better conditions. Thus, while the other areas of the developing world mainly turn to official sources for their financing, Latin America must increasingly turn to private financing, with a corresponding deterioration in the structure of its debt with regards to its terms and an increase in its average cost. In particular, while the countries which have continued access to official financing face a relatively stable supply of loan resources, those which mainly turn to the markets face a supply of resources which is difficult to anticipate. This source can be highly unstable depending upon the use which the industrial countries make of the financial resources, the magnitude of the surpluses on current account of the petroleum countries and the way in which these are used.

Amongst the Latin American countries it is necessary to distinguish at least two main categories: the major debtors and the rest of the countries. In the case of the former, the amount of the debt reaches figures which represent considerable involvement for the creditors, or at least for some of them. For this reason, the creditors will most surely adopt a prudent attitude towards these debtor countries and will be careful since their association with heavy debtors may mean not only profits but losses as well.

In the case of those countries whose debt does not reach substantial magnitudes from the point of view of the creditors, at least two different types of mutually-opposing effects maybe considered. On the one hand, the lower the debt in terms of indicators such as the coefficient of debt servicing to exports, the easier it is to obtain good ratings in terms of risk. On the other hand, no creditor, or at least very few, will run too high risks in the case of the debt not being repaid promptly. As a result, the creditor will be less likely to continue lending if circumstances arise which could accentuate the risk. At the very least, the creditor will be more likely to require the application of restrictive domestic policies in order to reduce the deficit on current account as a prior condition for the granting of new loans, even if these were only for the refinancing of the debt over a longer period of time.

Thus, the external pressure exerted over the different countries in order to promote the adjustment of their balances of payments is not equilibrated. This is not a new or original conclusion. It is recognized that the existing mechanisms and institutions have more tools for the promotion of the reduction of a deficit (in the case of a country whose currency is not reserve currency) than that of a surplus. Moreover, when the country with a deficit is sufficiently "large" in terms of its influence over the world economy, such influence is taken into account in as far as its effects over the other countries or over the private creditors are concerned, thus contributing to promoting a more careful adjustment process which does not hurt others. This does not happen in the case of countries whose individual economic alternative policies do not produce a visifle effect on other countries, or create serious consecuences for their creditors. This is the case in many of the developing economies. Any apparent weakening in their situation of solvency —judged by generally incomplete and static indicators— produces a more or less general withdrawal of private creditors.

These considerations justify a general conclusion: "small" countries need to be extremely careful with their economic policies, and are forced to give priority to external balance over other aspects of their economy.

"SOLVENCY" AND THE AVAILABILITY OF FINANCING

Moreover, however, the same considerations also point to the necessity of looking for a way to maintain the external solvency of these countries according to the criteria by which it is measured by the outside world. An obvious way of obtaining this goal is to look for measures which would permit the reduction of fluctuations in the indicators used to judge solvency, and particularly in those indicators which are most widely used, such as the debt service/exports coefficient. Even though there is a certain possibility of affecting this coefficient through appropriate debt exchange policies without discouraging exports, the usefulness of these policies may vary and, in fact, does vary for reasons which are completely beyond the control of the exporting country. For example, alterations in the prices of certain export products can provoke alterations in the value of these exports easily by 20% or more in one year. In any case, an increase in the external indebtedness of the magnitude registered during the past four years has to be reflected in a short-term deterioration of the debt service/export coefficient.

Another way to improve the external judgement regarding the solvency of debtor countries is by increasing the possibilities of their access to official sources of financing. An important step in this direction is the recent agreement of the Executive Board of the International Monetary Fund to establish a supplementary financing service, to be used in those cases in which the external disequilibrium of a country is too high in proportion to its IMF quota and, as a result, cannot be financed by the "normal" or "ordinary" resources of the institution. However, the usefulness of this new facility is limited by the condition that the country must first make use of the IMF credit in the highest tranches in order to be able to draw on the resources of th new facility. This conditionality makes the new IMF facility accessible only when its use is accompanied by a strict conditioning of the country's policies. For this reason, the supplementary financing facility, in spite of opening an additional access to official resources, can contribute towards an accentuation of the already existing tendencies to put the burden of international adjustment on the deficit countries.

On the other hand, the resources of the new facility are lent under commercial terms and conditions, although the cost for the debtor is somewhat lower than the commercial cost would be, because of the conditionality of the loans.[1]

The efforts made in the aforementioned direction have contributed little to easing the access of the "not large" Latin American countries to longer-term resources, access which would permit them to improve the structure of their debt simultaneously as it increases, thereby minimizing problems in servicing the debt. Nor have these efforts contributed much to making international recognition of the inevitability of increases in the external debt possible. This inevitability is due to the existence (at least in the near future) of surpluses on current account in other regions, which cannot be eliminated and which necessarily have as their counterpart a deficit on current account of the non oil exporting developing countries, especially Latin American countries.

THE FUTURE GROWTH OF THE DEBT AND THE POSSIBLE AREAS OF ACTION

Actually, even though it is possible to expect with some optimism that the surpluses on current account of the petroleum exporters and West Germany and Japan, will gradually be reduced in the future, this will not occur immediately. As a result, the external debt of the countries

[1] The maxinum term is seven years, and the interest cost is between 0.2% and 0.325%, above the average field, in periods of six months, of United States Treasury Bonds with five-year maturity, rounded to the nearest 1/8 of 1%. Until the first of July of 1978, the interest the debtor countries will pay for drawing on the new IMF facility has been established at 7.08 annually.

with a deficit —when taken together— will continue to grow above present levels. The experience of 1975 shows that a serious recession can lead to a surplus in the industrial countries as a group, but at the same time the developments of 1976 and 1977 indicate that this surplus rapidly melts away when these economies begin to recover.[2] Thus, the fate of the rest of the world is very closely related to the level of economic activity of the more developed countries. A decline in the level of their activity produces additional complications in the situation of the developing countries, including those of Latin America, since the surplus of the industrial countries is added to that of the petroleum exporting countries to determine the deficit of the rest of the world. On the other hand, a high level of economic activity in the industrial world which produces a deficit or diminishes the surplus on current account in their balance of payments, will considerably improve the position of the developing countries.

It is known, however, that the surplus of some of the petroleum exporting countries does not respond easily to changes in the level of domestic economic activity, since their capacity for the absorption of resources is extremely limited. As a result, it can be expected that the surpluses produced by the increase in the price of petroleum will continue for some years to come, as will the deficits which are their counterpart elsewhere. As a result, the level of the external debt of the non-oil-exporting developing countries —the Latin American countries in particular— will continue to increase. In order to examine realistically the nature of possible solutions it is important that this fact be recognized.

Nevertheless, the recognition of the inevitability of the continued increase in the foreign debt of the developing non-oil-exporting countries, including those of Latin America, does not mean that it is impossible to adopt measures designed to regulate and handle the external situation of these countries. On the contrary, a realistic appreciation of the problem is the first step toward finding acceptable solutions.

Even if the total debt were to continue growing, it does not necessarily follow that amortization and interest rates, which are such a burden annually to the debtor countries, must also increase. An expansion of exports would make it possible to present larger annual payments toward the debt without such payments absorbing an unusually high proportion of the available funds. Likewise, a relative increase in the longer-term debt would allow the level of the debt to rise without causing an increase in annual payments. In the case of an expansion of exports, the key variable would be an ever-increasing access to the

[2] The 11 800 million dollars deficit registered in 1974 gave place to the 17 100 million surplus in 1975 and to the deficits of 2 200 million and 8 500 million respectively in 1976 and 1977.

main buying markets. In case of the second solution, it would be necessary to find the means by which to simultaneously alter the structure of the debt, doing so in such a way that its level could continue to rise without occasioning serious tensions in financial markets.

With this purpose in mind it seems necessary to act in two strategic areas: the expansion of exports towards the industrial countries and the improvement in access to capital markets. Both areas of action are important and it is advisable to act in parallel in both areas. The purpose of this paper is to touch on only some of the aspects of the second area: access to capital markets.

ACCESS TO LONGER-TERM CAPITAL MARKETS

With very few exceptions, only the largest countries of Latin America have placed long-term bonds in external markets. They presently total approximately 3 000 million dollars, scarcely 3.6% of the total indebtedness of the region. About 80% of these bonds correspond to Argentina, Brazil and Mexico.

Since the Second World War the rest of the Latin American countries have not really turned to the long-term capital market, in spite of the fact that prior to the crisis in the thirties they did it regularly. This is due, of course, to the absence of a market for the placing of such bonds from the end of the thirties until perhaps the end of the fifties, and the beginning of the sixties. It is also the result of the access of these countries to other official sources of long-term financing and to the loss —through lack of practice— of the experience acquired in the second half of the nineteenth century and the first three decades of this century. Moreover, the generalized cases of discontinuation of payments during the great crisis led private creditors to apply a large dosis —perhaps now exaggerated— of prudence to long-term lending agreements.

The countries which usually provide capital have erected different types of barriers around access to their capital markets. The Development Committee of the World Bank and the IMF has studied these barriers and has proposed their reduction, but without great success.

Perhaps a more promising approach is that of converting Latin American countries into such attractive borrowers that it would be in the interest of the lender countries —or intermediaries— to reduce the barriers around access to their capital markets. The achievement of this objective requires —in addition to economic policies appropriate for the debtor countries— action with respect to one vital aspect: payment guarantees. The international development credit organizations —the World Bank and the Inter-American Development Bank— that serve Latin America are empowered by their founding charters to extend guarantees. These guarantees, however, will oblige them to freeze the resources which back them up, thereby keeping these resources from other uses. As a result, these organizations have not been at all enthusiastic about putting into action a plan of guarantees —full or partial— for the bonds issued by developing member countries. Actually, these guarantees would not add anything immediately to total available resources, although they would surely contribute to starting a bond market which, in the future, could operate without an external back-up guarantee.

With the intention of increasing available resources in the near future, it would be necessary to look for new resources, in addition to those which already exist, which would serve to back up guarantees that could be given in order to assure the placement of long-term bonds on the markets.

A "REFINANCING SERVICE"

The guarantees can also be indirect. For example, if it were possible to obtain resources for refinancing payments of the debt when necessary, the disposition of the creditors toward the debtors would undoubtedly improve. Thus, a "refinancing service", financed by funds of the creditors themselves and managed by an international organization such as the Monetary Fund would be an extremely useful contribution toward the improvement of the creditors' appraisal of the probability of punctual payment of future amortizations of the debt. This service could establish common norms for determining rights and access to resources, and at the same time provide the necessary consideration of individual cases in order to determine the amount and the conditions of the refinancing. The countries would, of course, be free to resort to such a service voluntarily, thus preserving their freedom to choose the most adequate type of solution for their individual circumstances.

This service would be open to all member countries.

A FINANCIAL SECURITY NET FOR LATIN AMERICA

In its financial relations with the industrial countries, Latin America has progressed much more than other groups of developing countries. As has been previously indicated, the foreign debt without official guarantee has grown much more rapidly than the guaranteed debt, as a result of which the relative importance of the former has risen substantially in the last few years. Furthermore, a few countries in the area have already begun to penetrate the longest-term capital markets of the world; appropriate solutions to the problems of these countries must be conceived soon. Clearly there is great urgency for solutions to problems not only on a world scale, but also on regional levels, with extraregional cooperation.

Solutions on a regional scale with collaboration from outside the region will have to simultaneously cover several aspects at the same time: collaboration for "last resort" financing of a temporary disequilibrium in the balance of payments; collaboration in exploring and recommending the necessary adjustment policies; and collaboration in establishing the bases for a regional guarantee plan.

Taking these general points into consideration, the establishment of a Financial Security Net for Latin America has been proposed.[3]

OBJECT OF THE FINANCIAL SECURITY NET

The direct purpose of the Net is that of providing additional external financing for the balance of payments of the region's countries through cooperation amongst themselves and through the collaboration of regional or extraregional organizations and countries outside of the region. The additional resources of external financing would contribute to smoothening the adjustment process and helping thereby to reduce the amount of effort necessary in terms of the sacrifice of growth. The possibility of access to additional resources for the financing of the disequilibria in the balance of payments would minimize the need for adopting reversible economic policies dictated by the immediate situation, and would facilitate the adoption of short and long range policies oriented towards achieving a more balanced development of the region's external trade. At the same time, the Net could contribute to avoiding the use of restrictive measures regarding commerce or international payments in the region.

In addition to its main objective, the Net could also serve other important functions. In the first place, the utilization of the Net's resources ought not to be automatic but would have to be discretionary; that is, in order for the countries to make use of these resources they would have to receive a favorable decision from the authority of the mechanism. In some cases, the countries would have to agree to apply specific economic policy measures. Thus there arises the possibility of establishing a mechanism for consultation regarding economic policies in the region. This would promote progress towards their coordination.

[3] See CEPAL, *Posibles características de una red de seguridad financiera para América Latina* (*Possible Characteristics of a Financial Security Net for Latin America*), E/CEPAL/1009, Santiago de Chile, 31 de julio de 1975.

Secondly, the existence of an *additional* mechanism for the financing of the balance of payments would contribute to improving the foreign image of the security of regular and punctual servicing of the external debt.

Thirdly, the existence of the Net would permit the establishment of a regional plan for guarantees with extraregional collaboration linked to it. Such a mechanism could be useful to some of the countries of the region in facilitating their access to longer-term external capital markets.

Extraregional support is indispensable if all these objectives are to be reached. If such support does not exist, some of the region's countries —principally the contributors to the Net— could have their external credit negatively affected by the guarantees given to others. Considering the amounts which would eventually be involved, this effect could have quantitative importance since even while a country may be only a contributor to the Net it may also need external capital markets for its own financing. To the degree to which guarantees of considerable size are given, they will commit a considerable amount of resources. If, however, there are also extraregional contributions, the size of the guarantee given by an particular country in the region can be reduced in proportion to the external participation. Furthermore, extraregional participation would make it possible to establish the Net even without the participation of one or two of the large Latin American countries.

GENERAL PLAN FOR THE FUNCTIONING OF THE NET

The Net would operate by virtue of commitments made by the governments or central banks to place an agreed-upon maximum amount of resources at the disposal of the system — in case of necessity. These resources could be used in various ways: for direct drawings, through the placing of securities in the market of the country against which the drawing is made, or through the placing of securities in the international markets with the guarantee of that country. In either of the last two cases, the country would be obliged to provide resources directly, while the placing of securities would not permit the use of committed resources at the time and under the conditions agreed-upon.

It is to be hoped that there would be extraregional contributions which would be managed by the Net in the same way.

The utilization of the system's resources would be discretionary in three aspects: the need for making use of the system, which gives rise to the *need requirement*; judgement regarding previous reasonable utilization of other sources of financing, or the *requirement of secondary utilization,* and the conditions for the use of the Net's own resources, or the *adjustment requirement.* The fulfilment of each one of these requirements would be judged by the governing organs of the Net: an Executive Council and a Governing Board.

The drawings of the resources would be by tranches in proportion to the quota. This quota would correspond to the volume of resources which a country agreed to place at the disposition of the system. Each successive tranche could be obtained by increasing voting majorities within the Executive Council, and the rate of interest would also increase.

The Executive Council would be made up of five members, elected by the weighted voting of member countries in their individual capacity (and not as representatives of specific countries). Each member of the Council would have one vote. The Governing Board, on the other hand, with one governor for each country, would have a weighted vote. The countries or organizations which were contributors to the system would receive for their resources —when they were used— a remuneration equivalent to the amount which could have been obtained through alternative uses. Assuming that the countries of this region were to distribute their contributions according to the new quotas of the International Monetary Fund, the following table suggests three alternatives for the sum total of regional contributions. Extraregional contributions which would allow the size of the Net to reach more than two thousand million in Special Drawing Rights would be hoped for.

MINIMUM NET SIZE

The net could operate with almost any minimum size. However, it is not worth establishing the Net if its size is not sufficient to make it attractive as a possible —eventual— source of resources. It is for this reason that 2 000 million in Special Drawing Rights has been chosen as the minimum size. This minimum size takes into account the fact that not all of the contributions can actually be drawn upon. The contribution of the debtor countries beloging to the Net will not normally be drawn upon. It also takes into account the fact that the sum of the global deficit in the balance of payments of the region will reach an average of 2 800 million dollars in 1975 and 1976.

FINAL CONSIDERATIONS

The initiative for studying a possible regional Financial Security Net was taken by member governments of the U.N. Economic Commission for Latin America during the XVI Period of Sessions of the ECLA in

Table 7

POSSIBLE QUOTAS IN THE SYSTEM

Country	Quota IMF[1] (millions SDR)	Percentage compositions	Possible quotas[2] I	II	III[3]
			Millions of SDR		
Argentina	535	14.26	143	214	285
Bahamas	33	0.88	9	13	18
Barbados	17	0.45	4	7	9
Bolivia	45	1.20	12	18	24
Brazil	665	17.73	177	266	355
Chile	217	5.79	58	87	116
Colombia	193	5.15	51	77	103
Costa Rica	41	1.09	11	16	22
Dominican Republic	55	1.47	15	22	29
Ecuador	70	1.87	19	28	37
El Salvador	43	1.15	11	17	23
Granada	3	0.08	1	1	2
Guatemala	51	1.36	14	20	27
Guyana	25	0.66	7	10	13
Haiti	23	0.61	6	9	12
Honduras	34	0.91	9	14	18
Jamaica	74	1.97	20	30	39
Mexico	535	14.26	143	214	285
Nicaragua	34	0.90	9	14	18
Panama	45	1.20	12	18	24
Paraguay	23	0.61	6	9	12
Peru	164	4.37	44	65	87
Trinidad and Tobago	82	2.19	22	33	44
Uruguay	84	2.24	22	34	45
Venezuela	660	17.60	176	264	352
Total	3 751	100.00	1 000	1 500	2 000

1 Quotas suggested in the document IC/MS/DOC/75/26 Rev. 1.
2 The three alternatives are calculated with respect to the total size of the system: SDR 1 000 million (I), SDR 1 500 million (II) and SDR 2 000 million (III).
3 Special Drawing Rights.

Port Spain, Trinidad and Tobago, in May of 1975. In accordance with resolution 348 (XVI), the Secretariat of the ECLA called together a group of experts which met in Santiago, Chile in July of 1975 and prepared a document outlining the general points for a possible financial security net.[4] This document provided the basis for discussion for the

4 E/ECLA/1009, *op. cit.*

governors of American central banks, first on a political level and later at the level of experts.

In those meetings no agreement was reached, and doubts were raised regarding the feasibility of obtaining external support for the Net, considered indispensable for its success. Furthermore, experts from certain countries have expressed the fear that the existence of the Net could limit their own possibilities of obtaining foreign financing.

Both problems exist, whether real or not, in the sense that they are considered as such by some country or other. It is only natural that the feasibility of external support is impossible to determine as long as the type and amount of the support sought, as well as the nature of the mechanism, have not been specified. The very existence of the mechanism may turn out to be a requirement for the acquisition of such support; in that case the possibility of seeking a regional agreement whose operation was conditioned on the attainment of the required external support should be considered.

As far as certain countries possibly being limited in their access to th foreign financing as a result of the existence of the Net is concerned, two things should be borne in mind: first, that greater access of new countries to the financial markets may possibly reduce the available offer for those who already have ample access; and secondly, that the creditors may decide to demand the Net's guarantee from all member countries, even though they were prepared to make loans without it.

The first consideration does not constitute any serious problem. Latin America contributes a very small percentage to the total amount of medium and long-term placing of capital, and this percentage is concentrated in the larger countries. The market could absorb substantial expansion in the access which the smaller Latin American countries have to the market of medium and long-term capital without any perceptible change.

But the second consideration should be examined more carefully. For some countries the Net's guarantee could mean their having or not having access to the market; those would be the ones which at present do not have access but could obtain it by the Net's guarantee. Other countries, those which already have open access to the market, might see in the new policy a suggestion that they obtain the Net's guarantee also, in which case it might appear at first that these countries would suffer an economic loss. The existence of the Net would produce an overall gain for the first group, opening up a new possibility for them, but would mean something entirely different for the second group, if the creditors were to demand the Net's guarantee from all countries.

But there is no reason to believe that the creditors would demand new conditions of their present debtors, unless the economic situation of the latter were to worsen, in which case, with or without the Net, the creditors would seek ways to improve their guarantee or raise the interest rates of the market. The Net's guarantee, where necessary, would prevent the additional cost of a charge over and above that of the rate of interest; unless demanded by the creditors, it would permit the reduction of such an extra charge. The market has continually proven its ability to take into account a change in the condition of the debtor.

In any case, the guarantees which the Net could grant would be only one of its facets. Even without direct guarantees, the existence of an additional mechanism of last resort financing for transitory disequilibria in the balance of payments represents an improvement in the situation of the debtors. The net could be, therefore, an important contribution to the maintenance and expansion of the access of countries of the region to medium and long-term capital markets.

Nevertheless, the lack of agreement regarding the probable advantages of the Net will pose a problem for its materialization. This is not a question of life or death. After all, it would not be the only financial security net in the world to have run up against problems.

Notes on Brazilian External Debt and its International Implications

Pedro S. Malan

The author belongs to the Institute of Economic Research of the Brazilian Ministry of Planning and the Graduate Program in Economics of the Catholic University of Rio de Janeiro. The opinions expressed in this article reflect only the personal views of the author.

Among the semi-industrialized countries, Brazil figures conspicuously today as the major borrower in international capital markets. Public and private external debt (respectively 55% and 45% of the total) will be near US $ 30 billion by the end of 1977, nearly one-fourth of Brazilian Gross Domestic Product and almost two and half times the value of 1977 exports (estimated at US $ 12.8 billion). Amortization plus gross interest cost will reach some US$ 5.4 billion in 1977, more than 40% of expected export earnings. Around 55% of the debt (two-thirds of which is made up of currency loans) falls due in the four-year period 1977-1980. The purpose of these notes is to discuss how serious the so-called "problem of the debt" is for Brazil, (and its creditors) and to suggest the major lessons and implications —if any— of the Brazilian problem for the global issue of LDC indebtedness.

As in known, governments of "commercial countries"[1] such as Brazil, tend to view the rapid build-up of the external debt as the natural result of "successful" *growth-cum-debt* policies, in which the required transfer of real resources is continuously financed through the capital account. Even after the dramatic rise in oil prices, the official view has been that the increase in "absorption" permitted by this sort of borrowing exceeds the discounted present value of the debt service obligations incurred. Therefore, the official discussion is reduced to the "technical" problem of administering the time profile of the debt and to a mechanical "analysis" of conventional indicators designed to show the country's potential ability to honour its obligations.

In these notes, we try to argue that this is *not* the most relevant issue at stake. There is much more involved in the apparently technical problem of managing the debt, or even the balance of payments. One must dwell on the question of the implied ability to transform the do-

[1] "Commercial" developing countries are those which have regular access to commrcial bank lending. The majority of non-OPEC LDCs, as is known, depend mainly on foreign-aid, being unable to attract much bank lending. Nine "commercial" countries (Brazil, Mexico, South Korea, Taiwan, the Philippines, Argentina, Peru, Colombia and Israel) accounted for more than 80% of LDC bank debt outstanding by the end of 1976. See David O. Beim, "Rescuing the LDCs", *Foreign Affairs,* July 1977, pp. 718-19.

mestic *structure* of the Brazilian economy (in the direction of increasing the share of her tradeable sector) *and* on the evolving nature — and future — of the international resource-transfer mechanisms presently under sharp, world-wide discussion.[2]

Therefore, these notes are organized as follows: section I refers rather briefly to the basic aspects of recent Brazilian experience of growth-cum-debt: how it evolved, the problems it temporarily solved and the hard questions it poses for present and future choices.[3] Section II deals with the international issue of LDC (and East European) debt and its alternative solutions, from a Brazilian perspective. Section III presents, by way of conclusion, what we think are the major (as yet unresolved) domestic and international issues at stake.

I

During the last three decades with the heavy contribution of foreign capital and the strong — and increasing — participation of the public sector in economic life, the Brazilian economy, in spite of chronic inflation and recurrent balance-of-payments disequilibria, experienced one of of the most rapid and extensive transformations of productive structure ever seen in semi-industrialized countries living under so-called market-economy regimes.[4]

Indeed, today, Brazil is internationally viewed not only as one of the most modern and sophisticated industrial economies of the "developing world", but also as one of the few semi-industrialized economies to have apparently accomplished, with a reasonable degree of success, the admittedly difficult transition from an industrial development based on seemingly unjustified — and highly criticized — protection of domestic market activities to an outward-looking phase of development based on expansion of non-traditional exports, progressive "liberalization" of the foreign trade regime and increasing integration with the international capital markets.

[2] For a good, general survey, see J. Williamson, *"Resource Transfer and the International Monetary System"* (unpublished paper), Rio de Janeiro, June, 1977.

[3] This section relies heavily on P. Malan and R. Bonelli "The Brazilian Economy in the Seventies: Old and New Developments", *World Development*, Vol. 5, Nos. 1 & 2, January - February, 1977, pp. 19-45.

[4] In the last three decades (1945-1975) the average rate of growth of *real* income at factor cost has been 7% per year, a performance perhaps matched only by the Japanese experience since World War II. Per capita income grew at an average 4% a year in real terms over the period. Industrial growth from 1945 to 1975 reached an average rate 8.8% per year in real terms, bringing industry's share in income at factor cost from 20.8% in 1945 to 34.2% in 1975 (constant cruzeiros at 1970 prices). The yearly rate of increase of agricultural real output was of the order of an average 5.6% from 1945 to 1975. See P. Malan and R. Bonelli, *op. cit.*

This transition has to be seen in historical perspective and in the light of the changes in world economic conditions. As we know, the post-war period was marked by the asymmetrical expansion of the main industrial economies,[5] the upsurge in the internationalization of capital under the aegis of the so-called transnational corporations,[6] a remarkable change in the patterns of trade,[7] and by the inherent contraditions of the Bretton Woods institutional arrangement which ultimately led to its collapse in August 1971. A synchronized boom in the advanced economies in 1972-1973 *helped* to feed the worst inflation the *integrated capitalist* world has ever experienced.[8]

The European return to full convertibility in 1959 dramatically accelerated some of these trends. World trade, for example, grew at an annual rate of nearly 10% a year in dollar terms between 1959/1961 and 1969/1971, and at an amazing 18% a year from 1967 to 1973.[9] Not less important seem to have been the stimuli convertibility gave to private international capital movements. Fueled by US balance of payments deficits, the 1960's were marked by the increased importance, in both the composition of world reserves and the expansion of international liquidity, of deposits denominated in the national currencies of the major industrial countries, especially deposits denominated in dollars held outside the United States.[10]

[5] The *annual* average rates of increase of output per man-hour from 1950 to 1970 in Japan (9%) and Germany (6%) were, respectively, nearly three and two times greater than the annual average rates of increase in the United States (2.8%) and the United Kingdom (3.2%). See US Department of Labor, unpublished estimates, as quoted by R. I. McKinnon in E. Classen and P. Salin (eds.) *Stabilization Policies in Interdependent Economies* (North-Holland. 1972, p. 22).

[6] There has been an exponentially growing literature on the subject since the late sixties. See the several works associated with Professor Raymond Vernon and the Harvard Multinational Enterprise Study.

[7] The share of non-OECD countries in world exports declined from 34% in 1950 to 19% in 1968 (Latin America's share declined from 10% to 5% in the period). The proportion of manufactures in world trade rose from below 40% in the thirties to 45% in 1953, 54% in 1970 and 67% in 1968, a phenomenon very closely related to international investments of the multinational corporations and, very likely to Professor Linder's well known hypothesis about the influence of patterns of demand and income levels in the shaping of trade among developed countries. For basic data see GATT, *International Trade*, several issues.

[8] These phenomena have been interpreted — and indeed predicted — by Professor Robert Triffin, among others. See his early works *Europe and the Money Muddle* (Yale University Press, 1957), *Gold and the Dollar Crisis* (Yale University Press, 1960) and the more recent "International Monetary Collapse and Reconstruction in April 1972', *Journal of International Economics*, vol. 2, No. 4, September 1972 and "The Threat to World Economic Order: the World Inflation and the Oil Explosion", *mimeo*, American Enterprise Institute, April 1975.

[9] See IMF, *International Financial Statistics*, several issues.

[10] This is another area where there is — or was — an exponentially growing literature, both academic and applied. For a sample of the first, see J. William-

Indeed, world reserves increased from US $ 45.5 billion in 1949 to US $ 78.2 billion in 1969, which resulted in an average rate of increase of 2.75% per year over the two decades. This rate should be compared with an average rate of increase of 22.7% a year from 1969 to 1974, (when gross reserves reached US $ 217.9 billion) which represents an almost threefold increase in the span of five years.[11] The use of the national currencies of the richest and most capitalized countries in the world as international reserves accounts for 93% of total reserve creation over these five years.[12] As Professor Robert Triffin pointed out, this "system" of credit reserve creation "undoubtedly contributed to the ability of the (advanced) countries to expand their loans and investments in the Third World". As a result, the increase in the overall surplus of the less developed countries balance of payments over these five years (US $ 56.8 billion) was not derived from current account surpluses but from the *over-financing* of their current account deficits by capital imports from the developed countries, especially the United States.[13]

It is not our purpose here to elaborate on the origins and consequences of these phenomena, but only to note that the late sixties and the early seventies were rather peculiar years from the point of view of the international economy, *a peculiarity which has to be taken into account when analyzing the "success' of the increased openness of the Brazilian economy, both in terms of commodity trade and international capital movements.* In fact, the revival of international trade and investment in the 1960's, though benefitting essentially the more advanced economies, spilled over to the periphery of the system: countries whose exportable production was complementary to the center, and semi-industrialized countries with relatively high levels of per capita income, relatively cheap labor supplies, relatively "sound and stable" economic policies and large, growing, and protected domestic markets.

Brazil has traditionally benefited — or suffered, according to the political views of the interpreter — from the attraction that the size of her domestic market, her skewed distribution of income, westernized urban consumption patterns, and protective practices have exercized on foreign investment. Indeed, partly due to one of the most favourable legislations with respect to foreign capital,[14] "since World War II,

son "International Liquidity: A Survey" *Economic Journal,* September 1973; for the second, *Euromoney*, the publication which owes its birth to the Euro-currency market.

[11] See IMF, *International Financial Statistics,* various issues.

[12] As demonstrated by Prof. R. Triffin in *Euromoney*, July 1975, p. 80.

[13] See R. Triffin, *op. cit.*, for an elaboration of these points.

[14] As was recognized by the Brazilian Government itself: "A Legislação Brasileira é, tradicionalmente, uma das mais favoráveis do mundo com relação as inversões de capital estrangeiro", Relatório da SUMOC (now Central Bank) 1959, p. 37.

direct investments have grown faster in Brazil than in any other country in Latin America except Venezuela. By the end of 1956, US direct investments in Brazil were exceeded only by investments in Canada, the U. K. and Venezuela".[15]

This is probably no longer true, after years of massive US direct investment in Europe beginning in the late fifties. The point we would like to emphasize is that the economic Ministers of the regime which came to power in 1964 were keenly aware of the crucial role that foreign capital had played in the structural changes that were taking place in the Brazilian economy. They were accordingly deeply committed to assuring the continuance of this role by pursuing an overtly open capitalistic development.[16]

The increased openness of the Brazilian economy beginning in the mid-sixties has had two dimensions, one related to commodity trade and the other to net inflows of foreign capital. With respect to trade, the bias against exports[17] was transformed — through bureaucratic simplifications, a complex system of credit and tax incentives, and by the adoption of the minidevaluations policy in August, 1968 — into a bias for sales abroad as opposed to sales to the domestic market.[18] From 1967 to 1973, Brazilian exports increased at a rate of 24.8% a year, while world exports increased by 18.3% a year. Since export prices increased more than import prices (an average 9.4% a year as opposed to 6.2% for import prices), the terms of trade improved by 20% from 1967 to 1973, allowing for a higher rate of income growth than product growth. Due to the 13% a year increase in the *quantum* of exports, the current capacity to import increased by 150% from

[15] See *US Investments in Latin American Economy*, US Department of Commerce, 1957, p. 64. It should be noted that Venezuela appears as third in the list due to oil investments. Over half the US $ 1.2 billion invested in Brazil was in the manufacturing sector (US $ 701 million). The comparable figure for Venezuela was US $ 114 million.

[16] Public sector intervention in economic life, both as policy-maker and as direct producer through state enterprises, *increased* after 1964 in spite of all the privatist rhetoric of the successive governments. This is one of the most fascinating areas of research in the political economy field in Brazil.

[17] Which, from 1947 to 1964 have fluctuated between US $ 1 100 million (1949) and US $ 1 771 million (1951, the highest level up to 1968) with an average of US $ 1 448 million. Indeed, one of the most remarkable aspects of the Brazilian experience of economic development was the attainment of a 7% average rate of growth of GDP in real terms for two decades (1947-1967), with exports almost stagnant (the yearly rate of increase *in dollar terms* was only 2.1% between 1947/48 and 1967/68, less than the rate of population increase). Import capacity was stagnant as well, since import prices did not fall during the period.

[18] See C. von Doellinger et al. *Transformação da Estrutura das Exportações Brasileiras: 1964-70,* INPES/IPEA, Relatório de Pesquisa No. 14, 1973 and *A Política Brasileira de Comércio Exterior e Seus Efeitos, 1967-1973,* INPES/IPEA, Relatório de Pesquisa No. 22, 1974. See also W. G. Tyler, *Manufactured Export Expansion and Industrialization in Brazil.* Institut für Weltwirtschaft Kiel University, 1973, especially Chapter 7.

1967 to 1973, the sharpest sustained increase Brazil has experienced since the 1920's.

This increasing import capacity was more than fully utilized. This was to be expected, since in a growing semi-industrialized economy imports have to grow at a slightly faster rate than exports in order to assure the much-needed transfer of real resources from the rest of the world. In fact, Brazilian imports (CIF) showed an increase of 27% a year from 1967 to 1973, while *world* imports increased by 17.5% a year. The breakdown of this increase in its price and quantity components shows that the *quantum* imported rose by 18.6% per year in the period, while import prices increased at a rate three times lower (6.2%). The implied income-elasticity of demand for real imports — near 2 — suggest the validity of a crucial observation by Diaz-Alejandro:

> For the range of growth in which a country has developed consumer and intermediate goods industries but has not yet developed significantly its capital goods industry, the greater the (rate of growth of) per capita income, the more likely it will be that its short-run marginal propensity to import will be proportionally greater than its average propensity to import *due to its dependence on imported capital goods and the cyclical nature of the demand for these items.*[19]

Indeed, capital goods imports, which represented slightly more than one-fourth of the import bill in 1965-1966, reached 41% of total imports in 1971-1972.[20]

This very high rate of capital accumulation (since domestic production of capital goods rose by an impressive 20.5% a year on the average between 1967 and 1973) was accomplished *simultaneously* with very high rates of growth of consumption expenditures. This conjunction of a high investment effort with a high propensity to consume *was only made viable through a policy of rapidly expanding external indebtedness.*[21] As we noted above, the international setting allowed such a

[19] Carlos Diaz-Alejandro. *On the Import Intensity of Import Substitution*, Kyklos, 1965, p. 509 (our emphasis), Diaz-Alejandro is careful to note that this should not be confused with a distinction between short and long-rung elasticities of demand for imports, the first assuming a given productive capacity and the second allowing for changes in both domestic demand and supply conditions.

[20] It should be pointed out that data recently published by CACEX (Carteira de Comércio Exterior) of Banco do Brasil, showing the breakdown of capital-goods imports by sectors of demand, over the 1964-1974 decade, do suggest a remarkable aspect of the Brasilian case: a (stable) near half of the imports go to sectors sucha as electric energy, transport and communications, characterized by dominant public participation and by the fact that they are domestic (non-traded) activities. This poses some rather interesting problems for future research. For the basic data see CACEX, *Relatório Anual*, 1973 and 1974.

[21] This is not to imply that Brazil simply needed a supply of "poupança externa" (foreign savings) to "supplement" its domestic savings in the process of

course of action.[22] Brazilian total foreign debt, therefore, increased almost four-fold from 1967 (US $ 3.3 billion) to 1973 (US $ 12.6 billion).[23] Most important, currency loans, which accounted for only 20% of total debt in 1967, represented almost two-thirds (62.4% or US $ 7.85 billion) of total debt by 1973, increasing at an average rate of over 50% a year between 1969 and 1973.[24] This was caused partly by reasons linked to world developments previously noted, and partly by the decision-making process in Brazil, based entirely on the short-run maximization of the rate of GDP growth.

Recent studies suggested that this objective was attained in the 1968-1973 period partly because of the high levels of idle capacity inherited from previous capital accumulation. It is relatively clear by now the extent to which this performance depended upon the international economic conditions, in that particular period. We do not want to deny the role that economic policy played in helping to materialize the potentiality for growth which existed in 1967, but we do believe that the policy has been continued too long, outliving its usefulness and contributing to the serious imbalances observed since 1974, sharply aggravated by the oil crisis.

In more than one sense, 1974 has to be seen as an important benchmark in the evolution of the Brazilian economy. Unfortunately, in official and semi-official interpretations, too much emphasis has been placed on the effects of the quadrupling of oil prices. It is true that Brazil produces domestically only around 20% of its total consumption of oil. It is also true that the rise in oil prices dramatically changed the terms of trade against Brazil and negatively affected real disposable income. Perhaps more important, the oil crisis has made explicit the high social costs involved in a pattern of resource-use which is intensive in a commodity scarcely available domestically, thereby gene-

financing high levels of expenditure in consumption and investment. For a critique of this simple-minded interpretation for the Brazilian case and the presentation of an alternative hypothesis, see P. Malan and J. Wells, "Endividamento Externo etc.: Uma Nota para Discussão", ESTUDOS CEBRAP, No. 6, October-December 1973.

[22] See J. Wells, "Euro-Dollars, Foreign Debt ant the Brazilian Boom", Working Paper No. 13, Centre of Latin American Studies, University of Cambridge, October 1973, for a careful analysis of this problem from a non-parochial point of view.

[23] From World War II up to 1960 Brazilian total foreign debt was practically unchanged, at around a US $ 1.9 billion average. From 1960 to 1964 it increased from US $ 1 955 million to US $ 2 700 million, which required a re-scheduling by the Castelo Branco Government.

[24] Leading to a peculiar process of simultaneously increasing Brazil's foreign debt and Brazil's international reserve position, which reached an elusively all-time high of US $ 6.4 billion by 1973. The problems of economic management involved in the sterilization of these reserve gains would deserve a special study, particularly for the implicit distributional implications it has had. See P. Malan and J. Wells, *op. cit.*

rating serious questions for the long-run. It should be obvious however that these questions go beyond the problem of managing short-term balance of payments "disturbances". Likewise there was a certain naiveté involved in the hopes that had it not been for the OPEC decision,, Brazil would have been able to continue its "economic miracle" up to the end of the decade.[25]

It is clear by now, however, that the more than doubling of the import bill in 1974, and the implied US $ 4.6 billion deficit in the trade balance (exports rose by 28%) could not be blamed on petroleum prices alone. The 102% rate of increase in imports was split into a 51% rate of price increase and an historically high 34% rise in the quantity imported (especially basic metals, capital goods, chemicals and steel products). Excluding oil, the quantity index showed a higher increase than the price index.[26] In short, the quadrupling of oil prices, could not have accounted for the *whole* of the imbalance. Undoubtedly, the recession experienced by the advanced capitalist economies in 1974-1975 (the rate of *real* GNP growth was *minus* 2.1% for the OECD area)[27] and the change in the patterns of trade associated with the developed countries' effort to finance with increased *exports* their higher import bill,[28] would have to affect the prospects of the Brazilian economy for dealing with its balance of payments through increasing exports and reducing imports.

As is well known, the surplus of the OPEC countries (respectively US $ 67 billion, $ 43 billion, and $ 39 billion for 1974, 1975 and 1976) was the deficit of the rest of the world. Since advanced economies managed to transfer the burden of the deficit quite rapidly through exports surpluses, a disproportional burden fell on non-oil producing develop-

[25] See *Projeto do II Plano Nacional de Desenvolvimento: 1975-1979*, Brasília, September 1974, especially pp. 23 and 67. In fact, despite some mildly cautious remarks about future difficulties, the plan projected rates of GNP growth of 10% a year up to 1979, an export growth rate of slightly more than 20% a year, an import growth rate of slightly less than 20% a year, an (implicit) rate of inflation of some 15% for 1975, and a yearly average rate of growth of personal consumption of 9.2%, in real terms, up to 1979.

[26] It is true that the foreign exchange cost of oil imports in 1974 was US $ 2 billion higher than in the previous year. But it should be noted that only 115 multinational corporations operating in Brazil got authorization to import US $ 3 billion. Since their exports were less than US $ 900 million, the trade deficit of only slightly more than one hundred firms was around US $ 2 billion out of a total of US $ 4.6 billion. See *Jornal do Brasil*, mayo 30, 1976.

[27] As the OECD observed, "Both the boom phase of 1972-73 and the recesion of 1974-75 have been remarkably synchronized among the big countries ..." See *OECD Economic Outlook*, No. 17, July 1975, p. 8.

[28] In which effort they have been very successful: OECD country imports rose by only 1.5% in 1974 and declined by —9.5% in 1975. Their exports rose by 7.5% in 1974 and declined by only 5.5% in 1975. Most important, OECD exports to OPEC countries rose by 42% in 1974 and by 48% in 1975. See OECD, *Economic Outlook*, No. 18, December 1975.

ing countries. Indeed, for these countries as a group, current account deficits (*including* official transfers) rose from US \$ 2.5 billion in 1973 to US \$ 17.5 billion in 1974 and to US \$ 27 billion in 1975.[29] The magnitude of the Brazilian deficit (US \$ 7 billion, approximately, in both 1974 and 1975 and US \$ 6 billion in 1976) compared to these figures, which refer to some eighty to ninety developing countries, expresses well the dimensions and the peculiarity of the Brazilian problem, which cannot be explained simply by reference to a general "international crisis".

The fact is that, in the last four years (1974-1977), the Brazilian economy has experienced an accumulated deficit on current account of near US \$ 24 billion (around US \$ 10 billion due the trade deficits and around US \$ 7 to 8 billion due to gross interest payments on foreign debt). These 24 billion had to be financed through the capital account (and loss of reserves in 1974-75), increasing total foreign debt from US \$ 12.6 billion in 1973 to something around US \$31 billion in 1977. Current account deficits of this magnitude (on average near 6% of GDP) reflect, simultaneously:

a) a *level* of expenditures, public and private, in consumption and investment, which is too high in relation to domestic productive capacity[30] (at given prices) and, more important

b) a *composition* of total expenditure and thereby a pattern of income distribution which is not sustainable at the level of existing capacity.[31]

Since 1974, the government has been trying to avoid the hard choices involved in changing the rate and composition of expenditures without a clear definition of priorities. Efforts have been made to simultaneously increase expenditures on social services and infrastructure and to stimulate private investment in import substitution activities. Indeed, the latter is seen in many government circles as the long-term way out of the recurrent balance of payments disequilibria which Brazil has always faced after periods of rapid growth. Almost two years ago, commenting upon the ambitious investment programs and estimates of the government, we wrote:

[29] See OECD, *Economic Outlook*, No. 18, p. 11.

[30] As Professor Swan reminded us long ago: "...there is no substitute, even in the short-run, for an effective limitation of expenditure to the level of the goods and services available from full employment output plus the maximum import surplus that we can afford long after allowing for a temporary run-down of reserves". T. W. Swan, "Longer Run Problems in the Balance of Payments", in R. Caves and H. Johnson (eds.), *AEA Readings in International Economics*, Richard Irwin, 1968, p. 460.

[31] See R. Cooper, *Currency Devaluation in Developing Countries*, Essays in International Finance, No. 86, Princeton, 1971, p. 26.

> The strategy of attempting too much without a clearly defined set of priorities may well be self-defeating. Although much needed because they have seriously lagged behind in the past, investments in social services and infrastructure programs with long maturity periods do compete for scarce resources with investments in the internationally traded activities (those producing exportables and/or import-competing goods). The attempt to stimulate both sets of activities simultaneously, under conditions of a declining rate of growth and the incapacity to make free use of external supply sources, may well exacerbate inflation once again, as has happened so often in the past, and require some selective cuts in expenditure in order to relieve the inflationary pressure from the demand side.[32]

In more than one sense, the prediction is proving accurate. But for our purposes in this article the relevant aspect to point out is that, my opinions apart, the "natural" solution to the adjustment to disequilibrium is to give priority to the "tradeable" sector of the economy in terms of the allocation of scarce real and financial resources. In this connection, public investment is not enough. Much depends on the rate of private investment particularly by foreign-owned concerns which now hold, according to the best estimates available, almost one-third of the capital stock of the manufacturing sector. This proportion is higher exactly in the sectors in which the government would like to stimulate new import substitution, being almost 50% in the capital goods sector.[33]

Ironically, what some people have called a unique opportunity to change the "Brazilian model" (in the direction of mass consumption of "traditional" industries, output and emphasis in the "domestic market") may well result in merely reinforcing the general lines of the "model" which has been evolving since the fifties: higher public investments and manipulation of incentives to increase the private profitability of the "dynamic" sectors, those in which foreign capital is predominant due to its control of the key variable: technology. The increasing "internationalization" of the Brazilian economy, with all its implications for patterns of consumption, output mix, and other less tangible items, seems to be a fact of life to which more Brazilians will have to become more accustomed in the years to come. In the very apt expression of L. Taylor,[34] the "narrow limits of the possible" are likely to assert themselves with especial force under present circumstances.

The discussion of "problem of the debt", in our view, is not a dis-

[32] See P. Malan *"The Brazilian Economy, 1975 and After: The Major Issues at Stake"* (unpublished paper), IPEA/INPES, January 1976, p. 4.

[33] See P. Malan and R. Bonelli, *op. cit.* for details.

[34] See L. Taylor "Short-Term Policy in Open Developing Economies: The Narrow Limits of the Possible", *Journal of Development Economics*, Vol. 1, 1974.

cussion about Brazilian capacity to pay, but about the constraints which the debt imposes upon relevant *domestic* choices. This is a lengthy discussion however and it would be better to move on to section II of this paper. Is there a "global" problem of LDC debt?

II

The issue of LDC debt is a *global* issue essentially because it is high rates of export growth that must provide a solution to the problem, even for higher income LDCs which could rely on foreign investment in import substitution activities.[35] As Professor Fishlow rightly argued, the question of LDCs' foreign debt "is intimately linked to a whole panoply of economic issues that make up the North-South agenda: trade, foreign investment, the structure of the international monetary system, commodity prices, the poverty of the Fourth World, etc."[36] The issue is a crucial one, and likely to remain on the agenda — political and economic — for many years to come. The remaining part of this section attempts to show why we believe that current account deficit of non-oil developing countries should be a source of serious concern.

Total foreign debt of LDCs at the end of 1977 is unofficially estimated at well over US $ 200 billion. This is almost twice the outstanding external public debt of LDCs at the end of calendar year 1973: US $ 119 billion.[37] During the following three years the combined current account deficits of LDCs, before official transfers, amounted to a significant US $ 90 billion.[38] In great measure, this was due to the dramatic rise in oil prices, but recession in the industrialized countries, and hence reduced export markets, did play a role. The surpluses accumulated by the oil exporting countries were, as we know today, effectively recycled through the private international banking system with relative success. Many believe that this was an unexpected happy outcome and that the process could continue — smoothly — in the future. This optimistic view deserves a closer, critical scrutiny.

[35] For an attempt to show that this is not a long-term solution see N. Leff and A. Delfim Netto, "Import Substitution, Foreign Investment and International Disequilibrium in Brazil" *The Journal of Development Studies*, vol. 2, No. 3, April 1966.

[36] See his Statement to the Subcommittee on Foreing Economic Policy, Senate Committee on Foreign Relations, September 23, 1977, p. 19.

[37] See *Second Annual Report on Developing Countries, External Debt and Debt Relief Provided by the United States*, United States Treasury, January, 1976.

[38] The importance of the Brazilian case could be gauged by the fact that her current account deficits over the 1974-76 period were US $ 20 billion, over 20% of the total combined deficit of almost ninety LDCs.

At least 40% of the over US $ 200 billion LDC debt is owed to commercial banks. This remarkable shift towards private bank lending has some important allocational implications and has obviously affected the terms under which new debt is incurred. The so-called "commercial countries" have been the major beneficiaries of the shift. Brazil and Mexico, the two largest borrowers, account for nearly one-half of total bank debt outstanding. Adding the next seven largest borrowers to the list makes nine countries account for more than 80% of total bank debt.[38 bis] It is not true to say that the nearly ninety other countries borrowed the difference. Many of them simply cannot attract bank lending at all and depend on foreign aid for their survival. The different interests of commercial and aid-dependent countries has been apparent since the preparations for the IVth UNCTAD conference (Nairobi, May 1976). If this divergence of views will be accentuated in the future, only a discussion about alternative ways to finance required real resource transfers to LDCs could tell.

As J. Williamson indicated[39] such real resource transfer may involve "current account financing" (through price changes, through aid or through default) or "capital account financing" (through borrowing or through running down reserves). *All* countries, commercial or aid-dependent, would rather have a current account financing of the required real resource transfers (specially through price changes)[40] since this does not — as capital account financing does — involve a reverse transfer in the future. This is one of the basic reasons why any discussion about alternative solutions to LDC debt involves a lengthy discussion about trade, tariffs, preferences and commodity agreements. In *this* discussion, commercial and aid-dependent countries are likely to form a common front. After all the advanced countries cannot both insist upon the need for debt service payments as originally scheduled, and at the same time limit access to their markets.

With respect to capital account financing through borrowing a sharp division is likely to emerge between commercial and non-commercial countries. The first are deeply aware of the need to assure continuing availability of external finance (besides rapid growth in world trade), due to the rising service payments drain on foreign exchange for imports. Therefore, they are likely to refuse any "radical" proposal to

[38 bis] Similarly, approximately ten LDCs account for some 85% of total exports of manufactures of the LDC world. See A. Lewis *Aspects of Tropical Trade*, Wicksell Lectures, Stockholm, 1969.

[39] See J. Williamson, *Resource Transfer and The International Monetary System*, paper presented to a Conference commemorating the 25th anniversary of the founding of the Banco Nacional de Desenvolvimiento Económico, Rio de Janeiro, July, 1977.

[40] Not only commodity prices of LDCs exports. Continuing world inflation reduces the real burden of the debt, but obviously this is not an adequate solution to the problem.

default, lagging payments of rescheduling, asking rather for new loans.[41] As we noted in the previous section, for the case of Brazil (and most higher income LDCs) the problem is not the imminence of default or rescheduling but the burden of internal adjustment. The implication of this high demand for new loans by commercial countries is that the larger the role of the private banking sector in allocating these loans, the higher the concentration in creditworthy countries, the higher the involvement of private foreign banks in domestic affairs and the harder the terms on which new loans are contracted.

The inherent instability of the arrangement is aggravated when one recognizes that due to mounting net factor payments to foreigners, the same future current account deficit implies a lower inward resource transfer than in the past. Since the desire to obtain command over additional real resources is one of the basic features behind the LDCs' demand for a "new international economic order", the point is not irrelevant. In fact, as Williamson pointed out, there is "on record official endorsement of the view that promotion of resource transfer in a particular direction is a proper and legitimate objective of international monetary organization".[42] Of course, as Williamson himself recognizes, "the proposition that the international monetary system *ought* to be organized with a view to distributing income to LDC*s* is one which would be resisted in most developed countries". Their preference is clearly for so-called mutually-beneficial capital account financing, or for schemes which involve collective provision of aid.[43]

There is a widespread feeling that the paraphernalia of "facilities" now in operation will not be enough to eliminate the concern about lagging payments or even default risk,[44] in itself a reason for slowing down inflows and hardening lending terms. In our view this is very much linked to the very high proportion of private *vis-à-vis* official lending. That has meant shorter maturities, larger interest rate changes and greater vulnerability to conditions in international capital mar-

[41] As David Beim rightly asserted, the difference between a rescheduling of debt and a new loan "is nearly metaphysical. The economics are the same —money is repaid later rather than now. It is the psychology which differs — a rescheduling is a confrontation, an admission of failure, an emotional catharsis, while a new loan is business as usual" D. O. Beim, "Rescuing the LDCS", *Foreign Affairs*, July 1977, p. 727.

[42] J. Williamson, *op. cit.*, p. 2. The "official endorsement" is the *Outline of Reform* presented by the Committe of Twenty and published by the IMF in 1974. It lists as one objective of international monetary reform "the promotion of the net flow of real resources to developing countries", p. 8.

[43] Witness the appearance, within the framework of the existing international monetary system, of schemes such as the Compensatory Financing Facility, the Buffer Stock Facility, the Extended Fund Facility, the Trust Fund, the Subsidy Account, the Supplementary Facility and so forth. See IMF's *Annual Reports* for details.

[44] Either forced or deliberate.

kets. As is known, currency loan operations are medium-term banking revolving credits with floating interest rates and payable every six months. Obviously, borrowers undertake a considerable share of risks and potential adjustment burdens. As Diaz-Alejandro noted, for many LDCs "the expansion and integration of world commodity and money markets have raised the price of domestic policy mistakes and reduced some kinds of policy flexibility".[45] As we noted in Section I, this certainly happened in Brazil. It will certainly happen with many other countries as well. Including — as is being increasingly recognized — East European countries which now face a foreign debt of over US $ 50 billion, more than 60% of it owed to commercial banks.[46] This is one of the fascinating new developments in the whole discussion.

The alternative solutions to the problem of LDC debt, as we noted, cannot be partial solutions focusing only on international credit markets. It is becoming clearer however, that they would require a greater participation for multilateral official institutions, in the provision of longer-term finance. As of today, since low absorption OPEC countries invest their surplus in the form of short-terms assets, LDCs also have to borrow in shorter form than they would like to. The result is that the world economy has been experiencing what is perhaps an excessive build-up of potentially destabilizing liquid debt. It is not at all clear that private banking sector intermediation will continue to be a suitable way of tackling this issue.[47] Indeed, the very nature of the banking business, entirely based on confidence, may well aggravate the problem: given the need to maintain (depositor's) confidence banks would always rather extend new loans than consider other alternative to borrower's difficulties. These new loans usually come with harder conditions. In this situation, the simple mathematics of compound interest do suggest the likelihood that ultimately, debt-servicing costs may exceed new capital inflows for many important LDCs. Case-by-case considerations do not constitute a proper answer. Neither do schemes nor sanctions designed to avoid — or penalize — default. The alternative solutions to the global issue of LDC indebtness must be sought elsewhere. Unfortunately, they depend on (as yet) unresolved problems. To these we now turn, by way of a conclusion to these notes.

[45] See C. F. Diaz-Alejandro, "The Post-1971 International Financial System" in G. K. Helleiner (ed.), *A World Divided*, Cambridge University Press, 1976, p. 200.

[46] See R. Portes, "East Europe's Debt to the West: Interdependence is a Two-Way Street", *Foreign Affairs*, July 1977.

[47] Fishlow has proposed the channeling of private commercial bank deposits to official banks, through swaps of "developing country loans currently held by the private banks for the bonds of the international institutions". See Fishlow, *op. cit.*, p. 20. It is not clear how this arrangement could work.

III

The somewhat frustrating discussion on the subject of the so-called new international economic order and the collapse of the North-South Conference have *not* eliminated the basic themes from the agenda. Indeed, after heated controversies it is widely recognized that to discuss alternative solutions to LDCs' debt necessarily involves at least a discussion of trends of and alternatives to the present international trading system, of the whole issue of foreign direct investment prospects, and of the international *monetary* system the world has yet to agree upon.

As to trade, LDCs are certainly right in arguing that the industrialized countries cannot continue to be "internationalists in finance and protectionists in trade, accommodating LDCs' borrowing needs but denying them the means to earn their way out of debt"[48] by exporting more goods and services to the developed world. As to foreign investments, the extent to which they are a "mixed blessing" is being unravelled by closer observation and analysis of countries which went farther than others in their reliance on foreign direct investment.[49] With respect to the international monetary system, lip service notwithstanding, no developed country seems to seriously believe that it should have any explicit redistributional role to play. Yet, all the relevant questions under discussion involve present and/or future inter-country income distribution.

[48] See D. Beim, *op. cit.*, p. 731.

[49] For a discussion about Brazil see P. Malan and R. Bonelli, *op. cit.*, section 5.

Why Nigeria Abstains from Borrowing in the Euro-Market

Samuel Bandele Falegan

The author is director of research, Central Bank of Nigeria.

It is coincidental and indeed ironical that, at a time when the Nigerian Government is exploring the Euromarket for raising loans to finance some of the key projects in its Third National Development Plan 1975-80, I was requested to present a paper on why Nigeria abstains from borrowing in the Euromarket.

The decision by the Nigerian government to explore the possibilities of Euromarket loans is not due to any particular attraction which the Euromarket offers *vis-à-vis* other sources of loanable funds. Rather, it must be seen as a logical development following the realization that non-inflationary domestic financing resources for the Third National Development Plan are now likely to fall short of original estimates. The view is taken that all avenues of international borrowing —private, governmental, bilateral and multilateral— should be explored for the purpose of closing the resource gap and ensuring that finance does not constitute the bottleneck in the implementation of the Plan. The official view is that there are a number of projects in the Plan which are self-liquidating and therefore can be prudently financed with funds obtained on open market terms, if it becomes necessary to do so. Nigeria's abstention from borrowing in the capital markets, including the Eurobond market, therefore, has probably run its course and already many Euromarket offers have been received by Nigeria.

Nevertheless, it still seems a fair question to ask why Nigeria has had to wait until now to tap the resources of the Euromarket. I plan to explore this question in a rather round-about way. In the first part of this paper, an attempt is made to provide a brief historical background to Nigeria's external borrowing and to highlight the extent and direction of need. In the second part, alternative sources of external financing available to Nigeria are discussed in respect of their terms, conditions and over-all suitability. The concluding part summarizes the main disattractions of the Euromarket borrowing relative to other alternative sources of finance.

BACKGROUND TO EXTERNAL BORROWING

Nigeria has in the past relied largely on World Bank group loans and inter-governmental loans for financing the offshore costs of its development programs.

Between 1962 and 1975, Nigeria launched three Development Plans in the following order:

a) The 1962-68 1st National Development Plan.
b) The 1970-74 2nd National Development Plan.
c) The 1975-80 3rd National Development Plan.

Table 1 shows the summary of the three plans and the means of financing them. What is important for the purpose of our analysis is the sources of external financing. While foreign aid was expected to account for nearly 50.2 per cent of the First Plan, external financing of the Second Plan was to account for just 15.3 per cent. The Third Plan, on the other hand, other than technical assistance involving manpower and other related skill, was to be exclusively financed from internal sources in spite of its large size.

The Third National Development Plan, covering 1975-80, was completely revised in late 1976 with budgetary expenditures greatly expanded for both current and development purposes. A new target for public sector domestic capital formation was set at N42.7 billion, 30 per cent above the planned investment in the original version of the Plan.* As nearly two years of the Plan had already elapsed, it was expected that the bulk of the increase in expenditure over the rest of the Plan period would be in investment outlays originating from the public sector. Priority in the allocation of investment funds was given to agro-allied industries, petroleum and petro-chemicals, fertilizers, iron and steel plants and manufacturing lines employing steel imputs. In addition, considerable investment in education, airports, inland waterways transportation and communications are to be undertaken. As originally conceived, the Plan had envisaged a yearly net accretion of external reserves over the planned period as shown in Table 2 totalling N16.9 billion. That, in fact, largely explains the inward-looking approach to borrowings.

As it turned out, only a small percentage of the First and Second Plan was able to be financed from long-term loans and for the First Plan in particular, of which only 5 per cent was financed from external sources, there was a recourse to short and medium-term borrowing to fill the gap. On the other hand, attention is now being seriously turned to external financing in order to implement the Third Plan which was originally conceived to be financed solely from domestic sources. There are a number of reasons for the change in policy stance and philosophy.

* N1 = $ 1.5352.

i) The size of the Plan had increased by 30 per cent to N42.7 billion.

ii) The expectation of an increase in oil exports seems to have waned. For example, while the Plan envisaged a net accretion of reserves of N3 797.6 million and N3 999.2 million in 1975 and 1976 respectively, the actual outcome for those two years was a depletion of reserves resulting in a deterioration in the balance of payments. The surplus of N3.1 billion recorded in 1974 was reduced to only 157.5 million in 1975 while a deficit of N241.6 million was recorded in 1976.

iii) The process of monetizing oil revenue has turned out to be more inflationary than was anticipated and it becomes necessary to cushion the domestic financing with external support.

iv) The mere availability of financial or monetary resources does not in any way guarantee the successful implementation of a project without the necessary manpower expertise, and technical and technological support, all of which have to supplement domestic effort.

v) There are a number of the projects which though they require long-term financing, are nonetheless not self-liquidating but provide the social infrastructure for other self-liquidating projects for overall devel-

Table 1

RESUME OF THREE NIGERIAN DEVELOPMENT PLANS

	1962-68 Plan (N million)	*1970-74 Plan (N million)**	*1975-80 Plan (N billion)***
1. Planned public expenditure	1 353.0	1 976.4	40.7
Less underspending	50.0	416.4	15.9
2. Requirement for capital program	1 303.0	1 560.0	24.8
Less domestic resources	518.0	1 258.0	19.4
3. Balance	785.0	302.0	5.4
Less uncovered gap	106.4	0.0	3.4
4. Foreign aid	678.6	302.0	2.0
Foreign aid as percentage of planned public expenditure	50.2%	15.3%	4.9%

* These are figures as they stood in the Third Plan before subsequent revisions.
** Third National Development Plan 1975-80 *Financing Program*, JPB (76)3, 28th December, 1976.

Table 2

1975-1980 BALANCE OF PAYMENTS FORECAST

(Current Account - N million)

	1975-76	*1976-77*	*1977-78*	*1978-79*	*1979-80*
A. MERCHANDISE					
I. Exports:					
1. Oil	7 120.3	7 913.0	8 665.1	9 603.8	10 633.2
2. Non-Oil	346.8	355.6	368.6	387.0	396.0
3. Sub-Total	7 467.1	8 268.6	9 033.7	9 990.8	11 029.2
II. Imports:					
4. Oil	47.5	47.5	45.6	41.0	38.2
5. Non-Oil	2 167.1	2 925.2	3 925.0	5 293.6	6 782.0
6. Sub-Total	2 213.7	2 972.7	3 970.6	5 334.6	6 820.2
7. Trade Balance	5 253.4	5 295.9	5 063.1	4 656.2	4 209.0

B. SERVICES					
I. Non-Factor:					
8. Oil (net)	— 361.6	— 372.5	— 303.0	— 334.5	— 385.1
9. Non-Oil (net)	+ 262.8	— 386.1	— 554.2	— 695.3	— 968.3
10. Sub-Total	— 624.4	— 758.6	— 857.2	—1 029.8	— 1 353.4
11. Government Transactions (net)	— 127.6	— 134.0	— 141.8	— 151.3	— 162.9
12. Total Non-Factor Service	— 752.0	— 892.6	— 999.0	—1 181.1	— 1 516.3
II. Factor Payments:					
13. Oil	—1 033.2	—1 140.0	—1 264.3	—1 391.9	— 1 516.4
14. Non-Oil	— 274.4	+ 441.9	+ 587.9	+ 686.9	+ 764.3
15. Sub-Total	— 758.8	— 698.1	— 676.4	— 705.0	— 752.1
16. Unrequitted Transfers	— 61.2	— 70.7	— 82.5	— 94.3	— 109.0
17. Current Account Balance	+3 681.3	+3 634.5	+3 305.2	+2 675.8	+ 1 831.6
C. DIRECT INVESTMENT	CAPITAL	ACCOUNT			
18. Oil (net)	52.7	237.2	275.0	309.8	387.1
19. Non-Oil (net)	52.5	112.5	128.4	147.2	122.9
20. Sub-Total	105.2	+ 349.7	+ 403.4	+ 458.6	+ 510.0
21. Official Capital	+ 11.0	+ 15.0	+ 9.0	+ 2.0	+ 1.0
22. Overall Balance	3 797.6	3 999.2	3 717.6	3 136.6	2 342.6

Source: Third National Development Plan 1975-80.

opment. Such projects include an integrated rural development, involving road network, water supply, agriculture and communication. The most appropriate financial institutions for financing such projects are the World Bank, regional banks and bilateral official and intergovernmental long-term loans. On the other hand, there are a number of projects that are self-liquidating, that is, they can generate foreign exchange and are profit-oriented and, as such, generate sufficient funds to repay any borrowing for financing them. In addition, such projects have potential for export revenue and import substitution, or provide essential infra-structure to support exports or import-substitution. Such projects will require direct borrowing on medium-term from international money and capital markets and Euro-syndication markets. Projects already identified for such medium-term financing are petrochemicals, nitrogenous fertilizers, liquified natural gas and railways.

Structure of Nigeria's external debt

Nigeria's debt can broadly be classified into two categories:

a) Long- and medium-term debts, with relatively low but divergent interest rates, furnished by foreign governments and international institutions.

b) Government guaranteed short-term debts including supplier credits, contractor finance, and guaranteed private investment.

Nigeria's public external debt rose from N140.8 million to N435.2 million between the end of 1962 and the end of 1965. There was a decline to N430.4 million at the end of 1967. By the end of 1970, external debt had risen to N488.8 million. Thereafter it declined substantially to N349.9 million in 1975 but rose again to N374.6 million in 1976. Short-term debt as a percentage of total external debt was very high in 1963 when it stood at 28.1 per cent. It had by the end of 1970 declined to 12.2 per cent and has virtually disappeared since then (see Table 3).

Loan repayment and interest payments tended to increase steadily during the decade of 1960-1970, reaching N31.0 million in 1970 (see Table 4). Between 1971 and 1975 the total payments tended to be stable, averaging N29.7 million per annum. Short-term debt service as a percentage of total debt-service was high, having risen from 35 per cent to a peak of 75.1 per cent between 1963 and 1965. Although there was a drop in the ratio to 47.1 per cent in 1970, this was still slightly higher than what it was in 1969. Over the period covered, no discernible trend emerged.

In 1967, a new element developed rapidly in the external indebtedness of Nigeria in the form of short-term liabilities. The civil war severely affected nearly all sectors of the economy and foreign exchange was especially diverted to prosecuting the war. In 1967, it became a policy not to allow Central Bank holdings of foreign exchange reserves to fall below a minimum of 25 per cent of the Bank's demand liabilities and to base foreign exchange payments on earnings because the demand far exceeded the supply of foreign exchange. As earnings fell short of approved payments, the country started incurring and accumulating short-term liabilities. These are not short-term liabilities in the conventional sense but commercial trade credits, the payments of which were overdue and there was no foreign exchange to pay for them or foreign exchange cover was made available after the expiry of the period of payment specified by the foreign supplier. The maturity of liabilities

Table 3

ESTIMATED EXTERNAL SHORT-TERM AS PROPORTION OF TOTAL EXTERNAL DEBT

(N million)

Year-end (*1*)	*Debt outstanding* (*2*)	*Short-term debt* (*3*)	*(3) as % of (2)* (*4*)
1960	82.4	—	—
1961	85.8	—	—
1962	140.8	—	—
1963	181.4	51.0	28.1
1964	365.6	68.2	18.7
1965	435.2	93.4	21.5
1966	438.6	91.2	20.8
1967	430.4	73.8	17.1
1968	426.0	65.6	15.4
1969	456.0	54.4	11.9
1970	488.8	59.8	12.2
1971	214.5	—	—
1972	263.4	—	—
1973	276.9	—	—
1974	322.4	—	—
1975	349.9	—	—
1976	374.6	—	—

Sources: Compiled from *External Medium and Long-term Public Debt, Past Projected Amounts Outstanding, Transactions and Payments 1956-1975*, Report No. EC.149, IBRD, October 14, 1966; *Suppliers' Credits from Industrialized to Developing Countries: A Study by the Staff of the World Bank*, Revised Edition (April, 1967); Central Bank of Nigeria, *Annual Reports*, 1960 to 1976; other returns from the Central Bank of Nigeria; and D. Avramovic, *et al.*, *Economic Growth and External Debt*, Table 8, p. 111.

ranged between three and six months. However, some of the liabilities got rolled over and delay in payment went beyond one year. These short-term liabilities which stood at N8.0 million at the end of June 1967 rose to N198.0 million at the end of 1970. Apart from the magnitude of the liabilities, the rate of increase was phenomenal. In July 1968, short-term liabilities totalled N35.4 million. By the end of the year, they had increased to N48.2 million. By July 1969, they had totalled N72.0 million. twice the amount of a year earlier and the increase persisted throughout 1969 reaching a peak of N112.0 million. In the first two months of 1970, the short-term liabilities declined to N73.6 million, only to rise to N198.0 million at the end of the year. At the same time, total foreign exchange holdings stagnated around N91.6 million, but rose to N144.0 million at the end of 1970. Also, under the payments arrangement established for imports, capital goods imports (that is machinery and plant) were to be paid for, between one and seven years, depending on the amount involved.

Table 4

EXTERNAL DEBT-SERVICE PAYMENTS INTEREST AND AMORTIZATION

(N million)

Year	*Interest*	*Amortization*	*Total*
1960	2.8	0.8	3.6
1961	6.3	3.1	9.4
1962	4.9	3.2	8.1
1963	12.4	10.2	22.6
1964	4.4	10.8	15.2
1965	5.9	13.8	19.7
1966	10.1	30.7	40.8
1967	6.9	14.6	21.5
1968	7.5	12.3	19.8
1969	9.0	16.6	25.6
1970	12.4	18.6	31.0
1971	14.7	15.2	29.9
1972	11.5	14.7	26.2
1973	16.9	13.9	30.8
1974	14.9	14.2	29.1
1975	23.2	9.5	32.7
1976	13.4	17.0	30.4

Source: Federal Republic of Nigeria *Official Gazette,* various issues.

ALTERNATIVE SOURCES OF FINANCING

Nigeria relied, in the past, on the World Bank group loans, intergovernmental loans, contractor finance, supplier credits, and deferred payments for external financial support of domestic resources. The terms and conditions of the sources of financing are examined.

A. *World Bank Group*

A very important distinction between the World Bank and the Euromarket loans is the motivation for giving the loans. The guiding principle for Euromarket loans is maximum profit while that of the World Bank is developmental and the long-run economic benefit to the recipient and the profitability of the Bank.

The World Bank's loans to Nigeria have largely gone into financing agriculture, road network, electricity, water supply, railways, irrigation and port development. For the first development plan, the World Bank made loan commitments of N90.4 million. At the end of 1976, total World Bank loans to Nigeria outstanding amounted to N258.6 million.

Virtually all of the World Bank loans to Nigeria have been for specific projects and the bulk of the loans have been made to quasi-official institutions with a guarantee by the Federal Government. The largest loan commitment of the Bank to Nigeria was made in 1964 when the Niger Dams Authority secured a loan of N58 million for the construction of Nigeria's dam project. The World Bank ties its credits to the purchase of specified commodities and services but permits purchases in any of its member countries. The loans are limited to the foreign exchange requirements of the projects and all loans are repayable in foreign exchange. The World Bank and the leading Consultative Group members accepted, in 1966, a Nigerian request to finance both foreign exchange and local costs of development projects in Nigeria.

B. *US aid*

When the 1962-68 Plan was launched in 1962, the US announced a total aid commitment of N160 million covering the Plan period, about N60 million of which was to be provided in the form of grants and technical assistance and the rest in loans. Since then, there has been no evidence of official aid from the United States. All US aid loans to Nigeria have been development loans, with an average annual interest charge of 2 per cent and repayment periods extending from 10 to 40 year and with grace periods extending to additional ten years. Over 80 per cent of US aid is tied to direct procurements from the US with all loans repayable in US dollars.

C. *United Kingdom*

Since the Second Development Plan, British aid had totalled about N72.6 million, made either directly to the Government, or its agencies, part of which was raised directly in the London money market to finance port expansion. British loans are also mainly project loans, largely tied to procurement from Britain and repayable in foreign exchange.

D. *Other sources of foreign aid*

West Germany, in 1961, lent Nigeria N17.8 million for a new Lagos-mainland bridge, a cottage hospital and a technical school. All other financial assistance from West Germany has been of short-term duration in the form of contractor finance, suppliers' credit and government-guaranteed deferred payments. The bulk of Israeli loans to Nigeria was also on a short-term basis. Italy loaned N18 million toward the Niger Dam project, while the Netherlands lent N2 million for the same purpose. The Canadian loan of N1 million, received in 1967, was the first type of loan Nigeria received which was to finance the entire local cost of a project. Part of the loan was to cover procurement of materials, equipment and services from Canada, free of interest, and the remaining to cover loan costs in Nigeria with an interest rate of 3 per cent.

Other sources of financial aid have been Japan, Poland, Czechoslovakia and Switzerland. Like loans from the US and the United Kingdom, these loans have been tied both to specific projects and to specific sources of procurement.

Forms of medium-term loans

A. *Contractor finance*

The Nigerian Government (or any of its agencies including state governments) enters into agreement with a foreign contractor who supplies equipment and construction for a particular project. The contractor finances the cost from his resources and the government agrees to pay him over an agreed period of time. The terms of such deferred payments vary considerably, but interest charges usually range from 6 to 10 per rent per annum. As a rule, the borrower pays about 10 per cent of the cost of the contract as down payment, which the contractor combines with his resources to begin work. Thereafter, the contractor meets other finances from his own resources by discounting the promissory notes issued by the borrower. The contractor passes the discount charges to the borrower.

B. *Supplier credit*

The supplier credit operation resembles contractor finance except that the lender sells the equipment and agrees to be reimbursed by the purchaser/borrower over a period of time, usually 5 years, and at an interest charge of not less than 7 per cent per annum. This kind of financing has all features of a guaranteed export credit.[1] The term "guarantee" refers to the coverage against losses of non-payment due to political or transfer difficulties in the borrowing country. The coverage is provided under export credit guarantee programs sponsored by public authorities and banking institutions of industrial countries. While the private sector of the Nigerian economy has employed export credits from major industrial countries for industrial projects, the public sector (government and its agencies) had in the past also been much involved in them, with the Federal Government issuing guarantees against default.

Not only are the maturities of suppliers' credits inappropriate to the life of the equipment or to the pay-off period of the project, but the credits also involve payment before production begins.

C. *Guaranteed private investment*

Under this method of financing, the Nigerian government gives two guarantees. One provides the necessary foreign exchange to enable the creditor to be paid in full when his loan is due. The second provides that all obligations be fulfilled regardless of the fate of the project. To quote from Ayida's study:

> Such investment may be an industrial project sponsored by a Nigerian company in which a foreign private investor provides about 5 per cent to 10 per cent of the equity capital and a public development agency or government in the recipient country provides the rest. The equipment required for the project is supplied by the foreign partner to the company under supplier credit arrangements. There are known cases where the foreign investor is the consultant who prepared the feasibility study for the project, the financial adviser and banker who finalised the credit arrangements, the manufacturer who supplied the equipment, the technical partner and managing agent who runs the factory under a managing agency agreement with fees or commissions . . .[2]

Short-term financing has been employed to finance projects for which

[1] L. G. Guadaguali, "Financing Economic Development through a Guaranteed Medium-term Export Credit", *International Development Review,* No. 2, June, 1967, pp. 1-18.

[2] See A. A. Ayida, "Contractor Finance and Supplier Credit in Economic Growth" *The Nigerian Journal of Economic and Social Studies,* Vol. VII, No. 2, July 1965, pages 181-182.

long-term financial assistance on more favourable terms can be obtained. The urge for industrialization in Nigeria has often led to indiscriminate use of short-term credit without a rational assessment of the changes for a successful business undertaking. Some projects of dubious worth thus have been undertaken, and expensive equipment has been bought and incorporated into projects which are not necessarily suited to local conditions.[3]

The use of contractor finance and other forms of short-term lending has been stimulated by the lengthy procedures which long-term loans from international lending institutions and foreign governments entail. As a rule, finance from these latter sources has been used for major infrastructural projects, rather than for small to medium-size industries. For these reasons, contractor finance has been regarded as a necessary supplement to long-term borrowing. It is difficult to dispute this view provided that the rate of return is sufficient to cover and leave some margin of profit — that is, the projects are self-liquidating.

Overall, there is no uniform standard for export credits, whether suppliers' credit, contractor finance or deferred payments. While the nominal maturities of exports credits are, in general, longer than those available in the Euromarket today, rates of interest on suppliers' credits (including the cost of the guarantee provided by the export credit agency of the exporting country) have tended to go up in the last 3 or 4 years, and are now close to, or even surpass, the fixed interest rate which Nigeria would pay on a Euro-bond issue (about 8.25-8.50 per cent for a 5-7-year issue). The conditions for supplier credits differ from transaction to transaction, and from country to country. The best financial terms do not always correspond to the best transaction, while countries which compete on price are often not able to provide export credits on generous terms.

Terms of foreign aid

The terms on which Nigeria has secured its foreign loans in the past, range between five years and forty years, while interest charges range between less than one per cent for IDA assistance and over eight per

[3] For example, a West German firm, Ferrostaal A. G., built a N 5.8 million cement factory in Sokoto with payment guaranteed in 1964 by the Federal Government. The factory had to stop production until new machinery could be installed due to the unsuitability of the machine for treating local limestone. (See, *West Africa* (October 1, 1966), p. 1124). It was later discovered that neither a technical nor a feasibility report was ever produced before an agreement was signed. (See, *ibid.* (November 19, 1966), p. 1315). The first payment on the credit was due before the firm found a "solution" to its "unsuitability" problem.

cent for open market borrowing. Loans from the US imposed the cheapest and least burdensome terms, both as to maturity, interest rate and grace period. West Germany imposed one of the most costly terms. Apart from high interest cost, little or no grace period is provided on their loans.

The British loan interest charges are among the most costly, with such interest charges ranging between 5 and 9 per cent or more. Interest costs on loans from Britain are uncertain, being based on the United Kingdom bill rate prevailing at the time the loan is actually contracted. Cost of official borrowing is usually one per cent above the Bank of England rate. British loans have a repayment period of 15 to 20 years.

All borrowings of short-term and medium-term nature from private foreign suppliers have average terms that are relatively unfavourable compared with long-term loans from foreign governments and international institutions both as to the length of the grace period and rate of interest.

AID-TYING

Foreign aid donors stipulate that the aid must be spent to import goods and services from donor countries. Lending countries also often require that aid funds be spent only for particularly approved projects which form part of the overall development plan.

Aid-tying poses problems for the recipient country. For example, Nigeria received N 98 million from the World Bank and four other countries: the US, the UK, the Netherlands and Italy, for the Niger Dam project. The World Bank tied its loan to the offshore cost of the Niger Dam project only; the other donor countries tied their loans *both* as to project and procurement. Although there is some international standarization of equipment and machinery, significant discrepancies in engineering specification do exist. As one authority had noted:

> Where there are many donors involved the problem becomes nightmarish. Imagine trying to build the Niger Dam from seven different tied loans — it makes things very difficult for contractors who have to buy from sources they are not used to, and do not know. Some of the smaller local contractors have felt unable to tender for projects for this reason. It undermines the good principle of accepting the lowest tender, which may no longer be the best from the country's point of view, if its currency-mix is less appropriate to the tied aid than of higher tenders.[4]

The value of aid is reduced when it is tied to projects and to sources

[4] See I. M. D. Little, *Aid to Africa*, The Macmillan Company, New York, 1956, pp. 29-30.

of procurement because the recipient cannot buy its imports from the cheapest market.

> Sometimes the prices which the recipient has to pay for imports are magnified by the fact that aid-tying may introduce a strong monopoly element. There may be very few potential suppliers — even only one — of the equipment involved in double-tied aid... there have undoubtedly been cases where the recipient was thus exploited. Even where the recipients are not exploited, the consciousness of having to pay more than world prices is not good for aid relations.[5]

The Euromarket offers

A number of proposals has already been made by some Eurobanks to the Nigerian Government for medium-term syndicated bank loans and/ or direct Eurobond issues. The characteristics of the loan offers are summarized below:

a) Medium-term maturities — loans offered so far are all of medium-terms ranging between five and seven years. The amortization is shown in Table 5.

b) All the syndicated loan offers have variable interest rates and are all between 1¼ per cent and 2 per cent above the London interbank offering rates (LIBOR) which is currently about 8 or 9 per cent. This practice, which probably emanates from inflation and fluctuation in interest rates on deposits, and in exchange rate fluctuations, introduces a great many uncertainties, and is more burdensome, particularly when there is the predictable expectation that the rates may start rising in future.

c) The Eurobond offers have a fixed interest rate, but the maturities are not longer than those for syndicated bank loans.

d) There are various "middle bank negotiators" involved in matching the borrower and the ultimate lender ranging from the management group and syndicators to agency banks, etc., each charging its own fees. There is therefore a chain of variable charges, apart from the interest charge, in the following order:

i) Commitment fee of at least of 0.5 per cent per annum.

ii) Agency fee of not less than $ 10 000 per annum for administration of the loan.

iii) Placement fee of up to 0.625 per cent payable to participating banks.

[5] See I. M. D. Little and J. M. Clifford, *International Aid*, Aldine Publishing Company, Chicago, 1966, p. 165.

iv) Management fee of 0.375 per cent of total amount for arranging transactions.

v) Legal fees and other expenses of $ 35 000.

e) The grace period for the loan offered ranges between six months and two years, while the drawing down period of the loan ranges between twelve and twenty-four months.

f) The projects already identified for financing include petrochemicals, nitrogenous fertilizers, liquified natural gas, and railways.

CONSTRAINTS IN BORROWING FROM THE EUROMARKET

Generally the Euromarket medium-term loans create the impression of providing financing when actually they are creating an obligation to repay at a time when the project will most likely be short of funds, that is, when the plant has been built but is not yet operating fully or profitably. Implicit in the relative medium-term maturities is the fact that no matter how profitable the projects, and the speed with which they are executed, the borrower cannot be expected to start repaying the loans from the proceeds of the project or be net capital importer by the time amortization on such loans falls due. The grace periods of between six months and two years are too short for the projects to reach full operation before starting principal repayment instalments.

The short maturity period of most Eurocredits could lead to a situation where debt servicing becomes a problem, thereby compounding the balance of payments problem of the borrowing country. Already, as shown in Table 6, there has been serious and persistent deterioration in Nigeria's balance of payments since the huge surplus achieved in 1974. Rather than achieving a net accretion of reserves there was a deficit of N 241.6 million in 1976 and it is estimated that there may be additional deficit during the rest of the Plan. Since the government's intention is to use the external borrowing to "cushion" the deficit, reliance on medium-term lending of this nature will concentrate debt-service between 1979 and 1987 and may not achieve that objective. Both Table 7 and Chart I for example, compare the external debt service burden of $ 1 800 million raised from three sources — Euromarket, IFC, IBRD, with different terms and conditions. While a World Bank loan matures within a period of 15 or more years, the proposed Euromarket loans are to mature between 5 to 7 years. The debt-service burden of the World Bank loan is spread over a longer period than a Euromarket loan. Also, while the World Bank grace period ranges between two and five years, that of the Euromarket ranges between six months and two years. With an interest of 8½ per cent charged by the World Bank, total interest payments amount to $ 1 224 million while that of those of the IFC with an interest rate of 9.67 per cent amount to

Table 5

EUROMARKET LOANS. SUMMARY STATEMENT

Terms of loan offer

Maturity period	*Period of grace (drawdown)*	*Interest rate*	*Commencement fee*	*Management fee*	*Agency fees*	*Other remarks*
6 years	2 years	1¼% p.a. above LIBOR	½% p.a. on undrawn part of loan	⅝% flat on loan +	$ 25 000 p.a.	Repayment is in 9 semi-annual instalments. Loans will be subject to the laws of England
7 years	2 years	1⅛%-1½% over LIBOR	⅜% p.a.	½% flat on loan	—	Legal fees = $ 35 000
7 years	2 years	1.625% p.a. over LIBOR	½% p.a.	0.375% on amount of loan	$ 10 000 p.a.	Placement fee = 0.625% on the amount of loan. The loans will be governed by English law.
7 years	1 year	1⅛% first 3 years 1¼% last 4 years over LIBOR	½% p.a.	¾% flat	$ 5 000 p.a	Legal expenses = $ 120 000 maximum
5 years 7 years	1 year 2 years	2% over LIBOR 1½% p.a. over LIBOR	—	—	—	—
6 years	1 year	1¾% p.a. over LIBOR	½% p.a.	½% flat + $ 25 000	$ 15 000 p.a.	Legal fees, cost of documentation, etc., to be paid by borrower

$ 957 million. Interest payments on the same loan from the Euromarket amount to $ 723 million. The implication of this difference in interest payment is that the servicing cost, though higher, is spread over a longer period in the case of the IFC and World Bank loans than in the case of the Euromarket loan. This ensures that the project has been completed and operating fully and profitably to provide the interest charges and the principal repayment. The debt-service implication and the maturity spread are shown in Chart I.

Given the variability of the London interbank offering rate (LIBOR), interest charges on Euromarket loans are not fixed. The implication is that the cost of servicing the loan and therefore the impact on the balance of payments cannot be determined with any degree of certainty. For a World Bank loan, however, servicing costs are known throughout the life of a loan agreement. While all sorts of fees as shown above are charged on borrowing in the Euromarket, the World Bank charges only commitment fees.

The interest rates applicable to most Eurocredits are unstable. Because of this, the servicing cost of a loan cannot be determined over the life of the agreement. If the interest rate rises, the servicing cost will also rise, thereby further aggravating the servicing cost. Where a "floating interest rate"[6] clause is built into the agreement, there may be no option but to repay the loan at once if there is no agreement as to the terms at which the loan is to be rolled over. In measuring the debt service capacity of a country three variables have usually been identified:

Table 6

BALANCE OF PAYMENTS: 1974-1980 DEVELOPMENT PLAN

Year	*Plan Estimate*	*Actual*
1974	+4 072.0	+3 102.2
1975	+3 797.6	+ 157.5
1976	+3 999.2	− 241.6
1977	+3 717.6	− 600.0[e]
1978	+3 136.6	n.a.
1979	+2 342.6	n.a.
1980	n.a.	n.a.

[e] Estimates

[6] Interest rates fare determined periodically at the time credit is to be rolled over.

Table 7

SCHEDULE OF SERVICING COST FOR $ 1 800 MILLION LOAN

($ million)

	Eurobanks	*IFC*	*IBRD*
Rate of Interest	LIBOR + 1-2%*	9.67%	8.5%
Maturing Period	5-7 years	10 years	15 years
Grace Period	6 months to 2 years	2 years	4 years
Year			
1979	61.574	—	—
1980	167.321	174.06	—
1981	151.281	156.65	—
1982	123.092	139.25	153.00
1983	94.716	121.84	142.80
1984	66.441	104.44	132.60
1985	38.368	87.03	122.40
1986	18.740	69.62	112.20
1987	1.140	52.22	102.00
1988	—	34.81	91.80
1989	—	17.41	81.60
1990	—	—	71.40
1991	—	—	61.20
1992	—	—	51.00
1993	—	—	40.80
1994	—	—	30.60
1995	—	—	20.40
1996	—	—	10.20
Total Service Cost	722.997	957.33	1 224.00
Percentage of Total	40.16	53.19	68.0

* London inter-bank offering rate currently estimated at 8.5 per cent.

a) Fluctuating variables consisting of exports and capital flows;

b) Off-setting variables consisting of reserves, compensatory finance and compressible imports and,

c) Rigid variables consisting of minimum tolerable imports, interest and amortization debt-servicing.[7]

Until recently, when forecasting a country's future balance of payments, debt service on debt outstanding at the base period has been

[7] See Dragoslav Avramovic *et al, Economic Growth and External Debt*, Johns Hopkins Press, Baltimore, 1966, page 13.

SERVICING COST OF $ 1 800 MILLION LOAN

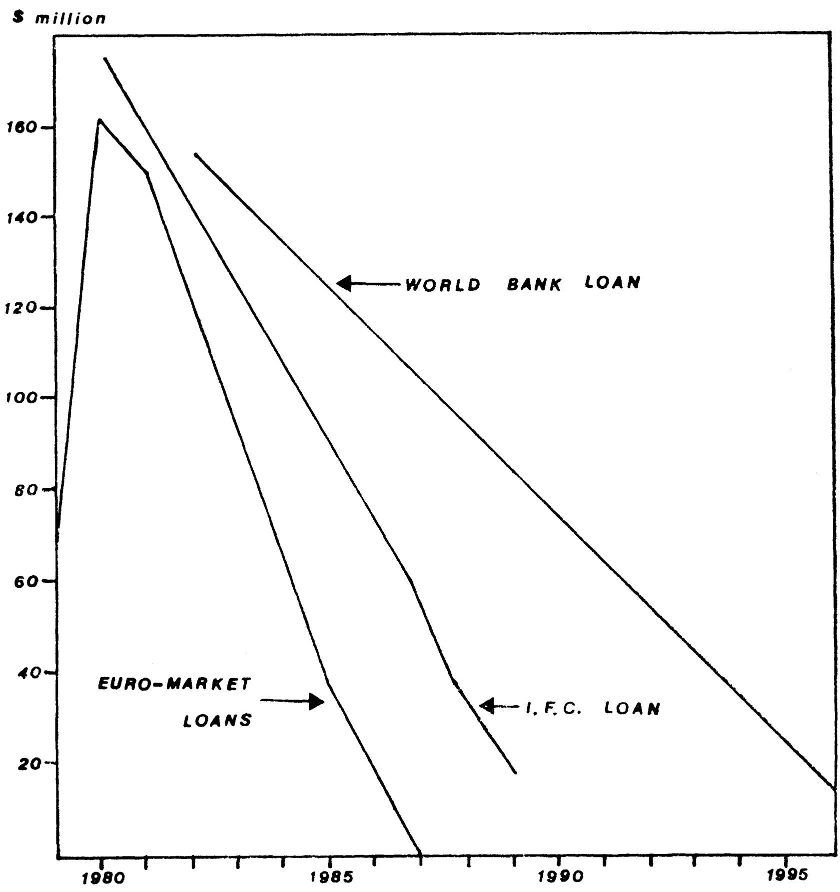

Table 8

EXTERNAL DEBT-SERVICE PAYMENTS: LONG, MEDIUM AND SHORT-TERM

(N million)

Year	*Total debt service charge (1)*	*Long-and medium loan service (2)*	*Short-term debt service (3)*	*(3) as % of (1) (4)*
1960	3.6	3.6	—	—
1961	9.4	9.4	—	—
1962	8.1	8.1	0.0	0.0
1963	22.6	14.6	8.0	35.4
1964	15.2	6.4	8.8	57.9
1965	19.7	4.9	14.8	75.1
1966	40.8	27.0	13.8	33.8
1967	21.5	12.7	8.8	40.9
1968	19.8	8.0	11.8	59.6
1969	25.6	13.6	12.0	46.9
1970	31.0	16.4	14.6	47.1
1971	29.9	29.9	—	—
1972	26.2	26.2	—	—
1973	30.8	30.8	—	—
1974	29.1	29.1	—	—
1975	32.7	32.7	—	—
1976	30.4	30.4	—	—

Source: Federal Republic of Nigeria *Official Gazettes*, various issues.

one of the given elements with major unknown variables being exports, imports and debt service on new borrowing. With the advent of variable interest rate, interest, which was once a rigid variable, has become a dependent or fluctuating variable, fluctuating with short-term money market conditions.[8] If, as appears evident, the variable interest is at the peak or high rate and continues to increase relative to credits with fixed interest rate, the amount of interest payments subject to uncertainty will also increase. Also, any further increase in such rates will lead to an increase in interest cost and in total debt service. Superimposed on that may be the floating exchange rate for which an adjustment clause may also be demanded by the lender.

For the projects for which loan offers have been earmarked, one is not sure how long it will take to construct each plant, but a project like

[8] See T. M. Wein: "The External Debt Situation of Developing Countries", *Finance and Development*, December 1976, Vol. 13, No. 4, page 25.

railways will certainly take more than the life of the loan before it can start functioning, hence it cannot be expected to be self-financing and self-liquidating.

External debt service of Euromarket borrowing

Tables 4 and 8 show the existing structure of debt-service payments and the relationship between long-term and short-term debt service payments. In looking at the future debt-servicing problem of Nigeria *vis-à-vis* borrowing from the Euromarket, the denominator of the debt-service ratio is limited to visible export earnings only, instead of earnings on current account. (Earnings on the services account in Nigeria's balance of payments represent an insignificant and declining proportion of total earnings on current account and there is a lack of accurate data on the services account.) Since Nigeria's ability to service existing and additional debt is primarily determined by foreign exchange earnings, the structure of Nigeria's export trade from which the foreign exchange is earned is relevant to a discussion of the debt-service ratio.

Table 9

OIL EXPORTS

(N million)

Period	*Value of oil exports* (1)	*Retained value of oil exports* (2)
1960	8.8	15.4
1961	23.0	23.2
1962	34.4	19.6
1963	40.4	28.6
1964	64.1	50.2
1965	136.1	71.2
1966	183.9	86.8
1967	144.8	97.4
1968	74.0	57.6
1969	261.9	53.3
1970	509.6	253.2
1971	953.0	604.8
1972	1 176.2	900.7
1973	1 893.5	1 403.3
1974	5 365.7	5 192.9
1975	4 563.1	4 190.4
1976	6 281.1	5 224.2

Source: (1) CBN, *Economic and Financial Review*, various issues.
Source: (2) CBN, *Annual Report*, various issues.

Table 10

DEBT-SERVICE RATIOS

(N million)

Period	*Gross Exports (1)*	*External Debt Service (Actual) (2)*	*Ratio of Debt-Service to Gross Exports % (3)*	*Non-oil Exports plus retained value of oil exports (4)*	*Ratio of 2 to 4 (%) (5)*
1960	339.4	3.6	1.1	346.0	1.0
1961	346.9	9.4	2.7	347.3	2.7
1962	337.0	8.1	2.4	322.2	2.5
1963	379.3	22.6	6.0	366.9	6.2
1964	429.3	15.2	3.5	415.3	3.7
1965	536.5	19.7	3.7	471.7	4.2
1966	568.2	40.8	7.2	471.1	8.7
1967	483.6	21.5	4.4	436.2	4.9
1968	422.2	19.8	4.7	405.8	4.9
1969	636.3	25.6	4.0	427.4	6.0
1970	885.4	31.0	3.5	629.3	4.9
1971	1 293.4	29.9	2.3	945.1	3.2
1972	1 434.2	26.2	1.8	1 158.7	2.3
1973	2 277.5	30.8	1.4	1 787.2	1.7
1974	5 794.8	29.1	0.5	5 621.9	0.5
1975	4 925.5	32.7	0.7	4 552.8	0.7
1976	6 709.8	30.4	0.5	5 652.9	0.5

Sources: FOS, *Annual Abstract of Statistics.*
CBN, *Annual Report,* various issues.
CBN, *Economic and Financial Review,* various issues.

In calculating the debt service ratio, only non-oil exports and the *retained value of oil exports* is included in the denominator. This is because the oil companies do not turn over their total foreign exchange earnings to the Federal Government of Nigeria but only a fraction consisting of royalties, rentals, profits and the value of local expenditures. In addition, under the Nigerian Exchange Control regulations, the oil companies are allowed to offset their exports with their imports and submit the balance to the foreign exchange authorities in Nigeria. This "balance" equals the retained value of oil exports less imported goods for local consumption plus retained profit, royalties, and rental payments.[9] An estimate of the retained value of exports compared with total oil exports is shown in Table 9.

[9] For a detailed discussion of the balance of payments effect of the oil industry, see S. B. Falegan, "Impact of Crude Petroleum Industry on Nigeria's Balance of Payments 1960-1973", Central Bank of Nigeria, *Economic and Finance Review,* Vol. II, No. 2, December 1973.

The calculation of debt-service ratio is based on *a*) gross exports and *b*) non-oil exports plus retained value of oil exports and the two approaches are compared (see Tables 9 and 10). The two approaches indicate that Nigeria's debt-service ratio at the end of 1970 was significantly below the established limit of 10 per cent. In that year, the second approach resulted in a figure which is slightly closer to this limit than the first approach. At the end of 1976, both approaches produced the same result of only 0.5 per cent.

Because of inadequate data and other related information, it is not possible to provide an estimate of the debt-service ratio arising from Euromarket loans. As shown in Table 7, the annual interest cost on Euromarket borrowing, added to the existing level of debt service will increase the debt-service burden, but the debt-service ratio will still be below the critical level of 10 per cent. However, given other demands on foreign exchange earnings, the pressure on the balance of payments is bound to increase, unless the increase in export earnings more than compensates the demand for imports of goods and services.

Conclusion

Euromarket financing is a new element in Nigeria's external borrowing arrangement. From the available information, the Eurodollar market is not an ideal market in which to borrow for developmental purposes. The market is a highly technical one and it takes a newcomer a long period to understand the technique of the market. Consequently problems of a technical and commercial nature are likely to arise. Being a newcomer to the market and not knowing enough about who provides the necessary funds and why, borrowers can only secure the loans on terms less desirable than necessary. Thus several other unnecessary costs like transportation, printing, out-of-pocket expenses, etc., are charged on the loan. It is therefore necessary to pay particular attention to the terms of any loan to be contracted bearing in mind the viability of the projects to be financed and the debt servicing problems that may arise from such loans. It is necessary to know the nature of the market and the peculiarities of the various lenders. Projects for Euromarket financing should be those which are able to pay their way.

Since the projects earmarked for external financing involve a substantial amount of imported equipment, financing from suppliers' credit is less tedious than borrowing from the Euromarket. Such credits have longer maturity than Euromarket credit. Better financial terms are also obtainable than from Euromarket credit. Resort to the Euromarket will be needed only to complement domestic savings required to finance local expenditure.

One of the underlying principles on which loan terms and conditions which will be of mutual benefit to both the donor and the recipient ought to be based is that the projects and programs on which loans are spent should eventually be able to provide sufficient income or return out of which the underlying debt can be serviced. But the unfavorable terms of some of the existing loans, coupled with problems of double-tying of aid funds work against this objective. The awareness of these problems and the difficulties so far experienced with the development plan made Nigeria request —and the IDRB and the Consultative Group agreed in 1966 to provide— program support in the future as distinct from project-to-project assistance for Nigeria. "With program support, Nigeria will be able to implement meaningfully her development program. For, with program support comes the full knowledge that within an agreed program, the Consultative Group members will finance that part of development expenditure which Nigeria cannot meet from her own resources.

All told, however, the overwhelming benefits of a World Bank Group loan cannot be over-emphasized in spite of the hardening terms, especially interest rate charges. The World Bank, the International Finance Corporation (IFC), the International Development Association (IDA) and regional banks still offer less onerous terms than the Euromarket. The same goes for bilateral inter-governmental loans including the use of export credits as they provide a better alternative source of external financing to Euromarkets loans for developmental and long-range benefit to the borrowing country.

Final Report from the Meeting

Miguel S. Wionczek

Prepared by the Coordinator of the meeting (Mexico City, October 27-30, 1977), acting on his own responsability.

From October 27 to 30, 1977, a private international meeting of some 30 experts and practitioners in the field of North-South financial relations was held in Mexico City under the auspices of El Colegio de Mexico and the Center for Economic and Social Studies of the Third World. Its purpose was to discuss solutions to the problem of the external public indebtedness of the LDCs. The amount and the nature of the debt has recently given rise to increasing concern at the international level as well as in the creditor and debtor countries.

The informal agenda of the meeting covered:

a) overall LDC external debt developments over the past 10 years;

b) problems facing multilateral lending agencies, international private capital markets and the creditor countries as a result of growing LDC external indebtedness;;

c) problems faced by the LDC debtor countries as a result of the hardening of terms and conditions of external financial flows;

d) the role of new sources of external financial flows to the LDCs (the OPEC surplus countries) and of private intermediaries (international private commercial banking institutions) in North-South financial relations;

e) a review of recent developments in international conferences and meetings devoted fully or partly to LDC external debt problems (particularly the Paris Conference and UNCTAD IV), and

f) policy-oriented proposals for solving or alleviating some or all of these problems and ensuring the LDCs a constant and adequate flow of net external financial resources for their economic and social development.

The experts (who participated in the meeting in an exclusively *private* capacity) represented a broad spectrum of personal, professional and institutional experiences acquired, respectively, in international lending agencies, financial and monetary authorities of both creditor and borrower countries, international private banks and academic institutions in the developed and the developing world. The group included nationals of the US, Canada, Western Europe, Japan, Latin America, Africa and the OPEC countries.

The participants had at their disposal a general survey of the LDC's external indebtedness, drafted by an ad hoc working group set up by the organizers, 16 papers prepared specifically for the meeting by participants and 10 papers containing some of the most relevant material published during 1977. The discussions were greatly enhanced by the fact that the meeting was a private, informal gathering limited to invited participants. Although the meeting did not produce any declaration, resolution or agreed-upon statement, as had been originally planned, it was decided that a report by the Coordinator, acting on his own responsibility, might be of help in future international discussions, especially at the UNCTAD Trade and Development Board meeting at ministerial level to be held in Geneva in the early spring of 1978.

Consequently, this report gives a composite picture of opinions expressed and positions adopted during the meeting without attributing any specific opinion to any particular participants. For the purpose of making a positive contribution to the debate, the report puts much more emphasis on areas of agreement among the participants than on points where there were differing positions or interpretations of the facts.

Much more agreement emerged during the meeting than was expected by the organizers, even on some particularly controversial questions. Only future developments will show whether the consensus on so many areas was due to the private nature of the meeting or to the fact that several years of international discussions on the subject are resulting in growing mutual understanding of the respective —and often conflicting— positions of the lenders, the borrowers and public and private financial intermediaries.

AREAS OF BROAD CONSENSUS ON THE LDC DEBT

In the early part of the discussion, centering on the general information paper and the presentation of various international viewpoints, a certain consensus was reached that the LDC debt problem should be viewed, evaluated and treated in the more general framework of international economic relations and, specifically, in the context of North-South economic relations and should *not* be separated from the wider range of issues including trade policies, flows of official development assistance and the uncertainty of the world economic recovery.

The participants identified a number of reasons why this broader framework was vital if the discussions were to lead to constructive policy-oriented proposals:

a) the growing interdependence of different national and regional segments of the world economy;
b) the objective need to expand the net flow of financial and real resources for the development of the LDCs;
c) serious and growing political obstacles in some important DCs to the expansion —in real terms— of the flows of official development assistance;
d) the presence on the international financial scene of new actors (oil surplus countries and international private financial intermediaries), whose behavior as providers of loanable funds for the LDCs is difficult to predict under conditions of general economic uncertainty;
e) the gestation in the international economy of structural problems —which are not yet fully identified and understood— that seem to be leading to persistent new balance-of-payments disequilibria;
f) interrelatedly, the growing uncertainty about the short- and medium-term prospects for the world economy.

Many participants stressed the need *not* to separate the LDC debt from the other issues of North-South economic relations and the uncertainty of the world economic recovery. It was argued that if the debt issue were separated from other issues, it would be easy enough to demonstrate that by itself the debt might be "unimportant". Nobody presented a case for such a separation at the meeting.

It was also noted that in the existing international institutions such subjects as development finance, short-term stabilization and adjustment, economic stimulation, trade, etc., were unfortunately, compartmentalized, and, that it was therefore very difficult to design policy proposals within a holistic approach. Nevertheless, from the first day of the discussions an informal consensus started emerging that the meeting should not —and could not— be restricted to looking at partial proposals focusing only on international credit availability and terms.

THE KEY ISSUE: THE STRUCTURE OF THE DEBT

Given the documentary and statistical evidence that was available, the LDCs' present aggregate indebtedness position was discussed only very briefly. The view prevailed that while the aggregated LDC debt had increased very rapidly in the past 10 years, the aggregate size of the debt —in nominal terms— was of very limited use as a yardstick for policy-oriented solutions. The meeting felt that the key issue was the structure of the debt and the amount and the structure of the debt burden, reflecting the hardening in 1974-1976 of conditions and the shortening of terms on LDC commercial borrowing, which accounts at present for about one half of the total debt outstanding of some 80 LDCs. In fact, the solution to these problems would be in the best interests of both LDCs and DCs.

Some participants stressed that the real question was that of servicing the LDC debt rather than the LDCs' capacity to repay the debt. While some clarifications were made, no clearly opposing viewpoint was presented. In the light of a very good debt servicing record in the past 10 years, it was thought that any major defaults by LDC borrowers were highly unlikely because of the mutual interest of lenders (public and private) and borrowers in continuing financial relations. This was based on the assumption that there would be new lending and a speedy world economic recovery. However, under less satisfactory international conditions, the danger of default clearly does exist.

It was frequently recalled in the discussions that the restricted view of LDC external indebtedness as a purely financial problem had led in the past to long and largely sterile political confrontations in United Nations meetings and elsewhere. Governments of the lender countries were publicly adopting the position that there was no such thing as a generalized LDC debt problem and hence external debt difficulties should be treated on a case-by-case basis. For their part, the LDCs insisted that while there were many special cases, there was also a generalized debt problem. The differences between these two viewpoints were not only political but also conceptual.

THE NEED TO LINK THE GENERALIZED APPROACH WITH THE CASE-BY-CASE APPROACH

In the opinion of most participants, the problem of the LDC external debt could be treated meaningfully only by integrating it into a larger framework covering balance-of-payments adjustments, LDC development needs and domestic policies, development assistance, non-concessional resource flows, international trade and the world economic recovery. Within this broader analytical, policy-oriented framework, there was room both for the generalized and the case-by-case approach, linking short-term stabilization and adjustment with growth and long-term development financing.

Within the general broad framework suggested, *three* viewpoints were presented. While their underlying analysis and prescriptions differed, they cannot be considered mutually exclusive. All three recognized that problems of external debt management and development finance differed considerably between the two major LDC categories: the poor countries (including the least developed and the most seriously affected countries) and what are called middle-income countries.

The differences were due as much to development levels, including factor endowments, as to the fact that only the second group has access to external financial resources on market terms. The point was made that perhaps an important factor determining a country's creditworthiness and its attractiveness to international lenders was not only its income level but also its growth potential.

THE NEED TO SUPPORT "ACCEPTABLE" GROWTH RATES IN THE LDCs

According to the *first* viewpoint, while the LDC debt problem needs to be analyzed and treated both on a case-by-case basis and through a generalized approach a clear distinction should be made between these two approaches. It was argued that the case-by-case approach is suitable for situations where individual debtor countries show a clear departure from the average. This might be the consequence of either external or internal factors. In the first case the problem of excessive indebtedness (in terms of its structure and the debt burden) should be dealt with primarily by unconditional relief. In the second, conditional relief is required.

The discussion about the question of departure from averages showed that there are at least two ways this can be measured: departure from intercountry averages, and departure from historical trends. Under the first definition unconditional relief is defined rather narrowly. Under the second the debtors would qualify for assistance if they departed from reasonable expectations and/or "5-year moving averages" or some such yardstick. Thus, under the broader definition, all debtor countries would qualify for unconditional relief simultaneously. According to this view, the case-by-case approach should be linked with the generalized approach not because of the aggregate magnitude of the debt —which is hardly meaningful— but because in *all* cases the LDCs' capacity to pay for imports would not support "acceptable" growth rates. The generalized approach aims at ensuring all LDCs the net external resource flows needed to sustain "acceptable" growth rates that would, in turn, stimulate world economic expansion. However, this approach would have to take into account the different situations of the poor and the middle-income LDCs.

In the case of the poorest countries, whose unsatisfactory import capacity was due mainly to severe restrictions on their productive and export capacity and to their unattractiveness for external non-official capital flows, the main solution would be the expansion of concessionary assistance, together with improved absorptive capacity.

In the middle-income countries many internal and external factors, including limited absorptive capacity, are responsible for the behavior of their capacity to import and hence for the magnitude of additional external resources needed. First, capacity to import, the major determinant of their rates of economic growth, depends to a large extent on the nature and the quality of domestic economic management. Second, capacity to import also depends on various exogenous factors such as the trade policies of the advanced countries and the size of private capital flows to the LDCs that together determine the LDCs' prospects for expanding their exports — mainly, but not exclusively of non-traditional (manufactured) commodities. More specifically, LDC import capacity depends on the growth of world demand for imports, determined, in turn, by the real growth of the DC economies and the trends of intra-LDC trade.

Thus, "good" domestic economic management, particularly ever expanding internal savings for investment, together with an expansion of the non-traditional export trade from the South to the North and a general expansion of the world economy were viewed as the prerequisites for the middle-income LDCs —which account for some 80% of the present LDC public external indebtedness— having a "manageable" debt position. If these prerequisites are met, the problem of the middle-income LDC debt would become residual and could be handled by expanded official lending at non-concessionary terms *and* by international private capital markets.

THE DUAL PROBLEM OF SHORT-TERM ADJUSTMENT AND LONGER-TERM DEVELOPMENT FINANCE

The *second* viewpoint suggested that LDC external indebtedness should be treated as a dual problem of short-term adjustment (stabilization) and longer-term development finance. The former calls for additional financial and other measures, since exclusive emphasis on short-term finance for adjustment purposes is not enough. Short-run financial support has to be supplemented with other stabilization devices and measures such as access to the expected new financing within the context of an integrated commodity program. In the case of balance-of-payments difficulties, their origin should be taken into account. If the difficulties were due to factors beyond their control, the deficit countries should have access to unconditional balance-of-payments relief. If the difficulties were due to internal factors, conditional relief which was mutually acceptable to international financial agencies and to the deficit countries would be in order.

In the field of development finance a distinction should be made between poor and middle-income LDCs. The problem of the first group should be taken care of by concessionary financing and measures to relieve the debt service burden. With the middle-income countries, a distinction must be made between the general provision of development finance and the case-by-case approach in situations where the net flow of financial resources is declining in response, among other reasons, to the accumulation of "bad debts", very often due to reasons beyond the borrowers' control.

This viewpoint stressed that at the present time there is no coordination between stabilization programs and adjustment methods and measures, on the one hand, and development financing for economic growth, on the other. This can be clearly seen from several facts. First, stabilization measures and facilities are mainly of a short-run character, although the recent supplementary and compensatory facilities increasingly provide for somewhat longer- (medium or almost medium) term repayments. Second, a paradoxical situation has arisen in the field of development finance where, because of the nature of development, access to external resources with long-term maturities is clearly needed. However, because of the growing use of commercial credits for development purposes, an increasing portion of the external resources are being lent not only on harder financial terms but also with medium-term maturities.

The combination of *a*) adjustment financing for stabilization objectives with longer repayment terms and *b*) development finance for growth objectives with shortening terms is responsible to a considerable extent for the potentially dangerous "bunching" of the debt service burden. The problem can hardly be solved by one-shot *ex-post* debt rescheduling and other partial, ancillary measures. The situation calls for the restructuring of the whole package. The LDCs need not only short but also medium-term balance-of-payments assistance. At the same time they need a return to long-term development financing conditions. This would entail closer cooperation between multilateral and bilateral public lenders and international private lenders, and also cooperation between all of them and the LDC borrowers. These conditions have not been fulfilled as yet. The problem of the debt and the declining net flows has been treated in a piecemeal and haphazard *ex post* way.

BEYOND DEVELOPMENT FINANCE

The *third* viewpoint, which in many ways is similar to the second, started from the assumption that the recent dramatic increases in the current account deficits of the LDCs and hence the substantial increase in their overall indebtedness is the mirror image of the structural or persistent current account surpluses in certain developed and oil-exporting countries, as well as of real structural problems of growth and stabilization (stagflation) in many advanced nations. If these surpluses persist —and there is evidence that they will do so at least in the medium-run of the next five years— the corresponding deficits will have to be financed. In other words, the external indebtedness of the LDCs has its roots largely in international developments beyond the control of the debtor countries.

The fact that so far the *ex ante* deficits have mainly been financed *ex post* has been a favorable factor. Indeed, given the new levels and forms of global interdependence, if attempts had been made to suppress these deficits through domestic retrenchment in the LDCs, the world economy would have been thrown into a new recession with catastrophic consequences for international trade and, consequently, for growth rates in both the LDCs and the DCs.

The solution to the problem should be sought in a broader package that would include *a*) measures to correct imperfections in the present balance-of-payments support facilities, in official development assistance and in private capital flows to LDCs; *b*) liberalization of trade policies by the industrial countries and the adoption of policies for a speedy improvement in the world economy; and *c*) rules and procedures to ensure economic growth in the isolated "heavy debt" cases due to mismanagement or unexpected domestic or external problems.

The ways that both adjustment and development needs have been financed recently have had certain undesirable effects. For one thing, the least developed and most seriously affected LDCs have received inadequate levels of net official flows. On the other hand, the more advanced LDCs, which have access to private capital markets, have managed to finance most of their *ex ante* deficits with loans on terms and conditions not necessarily consistent with their debt servicing capacity, particularly given the greater likelihood of a slowdown in the recovery of the major advanced economies. In this connection two general proposals were put forward: first, that the share of official flows in total net flows should be increased substantially, and second, that maturities on commercial loans should be lengthened to allow debtor countries to service their debts out of increments in income that externally financed projects are expected to produce.

Since official development assistance is not likely to increase at satisfactory rates, the opinion of some participants was that there appears to be a strong case for correcting its terms *ex post*. If past official development loans to the poor LDCs were converted into grants and their debt service payments waived for, say, a period of five years, there would be significant gains in the volume of net resource transfers and in the quality of assistance. Estimates exist showing that this would perhaps enable them to improve their growth prospects significantly.

Since generalized debt reorganization would be counter-productive, the structure of commercial debt should be improved by lengthening maturities on new loans. Considering that new measures to improve the access of developing countries to bond markets would work very slowly, some official intermediation is required as an interim step. For example, a medium- to long-term balance-of-payments support facility might be established under the *joint* management of the IMF and the World Bank. The funds made available by it would supplement external funds expected from official and commercial sources so as to allow the LDCs to finance their development programs and improve their debt profile *at the same time*. Again, it was noted that such measures would not only serve the interests of the LDCs but also enhance prospects for world economic recovery via DCs' export trade.

AREAS OF AGREEMENT ON THE DIAGNOSIS

The three views seemed to coincide on a number of important points, including:

a) the LDC external debt problem must be handled within a larger framework which recognizes global interdependence and covers balance-of-payments adjustments, LDC development needs, official development assistance, "stagflation" in the DCs, international trade and world economic recovery;

b) finding solutions to the debt problem is the joint responsibility of the LDC borrowers and the DC lenders:

c) the LDCs' external indebtedness is only one face of the general problem of ensuring "acceptable" growth rates in the LDCs;

d) up till now, the problem of the debt and declining net financial flows to the LDCs has been treated in a piecemeal and haphazard *ex post* way;

e) the LDC debt built up in 1974-1976 cannot be repeated —not so much because of its aggregate size but because of its structure;

f) linking short-term stabilization and adjustment with long-term economic growth and development finance would make it possible to combine the generalized and the case-by-case approach;

g) the combination of the generalized and the case-by-case approach must take into consideration the different situations of the poor and the middle-income LDCs;

h) the balance-of-payments adjustment facilities available to the LDCs need to be strengthened and expanded; exclusive emphasis on short-term finance for adjustment purposes is not enough;

i) in addition to expanded adjustment facilities, the poorest LDCs need a continuous increase in long-term official concessionary assistance;

j) the debt of the middle-income LDCs might be handled by increased official lending at non-concessionary terms and by international private capital markets, but only if there is a speedy recovery in the world economy;

k) it would be much easier to solve the middle-income LDC debt problem if new mechanisms were devised to re-cycle more OPEC surpluses into capital formation, through —*inter alia*— more OPEC investments in middle-income LDCs;

l) even if adjustment facilities were strengthened and development financing increased, the trade policies of the developed countries, particularly on non-traditional (manufactured) LDC exports, would have to be liberalized; and

m) a satisfactory solution to the problem of LDC indebtedness and development financing depends heavily upon the pace of world economic recovery.

During this phase of the discussions, many participants referred to asymmetries and discontinuities which made it particularly difficult to find solutions to the problem. The following major issues were among those identified: the asymmetry in adjustment for the deficit and the surplus countries which put the major burden of adjustment on the deficit DCs and LDCs; the asymmetry in lending where short to medium-term liabilities were being transformed into long-term assets; the asymmetry in the distribution of financial assistance flows that was clearly favoring the middle-income LDCs; and, finally, discontinuities in the terms of lending, i.e., the absence of medium-term resources. It was argued that any lasting solution would have to include measures to eliminate or alleviate these asymmetries and discontinuities.

Thus, it could be said that the direction of the discussions was set by some sort of implicit informal consensus that started emerging in the early stages of the meeting. Perhaps the underlying spirit of the meeting could be summed up in the following statement by one of the participants: "In much of the recent discussions at the international level, there seems to be considerable self-satisfaction at the 'success' with which the international system dealt with its most recent crises. But in terms of meeting the long-term needs of developing countries and of world economic recovery it is not so evident that there has been any 'success'. While the world has survived its most recent economic shocks through a series of *ad hoc* responses, it would be wise to spend less time on congratulating ourselves for that and more time on preparing means for dealing successfully with the foreseeable problems of the future."

THE UNCERTAIN FUTURE OF PRIVATE COMMERCIAL CREDITS TO LDCs

Given the importance of private lending in the total flow of financial resources to LDCs, the meeting devoted considerable attention to the future of private commercial loans to the LDCs. While there was agreement that the private international intermediaries has played a useful role in the recent past in recycling surplus resources to the LDCs, it was noted that the cost of borrowing in international capital markets rose considerably in 1974-1976 because of higher average basic costs of loanable funds and increases in "front load". Although some participants argued that both phenomena reflected supply-demand conditions, no convincing evidence was presented for this; since 1975, at least, the supply of privately loanable funds has exceeded overall global demand because of weak demand for long-term corporate borrowing in the major industrial countries. The reasons for the trend toward the higher "front load", which continued when the average basic costs of private loan declined in 1977 in response to the growing competition among private lenders, were not clarified either. While some participants thought that it reflected a growing concern with the risks of lending to many LDCs and should be considered a sort of insurance, others suggested that the higher lenders' commissions reflected the need to offset higher operating costs and hence should not be considered as anything other than profits.

It was pointed out that the increased price of funds through commercial channels had an indirect effect on the cost of multinational official lending by pushing up interest rates for international lending agencies' bonds in 1974-1976. In the opinion of many participants, any discussion of the effective cost of external resources should take into account world-wide inflationary conditions that are cutting down real interest rates substantially compared with nominal interest charges. On the other hand, it was stressed that the effective cost of borrowed money was considerably higher than the nominal interest rate.

Considerable attention was given to the end-uses by the borrowing countries of resources from international capital markets. There seemed to be a consensus that prior to the onset of the world recession in 1974, LDC borrowing from international private sources was due in many cases not to the shortage of multilateral and bilateral resources but to the interest of borrowers in avoiding the conditionality attached to official credits, notably those from the IMF. As long as the borrower looked credit-worthy, private loans to LDCs were free of surveillance and had no ideological or political strings attached. This resulted in a considerable degree of "lax borrowing" and, on occasion, in bad management of borrowed funds. In some cases the private lenders were as much responsible as the official borrowers for "debt crises" in the LDCs. Here another asymmetry could be detected, related this time to the attitudes of the lenders towards the borrowers. The very liberal treatment of "good risk" borrowers was being replaced almost without warning —once they were considered no longer credit-worthy— by strong pressures from private lenders to "restore order in the house" at almost any political and social cost.

Abrupt changes in the borrowers' image of credit-worthiness at the private lenders' end were the subject of considerable concern at the meeting. It was pointed out repeatedly that in the future, such changes might affect the flows of financial resources to the LDCs much more than the supply-demand conditions prevailing in international capital markets at any given moment. Moreover, it was noted that the worry about their own image was one of the major reasons for the projection by many larger borrowers of the generalized approach to the LDC problem. Given the lack of a definition of the "good risk" and the volatile character of its image, some participants expressed concern about a hypothetical situation where, through the working of the domino theory and without any factual basis, a few major defaults might affect the access of other borrowers to international capital markets in spite of the ample availability of external loanable resources.

It was considered highly likely that flows of privately-held resources or resources handled by intermediaries would also become subject to controls by the domestic monetary authorities in major lending countries as a result of the authorities' concern about the external overextension of some private lenders. This is related not so much to the global volume of lending as to its concentration in major banking institutions operating on a worldwide scale; such a move was made in the US in the fall of 1977 after a series of informal warnings by the Office of the Comptroller of the Currency about the "risky" external overextension of some US banks. The meeting felt that this trend will continue in the US and maybe extended to other countries. The restrictive results of such unilateral measures may not necessarily be offset by the free activities of the offshore banking centers.

Some participants thought that there were other reasons why an adequate flow of private financial resources to the LDCs could not be assured in the long run. First, a strong world economic recovery would immediately increase the demand for loanable funds in industrial countries. Second, the availability of financial resources for non-oil LDCs might be reduced substantially even in the medium-run by the expansion of the absorptive capacity of the oil-surplus countries. Opinions were heard to the effect that this has already advanced much more than is generally thought. It was also pointed out that a number of oil-producing LDCs have passed from being net lenders to net borrowers in the past few years, both because of the growing requirements of domestic investments and for considerations of portfolio management and not because of adverse developments as regards their oil output and exports.

In brief, many participants considered that so many uncontrolable factors are responsible for the volume of private financal resources and for the conditions under which they might be available to the LDCs in the future, that much closer cooperation is needed among international development financing agencies, national monetary authorities in the lending countries and international capital markets. Such cooperation could, however, only be of major help in the case of the minority of LDCs, mostly middle-income countries, that have access to private capital sources.

OPEC's CONTRIBUTION TO THE FLOW OF FINANCIAL RESOURCES TO LDCs

The presence of participants from oil-producing countries permitted a frank exchange of views on the role of these countries in the flow of financial resources to the non-oil producing LDCs. The updating of information on multilateral and bilateral development assistance from oil-producing countries brought to the attention of the meeting the fact that OPEC's share in long-term official concessionary assistance is many times larger than that of the OECD in terms of per cent of GNP and per capita GNP. Moreover, the OPEC participants stressed that the surplus income from oil should, in fact, be considered not as income but as productive wealth for investment in the economic development of their countries. Finally, evidence was offered that the economic effects of their assistance upon the respective OPEC lenders were different from the economic effects of DC financial assistance.

Not only does OPEC assistance originate in the transformation of capital assets into financial assets which under inflationary conditions might be considered unwise from the lenders' viewpoint, but it does not generate any demand for OPEC lenders' goods and services. The reason is simple. While the OPEC lenders have no goods and services to offer except oil, the income elasticity of oil in most LDCs is lower than that for capital goods and foodstuffs from the advanced countries. Thus, the multiplier effects of OPEC assistance on the OPEC economies are close to zero. The case of development assistance from the OECD and of international commercial medium- and long-term loans that generate the OPEC countries insist on reasonable rates of return on their financial exports from the DCs is clearly different. All these factors explain why productive investment is not being tapped.

While only partly relevant to the subject of the meeting, the impact of oil price increases on the non-oil LDCs was raised on many occasions. A consensus was reached that any direct impact mainly affected larger semi-industrialized LDCs. The view, which is still held by large sectors of public opinion in the DCs, that the recent oil price increases were mainly responsible for the economic and financial difficulties of both DC and LDC economies, is not supported by the evidence. The gestation of stagflation in the DCs preceded the rise in oil prices in 1973. Moreover, the energy imports bill of most LDCs was relatively small because of their low level of industrialization and lack of other factor endowments. The main change the oil prices increases have brought about in the payments structure of LDCs after 1973 has not been the relative size of the deficit but the fact that a new source is being tapped as a lender.

Finally, the discussions touched briefly on the general issue of recycling OPEC surpluses. Mention was made of the need not only for recycling from surplus to debtor countries but also for creating new channels and mechanisms to permit the surpluses to be placed in acceptable long-term capital formation. Until this takes place world economic recovery maybe retarded because a major source of long-term investments.

The lender of last resort

Not much progress was made in rather brief discussions on the subject of the lender of last resort. While it was pointed out that the recent experiences of some private banks in the DCs that had run into solvency difficulties strongly suggested that national monetary authorities would never permit the multiplication of such cases, it was also mentioned that foreign banks could hardly expect assistance from the central banks of the host countries. The absence of last resort lending or support for giant offshore banking operations was briefly noted. Finally, a distinction was made between temporary liquidity problem and insolvency. A voice was heard to the effect that perhaps there was a more pressing need for a lender of last resort for the LDC borrowers than for the DC private lenders.

Domestic debt management in LDCs

Domestic debt management by LDC borrowers was discussed thoroughly within the context of the general proposition that solving the problems was the joint responsibility of borrowers and lenders. Considerable room for improvement in domestic debt management in many LDCs was detected and the exaggerated emphasis on the "sovereign right" of the free use of external resources by borrowers was subjected to hard questioning. The equating of sovereign rights with financial irresponsibility was considered not only unacceptable but highly damaging in the long-run to the borrowers themselves, as some recent individual debt crises have widely demonstrated. There was a consensus that financial responsibility and discipline do not exclude the use of some external resources for consumption purposes, particularly in the poorest LDCs, provided such cases are spelled out in advance. It was felt that the planning of alternative uses of global financial resources needs to be integrated with over-all economic long-term planning. Careful debt management and the integration of financial planning with overall long-term planning could help many LDCs both to discover the existing unused capacity to generate financial surpluses internally, and to identify sectoral and other bottlenecks responsible for low productivity of available domestic and external savings, and thus strengthen the LDCs' position in international negotiations for a lasting solution to their debt.

While it was recognized that there are serious political and social obstacles to improving the LDCs' financial and economic performance, note was taken of the fact that the search for a solution was complicated further by internal conflicts within the LDC governments —often between the Treasuries and the central banks, on the one hand, and the agencies in charge of public and defense expenditures, on the other. As a rule, the first represent conservative expenditure-restricting attitudes, while the second push for expansionary policies, particularly if external financing is relatively easily available. In the early seventies when the LDCs' access to international capital markets improved because of growing liquidity in these markets, the "spenders" gained ascendancy over the "conservatives" in many LDCs. Only very recently, with concern growing over the magnitude of the external debt service, has this trend been reversed in favor of the "conservatives". In some cases the reversal came too late to avoid a debt crisis. Whether these are repeated will depend to some extent upon the degree of internal compromise reached by the two schools of thought.

The existence of internal conflicts was also noticeable in the individual countries' relationships with external sources of funds for both adjustment and development finance. On many occasions the LDCs —individually and as a group— were speaking in international forums with two separate voices, with little coordination between them. Conservative voices and low-profile attitudes could be observed, for example, in the IMF. But expansionists were active in negotiations with multilateral and bilateral official development finance agencies and, of course, in international capital markets.

Debt renegotiation experiences

The discussion of LDC debt renegotiation experiences during the past 20 years was rather brief. There was agreement that the overall effects of renegotiation efforts that involved 10 LDCs were beneficial, especially if the potential repercussions of failure to make such efforts are taken into account. Nevertheless, it was recognized that in most cases the conditions that had made renegotiation necessary were not eliminated. To a large extent, this basic shortcoming explains why the countries that renegotiated their debt once were forced to do so again, sometimes several times. While renegotiations offer some relief, their benefits are, as a rule, modest. This is due as much to the philosophy of the renegotiations as to their mechanics.

Renegotiations were considered as a kind of last resort short of default, which was viewed by both creditors and lenders as the ultimate disaster. Multilateral mechanisms for debt renegotiation are very cumbersome, renegotiations were mainly undertaken to satisfy the interests of the creditors and the terms have followed those prevailing in commercial market dealings. Moreover, renegotiations have been part and parcel of broader orthodox programs of financial and economic adjustment. Neglect of the fact that the difficulties in servicing the LDCs' external debt are mainly of a long-term nature put severe limits on the usefulness of practically all renegotiations undertaken and completed in the past two decades. Future debt renegotiations might be more useful to the LDC borrowers if two conditions are fulfilled: first, some agreement must be reached between creditors and borrowers on the general guidelines; and, second, any international agreement in this field must give due consideration to such underlying factors as the LDCs' long-term development capital requirements and world economic and financial conditions.

The future of the LDCs and the revival of protectionism

The discussion on renegotiations led to a short debate on ways to avoid them in the future. Participants from the LDCs and some international organizations stressed the direct link between the external capital needs of the LDCs and world trade conditions. The transfer of real resources for development, they argued, could be financed either through current account transactions or through capital accounts. Most if not all LDCs would prefer an increase in the current account financing of real resource transfers (export trade expansion accompanied by an improvement in the terms of trade) rather than an increase in transfers through borrowing. One reason for this preference was clear: the expansion of LDC export trade does not produce future reverse transfers. The position of the DCs on this was considered not only inconsistent but contradictory: while they act as internationalists in financing, they are becoming increasingly protectionist on trade. In short, the DCs are doing less and less to help the LDC borrowers to export their way out of debt. If this tendency is not reversed in the near future, both sides, not merely the borrowers, will be seriously affected. This was the message of a recent major GATT study emphasising that international trade was on the brink of sliding into protectionism; this would cause serious damage to national economies, individual living standards and to relations between the LDCs and the DCs.

A consensus emerged that there was a clear interdependence between faltering economic recovery in the DCs and rising protectionism. Stimulation of LDC exports would not only help to alleviate the external debt problem, but because of subsequent increases in LDC imports from DCs, it would also aid economic growth in the advanced countries and thereby weaken protectionist forces. This harmony of interests between LDCs and the DCs on the trade front can only be achieved, however, if the latter try seriously to restructure their economies toward the new set of comparative advantages emerging in the world economy. In brief, forces that threaten the liberalization of world trade must be kept in check if only because otherwise the world economic recovery would be thwarted and LDC indebtedness might become unmanageable.

DEBT DATA REPORTING AND INFORMATION EXCHANGE

The meeting devoted some time to discussing debt data reporting and information exchange. It was noted that within the past five years the reporting on LDC debt had improved very considerably, thanks principally to World Bank and OECD efforts and to parallel reporting systems organized at the BIS, the US banking regulatory agencies and some international private banks. It was emphasized that the debt information which has been publicly available since 1974 is still far from complete. No concern was expressed about the fact that different sets of aggregate and country figures are published by alternative sources of information. Such a situation, it was felt, is inevitable given different definitions of the debt, among other factors.

Attention was drawn, however, to the fact that the available figures are still far from complete and should be considered as approximations only. The information on LDC private debt from private sources is very inadequate; the aggregate data by definition do not include short-term indebtedness (both commercial short-term debts and IMF drawings), although it is known that the use of short-term credits for long-term financing has been increasing lately in many LDCs. Finally, for political and national security reasons, information about the military debt, which is sizeable and growing, has been virtually left out of the existing international debt reporting systems.

Another gap comes from lack of information on LDC operations with offshore financial centers. Some progress on this has been achieved lately at the BIS. Although major US and other banks have started reporting to the BIS on their assets and liabilities in off-shore activities, the gaps in reporting by "minor" international private off-shore intermediaries are striking. In view of the absence of any international surveillance or harmonized reporting procedures among national regulatory authorities about these intermediaries, these gaps can hardly be expected to be filled.

Another unresolved issue was lags in reporting. In the fall of 1977 aggregate information on LDC external indebtedness outstanding at the end of 1976 —within the World Bank definition— was available for only about one half of all reporting LDCs. In spite of World Bank and OECD efforts to publish new information on a monthly basis, the actual lag was thus of the order of 12 to 18 months. All these difficulties were recognized at the meeting as an important shortcoming which influences people's perception of the debt problem and, therefore, the solutions proposed for it. It was agreed that additional efforts were needed to improve the coverage and to shorten the lags particularly in periods of rapid debt accumulation, and that greater cooperation was called for among the various sources of data.

Participants from the international private banking community stressed the great importance for their lending activities of access to the improved and expanded debt data reporting. It became clear at the meeting that international private banks seem to be the major users of this information in their endeavors to establish the degree of credit-worthiness of LDC borrowers. The general problem of risk evaluation by private lending institutions was discussed in some detail with emphasis on the evaluation methods and the criteria applied by large private lenders to developing countries.

The discussion made it clear that there was no generally acceptable formula to be applied by any single private lender to the different LDCs, much less a set of standard rules agreed to by the international banking community as a whole. Simple indicators such as the size and the rate of growth of total indebtedness and the debt service ratio were considered of extremely limited value. Some participants pointed out that in projecting the debt burden, calculations of export proceeds are inadequate unless they take into consideration whether estimates of future prices and rates of export expansion are reasonable, particularly given the uncertainty of the world economic recovery. Estimates of future import prices were also considered indispensable.

The persistent calls by international private banks for access to the World Bank and IMF periodical reports on the economic prospects of individual LDC borrowers were discussed briefly. The position prevailed that such access was not possible, not only because of the confidential nature of these reports but also because their general circulation might make it possible for them to be used improperly for major speculative activities against weak LDC currencies. This danger has increased in the world of floating exchange rates. It was also recognized that lack of access to the in-depth evaluation of the economic trends and prospects of individual borrowing countries put the largest private lenders in an advantageous position because only they could undertake such exercises by themselves. The suggestion that the evaluation of "country risk" could be facilitated by pooling knowledge among private bankers and perhaps even financing jointly an "international Dun and Bradstreet" to do country evaluations for general use by the private lending institutions was met with great scepticism on the grounds of inter-bank competition. It was pointed out, however, that the degree of cooperation in this field was increasing steadily because of the growing practice of consortia lending. It was mentioned in passing that under present circumstances the lenders knew much more about the borrowers than vice versa if only because "country risk" evaluation exercises were as a rule much more advanced and much better organized than the "borrowing risk" evaluation processes in most LDCs. This phenomenon was another example of asymmetries in international financial relations. The point was also made that under the present worldwide inflationary conditions, analysis by "age of debt" might be advisable, since the "old" debt has become less in real terms than the new borrowing.

PROPOSALS

Many proposals were made during the meeting. They were directed respectively to international financial agencies, the developed lender countries, the oil-surplus countries, the international banking community and the LDC borrowers. Attempts were made by participants to integrate these proposals into a broad policy package reflecting the major lines of their agreement. However, because of shortage of time and the lack of a clear mandate the meeting decided not to draft such a policy package formally. It was thought that in view of the general and deepening concern about the world economic recovery in the near future, the drafting of such a policy package should start relatively early in a proper international forum. Some participants thought that the forthcoming meeting of the UNCTAD Trade and Development Board at ministerial level might be such a forum.

It was agreed that the situation of the world economy called at least for contingency planning concerning LDC indebtedness. As a participant representing perhaps one of the most optimistic views put it, "should there be a prolonged period of relative stagnation in the OECD economies, LDC export earnings would probably fall below the levels needed to maintain both tolerable growth rates and normal servicing of their external debt. It would be wise, therefore, for the international community to develop a consensus on policies and to put into place the institutional basis for such an eventuality".

The meeting agreed on the need for both a policy package and contingency planning; within this context, it was proposed that international multilateral agencies should take measures to help increase the flow of official development assistance, with the highest priority being given to concessionary development assistance to the poorest LDCs. It was considered that there was no alternative to a bigger role for multilateral official institutions in the provision of medium- to long-term development finance; this, of course, should not exclude close cooperation with the private international banking system.

For the purpose of adjustment it was recommended that international agencies strengthen the existing compensatory and supplementary financing facilities and assure unconditional access to them for those LDCs whose balance-of-payments difficulties are due to factors beyond their control. These agencies should also keep in mind that lack of flexibility in the LDC adjustment process may have a very negative impact on the world economic recovery.

For the purpose of establishing a link between short-term adjustment and stabilization and longer-term development finance, it was recommended that medium-term balance-of-payment support facilities be established similar to the General Agreement to Borrow scheme already available to the advanced countries.

It was also thought that, given political difficulties about expanding the flows of official development assistance to LDCs in the short run, international financial agencies should consider establishing mechanisms to ensure the continuation of private lending to the LDCs in spite of increasing lending risks. Such mechanisms might include risk insurance and, in the case of private lending to the poorest LDCs, perhaps some sort of subsidy for the spread in interest rates.

While no agreement was reached about debt reorganization and relief, many participants felt strongly that if no rapid recovery takes place in the industrial economies, this may become unavoidable. It was felt, therefore, that there is a great need to continue working multilaterally on mutually acceptable guidelines for cases of debt renegotiation and relief. International financial agencies should get involved in the work on these guidelines if only to disarm possible political frictions between the borrowing and the lending countries.

It was noted that a very considerable degree of agreement on such guidelines was reached by the UNCTAD Group of Governmental Experts, comprising experts from the DCs and the LDCs, in early 1975 and that some elements of agreement on debt re-organization could also be detected in the positions of the Group of Eight and the Group of Nineteen at the Paris Conference.

It was recalled that the common elements that could provide guidance and contribute to broadly comparable treatment of debtor countries in similar situations were defined by the UNCTAD Experts Group as follows:

a) Debt re-organization should take into account the development prospects of the debtor country, to enable it to continue debt servicing payments and restore its credit-worthiness.

b) Re-organization should be conducted within the customary multilateral framework with the aim of concluding an agreement as speedily as possible to avoid prolonged uncertainty regarding the availability of foreign exchange.

c) The terms of debt relief, such as consolidation, repayment, grace periods and interest rates, should take into account both the anticipated long-term debt servicing capacity of the debtor country and the legitimate interests of the creditors.

d) Debt re-organization arrangements should provide for flexibility to review the situation at the end of the consolidation period in the light of unforeseen circumstances. They should also provide for accelerated repayments in an agreed upon manner if the debtor's economic situation improves more rapidly than anticipated.

There was a consensus at the meeting that the *developed lender countries* must keep in mind that the problem of LDC indebtedness can be managed in the long-run only if LDCs are assured a constant flow of development finance on terms and conditions that are in accordance with the goal of "acceptable" growth rates and take into account their repayment capacity. The LDCs' repayment capacity will depend not only on these terms and conditions but also on world trade which, in turn, will depend to a great extent upon the growth rate of the advanced economies.

Thus, it was felt that the developed lender countries should take action in three fields simultaneously: *a*) increasing bilateral (in addition to multilateral) official development assistance, *b*) opening the DC capital market to LDC borrowers and *c*) liberalizing trade. Since the problem of the LDCs can not handled exclusively by official financial assistance and private lending, opening the DC markets to LDC exports is required as well. The meeting felt that given the recent rise of protectionism in the major DCs, there is an urgent need to return to a standstill within GATT on trade restrictions and to keep open the LDC manufactures' access to the DC markets under preferential schemes. The developed lender countries should keep in mind that if they introduce new restrictions on LDC exports then some sort of compensation for the fall in the purchasing power of the LDC debtor countries will be necessary if they are to be expected to continue honoring their financial obligations to the lenders.

As regards the *oil surplus countries,* it was felt that their contribution to the orderly management of the LDC debt problem could be improved in three not mutually exclusive ways: *a*) through lengthening the terms of their placement of funds in international capital markets, which would encourage private banks to lend on longer maturities to all borrowers, including LDC borrowers, *b*) through direct investments in the LDCs, and *c*) through increased placement of funds with international financial institutions that would (partly or wholly) guarantee the risks of the contributing countries.

While the meeting considered it unlikely that *international private capital markets* would provide LDCs with more resources in the future on more liberal terms and conditions, some participants thought that there was a possibility of mobilizing more private funds in the DCs for long-term lending to LDCs by creating some incentives for buyers of LDC bonds through exempting from taxes bonds purchased by institutional and private savers. It was also felt that close cooperation between private financial intermediaries, international agencies and national monetary authorities monitoring private lending operations to LDC*s*, including the activities of off-shore banking centers, would be of great assistance in detecting "abnormal" and risk-involving lending activities and thus would help to avoid unexpected individual debt crises and to create a climate of greater certainty in international private capital markets.

Since solving the LDC debt problem is the joint responsibility of the LDC borrowers and the lenders, it was recommended that the *LDC borrowers* devote more attention than in the past to debt management. Considerable room for improvement in the domestic management of external debt in many LDCs was detected. The equating of sovereign rights with financial irresponsibility and the lack of interest in integrating financial planning with overall long-term economic planning was considered not only as weakening the LDC position in international negotiations for lasting solutions to the debt problem, but also highly damaging to the individual LDC borrowers themselves, as some recent debt crises have demonstrated. It was further recommended that in the present period of uncertainty in the world economy, LDCs should give serious thought to the possibility that they may be forced to rely more on better management and use of their own financial resources. LDCs should keep in mind as well that excessive use of external borrowing —although it can perhaps solve short-term problems— considerably limits domestic economic options and increases the borrowers' political and economic dependence.

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List of Participants in the Mexico City Meeting

Al Shaikhly, Salah
President
Iraqi Fund for External Development
Bagdad, Iraq

Anguiano Roch, Eugenio
Research Associate
El Colegio de México
Mexico City

Arsenis, Gerassimos
Director
Division for Money, Finance and Development
UNCTAD
Geneva, Switzerland

Buira, Ariel
Assistant Manager
Banco de México
Mexico City

Del Mazo, Alfredo
Director of Public Debt
Ministry of Finance
Mexico City

Falegan, Samuel Bandele
Director of Research
Central Bank of Nigeria
Lagos, Nigeria

García Moreno, Víctor Carlos
Coordinator - NOEI
CEESTM
Mexico City

González del Valle, Jorge
Director
Center for Latin American Monetary Studies
Mexico City

Greayer, Anthony
Director
Grindlay Brandts Ltd.
London, England

Green, Rosario
Professor
El Colegio de México
Mexico City

Haliday, John Arthur George
Visiting Professor
El Colegio de México
Mexico City

Helleiner, G. K.
Professor
University of Toronto
Toronto, Canada

Holsen, John A.
Chief Economist
Latin America and Caribbean Region
World Bank
Washington, D. C.

Kröller, Edgar
Head, Financial and Technological Policies Division
OECD
Paris, France

Malan, Pedro Sampaio
Professor
Catholic University of Rio de Janeiro
Brazil

Márquez, Javier
Adviser
Banco Mexicano, S. A.
Mexico City

Massad, Carlos
UN Economic Commission for Latin America
Santiago, Chile

Müller, Ronald
Professor
The American University
Washington, D. C.

Navarrete López, Jorge Eduardo
Mexican Ambassador
Belgrade, Yugoslavia

Nishikawa, Jun
Professor
Waseda University
Tokyo, Japan

Ojeda, Mario
Professor
El Colegio de México
Mexico City

Osorio-Tafall, Bibiano F.
Director General
CEESTM
Mexico City

Paz, Pedro
Professor
Universidad Nacional Autónoma de México
Mexico City

Rabitsch, Elisabeth K.
Consulting Economist
Citibank, N. A.
New York, N. Y.

Reynolds, Clark W.
Professor
Food Research Institute
Stanford University
Stanford, California

Shihata, Ibrahim F. I.
Director-General
OPEC Special Fund
Vienna, Austria

Silva Herzog, F. Jesús
Research Associate
El Colegio de México
Mexico City

Urquidi, Víctor L.
President
El Colegio de México
Mexico City

Villarreal A., René
Director of International Financing
Ministry of Finance
Mexico City

Wionczek, Miguel S.
Senior Research Associate
El Colegio de México
Mexico City

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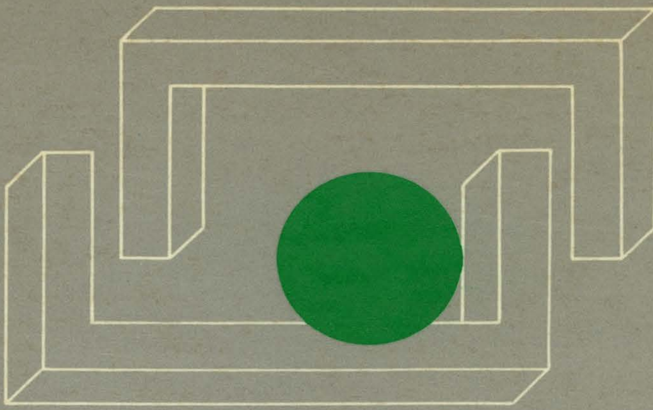

This volume contains the proceedings of a private international meeting of some 30 experts and practitioners in the field of North-South financial relations, organized at the end of October 1977 in Mexico City under the auspices of El Colegio de México and the Center for Economic and Social Studies of the Third World.

A consensus was reached at the meeting to the effect that the LDC debt problem should be viewed and treated in the more general framework of international economic relations and, specifically in the context of North-South economic relations and should not be separated from the wider range of issues including trade policies, flows of official development assistance and the uncertainty of the world economic recovery.

The viewpoints presented also coincided on a number of important points, including:

- The solution of the indebtedness problem was the joint responsibility of the LDC borrowers and the lenders;
- The LDC external indebtedness problem represented only one face of the general problem of ensuring the LDC "acceptable" growth rates;
- The problem of the indebtedness and the declining net financial flows the LDC has been treated until now in a piecemeal and haphazard *ex-post* way; and
- The LDC borrowing of 1974-76 could not be repeated not because of the aggregate size but because of the structure of the debt.