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# EXTERNAL DEBT CRISIS AND DEVELOPMENT

## The international debt situation in mid-1987

## Report of the Secretary-General



* A/42/150.

# I. INTRODUCTION

1. The problems posed by the external indebtedness of developing countries do not seem much nearer to a solution in mid-1987 than a year ago. Some developments in the international economy during the past year may, in fact, have dimmed prospects for their early solution. On the other hand, attitudes towards these problems have evolved considerably, and there are indications of more realistic and pragmatic approaches that may facilitate the correction of the debt overhang that troubles the world economy.

2. Assessments of the international debt situation have gone through cycles of optimism and pessimism in recent years while the problem grew in size and complexity. The atmosphere of crisis created in August 1982 by the inability of Mexico to fulfil its debt-servicing obligations was followed in 1983-1984 by frequent expressions of confidence that the problem was at least manageable. The economic recovery in the industrial economies and world trade in 1983 led to predictions that growth in the developing countries would pick up and the expansion of their exports would be sufficiently large to contribute significantly to the solution of the debt problem of the latter countries. 1/ The sharp deceleration of the growth of world output and trade in 1985 quickly reversed this perception. The Baker initiative, 2/ announced in the autumn of that year, generated some cautious optimism. It soon came to be regarded as inadequate, however, and by the beginning of 1987, amidst slow growth in the world economy and international trade, falling commodity prices and the reluctance of commercial banks to respond, there was a widespread feeling that the initiative had failed to swing the situation into a growth mode. After half a decade of difficult adjustment in their economies, many developing countries are now showing unmistakable signs of debt fatigue and the Organisation of Economic Co-operation and Development (OECD) and creditor countries find it necessary to "decompress" the situation by reducing the debt burden. 3/ There are also indications that bank creditors are beginning to change their posture after realistic assessments of the difficulty of the debtors in servicing their debts in the near future.

3. The crisis has been high on the agenda of all relevant international forums. In resolution 41/202 of 8 December 1986, the General Assembly examined the major elements of an approach to the problem of external debt of the developing countries and invited "all those involved to take them into account in addressing the problems of external indebtedness of developing countries, with a view to reaching equitable, durable and mutually agreed solutions". It also requested the Secretary-General to submit to the General Assembly at its forty-second session an updated version of his report on the international debt situation (A/41/643). The present report has been prepared in response to that resolution.

4. Chapter IV of the World Economic Survey 1987 discussed at length the foreign debt crisis of the developing countries in the overall context of international finance and balance of payments. 4/ The present report complements and updates that analysis. Chapter II presents a brief assessment of the magnitude and nature of the problem in mid-1987. Chapter III discusses the major parameters that have influenced the evolution of the debt situation since the beginning of the crisis.

Using projections of some of these parameters, chapter IV assesses the likely evolution of the debt situation in the coming years. Chapter V discusses recent debt renegotiations and initiatives for the resolution of the problem. Policy conclusions are presented in Chapter VI.

## II. THE INTERNATIONAL DEBT SITUATION IN MID-1987

5. The size of the external debt of the developing countries continues to increase and is estimated at around $1,020 billion for 1987 (table 1). Around $700 billion of this debt is owed to private creditors, mostly banks, and somewhat over $300 billion to official creditors, including international financial institutions. Total debt amounted to twice the export earnings of the capital-importing developing countries at the end of 1986. Despite the debt rescheduling already undertaken, these countries were, at the beginning of 1987, scheduled to repay close to $150 billion of their outstanding debt during 1987-1988. The total estimated debt-service payments on the long-term debt of countries covered by the World Bank's Debtor Reporting System amounted to just over $100 billion in 1986. These debt-service payments were equivalent to 24 per cent of the exports of the capital-importing developing countries. Interest payments alone amounted to 12 per cent of export earnings of these countries in 1986 and preliminary estimates indicate only a slightly lower figure for 1987 (table 2).

Table 1. External debt of the developing countries: major dimensions (1982-1987)

(Billions of US dollars)

| | 1982 | 1983 | 1984 | 1985 | 1986 a/ | 1987 b/ |
|---|---|---|---|---|---|---|
| Total debt of developing countries | 778 | 841 | 880 | 939 | 979 | 1 022 |
| Long-term | 576 | 659 | 703 | 763 | 807 | 847 |
| Official | 184 | 202 | 219 | 251 | 271 | 289 |
| Private | 392 | 457 | 484 | 512 | 536 | 558 |
| Short-term | 182 | 152 | 144 | 139 | 133 | 138 |
| Use of IMF credit | 20 | 30 | 33 | 37 | 39 | 37 |

Sources: Department of International Economic and Social Affairs, United Nations, based on World Bank World Debt Tables, 1986-1987 edition; IMF, World Economic Outlook, April 1987; and United Nations, World Economic Survey 1987.

a/ Preliminary.

b/ Projection.

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Table 2. Key debt ratios of developing countries a/

| | 1982 | 1983 | 1984 | 1985 | 1986 b/ | 1987 c/ |
|---|---|---|---|---|---|---|
| **Debt/export ratios** | | | | | | |
| Capital-importing developing countries | 156 | 164 | 158 | 171 | 183 | 183 |
| Fifteen heavily indebted countries | 270 | 290 | 272 | 284 | 338 | 350 |
| Countries heavily dependent on official borrowing | 218 | 242 | 259 | 292 | 329 | 345 |
| Sub-Saharan Africa | 214 | 227 | 223 | 257 | 282 | 294 |
| **Debt-service/export ratios** | | | | | | |
| Capital-importing developing countries | 25.4 | 23.4 | 23.7 | 23.9 | 24.7 | 22.6 |
| Fifteen heavily indebted countries | 49.4 | 42.5 | 41.1 | 38.7 | 43.9 | 40.7 |
| Countries heavily dependent on official borrowing | 17.4 | 20.1 | 23.6 | 25.2 | 32.7 | 36.6 |
| Sub-Saharan Africa | 21.9 | 23.6 | 25.3 | 25.1 | 30.4 | 31.4 |
| **Interest service/export ratios** | | | | | | |
| Capital-importing developing countries | 14.6 | 14.0 | 13.8 | 13.3 | 12.4 | 11.0 |
| Fifteen heavily indebted countries | 30.8 | 30.0 | 28.8 | 26.8 | 27.3 | 24.9 |
| Countries heavily dependent on official borrowing | 8.8 | 9.3 | 10.8 | 10.9 | 11.0 | 11.8 |
| Sub-Saharan Africa | 10.9 | 11.1 | 11.7 | 11.3 | 11.3 | 12.5 |

Source: IMF, *World Economic Outlook*, April 1987.

a/ IMF definition, which includes in capital-importing countries Greece, Portugal, South Africa, European member countries with centrally planned economies and China.

b/ Preliminary.

c/ IMF projection.

6. The growth of external debt of the developing countries has slowed down perceptibly in the last few years, as new financing has dried up. In 1986 the outstanding debt increased by about 4 per cent, but the bulk of the increase was due to the sharp depreciation of the dollar against other major currencies in which part of the debt is denominated. The real rate of increase is probably of the order of 1 per cent. Over the period 1982-1986 the rate of growth of debt in dollar terms was around 6 per cent. This is in sharp contrast to the 1970s, when it increased by around 20 per cent per year, as borrowers found borrowing easy and relatively inexpensive and the banks eagerly sought to lend.

7. The slow-down of the growth of debt did not prevent a further deterioration of the major debt indicators as the debt-servicing capacity of the developing countries also declined, largely as a result of falling commodity prices. Table 2 shows some key indicators of the debt situation. The debt/export ratio of the capital-importing developing countries increased from 171 per cent in 1985 to 183 per cent in 1986, a level expected to be maintained in 1987. The corresponding debt-service/export ratio increased from around 24 per cent to 25 per cent and is expected to decline to 23 per cent in 1987.

8. The debt situation of a large number of countries is far more critical than the overall picture suggests. The debt/export ratio of the 15 heavily indebted countries increased from 284 per cent in 1985 to 338 per cent in 1986 and is expected to reach 350 by the end of the current year. For countries depending primarily on official borrowing, that is, mainly low-income countries that include much of sub-Saharan Africa, the ratio increased from 292 per cent in 1985 to 329 per cent in 1986 and to an estimated 345 per cent in 1987.

9. The debt-service burden of the heavily indebted countries remains very high. Despite the reduction in interest rates, it increased in 1986, when their debt-service cost amounted to 44 per cent of their exports, more than half of which was accounted for by interest payments. For countries largely dependent on official finance, the debt-service ratio increased persistently during the 1980s, reaching 33 per cent in 1986, and it is estimated that it will increase to 37 per cent in 1987, as the fall in the rate of interest had little immediate impact. With stagnant or falling incomes in many of these countries, their debt/GDP ratio also increased sharply during the 1980s, and reached 67 per cent in 1986, the highest for any country group.

10. The growing burden of external debt of a large number of developing countries points to the inadequacy of the current international strategy to resolve the problem. The present strategy, as understood from action taken so far and pronouncements made, is based on a number of elements:

(a) Growth in world output and trade would enable developing countries to grow out of their debts by increasing exports;

(b) Debtors would continue to honour their debt-servicing obligations, debt relief would be applied selectively, and debt rescheduling would be undertaken on a case-by-case basis, as debtor countries undertook necessary adjustments;

(c) Additional finance would be forthcoming to support the necessary adjustment efforts.

11. The dissatisfaction with the strategy is due largely to the fact that some of these basic premises have not been realized. The growth of world output and trade has not picked up; the crucial need for adequate new finance has not been met; and in fact, there has been a large net outflow of financial resources from the developing countries.

12. The premise that debts should be honoured in full has come to be questioned both in the market place and in unilateral action by some debtors in recent months. For more than a dozen large debtors, the financial markets now price debt instruments far below their face value. In the secondary markets for these assets, developing country debts are being priced at an average discount of around 40 per cent. Major creditor banks have recently increased their loan loss reserves against developing country debt in recognition of this assessment of the markets. Furthermore, Brazil, the largest debtor country, has suspended interest payments on bank debt as well as, more recently, repayment of principal on some of its official debt. Peru has been pursuing its declared policy of limiting its total debt-service payments to a fixed percentage of its total exports. In a number of instances, IMF-sponsored adjustment programmes have been suspended by debtor countries.

## III. CRITICAL PARAMETERS OF THE DEBT SITUATION

### Growth of world output and trade

13. One of the factors on which hopes for an early solution of the debt problem were pinned in the mid-1980s was a recovery of growth in the industrial countries. 5/ The actual rate of growth turned out to be less than adequate to make a significant impact on the debt problem (see table 3). The 4.7 per cent growth of the developed market economies in 1984, which generated some growth optimism, dwindled to an average of only 2.7 per cent during 1985-1986 and 1987 does not hold out a better prospect. The growth of world output declined from 4.5 per cent in 1984 to an average of 3.2 per cent during 1985-1986.

14. The deceleration of growth of world trade during the 1980s has been even more marked than the growth of world output. After its 9 per cent recovery in 1984, the volume of world trade grew by only 3.4 per cent during 1985-1986. Present indications are that it may not grow by more than 3 per cent in 1987.

Table 3. Growth of world output and trade, 1971-1987

(Annual percentage change)

| | Average 1971-1980 | Average 1981-1986 | 1984 | 1985 | 1986 a/ | 1987 b/ |
|---|---|---|---|---|---|---|
| Growth of output | | | | | | |
| World | 3.9 | 2.7 | 4.5 | 3.4 | 3.0 | 3.2 |
| Developed market economies | 3.1 | 2.2 | 4.7 | 2.9 | 2.4 | 2.6 |
| Developing countries | 5.6 | 1.5 | 2.2 | 2.0 | 2.5 | 2.7 |
| Energy exporters | 6.0 | -0.3 | 0.0 | 0.0 | -1.6 | 0.5 |
| Energy importers | 5.0 | 2.8 | 3.8 | 3.4 | 5.5 | 4.3 |
| Centrally planned economies of Europe | 5.2 | 3.3 | 3.8 | 3.6 | 4.3 | 4.1 |
| China | 5.7 | 8.8 | 12.0 | 12.3 | 7.0 | 7.0 |
| World trade volume | 5.0 | 2.7 | 8.9 | 3.2 | 3.5 | 3.0 |

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

a/ Preliminary estimate.

b/ Projection.

## Commodity prices

15. One of the factors that have contributed to the debt crisis in many countries is the sharp decline in commodity prices during the 1980s. About 70 per cent of the total debt of the developing countries is owed by countries whose exports of primary commodities account for 50 per cent or more of their total exports. In the case of countries of sub-Saharan Africa, primary products account for over 90 per cent of total exports. Oil is practically the only export of a number of debtor countries. Even some of the more advanced of the highly indebted countries with a fairly diversified economy still depend on primary exports for a large proportion of their foreign exchange earnings.

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16. The beginning of the downturn of oil prices coincided with the beginning of the debt crisis in 1982. Prices plunged by 45 per cent in 1986 and by mid-1987 were still about 20 per cent lower than in 1985. The slowing down of growth in industrial countries, declining demand and high rates of interest contributed to a sharp fall of non-fuel commodity prices in the 1980s. The average dollar prices of these commodities fell sharply at the beginning of the 1980s and in 1986 remained 20 per cent below their 1979-1981 levels (see table 4). The fall in Special Drawing Right (SDR) terms has been even steeper. Furthermore, the fall in commodity prices was accompanied by an increase in the dollar prices of manufactures. In 1986, prices of non-fuel commodities in terms of prices of manufactures were 25 per cent below their 1979-1981 levels and declined further in the first half of 1987. These movements in prices meant a very large terms-of-trade loss for the developing countries, estimated at around $94 billion for the year, in their trade with the developed market economies. 6/ A part of this loss has been reversed in 1987 as oil prices increased. Some non-fuel commodity prices have shown a significant upturn in recent months but the prospects for the near future, in general, continue to be dim.

Table 4. Commodity prices 1982-1987

(1979-1981 = 100)

| | Combined index of non-fuel commodity prices (in US dollars) | (in SDR) | Prices of manufactures a/ | Real prices of commodities b/ | Oil prices (dollars per barrel) c/ |
|---|---|---|---|---|---|
| 1982 | 78 | 89 | 97 | 80 | 34.00 |
| 1983 | 83 | 98 | 93 | 89 | 29.50 |
| 1984 | 84 | 103 | 91 | 92 | 29.00 |
| 1985 | 75 | 93 | 91 | 82 | 25.40 |
| 1986 | 79 | 85 | 110 | 72 | 13.72 |
| 1987 (Jan.-June) | 73 | 72 | 122 | 60 | 17.52 |

Sources: Department of International Economic and Social Affairs, United Nations, based on UNCTAD, Monthly Commodity Price Bulletin, and United Nations, Monthly Bulletin of Statistics, September 1987; Petroleum Intelligence Weekly, and OPEC Annual Statistical Bulletin.

a/ Dollar prices of manufactures exported by developed market economies.

b/ Index of dollar prices deflated by the index of prices of manufactures.

c/ Price per barrel of Arabian Light. Prices are official prices except for 1985 and 1986, which are estimated netback values. Figure for 1987 is a rough estimate, based on netback value for January and official prices for the other months.

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Interest rates

17. Low or negative real rates of interest spurred international borrowing in the 1970s; their sharp increase during the 1980s greatly contributed to the worsening of the problem of debt, much of which was contracted at floating rates. The United States prime rate and the LIBOR (London Interbank Offer Rate), the two major rates to which interest charged on loans to developing countries are linked began to rise in the late 1970s and reached a peak in 1981. The rates had declined significantly by 1986 but have been edging up in recent months. Reduction of debt burden over time depends, ceteris paribus, on the rate of interest remaining below the rate of growth of exports of the debtor country. For most debtor countries during the 1980s the opposite was the case.

18. The amount of interest payments made by a debtor country depends both on the volume of outstanding debt and the rate of interest charged on the debt. As the debt of the developing countries accumulated rapidly during the 1970s, so did the interest payments, but the increase in the rate of interest itself had a large influence in swelling the amount of interest payments. According to one estimate, additional interest payments due to increase in the rate of interest alone amounted to around 1.4 per cent of the GDP of the major Latin American debtor countries between 1979 and 1983 when nominal interest rates were at their highest. 7/

19. While the nominal rates of interest have fallen significantly since 1982-1983, the external debt burden of developing countries is more affected by the real rate of interest. The real rate, measured by deflating the nominal rate by either the GDP deflator of the developed market economies or, as a measure of the real interest burden of the debtor developing countries, deflated by changes in prices of primary commodities exported by them, was much higher during the first half of the 1980s than in the second half of the 1970s (table 5). It was only in 1986 that there was a significant reduction of the real rate for the energy-importing developing countries. As the table also shows, the real rates for the developing countries were also much higher than for the developed market economies over the 1980s.

20. The rise in nominal interest rates directly increased the interest costs of private borrowings. It also raised the average interest charged on official loans as official lenders sought to cover the increased cost of loanable funds. While interest rates paid on outstanding private loans have tended to fall in the past two years, actual average rates paid by developing countries on non-concessional official debt increased in 1986 (table 6).

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Table 5. Nominal and real rates of interest, 1975-1987

| | Nominal rate of interest | | Price deflator | | Real rate of interest e/ | | | |
|---|---|---|---|---|---|---|---|---|
| | LIBOR a/ | United States prime rate b/ | GDP of developed market economies c/ (1) | Non-fuel commodities exported by developing countries d/ (2) | LIBOR adjusted by (1) | LIBOR adjusted by (2) | United States prime rate adjusted by (1) | United States prime rate adjusted by (2) |
| | Percentage | | Percentage change | | Percentage | | | |
| 1975 | 7.8 | 7.9 | 11.1 | -19.0 | -3.0 | 32.9 | -2.9 | 33.1 |
| 1976 | 6.1 | 6.8 | 7.3 | 14.1 | -1.1 | -7.0 | -0.5 | -6.3 |
| 1977 | 6.3 | 6.8 | 7.2 | 26.0 | -0.8 | -15.7 | -0.4 | -15.2 |
| 1978 | 9.1 | 9.1 | 7.4 | -7.6 | 1.6 | 18.1 | 1.5 | 18.0 |
| 1979 | 11.9 | 12.7 | 8.0 | 14.1 | 3.6 | -1.9 | 4.3 | -1.3 |
| 1980 | 14.0 | 15.3 | 9.3 | 13.4 | 4.3 | 0.6 | 5.5 | 1.7 |
| 1981 | 16.7 | 18.9 | 8.9 | -15.5 | 7.2 | 38.0 | 9.2 | 40.6 |
| 1982 | 13.6 | 14.9 | 7.2 | -15.1 | 6.0 | 33.7 | 7.1 | 35.2 |
| 1983 | 9.9 | 10.8 | 5.3 | 5.1 | 4.4 | 4.6 | 5.2 | 5.5 |
| 1984 | 11.3 | 12.0 | 4.6 | 1.2 | 6.4 | 10.0 | 7.1 | 10.7 |
| 1985 | 8.6 | 9.9 | 4.3 | -10.7 | 4.1 | 21.7 | 5.6 | 23.1 |
| 1986 | 6.9 | [illegible] | 3.8 | 5.3 | 3.1 | 1.6 | 4.6 | 3.1 |
| 1987 f/ | 6.9 | 7.8 | 3.3 | -7.6 | 3.5 | 15.7 | 4.4 | 16.7 |

Source: Department of International Economic and Social Affairs, United Nations, based on IMF, International Financial Statistics, UNCTAD, Monthly Commodity Price Bulletin, and other official national and international sources.

a/ Six-month London interbank offered rate on United States dollar deposits.

b/ Interest rate that the largest United States banks charge their most creditworthy business customers on short-term loans.

c/ Implicit price deflator of aggregate GDP of developed market economies.

d/ UNCTAD index of dollar prices of non-fuel commodities exporter by developing countries.

e/ One plus nominal rate of interest divided by one plus rate of change in the specified price deflator.

f/ Figures for 1987 are averages of the first six months for LIBOR and first six months for the United States prime rate.

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Table 6. Average nominal interest rates paid by developing countries by type of debt and creditor, 1980-1986 a/

(Percentage)

| | 1980 | 1982 | 1983 | 1984 | 1985 | 1986 b/ |
|---|---|---|---|---|---|---|
| Concessional debt | | | | | | |
| Bilateral official | 2.3 | 2.1 | 2.0 | 1.9 | 2.1 | 2.7 |
| Multilateral loans | 1.9 | 1.5 | 1.3 | 1.3 | 1.3 | 1.5 |
| Non-concessional debt | | | | | | |
| Bilateral official | 6.8 | 8.1 | 7.3 | 7.0 | 7.4 | 9.0 |
| Multilateral loans c/ | 9.6 | 8.3 | 8.4 | 8.4 | 8.4 | 10.0 |
| Private debt | | | | | | |
| Bonds | 7.5 | 8.0 | 7.6 | 7.4 | 7.6 | 7.5 |
| Floating rate bank debt | 15.5 | 17.1 | 12.2 | 12.1 | 10.5 | 8.5 |
| Short-term bank debt | 12.0 | 12.5 | 10.0 | 10.5 | 8.2 | 6.9 |

Sources: For private debt, OECD, Financing and External Debt of Developing Countries, 1985 Survey (Paris, 1986) and information by OECD; for official debt, Department of International Economic and Social Affairs, United Nations, based on data of the World Bank Debtor Reporting System.

a/ Dollar value of annual interest payments and other charges (including spreads and fees on floating rate debt) as a percentage of disbursed and outstanding debt at the beginning of the year.

b/ Estimates (official debt is based on scheduled payments as at end-December 1985 at end-1985 exchange rates).

c/ Excludes use of IMF credit.

## Adjustment in developing countries

21. Changes in economic structure are an essential feature of the economic growth process itself. For a large number of developing countries, however, adjustment during the 1980s, imposed on them by the problem of debt, the slow growth of the world economy and, in a number of cases, natural disasters, has meant a large reduction in expenditure on consumption or investment or both. It has meant slow growth or, in many cases, a large decline in living standards. The attendant social cost has been very large.

22. One measure of the adjustment that has taken place is the changes in their external balance, which have been very large during the 1980s. The trade deficit of the energy importing developing countries shrank from $58 billion in 1980 to $8 billion in 1986. For the heavily indebted countries, the change was even more marked. The $8 billion deficit of the 15 heavily indebted countries in 1980 turned into a surplus of around $40 billion in 1985 and $23 billion in 1986. These changes in trade balance were the result of a large compression of imports as well as a significant expansion of exports. Imports of the energy importing developing countries increased at an annual rate of barely 1.8 per cent during 1980-1986, compared with 4 per cent during the second half of the 1970s, while their export volume increased at 7.6 per cent. Despite this increase in export volume, export revenue did not increase significantly. The difference between changes in imports and exports was even sharper among the heavily indebted countries (table 7).

23. Imports can be temporarily cushioned from a decline in export earnings by drawing down foreign exchange reserves or by borrowing, but reserves were not nearly large enough to meet a crisis of the present magnitude. The capital-importing developing countries' foreign exchange reserves amounted to $109 billion in 1980, or enough to cover only 2.7 months' current expenditure. This was drawn down by more than 25 per cent by 1982. Their reserve position improved somewhat by 1985 but in the first quarter of 1987 it was not much higher than at the beginning of the crisis.

24. Reduction of imports and increase in exports are the means by which expenditure is reduced in debtor countries and a surplus generated to meet increased debt-service payments. However, this surplus is, in many countries, associated with a declining income. In fact, compression of imports itself often contributes to the decline in income.

25. For the developing countries as a whole, GDP per capita declined at an annual rate of 1.1 per cent during 1981-1985. In Latin America, which includes some of the most heavily indebted countries, per capita GDP in 1985 was almost 10 per cent below its 1980 level. In Africa it declined by around 18 per cent over the same period and by another 5 per cent in 1986. The social impact of this decline has been serious. The distribution of income was adversely affected as real wages fell more than per capita income. 8/ Expenditures on health and education were sharply curtailed in many countries, unemployment rose and the economic condition of many vulnerable social groups deteriorated further. 9/

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Table 7. Growth of exports and imports of developing countries, 1982-1987

(Percentage)

| | 1982 | 1983 | 1984 | 1985 | 1986 a/ | 1987 b/ |
|---|---|---|---|---|---|---|
| Volume of exports | | | | | | |
| All developing countries | -6.1 | -0.6 | 3.3 | -0.5 | 8.3 | 2.0 |
| Capital importing developing countries | 1.7 | 5.6 | 7.6 | 2.5 | 5.8 | 3.4 |
| Net energy exporters | -3.9 | 3.4 | 3.5 | -4.1 | 4.5 | 2.0 |
| Net energy importers | 5.4 | 6.9 | 10.0 | 6.1 | 6.5 | 4.1 |
| Fifteen heavily indebted countries | -5.1 | 6.4 | 9.6 | 1.8 | -6.5 | -1.3 |
| Sub-Saharan Africa | 2.8 | 0.7 | 6.2 | 1.6 | 8.2 | 5.3 |
| Volume of imports | | | | | | |
| All developing countries | -1.0 | -3.0 | 0.8 | -5.0 | -7.2 | 0.0 |
| Capital importing developing countries | -4.0 | -2.9 | 4.0 | -2.0 | -4.4 | 2.5 |
| Net energy exporters | -4.3 | -10.9 | -0.7 | -6.2 | -21.0 | -9.0 |
| Net energy importers | -3.8 | 1.1 | 6.0 | -0.2 | 2.0 | 5.9 |
| Fifteen heavily indebted countries | -10.2 | -16.2 | -2.1 | -2.4 | -20.3 | -9.1 |
| Sub-Saharan Africa | -4.2 | -8.0 | -2.4 | -0.3 | 3.0 | 2.4 |

Sources: Department of Economic and Social Affairs, United Nations, and IMF, World Economic Outlook, April 1987.

a/ Estimates.

b/ Projections.

Flow of external finance

26. An outflow of resources is eventually called for if expenditure for investment or consumption has been financed from an inflow of foreign resources at an earlier period. What makes the current situation an extraordinary one is, in the first place, the sudden and sharp reversal of the trend, and secondly the fact that it is premature for most developing countries to start repaying their debt at this time and to be crowded out by the borrowing of large developed countries. The capital importing developing countries as a group have actually had a negative transfer of financial resources since 1984. Their negative cash flow was $24 billion in 1986, in sharp contrast to a positive inflow of $40 billion in 1980. For the 15 heavily indebted countries, the negative transfer has been even larger. 10/

27. Official finance is today the only net source of external finance for developing countries, as banks are reducing their exposure and taking more money out than they lend, but it has slowed to a virtual standstill during the 1980s. Over the period 1980-1985, it increased at a rate of barely 1.5 per cent in current dollars. Official development assistance from the countries of the Development Assistance Committee (DAC) increased in real terms by around 3 per cent over the period. Financing by the countries of the Organization of Petroleum Exporting Countries (OPEC) declined sharply in the wake of falling oil prices.

28. In 1986, official financial flows to developing countries increased by 16 per cent. This increase was, however, due largely to the depreciation of the dollar against other major currencies. In 1985 dollars and prices, official financial flows actually declined (table 8). The financial situation of many African countries remains critical and has been under intensive international examination. It is currently being studied by the Advisory Group on Financial Flows to Africa recently constituted by the Secretary-General. There was a significant increase measured in dollars in the net flow of official finance to sub-Saharan Africa and the least developed countries in 1986. In real terms, however, the increase was extremely modest and, as the President of the World Bank recently stated, the reforms in IDA-eligible countries with adjustment programmes "will fall far short of their objectives if major increases in medium-term financing are not forthcoming". 11/

29. Present indications are that official flows are unlikely to increase significantly in the near future in the absence of some determined international effort. Much depends on efforts to increase the resources of international lending institutions, particularly the World Bank and the regional development banks.

30. Official development finance is especially needed by the low-income developing countries with little access to capital markets, but the profound changes in the volume and composition of financial intermediation that have taken place in the 1980s have increased its importance for other developing countries as well. The share of official finance in the total financial flow to developing countries increased from about 36 per cent in 1980 to 67 per cent in 1986. It now has a critical role to play not only in financing the bulk of the needs of the low-income countries but also in supplementing the resources of more advanced developing countries and restoring their creditworthiness through investment in production of tradable goods.

Table 8. Net capital flow to developing countries, 1980-1986 a/

(Billions of current United States dollars)

| | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|
| 1. Official development finance | 45.6 | 46.5 | 44.9 | 42.3 | 47.5 | 49.0 | 56.6 |
| ODA | 37.6 | 37.3 | 34.1 | 33.4 | 34.9 | 37.1 | 44.1 |
| Bilateral | 29.8 | 29.4 | 26.7 | 25.9 | 27.1 | 28.6 | 34.6 |
| Multilateral | 7.8 | 7.9 | 7.5 | 7.6 | 7.8 | 8.5 | 9.5 |
| Other | 8.0 | 9.2 | 10.8 | 8.6 | 12.7 | 11.9 | 12.5 |
| 2. Export credit | 16.9 | 18.4 | 14.6 | 8.3 | 5.4 | 2.9 | 2.0 |
| 3. Private flows | 66.0 | 74.3 | 58.3 | 47.4 | 33.1 | 30.4 | 26.0 |
| Bank lending | 49.0 | 52.0 | 37.6 | 34.1 | 17.4 | 13.5 | 5.0 |
| Direct investment | 11.2 | 17.1 | 12.7 | 9.3 | 11.5 | 7.5 | 11.0 |
| 4. Total capital flow (1 +2 +3) | 128.4 | 139.1 | 117.8 | 97.7 | 86.1 | 82.3 | 84.7 |
| Least developed countries | 10.2 | 8.9 | 9.3 | 8.8 | 8.9 | 10.6 | 12.8 |
| Sub-Saharan Africa | 16.4 | 17.3 | 17.4 | 14.8 | 13.2 | 16.5 | 18.7 |
| Latin America | 55.9 | 64.3 | 49.9 | 26.6 | 27.0 | 19.0 | 17.2 |
| 5. Total capital flow at 1985 prices and exchange rates | 119.5 | 134.3 | 116.2 | 96.7 | 87.0 | 82.3 | 69.7 |
| Official development finance | 42.4 | 44.9 | 44.3 | 41.9 | 48.0 | 49.0 | 46.8 |
| ODA | 35.0 | 36.0 | 33.6 | 33.1 | 35.3 | 37.1 | 36.6 |
| Memo item: IMF lending to capital-importing developing countries b/ | 3.4 | 5.7 | 5.7 | 11.1 | 4.2 | 0.2 | -2.7 |

Sources: OECD, Financing and External Debt of Developing Countries, 1986 Survey, Paris, 1987; IMF, International Financial Statistics and IMF Survey, various issues.

a/ Flows are net of amortization but do not take into account interest payments and capital flight.

b/ Includes IMF Trust Fund.

31. Private flows from all sources to the developing countries declined from $66 billion in 1980 to $26 billion in 1986, and its share in total flows from 52 per cent to 30 per cent. Export credit virtually disappeared.

32. The flow of direct foreign investment has remained practically constant over the years. It declined to $7.5 billion in 1985 from $11.5 in 1984 and recovered to $11.0 in 1986, which is close to the average for the 1980s. Much optimism has recently been expressed about debt-equity swaps, but for most debtor countries the prospects of a substantial increase in foreign investment through that mechanism do not appear bright.

33. The volume of bank loans, the largest component of private flows, has declined precipitously and by 1986 it had completely dried up. Central to this issue is the question of creditworthiness raised by the debt problem itself. In the perception of the banks, several debtors have lost creditworthiness. New lending by banks reporting to the Bank for International Settlements to non-OPEC developing countries fell from around $40 billion in 1980 to $20 billion in 1982 and was practically nil by 1985 (table 9). Net lending in 1986 was actually a negative $3.8 billion if the Chinese province of Taiwan is excluded. The sharp fall in 1986, after a pause in 1985, is particularly disturbing and reflects difficulties in working out credit packages between the banks and debtor countries. A rebound in concerted bank lending is, however, expected in 1987. 12/

Table 9. New lending by BIS reporting banks, 1980-1986 a/

(Billions of United States dollars)

| Lending to: | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 |
|---|---|---|---|---|---|---|---|
| Developing countries | 45.9 | 44.1 | 28.0 | 22.4 | 7.9 | 11.3 | -0.1 (-4.0) b/ |
| OPEC countries | 7.0 | 4.2 | 8.2 | 9.8 | -1.9 | 0.2 | -0.2 |
| Others | 38.9 | 39.9 | 19.8 | 12.6 | 9.8 | 11.1 | 0.1 (-3.8) b/ |

Source: Bank for International Settlements, Fifty-seventh Annual Report, Basle, 1987.

a/ New lending calculated from changes in claims or assets.

b/ Excludes the Taiwan province of China.

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## IV. DEBT PROFILES AND THE DEBT-SERVICE BURDEN IN THE SECOND HALF OF THE 1980s

34. In the 1960s and early 1970s a rule of thumb for sound balance-of-payments management in developing countries was that debt service (amortization plus interest) should not exceed 15-20 per cent of export (goods and services) earnings. 13/ Like other indices of indebtedness - such as debt over exports or debt over GDP - the debt service ratio is not a complete indicator of the vulnerability of a debtor country to the volatility of export earnings and the cost and availability of foreign borrowings. However, it does convey a rough idea of the burden of external debt. The first oil shock in 1973 and the recession in 1975 pushed a large number of energy-importing developing country borrowers beyond old benchmarks. At first, this was considered a temporary expedient. However, the gradual internationalization of capital markets, the pressure for recycling and the expectation of creditors and borrowers that the rapid growth of international trade in the previous two decades would be repeated in the 1980s, led many developing countries - including several oil exporters - to continue to raise debt levels with the concurrence of their creditors. In Latin America already in 1980 interest payments alone reached 17 per cent of exports of goods and services.

35. The increase in interest rates (see table 5), the global recession of 1982, the considerable slow-down of international trade, and decline in primary commodity prices (see table 4) thus found indebted developing countries heavily exposed. 14/ Despite adjustment efforts started in 1982 or 1983 and an increase in the volume of exports well above that of imports, by 1986 debt-service ratios were higher than ever. Interest alone reached 28 per cent of export earnings in Latin America; in sub-Saharan Africa it moved from 7 per cent in 1980 to about 12 per cent.

36. While there are many different criteria to assess the debt-service burden, virtually all analysts agree that present levels of debt service are excessive, constrain growth in the world economy, make balance-of-payments management particularly difficult and add to global financial instability. Thus the analysis of probable changes in debt-service burdens in the coming years is particularly important. If, under current policies, debt-service burdens could be expected to recede rapidly, the debt strategy would need only marginal adjustments. However, if the prospects are that they will remain high, or even grow, intensifying the "fatigue" of debtors and creditors, this would indicate that much more than marginal changes in the debt strategy was required. What follows is an assessment of the likely evolution of debt service burdens under current policies. It is based on the recently published projections prepared by IMF and the World Bank, and on United Nations calculations based on Project LINK's medium-term baseline projections. 15/

### The driving forces behind changes in debt profiles

37. The dynamics of the external debt of the developing countries is linked to the evolution of their current account position (balance on goods and services trade) and its financing requirements. The premises behind the projections are the following. The international economic environment, which substantially affects the current account balance of the developing countries, is itself, to a large extent,

determined by the economic performance and macro-economic policies of a few large industrial countries. The rate of growth of real GDP and rate of increase in prices in the industrial countries are the key determinants of the developing countries' export earnings and their purchasing power over imports. Average interest rates in the industrial countries determine to a large extent the cost of external borrowing for the developing countries as well as the level of interest service on their existing stock of foreign debt. Fluctuations in exchange rates among key industrial country currencies affect the foreign currency price of the developing countries' exports and the competitiveness of some exports in the various currency zones. Depending on the currency denomination of external debt, changes in exchange rates can significantly alter the burden of foreign debt in terms of local currency. Also, commercial policies in the industrial countries determine the degree of openness of their markets to exports from the developing countries.

38. On the other hand, domestic policies of debtor countries also critically affect the dynamics of their external debt position. Their macro-economic, commercial and exchange rate policies influence both the aggregate level of spending and its distribution between tradables and non-tradables and between foreign and domestically produced goods and services. In addition, structural transformation policies can facilitate the shifting of productive resources and expand the output of tradables while expenditures are diverted towards non-tradables. Thus debtor countries can affect their current account balance, and thereby their external debt position, by controlling imports and by strengthening their export sector and its competitiveness. Successful adjustment policies may also affect capital flows. They can arrest capital flight and assist in the repatriation of capital held abroad by nationals and help to restore creditworthiness.

39. A strong economic performance in the industrial countries would lead to improvement in both the terms of trade and the volume of exports of the developing countries. This, in turn, would lead to faster economic growth in the developing countries without deterioration in their current account balance. The capability of the developing countries to service their external debt would increase, and the rate of expansion of their external debt might decelerate or begin to decline. Lower interest rates would reinforce the favourable effects of a strong economic performance in the industrial countries upon the debt position of the developing countries.

40. A weak economic performance in the industrial countries, on the other hand, would lower demand for imports, weaken the terms of trade of the developing countries and the demand for their exports. This would result in slower economic growth in the developing countries and - if reserves or credit were available - some deterioration in their current account position. Thus, in this case, the developing countries' external debt and its servicing requirements would grow faster. If reserves were exhausted or external financing were unavailable, the developing countries would have to close the emerging deficits in their current accounts by cutting their imports, which in turn, would lead to a reduction in the rate of growth of output, 16/ a contraction in international trade and deflationary feedback to developed countries.

Debt projections

41. The medium- and long-term projections for the key global parameters are reported in table 10. The projections portray a weak international economic environment. The annual rate of growth in international trade is expected to be only about 4 per cent. As discussed in World Economic Survey 1987, the continuation of massive external payment imbalances among the large industrial countries and the induced adjustments in income and exchange rates in those economies are the main reasons why the rate of growth of output is only expected to be about 2.5 per cent per annum for the industrial country group. The main difference between the IMF and the United Nations projections stems from their different assumptions about the average level of international interest rates in the period 1986-1991. The assumed level of international interest rates in the IMF projections is significantly lower than in either the United Nations or the World Bank simulations (see table 10). 17/ 18/ The main consequence of this, as far as the debt projections are concerned, is to lower the level of annual interest payments for each existing stock of debt.

42. Apart from this, macro-economic policy assumptions for the large industrial countries are fairly similar for the medium-term baseline scenarios of IMF and the United Nations and the low-case scenario of the World Bank. 19/ The overall stance of fiscal policy in the major industrial countries is assumed to tighten gradually while their overall monetary policy is expected to become less accommodating as the favourable impact of the lower oil prices in 1986 fades away. In these baseline projections there is no anticipation of dramatic shifts in policies directed at rapidly correcting the existing payments imbalances of the United States, Japan and the Federal Republic of Germany.

43. The projections for the developing countries' key debt ratios and GDP growth rates are reported in table 11. The two debt indicators in the table are: (a) the ratio of debt-to-exports of goods and services; and (b) the ratio of interest payments-to-exports of goods and services for various country groups. There are certain important differences in the country coverage (within each country grouping) and in the types of debt covered that result in significant differences in the ratios at each point in time. Nevertheless, the profiles projected by IMF and the United Nations are very similar, particularly with regard to debt-to-export ratios. The United Nations projections, however, show significantly higher interest payments-to-export ratios. This stems mostly from the assumptions about international interest rates in the coming years. 20/

44. With regard to real GDP, all projections indicate an acceleration of growth compared to the first half of the 1980s. According to the United Nations projections of 3.8 per cent growth in 1986-1991, by 1991 per capita GDP of capital-importing developing countries will be only about 10 per cent above its 1980 level. When this figure is adjusted for terms of trade changes and changes in net factor income resulting from interest payments, the per capita income in this group of countries in 1991 will be below that of 1980. Much the same picture emerges from the projections of IMF and the World Bank once they are adjusted to include the same country coverage as that used by the United Nations Secretariat. They then indicate that by the early 1990s, capital-importing developing countries would not have restored the per capita income levels of 1980.

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Table 10. Medium- and long-term projections of key parameters of the world economy, 1986-1995

| | 1986-1988 | | 1989-1991 | | 1986-1995 |
|---|---|---|---|---|---|
| | United Nations a/ | International Monetary Fund b/ | United Nations a/ | International Monetary Fund b/ | World Bank c/ |
| | Average annual per cent change | | | | |
| Industrial countries | | | | | |
| Real GDP | 2.5 | 2.5 | 2.6 | 2.9 | 2.5 |
| Inflation d/ | 3.1 | 3.2 | 4.1 | 3.2 | 3.3 |
| World trade | | | | | |
| Value e/ | 10.5 | 10.2 | 9.5 | - | - |
| Volume | 3.5 | 4.2 | 4.0 | - | - |
| Price of oil e/ | -7.0 | -12.2 | 5.0 | 3.0 | - |
| Value of developing countries' exports e/ | 2.5 | 3.6 | 10.5 | 9.2 f/ | 7.5 |
| World finance | | | | | |
| Total external credit to developing countries e/ | - | 5.9 g/ | - | 3.8 g/ | 4.1 h/ |
| Total external debt outstanding e/ | 3.5 | 6.5 | 3.0 | 4.5 | 2.7 |
| Dollar exchange rate i/ | -8.3 | - | -1.0 | - | - |
| | Percentage | | | | |
| LIBOR j/ | - | 6.7 | - | 6.8 | (9.4) k/ |
| Prime interest rate (United States) | 8.4 | - | 9.4 | - | - |

Sources: Department of International Economic and Social Affairs, United Nations, based on Project LINK (April 1987 baseline projections); IMF, World Economic Outlook, April 1987; World Bank, World Development Report 1987, June 1987.

a/ Based on Project LINK's post-meeting baseline forecast prepared for the Secretariat (April 1987).

b/ World Economic Outlook, pp. 192-194.

c/ World Development Report 1987, pp. 24-35 (low-case scenario).

d/ GDP deflator.

e/ In dollar terms.

f/ Calculated from IMF's projections for rates of change in trade prices and export volume of capital-importing developing countries.

g/ Calculated from IMF's projections for official and private flows to the developing countries. Includes trade financing.

h/ Calculated from table 2.8 in World Development Report 1987, p. 28. Net official transfer plus net long-term official and private loans.

i/ Nominal effective dollar exchange rate, which is endogenously determined in the LINK system.

j/ London interbank offer rate on six-month dollar deposits.

k/ Interest rate reported for 1986-1995 for the low-case scenario in table 2.5 in World Development Report 1987.

Table 11. Medium- and long-term projections of debt indicators and GDP growth rate of developing countries, 1980-1995

| | Ratio to exports of goods and services a/ | | | | | | | | | | Average rate of growth of real GDP | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | External debt b/ | | | | | Interest payments c/ | | | | | | | | |
| | Actual | | Projection | | | Actual | | Projection | | | Actual | | Projection d/ | |
| | 1980 | 1986 | 1988 | 1991 | 1995 | 1980 | 1986 | 1988 | 1991 | 1995 | 1973-1980 | 1980-1985 | 1986-1991 | 1986-1995 |
| | Percentage | | | | | | | | | | Per cent change | | | |
| Capital-importing e/ | | | | | | | | | | | | | | |
| United Nations | [illegible] | 203.6 | 184.0 | 151.0 | - | 8.8 | 13.0 | 12.5 | 10.0 | - | 5.6 | 2.3 | 3.8 | - |
| IMF f/ | 113.5 | 182.8 | 174.0 | 147.0 | .. | 9.2 | 12.4 | 10.3 | 8.6 | .. | (5.5) g/ | 3.3 | 4.4 | .. |
| World Bank h/ | 89.8 | 144.5 | .. | .. | [illegible] | 7.0 | 10.6 | .. | .. | 7.2 | 5.4 | 3.5 | .. | 3.9 |
| Highly indebted countries i/ | | | | | | | | | | | | | | |
| United Nations j/ | 167.2 | 338.0 | 302.0 | 250.0 | - | 16.6 | 27.0 | 26.0 | 22.0 | - | 4.7 | 0.3 | 2.6 | - |
| IMF | 167.2 | 338.0 | 324.0 | .. | .. | 16.0 | 27.0 | 23.2 | .. | .. | (5.9) g/ | 1.0 | (3.7) k/ | .. |
| World Bank l/ | 125.2 | 268.0 | .. | .. | 146.0 | 12.1 | 23.0 | .. | .. | 13.5 | 5.4 | 0.2 | .. | 3.5 |
| Latin America | | | | | | | | | | | | | | |
| United Nations m/ | [illegible] | 353.0 | 331.0 | 290.0 | .. | 17.0 | 28.0 | 26.5 | 23.0 | - | 5.5 | 1.5 | 3.5 | - |
| IMF n/ | 184.0 | 355.0 | 342.0 | 282.0 | .. | 16.8 | 27.8 | 23.0 | 19.0 | .. | (5.7) g/ | 1.5 | 4.4 | .. |
| Sub-Saharan Africa | | | | | | | | | | | | | | |
| United Nations o/ | 146.0 | 284.0 | 300.0 | 330.0 | - | 7.0 | 11.5 | 12.0 | 13.0 | - | 2.8 | 1.5 | 3.0 | - |
| IMF o/ | 146.5 | 282.0 | 301.0 | .. | .. | 7.0 | 11.5 | 12.5 | .. | .. | 3.1 | 1.7 | (3.6) k/ | .. |
| World Bank p/ | 77.8 | 221.3 | .. | .. | 145.0 | 3.8 | 12.1 | .. | .. | 7.0 | 3.2 | 1.0 | .. | 3.2 |

Sources: Department of International Economic and Social Affairs, United Nations, based on Project LINK (April 1987 baseline projections); IMF, World Economic Outlook, April 1987; World Bank, World Development Report 1987, June 1987.

a/ Exports of goods and services in terms of United States dollars.

b/ Total external debt outstanding and disbursed in terms of United States dollars.

c/ Total interest payments due on external debt.

d/ United Nations projection is based on Project LINK baseline forecast prepared for the Secretariat; IMF projection is the medium-term scenario reported in World Economic Outlook, pp. 192-194; World Bank projection is the low-case scenario reported in World Development Report 1987, pp. 24-55.

e/ All developing countries excluding high-income oil exporters.

f/ Includes China, Greece, Hungary, Poland, Portugal, Romania and South Africa. Figures do not include IMF debt.

g/ 1968-1980.

h/ Includes China, but excludes South Africa. Figures include only long-term debt.

i/ Fifteen highly indebted countries in the Baker Plan. (Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia).

j/ United Nations projections, excluding Côte d'Ivoire, Morocco and Yugoslavia.

k/ 1986-1988.

l/ Includes Costa Rica and Jamaica.

m/ Excludes Caribbean.

n/ Western hemisphere.

o/ Excludes Nigeria.

p/ Includes Nigeria.

Debt profiles: main findings

45. In all three projections the debt-to-export ratio decreases but in 1991 it is still above that of 1980. For Latin America it is 50 per cent higher and for sub-Saharan Africa more than twice the 1980 figure. In both groups of countries the debt-to-export ratio would be of the order of 300 per cent by 1991. The decrease in the debt-to-export ratio is accompanied by a corresponding reduction in debt-service burdens. For capital-importing developing countries as a group, the ratio of interest payments-to-exports by 1991 should become similar to that of 1980. However, for heavily indebted countries and for Latin America, the reduction in the ratio of interest payments-to-exports would be insufficient to remedy their difficulties. For sub-Saharan Africa, the ratio actually increases.

46. The projections by the United Nations and IMF indicate that by the early 1990s Latin America would still be paying abroad about 20 per cent of its total exports of goods and services in interest. Negative financial transfers - net interest and dividend payments exceeding net capital inflows - would continue from many of these countries. 21/ Present conditions are already characterized by low reserve levels, deep import cuts and depressed investment levels. The projections seem to imply an unsustainable situation. In sub-Saharan Africa, interest payments in relation to exports, although lower than in Latin America, would increase and reach a ratio of 13 per cent by 1991. The implications of this for a region whose terms of trade are unlikely to improve and whose net investment is hardly positive 22/ also point to an unsustainable situation.

47. The question of unsustainability can be seen in terms of the aggravation of social conflicts. It can have domestic political repercussions when there is a protracted period of mostly contractionary adjustment with stagnant or falling income. It can also be seen in terms of likely reactions to even small shocks when an economy is in a highly vulnerable external position. A further deterioration of export prices or other shocks could lead to a suspension of payments as recently done by Brazil, Côte d'Ivoire, Ecuador and Zambia.

48. While the question of unsustainability can be perceived differently by the various actors, recent actions taken by official creditors (e.g. the increased flexibility of the Paris Club) reflect a wide recognition of this problem. Recent decisions of creditor banks to build up their loan-loss reserves against developing country debt and the large discounts on developing country debt instruments in the secondary markets reflect the same assessment. This does not mean that all developing countries share this predicament. Several developing countries in Asia have a more manageable balance-of-payments situation and a few countries in the area are even reducing their debts.

49. If recent price increases for oils and metals are maintained, this should improve prospects of energy-exporting countries as well as of exporters of metals. Yet present indications are that serious debt problems are likely to persist in virtually all countries in Latin America and sub-Saharan Africa, and also in several countries in North Africa and the Mediterranean, e.g. Egypt, Morocco and Yugoslavia, and some countries of the Middle East and Asia, particularly the Philippines. Judging by arrears, suspension of interest payments and recent

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private and official reschedulings, the majority of developing countries are facing serious debt problems in 1987, and according to the analysis presented in tables 10 and 11, few of them would be able to extricate themselves from their debt difficulties by the early 1990s.

50. The projections in tables 10 and 11 suggest that total credit to developing countries would grow in dollar terms at about 3 per cent per annum 23/ under current policies. While this figure is low when compared to the 1960s or 1970s, a higher figure appears implausible, given the international trade outlook. It is true that individual developing countries can effectively use more external resources and invest profitably in export-oriented activities. However, this is not an option that will succeed for all simultaneously when international trade prospects indicate only modest market growth. Debt-carrying capacity of developing countries, and particularly those with serious debt problems, is closely linked to international trade. As the export option will not succeed for all, the options left to avoid a protracted period of contractionary adjustment are basically measures to reduce interest costs or to lower debt levels through devices such as debt equity swaps and debt relief. Increasingly, such measures are being considered in the new official and private restructuring packages analysed in the following chapter.

## V. OVERVIEW OF RECENT DEBT RENEGOTIATIONS

51. The renegotiation experience of 1986-1987 revealed decreased confidence in the existing debt strategy. Recognizing that the debt problem was a solvency rather than a liquidity problem, creditors and debtors searched for new ways out of the crisis.

52. Since the beginning of July 1986, at least 25 countries have renegotiated their external commercial bank or Paris Club debts or both. Latin America's three largest debtors - Brazil, Mexico and Argentina - were all involved in debt renegotiations. The current fourth round of renegotiations was initiated by Mexico after the oil shock of early 1986. Following Mexico's 30 September 1986 rescheduling of commercial bank debt, the debt crisis seemed to have subsided. However, new debt repayment problems in Latin America and Africa stalled debt talks with the Philippines in late 1986 and, finally, Brazil's February 1987 interest payment suspension raised fears of a reopening of the crisis on the scale of 1982 and questions of the adequacy of current renegotiations.

53. The difficulties faced by debtors in simultaneously servicing their debts and adhering to harsh adjustment programmes, led to some notable developments in 1986-1987. This was the case both in Latin America, especially in Mexico and Brazil, and in Africa, where Zambia's foreign exchange crisis led, on 1 May 1987, to the suspension of its adjustment programme negotiated with IMF, soon followed by a unilateral debt servicing suspension on 28 May by Côte d'Ivoire. After years of adjustment programmes, a widening feeling of adjustment fatigue could be seen to have set in. In recognition of this and of the lackluster international economy, creditors acknowledged the need for new steps.

54. One important development was the easing of rescheduling terms by both commercial and official creditors. A second development was the introduction of novel features into renegotiation agreements.

Easier rescheduling terms

55. There has been a greater response by creditors to debtor country demands for easier conditions of repayment. This took place within a process of debt renegotiation that has followed a given pattern since the early 1980s: evaluation of each country's adjustment task by domestic authorities, creditors and international agencies, leading to acceptance of an adjustment programme approved by IMF; multilateral agreement on general rescheduling terms with creditor groups; detailed agreements and implementation on a bilateral level. Negotiations have taken place on a country-by-country basis, each debtor negotiating with co-ordinated groups of private and official creditors, and with IMF and the World Bank. Rescheduling has tended to be on a serial basis, which necessitates ongoing consultations between creditors and debtors year after year.

56. Since 1981, one can distinguish four rounds of multilateral renegotiations. The number of countries rescheduling official debt increased from 3 in 1980 to 16 in 1983, 20 in 1985 and 16 in 1986. Since 1984, 15 out of 30 countries renegotiating official credits with the Paris Club have included reschedulings of already rescheduled debt. Commercial bank agreements have grown from 5 in 1980 to 20 in 1983 and 14 or more in each year since. Official creditors have rescheduled both interest and principal, while bank creditors have rescheduled the principal alone. Before the current round of renegotiations, the Paris Club standard rescheduling terms had been 10 years' maturity with 5 years' grace. Commercial bank rescheduling terms had tended to be 7 years' maturity, 3 years' grace and 0.75 per cent service charge, although under the multi-year rescheduling agreements the average maturity had been extended to 12.5 years. The easing of the rescheduling terms by official and private creditors in 1986-1987 mainly involved increases in the length of the repayment period and reductions in the interest spread.

57. Two notable features of 1986-1987 renegotiations were, first, the fact that debtors, particularly those in Latin America, began to co-operate with one another in attempting to find a solution to the debt problem and in keeping one another informed of their moves, and, second, the increasing role of precedent in determining debtors' bargaining stances. 24/ The easier terms granted to Mexico established a precedent, after which several other countries demanded similar or better terms, which they were largely successful in obtaining, although not, for the most part, until the debt strategy seemed to unravel. Brazil's unilateral suspension of interest payments on 20 February 1987, coupled with the announcement by Ecuador of suspension of payments until at least June, hints of a suspension of payments by Argentina and statements by a Philippine official that his country should consider similar action, all led to demands from other countries for better terms.

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58. A major concession that Mexico and several other debtors sought from commercial banks was a reduction in interest rates paid by moving from a United States prime to a LIBOR base, as LIBOR has tended to be lower than the prime rate. In Mexico's previous rescheduling agreement of 29 August 1985 it had rescheduled maturities falling due during 1985-1998 on a graduated scale, with spreads increasing from 0.875 in 1985-1986 to 1.125 in 1987-1991 and 1.25 in 1992-1998. In its September 1986 agreement, Mexico rescheduled maturities due during the period 1985-1990 at 0.8125 over LIBOR. In addition, amortization on the rescheduled maturities was lengthened from 14 to 20 years, with 7 years of grace, and no commissions were charged. Subsequently, the Philippines, Venezuela, and Chile demanded interest rates comparable to, or better than, Mexico's, and Argentina sought a reduction in its rates. In February 1987 Chile achieved a reduction to one percentage point over LIBOR, the second lowest interest rate after Mexico at that time. In March, Venezuela's margin was reduced from 1.125 to 0.875. In May, the Philippines achieved a reduction from 1.625 to 0.875 over LIBOR (which can be raised to a full point if amortization schedules are not met). The rescheduled debt is to be paid over 17 years from 1987 with 7.5 years' grace. In mid-April, Argentina reached agreement with its creditor banks to reschedule over 19 years at 0.8125 over LIBOR.

59. In May 1987 the Paris Club took an initiative to ease official rescheduling terms for hard-pressed lower-income countries. The persistence of the African debt problem provided the main impulse for the initiative. The initiative grants more extended terms for repayment. Essentially, it relaxes the Paris Club practice of limiting rescheduling to 10-year periods with a 5-year grace period. It includes an agreement in principle to plan for long-term rescheduling of debt for sub-Saharan countries for 15-20 years with a grace period of up to 10 years. Before the initiative, since July 1986, 16 countries had rescheduled their Paris Club debts, receiving at most the standard terms. The Philippines received in addition the concession of "consolidating" (rescheduling) 70 per cent of interest instead of the previous limit of 60 per cent. After the initiative, Zaire was the first to benefit, with a new maturity of 15 years and 6 years' grace. A similar treatment was applied shortly after to Mauritania. Mozambique rescheduled in early June with the easiest terms ever accorded to a developing nation: repayment over 20 years with 10 years' grace. Finally, Uganda, the fourth to benefit from the initiative, rescheduled its debt on 18 June over 15 years with 6 years' grace.

<u>Novel features of debt renegotiations</u>

60. The declining confidence in the present debt strategy was reflected, even more than in the easing of terms, in the novel features of the past year's renegotiations. During the year, signaling their doubts about collecting fully on problem loans, many banks substantially increased their reserves against losses on loans to particular countries. This is expected to reduce the willingness of the banks to provide new money in the involuntary lending that has characterized the process of renegotiating bank debt. Unlike Paris Club negotiations in which interest payments could be rescheduled, bank negotiations have included involuntary new loans that were used to cover a significant part of interest requirements. This may now be less likely. Indeed, the hesitancy of banks to participate in new-money packages had already manifested itself in the lengthy and difficult negotiations of 1986 and 1987, and in delays in final signing of packages.

61. In response to the greater reluctance of banks to contribute to the new-money feature of debt renegotiations, some novel features have recently been introduced into the renegotiations. These new features have been characterized as a "menu" of options and have been encouraged by the Governments of creditor banks. 25/ In part, the menu approach was designed to meet objections of Japanese and European banks that the conventional approach to debt renegotiation was tailored to meet the regulatory needs of United States banks.

62. The menu approach to debt renegotiation has been facilitated by the development of a secondary market for developing country debt instruments, which are now being sold at prices ranging from about 70 per cent to 10 per cent of their face value. For the debtors, this provides effective debt relief if they can repurchase their debt at a discount. For the creditors, it provides a way of cleaning their books of assets that the market deems to be not worth their full face value and thus reduces their exposure. The size of the market is, however, still small, with an estimated volume of transactions of around $8 billion in 1987.

63. Used in Argentina's renegotiation and adopted by Brazil, menus provide a variety of financing options so that banks can now choose the manner in which they can best provide new funds or the cash flow equivalent. For example, Argentina's menu included a trade-credit facility, an investment fund intended for on-lending, new-money bonds, an early participation fee, debt-equity swap provisions and exit bonds. Exit bonds were designed for smaller banks - primarily those with exposure of up to $5 million - and allow them to end or reduce their exposure, releasing them from new money obligations.

64. Another novel feature in debt renegotiations was specifically designed for Mexico's renegotiation needs as seen in the summer of 1986: contingency and performance-related loans. Under the Mexico agreement, credit availability automatically rises if petroleum prices fall below $9 per barrel, and availability falls if prices rise above $14. If economic growth does not reach 3 to 4 per cent in 1987, Mexico will also be entitled to $500 million of special additional financing. 26/

65. A further novel feature, included in Argentina's menu, gives a more direct role to the World Bank in debt-rescheduling packages. Some of the new money provided by rescheduling bank creditors is to take the form of co-financing ($500 million) that is directly linked to a loan of the same size by the World Bank in support of structural economic reform. Disbursements are to be made together, and in the case of default in service of the bank loan, default would be triggered in the World Bank loan, jeopardizing access to official credit flows.

66. Debt-equity conversion programmes have recently been included as part of current efforts to increase the options available to banks to deal with debt. However, these programmes, which provide an opportunity to convert debt into equity or direct investment in the debtor country, have frequently antedated their insertion into debt renegotiations. For many banks, debt-equity swaps are a means to retire from general-purpose, sovereign-risk lending in favour of traditional, market-based relations with debtor countries, in particular trade finance and investment in specific projects. Swaps are attractive to banks because they allow

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them to decrease their exposure and strengthen their balance sheets. To the degree that the debt burden of the borrower country is reduced, the banks' confidence in the outlook of the country should improve. In the view of the major creditor banks that are prominent in the bank committees that renegotiate with the debtor countries, conversions add to the attractiveness of the packages and make it somewhat easier to convince the hundreds of bank creditors to participate. Indeed, some banks appear to insist that new money be conditional on a policy package that encourages conversions. 27/

67. Discussions of debt-equity swaps were included in the bank debt renegotiations of the past year for Argentina and the Philippines, and may form part of Brazil's negotiations. Argentina, in an effort to assure additionality - i.e. to attain additional investment rather than simply give easier terms on investments that would be made anyway - required that the amount swapped be matched by an equal amount of new cash investment. The Philippines, to reduce interest payments on debt, created Philippine Investment Notes, which may be issued to bank creditors in lieu of payment of the spread conventionally added to the base interest rate. The Notes can be traded, and in particular may be traded for equity, on better terms for currency conversion than are available under the Philippines' existing debt conversion scheme (investors avoid the 5-10 per cent Central Bank charges for conversion of dollars to pesos).

68. A final novel feature, which actually eliminated the need for new money, was incorporated in Chile's 24 February renegotiation with commercial banks. The agreement provides for annual rather than semi-annual interest payments. As a projected result, the 1987-1988 financing gap could be covered without increasing debt through new money. Ecuador was reportedly seeking a similar concession.

69. Viewed against the magnitude of the total debt of the developing countries, any one of these innovations, however valuable, can make only a limited contribution to the solution of the problem. The swap, which has attracted the most attention, has till now led to the conversion of only about $5 billion of debt into equity, which is small in comparison with the total debt. The availability of investment opportunities, the question whether some of the swaps are not merely substitutes of foreign investment that would have taken place anyway, and their possible adverse macro-economic and political implications limit the scope of some of these options. The exit bond, so far designed primarily for small banks, offers a promising market solution of the problem through securitization of debt, if offered at attractive terms. 28/

Implications of the year's development

70. Other notable developments were the various efforts of the international community to mobilize financial support for low-income debt-distressed countries, in particular those in sub-Saharan Africa. For the latter, aside from the longer repayment terms accorded by the Paris Club noted above, there has been discussion in the Interim Committee and at the Venice Summit of according debt relief by applying concessional interest rates to Paris Club debt. At the meeting of the Interim Committee in April 1987, the British Chancellor of the Exchequer called for a reduction of interest rates on the officially guaranteed debt of these countries

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significantly below market levels. A proposal of the Managing Director of IMF to triple the resources of the Fund's Structural Adjustment Facility is under consideration. This would permit the Fund to accord concessional new credits to low-income countries, many of which have already been under IMF adjustment programmes and have to pay non-concessional Fund charges and make repurchases resulting from earlier Fund drawings.

71. However, the initiatives over the past year essentially continue the same basic debt strategy, which reschedules old debt and introduces some new money, adding to a debt burden that is for many countries already unsustainably high. But rescheduling fatigue has set in. Renegotiations were drawn out, and it required major efforts to put the packages together. In addition, as new agreements come into effect, there is no confidence that there will be no need for further renegotiations. With this "short leash approach", renegotiations, as soon as they are finished, start all over. The attempts to shift from annual to multi-year rescheduling agreements have been undermined by the high volatility of the international economy: even when creditors have confidence in the adjustment commitment of debtors, these rescheduling agreements have had to be reopened when economic assumptions prove over-optimistic.

## VI. POLICY CONCLUSIONS

72. The lessons of the 1980s, and in particular of the last five years, are gradually leading to the recognition that the debt problem faced by a large number of developing countries is unlikely to be solved by the strategy that emerged in the mid-1980s. Nevertheless, the three key elements of that strategy remain valid: improved domestic policies, an international environment that is conducive to smooth debt servicing and increased net financial flows on concessional and non-concessional terms to debtor countries. The first implies that debtor countries should not relax efforts to increase domestic savings and to expand exports at a faster rate than imports. Regarding the international economic environment, faster growth of international trade, access to markets for debtor countries and lower real interest rates in large industrial countries should considerably facilitate debt servicing. Fresh financial resources are also required. In this context, support for multilateral development institutions, in particular a capital increase for the World Bank and regional development banks, assumes special importance.

73. However, a fourth element needs to be added to the debt strategy, namely recognition that the debt-servicing burden of some countries is unsustainable. Likely scenarios for the medium term raise the spectre of insolvency. Debt-service burdens are already excessive and are likely to remain unduly large in the next few years. It is thus not without reason that international commercial banks are reluctant to increase their exposure to countries with debt problems.

74. By the same token, direct investment cannot easily substitute for private credit flows, particularly in countries with balance-of-payment difficulties. More flexible arrangements to accommodate foreign investment are not very effective if risks that profits could not be repatriated smoothly remain high. Only if general

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conditions improve and this leads to expectations that balance-of-payment difficulties would ease can direct investments be expected to play an important part of the role previously played by private credit.

75. While situations differ among countries, the general policy orientation to the solution of the debt problem that is gaining ground is that the debt-service burden must be reduced either by lowering interest payments and related costs, or by reducing actual debt levels, or both. A conversion of rates from prime to LIBOR and a reduction in spreads in the case of commercial debts is a significant step forward, which has been taken recently in debt restructuring exercises of some countries, and should be extended to other countries facing severe debt difficulties.

76. For low-income countries, a variety of mechanisms are potentially available to reduce official interest payments. The proposal of the British Chancellor of the Exchequer in this regard deserves urgent consideration. It could be argued that the interest rate on debts rescheduled in the Paris Club should be no higher than the current OECD minimum consensus rate for poor countries or in the case of severely affected countries the rates on loans extended by the International Development Association of the World Bank. This would require an ODA window in the Governments of creditor countries for a subsidy account to pay a certain part of the interest payments due. A measure aimed in this direction would be a flexible use of the Structural Adjustment Facility of IMF. An early agreement and implementation of the recent initiative of the Managing Director of the Fund to increase the resources of this facility from SDR 3 billion to SDR 9 billion could be particularly effective at this stage.

77. Proposals for debt relief for low-income countries come at a critical juncture. As shown above, the burden of debt servicing is expected to worsen for sub-Saharan Africa in the medium term. The accord at the Venice Summit on debt-relief proposals for the low-income countries, especially hard-pressed debtor countries in Africa, shows a clear recognition of their plight. Donor countries that have not done so already should write off concessional debt of low-income countries. Full implementation of Trade and Development Board resolution 165 (S-IX) has assumed greater importance as the debt-servicing capacity of these countries has worsened.

78. For private debt, several proposals have been put forward. Some of these proposals entail the establishment of an international institution to assist debtors in restructuring maturities and easing the debt burden. 29/ The various proposals make a case for an international institution, or a facility in an existing multilateral institution, whose role would be to acquire debt at a discounted value from private banks and to restructure the debt-servicing obligations on that debt. Eligible debtor countries - implementing growth-oriented adjustment programmes - would capture in the process a share of the existing differential between the nominal and market values of the corresponding debts. The financing of this institution or facility would depend on whether debt acquisition would be made through swaps with securities issued by the institution or by simple purchases from commercial banks using funds borrowed on the market by the institution.

79. Although sponsorship would not be limited to donor countries with current account surpluses, the institution could be an important channel for recycling funds of countries with large surpluses. 30/ One crucial issue would be the question of collateral for the institution or facility. The institution would require a paid-in capital, preferably supported by a substantial callable capital contributed by donors. Donor countries or sponsors in this case would not need to pay in cash. The obligations issued by the institution or facility to be exchanged for the claims of commercial banks on developing countries would be guaranteed by the capital subscribed by donor countries or sponsors. In both options, a rapid development of a secondary market in the financial instruments held or issued by the new agency would lead to a significant increase in the volume of bank debt that the institution could repackage.

80. Other debt reduction mechanisms involve market-oriented solutions: for example, debt equity swaps, securitization of debt or even direct repurchase by the debtor country at the market rather than the nominal value of the debt (to the degree that the debtor can mobilize the requisite foreign exchange). What is critical in any market-oriented solution is that the individual debtor country capture an adequate part of the differential between the face value and the market value of its external debt. In the case of debt equity swaps, this does not necessarily occur. The difference can be easily captured by an outsider. However, debtor countries, by regulating the foreign exchange conversion, by conditioning the domestic use of resources obtained through this operation and by requiring that debt equity swaps must be matched by additional capital, may obtain a significant part of the discount.

81. Securitization of debt, of which exit bonds represent a potentially important case, constitutes a promising avenue. Securities issued bv the debtor country could be exchanged for outstanding bank loans having the same face value. The key question is how to set the level of future interest streams for the new financial instrument in a way that is acceptable to the creditor and also reduces the burden for the debtor. If a creditor bank were intent on removing a loan from the books, it could sell the loan in the market at a loss. The alternative of swapping the loan for a debtor country bond paying a below-market interest rate could entail a smaller loss. Given the current average discounts on commercial debts, many debtors might reduce interest costs on outstanding bank loans by about one third. If a secondary market for such securities developed, increasing their liquidity, these operations could gather momentum and reduce significantly the present debt overhang. As with exit bonds, such schemes could be negotiated with commercial bank committees.

82. In summary, in the course of the last year, the spectrum of options and proposals for dealing with the debt problems of developing countries, in the absence of a major revival of world trade in the near future, has widened. This is reflected in the emerging consensus in major recent international forums, the latest of which resulted in the Final Act of the seventh session of the United Nations Conference on Trade and Development. 31/ Both private and official creditors are ready to discuss with debtors approaches to debt decompression that were not even on the table a year ago. The policy options have been widened, and there is a new recognition that if world economic growth cannot be counted on to solve the problem, some degree of debt relief may be necessary.

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## Notes

1/ See for example, William R. Cline, International Debt and the Stability of the World Economy, Inutitution of International Economios, Washington, D.C., 1983.

2/ After the United States Secretary of the Treasury, Mr. James A. Baker III.

3/ OECD, Financing and External Debt of Developing Countrie8, 1986 Survey, Paris, 1987.

4/ That chapter also dealt with the external debt and economic adjustment efforts of the European centrally planned economies. The latter have continued their adjustment efforts. The most severely affected countries, particularly Poland and Romania, have recently worked out multi-year reschedulings of their official and private debts. Nevertheless, the external payments situation of some of the latter countries continues to be of considerable concern and therefore needs to be monitored carefully. Though some of the considerations elaborated on in this report apply to all indebted countries, the main focus here is complementing and updating the analysis of the situation of the developing countries presented in the World Economic Survey 1987.

5/ For a discussion of the role of recovery in industrial economies in the resolution of the debt crisis, see Carlos Massad, "Debt: An Overview" and William R. Cline, "International Debt: Analysis, Experience and Prospects", in Journal of Development Planning, No. 16, 1985 (The Debt Problem: Acute and Chronic Aspects).

6/ United Nations, World Economic Survey 1987, chap. III.

7/ Jeffrey D. Sachs, External Debt and Macroeconomic Peformance in Latin America and East Asia, Brookings Paper on Economic Activity, 2, 1985.

8/ For example, real wages in Mexico fall by 40 per cent during 198[illegible]-1985. See Rudiger Dornbusch, Our LDC Debts, National Bureau Working Paper No. 2138, NBER, January 1987.

9/ See, for example, Giovanni Cornia, Richard Jolly, and Frances Stewart, Adjustment with a Human Face, Vol. I, Clarendon Press, Oxford, 1987; and Khadija Haq and Uner Kirdar (ed.), Human Development, Adjustment and Growth, North-South Roundtable 1987.

10/ Report of the Secretary-General entitled "Net transfer of resources from developing to developed countries", A/42/272.

11/ Address of Mr. Barber B. Conable, President, World Bank, to the Keidanren (Federation of Economic Organizations), Tokyo, 27 March 1987.

12/ OECD, Financing and External Debt of Developing Countries, 1986 Survey, Paris, 1987.

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Notes (continued)

13/ Given interest rate levels and loan maturities at that time, this implied typically that 4 to 6 per cent should be used to cover interest payments and 9 to 11 per cent to cover amortization.

14/ As analysed in World Economic Survey 1987, some centrally planned economies of Eastern Europe were also adversely affected.

15/ IMF projections are reported as baseline and medium-term scenarios in IMF, World Economic Outlook, April 1987 (Statistical Appendix, pp. 109-194). The World Bank figures reported here are based on World Bank, World Development Report 1987, chap. 2, pp. 14-35. The United Nations projections are based on the Secretariat's calculations using Project LINK's post-meeting baseline solution (April 1987). In addition, a small debt-simulation model for the group of 15 highly-indebted countries has been constructed to check the consistency of the Secretariat's calculations, and to perform policy scenarios. The key global parameters projected by the Project LINK system were used as inputs into the debt simulation model.

16/ The reduction in output in any individual developing country will depend on the composition of imports and the ability to substitute domestic production for imported inputs.

17/ The discrepancy between the IMF and the United Nations projections is larger than the actual margin of difference between LIBOR and the United States prime rate for the period 1983-1987. One reason for this discrepancy may be the fact that the United Nations projections (Project LINK) are based on endogenously determined exchange rates, while the IMF assumes fixed exchange rates during the forecast horizon. Since the dollar is projected to weaken gradually vis-à-vis other key currencies (see table 10), the resulting acceleration of inflation in the United States can explain at least part of the higher level of nominal dollar interest rates (in the United States) as projected by Project LINK. Given the large external imbalances among the major industrial countries, the assumption of fixed exchange rates among their currencies perhaps introduces unwarranted inconsistencies to the projections.

18/ The statistical relationship between LIBOR and the United States prime rate is as follows:

$$\text{LIBOR} = \underset{(0.1)}{-\,0.001} + \underset{(21.6)}{0.908} * \text{Prime rate}, \quad R^2 = 0.98$$

for the period 1976-1986. The figures in the parentheses are the t-ratios.

19/ This World Bank scenario assumes no major policy departures (i.e. it assumes only a gradual but not a dramatic decrease in the United States fiscal deficit).

Notes (continued)

20/ It is important to note, however, that the current interest rate (end of July 1987) is virtually the same as that used in the United Nations projections for 1986-1988.

21/ This view is also shared by bank analysts:

> "If strong export growth is beyond reach, debtors can in principle contain their debt ratios by compressing imports sufficiently to generate trade surpluses large enough to effect the requisite net financial transfers to their creditors. During 1983-86, such transfers by the 10 major debtors averaged 4 per cent of GDP and about 25 per cent of earnings from goods and services exports. Yet even this high level of transfers, without export growth, failed to reduce debt ratios; and the debtors paid a heavy price in terms of economic growth forgone. This unhappy experience now has heightened the debtor countries' determination to reduce their net financial transfers - by reducing interest payments and increasing net capital inflows - to levels consistent with desired economic growth."

> Morgan Guaranty Trust Company of New York, World Financial Markets, June-July 1987.

22/ There is evidence that the stock of capital - including physical infrastructure - has decreased rather than increased in several sub-Saharan African countries. For a typical country in this region with a rate of investment of 10 to 12 per cent of GDP, net investment (additions to the capital stock minus depreciation) should be in the order of 2 to 4 per cent. Interest payments abroad would be equivalent to about 50 per cent of net investment.

23/ The projections for the medium-term point to an annual growth rate of 3 per cent (United Nations), 3.3 per cent (IMF) and 2.7 per cent (World Bank).

24/ Brazil informed Argentina and Mexico of its interest suspension before it informed its creditors. Similarly, Argentina held consultations with Brazil before its meeting with the creditors. The Philippines, in early January, agreed to a meeting with a group of Latin American countries also in renegotiations.

25/ The heads of State or Government of the seven major industrial countries stated in their economic declaration of 10 June 1987 at Venice that "... we support efforts by commercial banks and debtor countries to develop a 'menu' of alternative negotiating procedures and financing techniques for providing continuing support to debtor countries" (see A/42/344, annex, para. 24).

26/ Mexico also received a new concession from IMF, easing the performance criteria used to measure fiscal deficits. The Fund agreed to exclude from calculation of the operational deficit the effects of inflation on interest payments on the domestic debt. Accordingly, a nominal deficit of 13 per cent was calculated as a real deficit of 3 per cent. This concession was aimed at facilitating an expansionary adjustment process.

Notes (continued)

27/ See, for example, Morgan Guaranty Trust Co., World Financial Markets, June/July 1987, p. 14.

28/ Relaxation of banking regulations in creditor countries should also help the growth of secondary markets in developing country debt. For example, the United States Federal Reserve Board's recent decision to allow United States banks to acquire, without limit, assets of a non-financial company in debtor countries is expected to facilitate debt-equity swaps.

The development of secondary markets may also benefit debtor countries in ways other than reducing their external debt directly. Recently, there has been a significant reversal of capital flight in some of the heavily indebted countries. A part of this is probably due to the possibilities of debt-equity swap that expatriate capital finds attractive.

29/ See, for example, (a) Peter B. Kenen, "Outline of a Proposal for an International Debt Discount Corporation" (background material presented to the United States Sub-Committee on International Finance and Monetary Policy, Senate Committee on Banking, Housing, and Urban Affairs, 26 March 1987); (b) Proposal for a debt reconstruction facility in the World Institute for Development Economic Research, Mobilizing International Surpluses for World Development: A WIDER Plan for a Japanese Initiative, Tokyo, Japan, 7 May 1987; (c) Proposal by the United Nations in the World Economic Survey 1987 (p. 10); (d) Proposal for an International Debt Restructuring Agency preferably as a joint subsidiary of the International Monetary Fund and the World Bank, by Benjamin Cohen (see "An International Chapter 11 - Create an Agency to Aid Third World Debtors", New York Times, 11 August 1987).

30/ This is particularly the thrust of the WIDER proposal for a Debt Reconstruction Facility.

31/ Final Act of the seventh session of the United Nations Conference on Trade and Development, TD/L.316/Add.2.

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