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MACROECONOMIC POLICY QUESTIONS: EXTERNAL DEBT CRISIS AND DEVELOPMENT

The developing country debt situation as of mid-1995

Report of the Secretary-General

EXECUTIVE SUMMARY

Owing to the important political, economic and social dimensions of foreign debt crises of developing countries, the General Assembly has for many years closely monitored the debt situation of these countries and its treatment by the international community. In its resolution 49/94 dated 19 December 1994, the Assembly requested the Secretary-General to report to the Assembly's fiftieth session on the major developments that took place in the international treatment of the debt of developing countries during the past year. The present report responds to that request and also identifies weaker areas within the international debt strategy that the Assembly may wish to address in its deliberations.

The report is organized as follows. Following a brief introduction, section II updates the current strategy in terms of new measures launched and the restructuring agreements concluded from July 1994 to June 1995. Improvements in the international debt situation should be visible in the conventional debt indicators and the most recent data are analysed in section III. It is argued, however, that such indicators offer an incomplete picture of the debt situation, as they do not take into account problems such as arrears, let alone slow economic growth and deteriorated social conditions in debtor countries. Section IV thus takes the analysis further by looking at countries that are still classified as severely indebted despite the

* A/50/150.

initiatives adopted so far. By identifying the types of debt held and restructuring arrangements applied, this assessment attempts to highlight the weaker elements of the current debt strategy.

The conclusion of the present report is that although significant relief has been accorded to some countries and for certain classes of debt, the international strategy has not comprehensively addressed the full stock of debt, leaving a vulnerability for countries whose debt-servicing obligations still exceed their "capacity to pay". Certainly, removing the "debt overhand" by itself would not solve the development problems of the debt-crisis countries. But while a debt overhand remains, even the most rigorous and effective programmes of domestic economic stabilization and structural adjustment leave the countries in question with serious obstacles to moving to a sustained and sustainable development path. For them, escape from debt overhand is a race against time.

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I. INTRODUCTION

1. The report of the Secretary-General on the external debt situation of developing countries, presented to the General Assembly at its forty-ninth session (A/49/338), noted that an increasing differentiation had taken place among countries affected by the 1980s debt crisis. Some countries, particularly middle-income countries of Latin America that had owed considerable amounts to international commercial banks, were experiencing an improvement in their economic conditions and regaining access - albeit at a high financial cost - to international capital markets. This seemed to suggest that their debt crisis was finally behind them. It was certainly over for their commercial bank creditors. On the other hand, the majority of low-income countries - and some lower middle-income countries - continued to suffer debt-servicing difficulties. They also experienced low rates of economic growth and their borrowing was restricted to the official sources of largely concessional financial resources. For these countries, the external debt crisis was very much alive.

2. One year later the situation in the low-income countries with debt crises is little changed, although certain initiatives may begin to change that. There is a new appreciation, however, of the fragility of the situation in some of the middle-income countries that the markets once seemed to judge as past their debt crises.

3. The General Assembly has closely followed the external debt problem of developing countries since the debt crisis erupted in the early 1980s, and "External debt crisis and development" has been on the Assembly's agenda annually since its forty-first session. The Assembly discussions embodied a series of resolutions that reflected the concern of the international community about the severity of the debt problems of developing countries, as well as the evolving consensus over the measures required to reduce the debt burden of these countries. These resolutions have also emphasized the need to further strengthen the international strategy so that a durable solution to the debt problems could be reached.

4. In its resolution 49/94, adopted by consensus on 19 December 1994, the General Assembly, *inter alia*, welcomed the measures taken by the international community in reducing the debt burden of heavily indebted developing countries and the economic adjustment efforts undertaken by these countries. The Assembly called upon official and private creditors, however, to consider appropriate new measures to extend further relief to debt-distressed countries. It also requested the Secretary-General to report at its fiftieth session on the implementation of that resolution. The present report responds to that request. 1/ As in previous reports, the present one draws heavily on information and analysis of the World Bank, the International Monetary Fund (IMF) and the United Nations Conference on Trade and Development (UNCTAD).

II. THE INTERNATIONAL DEBT STRATEGY: AN UPDATE

5. Since the emergence of the debt crisis, the international community has devised a series of measures to deal with the persistent difficulties developing countries faced in servicing their external debt obligations. 2/ These measures evolved into what is called the "international debt strategy", which has two fundamental parts. First, the debtor country addresses its domestic adjustment requirements, generally in a programme supported by the multilateral financial institutions. Second, the debt-servicing obligations are modified under negotiated arrangements, whose major elements are reviewed below.

6. The approach to debt restructuring of the international strategy started to acquire its present structure in the mid-1980s, when it was recognized that the existing treatments of debt servicing only postponed the payments, leaving the debt overhang unchanged, which discouraged investment and undermined the economic growth prospects of debtor countries. Increasing arrears in interest and principal payments, moreover, signalled the debtors' inability to pay and that the stock of debt needed to be made more manageable. At the same time, the emergence of a market where commercial bank loans of the countries affected by the debt crisis were traded at a growing discount indicated the creditors' increasing perception that debt would not be serviced in full. By the early 1990s, however, debt and debt-service reduction became a common component of debt-restructuring agreements that debtor countries negotiated with their bilateral official and private creditors.

7. The amount of relief extended has not been uniform, and its modality has reflected the particular situation of the creditors and debtors involved in each case. For both private and official bilateral creditors, the particular debt restructuring results from choices made from different but more or less standard "menus of options". Table 1 identifies the major components of the international debt strategy in its current form. As shown, only some types of debt are subject to restructuring, but considerable relief may be granted on the restructured debt. 3/

Table 1. Debt and debt-service reduction in the international debt strategy

Creditor		Debitor: Low-income countries	Middle-income countries
Private	Commercial Banks	IDA Debt Reduction Facility Debt conversions	Brady Plan Debt conversions
	Other private creditors		
Bilateral	Paris Club	Naples terms	Houston terms (lower-middle income countries only)
	Other bilateral	Voluntary debt cancellation/conversion	Voluntary debt cancellation/ conversion
Multilateral	World Bank (Non-concessional debt only)	Fifth Dimension ("IDA-only" countries)	
	IMF		
	Others		

Source: UN/DESIPA.

Note: "IDA-only" countries signifies member countries of the World Bank that are authorized to borrow only the highly concessional resources of the International Development Association.

Shaded areas indicate the absence of a debt or debt-service reduction initiative.

A. Private creditors

8. Restructuring agreements involving the reduction of the stock or the servicing of commercial bank debt allow the debtor countries to buy back part of their outstanding debt at a discount or convert it into securities that entail either lower interest obligations or a reduced face value. The securitization approach is a common feature of "Brady Plan" arrangements that were first applied in 1990. Many of these new debt instruments have the repayment of principal collateralized with zero-coupon bonds issued by the United States Treasury (or other Treasury obligations). A partial guarantee is also sometimes offered on interest payments for a certain period of time. Under the Brady Plan, multilateral and bilateral credits have also been extended to the debtor country to meet up-front costs, such as purchasing the United States securities that serve as collateral.

9. This approach has mainly been applied to the renegotiations of bank debt owed by middle-income countries. The standard procedure is for the debtor country Government to negotiate with a "steering committee" drawn from its bank creditors a menu of alternatives from which each of the creditor banks would then choose. The bankers' concern is that all banks make comparable concessions in according relief to the debtor country. During the period under review, two additional developing countries closed debt and debt-service reduction agreements with their commercial bank creditors: the Dominican Republic and Ecuador. Treatment of past-due interest was part of the agreement in both cases. The Dominican Republic was fully able to meet up-front costs from its own resources, while additional borrowing from official creditors was required in the case of Ecuador. The closing of these agreements brought to 13 the number of countries that have negotiated Brady agreements with their creditors. Debt reduction obtained through these operations amounted on average to about one third of outstanding commercial bank claims on the countries concerned. 4/ Other countries currently negotiating Brady packages include Panama and Peru.

10. Buy-back operations have also been conducted by low-income countries with the assistance of official creditors and donors. Qualifying low-income countries have benefited from the Debt Reduction Facility of the International Development Association (IDA), the concessional lending arm of the World Bank. The IDA facility is financed by bilateral donors and transfers from net income of the World Bank on its regular lending operations. It provides grants of up to $10 million per country for the reduction of their commercial bank debt through buy-backs. However, only seven countries have concluded buy-back agreements supported by the facility since it was created in 1989. Recent agreements include those of Sao Tome and Principe and Zambia.

11. Debt reduction is not a universal feature of all restructuring. Traditional rescheduling of debt servicing with commercial and bilateral official creditors still takes place. In May 1995, for example, it was announced that Algeria had reached an agreement with a steering committee of creditor banks on rescheduling $3.2 billion of its commercial bank debt. Algeria had been in arrears on its bank debt since March 1994, and the accord will help the country to regularize its situation with its bank creditors.

B. Bilateral official creditors

12. Creditor Governments generally restructure debt servicing owed to them through a multilateral forum known as the Paris Club. As in the case of commercial bank steering committees, the Paris Club agrees to a menu of comparable treatments to be applied to a particular debtor and each creditor is then to choose from among the alternatives in a bilateral implementing agreement. Since the 1980s, official bilateral creditors have been gradually extending the degree of concessionality in their restructuring of developing countries' external debt. The extent of relief provided depends, inter alia, on the per capita income level of the country concerned, as well as on the amount of debt subject to restructuring. Rescheduling only affects payments falling due in a certain period (the so-called "consolidation period") on debt that was contracted before a certain date (the "cut-off date"), although with the introduction of the Naples terms, discussed below, the possibility of treating the full stock of relevant debt at one time was introduced.

13. The Paris Club has a set of standard terms and special treatments. In particular, the "Houston terms", which entail long-term rescheduling of payments, are applied to lower middle-income countries, while "Naples terms" are now available to eligible low-income countries. The latter were adopted by the Paris Club in December 1994 and are actually an extension of the earlier "enhanced Toronto terms". That is, in cases in which the Paris Club would have offered the option of debt-service reduction of 50 per cent on affected debt, the Naples terms raised the percentage to 67 per cent. Relief on the entire stock of debt (50 or 67 per cent) may be obtained in exceptional circumstances and is considered an "exit option", meaning that the debtor country will not ask for further rescheduling of its remaining debt.

14. Middle-income countries usually reschedule under standard terms. Lately, some flexibility has been introduced in the standard terms in the form of extended maturities and graduated payments that allow for smaller principal repayments to be made at the beginning of the repayment schedule. Table 2 highlights the major features of current Paris Club rescheduling terms.

15. In the year ending in June 1995, the Paris Club granted Croatia a graduated repayment schedule. Houston terms were applied to the Philippines, enhanced Toronto terms to Sierra Leone 5/ and Naples terms to Bolivia, Cambodia, Guinea, Guinea-Bissau, Haiti, Nicaragua, Senegal, Togo and Uganda. Among the countries receiving Naples terms, all - with the exception of Guinea - received a 67 per cent reduction on the consolidated eligible maturities. As of mid-1995, Uganda was the only country to receive a 67 per cent reduction on the eligible stock of debt.

16. Debt forgiveness and debt conversions have also been undertaken by individual creditor countries outside the multilateral framework. Creditor Governments that have not participated in the Paris Club rescheduling (some Arab creditors, China, some Latin American creditors and others), have conducted bilateral restructuring through which a great deal of relief has been extended in some cases, particularly when low-income debtor countries were involved.

Table 2. Major features of current Paris Club rescheduling terms

	Standard terms	Houston terms	Naples terms
Eligibility		Lower-middle income countries (per capita income: less than $ 1,345 in 1993) and severe debt burden (debt/GNP = 50% or higher; debt/exports = 275% or higher; or scheduled debt service/exports = 30% or higher) Case-by-case basis	IDA-only borrowers, with 2 treatment possibilities: 67% option: per capita income less than $500 or debt/exports more than 350% 50% option: all others Case-by-case basis
Non-ODA credits	Flat payments: maturity: 10 years grace period: 5 years interest rate: market Blended payments: maturity: up to 14 years grace period: shorter than above interest rate: market	maturity: 15 years grace period: up to 8 years interest rate: market Possible debt conversion of up to $ 10 million or 10% of debt, whichever is higher.	I. <u>50% Option</u> (ex- enhanced Toronto terms): * Debt reduction: 50% of debt-service obligations; remaining rescheduled: maturity: 23 years grace period: 6 years interest rate: market * Debt-service reduction: 50% on a present value basis: maturity: 23 years grace period: none interest rate: concessional * Commercial option: maturity: 25 years grace period: 14 years interest rate: market II. <u>67% Option</u>: * Debt reduction: 67% of debt-service obligations; remaining rescheduled: maturity: 23 years grace period: 6 years interest rate: market * Debt-service reduction: 67% on a present value basis: maturity: 33 years grace period: none interest rate: concessional * Commercial option: maturity: 40 years grace period: 20 years interest rate: market III. <u>Stock treatment</u>: Debt or present value of servicing falling due on the stock of debt reduced by 50% or 67%
ODA credits	maturity: 10 years grace period: 5 years	maturity: 20 years grace period: 10 years	Under the 50% option: debt rescheduled: maturity: 30 years grace period: 12 years Under the 67% option: debt rescheduled: maturity: 40 years grace period: 16 years

Sources: UNCTAD, World Bank, *World Debt Tables 1994-1995;* and IMF, *Official Financing for Developing Countries, 1994.*

C. Multilateral creditors

17. Debt owed to the multilateral financial institutions cannot formally be restructured and is not subject to cancellation or reduction. In practice, however, there has been a series of initiatives to tackle the difficulties developing countries have encountered in servicing their multilateral debt. One indirect approach used for low-income countries is to offer new lending on concessional terms, which provides foreign exchange that can be used to service older debt.

18. Some interest-payment relief is extended by the World Bank, however, through its Fifth Dimension facility. Heavily indebted countries that already have IDA borrowing programmes can receive additional IDA credits (which are on concessional terms) to help finance payment of their outstanding non-concessional loans from the World Bank.

19. IMF has no programme comparable to the Fifth Dimension facility, but it operates the Rights Accumulation Programme for countries that have fallen into arrears and wish assistance in working back into regular status. The programme allows countries to accumulate "rights" towards future drawings of Fund resources while they establish a satisfactory record of policy adjustment and meet payment schedules. The latter is generally accomplished with the help of resources provided by bilateral donors. The Programme, as established, was limited to the 11 countries that were in protracted arrears to the Fund at the end of 1989. 6/

III. DEBT INDICATORS AT THE GLOBAL AND REGIONAL LEVEL: MIXED MESSAGES

20. The gross external debt of capital-importing developing countries reached an estimated $1.6 trillion by the end of 1994, a $100 billion increase over 1993. 7/ As a result of improved economic conditions in debtor countries as well as developments in the international capital markets, the growth in long-term lending to developing countries was dominated by private creditors in 1994. Although the indebtedness of developing countries to private creditors has been increasing since 1991, this was the first time in a decade that the increase in private debt exceeded that observed in official debt. Private lending, however, was directed mainly to countries that have not had to restructure their debt and to the major borrowers in Latin America. As a result, Asia has built up the largest debt of the main geographical regions of the developing world, holding about 37 per cent of the external debt of capital-importing developing countries in 1994, up from 25 per cent in 1984 (see figure 1).

21. Another trend that has been accentuated lately refers to the change in the composition of long-term debt of developing countries. As figure 2 shows, Latin American external debt is still dominated by private debt, but the composition of its private debt changed significantly after 1989. Most of its debt owed to private creditors is now in the form of bonds. By the end of 1994, 38 per cent of Latin American long-term debt was in bonds compared with 5 per cent in 1989. This change reflects both the restructuring operations conducted under the Brady initiative and successful new borrowing in the international capital markets.

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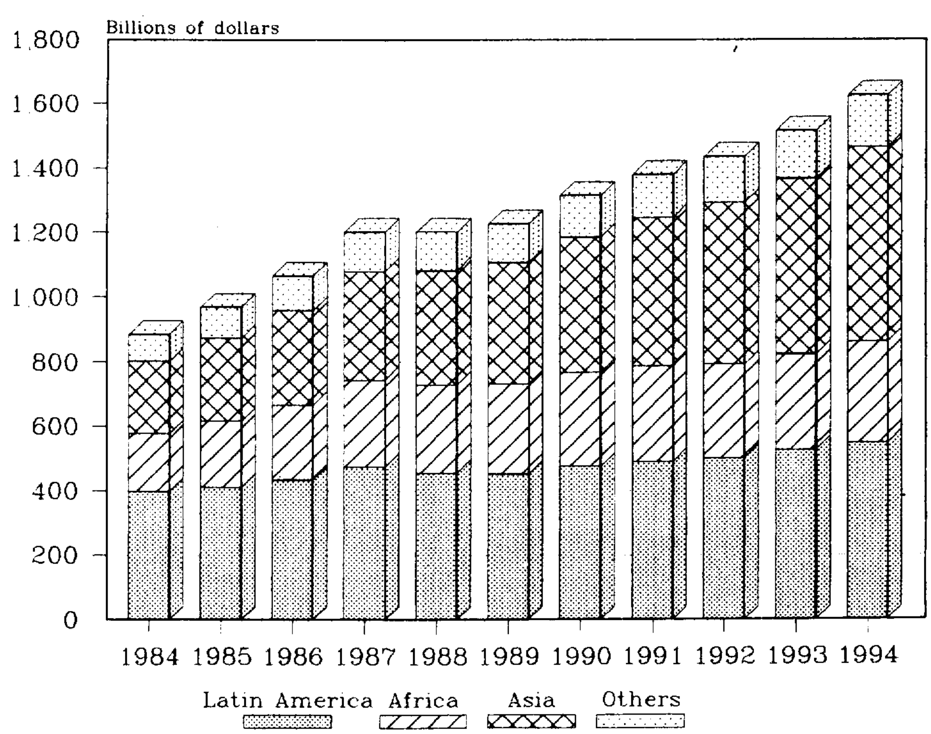
Lending through bonds has been favoured by private investors owing to the relatively high returns and short maturities of the bonds. Moreover, the fact that the debtor countries on the whole continued to service their bond obligations, even during the worst days of their external debt crisis, may have given foreign creditors a sense that the debt servicing of bonds would have seniority over other debt instruments. 8/ Certainly, negotiated rescheduling of bonds held by thousands of investors would be more complicated than rescheduling payments to hundreds of banks.

22. Asian and African external debts are largely owed to official creditors, but while in the former the share of private debt has been increasing recently, in the latter it has persistently declined. The shrinking participation of foreign private creditors in African external debt is most striking in sub-Saharan Africa (excluding Nigeria and South Africa). As shown in figure 2, it represented only 15 per cent of the subregion's long-term external debt in 1994. The remaining external debt of sub-Saharan Africa is owed to official creditors and consists mostly of concessional loans (58 per cent of total long-term debt). In a curious way, Latin America and sub-Saharan Africa share a common characteristic as far as the structure of their debt is concerned: both regions have been accumulating increasing amounts of debt that is in principle difficult to restructure.

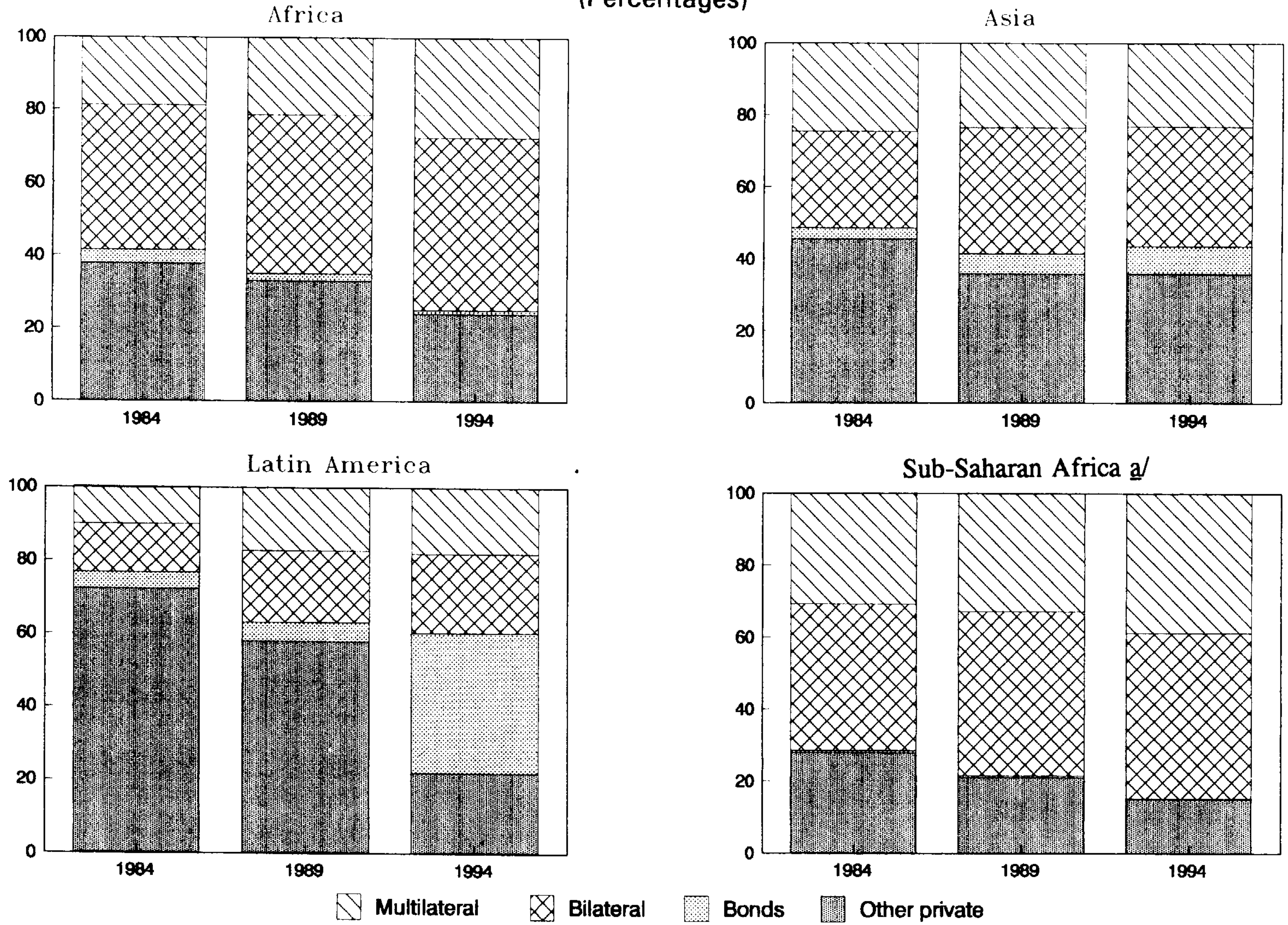
Figure 1. Foreign debt of the capital-importing developing countries, 1984-1994



Source: United Nations, *World Economic and Social Survey, 1995.*

Figure 2. Composition of the long-term external debt of capital-importing developing countries, by type of creditor, 1984, 1989 and 1994

(Percentages)



Source: *World Economic and Social Survey, 1995*.

a/ Excluding Nigeria and South Africa.

A. Aggregate measures of debt burden

23. One way of assessing the effectiveness of the current international debt strategy is to look at indicators of the debt burden (see table 3). The most commonly used indicators are: (a) ratio of external debt to gross national product (GNP); (b) the ratio of external debt to exports of goods and services; and (c) the debt-service-to-exports ratio. These indicators measure the level of indebtedness in terms of the capacity of the debtor country or region to generate income (GNP) and its ability to generate foreign exchange (exports).

24. Some analysts also use the present value of debt as a numerator. The present value of debt reflects the value today of the stream of payments of interest and principal to be made on the debt, discounted at a market interest rate. It indicates, in effect, what an investor would be willing to pay today to receive the future stream of debt-servicing payments. It thus takes into account the degree of concessionality of the existing stock of debt. For this reason it is considered by some to be a more accurate indicator of the indebtedness of a country than the face value of the debt.

25. As with most economic indicators, debt indicators must be interpreted with caution. This is particularly clear in the case of debt-to-GNP ratios in 1994. Thus, while the overall and regional ratios were largely unchanged, those of Africa and sub-Saharan Africa deteriorated appreciably. In this instance it had much to do with changes in exchange rates. The value of GNP of a debtor country has to be converted into the same currency as the debt, which is conventionally expressed in dollars since most of the debt is contracted in dollars. Exchange-rate devaluations reduce the dollar value of a country's GNP and the spate of devaluations in sub-Saharan Africa - in particular, that of the CFA franc - is one reason that the external debt of this region increased from 115 per cent of GNP in 1993 to 131 per cent in 1994, an increase that is not compatible with either the net credit flows to the region (less than $8 billion or about 5 per cent of 1993 debt) or the economic growth experienced last year (2 per cent in real terms). The point to draw from these numbers is not that the actual situation deteriorated so much in 1994 as that the earlier data, based on over-valued exchange rates, underestimated the severity of the problem.

26. Viewed from the foreign exchange constraint, the increase in debt in 1994 was within sustainable limits overall, owing to the robust growth of international trade last year and the recovery in the price of most non-oil commodities. 9/ But regions have been exhibiting different trends. While in Latin America the debt-to-export ratio has been falling for the past three years, in Asia it has been consistently rising during the same period. However, the level of the Asian ratio is only one third of that in Latin America.

27. The ratio of debt service to exports, another indicator, showed an easing of the debt burden in all regions in 1994. Only the Latin America ratio was above 20 per cent in 1994, a threshold that is generally held to mark the limit of sustainability of the countries' external positions. 10/ This indicator, however, should also be used with caution, because it refers to payments actually made, thus omitting arrears. They can be quite substantial, as in the case of sub-Saharan Africa where the accumulated arrears amounted to $44 billion by the end of 1994, or more than 27 per cent of the region's external debt.

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Table 3. Debt indicators for capital-importing developing countries, 1984-1994

(Percentage)

	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994[a]
					Ratio of external debt to GNP						
All countries of which:	40.5	44.4	47.2	49.7	44.9	41.8	39.7	40.3	39.5	38.6	38.7
Latin America	57.4	60.3	62.1	64.2	55.0	48.7	44.1	44.1	41.3	36.5	35.7
Africa	51.5	61.2	70.5	78.8	77.4	78.9	75.1	77.7	74.6	74.6	78.4
Asia	22.8	25.7	28.1	29.6	27.4	26.5	26.9	28.0	28.7	29.9	30.1
Memo item: Sub-Saharan Africa[b]	67.1	81.3	82.0	95.0	92.9	96.9	105.2	108.7	111.5	115.3	130.8
					Ratio of external debt to exports						
All countries of which:	162.8	180.9	200.0	187.0	159.8	145.3	138.4	135.8	134.0	135.6	132.9
Latin America	285.3	310.1	376.6	369.6	309.3	272.5	259.7	264.8	254.4	253.8	240.2
Africa	189.4	218.1	270.8	284.9	271.6	261.1	234.6	240.6	231.4	243.5	227.0
Asia	88.3	102.5	106.0	94.5	81.8	77.2	77.1	74.4	75.5	77.1	78.1
Memo item: Sub-Saharan Africa[b]	218.0	262.8	302.3	337.6	326.1	325.2	334.0	358.4	364.9	398.7	352.0
					Ratio of debt service to exports						
All countries of which:	22.7	23.5	24.5	21.7	20.0	17.4	15.6	14.3	14.6	15.2	14.2
Latin America	38.3	36.6	42.5	36.7	37.5	31.0	25.3	25.1	27.5	28.6	27.8
Africa	26.8	26.7	29.5	24.1	26.4	24.8	24.5	23.6	22.3	22.6	18.1
Asia	12.5	15.6	15.4	15.3	11.7	10.5	9.8	8.5	8.6	9.7	9.2
Memo item: Sub-Saharan Africa[b]	19.3	21.6	24.8	23.1	22.5	19.5	18.0	17.7	15.4	14.4	13.2

Source: United Nations, World Economic and Social Survey, 1995, table A.37.

[a] Preliminary estimate.
[b] Excluding Nigeria and South Africa.

28. Arrears are not a problem exclusive to sub-Saharan Africa. In fact, the majority of countries monitored by the World Bank have accumulated overdue payments. Out of 120 countries for which data were available for 1992 and 1993, 63 increased their interest arrears (25 of them outside sub-Saharan Africa), while another 25 decreased the amount of arrears but still had payments overdue. Only 31 countries did not have any arrears or cleared them during that year.

29. The persistence of arrears is a warning sign that, in spite of progress, a durable solution to the debt problem of the developing countries may not yet have been found. The large number of countries that continue to experience debt-servicing difficulties 13 years after the emergence of the crisis on to the international stage warrants concern.

30. Indeed, a considerable number of countries are currently classified by the World Bank as "severely indebted". Using the ratios of the present value of debt service to exports of goods and services and to GNP to assess the degree of indebtedness, the Bank considers as severely indebted those countries with either ratio higher than 220 per cent or 80 per cent, respectively. A "moderately indebted" country is defined as one having both ratios below the critical values, but with either ratio at 60 per cent or more of the threshold value. In its latest World Debt Tables, the Bank classified 51 countries as severely indebted (see table 4). 11/ Although most countries remain classified as severely indebted for a considerable length of time, some eventually leave the group, while others join. Recent "graduates" included Algeria, Cambodia, Egypt and Mexico, while new members were Guinea, Uruguay and Yemen. In the light of the debt and payment difficulties in 1995 of Algeria and Mexico, their removal from the list seems to have been premature. It is also a concern that Uruguay is again classified as a severely indebted country, as it had successfully completed a Brady restructuring in 1991. Moreover, all countries that left the category, with the exception of Cambodia, were reclassified as moderately indebted and not as less-indebted countries, which means that by these criteria they still do not hold solid external positions. The same applies to those moderately indebted countries whose debt indicators approached the established critical values. An abrupt increase in international interest rates or a major decline in the price of their exports might be enough to throw them back into the severely indebted category.

Table 4. Developing countries classified as severely indebted by the World Bank a/

Low-income countries b/	Middle-income countries b/
Burundi	Angola
Central African Republic	Argentina
Côte d'Ivoire	Bolivia
Equatorial Guinea	Brazil
Ethiopia	Cameroon
Ghana	Congo
Guinea	Ecuador
Guinea-Bissau	Jamaica
Guyana	Jordan
Honduras	Morocco
Kenya	Panama
Lao People's Democratic Republic	Peru
Liberia	Syrian Arab Republic
Madagascar	Uruguay
Mali	Cuba c/
Mauritania	Iraq c/
Mozambique	
Myanmar	
Nicaragua	
Niger	
Nigeria	
Rwanda	
Sao Tome and Principe	
Sierra Leone	
Somalia	
Sudan	
Uganda	
Viet Nam	
Yemen, Republic of	
Zaire	
Zambia	
Afghanistan c/	

Source: World Bank, World Debt Tables 1994-95, vol. 1, p. 187.

a/ Countries in which the ratio of the present value of debt servicing to exports is above 220 per cent or the ratio of the present value of debt servicing to GNP is above 80 per cent.

b/ Countries are classified as low-income if their 1993 GNP per capita is $695 or less and middle-income if their 1993 GNP per capita is more than $695 but less than $8,626.

c/ Countries not reporting to the World Bank's Debtor Reporting system.

B. Looking beyond debt indicators

31. If it thus appears that the debt situation of a large number of developing countries is still fragile, it is also the case that their overall economic situations are not as strong as might have been hoped. Growth rates of gross domestic product (GDP) in countries that "experienced recent debt-servicing difficulties" 12/ have been persistently lower than those of countries without debt-servicing problems. IMF estimated that the GDP growth rate for the former group averaged 2.4 per cent per year during the period 1987-1994; it reached an annual average of 7.1 per cent for countries without debt-servicing problems during the same period. Moreover, IMF forecasted the differences in growth rates to continue in 1995 and 1996, with growth of GDP in the former group averaging 3.3 per cent a year and in the latter group remaining above 7 per cent a year. 13/

32. This is not to say that the differences in growth rates should be attributed only to the debt problem. There are countries facing severe developmental constraints besides the external one, and diverse political problems whose solution could clear the way towards a more desirable development path. But even some debt-crisis countries that have been considered model adjusters - Mexico before 1994 being a major case in point - did not see robust economic growth.

33. The adoption of strong adjustment policies has long been an integral part of the international debt strategy. But results produced so far have underlined how long and difficult is the process. With hindsight, one can appreciate how often it has entailed false starts, inappropriate sequencing and a political-economic process of learning by doing. 14/ Slow growth, reduced employment opportunities and cuts in government expenditure have led to an increase in the number of people living in poverty in many countries, while the gap between the rich and the poor has increased in some others. Many countries have been registering a slow-down in their social progress, while social indicators have been deteriorating in others. 15/ Although lately there has been increasing emphasis by multilateral financial institutions and Governments on protecting the poor and other vulnerable groups during adjustment, there remains a need to translate these efforts into more effective policies in many cases.

34. The issue acquires even greater importance today as countries that were believed to have reached a sustainable path suddenly face new external constraints and are required to overcome new adjustment hurdles. This brings additional burdens to a large segment of their populations, often those that also failed to enjoy the limited period of "prosperity".

35. The Mexican and Argentine crises in 1995 are cases in point. The Mexican crisis alarmed the international community early this year, and many initially thought that the debt crisis had returned to this country in a new, virulent form. While the markets diagnosed the crisis as one of liquidity - born out of an unhappy combination of trade liberalization and an overvalued exchange rate - the Mexican economy has had to return to a difficult adjustment path with a sharp contraction of economic activity in 1995, lower incomes and higher unemployment. Argentina is another country where new austerity measures had to

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be introduced earlier this year, while already facing a severe unemployment problem.

36. The events in Mexico temporarily cooled off investors' attitudes towards lending to developing countries. Although some debtor countries have succeeded in placing bonds in the international capital markets in the first half of 1995, the interest rates needed to attract buyers continued to be quite high. This is an indication that these countries' creditworthiness was still not perceived to be solid. As of March 1995, among the 27 "moderately indebted" countries, only Chile, Colombia, India, Indonesia and Tunisia were rated "investment grade" by the major private credit agencies. 16/

IV. OUTSTANDING ISSUES

37. Why is it that after more than a decade of an evolving strategy and concerted efforts by both creditors and debtors, it is not possible to say that the debt crisis is finally over? The answer seems to be that the international strategy for bringing countries out of their debt crises was incomplete. The strategy can be characterized as first recognizing that for whatever reason a country found itself in a foreign debt crisis, it had to adjust its economy so as to raise its production of tradable goods and services, increase efficiency overall and stabilize its macroeconomy. The strategy recognized as well that there was no way that the required adjustments could be brought about while maintaining minimal standards of living if all the debt also had to be serviced on a timely basis. Thus, while debtor country Governments recognized that there would be costs of adjustment that had to be absorbed, the international community conceded that not all of the debt could in good conscience be serviced. Over time, the degree of difficulty and protracted nature of the adjustment process was increasingly appreciated by the debtors, and the depth of the necessary degree of debt relief was increasingly acknowledged by the creditors. But in almost all cases a gap remained between the overall degree of debt relief that was warranted and what was available at any one moment.

38. One part of the explanation for this seems tied to the fact that the international strategy, by separately dealing with discrete components of the debt stock, has failed to address adequately the "debt overhang" as such. In other words, in many instances the relief granted has not been sufficient to bring debt obligations in line with the debtor's capacity to pay.

A. Middle-income countries

39. Brady-style debt and debt-service reduction agreements, for instance, were devised for middle-income countries with significant private debt, specifically commercial bank debt. These agreements were meant as final restructurings of the debt, as the "exit option" with no mechanism for further renegotiation of that particular debt. In some cases, however, the cash flow benefit was small, since debtors had not been making full payments before the agreements went into effect. Often the net reduction in total debt was smaller than the reduction in bank debt since borrowings from multilateral sources rose to finance the United States treasury bonds purchased as collateral. Thus, although the Mexican

agreement - the first Brady Plan arrangement - reduced Mexico's commercial bank debt by 17 per cent, it reduced Mexico's overall debt (net of reserve holdings) by less than 2 per cent. In the case of Venezuela, there was a small reduction in commercial bank debt but a small increase in the net debtor position of the country. In the case of Uruguay, a one-third reduction in bank debt translated into less than a 3 per cent improvement in the net debtor position. 17/

40. The case of Costa Rica illustrates another difficulty. Its bank debt was reduced by 57 per cent and the net overall debt by 23 per cent as a result of its Brady Plan agreement. However, the cash flow benefits were not large, owing to the arrears that Costa Rica had been accumulating. Also, the standard Paris Club rescheduling was arranged on Costa Rica's debt to bilateral official creditors, and that debt had been roughly as large as its bank debt. Indeed, soon after, new debt-servicing difficulties arose.

41. Middle-income countries commonly owe considerable amounts to bilateral official creditors. A significant number of severely indebted middle-income countries, for example, owed more than 40 per cent of their debt to bilateral official creditors at the end of 1993, including Bolivia, Cameroon, Congo, Jamaica, Jordan, Morocco, Peru and the Syrian Arab Republic. The relief usually granted to these countries through the Paris Club was merely to defer principal repayments, charging commercial interest rates on the deferred amounts, terms that were far less accommodating than those agreed by their commercial bank creditors.

42. For political reasons, treatment of such debt could be far more concessional, as it was for Poland, a middle-income country that is not usually grouped with the developing countries. The Paris Club granted Poland a 50 per cent reduction in the entire stock of bilateral debt (or an equivalent reduction in the scheduled debt service calculated on the basis of net present value), phased over several years. 18/ Full implementation of this agreement was approved in April 1994. With comparable relief also obtained from its bank creditors, Poland may soon graduate from the severely indebted group. The Polish agreement may, in fact, serve as an indication of how little official debt relief other middle-income countries received. Furthermore, Poland's graduation will highlight the importance of treating the whole stock of debt at once.

43. Indeed, the treatment of the debt of some middle-income countries has improved. Bolivia and Cameroon have recently rescheduled under concessional terms actually meant for low-income countries: enhanced Toronto and Naples terms, respectively. Several countries (Congo, Ecuador, Jamaica, Jordan, Morocco and Peru) restructured Paris Club debt under the Houston terms which grant a somewhat longer maturity and grace period than the standard terms, although no debt-service reduction is explicitly obtained under these terms.

44. In sum, except in exceptional circumstances, the Paris Club offers no debt reduction to severely indebted middle-income countries. And financing the collateral in Brady Plan arrangements diluted the net benefit of the reduction in commercial bank debt. The overall degree of relief could thus be rather small. At first, this did not seem to matter, at least to the financial markets that celebrated the regularization of relations of middle-income debt-crisis

countries with their creditors by providing large-scale capital inflows to several of the countries. As was seen by early 1995, however, in some cases those flows were not sustainable.

B. Low-income countries

45. The debt of severely indebted low-income countries is owed mostly to official creditors. In some countries (Côte d'Ivoire, Guyana, Lao People's Democratic Republic, Madagascar, Mauritania, Mozambique, Myanmar, Nicaragua, Nigeria, Sudan, United Republic of Tanzania, Viet Nam, Yemen and Zaire), bilateral debt dominates the structure of total long-term debt. As was seen above, creditor Governments have increased the concessionality of terms applied to Paris Club restructuring of the debt of low-income countries. Accordingly, several countries have been granted enhanced Toronto terms since 1991, and more recently, Naples terms.

46. The enhanced terms, however, have not been enough to lift these countries out of their debt problem. According to the World Bank, the application of enhanced Toronto terms and rescheduling of official development assistance credits on agreed Paris Club terms alone would bring the debt-to-export ratio below the critical value of 200 per cent in only 3 out of 32 severely indebted low-income countries. 19/ Naples terms go somewhat further, but their impact will only be felt if and when the cancellation of the agreed share of the debt stock takes place.

47. The limited impact of Paris Club initiatives so far can be partially explained by the fact that, as mentioned above, Paris Club does not restructure the entire stock of debt owed but only part of it. Furthermore, many countries are not indebted exclusively to Paris Club creditors. The net result is that only a share of bilateral debt ends up receiving the concessional treatment. A related problem is that creditors' choices are not uniform, and some creditor Governments - owing to complex legal and political constraints - have not been able to select the concessional options, so the scope of debt reduction varies between countries. Accordingly, the overall relief granted may be less than the stipulated 50 or 67 per cent, depending on the composition of creditors involved in the rescheduling.

48. As cases in point, lack of consensus among creditors prevented Bolivia and Nicaragua from having the stock of eligible debt treated in their latest restructuring with the Paris Club, although both countries met the eligibility criteria to be considered by creditors on the matter of the stock of debt. In addition, some low-income countries have not received concessional treatment on their rescheduling with the Paris Club (Kenya and Nigeria). 20/

49. Another practice that contributes to relief being smaller than anticipated is the "de minimis" clause. It allows those creditors whose claims are below an agreed amount to be excluded from the rescheduling agreement. The recent Ugandan restructuring illustrates these problems well. First, the stock treatment did not include all outstanding debt, but only that contracted before the cut-off date of 1 July 1981. Second, the debt covered was reduced further by a high "de minimis" clause, and thus only three creditor countries

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participated in the agreement. As a result, 49 per cent of Uganda's pre-cut-off debt was cancelled, which corresponds to 26 per cent of the country's debt to Paris Club creditors. 21/

50. In any event, the Naples terms do not solve the problem of debts owed to Governments that do not participate in the Paris Club. Paris Club agreements include a clause of comparability of treatment, under which the debtor would seek to receive comparable concessions from its various other bilateral official creditors. The clause, however, may hinder negotiations at the Club, as debtor countries with relatively little bargaining power face obstacles in obtaining the comparable relief. 22/ For many severely indebted low-income countries (including Ethiopia, Guinea, Guyana, Lao People's Democratic Republic, Madagascar, Mali, Mozambique, Nicaragua, Niger, Somalia, the Sudan, the United Republic of Tanzania and Viet Nam) a significant share - sometimes almost all - of their bilateral debt is owed to non-Paris Club countries. Moreover, the multilateral institutions, which are the largest non-Paris Club creditors, are fully excluded from Paris Club treatments.

51. Many severely indebted low-income countries are highly indebted to the multilateral creditors. By the end of 1993, multilateral debt, including amounts owed to IMF, represented at least 50 per cent of total public and publicly guaranteed debt of Burundi, Central African Republic, Ghana, Guinea-Bissau, Honduras, Kenya, Liberia, Niger, Rwanda, Sao Tome and Principe and Uganda. In 1994, the multilateral debt service of severely indebted low-income countries amounted to $3.2 billion and represented about 47 per cent of all obligations met by these countries. In countries such as Bolivia, Burundi, Honduras, Mauritania, Niger, Uganda and Zambia, multilateral debt service alone corresponded to at least 20 per cent of their exports of goods and services in 1993.

52. When countries such as these receive relief from their bilateral creditors, the anomalous situation could arise wherein that relief might mainly help to meet financial obligations to their multilateral creditors. In effect, something like this already happens. Debtors typically let arrears accumulate mainly on bilateral and long-term private debt, since costs of not servicing short-term debt (basically trade lines) and multilateral debt would have even more devastating consequences for the countries concerned. According to a recent study, sub-Saharan African countries met 84 per cent of their scheduled payments to their multilateral creditors in 1992, while private creditors received 64 per cent of expected payments and bilateral creditors only 14 per cent of what was due. 23/

53. Although multilateral debt is not subject to restructuring, new loans are usually extended to those countries that have been adhering to adjustment programmes supported by the multilateral financial institutions, and these new loans can help refinance payments falling due on the old loans. However, to the degree that there is difficulty servicing multilateral debt, this only postpones the problem and worsens it as it increases indebtedness.

54. In this regard it is quite significant that there has been increasing acceptance recently of the difficulties associated with the servicing of multilateral debt on the part of a number of low-income countries. The

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communiqué of the summit meeting in Halifax, Canada, of the group of seven major industrialized countries in June 1995 states that the group "... recognize[s] that some of the poorest countries have substantial multilateral debt burdens". Thus, the group agreed to encourage the Bretton Woods institutions to develop a comprehensive approach to assist countries with multilateral debt problems, through the flexible implementation of existing instruments and new mechanisms where necessary (see A/50/254, annex I).

55. One new mechanism had already been proposed by Mr. Kenneth Clark, the United Kingdom Chancellor of the Exchequer. It entails the establishment of a new concessional facility at IMF to be funded by loans from creditor countries. Although the creditors would receive market interest rates on these loans, countries that drew on the facility would pay highly concessional interest rates. The difference might be covered by the earnings of a trust fund, which could be established with the profits from a phased sale of small amounts of IMF's gold holdings. 24/ As only IMF holds significant amounts of gold, other mechanisms would be needed to underwrite comparable refinancing facilities at the multilateral development banks.

V. CONCLUSIONS FOR POLICY

56. The analysis above indicates that a more comprehensive application of debt-relief measures may be necessary. If so, which debt; if not, why not?

57. Although many countries have indeed benefited from the implementation of the debt-reduction initiatives hitherto developed, the debt of several countries is still unmanageable while the debt of others might become unmanageable. It would only be prudent to consider contingencies. Certain avenues of relief, however, have already been closed off for many countries and others are not considered practical.

58. In particular, the Brady Plan debt-restructuring arrangements - like the debt-stock treatments under the Naples terms for low-income countries - were meant to be "exit" options for the debtors and the creditors. They were intended to leave the countries with sustainable debt-servicing obligations while freeing the creditors from having to renegotiate repeatedly the debt servicing on the same debt. Even if the sustainability calculations were wrong, the creditors that took the exit option are beyond further debt restructuring on the affected debt. Any further relief must thus fall to the remaining creditors, who are mainly bond holders whose cooperation in new debt restructuring would be very difficult to mobilize and official creditors of one sort or another.

59. The Paris Club might thus find itself being asked to enlarge the number of countries to which it accords concessional debt relief. As presently conceived, the eligibility criteria for debt reduction through the Paris Club exclude countries that are severely indebted but have an income per capita above the $500 benchmark or a ratio of present value of debt to exports below 350 per cent, even if it is still above the critical value of 220 per cent identified by the World Bank.

60. Greater concessionality by the Paris Club need not be the exclusive approach (or even be sufficient in itself) to make debt servicing manageable. Similar steps may be needed on other portions of the debt, in particular multilateral debt. The debt owed by some low-income countries to the multilateral financial institutions has already become of special concern to the international community. As reviewed above, some of these institutions have started applying special mechanisms to alleviate the debt-servicing burden of selected countries. Again, the scope of the countries considered to require special, concessional treatment may not be broad enough to meet all contingencies.

61. It is also possible, however, that expanding the range of countries and types of debt, and deepening the relief granted well beyond what is already on the international agenda may only be necessary for exceptional types of cases, such as lowest-income or some post-conflict countries. The debt-servicing capacity of a country depends on developments in the international economy as much as on success in structural adjustment at home. One cannot emphasize enough the importance of debtor countries' adherence to policies that will correct macroeconomic disequilibria, maintain a stable economic environment and make relative prices reflect real resource costs. But these policies are not sufficient in themselves to promote fast and sustainable growth in the countries concerned, and that is the key to any strategy - as for middle-income countries - that envisions growing out from under a debt overhang.

62. The problem confronted by the severely indebted countries may be seen as a race against time. If investment is sufficiently high and efficient, the capacity to produce tradable goods and services may grow rapidly enough to catch enough of the opportunities thrown up by the international economy. Those opportunities depend, however, on the sustained growth of world income and open markets in the world's large economies, even in the face of new competition from developing countries.

63. More generally, innovative enterprise activity in the heavily indebted countries needs to be boosted, which requires in addition to the appropriate price signals a measure of business confidence. A debt overhang inhibits that confidence, in particular in the absence of contingency plans for maintaining the liquidity of countries whose debts still exceed their long-run debt-servicing capacity, especially should there be, say, a severe international economic downturn. In this regard, the proposed expansion of the resources at the disposal of the General Arrangements to Borrow at IMF would be a supportive step, as would maintenance of adequate regular multilateral lending capacities through appropriately timed IMF Quota increases, development bank capital increases and concessional fund replenishments, as discussed in A/50/397.

64. In addition, while much attention is given to short-term monetary and fiscal indicators, when long-term social and economic goals suffer, confidence suffers as well. Adjustment policies are not substitutes for development policies. The practice of giving priority to economic adjustment and then applying palliatives on the social level - through, for instance, the adoption of special funds to finance projects that aim at mitigating the social costs of adjustment - has produced limited results. Confidence and the investment that it determines thus hinge as well on maintaining a degree of social equilibrium.

65. As always, it is the entire package of adjustment measures, plus adequate debt relief, official financial support and a buoyancy in an open world economy that builds confidence in the private sector and charges up dynamic development processes.

Notes

1/ A companion report contains an assessment of recent trends in financial flows to developing countries (see report of the Secretary-General on agenda item 96 (a), "Macroeconomic policy questions: financing of development", A/50/397).

2/ The external debt difficulties of heavily indebted transition economies have been treated by the international community in a manner parallel to that of the developing countries. The external debt situation of the transition economies is thus not covered in this report.

3/ "Debt conversion" is noted in the table as one type of treatment of official and bank debt, although the bulk of actual cases has involved bank loans. In the latter type of conversion, banks would typically sell their claims at a discount on the secondary market to potential direct investors (debt-for-equity swaps) or to non-governmental organizations (as in debt-for-nature or debt-for-education swaps). The loan paper would then be exchanged for equity shares or budgetary programme commitments. In the conversions of debt owed to official creditors, specific arrangements would be made between debtor and creditor (e.g., allowing debt servicing to be paid in local currency and then returning the funds to the debtor Government for use in environmental programmes).

4/ See World Bank, World Debt Tables 1994-95, vol. 1 (Washington, D.C., December 1994), p. 30.

5/ The agreement with Sierra Leone was concluded before the adoption of the Naples terms.

6/ See IMF, Annual Report 1994 (Washington, D.C., 1994), p. 143.

7/ Data and country groupings are those of United Nations, World Economic and Social Survey, 1995 (United Nations publications, Sales No. E.95.II.C.1).

8/ Nevertheless, the 1980s debt crisis entailed the suspension of debt servicing on bonds by some countries (e.g., Costa Rica, Guatemala, Nigeria and Panama). For details, see J. J. Fernandez-Ansola and T. Laursen, "Historical experience with bond financing to developing countries", IMF Working Paper No. WP/95/27 (March 1995).

9/ For additional details, see United Nations, World Economic and Social Survey, 1995, pp. 35-40.

10/ See IMF, Official Financing for Developing Countries (Washington, D.C., April 1994), p. 14.

11/ Out of the 57 low-income countries for which information is available, 33 are considered severely indebted, 13 moderately indebted and only 11 are classified as less-indebted countries. Among the 96 middle-income countries, 18 are severely indebted, 19 are moderately indebted and 59 are ranked as less indebted.

12/ This is a category that IMF employs in its World Economic Outlook. It includes 72 developing countries that incurred arrears or entered into debt-rescheduling agreements during the period 1986-1990.

13/ See IMF, World Economic Outlook (Washington, D.C., May 1995), p. 121.

14/ See World Economic and Social Survey, 1995, chap. V.

15/ See United Nations, Report on the World Social Situation, 1993 (United Nations publication, Sales No. E.93.IV.2).

16/ See Financial Flows and the Developing Countries: A World Bank Quarterly, May 1995, p. 10.

17/ See World Economic Survey, 1991 (United Nations publication, Sales No. E.91.II.C.1), p. 163.

18/ Comparable treatment was agreed as well for Egypt in the same year, 1991, before a general concessional treatment for low-income countries was first adopted (the enhanced Toronto terms).

19/ See World Bank, World Debt Tables 1994-95, vol. 1, p. 44.

20/ See UNCTAD, Trade and Development Report 1995 (United Nations publication, Sales No. E.95.II.D.16), p. 37.

21/ Information provided by UNCTAD/Development and Finance Branch. See also C. Katsouris, "Naples debt deal falls short of needs", Africa Recovery, vol. 9, No. 1 (June 1995), p. 11.

22/ See OECD, Financing and External Debt of Developing Countries, 1992 Survey (Paris, 1993).

23/ See Non-Aligned Movement, Ad Hoc Advisory Group of Experts on Debt, The Continuing Debt Crisis of the Developing Countries (August 1994).

24/ The profits would represent the amount by which the net sale price exceeded SDR 35 per ounce, which is the official valuation of Fund gold (at the end of June 1995, the market price of gold was almost SDR 247 per ounce).
