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Sessional Committee II

DRAFT REPORT OF SESSIONAL COMMITTEE II OF THE TRADE AND DEVELOPMENT BOARD

Rapporteur: Mr. H. Aschentrupp (Mexico)

Addendum

AGENDA ITEM 3 : DEBT

<u>Speakers</u> :	Secretariat	Japan
	Nigeria	Indonesia
	Mexico	China
	Brazil	Canada
	Norway	United States
	Algeria	United Republic of Tanzania

Note for Delegations

This draft report is a provisional text circulated for clearance by delegations.

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The UNCTAD Editorial Section
Room E.8106
Fax No. 907 0056
Tel. No. 907 5654

Chapter III

DEBT ISSUES IN A DEVELOPMENT CONTEXT, INCLUDING THE RECENT EVOLUTION OF DEBT RESCHEDULING

(Agenda item 3)

1. For its consideration of this item, the Board had before it the following documentation:

"Trade and Development Report 1993".

Consideration in Sessional Committee II

2. In his introductory statement, the Chief of the Development Finance Programme, Global Interdependence Division, highlighted the salient features of the analysis made in Part III of the Trade and Development Report, 1993.

3. The spokesman for the African Group (Nigeria) said that many developing countries, especially in Africa, were experiencing a severe socio-economic crisis characterised by a heavy external debt burden, deteriorating terms of trade, high (and sometimes very high) inflation and drastic falls in the standard of living. Structural adjustment programmes had necessitated tremendous sacrifices and resulted in political tension in many countries. For Africa, the past 10 years had been a lost decade for development. The sustained growth in the industrialized countries during this period had not served as an engine of growth for the region due to the debt problem and the other features of the socio-economic crisis just mentioned, as well as protectionism, a decline in foreign direct investment and negative transfer of resources.

4. The focus in development assistance should be shifted towards basic needs, human development and infrastructure. Structural adjustment programmes had not yet yielded their full benefits owing to the unfavourable external environment. Under their present debt burden, African countries could not achieve self-sustained growth. The debt problem required concerted efforts by the Bretton Woods institutions and the international community. The Brady Plan, the Toronto options, the Trinidad terms, and other initiatives were helping but did not provide an adequate solution. There was a need for a concerted international debt management strategy within the framework of growth and development which must aim at reducing both the debt stock and the burden of debt service. Excessive reliance on debt rescheduling through market mechanisms only served to perpetuate the problem of external imbalance and caused the debt stock to rise

further. He requested that all official debt of low-income and least developed countries be cancelled, and that substantial financial resources be made available to sub-Saharan Africa.

5. The representative of Mexico stressed that over-indebtedness was a result both of excessively expansionist economic policies in debtor countries and of an international financial system which was too permissive and ruled by irrational norms. It was of the utmost importance to resolve the debt problem, since it could cause a vicious spiral of instability leading to high interest rates which would in turn hamper growth and instigate instability. Moreover, the net flow of capital from developing countries to international financial institutions, which was one of the consequences of the debt problem, should be reversed. Reorganization of multilateral debt would be a step in the right direction. Moreover, an inflow of financial resources to highly indebted countries was necessary for the restoration of their financial viability and the consolidation of the economic reforms which they had undertaken. In measures to tackle the debt situation, it was important to bear in mind that responsibility should be shared between debtors and creditors and that the issue was closely related to others such as the net transfer of resources, trade, poverty and environmental degradation.

6. Brady deals could have two advantages, as in the case of Mexico: a direct one in the form of a reduction in debt service, and an indirect one in the form of the encouragement of national and foreign investors. The latter category of benefits, which led to a reduction in international interest rates, an increase in capital formation, and repatriation of flight capital, had a greater cumulative effect than the former. He concluded by stressing that efforts to deal with the debt of the Central and Eastern European countries should not be detrimental to efforts to overcome the over-indebtedness of developing countries.

7. The representative of Brazil said that most of the problems relating to external debt had not yet been overcome. Progress had been made mainly in restructuring debt to private banks. There had also been a growing degree of concessionality in the renegotiations of official debt within the Paris Club, but debt service difficulties continued in more than 60 countries, many of them least developed countries. Since the beginning of the 1990s, Brazil had opted for the treatment of external debt on a country-by-country basis in the Paris Club, as well as in the committee of creditor private banks. Its foreign debt negotiations were well advanced: within the Paris Club it had negotiated 11 bilateral agreements, and in its negotiations with private banks the term sheet had been approved by both parties and a final agreement was near.

8. However, the external debt problem had to be seen in the wider context of foreign financing of development. In the 1950s, foreign direct investment, especially by multinational companies, had accounted for the bulk of financial transfers; in the 1960s, official credits had played a very significant role; from the mid-1970s, private bank credit had increased sharply until the 1982 debt crisis; and subsequently net transfers had become negative. Currently, the non-financial private sector had become the main agent for financing development. While the increase of investment flows was frequently attributed to liberalization in developing countries, it was also a result of the present situation in the industrialized countries, characterized by low interest rates and modest growth. The volatility of these flows limited the potential of direct investment as a means of financing development, and the private sector was capable of making only a limited contribution to the financing of infrastructure, housing, health and education. Since the present economic situation in industrialized countries was not conducive to an urgently needed increase in ODA, wider scope should be given to multilateral financial institutions. These could play a more aggressive role in raising resources from private financial markets and making them available for infrastructure projects in developing countries.

9. The representative of Norway, speaking on behalf of the Nordic countries, agreed with the conclusion in the Trade and Development Report that there was still unfinished business regarding debt, especially that of low-income countries (particularly in sub-Saharan Africa).

10. As regards African debt, the standard procedure of short-leash rescheduling had left the debt overhang intact. As documented in the Report, the average contractual debt service of low-income Africa was a staggering 80 per cent of annual export income, and it was clear that official development assistance could never fill the financing gap between debt obligations and payments capacity. Thus, the Nordic countries welcomed the recent recognition by several Paris Club creditors that a number of the severely indebted low-income countries needed debt relief going well beyond 50 per cent. Provided these countries were committed to, and had an adequate track record of, economic reform and structural adjustment, the Nordic countries were willing to grant them reductions of up to 80 per cent of their stock of debt.

11. The Nordic countries welcomed the fact that the Paris Club, following the introduction of the enhanced Toronto terms at the end of 1991, had now put the stock-of-debt approach firmly on its agenda. However, the Nordic countries believed that, in appropriate cases, action should be taken promptly and that there should not be a further delay of three years. Existing mechanisms, such as the recently replenished IDA Debt Reduction Facility (6th dimension), must

be fully utilized. In IMF, a new Enhanced Structural Adjustment Facility (ESAF II) should be agreed upon before the end of 1993, and the IMF's Rights Accumulation Programme (RAP) for the clearance of arrears needed to be followed up and perhaps refined.

12. As pointed out in the Report, the relative share of multilateral debt in total debt was increasing. Direct multilateral debt relief was subject to well-known constraints. However, the World Bank's fifth dimension, which subsidized 90-100 per cent of the interest due to the Bank from IDA-only countries, offered effective multilateral debt relief, and the Nordic countries once again urged other donor countries to contribute to the fifth dimension. The possibility of setting up a similar scheme in the African Development Bank deserved consideration. However, there was a trade-off in that, if more was accomplished with regard to reducing bilateral and commercial debt for low-income countries, there would be less need for concern regarding their multilateral debt.

13. The representative of Algeria said that the Trade and Development Report, 1993 was in agreement with her country's view that the debt crisis was far from over. The Trade and Development Board should continue to review the debt problem.

14. Algeria had scrupulously fulfilled its debt-servicing obligations, devoting to them more than 70 per cent of its export revenues. The current Algerian situation involved a liquidity crisis. Access to credits was central to economic recovery and was indispensable for financing current economic reforms, as well as transition. However, her country's policy of servicing debt, far from strengthening its creditworthiness, had had the opposite effect. This pointed to the problem of the responsibility of multilateral financial institutions towards lower-middle-income countries, such as Algeria, which had continued to service their debts. No measure of relief had been taken to reward their efforts. The Report's treatment of this problem was inadequate.

15. She agreed with the Report on the need to improve the debt strategy. Her country had noted the proposals made concerning the Paris Club and the rescheduling of the official bilateral debt of the Russian Federation. The flexibility demonstrated by the Paris Club in this case should be applied without discrimination.

16. The representative of Japan said that recent active borrowing from the international financial markets by East Asian and Latin American countries, as well as the widespread decline in the debt service ratio, pointed to a gradual

but steady alleviation of the external debt situation. Yet the debt problem remained a crucial issue for the international community and would feature prominently in the Tokyo International Conference on African Development. The Japanese Government hoped that this Conference would make a major contribution to creating a consensus on the priorities for African development.

17. Regarding the bolder action on debt relief and reduction advocated in the Trade and Development Report, he pointed out that debt reduction might discourage the inflows of new money needed by developing countries, and it would demoralize developing countries which were performing well and faithfully meeting their debt service obligations. It was indispensable for the effects of the enhanced Toronto terms to be examined before consideration of a new approach. The recent announcement by the Japanese government of the next Medium-Term Target for overseas assistance for the period 1993-1997 was a manifestation of its determined support for self-help efforts of debtor and other developing countries. The Target included grant aid and technical assistance, and efforts would also be made to increase the grant portion. Particular attention would be paid to increasing grant assistance to least developed countries. Japan had provided US\$500 million as non-project grant aid to support structural adjustment efforts from fiscal year 1987 to fiscal year 1989, meeting the initial target announced in 1987. Under a second phase of three years starting in fiscal year 1990, US\$600 million had been allocated under this heading. The Government had decided to implement a third phase with grant assistance of US\$650-700 million over the three-year period starting in fiscal year 1993. Japan was one of the few countries that had provided new money in the form of official long-term lending in support of the Brady Initiative.

18. The spokesman for the Asian Group (Indonesia) expressed agreement with the Trade and Development Report that the debt problem, which was not the outcome of unilateral action, was not over, so that collective measures at the international level were needed and the developed countries should be especially understanding. Reiterating the gist of the Non-Aligned Movement memorandum to the Tokyo summit, he said that, regarding bilateral debt, residual Paris Club debt should be converted to equity investment or to local currency, that the eligibility criteria for severely indebted low-income countries should be loosened, that more generous debt and debt service reduction was required for severely indebted middle-income countries, and that there should be a once-and-for-all approach to the reduction of debt burden, on the basis of extended terms and applied in a single operation. On commercial debt, he said that, for the severely indebted 50 developing countries, a less costly approach (which maintained the essentials of the Brady plan) should be devised to achieve debt and debt-service reduction, the creditor Governments should induce banks to

participate in debt relief through tax drawbacks or exemptions, and international agencies including UNCTAD should provide better co-ordinated and more cost-effective technical assistance to enhance the administrative and negotiating skills of indebted countries. Concerning multilateral debt, consideration should be given to the use of SDRs as a means of reducing it, part of the debt might be converted into equity investment, concessional resources for regional development banks should be expanded to cope with the burden of debt, and the profits and reserves of multilateral financial institutions might be used for debt and debt-service reduction.

19. The representative of China said that, since the emergence of the debt crisis in 1982, the world had witnessed its serious adverse effects not only on the economic development of developing debtor countries but also on the global economy and financial system. Efforts on the part of debtor and creditor countries and of both commercial banks and international financial institutions had led to some degree of success in solving the debt problem. However, as pointed out in the Trade and Development Report, the debt crisis might have ended for some countries, but it had not for others, and the total volume of debt was still increasing.

20. China had consistently stated that the fundamental solution to the global problem of debt lay in reinvigorating economic development in developing debtor countries. However, the development prospects for developing countries were at present constrained by an unfavourable international economic environment consisting of recession in developed countries, declining international prices in primary commodities, and increasing trade protectionism. While responsible for their own development, developing countries generally (especially the debtor countries among them) needed the support of developed countries and the international community to reverse the unfavourable trends in the external environment, as well as to explore new approaches to increase the flow of capital to developing countries, especially that of official capital on concessional terms. Already there was a consensus among all countries regarding an early removal of the debt overhang. What was needed now was action or, as one would say in China, to "start forging while the iron is still hot."

21. The representative of Canada, commenting on various proposals of the Trade and Development Report, said it was not clear that all low-income countries needed a minimum debt reduction on "Trinidad terms", assumed to be a two-thirds reduction. At the Tokyo Summit, the Group of Seven had discussed a proposal to increase the level of concessionality under "enhanced Toronto terms" from the existing 50 per cent to as much as 80 per cent on a case-by-case basis. Canada had already indicated that it could accept this proposal to calibrate debt relief

according to debtors' needs. The Group of Seven had also agreed to support an early implementation of a reduction in the stock of official bilateral debt of low-income countries which had honoured the terms of their Paris Club rescheduling agreements and which had demonstrated ability to implement IMF adjustment programmes.

22. Similarly, it was not clear that all IDA recipients required concessional rescheduling terms. As a matter of fact, the 1991 Munich Summit of the Group of Seven had endorsed the application of concessional rescheduling terms for some lower-middle-income African countries, and the Paris Club would be discussing in more detail the implementation of concessional rescheduling terms for certain lower-middle-income countries at a meeting in October 1993. Canada also believed that for administrative or technical reasons it would be highly impractical to combine Paris Club rescheduling with donor group meetings. In any event, the Governments that participated in Paris Club rescheduling usually participated also in World Bank Consultative Group meetings, so that consistency was maintained in addressing the debt and development problems of a given country.

23. He concluded by stating that Canada would not support the rescheduling (much less the cancellation) of obligations to multilateral financial institutions for various reasons, including the need to protect the credit ratings of the World Bank and the Inter-American Development Bank, as well as to ensure that the revolving nature of IMF resources was maintained.

24. The representative of the United States, referring to debt problems that still existed in many of the poorest countries, said that debt relief alone would not be a solution. A comprehensive and coordinated approach to implementing sustainable economic reform, together with efforts to alleviate debt to sustainable levels, was the only path to growth and economic recovery.

25. Her country did not agree with many of the recommendations put forward in the Trade and Development Report. Regarding the recommendation that the Paris Club increase the scale of debt reduction, she insisted that this position was best taken up within the Paris Club itself on a case-by-case basis. She could not support the recommendation to shift the responsibility for debt rescheduling from the Paris Club to donor groups. The latter would not be the most competent forum for confronting the complexities of debt, and this shift would not benefit debtor countries, since there would be a blurring of functions and responsibilities.

26. Her country supported a successor to the Enhanced Structural Adjustment Facility in IMF, the continuation of the Rights Accumulation Programme, the

replenishment of the IDA Debt Reduction Facility, and the continued use of the fifth dimension of the World Bank to provide some interest-rate support on the non-concessional loans of IDA-only countries. However, she strongly opposed the suggestion of a rescheduling or reduction of debt owed to multilateral financial institutions, since such actions would jeopardize the credit rating of these institutions, which would in turn damage the contribution they could make to the development process.

27. Regarding the international debt strategy on commercial debt, she pointed out that dramatic progress had been made under the Brady Plan. It had provided external financial support as countries implemented sustainable reform. Investor confidence had been boosted, and many of the major debtors now had renewed access to international capital markets. In response to the recommendation for the need for Brady packages to offer greater debt reduction, it was the market-based approach of the plan that had induced the participation of the banks.

28. Concerning Russian debt, she emphasised the achievement represented by the rescheduling of \$15 billion of obligations and noted that a new initiative could be expected when the current rescheduling period expired.

29. The representative of the United Republic of Tanzania drew attention to the burden of external debt on his country's economy. He endorsed the recommendations on debt in the Trade and Development Report and thanked countries which had cancelled debt owed to them by his country.