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EXTERNAL DEBT CRISIS AND DEVELOPMENT

Report of the Secretary-General

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FOREWORD BY THE SECRETARY-GENERAL

I have had several occasions to bring to the attention of Member States my deep concern at the continuing debt crisis and its negative impact on the growth and development of a very large number of developing countries. The conditions under which these countries are carrying out their adjustment programmes in order to reform their economies and meet their debt obligations have led to serious social hardship and political turmoil.

Today, I cannot say that my concern has diminished. It is true that important initiatives have been taken, and some progress has been made. Debt reduction is now fully recognized as a major factor in a durable solution of the debt crisis. But much more remains to be done. If debt and debt-service reduction are to lead to a revival of growth and development, it needs to be applied soon to a much greater extent, cover a large variety of debts and encompass a wide range of countries. Approaches that rely exclusively on the voluntary actions of commercial banks are not likely to yield the required results.

Of course, there is much agreement now about the notion that developing countries themselves must pay the highest attention to improving their own economies in the face of scarce resources. In particular, they need to make sure that the public sector is efficiently run, and that the private sector is stimulated to invest and to improve productivity. Monetary and fiscal discipline is also crucial. At the same time, greater resources must be devoted to human development, both by the private and public sectors, if these nations are to face the challenges of an ever evolving world economy with confidence.

It is well known that a large number of developing countries have indeed been making this effort. However, incomes in many of them have actually declined, and may continue to do so. This decline must now come to a stop. An early solution of the debt problem is essential.

To bring about a lasting solution, additional resources commensurate with the task ahead will be required. I attach a great deal of importance to the active involvement of the Governments of the creditor countries in ensuring that debt reduction to the required extent is brought about expeditiously. There are cases where tax and regulatory changes will be essential.

The role of creditor country Governments is particularly important as regards the debt of the low income countries, especially in Africa, and in many middle income countries, for official debt is a significant part of their burden. The creditor country Governments and the multilateral financial institutions can play an important role in alleviating their situation.

The multilateral financial institutions have to be better endowed, with sufficient resources to carry out the role that is theirs during times of such difficulties for the developing countries. I would like to see them return to a position where they make a significant contribution to a positive transfer of resources to the developing countries. However, I also believe that the conditions under which their assistance is made available to developing countries need to be reviewed and adapted to the present very difficult circumstances these countries are facing.

The forty-fourth session of the General Assembly, as well as the forthcoming special session of the Assembly in April 1990, are important opportunities to forge the political consensus for reviving growth and development, and for eradicating poverty, based on national and international action. Let us fully use these two important meetings. Only when the 70 some countries that have been facing debt-servicing problems for the better part of the decade have rebuilt their economies and renewed their development will peace have a sound footing.

Javier Pérez de Cuéllar

I. INTRODUCTION

1. For several years, the General Assembly has actively sought to extend the area of international agreement on the external debt crisis and the policy approaches needed for a durable solution to the crisis. When the Assembly last addressed the issue, it reached almost a full consensus on a resolution in which it recognized the threat to economic, social and political stability in the developing countries with heavy debt burdens and called for additional economic policy reforms in both debtor and creditor countries, recognizing the shared responsibility of all parties involved. 1/ In particular, the Assembly welcomed the growing acceptance of increasingly diversified techniques to reduce the stock and service of debt, but it also saw the need to broaden the range of techniques further. Indeed, in the nine months that have followed the adoption of the resolution, the menu of policy options for debt relief grew substantially.

2. As a contribution to the Assembly's deliberations on the external debt crisis and development in 1989, the present report updates the analysis of the previous report of the Secretary-General, entitled "Towards a durable solution of the debt problem" (A/43/647), and describes the ongoing process of consultations on debt. The conclusions of the analysis and consultations are presented first in section II, followed by the updating analysis in sections III and IV and a concise summary of the status of international opinion as revealed by the consultation process in section V.

II. EXECUTIVE SUMMARY: THE NEED TO REDUCE DEBT EFFECTIVELY

3. Despite strenuous efforts by all concerned, the economic difficulties of most debt-troubled countries have worsened. Growth in Africa remains stagnant, and in Latin America it has deteriorated sharply. Investment as a share of total output remains at unusually low levels, and the domestic economies of many debtor countries are characterized by various forms of disorder.

4. The debt crisis stands at the centre of these difficulties. The negative net transfer of financial resources, which results directly from the crisis, rose sharply in 1988, reaching an unprecedented $33 billion compared with $26 billion in 1987 (see table 2 below). While not all countries covered by these figures are experiencing debt problems, it is clear that the drain of resources from countries in difficulty has increased.

5. The large budget deficit in a key industrialized country, as well as the imbalances among industrialized countries, have lead to uncertainty and high real interest rates. Those rates in turn have helped attract large amounts of resources from the rest of the world.

6. It is against this background that there has been fairly reluctant acceptance of the need for significant debt reduction. The purpose of debt reduction is to tackle directly situations of over-indebtedness and to allow countries to break the impasse created by slow growth, financial disorder and debt overhang. Whether the

magnitude of debt reduction now being negotiated will be sufficiently large and the response sufficiently prompt to achieve this remains to be seen. However, there are strong reasons to fear that the amount of debt reduction produced by recent arrangements will be insufficient to improve adequately the net resource transfer situation of these countries in the short or long term. Delays in reaching a satisfactory outcome imply a continued accumulation of economic, social and political costs.

7. There is now a need for banks to recognize their losses, which have in effect already been incurred in so far as no one believes that the claims can or will be met in full. The recent decision of some United States banks to significantly bolster their loan-loss reserves needs to be seen in this light. The fact that banks sell loans to others at substantial discounts reflects the probability of future losses. However, the free-rider problem and the different interests of banks, some of which wish to exit while others wish to maintain an active relationship with a client country, make it difficult and time-consuming to negotiate debt reduction. None the less, the process must go forward with dispatch.

8. There is now broad agreement regarding the need for adjustment and reform in troubled debtor countries. Differences of view persist, however, regarding the means through which these changes should be achieved, as well as on their time frames. When, for instance, Africa's ministers of planning and development and ministers of finance adopted a new framework of alternative adjustment programmes for African countries 2/ it was in order to insist that account must be taken of the structural characteristics of African countries, and not to question the need for fundamental adjustment. For countries that have suffered a serious loss of real income as a result of declining commodity prices, such adjustment is inevitably painful.

9. The international community has sought to contain the international debt crisis and cautiously manage the sensitive economic and financial adjustments of debtors and creditors. The strategy followed has been flexible and has incorporated new policy options as the consensus on the need for them to be widened. As a result, the progress achieved to date is significant, but for many highly indebted countries it remains insufficient. More needs to be done if the debt problem is to be mastered and conditions established that are conducive to the resumption of development.

10. First among the areas that merit particular attention is that negotiation of debt-reduction schemes is much too slow and cumbersome. It is disheartening to contemplate that agreements can take up to eight months or more to be negotiated and implemented. One reason for the delay is that banks are confronted with uncertainties concerning the application to them of regulatory and tax policies and accounting standards as well as changes in broader policy issues of creditor Governments, multilateral institutions and the debtor countries.

11. The negotiating process would benefit from a clarification of the positions of the concerned Governments and their commitment to a firm framework for debt negotiation that would be widely regarded as adequate to resolve the debt problem once and for all, rather than merely manage it through a recurring cycle of debt

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negotiations. Part of that framework has to be an understanding that adequate financial resources would be made available to support the debt reduction and financing needs of each debtor country that participates in the process. The current debt reduction efforts are severely underfunded, particularly if they are to be applied to more than a small handful of countries. And if the available resources - currently estimated at around $30 billion - were spread over a large number of countries, it would only partially reduce the debt overhang.

12. Various proposals have been made to generate additional resources for the debt restructuring needs of the developing countries. Following a proposal of President Mitterrand of France, these resources might come from the share of the developed countries of a proposed issue of special drawing rights (SDRs). Alternatively, gold reserves of the International Monetary Fund (IMF) could be tapped.

13. It is also necessary to focus on debt owed to Governments. In many cases, reduction of bank debt will not be sufficient to reach a sustainable debt-servicing burden. This especially applies to middle and lower-income countries whose foreign creditors have largely been official agencies. Thus, creditor Governments must also be more forthcoming in the reduction of Paris Club debt. Debt-service write-offs and reductions in interest rates for lower-income countries should be much larger than has been contemplated under the current options. Moreover, these options should be extended to the middle-income developing countries.

14. One additional and more general concern about the application of the international debt strategy is that the debt-rescheduling negotiations do not necessarily result in the financing appropriate to the adjustment programmes negotiated in other forums, nor is the burden sharing among different types of creditors or debtors distributed according to any clear principle. Indeed the Paris Club accords its most favourable terms to low-income countries, while commercial bank rescheduling committees accord their best terms to middle-income debtors.

15. The aid consortia organized by the World Bank and the round tables of the United Nations Development Programme (UNDP) have the function of endorsing a framework for new finance and restructuring of ODA debts. The Paris Club has a similar function for bilateral official debt restructuring, setting parameters for the subsequent talks of each official creditor with its debtors. A framework agreement among the creditors sets limits to each eligible country's negotiations.

16. Nothing of the sort exists for commercial bank debt relief. Numerous proposals have been made for an international facility for debt reconsolidation, which would buy up or collateralize bank debt at an appropriate discount and treat banks and debtor countries in a consistent way, but they have so far been coolly received. A study group of the World Institute for Development Economics Research, chaired by Mr. H. J. Witteveen, saw the merit of such a facility primarily in the opportunity to spread costs over many contributors. It estimated that even the largest contributor would not have to pay more than $100 million over five years in order to activate a facility commanding $50 billion, which would in turn bring about debt reduction of $125 billion. 3/ None the less, it concluded that such a

scheme would take too long to be negotiated and established, and that available resources for debt reduction would appear to be (a) those of debtors themselves, including returning flight capital, (b) those of IMF and the World Bank and (c) those which can be mobilized from the creditor countries.

17. If a new facility is not created, the functions intended for it will have to be carried out by the international financial institutions. The report of the Institute's study group makes an important proposal designed to meet the difficult free-rider problem. It sees IMF as the lead agency, negotiating in the first instance an agreed debt reduction with the debtor country and providing the funds. Then, if no agreement is reached between the debtor and the banks, the banks will face arrears to which IMF, contrary to present policy, should not object and which it should not make into a reason for discontinuing its services to the debtor country.

18. This would provide the leverage called for to bring the parties to the table: debtor countries would have to agree on a reform package in which debt reduction would play an important role to get the funds, and the banks would have to participate to get their part.

19. Whatever the precise mechanism, however, the central point is that adequate debt reduction will require a much more active involvement of creditor Governments - directly or through international organizations.

20. The large debts of some Latin American debtor countries tend to command most of the attention in the media and in the financial community. It is true that a few countries account for a very large share of those debts which are difficult to service, but this is a reflection of the great inequalities in size and economic activity that exist among the countries of the world, and it is essential to recall the very general nature of the international debt crisis. Debt burdens weigh heavily on many African countries. There too, a few countries account for the large bulk of the debt, but many others suffer from interest and debt-service burdens that, compared to the scale of their economies, are difficult to accommodate. The debts of Eastern European countries are in some cases very heavy, and their servicing puts additional strains on the economic reforms they are undertaking.

21. In Africa, official creditors - including international financial institutions - play a larger role, whereas elsewhere private banks account for most of the claims. But debt cancellation, as past experience amply shows, calls for strict burden sharing, as no creditor is anxious to help to pay off another creditor. This is one of the reasons in favour of allocating responsibility for the management of the international debt crisis to an internationally trusted agency, which would have to establish equitable rules and norms for the treatment of all debtors and creditors.

22. Debt reduction is no panacea. In particular, it is no substitute for policies that restore internal and external balance to manageable proportions, but it has become a condition for such policies to succeed. The long history of finance suggests that situations arise when it is necessary to write off debts that owe

their origins to shared assumptions about the future that turned out to be mistaken. Such debts represent a dead weight of the past that can make it impossible to build a new relationship that is more profitable to all parties. Banks are in general unable or unwilling to act on this recognition. The time has come for Governments to do so.

III. DEBT AND DEVELOPMENT

23. There is no unique relationship between debt and development. For many years, debt accumulation in a large number of developing countries proceeded pari passu with rates of economic growth that significantly exceeded the growth of population. It was only in the early 1980s, largely on account of major changes in the international environment, that accumulated debt became excessive in relation to the capacity of countries to service it. This capacity was eroded as terms of trade deteriorated considerably and interest rates rose. As this capacity has not been restored despite national and international efforts since 1982, the debt overhang persists and continues to have serious adverse implications for development.

A. Debt and economic growth

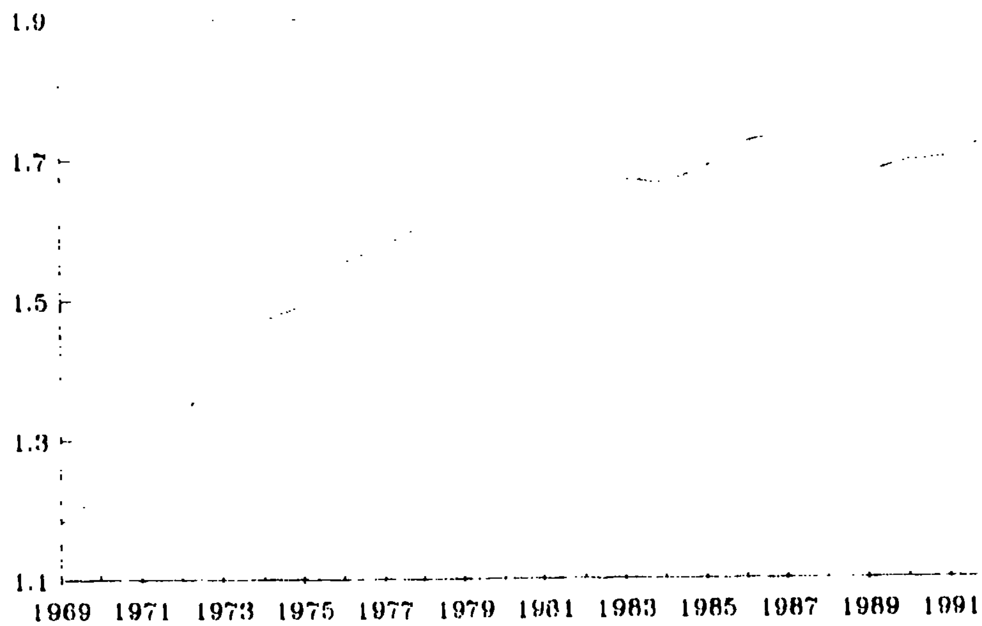
24. The effect of foreign debt in inhibiting development in the 1980s can be shown in various ways. One is to compare the economic performance of a group of heavily indebted countries before and after the onset of the international debt crisis, when these countries lost access to international financial markets. Figure 1 illustrates this for a grouping of 15 heavily indebted countries that is familiar in international discussions. 4/

25. The relatively rapid economic growth of these countries in the 1970s had been fostered by relatively high commodity prices and an unprecedented rate of foreign borrowing. Those were times of a generally optimistic outlook for terms of trade of developing countries and interest rates. As it turned out, instead of the terms of trade of these 15 countries rising over 5 per cent a year on average, as had been the case in the 1970s, they have fallen by 4 per cent a year in the 1980s, while interest rates have become very high in real terms. These new trends were brought about by factors beyond the control of the affected countries, including new macroeconomic policy priorities in industrialized countries and unforeseen changes in technology and in demand that lowered the resource intensity of production. Indeed, the supply enhancing responses to the predicament by the commodity-producing countries served to further weaken the international price trends.

26. Financing cut-backs followed debt-servicing difficulties and economic stagnation have ensued since. Moreover, based on policies in effect in early 1989, these economies were forecast to continue into the 1990s and to remain incapable of providing overall increases in domestic living standards, as the figure indicates.

Figure 1. GNP per capita of a group of 15 heavily indebted countries, 1969-1992

(Thousands of 1980 dollars)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, World Tables and Project LINK forecast (1989-1992).

27. At the same time, the foreign debt of many countries that were primarily indebted to official creditors also began to inhibit their development. The developing countries of Africa form a group of such countries that has been a focus of international attention. One reason is highlighted by figure 2, showing that for the grouping of mainly low-income countries of sub-Saharan Africa, average income per person has been falling since the mid-1970s. 5/

28. The debt crisis of these countries was much less a result of a realization that rapid increases in foreign borrowing were unsustainable, since lending to them did not generally reach very high levels. Rather the unexpected drop in earnings from commodity exports added a debt-servicing problem to countries whose domestic economies had already weakened substantially. Indeed, the terms of trade of this sample of countries have declined at an average rate of 4 per cent a year in the 1980s. For these African countries, as for other countries in debt-servicing crisis, major economic adjustments were needed in the 1980s and the debt crisis made it extremely difficult to marshall the resources to finance those changes.

29. The seriousness of the debt problem can also be highlighted by comparing key indicators of economic performance in the 1980s of countries that encountered debt-servicing difficulties with those that did not. Countries that did not develop a debt crisis have thus far averaged a growth rate of output per capita in the 1980s of 4 per cent a year, in contrast to a decline of 1 per cent a year for both the 15-country sample and sub-Saharan African sample. 6/

30. The countries that did not encounter debt-servicing difficulties were less adversely affected by the economic shocks of the early 1980s. In particular, the terms of trade of these countries fell by 1 per cent a year in contrast to the 4 per cent annual decline in the countries that had debt-servicing difficulties. 7/ Thus, in contrast to the steady investment of about 27 per cent of a rapidly growing GDP, the two debt-troubled groups of countries have since 1983 only been able to invest on the order of 17 per cent of their slowly growing level of output. In pre-crisis years both those groups of countries had managed higher investment rates, albeit not as high as those of the countries without debt-servicing difficulties.

31. The debt crisis has already lasted the better part of a decade, but it is increasingly recognized that if debt relief of sufficient magnitude is not forthcoming, its consequences are expected to continue to be felt to the end of the century. This is illustrated, for example, by the outlook to the year 2000 for the developing countries that have experienced recent debt-servicing problems in contrast to the outlook for those that have not. Table 1 shows this result for aggregates of developing countries differentiated by their debt situation and average income per capita in the mid-1980s. 8/ Thus, not only has GDP per capita been falling in the 1980s as a whole for heavily indebted low-income and medium-income countries, but in the 1990s it is expected to continue falling in the former countries and barely rise in the latter. GDP per capita of the middle-income group was expected to end the century still below the level attained in 1980; in the lower-income debt-crisis countries, where problems of economic deterioration preceded the debt crisis, the level would be below that of 1970.

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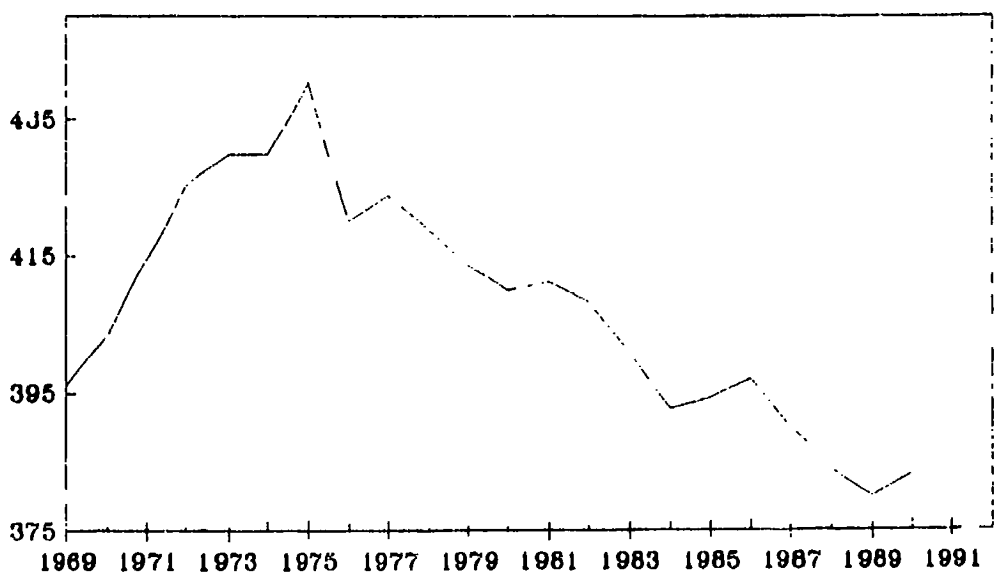
Figure 2. GNP per capita of sub-Saharan Africa, a/ 1969-1990

(1980 dollars)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, World Tables and IMF, World Economic Outlook.

a/ Excluding Nigeria.

Table 1. Per capita output of capital-importing developing countries, 1970-2000

	Level of GDP per capita (1980 United States dollars)				Average growth rate (Annual percentage change)		
	1970	1980	1990	2000	1970s	1980s	1990s
Low-income countries:							
High debt	342	316	292	281	-0.8	-0.8	-0.4
Others	172	243	404	711	3.5	5.2	5.8
Middle-income countries:							
High debt	1 514	1 913	1 696	1 838	2.4	-1.2	0.8
Others	715	1 121	1 461	2 069	4.6	2.7	3.5

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

32. Meanwhile, the countries that have evaded debt-servicing difficulties are expected to continue along a rather rapid path of economic growth. Thus, whereas in 1970 - and even in 1980 - the countries that were not in debt crisis had lower average levels of income than the debt-crisis countries, by the year 2000 the former group of countries will have surpassed the heavily indebted ones.

B. Net transfer of resources and investment

33. A principal mechanism through which the debt crisis operates on growth performance is through the net transfer of resources. Prior to the debt crisis, a net inward transfer of resources to most debtor countries allowed investment in those countries to reach levels above those which could have been financed from domestic savings alone. Assuming reasonable efficiency in the allocation of this investment, the growth of productive capacity and income was thereby made to accelerate. After the outbreak of the debt crisis, this relationship was reversed for many debtor countries; a net outward transfer of resources had to be financed from the national savings effort, so that investment fell below what would have been possible on the basis of the national savings effort alone. This, in turn, acted as a drag on capital formation and economic expansion.

34. The swing in net foreign resource transfers from the early to the middle 1980s was very large, as can be seen in table 2, which aggregates data for samples of all developing countries, other than the major oil-exporting countries, that have not been conventionally denoted as capital-importing countries. Measured thus, the aggregate net transfer went from an inflow of over $40 billion a year to an outflow that reached an estimated $33 billion for 1988.

35. Of course, not all countries were affected equally. Indeed, although the net transfer eventually turned negative for the aggregate of countries not in either high-debt sample pictured in table 2, it occurred relatively late in the 1980s and in certain cases - most prominently, the Republic of Korea - it occurred in the context of rapid economic growth out of which a net outward transfer could be effected without economic strain.

36. In the two samples of high-debt countries, coping with the swing in the net transfer was especially difficult. In the sub-Saharan case, a level of transfers that was low at the beginning of the decade - as imports had to be heavily restricted - became smaller at the same time that commodity export prices tumbled. Some recovery of their net transfer has been attained in subsequent years, in part as a consequence of the United Nations Programme of Action for African Economic Recovery and Development 1986-1990 (General Assembly resolution S-13/2, annex), but the needs still significantly exceed the resources at hand. 9/

37. For the group of 15 heavily indebted countries, the swing in the net transfer has been especially sharp. From a net inflow of about 2 per cent of GDP in the second half of the 1970s, the net transfer became a net outflow that reached 5 per cent of GDP at the nadir and is now about 3 per cent. The outlook, on the assumption of a continuation of international policies in effect at the beginning of 1989, is that there would be no significant improvement (see figure 3).

38. That the problems occurring in the net transfer were the direct result of the debt crisis is clear from the changes in the components of the net transfer; i.e., the largest changes involved credit instruments, including such official flows as export credits, but they were dominated quantitatively by changes in private lending, as can be seen in table 2. 10/ Moreover, forecasts of the debt-servicing burden indicate changes that are unlikely to encourage a belief in a return to normal credit flows on commercial terms any time soon. IMF, which estimated the debt-service ratio of the group of countries with recent debt-servicing problems to be 32 per cent of the value of goods and services exports in 1989, saw it falling to only 28 per cent by 1994. For the 15-country sample, the share of export earnings needed to service foreign debt was expected to fall from 41 per cent in 1989 to 35 per cent in 1994, while for a group of low-income African countries the Fund forecast the debt-servicing ratio to drop slightly from 28 per cent to 27 per cent. 11/

Table 2. Net transfer of financial resources of developing countries, 1980-1988

(Billions of United States dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988 a/
Fifteen-country sample	15.3	12.5	-14.3	-26.4	-28.3	-40.5	-30.5	-28.0	-38.5
Sub-Saharan sample b/	6.6	8.0	6.2	4.7	1.9	3.3	4.9	5.5	6.5
Other countries	19.8	22.1	19.4	21.0	16.8	11.7	4.9	-3.1	-0.5
Capital-importing developing countries as a whole c/	41.7	42.6	11.3	-0.7	-9.6	-25.5	-20.7	-25.6	-32.5
Memorandum item: components of the overall transfer									
Direct investment	-4.5	0.8	-2.0	-2.8	-2.4	-1.0	-1.3	0.4	4.0
Private credit d/	17.2	7.5	-18.7	-26.5	-33.0	-40.9	-32.1	-34.7	-46.0
Official loans and grants	29.0	34.3	32.0	28.6	25.8	16.3	12.7	8.7	8.0

Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on IMF, Balance of Payments and other sources.

a/ Preliminary estimates, rounded to nearest half-billion dollars.

b/ Excluding Côte d'Ivoire and Nigeria, which are included in 15-country sample.

c/ Sample of 98 countries.

d/ Including outflows of capital by residents.

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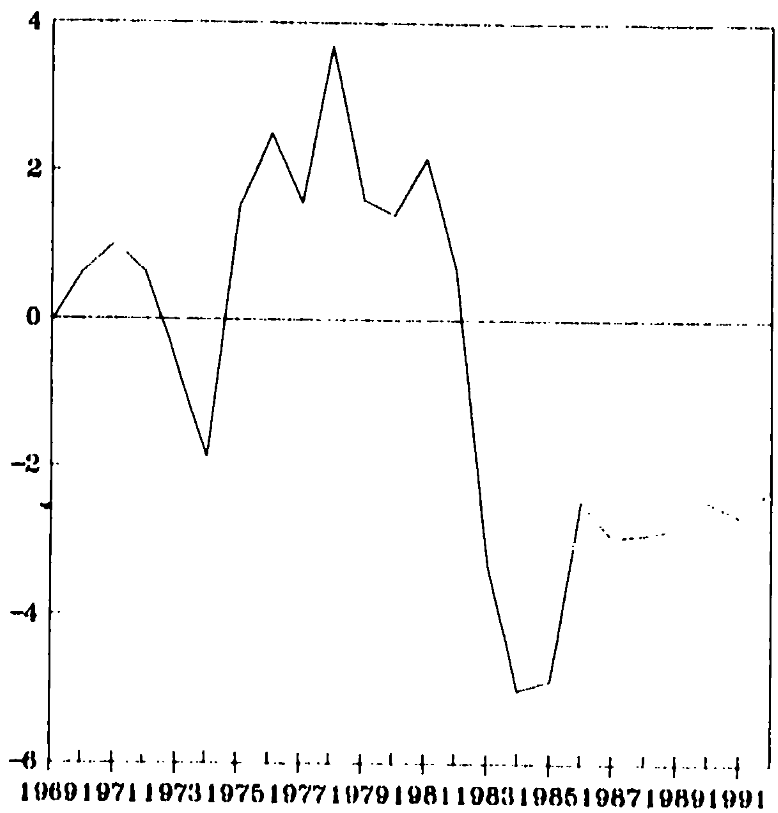
Figure 3. Net transfer of financial resources of a group of 15 heavily indebted countries, 1969-1992

(Percentage of GNP)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on World Bank, World Tables to 1987 and in part on forecast of Project LINK to 1992.

C. Adjustment, stabilization and the net transfer

39. In addition to its impact on investment and growth, the shift in net transfer has had an important bearing on the character and degree of success of stabilization and adjustment policies. Indeed, in a volatile economic environment and with conflicting policy requirements and the need to cope with limited financial inflows or actually to finance an outward transfer of resources, it is extremely difficult to implement fully a consistent and complete set of macro-economic and structural adjustment policies, as the case studies of policy making in Bolivia, Ghana, Jamaica, Mexico and the Philippines presented in World Economic Survey 1989 showed. 12/

40. The crux of the difficulties in fostering adjustment and stabilization is to be found in the impact of the debt crisis on the Governments' budget. The rise in international interest rates raised interest payments by the public sector; at the same time the fall in export earnings reduced government revenues, especially where the main export commodities were publicly owned or where the export sector was an important source of tax receipts, and the fall in sovereign lending widened the Government's financing gap. Further, the process of adjusting to the deterioration in the balance of payments added to fiscal difficulties. In particular,

(a) Currencies were sharply devalued, thus raising the domestic currency cost of debt service;

(b) Domestic interest rates were increased - sometimes sharply - to stem capital flight, thus greatly enlarging the public sector's domestic interest bill;

(c) Deflationary adjustment depressed economic activity and hence also tax revenues.

Most countries reacted with vigorous fiscal action. There were typically deep cuts in public investment expenditures (which hurt long-term growth) and higher prices for goods and services charged by public sector enterprises. Expenditure on essential social services was constrained or cut back (see paras. 44-46 below). The degree of fiscal retrenchment was often quite impressive. The "primary" budget balance, which records the balance on all spending and receipts other than interest, typically moved into surplus, sometimes quite sharply; it was not unusual for this swing to have amounted to 6 to 10 per cent of GDP.

41. There are limits, however, to the capacity of any Government to raise revenue and cut back on services affecting basic welfare. In many countries these limits resulted in a financing gap of the public sector that gave rise to an excessive rate of money creation or a rapid build-up of internal debt. This, in turn, has tended to perpetuate or even intensify financial disorder. Rapidly rising prices, large budget deficits, excessive money creation, rapid accumulation of internal debt, high real interest rates, frequent and substantial changes in exchange rates and capital flight are some of the more common manifestations of this disorder. 13/

42. Another manifestation is the growing instability of main macro-economic variables. The central Government fiscal balances of the countries that have not

undergone recent debt-servicing difficulties have been relatively less variable than those of the samples of sub-Saharan and 15 heavily indebted economies. From 1981 to 1988, annual variability was 8 per cent of the average deficit for those economies without debt-servicing difficulties, 12 per cent for the group of sub-Saharan countries and 24 per cent for the 15 highly indebted countries. 14/ Similarly, the variability of the growth of the money supply - defined to include highly liquid financial instruments ("quasi-money") as well as currency in circulation and private demand deposits - was lowest in the countries that eluded debt crisis. In contrast to a variability level of 15 per cent of the average rate of growth of money in this group, it was 21 per cent in the sample of sub-Saharan countries and 54 per cent in the group of 15 highly indebted economies. 15/

43. Large fluctuations in macro-economic policy send confusing signals to enterprises trying to plan for the medium term, reduce the confidence of economic actors in the stability of the domestic economy and are commonly thought to make macro-economic stabilization itself harder to achieve. When variability and unpredictability also affect the exchange rate, as has been the case for many countries, efforts to increase exports are thwarted by the confusing signals sent to potential investors in the export sector. 16/

D. Human development

44. The severe pressures on budgets of Governments described above have inevitably had an impact on the provision of services essential to the development of their countries. Nowhere is this more vividly illustrated than in the critical sectors of education and health, where expenditures have declined as a proportion of total central government outlays for the heavily indebted countries as a group. These declines will have a bearing on social progress and economic growth far into the future.

45. The impact of reduced family incomes and the compression of social expenditure on human development are perhaps best illustrated by the set-back in education. Figure 4 shows that primary school enrolment rates in both the high-debt and low-debt group of low-income countries rose strongly in the 1970s, with the rate of enrolment of the countries that were to develop debt problems in the 1980s growing somewhat faster than that of the other countries, whose educational levels were higher at the start. 17/ But whereas the enrolment rate of the low-debt group of countries continued rising in the 1980s and was expected to reach 100 per cent by the year 2000, the enrolment rate of the highly indebted countries completely stagnated in the 1980s at the low level of 75 per cent and was not expected to reach even 80 per cent by 2000. In other words, even by the end of the century, more than one child in five was not expected to enter primary school in the low-income countries that have undergone debt-servicing crises, which is about the same ratio that the other group of low-income countries had in 1970.

46. The impact that the debt crisis has had on education in the middle-income countries is also quite clear at the secondary level. As figure 5 shows, the 1970s was a decade of progress for countries that would later develop debt problems and for those that would not, as had been the case for primary education. But the rate

Figure 4. Primary school enrolment rates in low-income countries, 1970-2000

(Share of population aged 6-11)

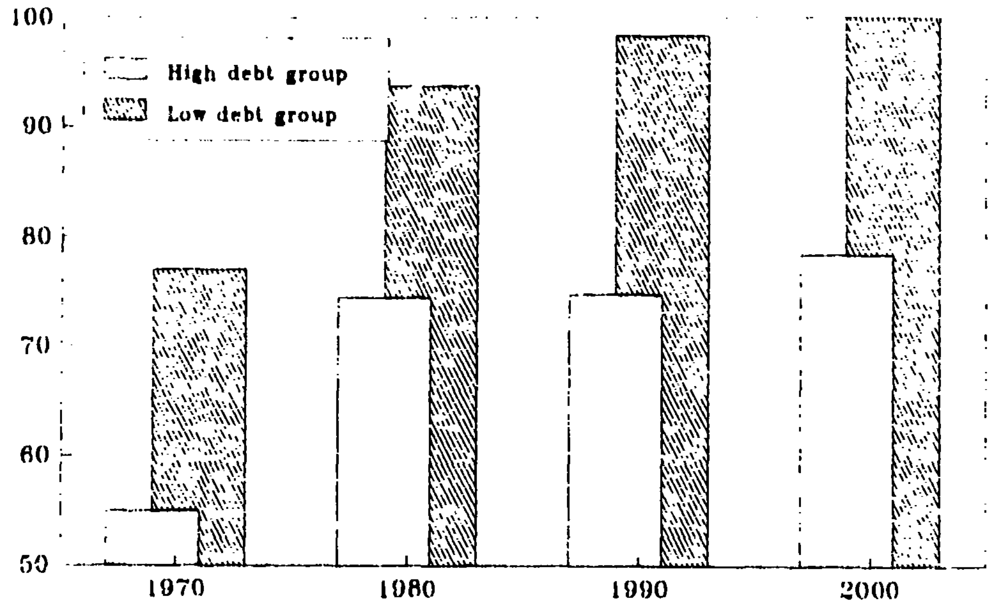
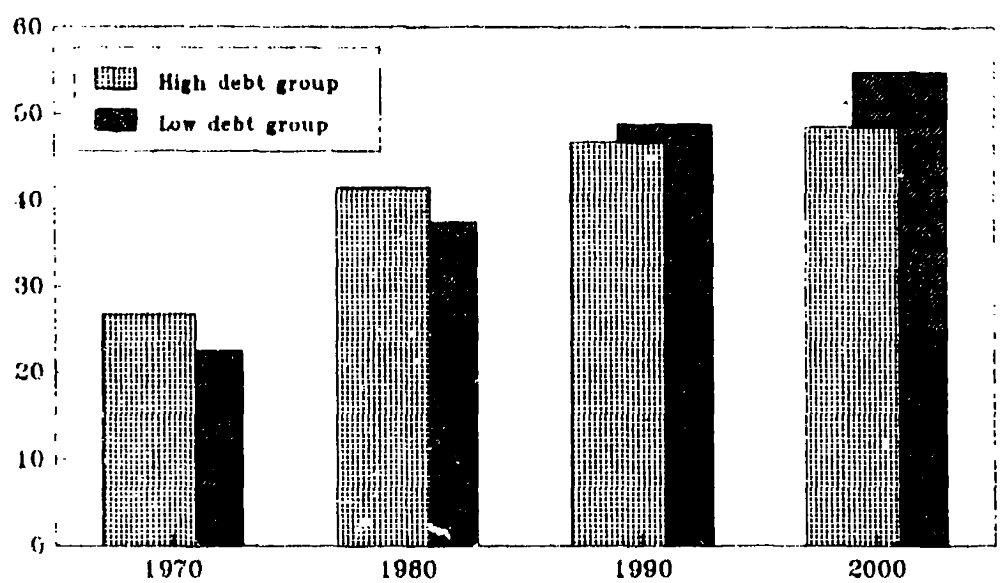


Figure 5. Secondary school enrolment rates in middle-income countries, 1970-2000

(Share of population aged 12-17)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data and baseline scenario discussed in A/43/554. High-debt countries are developing countries classified by IMF as ha had recent debt-servicing difficulties, as in its World Economic Outlook, April 1989; the criterion for inclusion in the low-income grouping was GNP per capita 1986 of no more than $450 as per World Bank, World Bank Atlas.

of growth of the enrolment share slowed especially sharply in the debt-crisis countries in the 1980s and was expected virtually to stagnate in the 1990s. With the enrolment share growing relatively more rapidly in the countries that did not develop debt crises, their initially lower enrolment share would become instead the relatively higher one.

IV. RECENT INITIATIVES IN DEBT POLICY

47. The breakthrough represented by the set of recent initiatives on debt was in the first place a conceptual one, in that it recognized that the developing countries in debt crisis were not moving towards a return to normal financing in the near future and needed a long-lasting reduction in debt servicing. The need to improve the net transfer of resources in the short and medium term was clear, but effecting such an improvement through new lending at the levels required meant seriously worsening the long-term outlook for debt servicing. In other words, more debt is not a solution to the present problem of transfer of resources. Thus the newly enhanced international debt strategy would seek to improve the net transfer through outright reduction of the debt or debt servicing in the short and medium term, as well as through some new lending by private creditors and multilateral agencies and through special bilateral commitments, notably those of Japan. With both private and official debt, great care would be taken to build on the past by adding to the range of already acceptable measures of debt relief so as to increase to the greatest extent possible the voluntary participation of creditors.

A. Private sector approaches to commercial bank debt

48. The financial markets had actually led the way in designing mechanisms for reduction of commercial bank debt, although the focus had been on helping some banks remove loans from their books that they no longer wanted to hold. With banks first swapping loans to different sovereign creditors and later engaging in cash sales, a secondary market emerged. Some debtor country Governments sought to benefit from the market discounts at which their debt was trading by designing programmes for swapping it into equity in local direct investments or local financial investments, most notably in Chile. In a few instances and on a small scale, secondary market purchases were also used by non-governmental organizations to help finance environmental and social programmes in debtor countries. But the scale of market-led reduction of debt-servicing payments was small, even when officially supported. This was the case, for example, in the 1988 arrangement by Mexico and a large United States bank that was supported by a special issue of United States Treasury bonds bought by the Mexican Government to guarantee payment of principal on bonds that were to replace bank debt at a discount. 18/

49. Interest rates have also been adjusted. The interest rate on loans from commercial banks is generally calculated as the sum of a fluctuating base rate and a fixed percentage point spread. After an initial period in which banks sharply raised the spread over the base rate, usually the London inter-bank offer rate (LIBOR) on six-month dollar deposits, the banks began to agree to reduce the spread. They have also agreed to eliminate the more expensive United States prime

rate bench-mark and stretch out the payment intervals, e.g., from quarterly to semi-annually. Other concessions by the banks have included extending the grace period before principal payments began and lengthening the amortization period. Restrictive clauses in bank rescheduling agreements with debtors - sharing and negative pledge clauses, 19/ in particular - have been waived, which, for example, permitted Bolivia and Chile to buy back portions of their bank debt.

50. Bank policies have been driven by two forces. One is the increasing recognition that the debtor countries were unable to cope with the higher debt-servicing burden and that in any case full payment was problematical. The other was to conciliate the increasingly sharp cleavages that were arising among various groups of bank creditors. In the first years of the debt crisis, banks perceived a mutual interest in protecting the international financial system and buying time to strengthen their capital bases individually. There was also a sentiment that the debtor countries faced mainly a liquidity problem related to international recession and high interest rates and that with economic adjustment the problem would quickly be resolved. Thus, postponing debt-service payments for a short time was warranted in all eyes. Seven years later, with the debt problem intractable and the systemic threat to the banking community receding, significant disagreements have emerged among the banks.

51. Widely divergent regulations and tax and accounting procedures among creditor Governments have been factors in the split among banks. But even during the early stages of debt rescheduling when there was a strong sense among the banks that they shared a common fate, they fiercely disputed among themselves about what constituted "eligible credits", which base date to use, and so on. These choices determined the amount of the bank's exposure that would be covered by rescheduling and the amount of concerted lending for which each bank was responsible in the cases of the major borrowers that received "new money". As the banks had different proportions of short-term and medium-term claims and of loans to the private sector versus those to official borrowers, the benefits of any rescheduling package were bound to be unequally distributed among them.

52. Today, in addition to this, the priorities of the various banks have become more differentiated. Some banks, for example, are favourably disposed to debt reduction because they feel that reducing their problematic loan exposure would eliminate some of the riskiness of their asset portfolio and the stock market price of their equity might rise. Certainly the behaviour of bank stocks since the new United States debt initiative was announced gives some credence to this view. For other banks, reducing the proportion of loans in their portfolio to higher risk developing countries is seen as a way to enhance their ability to comply with the international agreement to raise and harmonize capital requirements of banks by 1992. 20/ Most important to certain banks is the exchange of debt for a securitized instrument, which, even discounted or with a lower interest rate, enhances portfolio quality. And for some financial institutions, debt reduction is a way to liberate themselves from the continuous demand for new loans and on the time of their executives, thus freeing resources to pursue more lucrative business opportunities. However, for still other banks, which are not in a position to take deductions from reserves or earnings, debt reduction is an anathema. Indeed, debt reduction decreases the basic capital and therefore reduces the level of operations

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the bank can undertake. Also, the problem of banks that seek to be "free riders" and hope to benefit by sacrifices of other banks because of the sharing and negative pledge clauses in the rescheduling agreements has become most difficult.

53. In short, while banks were countenancing and according more favourable terms in successive rescheduling rounds, it was also becoming increasingly difficult to reach an agreement satisfactory to the banks as a whole, let alone to the debtor country. It became clear that a more direct role of creditor country Governments would be needed if debt was to be reduced in substantial quantities and in an orderly way. Major proposals were made to this effect by the Governments of Japan and France in 1988 and by the United States in March 1989. 21/

B. The strengthened international debt strategy

54. IMF and the World Bank acted upon the proposal of the United States as endorsed by the Interim and Development Committees of those institutions and that proposal immediately began to be applied to the ongoing renegotiations of Mexico's debt-servicing obligations to its commercial bank creditors. The core of the new approach is to use official incentives and pressures to encourage greater numbers of banks to choose debt or interest reduction options from the debt restructuring menu. The strongest incentives are financial "enhancements", which reduce the risk of loss from non-payment by the debtor, although efforts to reduce regulatory, accounting and tax impediments are also to be explored. The enhancements would take the form of investments in risk-free assets that would serve as collateral for principal repayments and a pool of funds to guarantee interest on a rolling basis. They are to be funded by IMF and the World Bank out of existing resources and remain within overall country lending ceilings, but they are to be complemented by new official lending by Japan. 22/ The chief official pressure on the banks is to de-link disbursements of IMF credits from having an agreed rescheduling of the debtor country's commercial bank debt. In principle, Fund programmes could proceed while arrears to the banks grew.

55. Although debt reduction was thus now international policy, the degree of cash flow relief it would provide was unclear. Up to $29 billion was to be made available for debt enhancement by the Fund and the Bank, but since those institutions' loans are provided on quasi-commercial terms, the maximum net reduction in interest payments would be less than the reduction in payments to the commercial banks. If the $29 billion were applied completely to the sample of 15 heavily indebted countries discussed in section II of this report, it would reduce their annual interest payments by at most 13.5 per cent. That estimate, however, assumes that the loans for enhancements would not have been available to the debtors for any other uses. If, instead, the countries were to give up a Bank or Fund adjustment loan to finance a debt enhancement operation, the net cash flow to the country would be negative in the first year since a loan opportunity was passed up, and then positive in subsequent years since interest payments would be lower. Even under favourable assumptions, the breakeven would not occur for four years. 23/

56. The magnitude of prospective relief of debt servicing may be put in a different perspective. According to one estimate, if in the first quarter of 1988

the countries for which the new debt strategy was designed had exchanged their variable-interest-rate debt for fixed-rate debt at the interest rates then prevailing, they would not have had to pay the higher interest rates that followed and would have gotten 50 per cent more relief over the next 12 months than the annual benefit that the enhanced debt strategy was now offering. 24/

57. In short, there are strong reasons to fear that the amount of debt relief through the enhanced international debt strategy available to the sum of potential beneficiaries will still be insufficient to improve adequately the net resource transfer situation of these countries in the short or long run.

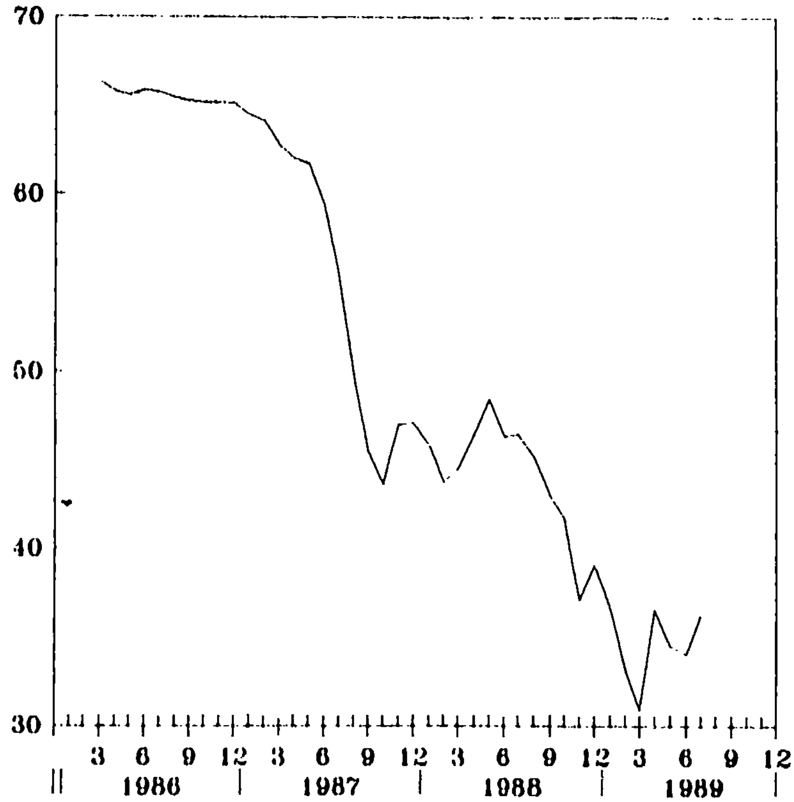
58. A disturbing possibility is that new debt strategy programmes would be negotiated for several countries, thereby heavily reducing their commercial bank debt outstanding, e.g., converting most of it to bonds, but at an inadequate discount, thus substantially increasing the indebtedness of the countries to official creditors, particularly, the multilateral financial institutions. In that case there would be some improvement in the net resource transfers to the countries and thus some improvement in economic growth, but without fundamentally reducing their economic vulnerability. What could happen in the next international shock - be it a sharp rise in interest rates or a fall in the terms of trade - is that the countries might again not be able to meet their debt-servicing obligations, but this time there would not be a meaningful amount of bank debt that is subject to rescheduling. Barring a new international rescue operation, the debtors might find it necessary to seek to reschedule their bonds or to disrupt the servicing of multilateral debt. If such a disruption became widespread, the institutions might find market resistance to their own bonds and a new risk premium added to their borrowing costs (even assuming the liquidity and solvency of the institutions were protected by disbursements from the major shareholders' own budgets). That risk premium would, in turn, have to be passed on to the borrowers from the institutions in general. In short, there is a danger - although hopefully it is small - that the financial condition of the multilateral development banks could be weakened significantly.

59. All these potential dangers notwithstanding, when the new international debt strategy was announced, the financial market responded positively, as indicated by secondary market price quotations, which rose in April after almost a continuous decline since 1986 (see figure 6). However, as the one application of the new strategy, the Mexican negotiations, dragged on and on, caution returned to the market.

60. Finally and only after very high level and intense intervention by the United States Government, the banks reached a framework agreement with Mexico on a debt restructuring package on 23 July 1989. It had taken seven months to arrive at that point and as of September, the detailed agreement had not yet been made final and implemented. Although Mexico would receive a degree of relief in its net outward transfer of resources, the financial market has been acting as though the agreement would not be the definite solution of Mexico's debt crisis. For example, the secondary market price quotations on Mexican debt, which rose slightly in late July as the agreement was reached, has since retreated again to less than 43 percent of face value.

Figure 6. Secondary market bids on bank loans of the group of 15 countries, 1986-1989 a/

(Percentage of face value)



Source: Department of International Economic and Social Affairs of the United Nations Secretariat, based on data of Salomon Brothers, New York, the Bank for International Settlements and OECD.

a/ Average of bids on countries, weighted by bank debt not guaranteed by official creditors.

C. Treatment of official debt

61. In the realm of debt owed to official creditors, several initiatives were announced in 1988 and 1989 and some implementation has begun. International attention focused on the need for permanent relief of debt-servicing obligations of the poorest countries of sub-Saharan Africa, which has in turn directed attention to the Paris Club, the chief forum for rescheduling official export credits and other loans extended by the Governments of the developed market economies.

62. The key initiative was that of the seven major industrialized countries at their summit meeting in Toronto in June 1988 when they agreed to broaden the range of debt rescheduling options acceptable to the Paris Club to include debt or interest reduction. 25/ By October, details were worked out for three new options for creditors:

(a) Partial write off, in which one third of the debt service due in the period being rescheduled would be cancelled and the remainder rescheduled at fairly standard terms for low-income countries (14-year maturity with 8-year grace period at market interest rates);

(b) Longer repayment period, wherein the full debt servicing due in the period is rescheduled at market interest rates, but for 25 years with a 14-year grace period; 26/

(c) Concessional interest rate, which is like option (a), except that instead of a write off, the interest rate on the full amount is reduced by 3.5 percentage points or 50 per cent (whichever results in the smaller concession).

Thirteen countries were able to benefit from those options as at July 1989. Option (a) was used by two creditor countries on about 35 per cent of the debt, option (b) was used by four creditor countries on 30 per cent, and option (c) was used on the rest of the debt by 10 creditor countries. 27/

63. As important as this initiative has been, there is reason to urge that it go even further. In particular, the new Paris Club terms have been denied to certain low-income, debt-distressed countries that should qualify on economic grounds but were not part of the World Bank s Special Programme for Africa. 28/ As it is, the dichotomy in treatment by the Paris Club of the debt of eligible, low-income African countries and other developing countries has become quite marked; e.g., even in 1987, the average maturity in the rescheduling of sub-Saharan debt reached 16 years, compared to under 10 for other countries. That period of time is shorter than the terms accorded middle-income countries by their commercial bank creditors, which averaged 15 years in 1987 and has ranged up to 20 years. 29/

64. Even for those countries which are covered by the new terms, the degree of relief has fallen short in that the debt-service payments required of several poorer countries would still be three to four times more than the cash payments these countries have been able to make in recent years. In addition, the World Bank has estimated that the debt-service payments of the countries covered would

fall by less than 5 per cent during the period 1988-1990. 30/ A key reason is that most of these countries were already under the grace periods of previous Paris Club reschedulings.

65. Indeed, in anticipation of this outcome, proposals for deeper cuts in interest payments had been made. In particular, the Advisory Group on Financial Flows for Africa appointed by the Secretary-General recommended a three-fold treatment of Paris Club debt of countries undergoing appropriate adjustment programmes. 31/ First, for the countries that could not be expected to borrow at market rates in the near future and were unable to service their debt, creditors were advised to reschedule all debt servicing due over a three-year period at an interest rate comparable to that charged by the International Development Association (IDA) of the World Bank (e.g., 0.5 per cent per annum). For countries whose debt-servicing capacity was less impaired and could look forward to renewed access to conventional finance in the foreseeable future, the Group recommended that interest rates on rescheduled debt should be substantially below market rates. And, for countries with immediate prospects of regaining creditworthiness, standard rescheduling would apply and the Group called on export credit agencies to renew credit cover as soon as adjustment and debt relief were under way. Although the Group addressed itself to the financial problems of a group of African countries, their conclusions are general principles that should be applicable to all relevant cases, wherever situated.

66. The Paris Club is also a forum for rescheduling loans that originally carried concessional terms as official development assistance (ODA). It was agreed as a minimum that in all such cases the maturity structure of option (b) (see para. 62) would apply with an interest rate at least as low as the original one. Individual donors, however, have accorded more favourable terms. Thus, in May 1989, France announced that it would cancel the equivalent of $2.5 billion of ODA debt owed by 35 low-income African countries and in July the United States decided to write off up to $1.3 billion of ODA loans to sub-Saharan African countries that were implementing adjustment programmes. Outside the framework of the Paris Club, the Union of Soviet Socialist Republics has indicated its readiness to write off debt or give 100-year moratoria to least developed countries.

67. Earlier, the Federal Republic of Germany, France and Sweden had cancelled export credits to some countries; Canada and the Netherlands cancelled aid loans; Belgium decided to accept payment in local currency; and Japan refinanced aid and export credits with grants. By the end of 1988, Canada, the Federal Republic of Germany, the Scandinavian group and the United Kingdom of Great Britain and Northern Ireland had cancelled almost all ODA debt owed them by low-income Africa, more than $3.2 billion in all; but because these loans were already on highly concessional terms, it was expected to reduce debt servicing by only $125 million a year. 32/

68. The creditors discussed in this section have thus far all been individual Governments and the debt restructurings have generally involved individual debtors negotiating with committees of creditors. There remains, however, one form of official debt that is by convention never either rescheduled nor forgiven, namely, that owed to the multilateral financial institutions. Several low-income and

middle-income countries have nevertheless run into difficulty servicing their debts to those institutions as to others. One result has been the emergence of arrears, and although they are sometimes incurred in the context of disagreement with the institutions on adjustment policies and financial needs, the problem is potentially more general. As at 1 April 1989, 11 countries were over six months in arrears to IMF, 8 to the World Bank and 3 to the Inter-American Development Bank. 33/

69. Resolving an arrears problem of this nature has two aspects: first, the institution and the country must co-operate to formulate a realistic adjustment programme that would facilitate new inflows of financial resources. This programme should be designed in view of the economic, social and political conditions of the country concerned. Secondly, priority must be given to clear the arrears and ensure that resources - domestically generated as well as new inflows - will be at hand to remain current on debt servicing to the multilateral lenders. The financial problem per se could be solved through new bilateral financial commitments and relief from other debt servicing. But efforts have also been made within the multilateral institutions to arrange new concessional loans that could be used for in-house debt servicing, at least for the low-income countries. This is particularly important to prevent further occurrences of arrears.

70. The largest programme of this type is that of IMF, first through its Structural Adjustment Facility (SAF), established in 1986 to re-lend SDR 2.7 billion of repayments to the IMF Trust Fund on highly concessional terms (10-year maturity, 5.5-year grace period and 0.5 per cent interest). This was supplemented in December 1987 by the Enhanced Structural Adjustment Facility (ESAF), which tripled the SAF, and was funded by several industrial countries and Saudi Arabia. Eligibility is restricted to low-income countries or, more precisely, to countries eligible to borrow from IDA. In any event, arrangements and disbursements from the SAF and the ESAF have been slow, totalling only SDR 1.4 billion as at the end of June 1989.

71. At the World Bank itself, IDA resources, the Special Facility for sub-Saharan Africa and a special programme of co-financing by donor Governments were made available and could play a similar role. In addition, explicit interest relief on outstanding regular loans to the World Bank was arranged in September 1988 for 13 low-income African countries, the resources being provided by IDA reflows and investment income and contributions from Norwegian and Swedish aid budgets. The countries eligible for that programme had once been considered economically strong enough to borrow on standard terms, but their situations had so deteriorated that they qualify now for the highly concessional IDA loans. What is still needed at the Bank and the other multilateral financial institutions is a comparable flexibility in financial policy for other cases, including but not limited to those that have built up significant arrears, middle-income countries as well as low-income ones, whose debt accumulation or debt-service burdens are clearly excessive.

V. STATE OF INTERNATIONAL OPINION ON THE DEBT CRISIS

72. The General Assembly in its resolution 43/198 had stressed that in an increasingly interdependent world economy, the debt problem had a global dimension requiring a broad approach with a political impetus for its resolution. It thus requested the Secretary-General to continue efforts begun in 1988 to help forge a common understanding on a solution to the problem through a process of high-level consultations, as appropriate, with heads of State or Government and other parties concerned.

73. In accordance with the request of the General Assembly, the Secretary-General has carried out extensive consultations, which have taken different forms. The Secretary-General has had the opportunity of discussing debt issues with heads of State and Governments, foreign ministers, and diplomatic representatives of a large number of Member States. A number of distinguished groups have produced reports on the situation and have discussed their findings with the Secretary-General. The Independent Group on Financial Flows to Developing Countries, chaired by Mr. Helmut Schmidt, submitted a report entitled Facing One World. The study group established by the World Institute for Development Economics Research on the debt problems of middle-income developing countries, chaired by Mr. H. J. Witteveen, submitted a report entitled Debt Reduction. 3/ The Cairo Seminar on African countries' debt problems contributed to the appreciation of that continent's financial needs. At the summit meeting of the group of seven major industrialized countries in Paris in July 1989, the political urgency of the debt problem was also strongly reflected. The communiqué of the meeting gave much attention to it. More recently, personal representatives of the Secretary-General interviewed several of the ministers of finance of Latin America, most in highly indebted countries. In addition, a number of prominent personalities in the international financial community were asked by the Secretariat to respond to questions intended to go to the heart of the issue.

74. These consultations and contacts were all of great value. What emerged from the personal consultations of the Secretary-General was above all the profound concern of political leaders in countries experiencing serious debt crises. These crises are a manifestation of a lack of resources that imposes sharp drops in living standards and investment. After painful adjustment efforts undertaken by those countries, higher international interest rates often make the debt burden grow even without an increase in the debt itself. The sudden switch from a positive to a negative net transfer of resources in the 1980s has imposed a political stranglehold on many countries, most of which already had their full share of development difficulties before this crisis. Countries in such situations run the serious risk of becoming ungovernable.

75. The reports from the various groups of eminent personalities and the consultations with financial experts were generally oriented towards technical aspects of the situation, although assessments of that which was politically feasible were essential to those discussions too. The replies to the Secretariat's questions were extremely thoughtful and extensive. 34/ An attempt has been made to reflect these views in the body of this report.

76. The key conclusion is that although there seems to be a greater convergence than last year in assessments of the situation and expectations about future developments, opinions vary greatly about the advisability and feasibility of measures to accelerate a resolution of the debt crisis. Some of the issues may be summarized as follows:

(a) The evolution of the "debt strategy" - in particular the recognition of the need, in many cases, for debt and debt-service reduction - is welcomed, but in most non-official comments the practical consequences are described as marginal;

(b) An end to the debt crisis is not yet in sight, although certain debtor countries may be on the verge of emerging from the debt trap. Hopes that a favourable turn in the world economic environment might dissolve the problem have evaporated after the brisk performance of the rest of the world economy in 1988 and 1989, which did not suffice to improve the situation of heavily indebted countries;

(c) Overcoming the debt crisis could take a long time unless drastic events radically change the situation: it will require great efforts from all parties involved - creditors and debtors, Governments, private banks and the multilateral lending agencies;

(d) Present trends of stagnation in heavily indebted countries entail great risks of political instability as well as of continued exodus of capital and skills;

(e) The amount of relief required to bring debt-service obligations in heavily indebted countries down to levels commensurate with the capacity to service debt and simultaneously restore investment and growth is unclear; e.g., it depends on the investment response of the private sector in the debtor countries and abroad to adjustment measures adopted by debtor country Governments;

(f) Extensive use of public funds in creditor countries for debt-relief operations would raise the question whether they are better used for such purposes than for regular development financing;

(g) As heavily indebted countries are recognized as being incapable of servicing their debts in full in the foreseeable future, the losses of creditors have, in a broad sense, already been incurred. This is reflected in the deep discounts at which their debts are being traded, but no individual creditor is willing to be the first to renounce his claim on the debtor. A co-ordinated settlement is necessary, as long recognized in domestic bankruptcy proceedings in all countries; the lack of accepted procedures in dealing with sovereign debt is making itself felt;

(h) Many proposals for a debt reconversion facility have been put forward, and the roles presently accorded to IMF and the World Bank may represent the first steps towards such an agency. But the need for and the role of such an agency remain controversial.

Notes

1/ General Assembly resolution 43/198 of 20 December 1988. While primarily addressing the plight of the developing countries, the Assembly also recognized the difficulties of some other countries with serious debt-servicing problems and invited all those involved in the latter to take account of the relevant provisions of the resolution.

2/ ECA resolution 676 (XXIV) "African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAP)", adopted by the Conference of Ministers in Addis Ababa, 10 April 1989. For the text, see A/44/315, annex.

3/ Debt Reduction, report of a study group of the World Institute for Development Economics Research (WIDER) on the debt problems of the middle-income developing countries, WIDER Study Group Series, No. 3 (Helsinki, May 1989), p. 25.

4/ The countries, which were the proposed initial beneficiaries of the 1985 debt management and adjustment proposal of the Secretary of the Treasury of the United States, are Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, the Philippines, Uruguay, Venezuela and Yugoslavia. The forecasts in figures 1 and 2 assume no major departures in debt policy.

5/ Nigeria is excluded from this sample of sub-Saharan countries partly because its large economic size would overwhelm the data of the large number of smaller countries. It is included in the 15-country sample.

6/ See World Economic Survey 1989 (United Nations publication, Sales No. E.89.II.C.1), pp. 152-157.

7/ Data from IMF, World Economic Outlook (Washington, D.C., April 1989), statistical annex.

8/ The debt criterion is that given by IMF in World Economic Outlook, (Washington, D.C., April 1989), statistical annex, for countries with and without recent debt-servicing difficulties and is applied to the countries classified by the Department of International Economic and Social Affairs as developing and for which country models were available with which to make the projection. Countries were placed into income groups according to whether their GNP per capita in 1986 was more or less than $450 according to the estimates and methodology of the World Bank in World Bank Atlas, 1988. For assumptions and other details underlying the baseline scenario, see "Overall socio-economic perspective of the world economy to the year 2000", report of the Secretary-General (A/43/554), 20 September 1988.

Notes (continued)

9/ See "Mid-term review and appraisal of the implementation of the United Nations Programme of Action for African Economic Recovery and Development, 1986-1990", General Assembly resolution 43/27 and annex; see also, World Bank and United Nations Development Programme, Africa's Adjustment and Growth in the 1980s (Washington, D.C., March 1989), pp. 12-19, and Economic Commission for Africa, African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation (AAF-SAP), document E/ECA/CM.15/6/Rev.3 (Addis Ababa and New York, July 1989), paras. 131-136, and document A/44/315, annex.

10/ While private outflows of domestic finance have contributed to the net transfer problem, they have not been the dominant influence in recent years; indeed, the period in which "capital flight" was commonly said to have been strongest was when the net private transfer was still positive, i.e., at the beginning of the decade (see Michael Deppler and Martin Williamson, "Capital flight: concepts, measurement and issues", Staff Studies for the World Economic Outlook, (Washington, D.C., IMF, August 1987), pp. 39-58, and John Williamson and Donald Lessard, Capital Flight: the Problem and Policy Responses, Policy Analyses in International Economics, No. 23 (Washington, D.C.: Institute for International Economics, 1988)).

11/ IMF, World Economic Outlook (Washington, D.C., April 1989), pp. 52, 53 and 200, (debt servicing is defined to include total interest plus amortisation on long-term debt, excluding debt-servicing payments to IMF itself).

12/ See World Economic Survey 1989, (United Nations publication, Sales No. E.89.II.C.1), pp. 158-184.

13/ The relationship between external debt and macro-economic disorder is examined in detail in UNCTAD, Trade and Development Report 1989 (United Nations publication, Sales No. E.89.II.D.14), part I, chap. 4.

14/ Variability is measured as the standard deviation in the sample period divided by the mean. The fiscal deficit of each group in each year was defined as the weighted average of the individual central government deficits given as a share of GDP (weights were the average United States dollar values of GDP over the preceding three years), as published by IMF in World Economic Outlook, April 1989.

15/ In contrast to the sharply different degrees of variability of policy, the average levels of policy variables have generally differed less, that is, while the fiscal deficit of sub-Saharan Africa averaged 6 per cent of GDP in the period 1981-1988, that of the 15-country sample and the group of non-crisis countries was virtually the same, namely, about 4.5 per cent. By the same token, the growth of the money supply in the non-crisis countries and in sub-Saharan Africa both averaged 23 per cent a year. Admittedly, that of the 15-country sample was substantially higher - 115 per cent annually - associated with the uncontrolled inflation in some members of the group, which brought the average rate of inflation of the group above 100 per cent for the decade.

Notes (continued)

16/ See UNCTAD, Trade and Development Report 1989, part I, chap. 5.

17/ The results in figures 4 and 5 are weighted averages of data and forecasts of gross enrolment rates for individual countries, whereas the weights are the estimates or forecasts of each country's population of the relevant age group. Sample sizes were: heavily indebted low-income group, 26; heavily indebted middle-income group, 33; less indebted low-income countries, 11; and less indebted middle-income countries, 21 (20 for secondary school enrolment).

18/ See World Economic Survey 1989, (United Nations publication, Sales No. E.89.II.C.1), pp. 71-72.

19/ These and other legal aspects of debt rescheduling are described in United Nations Centre on Transnational Corporations, International Debt Restructuring: Substantive Issues and Techniques, UNCTC Advisory Studies, Series B, No. 4 (United Nations publication, Sales No. E.89.II.A.10), pp. 22-40.

20/ The agreement is described in Bank for International Settlements, 59th Annual Report (Basle, June 1989), pp. 90-94.

21/ On the Japanese proposal, see summary records of the Second Committee of the General Assembly (A/C.2/43/SR.16), paras. 60-66; the proposal of France was made by the President in his address to the General Assembly (see provisional verbatim records of the General Assembly (A/43/PV.10), pp. 6-20); the proposal of the United States was contained in the remarks of the Secretary of the Treasury to the Brookings Institution and the Bretton Woods Committee Conference on Third World Debt (see Treasury News, United States Department of the Treasury, 10 March 1989).

22/ In addition to $4.5 billion of untied lending by the Export-Import Bank of Japan made available this spring, the Prime Minister of Japan announced at the Paris Summit of major industrialized countries in July that an additional $5.5 billion would be committed for co-financing of multilateral development financing programmes in highly indebted countries. Both of these initiatives are in addition to Japan's expanding commitments of official development assistance.

23/ For details of these calculations, see World Economic Survey 1989, (United Nations publication, Sales No. E.89.II.C.1), pp. 75-78.

24/ Statement of Shafiqul Islam, Senior Fellow, Council on Foreign Relations, before the Subcommittee on International Development, Finance, Trade and Monetary Policy of the Committee on Banking, Finance and Urban Affairs, House of Representatives of the United States, 5 April 1989. (The rise in market interest rates raised the interest obligations of just the 15-country sample by roughly $6.5 billion from the second quarter of 1988 until the first quarter of 1989; the maximum annual interest relief from the new debt strategy, under highly optimistic assumptions, as detailed in World Economic Survey 1989, (United Nations publication, Sales No. E.89.II.C.1), pp. 75-78, would be $5.5 billion.)

Notes (continued)

25/ "Economic declaration issued by the seven major industrialized countries at the end of their three-day summit", 21 June 1988, para. 30 (see IMF Survey, 27 June 1988, pp. 219-223). See also A/43/435-S/19974, annex I.

26/ Thus, principal payments to creditors taking this option do not begin until creditors taking the other options have been fully repaid.

27/ For further detail on Paris Club practices, see UNCTAD, Trade and Development Report: 1989, part I, chap. 2.

28/ The countries were Bolivia, Guyana and Nigeria, although Guyana did receive a 20-year maturity on rescheduled debt.

29/ See World Bank, World Debt Tables, 1988-1989 edition (Washington, D.C., January 1989), p. xiv.

30/ See World Bank, World Debt Tables, 1988-1989 edition (Washington, D.C., January 1989), box I-2.

31/ See Financing Africa's Recovery, report and recommendations of the Advisory Group on Financial Flows for Africa ("Wass Report"), (New York: United Nations, February 1988), paras. 141-143.

32/ Tony Killick and Matthew Martin, "African debt: the search for solutions", United Nations Africa Recovery Programme secretariat, Briefing Paper No. 1 (June 1989), pp. 4-5.

33/ World Economic Survey 1989, (United Nations publication, Sales No. E.89.II.C.1), p. 63.

34/ The Secretariat will circulate a note at a later date reporting more completely on the views of the respondents.
