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# ADLITH BROWN
## Memorial Lecture

# Transnational Banks and Problems of Small Debtors

Maurice Odle

Institute of Social and Economic Research
Regional Programme of Monetary Studies

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INSTITUTE OF SOCIAL AND ECONOMIC RESEARCH
UNIVERSITY OF THE WEST INDIES, JAMAICA

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The Adlith Brown Memorial Lectures honour the memory of Dr. Adlith Brown, Coordinator of the Regional Programme of Monetary Studies from 1980 to 1984.

This lecture, "Transnational Banks and Problems of Small Debtors" was delivered by Maurice Odle, Assistant Director, Information and Advisory Services Division, UN Centre for Transnational Corporation at the annual conference of the Regional Programme of Monetary Studies held in St. Kitts from November 5-7, 1986.

# Transnational Banks and Problems of Small Debtors

Maurice A. Odle*

## INTRODUCTION

Mr. Chairman, Ladies and Gentlemen, it is indeed an honour to have been asked to give the second Adlith Brown Memorial Lecture – especially coming after such an illustrious person as Dr. Courtney Blackman, Governor of the Central Bank of Barbados.

In trying to decide on a topic for tonight's lecture, three considerations were uppermost in my mind. One was the need to choose an issue that was fairly topical. A second was to choose something which had great relevance for most developing countries. A third consideration was to choose a subject in which Adlith Brown, a keen student of international economics, had herself shown considerable interest. I have therefore chosen to speak on the International Debt Crisis – a crisis that, like a bad dream, does not seem to want to go away. The title of the talk is "Transnational Banks and Problems of Small Debtors", and I shall concern myself more with the commercial bank loan aspect of the problem than with the borrowing from governmental and multilateral sources. In discussing the simmering debt crisis, I shall allude to the changing bargaining power between the lenders and the major borrowers, the difference in treatment by creditors of large and small borrowers and the relevance of the various proposed solutions and options for both 'large' and 'small' debtors.

Private bank debt as a share of the total external debt was on average roughly 20 - 25 per cent for the 'tiny' and 'very small' debtors, 45-50 per cent for 'not-so-small' debtors and 65-70 per cent for 'large' debtors. If a small debtor is defined as a country with a gross external debt (commercial bank loans plus other loans) of less than $10 billion, then all but 22 developing countries can be considered as small debtors at the end of 1985. Twenty-three of these small debtors had a foreign debt of between $1.5 billion and $10 billion (Table 1). The rest can be considered as being 'very small' debtors, i.e., to the transnational banks if not to GNP. Most are in Africa: of 35 African countries, 8 are in the $1 billion to $1.5 billion debt category, 11 had debts between $500 million and $1 billion, 5 owed between

*The views are those of the author and do not necessarily represent those of the United Nations.

$200 million and $500 million and 11 had debts of less than $200 million[1]. Most of the Caribbean and Pacific Island countries with a less than $200-million figure can be considered 'tiny' debtors.

Throughout this presentation the term 'small debtors' will be loosely used to characterize the 'small', 'very small' and 'tiny' borrowers. In addition, and for purposes of convenience, the term 'small debtors' will be used interchangeably with 'small countries'.

It is not conventional to look at the debt crisis from the point of view of the small debtors. International organizations such as the IMF, World Bank, UNCTAD and OECD and academic analysts typically classify Third World debtors into either high, medium and low income countries or into oil importing and oil exporting categories. The focus of the analysis by international organizations is seldom the size of indebtedness and the differences in treatment received by small and large developing countries at the hands of private, governmental and multilateral lenders.

An important measure of the grave and persistent nature of the crisis affecting both large and small debtors is the historical reversal of resource flows such that capital importing developing countries have now become capital exporters, i.e., the net resource transfer has become negative with loans and foreign investment inflows being exceeded by payment of principal and interest plus repatriation of capital, profits and dividends. Whereas in the late 1970s and up to 1981 developing countries had been receiving *net* resource transfers (inflows minus outflows) of the order of $40 billion a year, in 1982 the net transfer fell dramatically and in 1983 it disappeared altogether. In 1984 the net transfer turned into a net outflow which in 1985 exceeded $30 billion.[2] The inflow-outflow breakdown for 1985 is as follows: Capital importing developing countries received a capital inflow of $36 billion, made up of credit inflows ($13 billion), direct investment flows ($9 billion), and official grants ($14 billion). On the other hand, $54 billion was paid in interest on the accumulated foreign debt and $13 billion in income on the stock of direct foreign investment. The burden of the negative transfer was especially great in Latin America and the Caribbean where the figure for 1982 to 1985 had accumulated to $96 billion. During this period, Brazil alone transferred $44 billion to credit nations and received $11 billon back for a net outflow of $33 billion. By 1985 the figure for Sub-Sahara Africa was also turning negative. Of a United Nations sample of 83 developing countries, 30 (including a number of Caribbean countries) were found to be experiencing negative transfers by 1985 – Algeria, Argentina, Bahamas, Barbados, Brazil, Colombia, Congo, Ivory Coast, Ecuador, Gabon, Indonesia, Republic of Korea, Malaysia,

Mexico, Nigeria, Oman, Peru, the Philippines, Sudan, Suriname, Togo, Trinidad and Tobago, Uruguay, Venezuela, Yugoslavia, Zaire and Zambia. For the developing countries as a whole, negative transfers are predicted for 1986 and 1987.

From the perspective of the lenders, this system is untenable. To the lenders, the issue is not one of U.S.A. banks being less willing to reschedule loans than European and Japanese banks, or small banks being less willing to extend new credit than large banks. Nor are the banks worried about borrowers not being able to repay principal provided that interest is forthcoming. (This is because repaid loans cannot remain idle and have to be relent, hopefully, to less risky borrowers.) For them the real problem is their having to make new loans to large debtors merely in order for the latter to be able to repay the interest on past loans. Such involuntary loans are really designed to prevent default or protect past huge loans – digging a hole to fill a hole. From the developing countries' point of view, also, the situation is unsustainable since the austerity and belt tightening required to service the debt are socially unbearable.

#### CHANGING BARGAINING POWER BETWEEN LENDERS AND LARGE BORROWERS

The so-called debt crisis began with Mexico in 1982 and surfaced again in 1986 with Mexico. Over these last four years, the Latin Americans have slowly been able to turn the situation around, with implications for all countries big and small. In the first round of rescheduling in Latin America, the spread over LIBOR was typically 2.25 per cent, amortization periods were usually 6-7 years and commissions generally exceeded 1 per cent. These rather harsh credit conditions for renegotiating debtors were equivalent to a financing cost 1½ - 2½ times that at which loans were contracted in the normal credit market just prior to the crisis. This high renegotiation cost reflected the superior bargaining power of the transnational banks which had formed themsleves into a cartel, represented by the Bank Advisory Committee, to deal with the debtors on a one-to-one basis. Even the 'GANG of 4' very large borrowers (Brazil $104.7 million, Mexico $98 billion, Argentina $50.8 billion, Venezuela 34.7 million) were helpless at this stage. In the second round in 1983 the renegotiation conditions were softened (the range over LIBOR being 1-7/8 to 2-1/2 percentage points); and in the third round of 1984-85 the cost of the renegotiated loans (in the range of 7/8 to 1-1/4 percentage points) was actually below the cost at which loans were acquired in the pre-crisis credit market of 1980-81. In the fourth renegotiation round of 1985-86 Mexico got what no developing country had ever acquired before, i.e., an explicit growth target for the debtor country

during the adjustment process (e.g., 3-4 per cent in 1987). The need for such a growth rate has determined the nature of the financial package – e.g., the fiscal deficit is required to decline only gradually from the current 15 per cent of GDP to 10 per cent at the end of 1987. The financial package of $12 billion is more than double the amount the creditors were offering at the beginning of the negotiations, and the private banks' $6 billion share of the financial package was considerably greater than the earlier offer of $2.5 billion. This significant improvement in the renegotiated terms and conditions was primarily due to the conscious attempt of the Latin American debtor countries to exercise whatever bargaining power they possessed.

Although the Latin American countries have never really been able to set up a cartel – and at the time of the costly 1982 rescheduling they had not even begun to think along these lines – certain intercountry consultations were begun in late 1983. These debt communications later developed into formal regional meetings and/or resolutions, such as the January 1984 American Economic Conference in Quito, the May 1984 joint declaration by the Presidents of Argentina, Brazil, Colombia and Mexico, and a June 1984 meeting of Ministers of 11 debtor countries, called the "Cartagena Consensus" which met again in Santo Domingo and in Mar del Plata, Argentina. It was this rapidly developing unity among the Latin American countries which apparently caused the transnational banks to make concessions in the second and third rounds of renegotiation.[3]

The fourth round ended a few weeks ago and the major concessions made to Mexico were the result of a constellation of pressures within and outside of Latin America. First was the pressure from Mexico itself. That country indicated that with the fall in the price of oil it would not be able to honour its debt obligations especially given the massive private capital flight associated with the climate of uncertainty.[4] Mexico also made the intoxicating or 'crack' point that if in the absence of debt relief it was forced into a deflationary policy, its credibility for providing for the people would be so undermined that it would not be in a position to effectively cooperate with the United States in preventing the flow of drugs across the border. Accusations of rigged elections and growing popular discontent with the De la Madrid Government – as evidenced by the booing that took place when he opened the World Cup football series – also created a fear among the creditors and the home governments that more radical political forces could come to the fore with the much feared policy of debt repudiation. Second, the pressure from within Mexico was buttressed by regional consultation and collective action. A secret meeting of representatives of Latin American countries was held in Oaxtepec, Mexico, in mid-1985. Cuba also

organized several conferences in 1985, and the basic conclusion of these conferences was that the Latin American debt could not be repaid and should be written off by the creditors. Then in December 1985 a Cartagena Consensus meeting in Montevideo, Uruguay, criticized the Baker Plan as being inadequate, and in February 1986 a Working Committee of the Consensus expressed solidarity with any country which found it necessary to unilaterally limit payments to its creditors: "We still want to act in conjunction with our creditors and it has not yet come to unilateral measures, but if these become necessary, the Cartagena Group would support them". These developments and statements show the importance that threats sometimes have in the bargaining process.

Third, the national and regional pressure tactics got some unexpected help from certain international quarters. The May 18, 1986 *New York Times* article by Benjamin Weiner, President of Probe International, began as follows: "Fidel Castro is right. The third world debt should be renounced." The Pope, on the opposite side of the political spectrum from Fidel Castro, on a visit to Colombia in June/July of this year, added his voice to the economics of compassion:

> Dialogue between peoples is indispensible in order to reach equitable agreements which are not just subservient to economic laws which have no soul nor moral criteria . . . international solidarity is urgent, especially regarding the problem of foreign debt, which overwhelms Latin America and other countries of the world. . . The poor people cannot pay intolerably high social costs by sacrificing the right to development of which they are deprived, while other people enjoy opulence.

The Commonwealth Secretary General, Sonny Ramphal, at the 8th Commonwealth Law Conference at Ocho Rios, Jamaica, in September of this year made a forceful contribution to the conference theme, 'Justice at Home and Abroad': "Where is there justice abroad for poor countries hounded by insatiable interest rates demanding their pound of national flesh while the IMF acts out the dual role of Shylock and the judge?" The 101 nations' Non-Aligned Conference in Zimbabwe this summer endorsed the strategy of limiting the ratio of debt service payments to export earnings. And at the United Nations' 41st General Assembly, the most common theme of countries (as big as Brazil and as small as Barbados) was the foreign debt and the urgent need for a novel and effective solution. In his speech, the Barbados Foreign Minister, Cameron Tudor stated: "Unless developing countries are able to sell their goods and products at remunerative prices, they will be hard pressed to pay their international debts. No amount of rescheduling of debts, new loans to

consolidate old debts or the reduction of interest rates will address the fundamental cause of the debt crisis facing them."

The recently published Annual Report of the Inter-American Development Bank on 'Economic and Social Progress in Latin America' has added its voice to the call for adjustment with a human face. It paints a very grim picture for 23 countries which together account for two-thirds of the nearly $1 trillion that Third World debtors owe foreign creditors. Between 1980 and 1985 14 countries suffered a decline of more than 10 per cent in per capita income, and another seven countries suffered a drop of more than 15 per cent. The painful adjustment policy of reducing imports to a minimum worsened the recession in these countries (since capital goods and raw materials are a large proportion of imports) and has partly resulted in manufacturing in 1985 being less than what it was for the region in 1980. In 1985 the import volume was 37 per cent lower than the previous high achieved in 1981 and, in fact, fell to a lower level than in 1974. At the same time, the Latin American countries tried to export everything in sight. The rate of growth of exports in the 1980s was higher than the rate of growth in the 1970s. In 1985 exports were 20 per cent higher than they were in 1981. Despite this extraordinary export effort, economic growth in 1985 was less than 1 per cent. According to the Manager of the IDB's Economic and Social Department: "Not since the Great Depression of the 1930s has Latin America suffered such economic damage. In some ways the present crisis may be worse than the Depression because Latin American countries were starting to grow again in 1933-34, while in 1986 there is still no growth". It is within this context of pressure that the Baker Plan emerged and which allowed Mexico to reach a favourable agreement with its creditors.

#### IMPLICATIONS FOR SMALL DEBTORS

I have dwelt at length on the theme that Latin debtors, who are the largest borrowers, have, over the course of the four reschedulings during the 1982-86 period, gradually been able to extract concessions from their international creditors, even if these concessions are well short of the required debt relief. In the case of small debtors, however, the situation has not changed very significantly. Moreover, the terms and conditions of debt reschedulings by the small debtors have usually been more onerous than for the large debtors.

In the case of private bank debt, grace and repayment periods for small debtors were usually shorter than those granted to the large borrowers. In addition, fees and spreads were much higher and the banks typically resisted multi-year reschedulings.[5] In the case of

Jamaica, for example, up to 1985 the banks had only rescheduled 30 per cent of interest payments falling due in one or two years. For the African countries, the banks have rescheduled only a part of arrears and interest. Since 1974, over 25 African countries have rescheduled their debts and some of these countries have been involved in several renegotiations. Although the involvement of the IMF was expected to reduce the payback risks, the banks claim that the act of rescheduling effectively increases their risks and makes it necessary for them to impose substantial costs on the debtors in the form of interest, commissions, fees and spreads. In the typical Paris Club arrangement, rescheduling is for only one year at a time involving 100 per cent principal and 50 per cent interest. In addition to being less accommodating with respect to rescheduling terms, the commercial banks have not been very willing to extend new credit to the smaller countries even though the amounts requested have been relatively puny. Thus for Africa, whereas net transfers from private creditors were $6.4 billion in 1978, they declined to $0.7 billion by 1980 and minus $1.4 billion in 1982.

The difference in the structure of the debt has also, in at least one respect, not helped the smaller debtors. At least 25 per cent of the outstanding debt of small countries is owed to multilateral institutions whose charter prohibit the rescheduling of their loans. And the pre-rescheduled debt was getting shorter rather than longer. For example, in Africa the maturity of the debt changed from an average of 25.2 years in 1970 to average 15.9 years in 1982, and the average grace period fell from six years in 1970 to 4.3 years by 1982.

Although the small debtors enjoyed less favourable rescheduling terms and received hardly any new credits in the last few years, their objective situation was no different from the large debtors; in fact, in some respects it was probably worse. Whereas the average debt/GDP ratio for Latin America ranged from 23.6 per cent to 31 per cent during the 1977-82 period, the ratio for Africa, for example, ranged from 23.4 per cent to 31 per cent during the same period. For the very small islands of the Eastern Caribbean and Belize, the average in 1982 was 28.3 per cent.[6] The only real difference is that the structures of the debt are such that for large borrowers interest on short term commercial debt is a high proportion of the debt whereas principal is an important element in the debt of the small borrowers, partly because of the relatively high weighting of bilateral and multilateral loans and partly because of the high incidence of unscheduled repayment arrears.

Despite the less favourable debt relief treatment, the small debtors probably have less potential for improving their situation than the

large debtors. This is because the large debtors have a more developed industrial and technological structure and are more capable of switching to export oriented activity or of reducing the import content of their import substituting activity. Moreover, primary commodities prices on which small debtors are so dependent for foreign exchange earnings seem to be chronically depressed.

Since the debt problem is as real to small borrowers as it is to large borrowers, the question then is why is there this preoccupation with the difficulties of the large debtors. The explanation can only be that the international media views the problem essentially from the side of the commercial lenders, rather than of the borrowers, because of their concern with the supposed threat to the international banking system arising from a possible default. Nevertheless, "small debtors have big problems".

## PROPOSALS

Proposals are of either a unilateral, bilateral or multilateral type. As expected, the unilateral approach is the one that the borrowers find most attractive whereas the creditors are much more interested in a bilateral or multilateral solution.

### A. Unilateral Approach

#### (1) *Default*

Default is anathema to the creditors – a case of thinking the unthinkable. But today the creditors are very much aware of the possibility of default on the part of the debtors. The creditors have therefore devised a strategy for derailing attempts on the part of the debtors to form a cartel. One device is to offer concessions to a large debtor, in the form of involuntary loans (what Devlin calls a 'side payment') at the critical time of the negotiating process when the debtor appears to be contemplating the default option. By doing so the creditor is prepared to forego a part of the monopoly profits generated by the cartel in order to avoid the possibility, remote though it may be, of greater losses should the debtors succeed in forming a cartel. The debtor country, on the other hand, as part of a group that is contemplating the formation of a cartel, fears that other members of the group may also be attracted to the concessionary loan enticements of the creditors and that refusal to accept same, i.e., default, may be suicidal, by causing it to become isolated and the easy target for sanctions by the international community.

For this reason, only the very large debtors, e.g., Brazil and

Mexico, at the moment cause the creditors any default concern. These countries' debts are sufficiently large as to pose the threat of large potential losses to the banks and it is precisely to these countries, given their quasi monopoly power, that involuntary loans tend to be made. In addition, retaliatory measures against a defaulting Mexico would produce other costs in the form of losses that would be suffered by foreign investors in that country due to a collapsing economy, and possible political and social upheavals leading to a new government inimical to the foreign policy interests of the home countries of the creditors. To counter the bargaining power of the large borrowers, the convergence of interests of the foreign creditors, foreign investors and their home governments is therefore critical. At times the alliance can move in the direction of concessions. On the other hand, the existence of the alliance and the squeeze that can collectively be applied can be an effective deterrent to an individual default. The struggle between the large debtors on the one side, and the creditors and their home country allies on the other, constitutes a bilateral monopoly situation.

The Mexicos of the developing world are, however, the exception. The typical developing country, by itself, does not have sufficient clout to extract concessions from the creditors. What is probably necessary, therefore, is for all the debtors, large and small, Latin American and non-Latin American, to form a club, equal to the Paris Club and London Club of the creditors, to renegotiate the terms and conditions of servicing the debt. Despite differences in the structure and composition of the debt between the large and small borrowers, it is in the interest of all developing countries to seek collective action. Even the Latin debtors, who include most of the really large borrowers, do not account for more than 40 per cent of the developing countries' external debt. They could therefore benefit from the support of the smaller debtors. These smaller debtors, in turn, could invoke the most favoured nation principle and demand the same rescheduling terms and conditions as the large debtors, *ceteris paribus*. An international debt conference attended by debtors and creditors would then be in order, with the objective of working out debt reform and standard and reasonable rescheduling terms for all debtors, large and small. It would also be in the interest of the creditors to have such a conference, not only because international banking stability is a good trade off for excessively high fees, but also because a lot of their time and energy is involved in one-on-one negotiation with the debtors. Even the large borrowers, with their more favourable rescheduling terms, have to repeatedly return to the negotiating table for easier conditions.

Finally, in the present free-for-all system only the very large

debtors can, with any credibility, use the threat of default as a bargaining weapon. For the others, default is a non option since an individual country would be faced with a battery of possible sanctions, such as (1) termination of all lending, (2) repayment acceleration of principal and interest, (3) termination of trade credit, (4) withdrawal of export insurance, (5) termination of aid, (6) import ban, (7) seizure of foreign assets, and (8) an economic embargo.[7] Although many developing countries are in arrears, they are still far from a *de facto* default situation.

### (2) *Limiting Debt Servicing to a Proportion of Export Earnings*

Whereas a decade or so ago, a debt service ratio of 20-25 per cent of exports would have been considered as unbearable, many debtors, both big and small, have ratios twice this figure and more. The ratio for interest payments and principal on long term debt for five of the 22 developing countries with a gross external debt exceeding $10 billion (Peru, Chile, Argentina, Brazil and Mexico) exceeded 50 per cent in 1985; and four o the 23 countries with debt between $1.5 billion and $10 billion (Ghana, Jamaica, Costa Rica and Ecuador) also exceeded 50 per cent. If both short and long term debt are included, 26 countries would be in the above-50 per cent debt service category, of which 11 would be over 100 per cent and two (Bolivia, a small debtor and Argentina, a large debtor) would have a ratio exceeding 200 per cent. For those countries with a more than 100 per cent long plus short debt service ratio – for all intents and purposes – imports were being entirely financed by loan inflows.

A few countries have decided to limit such debt service payments. In July/1985 President Alan Garcia of Peru decided to limit service payments on the $14 billion debt to 10 per cent of exports. Peru then moved its international reserves out of U.S. banks to forestall any attempt on the part of its U.S. creditors to attach its assets. In early 1986, Nigeria said that it would limit foreign debt payments to 30 per cent of export revenues. In the meantime, Nigeria has been postponing payment for certain imports with foreign currency – with its central bank issuing promissory notes that can be converted to Nigerian *naira* for use only in Nigeria. In early October 1986, the Sudan Prime Minister announced that his country would be able to allocate only a part of its foreign exchange earnings to service its foreign debt, and Brazil is considering doing the same. The recent linking of oil prices to debt service relief in Mexico and to wheat prices in the case of Argentina is also *de facto* based on export earnings. Zaire has announced that it intends from January 1987 to limit

interest payments on its debt to 10 per cent of export earnings.

The limiting of debt service payments can be particularly attractive to those countries which are unable to secure new balance of payments financing and other rescheduling arrangements under reasonable terms and conditions. Small debtors, with their very limited bargaining power and minimal ability to secure new credit, may therefore want to consider this as a serious alternative. The advantage of this method of putting a cap on interest rates lies in its 'ability to pay' approach. The main problem, therefore, concerns arriving at what constitutes a reasonable debt servicing figure (as the percentage of exports).

### (3) *Conversion of Debt into Equity*

Within the last two years or so, a number of developing countries have begun to exchange portions of their foreign debt for equity in either their public sector or private sector companies. For example, Mexico and Chile have engaged in 23 and 26 debt-equity swaps, respectively, involving the retirement of $300 million and $28 million worth of debt, respectively. Over the next 12 months both of these countries are expected to convert another $1 billion worth of debt. The conversion process has been proceeding at a similar pace in the Philippines which has a $26 billion debt. The Brazilian Government has been giving 5-10 per cent cash awards to companies that convert debt into equity. The usual procedure involved in the conversion process is for an investment bank to buy some of the debt held by a commercial bank at a 25-30 per cent discount. The investment banker then presents the debt certificate to the central bank of the indebted country for redemption in local currency at a subsidized exchange rate of 25 per cent or so. The investment banker must then take the local currency and invest it either directly in the shares of a local company or it must sell the local currency to another company planning to invest in the country. In some cases there is no investment bank acting as middleman and the commercial bank is in direct contact with the would-be investor.

The conversion of debt into equity is attractive to both lenders and borrowers. The commercial bank is able to reduce its loans exposure in the country in question – even though by selling at a discount it incurs a loss. The developing countries find the conversion process attractive not only because it reduces their stock of external debt but also because it helps to make repatriation of funds contingent on economic performance, i.e., only if the business is successful will there be profit outflows, whereas in the case of foreign loans interest had to be paid abroad regardless of the state of the economy.

Conversion of debt into equity is, however, not an unmixed blessing. Countries are concerned about excessive foreign ownership of their economies. For this reason, Mexico has stipulated that foreign ownership in any one company cannot exceed 51 per cent as a result of any conversion. In the Philippines, foreign banks have used the conversion process to make substantial ownership inroads into the local banking system, despite the importance that the authorities had once placed on indigenization of this sector. The problem is that whereas the developing countries may want to use the conversion opportunity to privatize certain ailing public enterprises, the foreign banks may be very selective and be interested in acquiring only the most profitable industries, e.g., state-owned commercial banks. Also, not many existing foreign enterprises may want to take the risk of increasing their equity exposure in developing countries given the sluggish nature of their economies. In Venezuela the alternative proposal to convert into bonds $7 billion of the debt held by locally operating foreign subsidiaries was so firmly opposed by the creditors that it had to be dropped.

The conversion approach therefore has serious limitations. The limitations are even greater for the small debtors. Foreign investors tend to find their markets for certain commodities too small for very profitable investment. But exporting presents even greater problems. Most of the industries being privatized in the large developing countries are therefore domestic market oriented.

### B. Bilateral Rescheduling and Multilateral Co-financing

In order to have their private debts rescheduled, countries have to agree to an IMF supervised adjustment programme. Since mid-1982 to end May 1986, 35 countries, including 10 Sub-Saharan, have had their debt rescheduled with banks either in the form of repeated annual reschedulings or multi-year reschedulings. In addition, a number of Sub-Saharan African, Central American and Caribbean countries did not reschedule at the Paris Club in 1985, and so are in arrears, primarily because they were unable to reach agreement with their creditors on adjustment programmes. Most of these delinquent countries are additionally hampered by arrears to the IMF which technically prohibits them from being involved in rescheduling negotiations.[8]

Although there was a significant number of developing country standby or extended arrangements of the IMF during the 1980-85 period (28, 31, 19, 33, 29, 26 in 1980, 1981, 1982, 1983, 1984, and 1985, respectively) amounting to $42.9 billion SDRs, the IMF has

been unwilling to relax conditionality despite the debt crisis and its contractionary impact on the world economy. In addition, there were other shortcomings in the IMF arrangements. First, the average duration of the arrangements in the 1982-85 period (15 months) was significantly shorter than it was in the 1980-81 period (22 months). In fact there has been only one extended agreement since 1983. Second, the average duration of arrangements for the low income countries, many of which are in the small debtor category, was disproportionately low compared to that of other developing countries, or compared to the adjustment capacity of low income countries. Third, by having arrangements with such a short duration, the IMF assumed that developing countries would be quickly able to return to a sustainable balance of payments situation. This was really wishful thinking. Of the 26 developing countries with IMF adjustment programmes in effect at the end of 1985, four countries were undergoing their fifth adjustment programme since 1980, seven countries were in their fourth programme and nine their third. For some countries the protracted and painful series of adjustment efforts might have improved the balance of payments situation only temporarily, with significant trade deficits emerging as soon as the economy was re-stimulated. Faster growth tends to require increased imports of raw materials and other essential inputs and may cause a diversion of consumer durables from the export market to domestic usage.

However, the multilateral initiative of the U.S. Treasury of 1985 constitutes a fundamental break with the old IMF deflationary adjustment approach as it attempts to allow for some amount of growth in the economy. As mentioned earlier, it involves a co-financing arrangement of $20 billion from the commercial banks over three years, a $3 billion increase in lending by the World Bank and the Inter-American Development Bank, and a $2.7 billion IMF SDR Structural Adjustment Facility on concessional terms to low income countries (10-year loans at 0.5 per cent interest with 5-year grace period) to be supplemented by the World Bank and the developed countries to create a pool of $6 billion.

However, the amounts proposed in the Baker package appear to be very inadequate relative to the needs of the developing countries whose debt servicing requirements for 1986 alone are said to be in the range of $139 billion. Moreover, the September agreement with Mexico has already exhausted $15 billion of a $20 billion sum that was to be spread over three years for 15 developing countries. Since the $20 billion was also meant only for the largest 15 debtors it also means that a paltry concessionary sum of less than $6 billion was intended to be distributed to over 100 developing countries.

The debt crisis is not over. Each calm merely precedes the next storm. In a fundamental sense, we are sitting on a financial time bomb. Countries are unable to cope with the servicing of their debt even after deferring payments on principal, rescheduling interest payments and negotiating new loans simply in order to pay interest on past loans. But new private bank loans have not been available to all. The fact that a few large debtors accounted for about half of the new credit that has been available over the last few years shows that they have learnt to exert a monopoly power, through the threat of default rivaling that of the suppliers. The suppliers of credit, for their part, know that their home governments will not allow a large commercial bank to fail for fear of destabilizing the national financial situation. The crisis is therefore both a debtor crisis and a creditor crisis and involves both host and home governments. As such, the costs of adjustment should be shared equally between the developing countries which borrowed irresponsibly and the creditor countries which lent imprudently. Any solution to the debt crisis therefore has to contain elements of a non-market nature.

Similarly, the benefits of relief measures should be made equally available to the large debtors and the small debtors. The small debtors are in a disproportionately less strong position to take advantage of most of the proposals – unilateral, bilateral and multilateral – that have been made for debt relief. Most significantly, the small debtors, with nevertheless large debt servicing burdens, have not recently been in receipt of new commercial bank credit whether of an involuntary or spontaneous kind. The fact that private bank loans do not account for the majority share of the debt of many small countries is rather poor consolation. Lending from Western governments and multilateral institutions like the IMF and the World Bank have in recent years been dominated by fiercely conservative sentiments. Official development assistance is now 0.3 per cent of GDP and falling rather than rising towards the United Nations target of 0.7 per cent. In the case of the IMF, in addition to describing its conditionality as "being grandmotherly"[9] and its underlying market philosophy as rigid and insensitive, authors cite the threatening problem of its own illiquidity. In 1985 the net flow of IMF credit to the developing countries fell almost to zero, i.e., the $1 billion net flow of credit through regular facilities was offset by the $1 billion net repayments made to three specialized windows – the Compensatory Financing Facility, the Buffer Stock Financing Facility and the Trust Fund. In the first two months of 1986 net flows were negative to the tune of $500 million. The IMF has therefore relinquished most of its

responsibility of providing short term credit and now merely acts out the role of broker between the creditors and the debtors.

The only bright spot on this multilateral horizon, we have said, is the new growth philosophy that has been grudgingly proposed by the U.S. Treasury. Their new approach of trying to build growth into the adjustment process partly stems from the deflationary impact that forced compression of imports by the developing countries has on the economies of the developed countries. There is also the concern that the new democracies in such countries like Argentina, Brazil and the Philippines, which inherited the wanton debts of previous dictatorships, might be overthrown by more radical forces as a result of the economic and social misery that the traditional type of adjustment brings in its train. However, the resources made are totally inadequate for the new growth oriented adjustment process. Any lasting solution to the debt crisis will have to involve a total re examination of the workings of the international economy and a reassessment of the appropriateness of many of the previously rejected tenets of the proposed new international economic order. Some degree of debt relief in the form of write-offs is also essential.

The overall picture therefore remains bleak. Official development assistance is being 'crowded out' by other items on the conservative fiscal agenda in the developed countries, e.g., 'star wars' in heaven seems to take precedence over economic wars (on poverty) on earth. Private bank loans to the developing countries are also being crowded out by supposedly less risky claims by consumers and investors in the developed countries.[10] The major part of the adjustment burden therefore lies on the shoulders of the developing countries. In this regard, small countries, because of their undiversified economy, meagre natural resources and limited technological capability have the least capacity to smoothly adjust. However, small countries are content to rely on the fall-out or side benefits from the struggle being waged by the larger debtors whereas, in fact, they should be active members of such a debtors' movement. Even those small countries with a low, rather than high, debt servicing ratio should be concerned, since the worsening of the international economic climate has certain contagious effects for them also. However, achieving solidarity and singlemindedness of purpose and action from such a large grouping as the developing countries would take some doing.

What else can the small countries do to help themselves? Certainly, greater efforts have to be made to diversify their economies. Because their markets are small there are certain limits to the deepening of the import substitution process which, moreover, can be quite import intensive at times. A greater effort at increasing non-traditional

exports – assuming no increase in protectionism abroad – is therefore required. In this regard, foreign investment can play a useful role not only because of the capital and technology that this can bring, but also because of the marketing expertise that is associated with it. This new thrust at attracting foreign investment has to be reconciled with legitimate concerns about economic sovereignty. In any case, most small economies are not going to be able to attract the volume of foreign investment required for vigorous growth, and so domestic savings and investment rates will have to rise. There is no discernable light at the end of the tunnel. It is not for nothing, Mr. Chairman, that economics has been termed a dismal science.

Finally, despite the unfavourable international economic environment being mainly responsible for their woes, small countries also need to manage their economies more efficiently. An aspect of good management is sharp predictive and forecasting powers. In the mid-1970s when commodity prices went skyrocketing, small African and Caribbean countries for a year or so were not sure how they should react to this new found bonanza. Then they decided that high commodity prices were here to stay and set out on ambitious development programmes. The commodity prices, as history would have predicted, plummetted and these countries intensified their borrowings in order to maintain development expenditure levels in the expectation that prices would soon rise again. Unfortunately, commodity prices have remained chronically depressed and meaningful commodity stabilization schemes do not exist. The oil producers did not learn from the experience of the mineral and agricultural producers, and the 1973 and 1979 oil price increases have been followed by a significant fall. There is an unavoidable nexus between foreign trade, finance, debt, investment and production.

Mr. Chairman, the debt crisis does not seem to have an end, but I do.

## TABLE1: FORTY–FIVE DEVELOPING COUNTRIES WITH EXTERNAL BORROWING EXCEEDING $1.5 BILLION, END 1985

| Name of country | Gross external debt end 1985 $ billion | Percentage owed to commercial banks – end 1985 | Debt service ratio (excl. principal short debt) | Debt service (incl. principal short and long debt) |
|---|---|---|---|---|
| | | % | % | % |
| Trinidad and Tobago | 1.7 | 60.4 | 8.7 | 14.9 |
| Guatemala | 2.0* | .. | 39.0 | 53.5 |
| Oman | 2.0 | 60.3 | 5.2 | 15.5 |
| Ghana | 2.1 | 22.0 | 53.0 | 83.7 |
| Honduras | 2.4* | .. | 31.9 | 47.2 |
| Zimbabwe | 2.8 | 27.3 | 35.5 | 57.1 |
| Kuwait | 3.2 | 85.2 | 3.7 | 19.7 |
| Sri Lanka | 3.5 | 19.9 | 17.3 | 28.4 |
| Syria | 3.6* | .. | .. | 49.0* |
| Dominican Republic | 3.8* | .. | .. | 64.3* |
| Jamaica | 3.9 | 31.1 | 53.3 | 81.2 |
| Costa Rica | 4.2 | 34.4 | 57.2 | 78.1 |
| Jordan | 4.2* | .. | 23.4 | 50.7 |
| Bolivia | 4.3 | 39.5 | .. | 231.2* |
| Panama | 4.5 | | 13.2 | 27.5 |
| Zaire | 4.6 | 15.0 | 20.7 | 33.2 |
| Uruguay | 4.9 | 47.2 | .. | 168.1* |
| Tunisia | 5.7 | 27.3 | 22.2 | 41.4 |
| Singapore | 6.3 | | 6.8 | 19.6 |
| Ivory Coast | 6.7 | 46.1 | 21.1 | 37.2 |
| Sudan | 7.3* | .. | .. | 111.1* |
| Taiwan (Province of ) | 7.8 | 70.9 | 5.8 | 13.7 |
| Ecuador | 8.7 | 59.7 | 75.3 | 103.1 |
| Hong Kong | 10.7 | | 6.3 | 12.8 |
| Colombia | 13.1 | 49.5 | 39.9 | 99.0 |
| Pakistan | 14.0 | 16.3 | 21.6 | 36.2 |
| Saudi Arabia | 14.0 | 72.5 | 3.6 | 28.1 |
| Morocco | 14.1 | 37.5 | 37.0 | 80.4 |
| Peru | 15.2 | 44.3 | 70.0 | 144.7 |
| Algeria | 17.2 | 51.0 | 33.9 | 49.5 |
| Malaysia | 18.7 | 66.3 | 14.0 | 29.7 |
| China | 18.9 | 55.7 | 5.7 | 27.0 |
| Thailand | 19.3 | 53.4 | 30.9 | 71.5 |
| Nigeria | 19.8 | 53.1 | 32.8 | 102.2 |
| Chile | 21.5 | 66.4 | 51.1 | 106.2 |
| Philippines | 26.3 | 55.1 | 40.1 | 157.5 |
| Turkey | 28.5 | 43.9 | 31.9 | 75.5 |
| Egypt | 33.7 | 32.9 | 29.9 | 87.5 |
| Indonesia | 37.0 | 43.2 | 27.8 | 60.9 |

| Name of country | Gross external debt end 1985 $ billion | Percentage owed to commercial banks — end 1985 % | Debt service ratio (excl. principal short debt) % | Debt service (incl. principal short and long debt) % |
|---|---|---|---|---|
| Venezuela | 37.5 | 80.0 | 35.2 | 157.9 |
| India | 37.5 | 15.9 | 20.0 | 36.2 |
| Argentina | 48.5 | 68.6 | 62.1 | 228.9 |
| Korea | 50.1 | 68.6 | 23.1 | 74.2 |
| Mexico | 97.3 | 78.2 | 77.8 | 124.8 |
| Brazil | 105.5 | 74.9 | 73.4 | 110.6 |

*1984 data

*Source:* Calculations based on Morgan International Data, October 1986.

## NOTES


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