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SM/80/273

December 24, 1980

To: Members of the Executive Board

From: The Acting Secretary

Subject: External Indebtedness of Developing Countries

The attached paper deals with the main issues relating to the external indebtedness of developing countries. There are three companion papers to this study: an Annex (SM/80/273, Supplement 1, 12/29/80) covering in greater detail some of the issues in the main paper; a paper entitled "Survey of Multilateral Debt Renegotiations Undertaken Within the Framework of Creditor Clubs, 1975-80" (SM/80/274, 12/30/80); and a paper on "Debt Restructuring by Commercial Banks: Recent Experience of Some Fund Members" (SM/80/275, 12/31/80).

This subject has been scheduled for discussion on Monday, January 26, 1981.

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INTERNATIONAL MONETARY FUND

External Indebtedness of Developing Countries

Prepared by the Exchange and Trade Relations Department

(In consultation with the area and other departments)

Approved by C. David Finch

December 22, 1980

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I. Introduction and Topics for Discussion

The question of the external indebtedness of non-oil developing countries has become one of growing concern in recent years. Several factors have brought the debt issue to the forefront of the problems facing a number of countries, including the rapid rise in the level of external debt in the recent past, the changes in the composition of this debt (toward a greater proportion of debt owed to commercial banks) and the attendant deterioration in the terms of debt, and the rise in the level of debt service resulting from the afore-mentioned developments. Some countries have encountered or are experiencing debt servicing problems and concerns have been expressed that such problems may become more acute in the future as countries incur additional external debt obligations.

Debt difficulties, however, cannot be considered in isolation; they must be viewed in the broader context of the overall external positions of the non-oil developing countries and their underlying situations with regard to stability and growth. The fundamental changes that have occurred in recent years in the external environment facing developing countries are reflected in the present level and structure of their external indebtedness; the large external imbalances now in prospect for many of them will require further reliance on external finance associated with substantive adjustment efforts.

1. Overall financing needs

A detailed analysis of the financing requirements and prospects of non-oil developing countries is beyond the scope of this paper, but reference may be made to a number of Fund papers on this general subject. 1/ These papers have emphasized that the structural nature of the present imbalances increases the urgency to develop appropriate responses from the supply side, which will allow countries to achieve viable external positions, and to maintain the requisite demand policies to keep aggregate demand within the constraints set by available financing. While the global payments imbalance is broadly similar in real terms to that associated with the 1973/74 round of oil price increases, there are important differences in other respects. The combined current account deficit of non-oil developing countries is smaller in relation to their GDP than in the previous cycle. On the other hand, it is unlikely that the current account surplus of the oil exporters will decline as rapidly, or that the growth rates of the industrial countries will recover as quickly, as in the mid-1970s. Thus, the correction of the payments imbalances is not likely to be achieved within

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1/ See especially: "Fund Policies for Adjustment Under Current Conditions" (EBS/80/146, 6/30/80); World Economic Outlook papers; and the Managing Director's address before the Annual Assembly of German Banks (10/29/80), on which the following paragraphs are mainly based.

a short period, and substantial amounts of financing will be needed to permit the adjustment process to run its course without unduly impairing developing countries' growth prospects.

A major portion of the financing of these deficits will represent net borrowing, and thus the outstanding level of indebtedness of developing countries will continue to rise. Some countries will have recourse to official development assistance (ODA) for part of their financing requirements. It is unlikely, however, that ODA flows will experience a substantial increase. Thus, for the balance of these countries' needs and, more importantly, for countries that are not recipients of ODA flows, private financial institutions will continue to be a major source of financing.

In aggregate terms, notwithstanding its rapid increase in recent years, the outstanding level of total non-oil developing country indebtedness measured in relation to other variables such as overall exports, GDP, or foreign exchange reserves is broadly comparable to the level prevailing in the early 1970s; there was an increase, however, in the real burden of debt service. Furthermore, both the scale of the prospective imbalances and the incremental demand for private finance, are smaller in relation to the size of financial markets than was the case in 1973-74. It appears, therefore, that a continuation of recent growth rates in international bank lending would be sufficient, through 1981, to accommodate aggregate demand from developing country borrowers. The particular situation and prospects for an individual country, however, will tend to influence a bank's perception of that country's creditworthiness. While several countries face potentially serious debt problems, the severity of such problems could be significantly alleviated by the adoption of considerably strengthened adjustment and debt management policies.

In sum, while recent trends suggest that, given appropriate economic policies by borrowing countries, the general outlook as regards the aggregate level of transfer of financial resources is reasonably reassuring for the immediate future, several countries are likely to encounter debt difficulties. In this context, the situation regarding developing country debt and measures to deal with potential debt difficulties raises a number of issues, which are addressed in this paper.

2. Coverage of the paper

Section II presents a quantitative account of major developments regarding external debt of developing countries. A discussion of some conceptual and statistical questions is followed by a description of the very rapid increase in nominal debt and debt outstanding during the period 1972-79 and various measures of the relative importance of this debt. The debt situation of the non-oil developing countries is analyzed in more detail and the significant changes in debt structure--toward a greater proportion of debt to private creditors, and the associated changes in the average terms of debt--is described. Finally, on the

basis of available data, an attempt is made to extrapolate the debt situation for the period immediately ahead. It is suggested that the current debt situation and outlook is such that, in aggregate terms, and provided that appropriate national economic policies are pursued, the additional indebtedness in prospect through 1981 can be accommodated without undue concern.

Section III focuses on developments in real external debt and real debt burden (i.e., adjusted for inflation) for the non-oil developing countries which as a group were the most adversely affected by the economic events of the 1970s. It also discusses the use of external debt indicators, such as the ratios of external debt to GNP and debt service to export earnings, as analytical tools in appraising a country's external debt situation. The principal conclusion of this section is that, while the nominal burden of external debt increased substantially, when adjusted for inflation the increase was considerably smaller than suggested by nominal data. The impact of inflation, however, is found to differ considerably according to whether fixed or variable interest loans are the dominant form of lending.

In Section IV, there is a summary survey of the countries that experienced debt difficulties during the period under review, including a brief account of the balance of payments background to these difficulties. There were no major differences in the terms of borrowing; however, the economies of the countries encountering debt problems generally were characterized by expansionary financial policies resulting in high import growth, relatively high export variability and low growth of GDP and exports, suggesting a less efficient use of domestic and borrowed resources available to them.

The Fund has continued its efforts to assist countries in avoiding debt difficulties; Article IV consultations and financial support for adjustment programs are important elements in the avoidance process. However, when such problems emerge and lead to debt rescheduling, the Fund has an important role to play. These matters are discussed in Section V in the context of the question of multilateral debt renegotiations. The provisions of the recent UNCTAD resolution, in the form of a set of guidelines, together with proposals for the Fund's role in future debt renegotiations, are set forth in this section. It is proposed that the Fund respond positively to any request by a member country for an analysis of its debt situation in the context of the new guidelines. More generally, it is recommended that the Fund actively continue its technical and other assistance to developing countries in resolving their debt problems.

Section VI takes up the experience of a few countries which have sought a restructuring of their debts to commercial banks in recent years. The focus is on the role of bank financing in the evolution of the debt problems of these countries, the modalities and financial impact of the restructurings and the linkage of that process to other elements

of the international efforts to help the countries regain a viable economic path. A few general issues which emerge from this experience are identified.

It may also be noted that this paper is supplemented by three other papers; an Annex discusses in greater detail a number of topics that are briefly considered in the main paper, including debt ratios and the burden of debt; two other papers provide surveys of multilateral debt renegotiations and debt restructuring by commercial banks, respectively.

3. Main topics for discussion

This paper covers a range of issues of a descriptive, analytical, and policy nature. In organizing their discussion, the Executive Directors may wish to pay particular attention to a number of topics set forth below. Following discussion by the Board, it is proposed that this paper be made available for consideration by the Development Committee Task Force on Nonconcessional Flows at its meeting scheduled for March 11-13, 1981.

a. The general setting regarding the debt situation of the developing countries

In the broader context of the world payments situation, Executive Directors may wish to comment on the view that, provided appropriate adjustment policies are followed, the additional indebtedness in prospect for developing countries in the aggregate can be accommodated in 1981 without undue concern.

b. Debt servicing difficulties

Directors may, however, recognize that in a growing number of individual cases, debt servicing problems are becoming serious and that it is in the interests of both the debtor countries and their creditors that in such cases the problems be resolved in an expeditious and mutually acceptable manner.

c. Multilateral debt renegotiations

Directors may wish to comment upon the arrangements for the multilateral rescheduling of official and officially-guaranteed debts, especially the proposals for the future role of the Fund as set forth on pages 54-55.

d. Restructuring of debt to banks

Directors are also invited to comment on the arrangements for renegotiation of private bank debt, especially whether and in what circumstances the Fund should play a more active role.

II. The Dimensions of Developing Country Debt

1. Conceptual and statistical aspects

An examination of the external indebtedness and debt problems of developing countries must begin with a quantitative analysis of the dimensions of this debt, including its recent growth and current size, the importance of these data in relation to other pertinent economic variables, and any significant developments in the nature and composition of the debt.

In spite of significant advances in recent years regarding quality and coverage of debt data, serious deficiencies remain as regard basic statistics either from debtor or creditor sources. Partly as a result of this, a variety of estimates for debt of developing countries are in current usage reflecting definitional differences in the categories of debt covered, the particular purpose of each series, and the availability of information on each type of debt.

This paper concentrates on the medium- and long-term external debt of 94 developing countries, 1/ i.e., the disbursed and outstanding external debt contracted by the public and private sectors of these countries in maturities of one year or more. This definition covers debt contracted by the private sector without a guarantee from a public entity in the debtor country. Some information on private nonguaranteed debt is available in a manner to be incorporated in the more generally used series on public and publicly guaranteed debt. However, because of the preliminary and derivative nature of this information, much of the analysis of debt must be based on public debt data alone. 2/

1/ Throughout this paper the definitions of developing countries, non-oil developing countries, etc., correspond to those used in IMF, World Economic Outlook, May 1980, p. 85 (WEO). The number of countries included in the analysis is limited by the availability of information on debt on a comparable basis. The main source of debt statistics is the World Bank's DRS, that collects information from debtor sources on public and publicly guaranteed debt for 96 developing countries, not including centrally-planned economies. No statistics are available for some of the countries listed in WEO among the developing countries, and they are, therefore, not considered in this analysis; on the other hand, two countries for which DRS provides information, are not classified by WEO as developing countries, reducing the list of countries analyzed in this paper to 94.

2/ The information on private nonguaranteed debt is derived from publications of the Development Assistance Committee (DAC) from the OECD, which reports information, mostly collected from creditor sources, on debt of 143 developing countries and territories. Once the respective series are adjusted for the difference in country coverage, most of the remaining difference with the information provided by DRS can be attributed to private credits which are not guaranteed in the debtor country.

Total medium- and long-term debt statistics do not fully account for all external liabilities of a country as not all of them can be defined as debt. A possible operational criterion would to be to include as debt all term liabilities, i.e., all obligations that have a predetermined schedule of repayment. 1/ Using this criterion, it would be necessary to supplement existing published data in several ways. The most important omission from these data is the external liabilities of less than one year in original maturity, usually defined as short-term debt. Their outstanding amount as of end-1979 has been conservatively estimated to amount to $80-90 billion. These include, for the most part, bank loans of short maturities, overdrafts or revolving lines of credit, bills of exchange, and letters of credit. In general, such credits are related to trade transactions and, in a sense, are self-liquidating; their absolute level tends to maintain a stable relation to the value of a country's trade, and the amounts involved are normally rolled over from year to year. However, at any given moment, their outstanding amount may place an immediate claim on a country's foreign exchange reserves, thus affecting the overall payments position, including the country's debt servicing ability. In some cases, even though this type of financing is more costly than medium-term operations, countries have resorted to sudden increases in short-term borrowing. As these short-term credits are rolled over, they become the equivalent to a high cost, medium-term source of finance, and may become significant in terms of a country's general debt profile.

In spite of its importance, there is no comprehensive statistical record of short-term liabilities, including both bank and nonbank credits, on a basis consistent with the medium- and long-term debt statistics produced by the OECD and the World Bank. In the case of individual countries, often a substantial part of their short-term financial transactions, especially those involving the private sector, are not properly recorded in the balance of payments, but are reflected in the "errors and omissions" item.

A second omission, though for different reasons, is the use of Fund credit. This form of external liability traditionally has not been included in external debt statistics; only Trust Fund loans, reflecting the highly concessional terms of repayment, are included in the series reported by the World Bank. The exclusion of Fund credit has not, however, materially affected the aggregate debt picture as the outstanding amount of it 2/ does not exceed 2 per cent of the total outstanding medium- and

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1/ Even in this case some borderline cases would defy easy classification, such as, on the one hand, some categories of loans that can be easily rolled over transforming themselves in liabilities of indefinite maturity, or, on the other hand, some obligations arising from direct investment or nonresident deposits that have, as may be the case, fixed schedules of remittance or withdrawal.

2/ The total outstanding use of Fund credit by developing countries at end-1979 was $8.3 billion.

long-term debt. For individual countries, however, inclusion of Fund credit would, in some cases, give a somewhat different picture of the debt situation.

Up to the late 1960s capital flows to developing countries consisted largely of direct investment, short-term trade-related credits, and long-term, mostly concessional, flows associated with project financing by official lenders. Operations with the Fund, on the other hand, were considered primarily as monetary movements of a compensatory nature that provided short-term bridging finance between cyclical swings of a country's balance of payments. This clear distinction between the existing types of capital flows explained the focus on long-term flows in the analysis of external debt.

The rapid development of commercial bank lending during the 1970s has to a large extent blurred the above distinctions. For balance of payments support, countries gained access to private sources which provide medium-term finance not tied either to trade or projects. On the other hand, through the creation of new facilities and the mechanisms of successive Fund-supported programs, access to Fund resources was enlarged and its actual maturity was lengthened. In any case, the monetary nature of the use of Fund credit does not alter the fact that it constitutes a fixed-term obligation of the user of these resources that lays claim on its future foreign exchange earnings. Moreover, at present, published external debt data already include part of the liabilities of monetary authorities, e.g., medium-term borrowings by central banks from international capital markets.

In view of the above, and particularly in the light of the recent decisions regarding the role of the Fund in recycling and in meeting the balance of payments needs of members in the years ahead, the staff believes that it would be appropriate to take account of Fund credit in the analysis of external indebtedness.

A third question relates to payments arrears which arise when, either on an informal basis or through official limitations on the availability of foreign exchange, an undue delay occurs in the making of international payments. A recent staff paper on this subject 1/ defines undue delay as one "that exceeds the period reasonably needed to complete the administrative procedures required to establish the bona fides of an application for foreign exchange, having regard to the circumstances of the member concerned." A broader definition of arrears should also include any undue delay by governments in meeting their external obligations. As such, arrears may arise in connection with any payment, be it for merchandise, invisibles, or debt obligations, but in all cases they may be construed as a liability of the country akin to a loan that, although it does not have a fixed schedule of repayment, constitutes a priority claim on the country's foreign exchange reserves.

1/ "Review of Fund Policies and Procedures on Payments Arrears" (EBS/80/190, 8/27/80).

As of end-1979, 22 countries had accumulated arrears estimated in the above-mentioned staff paper at $5.1 billion. Although this does not significantly affect the aggregate picture of developing country debt, arrears are often a manifestation of debt servicing problems and, for the individual countries concerned, must be included in the analysis of the debt situation in that they can be equivalent to a substantial part of export proceeds. Furthermore, the emergence or elimination of arrears will tend respectively to under- or overestimate the debt service obligations of a given country.

Finally, depending on the circumtances of a particular country, consideration could be given to extend the analysis of the external debt situation to include certain other term liabilities such as obligations arising from the operation of bilateral trade agreements, private non-resident deposits, or certain types of leasing arrangements. Again, this is an area where no comprehensive statistical information is available; its absence, however, should not alter significantly the aggregate analysis of this paper.

If all the above-mentioned estimates for the different categories of external debt are taken into account, it would be possible to obtain a broad definition of the total external debt of all developing countries; at end-1979 this would amount to about $490 billion (Table 1). At that

Table 1. Total External Debt of Developing Countries, End-1979

(In billions of U.S. dollars)

Medium- and long-term debt of 143 developing countries and territories as reported by OECD	391.0
Short-term debt	85.0
Use of Fund credit	8.3
Arrears	5.1
Total	489.4
Of which:	
Medium- and long-term debt of 94 countries 1/	359.5
Medium- and long-term debt of 87 non-oil developing countries 1/	299.0
Public 2/ medium- and long-term debt of 94 countries 1/	287.9
Public medium- and long-term debt of 87 non-oil developing countries 1/	239.4

Sources: IBRD, World Debt Tables; OECD/DAC, Chairman's Report; and Fund staff estimates.

1/ Not including outstanding use of Fund credit or arrears.
2/ Public and publicly guaranteed debt.

date, the medium- and long-term debt of the 94 developing countries selected for analysis in this paper was estimated at $360 billion, or close to three fourths of this total.

2. Overall developments, 1972-79

Between 1972 and 1979 there was a fourfold increase in the outstanding medium- and long-term debt of developing countries. 1/ Over this period, the debt grew at an average annual rate of 21.7 per cent reaching by end-1979 a level of $360 billion (Table 2). At the same time, service payments on this debt increased more than fivefold, from $12 billion in 1972 to $63 billion in 1979, or at a rate of 26.6 per cent per annum. The faster pace of increase of service obligations reflects the progressive change in the structure of debt commitments toward debt contracted with shorter maturities and higher interest rates described more fully below. These rates of increase in debt and debt service may be compared with the 14-15 per cent average annual increase in both concepts during the 1960s.

The high rates of growth of debt and debt service during the period since 1972 have often been associated with the attempts by developing countries to maintain their levels of investment and economic growth in the face of an increasingly unstable external position arising from wide fluctuations of commodity prices and larger current account deficits due to higher import costs. However, the single most important factor in the increase in nominal debt and debt service obligations was the more rapid pace of inflation that characterized the period under review. As explained in greater detail in Section III, in real terms debt outstanding grew during this period at an average annual rate that can be estimated, depending on the choice of a base year and a deflator 2/, at between 6 per cent to 9 per cent, which is substantially lower than the real rate of about 12 per cent a year during the decade of the sixties. Debt service in real terms, on the other hand, increased at a rate of about 11 per cent per annum in both periods.

1/ The debt of 94 developing countries as explained in footnote 1 on page 5. Comparisons between any two points in time have to be viewed in the light of developments during the intervening period as well as the events in the end-years. Accordingly, in comparing 1972 with 1979 it must be borne in mind that 1972 was affected by the beginning of the commodity boom of 1972-74 while 1979 was characterized by a significant deceleration in the rate of growth of outstanding debt. The latter development was partly in response to higher interest rates in capital markets and partly a reaction to the sharp increase in medium- and long-term debt that took place in 1978 when a number of countries took advantage of favorable market conditions to consolidate their short-term debt into medium-term obligations.

2/ Considerable care has to be taken in this respect, as the years 1972-74 witnessed large fluctuations in all major price indices.

Table 2. Medium- and Long-term Debt of 94 Developing Countries

(In billions of U.S. dollars)

	1972	1973	1974	1975	1976	1977	1978	1979 1/	Average Rate of Change 1979/72 (Per cent)
A. Debt outstanding (disbursed), end of period									
Public debt 2/	72.0	88.3	107.6	130.5	158.0	197.4	250.1	287.9	21.9
Official creditors	47.4	55.5	65.2	75.6	87.7	103.9	122.7	134.0	16.0
Private creditors	24.6	32.8	42.4	54.9	70.3	93.5	127.4	153.9	29.9
Nonguaranteed debt	19.1	23.0	27.1	36.0	44.2	46.8	59.6	71.6	20.8
Total	91.1	111.3	134.7	166.5	202.2	244.2	309.7	359.5	21.7
B. Debt service									
Public debt 2/	8.2	11.3	13.8	15.3	17.7	23.5	34.1	45.7	27.8
Official creditors	3.6	4.4	5.0	5.8	6.4	7.8	9.4	12.0	18.8
Private creditors	4.6	6.9	8.8	9.5	11.3	15.7	24.7	33.7	32.9
Nonguaranteed debt	3.8	4.1	6.0	8.3	11.4	12.7	14.9	17.0	23.9
Total	12.0	15.4	19.8	23.6	29.1	36.2	49.0	62.7	26.6

Sources: IBRD, World Debt Tables; OECD/DAC, Chairman's Report; and Fund staff estimates.

1/ Preliminary.
2/ Public and publicly guaranteed debt.

Another dimension of the real values of debt and debt service is obtained when they are compared with the evolution of exports. Using exports of goods and services of the 94 developing countries as a scaling factor, it is apparent that until the early 1970s debt rose faster than export proceeds; subsequently, the export boom of 1972-74 sharply reversed this trend which only resumed its former path from 1975 onwards. As a result, the outstanding debt of these 94 countries, which in 1960 was equivalent to about 48 per cent of exports, rose to an average of about 122 per cent in the years 1970-72, thereafter dropping to 68 per cent in 1974 and increasing again to 97 per cent in 1979 (Table 3).

Debt service payments experienced a similar evolution: from a level of about 7 per cent of exports in 1960 they increased to about 15 per cent in 1970-72, fell to 10 per cent in 1974, and rose again to 17 per cent in 1979. Thus, in spite of its large size in nominal terms, by the end of 1979 the debt situation of developing countries relative to their exports was in the aggregate not markedly different from that at the beginning of the decade. 1/

The rise in gross external assets of developing countries, in particular their foreign exchange reserves, is another factor that may be considered in assessing the growth in the total debt of these countries. Again, the experience of the 1970s reverses that of the 1960s: during the earlier period debt grew faster than the accumulation of reserve assets by developing countries, so that reserves (valuing gold holdings at market prices) which in 1960 were equivalent to about 58 per cent of outstanding debt, by 1970-72 represented only about 32 per cent of this debt; subsequently reserves increased faster than debt and, by end-1979, they represented 53 per cent of the debt. Part of the increased borrowing in the period 1973-79 was for the purpose of reconstituting reserves.

In sum, for developing countries taken as a group, (i.e., including oil exporters) external indebtedness and the related service payments had by the end of the 1970s attained unprecedented levels in nominal terms; in real terms, however, or in relation to other economic magnitudes such as exports or reserves, the general debt situation does not seem to be substantially different from that at the beginning of the decade.

1/ It must be noted, however, that this conclusion applies to total debt, i.e., including private nonguaranteed, of 94 developing countries. As described in Section III, there was some deterioration when the analysis is limited to the public debt of 87 non-oil developing countries.

Table 3. Developing Country Debt 1/ in Relation to Exports and Reserves

(In per cent)

	1960	1970 2/	1971 2/	1972	1973	1974	1975	1976	1977	1978	1979
				Debt of 94 developing countries							
Debt outstanding/ exports	48	123	132	110	92	68	83	86	90	107	97
Reserves/debt outstanding	58	28	29	38	47	60	45	44	45	42	51
Debt service/ exports	7	15	16	15	13	10	12	12	13	17	17
				Debt of 87 non-oil developing countries							
Debt outstanding/ exports	49	126	140	111	94	85	103	108	108	116	109
Reserves/debt outstanding	54	29	29	38	47	44	31	32	34	36	43
Debt service/ exports	7	16	17	15	14	13	14	15	15	18	19

Sources: IBRD, World Debt Tables; OECD/DAC, Chairman's Report; IMF, International Financial Statistics; and IMF, World Economic Outlook.

1/ Total medium- and long-term debt, including private nonguaranteed debt.
2/ Fund staff estimates.

3. The non-oil developing countries

The evolution of the debt and debt service obligations of non-oil developing countries 1/ included in this study follows closely that of the totals analyzed in the previous section. By end-1979 the outstanding medium- and long-term debt of these countries was $299 billion and the corresponding service payments during that year were equivalent to $51 billion (Table 4).

When the total outstanding debt of non-oil developing countries is measured against exports or reserves, it follows a similar path to that of all developing countries. In regard to debt service payments, however, a considerable deterioration occurred between 1970-72 and 1979. As a result of this, and also because this group of countries started the decade in a more unfavorable position, by 1979 the level of debt indicators for these countries suggested a somewhat more serious situation than for developing countries as a whole. As of end-1979 outstanding debt was equivalent to 109 per cent of their aggregate exports, debt service payments amounted to 19 per cent of exports, and reserves covered only 43 per cent of the outstanding debt, compared to the above-mentioned figures of 97 per cent, 17 per cent, and 51 per cent, respectively, in all developing countries (Table 3).

Since 1973 non-oil developing countries have been exposed to a more unstable external environment. Most of them have suffered from the impact of the increases in petroleum and other prices, while in many cases their exports have been affected by relatively stagnant conditions and protectionist tendencies in their major markets. The resulting wide fluctuations in the current account positions were initially met with changes in reserves and short-term capital movements; over the period, however, with the tendency of reserves and these short-term flows to return to more normal levels, the larger nominal current account deficits were increasingly covered by recourse to debt. As a result of these developments medium- and long-term debt continued to increase in the period 1975-78 when the pressure of rising import prices subsided.

Disaggregated data on disbursements and repayments of private non-guaranteed debt are not available; an analysis may, however, be undertaken with respect to public and publicly guaranteed debt, which corresponds to about 80 per cent of the total medium- and long-term debt, and about which detailed information is available. Disbursements of public debt by non-oil developing countries since 1972 rose at an average annual rate of more than 25 per cent (see Table 4); from year to year, however, there were sharp variations in this rate as countries adjusted to the current account situations of their balance of payments, to the

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1/ Eighty-seven countries. Following the classification used in IMF, World Economic Outlook, op. cit., Algeria, Indonesia, Iran, Iraq, Nigeria, Oman, and Venezuela are excluded from the list of 94 countries considered in this paper.

Table 4. Debt of 87 Non-oil Developing Countries

(In billions of U.S. dollars)

	1972	1973	1974	1975	1976	1977	1978	1979 1/	Average Rate of Change 1979/72 (Per cent)
A. Total medium- and long-term debt									
Debt outstanding	75.9	91.4	113.5	140.1	173.0	204.1	254.9	299.0	21.6
Official creditors	40.0	46.7	55.3	64.9	75.9	90.5	107.6	118.8	16.8
Private creditors	35.9	44.7	58.2	75.2	97.1	113.6	147.3	180.2	25.9
Debt service	10.0	13.3	16.7	19.4	23.8	28.7	39.7	50.7	26.1
Official creditors	3.0	3.7	4.0	4.9	5.4	6.5	7.9	10.2	19.1
Private creditors	7.0	9.6	12.7	14.5	18.4	22.2	31.8	40.5	28.5
B. Public debt 2/									
Debt outstanding	60.5	73.1	91.3	112.4	135.0	166.5	208.2	239.4	21.7
Disbursements	12.0	16.8	22.6	29.2	33.2	39.5	53.6	58.1	25.3
Amortization	4.6	6.3	6.8	7.7	8.8	12.2	19.1	24.0	26.6
Net flow	7.4	10.5	15.8	21.5	24.4	27.3	34.5	34.1	24.4
Interest payments	2.1	3.0	3.7	4.9	5.7	7.2	10.0	13.4	30.3
Debt service	6.7	9.3	10.5	12.6	14.5	19.4	29.1	37.4	27.8
Net resource transfer	5.3	7.5	12.1	16.6	18.7	20.1	24.5	20.7	21.5

Sources: IBRD, World Debt Tables; OECD/DAC, Chairman's Report; and Fund staff estimates.

1/ Preliminary.
2/ Public and publicly guaranteed debt.

desired position in regard to reserves and short-term flows, and to market conditions in relation to the terms of newly contracted debt. The faster, but more steady, growth of amortization payments resulted in net borrowing increasing during 1972-79 at an average rate of 24 per cent per annum. This net flow of medium- and long-term public debt did not match the threefold increase in the current account deficit of non-oil developing countries that occurred in 1974; even though the net flow increased by 50 per cent, more than 55 per cent of the deficit in that year was financed by other capital flows. In the following years up to 1978, further increases in net borrowing and the relative improvement in the aggregate current account position raised the contribution of public debt inflows to the financing of the deficits to more than 95 per cent, permitting also some increase in the reserves to debt ratio. The renewed deterioration of the current account position of non-oil developing countries that took place in 1979, coupled with a hardening of terms prevailing in international capital markets, and a slowdown in the disbursement of medium- and long-term debt, led again to a reduction of the proportion of the deficit that is covered by this debt to about 60 per cent.

In terms of imports, net borrowing of non-oil developing countries, by end-1979 was only marginally higher than in 1972 when it amounted to about 10 per cent of imports. Moreover, an increasing part of the net borrowing was absorbed by the payments of interest on the previously existing external debt. These interest payments grew at an average rate of more than 30 per cent over this period, with the result that the net contribution of public and publicly guaranteed external debt to the financing of the import bill of the non-oil developing countries remained practically unchanged at about 7 per cent.

4. Changes in debt structure

The most important element in the growth of the total outstanding debt has been the rapid growth of debt to private creditors. Whereas by end-1972 the external debt obligation of the 94 developing countries were practically evenly divided between official and private creditors, by end-1979 the share of private creditors in the total had risen to 63 per cent (Table 2).

Debt to official creditors increased during this period at an average annual rate of 16 per cent; among these creditors, multilateral institutions increased their share in the total. Debt to private creditors, however, increased at an average annual rate of 26 per cent (including in this estimate the debt contracted without public guarantee, which is deemed to be almost entirely to private creditors). The development of the syndicated loan market during the early 1970s gave rise to an unprecedented increase in commercial bank loans which widely surpassed

the more traditional private debt sources like bonds and suppliers' credits, and by the end of the decade constituted the bulk of this category. 1/

This rapid growth of debt to private creditors, as well as the rise in total debt, was heavily influenced by borrowing by a relatively small number of countries. Commercial bank loans to developing countries were directed primarily to oil exporters and to major exporters of manufactures. 2/ As a consequence of this, by end-1979 these 28 countries accounted for 72 per cent of the total debt of the 94 developing countries and for 80 per cent of the total debt to private creditors (Table 5); the 30 low-income countries 2/ among the countries included in this paper, on the other hand, accounted for only 8.4 per cent of the total debt of developing countries. This last group of countries has had little access to private credit sources, having relied primarily on official finance which has provided over 75 per cent of their total borrowing; their outstanding debt to private creditors by end-1979 amounted to $7.5 billion, mostly suppliers' credits, accounting for only about 3 per cent of the total debt extended by private sources.

The concentration of lending to net oil exporters and major exporters of manufactures is also reflected in the fact that these countries are among those with the largest outstanding debt. Table 8 shows that 20 out of the 31 largest borrowers may be classifed as exporters of oil or manufactures, while only three low-income countries (Bangladesh, Pakistan, and Zaire) 3/ belong to the largest borrower group. A further sign of this concentration is that the six largest borrowers, Brazil ($52 billion), Mexico ($34 billion), Algeria and India ($17 billion, each), and Indonesia and Korea ($16 billion each), as a group account for 42 per cent of the total medium- and long-term debt of developing countries.

5. The terms of the debt

The marked change in the structure of developing countries' debt during the period under review, summarized above, has been the principal cause of the deterioration in the average terms of new debt commitments incurred by these countries. This deterioration has been characterized by an increase in the average nominal interest rate and a shortening of the average maturity of new loans (Table 6). 4/

1/ Developments in international capital markets have been the subject of several staff papers, the most recent ones being "International Capital Markets--Recent Developments and Near-Term Prospects" (SM/80/159, 6/30/80), and "Developing Country Access to Capital Markets--A Progress Report" (SM/80/158, 6/30/80).

2/ Classification of IMF, World Economic Outlook, op. cit.

3/ India, that on account of its per capita income level would be included in this group, is classified as a major exporter of manufactures.

4/ The increase in nominal interest rates is also associated with higher inflation which affects the real interest burden (see Section III).

Table 5. Debt of 94 Developing Countries Outstanding as of End-1979 by Level of Income and Creditor Structure

(In billions of U.S. dollars)

	Official Creditors	Private Creditors 1/	Total	Share in Total Debt
28 exporters of oil or manufactures 2/	80.5	179.6	260.1	72.4
(share in group total)	(30.9)	(69.1)	(100.0)	
36 other net oil importers	30.6	38.4	69.0	19.2
(share in group total)	(44.3)	(55.7)	(100.0)	
30 low-income countries 3/	22.9	7.5	30.4	8.4
(share in group total)	(75.3)	(24.7)	(100.0)	
Total	134.0	225.5	359.5	

Sources: IBRD, World Debt Tables; and OECD/DAC, Chairman's Report.

1/ Includes nonguaranteed debt.
2/ Classified in IMF, World Economic Outlook, May 1980, as "oil exporting countries," "net oil exporters," and "major exporters of manufactures."
3/ Countries, not including India, whose per capita GDP, as estimated by the World Bank, did not exceed the equivalent of $300 in 1977.

Table 6. Average Terms of Commitments, 1972-79

	1972	1973	1974	1975	1976	1977	1978	1979	Average 1972-79
Interest rate (in per cent)									
Official creditors	4.3	4.2	4.4	4.9	5.5	5.2	5.0	5.0	4.8
Private creditors	7.3	9.1	9.7	8.8	7.9	8.0	9.4	11.6	9.0
Average for all commitments 1/	5.6	6.7	7.0	6.9	6.8	6.8	7.9	9.3	7.1
Maturity (in years)									
Official creditors	24.2	25.4	23.4	23.5	22.1	22.6	24.8	25.0	23.9
Private creditors	8.9	10.8	10.1	7.8	8.1	8.0	8.9	8.9	8.9
Average for all commitments 1/	17.6	18.0	16.9	15.3	14.3	14.0	14.5	14.6	15.7

Sources: IBRD, World Debt Tables.

1/ Excludes commitments of private nonguaranteed debt.

While the terms applying to each of the various categories of debt have through most of the period fluctuated within a narrow range, the increasing importance of financial flows from private sources, which typically have higher interest rates and shorter maturities, resulted in an overall deterioration in the terms of external debt commitments.

Average maturities in each category showed little change over this period, remaining at around 24 years for officially supplied loans, and 9 years for loans from private sources. As a result of the overall shift in the sources of finance, however, the average maturity of all commitments dropped from 18 years in 1973 to 14.6 years in 1979.

As regards interest rates, the average rate on loans from official sources rose from about 4.3 per cent in 1972-74 to the level of around 5 per cent it has maintained for the following five years. The interest rate on loans from private sources has tended to fluctuate more widely, increasing first from 7.3 per cent in 1972 to 9.7 per cent in 1974, dropping thereafter to 7.9 per cent in 1976, and rising again to 11.6 per cent in 1979. The resulting average rate of interest on commitments 1/ during the 1972-79 period remained at or below 7 per cent until 1977, increasing thereafter to the level of 9.3 per cent it had in 1979.

The rate of interest prevailing in international capital markets has been affected by the large fluctuations in the flows through these markets arising from major international adjustments required during the 1970s. Over the medium term, however, interest rates have reflected developments in world prices, in particular the inflation in developed countries. As discussed in Section III, these developments, together with the shift in debt structure toward debt contracted under floating interest rates, has important implications for the analysis of the burden of the debt under inflationary conditions.

6. Likely trends in 1981

At this juncture it would be of particular interest to project the debt situation of non-oil developing countries for the coming years, especially as regards their ability to meet debt service obligations in the light of foreseeable developments in their balance of payments. Such a projection, however, would be fraught with major difficulties including the changing supply pattern of available funds, the uncertain evolution of the terms prevailing in private capital markets, and the variety of factors that make any projection of the current account of developing countries a highly tentative exercise.

1/ Excluding commitments of private nonguaranteed debt.

A more modest attempt is made in Table 7 to extrapolate current trends into the immediate future so as to estimate the situation prevailing at the end of 1980, and project the likely position at the end of 1981. 1/ On the basis of (a) projections for the current account deficit included in the World Economic Outlook, (b) an extrapolation of present trends as to the proportion of this deficit that is covered by medium- and long-term debt and the proportion financed from official or private sources, and (c) estimates of the likely evolution of average interest rates and maturities, Table 7 shows that the outstanding debt of non-oil developing countries could reach the level of $418 billion by end-1981 (i.e., an increase of 40 per cent over the end-1979 level), and that service payments on this debt would rise to $80 billion, of which $32 billion would be interest payments (in relation to exports of goods and services, total service payments would increase from 19 per cent in 1979 to about 21 per cent in 1981). This projection would imply that disbursements of new loans to non-oil developing countries would need to increase from about $77 billion in 1979 to $113 billion in 1981, of which, under present trends, private sources would have to make available $85 billion, about $25 billion more than in 1979.

Table 7. External Debt of Non-oil Developing Countries 1978-81

(In billions of U.S. dollars)

	1978	1979 (Preliminary)	1980 (Estimated)	1981 (Projected)
Outstanding (end of period)	254.9	299.0	353.0	418.0
Debt service	39.7	50.7	64.0	80.0
Amortization	26.3	32.8	40.0	48.0
Interest payments	13.4	17.9	24.0	32.0
Disbursements	76.3	76.8	94.0	113.0
From official sources	21.2	16.9	24.0	28.0
From private sources	55.1	59.9	70.0	85.0

Source: IBRD, World Debt Tables, OECD/DAC, Chairman's Report; and Fund staff estimates.

1/ Some indications about the possible situation in 1985 and 1990 are provided in IBRD, World Development Report, August 1980, p. 101.

The order of magnitude of the projected increase in external debt and debt service in 1980-81 indicated in Table 7 would seem to be in line with the rates prevailing in the immediate past. Thus, barring major unforeseen developments, the overall situation with respect to capital flows to developing countries, as suggested in Section I, should not create undue problems. However, it should be noted that the purpose of the aggregative analysis undertaken in this section has been to detect general trends and overall developments; it does not cover the situation in individual countries which may differ in significant ways from the developments suggested by aggregate data. The situation of an individual country will be the result of the particular circumstances affecting its balance of payments and external situation.

7. Overview

During the 1970s, developing countries (including oil exporters) increased their recourse to external borrowing at a very rapid pace; by the end of the decade the outstanding level of all external liabilities is estimated to have reached almost $500 billion.

The bulk of these liabilities consists of medium- and long-term debt that, for the 94 countries included in this analysis, had by 1979 reached a level of $360 billion, with corresponding service payments during that year estimated at $63 billion. These figures are large indeed; however, their importance is diminished when they are seen in relation to other relevant economic magnitudes. Once account is taken of the effects of inflation, the overall debt situation in relation to variables such as the value of exports or the level of reserves of developing countries was, at the end of the decade, not significantly different from that at the beginning of the decade. The aggregate situation of non-oil developing countries, however, worsened somewhat during this period.

The most significant development as regards external debt during this period was the growth of the syndicated loan market and the fast expansion of its share in the total borrowing by developing countries. In circumstances where the financial flows originating from official sources practically stagnated in real terms, the growth of Eurocurrency loans, which typically carried higher interest rates and shorter maturities, caused an overall deterioration of the average term structure of developing countries' debt.

Most of the funds from private sources were channeled to countries that export oil or manufactures. As a result, these countries were able to increase their debt at a faster pace than the other developing countries. However, the average terms of this borrowing showed higher interest rates and shorter maturities than that of other developing countries. In particular low-income countries, which have limited access to private sources of finance, contracted their debt under better than average terms.

In sum, the overall debt situation during the period under review adapted itself to the sizable strains introduced in the international payments system and, in broad terms, maintained its relative position vis-à-vis other relevant economic variables. Though some countries experienced difficulties, a generalized debt management problem was avoided, and in the aggregate the outlook for the immediate future does not give cause for alarm. It has to be borne in mind, however, that the debt picture in the second half of the 1970s was to a large extent affected by the export boom of 1972-74 which resulted in a sudden decrease of the real value of debt magnitudes, but which is not likely to be repeated in the foreseeable future. Furthermore, as explained above, a continued deterioration in the average terms of the debt occurred during this period, a factor that is increasingly complicating debt management. The present and prospective debt situation, therefore, requires continued vigilance.

Table 8. Developing Countries with the Largest Outstanding Debt 1/
1975-79

(In millions of U.S. dollars)

	Debt Outstanding (end of period)					Debt Service				
	1975	1976	1977	1978	1979 2/	1975	1976	1977	1978	1979 2/
Algeria	8,296	7,393	10,065	14,842	17,200	1,069	1,192	1,409	2,029	2,922
Argentina	4,583	5,476	6,160	7,816	10,500	1,005	1,427	1,386	2,198	2,700
Bangladesh	1,435	1,804	2,305	2,743	2,900	82	92	83	98	85
Brazil	21,171	25,985	32,100	45,250	51,800	3,979	4,820	6,330	8,050	10,800
Chile	4,011	3,647	3,773	4,646	7,300	480	784	857	1,469	1,650
Colombia	2,530	2,703	2,956	3,158	3,900	267	331	399	545	740
Ecuador	592	778	1,345	2,075	2,700	83	126	158	277	715
Egypt	5,100	5,606	8,140	10,313	12,000	690	869	1,058	1,218	1,350
Greece	3,864	3,592	4,267	4,647	6,000	662	753	866	906	1,600
India	11,950	13,591	14,928	15,862	16,900	746	841	935	1,058	1,100
Indonesia	8,929	10,208	12,041	14,221	16,000	498	1,086	1,371	1,643	2,250
Iran	6,502	5,177	8,311	10,901	9,700	1,585	1,508	1,987	2,375	2,400
Israel	5,915	7,184	8,085	9,209	10,000	712	448	664	744	856
Ivory Coast	1,034	1,248	2,132	3,199	4,000	139	183	299	482	680
Korea	5,769	7,125	9,066	12,509	15,800	658	949	1,254	1,960	2,766
Malaysia	1,616	1,970	2,645	3,184	3,600	194	260	500	762	800
Mexico	12,817	21,660	25,500	29,488	33,500	1,797	3,694	5,219	6,988	11,000
Morocco	1,573	2,296	3,608	5,156	6,300	156	222	307	642	799
Nigeria	1,455	1,425	1,764	3,094	4,100	240	446	735	807	1,300
Pakistan	5,617	6,042	6,850	7,614	8,100	254	322	391	442	494
Peru	3,043	3,594	5,148	6,156	7,800	447	480	696	765	1,350
Philippines	2,541	3,826	4,711	6,193	7,700	378	559	533	1,269	1,440
Portugal	666	1,212	2,549	3,399	4,200	114	145	299	344	550
Sudan	1,393	1,459	2,035	2,576	2,600	164	168	136	138	300
Syria	777	1,012	1,551	2,136	2,700	117	144	137	251	300
Thailand	1,096	1,050	1,815	2,584	3,300	187	188	401	755	800
Tunisia	1,197	1,337	2,005	2,759	3,300	144	147	190	251	360
Turkey	3,813	4,204	5,300	7,272	11,400	338	415	448	648	1,138
Venezuela	1,602	3,146	5,724	8,937	10,800	531	456	1,160	1,642	2,200
Yugoslavia	4,249	6,896	8,589	10,323	12,500	830	1,289	1,583	1,811	2,300
Zaire	2,572	2,213	2,759	2,970	3,700	160	138	160	505	500

Sources: IBRD, World Debt Tables; OECD/DAC, Chairman's Report; and Fund staff estimates.

1/ Medium- and long-term external debt (including nonguaranteed debt). The countries included are those with outstanding debt as of end-1979 of more than $2.5 billion.
2/ Preliminary.

III. Inflation and External Debt

As mentioned in Section II, nominal public external debt and debt service payments of non-oil developing countries have increased sharply between 1972 and 1979. In order to obtain a more realistic assessment of the debt situation, however, external debt developments in recent years must be analyzed in the context of the more inflationary environment that has characterized this period. By relating debt magnitudes to other relevant economic variables, a more reliable measure of the increase in the real burden of external debt is obtained.

1. Debt ratios

In discussions of the external debt situation, frequent reference is made to a variety of external debt indicators which, in most cases, scale external debt by GDP or earnings from exports of goods and services. These indicators are used for a number of purposes, including descriptions of past and present external debt situations, gauging of debt carrying capacity, and prediction of possible future developments, including potential debt servicing difficulties. In addition to their use as descriptive and predictive tools for analyzing the situation of a particular country, debt indicators are also frequently employed for comparing the debt situation of a number of countries or groups of countries. The principal external debt ratios in use are: outstanding external debt to GDP; debt service payments to exports of goods and services; interest payments to GDP; and net resource transfer or net flow to GDP.

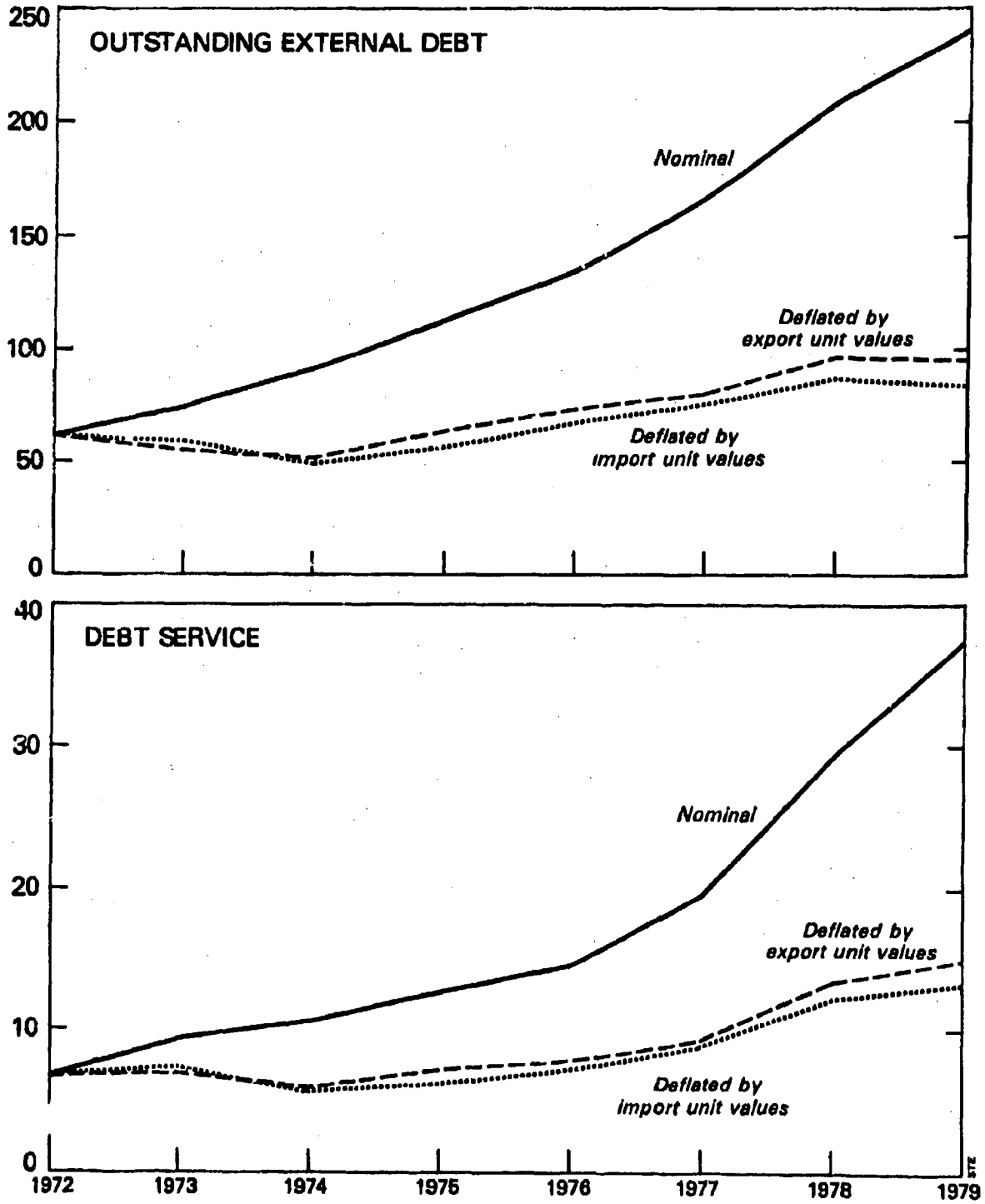
While the above debt indicators provide a useful tool for preliminary analysis of debt situations, for a number of reasons they must be used with considerable caution. In employing such indicators it is important to recognize the particular advantages as well as drawbacks of any given ratio, otherwise inferences drawn from them may result in misleading conclusions. First, it must be recognized that the change in a particular debt ratio over time may be more significant than the absolute level of that ratio at a point in time. Second, particular caution is necessary in using debt ratios for cross-country comparisons since two countries with, for instance, a similar debt service ratio may have entirely different underlying economic structures and hence prospects. Third, many debt ratios (e.g., debt service to exports, and interest payments to GDP) 1/ are strongly affected by inflation: for instance, in the early phases of a higher inflationary period these ratios tend to fall sharply. Finally, the use of debt ratios as an indication of future debt difficulties is subject to serious deficiencies, as market conditions and global economic circumstances change over time.

1/ The significance of ratios to GDP is affected by the appropriateness of exchange rates employed to convert GDP expressed in national currency into the currency of payments for debt obligations.

CHART

PUBLIC EXTERNAL DEBT AND DEBT SERVICE FOR 87 NON-OIL DEVELOPING COUNTRIES, 1972-79

(In billions of 1972 U.S dollars)



Sources *World Economic Outlook and International Financial Statistics.*

For the reasons mentioned above debt indicators, while useful in the assessment of debt situations, cannot take the place of comprehensive reviews of the economic situation and prospects of the countries involved, in particular their underlying balance of payments situation and prospects. A detailed discussion of the conceptual and statistical aspects of debt ratios is provided in the Annex to this paper.

2. The burden of external indebtedness, 1972-79

The selection of a deflator for external debt or debt service depends upon the purpose and perspective in question. For example, debt service payments can be deflated by export unit prices or import unit prices of the same country or group of countries in order to obtain a measure of real debt, but these measures are not identical numerically or conceptually (Chart 1). Scaling debt service payments by export earnings of goods and services provides an indicator of a country's ability to service its foreign indebtedness while deflating by import unit values provides an approximate measure of the opportunity cost of these resources in terms of foregone real imports.

The outstanding public debt of non-oil developing countries, deflated by export unit values for these countries, rose from $60.4 billion in 1972 to $94.4 billion (in 1972 dollars) in 1979 or by 56 per cent (Table 9). The annual rate of increase was 6.6 per cent which exceeded the growth rate of real GDP for these countries (5.2 per cent) but was lower than the expansion in their export volume (7.3 per cent). The growth in real outstanding public external debt has, therefore, in some sense been in line with the growth of real resources. The growth in real debt has been very uneven, however, reflecting fluctuations in export prices around their trend during this period. The commodity boom of 1973-74 resulted in a decline of 16.6 per cent in real outstanding external debt between 1972 and 1974 even though nominal debt rose by over 50 per cent during this period; subsequently, in the period through 1979, real foreign debt expanded rapidly at an average rate of more than 13 per cent.

The larger amounts of real external debt, along with the greater proportion of loans on commercial terms, resulted in an average annual growth rate of 12 per cent for debt service payments deflated by export unit values between 1972 and 1979 (see Table 9). This growth rate was uneven with the most rapid increases occurring in the period 1977-79 because of higher average interest rates, the expiration of grace periods associated with loans contracted in the mid-1970s, as well as the larger amount of real external debt. The rise in the volume of exports of goods and services tempered the growth in real debt service but still debt service as a rate of export earnings from goods and services was about one third higher in 1979 than in 1972, as it rose from 9.8 per

Table 9. Real Public Debt of 87 Non-Oil Developing Countries

(In billions of U.S. dollars, 1972=100)

	1972	1973	1974	1975	1976	1977	1978	1979
standing public debt	60.4	73.1	91.3	112.4	135.0	166.5	208.2	239.4
)eflated by:								
Export unit values	60.4	54.5	50.4	63.3	72.4	79.4	95.5	94.4
Import unit values	60.4	58.5	49.7	56.4	66.6	75.3	86.8	83.7
icial creditors	40.0	46.7	55.3	64.9	75.9	90.5	107.6	118.8
)eflated by:								
Export unit values	40.0	34.8	30.6	36.5	40.7	43.1	49.4	46.8
Import unit values	40.0	37.4	30.1	32.5	37.5	40.9	44.9	41.5
vate creditors	20.4	26.4	36.0	47.5	59.1	76.0	100.6	120.6
)eflated by:								
Export unit values	20.4	19.7	19.8	26.8	31.7	36.3	46.1	47.6
Import unit values	20.4	21.1	19.6	23.9	29.1	34.4	41.9	42.2
)t service	6.7	9.3	10.5	12.6	14.5	19.4	29.1	37.4
)eflated by:								
Export unit values	6.7	6.9	5.8	7.1	7.8	9.2	13.3	14.8
Import unit values	6.7	7.4	5.7	6.3	7.2	8.8	12.1	13.1
flow	7.4	10.5	15.8	21.5	24.4	27.3	34.5	34.1
)eflated by:								
Export unit values	7.4	7.8	8.7	12.1	13.1	13.0	15.8	13.5
Import unit values	7.4	8.4	8.6	10.8	12.0	12.3	14.4	11.9
resource transfer	5.3	7.5	12.1	16.6	18.7	20.1	24.5	20.7
)eflated by:								
Export unit values	5.3	5.6	6.7	9.3	10.0	9.6	11.2	8.2
Import unit values	5.3	6.0	6.6	8.3	9.2	9.1	10.2	7.2

)ources: IBRD, World Debt Tables; and IMF, World Economic Outlook.

cent in 1972 to 13.7 per cent in 1979 (Table 10). 1/ This measure indicates that a higher proportion of non-oil developing countries' exports of goods and services was pre-empted by principal and interest charges on their outstanding debt. Moreover, a larger proportion of fixed payments places greater pressure on the balance of payments, in case of adverse developments in export earnings, and also imposes additional strains on public finances.

The debt service to export earnings ratio, however, under normal market conditions tends to overstate the debt burden since the amortization component may be expected to be largely "rolled over" through new loan disbursements. Thus, interest payments relative to export earnings or GNP provide a better measure of debt burden when continued access to international capital markets exists. Between 1972 and 1979 the debt service relative to exports of goods and services, and to GNP increased at average annual rates of 7 per cent and 12 per cent, respectively, with the difference in the two figures due to the increasing share of exports in GNP during the period. Interest payments absorbed 4.9 per cent of export earnings in 1979 compared with 3.1 per cent in 1972, and represented 1.1 per cent of GNP in 1979 as opposed to 0.5 per cent in 1972 (Table 10). Thus, the burden of public debt for non-oil developing countries, measured by either debt service or interest payments, has increased noticeably in real terms.

The measures thus far discussed have primarily indicated the ability to meet debt service obligations on the outstanding external debt. For non-oil developing countries, however, an equally important real measure is the command over foreign goods which external debt provides or which is foregone because of debt service payments. Deflating debt service payments by import unit prices yields broadly similar trends as those already mentioned for export unit prices except that, since import prices rose faster than export prices for non-oil developing countries during 1972-79, the real cost in terms of foregone imports is about 11 per cent less than the ratio to export unit values. Year to year, these two measures also generate different results depending on the fluctuations in the terms of trade. Debt service payments, deflated by import unit values, nearly doubled between 1972 and 1979 increasing from $6.7 billion to $13.1 billion (Table 9).

A larger debt and thus greater amortization payments, requires greater annual gross borrowing in order to maintain the same level of investment. To gauge the command over real foreign resources gained by borrowing, the net flow or disbursements less principal payments, was adjusted by the import price deflator for non-oil developing countries. Real net flow, which was $7.4 billion in 1972, rose steadily through 1978 peaking at $14.4 billion. Lower real disbursements in 1979 combined with higher real amortization payments resulted in a drop in real net

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1/ These figures differ from those reported in Table 3; the data in that table cover total debt (i.e., including private nonguaranteed) of 94 developing countries while the data in Table 10 refer to only public debt of 87 non-oil developing countries.

Table 10. Selected Indicators for the Public Debt of 87 Non-Oil Developing Countries

	1972	1973	1974	1975	1976	1977	1978	1979
				(As a per cent of GNP)				
Debt service	1.6	1.8	1.6	1.8	1.8	2.2	2.8	3.0
Interest	(0.5)	(0.6)	(0.6)	(0.7)	(0.7)	(0.8)	(1.0)	(1.1)
Amortization	(1.1)	(1.2)	(1.0)	(1.1)	(1.1)	(1.4)	(1.8)	(1.9)
Net flow	1.8	2.0	2.4	3.0	3.1	3.1	3.3	2.7
Net resource transfer	1.3	1.5	1.8	2.3	2.3	2.3	2.4	1.7
			(As a per cent of exports of goods and services)					
Debt service	9.8	9.6	7.9	9.3	9.0	10.1	13.3	13.7
Interest	(3.1)	(3.1)	(2.8)	(3.6)	(3.5)	(3.7)	(4.6)	(4.9)
Amortization	(6.7)	(6.5)	(5.1)	(5.7)	(5.5)	(6.4)	(8.7)	(8.8)
Net flow	10.9	10.8	11.9	15.8	15.2	14.4	15.8	12.5
Net resource transfer	7.8	7.7	9.1	12.2	11.7	10.6	11.2	7.6
				(In billions of U.S. dollars)				
Memorandum items:								
GNP	414.4	516.3	655.0	715.5	799.3	890.1	1,034.5	1,248.4
Exports of goods and services	68.1	97.1	133.3	135.8	160.4	189.8	218.8	273.1

Sources: IMF, World Economic Outlook; IBRD, World Debt Tables; and Fund staff estimates.

flow to $11.9 billion. Net flow as a proportion of GNP, a measure of the extent to which foreign savings supplements resources available to these countries, rose from 1.8 per cent of GNP in 1972 to 3.3 per cent in 1978 before falling back to 2.7 per cent in 1979. 1/

In sum, the real burden of public external debt, regardless of the measure used, increased between 1972 and 1979. This greater burden stemmed from higher real external debt and, particularly, from a deterioration in average terms. The worsening in average terms was associated with the larger proportion of external debt incurred to private creditors.

As a general principle, the real debt burden measured by the debt service ratio increases in the early stages of debt accumulation and is expected eventually to reach a stable long-run value. The stability of this process, which admittedly involves much simplification (e.g., maintenance of a constant current account to GDP ratio), is predicated on the condition that the growth rate of nominal GDP exceeds or at least equals the nominal interest rate charged on foreign indebtedness. (A more detailed explanation of this phenomenon is provided in the Annex.) During 1972-79 the average nominal interest rate on outstanding external debt amounted to about one-third of the rate of increase of nominal GDP; even if this difference were to narrow in coming years, it appears that, in the aggregate, a precondition for a stable growth in external debt and its debt service exists. This condition can, however, be disturbed by a systematic deterioration in the current account position of these countries. Moreover, the external debt circumstances of a particular country may not be as favorable, and whether this condition is a reasonable one in terms of a country's short-run ability to service debt is another question. Other factors such as variability of export earnings, and conditions in the international capital markets, have an important influence on a country's ability to service its debt obligations.

3. Inflation and the rate of amortization 2/

Deflating nominal external debt and debt service payments corrects for certain changes caused by inflation but inflation has more far-reaching consequences on the evaluation of external debt than thus far discussed. Inflation, as will be demonstrated, distorts standard statistical measures of the current account of the balance of payments and interest payments,

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1/ Real net resource transfer (i.e., disbursements less debt service payments) moved in a similar fashion. Real net resource transfer rose from $5.3 billion in 1972 before peaking in 1978 at $10.2 billion and declining to $7.2 billion. As a share to GNP, real net resource transfer was 1.2 per cent in 1972, increased to 2.3 per cent in 1978, and declined to 1.6 per cent in 1979.

2/ A paper prepared by Ricardo Arriazu, "Inflation and its Impact on Debt Service: A Commentary" analyzed this issue. This paper was circulated to the Development Committee Task Force on Nonconcessional Flows in June 1980. A more detailed exposition of this subject is presented in the Annex to this paper.

and alters debt service payments. Since these measures are part of any analysis of a country's external debt position, it is essential that the manner in which these measures are changed by inflation be understood.

As has been long recognized, unanticipated inflation reduces the real debt burden of the debtor by lowering the real value of interest and amortization payments. Effectively, inflation transfers real resources from the creditor to the debtor. The extent of this transfer depends on the calendar maturity of the loan and the extent that inflation was not correctly foreseen. One result of this transfer is that standard debt indicators would exhibit a decline and, in some sense, a country's unused borrowing capacity would be expanded. Moreover, the market value of outstanding debt would diminish to reflect the lower future real transfers to the creditor or, put another way, with higher market interest rates, or discount rate, the same nominal payments have a lower present value.

This analysis has traditionally assumed a fixed interest rate loan which, in the international capital markets, is associated with official lending and with international bond issues. However, in the 1970s commercial bank syndicated credits or loans with variable interest rates have become an important form of lending. Interest rates on these loans are generally linked to the London Inter-Bank Offer Rate (LIBOR) which represents the cost of attracting deposits to commercial banks. Interest rates fluctuate with general credit conditions but, more broadly, they move in response to the rate of inflation. 1/ Thus inflation, even if it is imperfectly anticipated, has been incorporated into the interest rate and interest payments on these loans.

When inflation is fully anticipated and the nominal interest rate is correspondingly higher, 2/ it does not result in a real resource transfer from the creditor to the debtor because the resulting higher payments on account of interest compensate not only for the reduction in the real value of the originally contracted interest payments, thus maintaining constant the real interest rate, but also compensate for the deterioration in the principal of the loan. Under these circumstances actual interest payments include a component reflecting the erosion in future amortization payments, and therefore cause the real loan to be effectively amortized at a faster rate. The amortization rate is increased at a faster pace the longer the average maturity of the outstanding loans or the more rapid the rise in inflation.

One important implication of this more rapid amortization carried on through interest payments is that ratios, such as the current account of the balance of payments to GDP and interest payments to GDP, are biased upward by inflation. This distortion increases with higher inflation, longer loan maturity, and greater outstanding debt. In cases of fully

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1/ The relevant rate of inflation for this analysis is the one prevailing for the currency in which the loan is denominated.

2/ The nominal interest rate is then equal to the real interest rate plus an inflation premium.

anticipated inflation and floating rate loans, debt service ratios on these loans initially rise with higher inflation but this increase reflects the economic reality of faster amortization induced by inflation and not the distortion in the measurement of interest and amortization payments.

In reality the effect of inflation on external debt will vary according to whether foreign borrowing is subject to fixed or floating interest rates and the degree to which inflation is anticipated. Thus, the precise impact of inflation on amortization rates, real resource transfer, and debt indicators is a combination of many factors which cannot easily be measured. Furthermore, the degree to which inflation is anticipated influences the extent to which actual inflation is reflected in nominal interest rate movements.

An indication of the direction of the resource transfer on outstanding external debt of non-oil developing countries during the period 1972-79 associated with inflation is possible. It may be observed that for the period under review the average interest rate was less than the average rate of increase in export unit values (i.e., the real interest rate was negative) which implies that a real transfer of resources to debtors occurred. This transfer may or may not match the resource away from non-oil developing countries caused by even higher inflation rates for import prices. The magnitude and direction of the resource transfer in the future is difficult to estimate depending on several factors, including the proportion to which future debt of developing countries will be contracted under commercial or more concessional terms, and the degree to which the interest rate in capital markets will reflect future rates of inflation.

IV. A Survey of Debt Difficulties

1. Main developments

Debt difficulties cannot be considered in isolation from the underlying balance of payments conditions: they are a manifestation of an imbalance between resource availability and demand, reflected in current account deficits. Faced with such difficulties, some countries have undertaken adjustment policies aimed at increasing supply and curbing demand. Others have either sought to suppress the imbalance through the use of import and payments restrictions or by resorting to foreign borrowing. In some cases, where corrective measures were not taken, the situation deteriorated further resulting in the exhaustion of external reserves and, often, the accumulation of payments arrears.

A major feature common to virtually all debt problem situations has been the erosion of the international financial community's confidence in the debtor country's management of its economy. This has resulted not only in a slowdown or actual decline in net capital flows to that country, aggravating the foreign exchange crisis, but also in a general hardening of the terms of the credits available to the country and a disruption in the normal pattern of short-term trade credits.

Under circumstances of this kind it is not always possible to identify a particular situation as involving solely a debt problem, or to pinpoint the particular features that would necessarily constitute a debt problem. The most easily recognizable cases of debt difficulties are those that actually reached the point where the country had to seek a renegotiation of its debt. However, as suggested by the preceding discussion, a debt rescheduling is but one of several manifestations of a balance of payments maladjustment and does not cover other possible situations where the burden of external debt may become unsustainable.

The severity of the balance of payments pressures and the external debt problems faced by an increasing number of developing countries in recent years has been accompanied by a rise in multilateral debt renegotiations under the aegis of creditor clubs; there has also been a rise in the number of renegotiation of obligations to private creditors. 1/

In the period 1975-80, 11 developing countries sought and obtained debt relief in the context of multilateral renegotiations. These countries participated in a total of 18 debt renegotiations over the period, as shown in Table 11 below.

1/ Details regarding these renegotiations are provided in two companion papers: "Survey of Multilateral Debt Renegotiations Undertaken Within the Framework of Creditor Clubs, 1975-80" (SM/80/274) and "Debt Restructuring by Commercial Banks: Recent Experience of Some Fund Members" (SM/80/275).

Table 11. Multilateral Debt Renegotiations, 1975-80

1975	1976	1977
May - Chile	May - India	July - Zaire
June - India	June - Zaire	Sept. - Sierra Leone
		Dec. - Zaire
1978	**1979**	**1980**
May - Turkey	June - Togo	Feb. - Sierra Leone
June - Gabon	July - Turkey	July - Turkey
Nov. - Peru	Nov. - Sudan	Dec. - Liberia 1/
	Dec. - Zaire	Dec. - Pakistan 1/

1/ Scheduled but not completed as of this writing.

During the period under review, six countries had recourse to multilateral debt renegotiations for the first time; these were Gabon, Liberia, Sierra Leone, Sudan, Togo, and Zaire. Five other countries--Chile, India, Pakistan, Peru, and Turkey--which had each experienced several debt renegotiations previously, resorted to additional debt relief during the period under review. 1/ Chile, Gabon, Peru, and Sudan received debt relief only once during 1975-80; India, Sierra Leone, and Togo were involved in two debt relief exercises; and Turkey and Zaire resorted to three and four debt rearrangements, respectively, during the period under review. Except in the case of the renegotiations of India's debts, financial arrangements with the Fund in support of agreed programs were in place prior to the multilateral debt relief operations.

Another manifestation of debt problems--although less clear-cut than recourse to debt renegotiations--is the accumulation of payments arrears. These arrears may arise for a number of reasons, not all signifying a debt problem, and may correspond to payments due for trade transactions, invisibles, or debt service.

1/ In the case of Pakistan, a meeting to consider renegotiation of its debt, scheduled for mid-December 1980, was postponed to January 1981.

Information on arrears is not available on a systematic basis and should be viewed with caution. Even allowing for shortcomings of the data, however, there seems little doubt that the incidence and magnitude of payments arrears has risen sharply during the period under review. As indicated in the recent staff paper on this subject 1/, at the end of 1979 outstanding arrears amounted to more than SDR 5 billion, a level seven times higher than the total outstanding as of end-1975. On average, these arrears were equivalent to 40 per cent of the countries' 1979 merchandise exports, and in some countries this proportion exceeded 100 per cent. All of the countries, with the exception of Chile and India, that underwent a debt rescheduling operation during this period, had accumulated arrears in the period leading to the debt renegotiation.

2. The balance of payments background

The underlying balance of payments developments of countries that obtained debt relief in the context of multilateral renegotiations during the period under review are described in the companion paper referred to above. This section summarizes, in general terms, the major economic and balance of payments developments in these countries.

Broadly speaking, debt servicing problems in the cases under review evolved over a period of several years, rather than being related to developments in a single year, or the effects of a specific event. They reflected the accumulated effects of external and internal imbalances attributable to a variety of factors. In general, therefore, debt service difficulties during the period under review cannot be explained by developments during the period immediately preceding the actual debt rescheduling exercises. On the contrary, there was usually a substantial time lag between the emergence of debt service difficulties and the multilateral debt reschedulings. Moreover, in some instances the depleted level of reserves, the limited potential for new borrowing, or the accumulation of payments arrears, dictated an adjustment, frequently through a sharp reduction in imports. At times this resulted in an actual improvement in the current, or even overall, balance of payments during the period immediately preceding the debt renegotiation exercise.

In addition to general balance of payments difficulties that brought about debt servicing problems, in some countries specific factors contributed to these problems. Instances of these situations included the need for emergency imports after natural catastrophes leading to sharp increases in foreign borrowing, or the effects of political disturbances which resulted in capital flight or a sharp reduction in exports.

The pursuit of expansionary fiscal and monetary policies, and their impact on the balance of payments, was a characteristic feature of the situations under review. The circumstances underlying these policies varied among the countries in question. In some cases they reflected

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1/ See "Review of Fund Policies and Procedures on Payments Arrears" (EBS/80/90, 8/27/80).

mainly domestic factors such as a rapid rise in expenditures related to development plans, or in response to social and political pressures. In other instances, external factors were important; for example, expenditures were adjusted rapidly upwards in response to increased revenues from rising export prices. Some countries found it difficult to reduce budgetary outlays to sustainable levels during the falling phase of commodity prices.

The above policies led to increased demand pressures, including a rapid growth of import demand. In all the countries under review substantial increases in import volume took place during the period preceding the emergence of debt servicing problems. A further factor in the increase in imports was, however, the sharp rise in world energy prices during the 1970s. In addition to these developments, in most cases there was also a loss of export competitiveness as exchange policies failed to respond to inflationary pressures at home and abroad, with detrimental effects on production incentives.

Aside from developments in the trade account, debt service difficulties in some cases were compounded by adverse movements in the services accounts. In particular, officially recorded workers' remittances and tourist receipts fluctuated in several countries and at times these flows, as well as some proceeds from exports, were transacted through the parallel foreign exchange market.

While during the period under review many developing countries experienced adverse developments in their current account, it is a feature of most of the countries in which debt servicing problems emerged that they frequently attempted to finance their current account deficits through external credits of which a significant, though varying, share was of relatively short-term maturity and carried commercial rates of interest. In most instances accrued debt service payments rose sharply, although actual debt service payments often declined as external payments arrears on debt servicing accumulated. There was also significant buildup of short-term debt in the form of payments arrears.

A decline in official long-term capital flows was a major factor in aggravating balance of payments difficulties in some countries. In other countries, which had relied on substantial private foreign investments and credits, the balance of payments situation was strained by sharp declines or net outflows of private capital. In several cases this reflected noneconomic factors including political developments. The attempt to compensate for the declines in either direct foreign investment or official flows through increased commercial borrowing often led to sharply higher debt service obligations. With the buildup of large foreign debt obligations, private lenders and investors were in some cases desirous of reducing their exposure. In some cases the nationalization of foreign interests brought on additional debt servicing obligations.

Although the underlying economic and balance of payments situation differed considerably as between countries, it is nevertheless possible to observe a number of factors that contributed to the debt service difficulties in many of the cases. Several of these developments were also present during the same period in many other countries without leading to the emergence of debt service difficulties. The question that arises, therefore, is what distinguishes the group of countries that experienced debt problems from other developing countries?

In order to shed light on this question, an attempt was made to observe the principal differences between the countries that undertook debt renegotiations (including commercial debt restructuring) taken as a group, 1/ and the aggregate of all other non-oil developing countries. While these differences may provide some insights into the circumstances underlying the emergence of debt difficulties, it is important to recognize that no attempt is made to establish causality or to determine necessary conditions that lead to the emergence of debt problems.

As shown in Table 12, the countries in the group started the period with an already larger than average volume of debt relative to the size of their economies. By 1972 the outstanding external debt of the group was equivalent to almost 17 per cent of their GDP, compared to about 14 per cent for the other non-oil developing countries. Furthermore, during the period under review, this discrepancy increased, so that by end-1979 the debt to GDP ratio of the group was about one-third higher than that for all non-oil developing countries. These statistics should, however, be treated with due caution as intercountry comparisons involving GDP are affected by assumptions relating to the appropriateness of exchange rates.

The group contracted debt under terms slightly less favorable than the other non-oil developing countries. The average interest rate on commitments was about the same; the average maturity, however, was more than two years shorter.

1/ Henceforth referred to as "the group".

Table 12. Comparison of External Public Debt Indicators for a Group of Countries 1/ and for Other Non-oil Developing Countries, 1972-79

	1972	1973	1974	1975	1976	1977	1978	1979
				(In percentage)				
Average terms on commitments:								
Interest rate								
The Group	5.5	6.6	7.7	7.4	6.7	7.0	8.1	10.3
Other countries	5.6	6.7	6.9	6.9	6.9	6.9	7.8	9.1
				(In years)				
Maturity								
The Group	15.8	15.4	14.0	13.3	12.6	12.1	11.5	12.2
Other countries	17.8	18.4	17.2	15.5	14.5	14.2	14.8	14.9
				(In percentage)				
External debt/GDP:								
The Group	16.9	18.2	19.2	19.8	20.5	21.0	23.7	24.4
Other countries	14.3	13.7	13.3	15.2	16.4	18.4	19.7	18.6
Debt service/Exports: 2/								
The Group	11.9	13.8	12.2	16.8	16.9	19.2	24.9	29.1
Other countries	9.6	9.2	7.5	8.7	8.4	9.6	12.5	12.6

Sources: IBRD, World Debt Tables; and IMF, World Economic Outlook.

1/ Countries that renegotiated their debt during 1975-80.
2/ Goods and services.

The group had a weaker than average balance of payment situation thus making it more vulnerable to debt problems. As shown in Table 13, the average combined current account deficit of the countries in the group over the period under study amounted to 4.3 per cent of their combined GDP, somewhat higher than the 4.0 per cent for the other non-oil developing countries. To the extent that this larger savings gap was not covered by increased direct investment, the countries in the group had to rely more heavily than other countries on borrowing to meet their payments situation. Moreover, the underlying structure of the current account of the group was correspondingly weaker, as their export growth was considerably slower than that of the other countries (annual average growth of less than 14 per cent, against 18 per cent for the total). As a result of these differences, the outstanding debt of the group of countries increased faster, and the ratio of their debt service to exports deteriorated more rapidly than that of the others. Moreover,

the relatively slower rate of growth of exports, and hence of imports, largely restricted these countries' capacity to adjust to changed circumstances.

Table 13. Comparisons of Economic Indicators for a Group of Countries 1/ and for Other Non-oil Developing Countries, 1972-79

(In per cent)

	The Group	Other Non-Oil Developing Countries
Average current account deficit/GDP	4.3	4.0
Average growth in real GDP	3.6	5.2
Average growth in exports 2/	13.9	18.2
Variability of exports 3/	4.6	1.9
Average growth in imports 2/	14.0	18.5
Variability of imports 3/	6.1	2.4

Sources: IMF, International Financial Statistics; and Fund staff estimates.

1/ Countries that renegotiated their debt during 1975-80.
2/ Goods and services.
3/ Standard deviation around trend as a proportion of mean.

In the case of countries that encountered debt difficulties, the larger amounts of debt contracted relative to the size of their economies did not result in faster real GDP growth. Their real GDP expanded at an average rate of 3.6 per cent, far less than the rate of 5.2 per cent for the other non-oil developing countries. This not only resulted in the more rapid increase of the debt to exports ratio and debt to GDP ratio mentioned above (assuming that the GDP deflators of both groups of countries are about the same), but also suggests that the countries in the group made less efficient use of the resources available to them.

Finally, another important difference between the group and the other non-oil developing countries relates to the variability of export receipts. Measuring this variability as the standard deviation around trend, regression analysis results show a higher standard deviation for the group than for the other countries (4.6 per cent against 1.6 per

cent of the respective means). This higher variability can be explained by the concentration of exports of this group of countries in a few commodities. In most cases of debt difficulties this variability of export receipts was an important factor that triggered the debt service crisis. In this connection, countries subject to increased fluctuations in their export receipts would either need to maintain larger amounts of international reserves, or contract lower absolute levels of debt and debt service obligations. However, as explained above, the opposite appears to have been the case for most of the countries in the group.

V. Multilateral Debt Renegotiations

1. The basis of the multilateral approach

In pursuing its economic development objectives, a developing country will typically import capital from a variety of sources and thus incur external debt obligations to a large number of creditors, including governments, government agencies, multilateral institutions, and individual private banks or groups of banks. When such a country encounters balance of payments difficulties in which the burden of servicing the external debt is an important element, the rescheduling or refinancing of the external debt in order to alleviate the debt burden may be an important step in that country's efforts to overcome the balance of payments problem. Since it would be impractical, time-consuming, and inefficient for a debtor country to enter into separate rescheduling negotiations with each one of its numerous creditors, a multilateral framework can provide a focal point for rescheduling exercises. Such a framework, by bringing together the debtor and the official creditors, facilitates the rescheduling task by establishing general principles that will guide the renegotiations, including those that the country may undertake with its private creditors.

Apart from providing a convenient forum for the renegotiation of external obligations, an effective framework must have a number of other attributes. In the first instance, it must provide a vehicle for assessing the balance of payments situation and prospects, and in particular the debt situation, of the debtor country in question: the mere existence of a framework without an appropriate process for the identification and analysis of debt problems, would be unsatisfactory since, in the absence of such an analysis, debt negotiations would be conducted without reference to the economic needs and potential of the debtor country. Another important feature of a multilateral framework must be to provide for uniformity of treatment in its procedures, practices, and policies. Only in this way can such a framework become a viable international vehicle for debt renegotiation. Uniformity of treatment has several aspects: first, a common approach by creditors to debt questions that is an essential element of the multilateral approach serves to assure that a debtor country, by using the framework, will not renegotiate its debt on widely different terms with its different creditors; second, uniformity of treatment implies that all debtors availing themselves of the multilateral framework are accorded analogous treatment by the creditors. A third aspect of this question is that there exists a degree of uniformity between the renegotiation terms applied to public and publicly-guaranteed debt within the multilateral framework, and those applied to the renegotiation of private debt.

Another basic feature of a viable multilateral framework is that any debt relief granted should be within the context of a program designed to improve and restore the balance of payments position to an extent that would allow external capital flows to the country in question to be resumed at a sustainable level. To achieve this objective, measures

relating to debt and debt renegotiations must be in harmony with other policy measures taken in the context of the balance of payments adjustment program. In the absence of this, debt renegotiations might provide temporary relief but would not address the underlying policy issues.

The above analytical summary is by way of introduction to recent developments regarding multilateral negotiations. The evolution of the creditor club approach to debt renegotiations, including actual renegotiations that took place during the period 1975-80, is briefly described in subsection 2 below, and in greater detail in the companion paper entitled "Survey of Multilateral Debt Renegotiations Undertaken Within the Framework of Creditor Clubs, 1975-80" (SM/80/274). The initiatives in recent years for an amendment of existing procedures and for the evolution of more precise guidelines for debt renegotiations are analyzed in subsections 3 and 4.

2. The Paris Club and similar frameworks

a. Principal features

The evolution of multilateral debt renegotiations can be traced to 1956 when representatives of a number of European countries met in Paris to renegotiate large outstanding balances in bilateral clearing accounts with Argentina. By the end of 1980 there had been some 47 multilateral debt renegotiations covering loans provided or guaranteed by governments or official agencies for 15 debtor countries.

The most prevalent forum for multilateral debt negotiations has been the "creditor club" where some 35 of the reschedulings to date have taken place. The archetype of the creditor clubs, and the venue for the bulk of creditor club renegotiations, has been the Paris Club, which meets in Paris and is chaired by a senior official of the French Treasury. Other major creditor clubs have included the Hague Club (for the two renegotiations of Brazil's debt in the 1960s) and the London Club (for the four renegotiations of Ghana's debts). 1/

In addition to creditor clubs, multilateral debt renegotiations have also been held under the auspices of aid consortia. Although the chairmanship of such meetings is generally vested in an international organization (i.e., the World Bank or OECD), the principal framework of the negotiations is essentially the same as that under creditor clubs. Three consortia-sponsored meetings took place in the case of Pakistan

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1/ For the renegotiations in 1968 and 1969 of Peru's debt, the Paris Club was not the formal setting for the meetings which took place in London and Brussels, respectively; however, the procedures were identical to those of the Paris Club. Somewhat special circumstances governed the 1978 debt renegotiations of Gabon, a country that did not seek debt rescheduling through the auspices of the Paris Club; the agreement was reached by representatives of the principal creditor governments, using Paris Club procedures to agree on a common formula.

and 6 such meetings were held for India, all under IBRD chairmanship. In addition, Turkey's debts were renegotiated within the OEEC Consortium in 1959 and the OECD Consortium in 1965, and 1978-80. The renegotiations in the latter three years were chaired by the head of the French delegation, thus rendering the meetings identical to the Paris Club in every respect but in name.

Certain essential features of the Paris Club (and other creditor clubs) approach to debt renegotiations have evolved over the years. First, although in such renegotiations both the creditors and debtors are represented by government officials with the purpose of rescheduling a debt that has a government guarantee, the institutional framework has remained an informal one and no formal organization, based on internationally agreed criteria, has been established. Second, and reflecting the above, the Paris Club approach to requests for debt renegotiations has been a pragmatic, case-by-case one. The intent of this has been to maintain the maximum degree of flexibility, especially as debt situations may greatly vary in nature and seriousness and the creditors involved may be different in each case.

A third feature has been the common approach of the creditor members to individual requests. This had had two principal purposes: first, to avoid situations under which a debtor country would obtain widely varying rescheduling terms for similar types of debt from different creditors and, second, to assure a degree of equality of treatment accorded to various debtor countries.

Fourth, in the Paris Club framework, a clear distinction has generally been drawn between debt renegotiations as a means of alleviating the burden of debt service and thus facilitating a correction of the balance of payments, and official development assistance. In short, the principle has been maintained that a debt rescheduling should not be used as a vehicle for development aid. While this principle has been strictly adhered to in Paris Club negotiations, other multilateral debt meetings, such as some reschedulings under the auspices of IBRD Consortia, have combined the two, with the emphasis not on the balance of payments but on debt relief operations to sustain a level of resource transfer that would enable the country in question to execute its economic development plan.

A fifth feature of the Paris Club approach has been to provide debt relief in the context of a stabilization program designed to improve the balance of payments situation. Generally, this has involved the existence of an arrangement with the Fund, or making the entry into force of future debt relief provisions subject to the conclusion of such a program.

Apart from officials from the Paris Club creditors and the debtor country, Paris Club negotiations are attended by representatives from the Fund, as well as from the World Bank, OECD, and UNCTAD. The debtor country makes a detailed presentation of its situation and of the debt relief requested. The Fund representative presents a statement on the

economic, and in particular balance of payments, situation and prospects of the country concerned, including the status of that country's relations with the Fund. Taking into account these and other statements, the creditors evolve a common approach regarding the terms of the rescheduling which then becomes the subject of negotiation between them and the debtor country. The terms finally arrived at are set forth in Agreed Minutes which, in effect, constitute the guidelines for the actual debt relief which is subject to a series of bilateral negotiations that subsequently take place between the debtor and each creditor country. The question has sometimes been raised as to whether these bilateral agreements do, in their terms, correspond to the provisions specified in the Agreed Minutes. No systematic and comprehensive information on the outcome of the large number of bilateral agreements is available. The staff has made an effort to elicit this information from both creditor and debtor countries. On the basis of the limited information received to date, it would seem that during the period 1974-80 the bilateral agreements were generally in accordance with the guidelines specified in Agreed Minutes. In some instances, where differences were found, they may be attributed to definitional and other technical factors.

b. Summary of multilateral reschedulings, 1975-80

As previously indicated, during the period under review nine countries renegotiated their debt through the creditor club framework, four of which had more than one rescheduling. The companion paper to the present study, "Survey of Multilateral Debt Renegotiations Undertaken Within the Framework of Creditor Clubs, 1975-80," (SM/80/274), provides details relating to each of the 16 rescheduling exercises including the balance of payments background to the various renegotiations, and a description of the scope, amount, and terms of each rescheduling agreement. The present section will, therefore, be limited to a brief summary of the main features of the multilateral debt renegotiations in 1975-80. Table 14 below sets forth the principal quantitative aspects of the reschedulings.

The rescheduling exercises covered debts to governments or debts guaranteed by official institutions in the creditor countries of over one year original maturity. Two notable developments were the large number of cases in which arrears were a factor and had to be rescheduled along with principal and interest on debts falling due and, secondly, as a departure from a generally held principle, the rescheduling of previously rescheduled debt in two cases (Turkey and Zaire). In general, three categories of debt were consolidated in the rescheduling agreements: accumulated arrears, obligations falling due in the immediate period ahead, and future obligations subject to specified conditions (generally a Fund-supported program). In cases where obligations were rescheduled, the percentage varied between 70 and 90 per cent of the due amounts; the additional future maturities rescheduled were subject to less favorable terms, i.e., between 10 and 30 per cent. The terms of reschedulings varied; the grace period was between 2 1/2 and 5 1/2 years and the new

maturities were generally in the range of 7 1/2 to 10 years. The normal practice was for the interest rate on the rescheduled maturities to be determined by the ensuing bilateral negotiations.

Table 14. Summary of Multilateral Negotiations, 1975-80 1/

Country and Year	Consolidation Period	Estimated 2/ Amount (US$ million)	Maximum Repayment Terms Including Grace Period (In years)
Chile, 1975	1/1/75 to 12/31/75	178	10
Gabon, 1978	arrears as of 12/31/79	631	10
Peru, 1978	1/1/78 to 12/31/79	211	7 1/2
Sierra Leone, 1977	1/1/76 to 6/30/78	16	9 1/2
Sierra Leone, 1980	7/1/79 to 12/31/81	24	11
Sudan, 1979	10/1/79 to 6/30/81	421	10 1/4
Togo, 1979	4/6/79 to 12/31/80	282	9 1/4
Turkey, 1978	1/1/77 to 6/30/79	1,040	9
Turkey, 1979	7/1/79 to 6/30/80	1,000	8 1/2
Turkey, 1980	7/1/80 to 6/30/83	3,000	10
Zaire, 1976	1/1/75 to 12/31/77	186	9 1/2
Zaire, July 1977	1/1/77 to 7/31/77	203	9 1/2
Zaire, Dec. 1977	7/1/77 to 12/31/77	203	9 1/2
Zaire, 1979	7/1/79 to 12/31/80	1,300	10 1/2

Source: Agreed Minutes of the reschedulings.

1/ Excludes (a) India, in whose case the two reschedulings were in the context of provision of economic assistance, and (b) countries that have sought, but not undertaken, a rescheduling as of this writing (i e., Liberia and Pakistan).
2/ Includes maturities due and arrears.

The undertakings which were included in the Agreed Minutes covered the customary commitments. These included goodwill undertakings in about a third of the cases (i.e., the creditors' willingness to reconvene with a view to considering renegotiation of further debt service payments). Generally, the undertakings also included a nondiscrimination clause, under which the debtor undertook not to agree to other reschedulings that would result in more favorable treatment than that accorded to the creditors participating in the multilateral framework. There were also, in specific instances, other commitments relating to the early settlement of arrears and to the contraction of new debts. An important undertaking common to all the agreements related to the debtor country's arrangements

with the Fund. The nature of this undertaking varied; in many cases there was a direct commitment regarding the implementation of an existing program with the Fund; in certain other cases maturities falling due during a specified future period were to be rescheduled subject to the debtor country entering into or continuing to maintain a program with the Fund; and finally, in a number of instances, while no commitments were formulated, there were specific references to elements of a program in force between the country and the Fund.

The above summary shows that, while in a number of specific instances of countries facing especially serious problems the Paris Club rules were amended to fit the special circumstances in question, broadly speaking the practices that had evolved on the basis of over two decades of experience continued to be applied to multilateral reschedulings.

3. Evolution of new guidelines for multilateral debt renegotiations

In view of the rise in the external debt of developing countries and, more importantly, the increasing number of countries encountering debt difficulties, the question of the framework, arrangements, and guidelines for debt renegotiations has become an important issue. The principal consideration underlying the efforts made by developing countries over the past few years to modify existing procedures has been their perception that the present, basically ad hoc, arrangements are somewhat arbitrary and do not promote equitable treatment as between creditor and debtor countries.

The view has also gained increasing acceptance among developing countries that debt problems should be considered within the context of a country's overall development needs and prospects rather than merely as an emergency operation for a country in balance of payments difficulty. According to this view, a debt renegotiation should be one element of a package that would include an examination of the debtor country's resource needs, growth potential, and capacity to sustain a particular level of indebtedness. The objective of the developing countries has therefore been to move toward more formalized guidelines and procedures for debt renegotiations than those that characterize the creditor club framework, so as to obtain better terms for developing debtor countries in debt renegotiations, and to promote consideration of debt problems in the broader context of the country's economic development needs.

The initiatives for modifying existing procedures which have been largely concentrated in the United Nations Conference on Trade and Development (UNCTAD) are described in the Annex to this paper. A new set of guidelines for multilateral debt negotiations were adopted in September 1980 in the form of a resolution adopted by UNCTAD's Trade and Development Board (TDB). This implemented an earlier UNCTAD resolution (Resolution 165, S-IX) which has formed the basis of negotiations on this matter since March 1978. 1/

1/ Both the implementing resolution and Resolution 165 are reproduced in full in the Annex to this paper.

The operative part of the implementing resolution is that an interested developing country which believes that it faces external debt difficulties may initiate consideration of a "debt operation in the context of appropriate multilateral fora agreed upon by debtor and creditor." Such an operation should "be guided by and consistent with the agreed features" (described below). The resolution further provides that such a country should "be able to avail itself of the expertise of appropriate international institutions which could provide in consultation with it an objective and comprehensive analysis of its economic situation taking into account its social and economic objectives and development prospects." To this end the TDB "invites the executive heads of the IMF and IBRD in consultation with the Secretary-General of UNCTAD to consider as soon as possible effective procedures for responding in a coordinated manner to requests for analysis from developing countries and requests the Secretary-General of UNCTAD to report on the consultation to the Trade and Development Board at its Twenty-Second Session." The resolution goes on to state that "...only at the request of the debtor country concerned, apropriate international institutions would provide the multilateral forum with the abovementioned and other relevant analyses in order to aid the forum in arriving at satisfactory and equitable results."

The features for future operations relating to debt problems are appended to the implementing resolution. It is noted that "finding a means through which debt-servicing difficulties can be avoided was one of the most important tasks facing the international community," and that it is in the mutual interest of creditor and debtor countries to avoid "debt-servicing difficulties under conditions that are consistent with an orderly development process."

The objectives of international action, which may vary according to the nature of the problem of the debtor country, are specified thus: such action should be expeditious and timely; it should enhance the development prospects of the debtor country, and should bear in mind the socioeconomic priorities of the country and the "internationally agreed objectives for the development of developing countries"; it should aim at restoring the debtor country's capacity to service its short- and long-term debt and reinforce the country's own efforts to strengthen its underlying balance of payments situation; and it should protect equitably the interests of debtors and creditors.

As regards the operational framework, the features stress that international consideration of debt problems would be initiated only at the specific request of a debtor country. The analysis of the debt problem may vary from serious balance of payments difficulties needing immediate action to situations relating to longer term structural, financial, and transfer of resources problems, and requiring longer term measures. A number of elements should be considered in determining the appropriate international action. These were:

(a) Examination of the domestic economic situation of the country, including an analysis of the country's use of both domestic and external resources for safeguarding its development process.

(b) Impact of external factors on the developmental and financial problems of the debtor country.

(c) Estimates of short- and long-term developmental capital requirements and projected availabilities.

(d) Projection of debt-servicing requirements and review of measures adopted by the country concerned to avoid debt servicing difficulties.

(e) Particular consideration to the structure and prospects of all items of the balance of payments, exchange rate, and monetary policies.

The analysis would give special attention to short-term economic and financial policies, prospects, and requirements in cases of acute balance of payments difficulties and, in a parallel fashion, attention to financing long-term investment and associated resource transfers where long-term problems prevail.

As regards action, a "comprehensive program" would be agreed upon in the light of the analysis and objectives described above. Such a program would include domestic and international measures and would vary depending on the nature of the problem and the development prospects of the debtor country. Measures of an international nature to be implemented by bilateral and multilateral sources would range from debt reorganization to the provision of additional financial resources on appropriate terms and conditions. In cases of acute balance of payments difficulties in which debt service payments figured prominently and which required immediate action, "...the debtor country would undertake an economic program designed to strengthen its underlying balance of payments situation having regard to its development prospects. This program would be supported by interested parties. This support would, where necessary, include the reorganization of debts owed to or guaranteed by creditor governments."

Similarly, in the cases of longer run problems requiring longer term measures "...the debtor country concerned will undertake viable domestic policies, supported by donor countries and appropriate international institutions which would endeavor to increase the quantity of aid in appropriate forms and improve its quality." Where both types of problems were present, actions involving both long- and short-term measures would be required in a manner that would ensure that they are consistent and mutually reinforcing. Finally, the "Chairman of the multilateral forum, agreed upon by the debtor and creditor countries, would conduct the debt operation in a fair and impartial manner in accordance with the agreed objectives so as to lead to equitable results in the context of international economic cooperation."

In agreeing to the adoption of the implementing resolution, the representative of developed countries (i.e., Group B countries in UNCTAD) made an interpretative statement to be incorporated as part of the official record. The portion of this statement relating to debt renegotiation procedures was as follows:

> Part B of the resolution does not imply any agreement that UNCTAD has responsibility for overseeing the activities of organizations outside of its formal structure.
>
> Group B countries consider that debt, as a financial issue, should, within the UN system, continue to be within the competence of the Bretton Woods Institutions.
>
> Group B notes that there exist relationship agreements between the Bretton Woods Institutions and the United Nations, and these should guide the actions of the Secretary-General of UNCTAD.

4. The role of the Fund

a. Background

The Fund has a close interest in external debt questions and problems. This is because debt problems are generally a manifestation of underlying balance of payments difficulties and, therefore, external debt management policies are an important element in the overall framework of economic policies, including those for balance of payments adjustment. For this reason, the Fund assists its members in avoiding debt difficulties. External debt matters are regularly discussed and analyzed in the course of the Fund's Article IV consultation discussions with member countries in the context of the macroeconomic situation and policies of the country concerned. In cases where Fund resources are being made available in support of a program of adjustment, and where debt problems are a significant issue, emphasis is placed on appropriate debt management policies designed to avoid debt problems; the program will generally include performance criteria relating to the contraction of foreign debt during the period of the program in question; guidelines for such criteria were issued by the Board in 1979 (EBD/79/183, Rev. 1, 8/2/79).

An additional important aspect of the Fund's role is to assist in the resolution of debt difficulties in cases where such difficulties arise. Thus, for a very long time the Fund has in a number of ways cooperated with both creditor and debtor countries in multilateral negotiations. 1/ Its role generally has been conceived as that of an "honest broker" whom both the creditor and debtor could consult. Fund

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1/ As explained earlier, most of these have taken place under the aegis of the Paris Club; while for the sake of convenience references in this section will be to the Paris Club, they apply to multilateral debt renegotiations in general.

representatives have generally participated in Paris Club negotiations as observers in order to provide information and guidance at the request of the creditor and debtor countries. An important part of the Fund's contribution has been the assistance it has given to the debtor country in the preparation and presentation of its debt situation. As far as the creditors are concerned, the Fund has stood ready to provide an assessment of the economic situation and, in particular, balance of payments prospects of the debtor country so as to provide a basis for determining the degree of debt relief to be granted. In providing such analyses, the Bank has provided information and views regarding long-run needs and capabilities.

There have been proposals from time to time for a more activist role by the Fund in Paris Club negotiations. 1/ Earlier proposals in this regard envisaged vesting in the Fund the chairmanship of multilateral debt renegotiations. However, these proposals did not advance beyond the stage of informal discussions. The Fund's position 2/ was that the close and continuing collaboration between the Fund and all its members, both creditor and debtor countries, and the advisory role which the Fund played at debt renegotiation meetings, could be jeopardized if the Fund were also to chair such meetings.

More recent initiatives aimed at increasing the Fund's role were undertaken within the Paris Club in early 1979. They were intended mainly to improve and put on a more formal basis the Fund's relations with the Paris Club by providing for closer contacts and exchanges of information between the Chairman of the Paris Club and the Fund staff, including earlier availability of Fund assessments on the economic situation of renegotiating debtor countries. The Fund maintained its position that a request for debt relief is primarily an internal political decision for the debtor country and any role by the Fund in debt negotiations was subject to the concurrence of the debtor and the creditor countries.

In early 1980, discussions took place between the Managing Director accompanied by Fund staff and the Chairman of the Paris Club on the further contribution that the Fund could make to the process of debt renegotiations in present circumstances. In view of the seriousness of the debt servicing problems facing a growing number of developing countries, it was understood that the Fund staff would take certain steps to enhance the contribution it makes to Paris Club negotiations. Among the steps

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1/ Such proposals surfaced on a number of occasions, most notably during pre-UNCTAD IV discussions of the DAC Working Party on Financial Aspects of Development Assistance in February 1976, and again, as a follow-up to TDB Resolution 165, in May 1978.

2/ The position taken was based on the paper prepared for consideration by CIEC, "Avoidance and Resolution of Debt Servicing Difficulties" (SM/76/202, 9/27/76), describing the role of the Fund; the paper was discussed by the Executive Board on November 5, 1976 (EBM/76/154), which authorized transmittal of the paper to CIEC.

taken has been the proposal to include a thorough coverage of debt situations in Fund staff papers; both creditor and debtor countries make use of such papers as a reliable source of information and as a basis for analyzing the debt situation and implications of alternative rescheduling proposals. The staff has also been directed by the Managing Director to stand ready to provide assistance to member countries in their preparation for Paris Club debt renegotiation meetings, including assistance given in the course of regular Fund missions as well as by staff visits undertaken specifically for that purpose. At the suggestion of the Chairman of the Paris Club, an attempt has been made to attain greater continuity of Fund staff participation in Paris Club meetings in order to establish closer relations with the Chairman and members of the Paris Club and to place the staff in a better position to brief and assist the debtor country representatives who may be participating in a Paris Club meeting for the first time.

An important element in the Fund's role in debt negotiations has been the practice of the Paris Club to grant debt relief on condition that the country in question enter into or maintain a program involving use of Fund resources in the upper credit tranches. In general, Paris Club negotiations have followed the conclusion of an arrangement between the Fund and the debtor member, thus linking the debt renegotiation exercise to a Fund-supported program (as already mentioned, frequently the agreement reached at the Paris Club has made specific reference to a stand-by or extended arrangement with the Fund). In this way the creditors have been satisfied that debt relief would make a contribution to the resolution of the debtor country's balance of payments problems, in the framework of a program that would enhance its ability to service its debt, while the debtor has been assured of the financial support of the international community in its efforts to overcome its difficulties. This link has recently been the subject of some discussion. Certain creditor countries, while supporting this general principle, have argued that because the program with the Fund generally assumes a certain amount of debt relief, this tends to establish an indication of the relief to be provided and hence to some extent prejudges the Paris Club negotiations. On the other hand, some debtor countries have resisted the requirement that they enter into a program with the Fund before the debt relief provisions become effective.

In formulating a program with a country that has serious debt servicing problems and that has approached, or intends to approach, the Paris Club for a rescheduling of its debt, the Fund staff finds it necessary to take into account the probable amount of debt relief as an integral part of the program. Such an assumption is required in order to make an estimate of the financial resources that will be available to the country in the period ahead, and the residual financing gap that needs to be met. The extent of debt relief thus has an important bearing on the design and extent of the adjustment measures that must be taken. If no assumption were made about potential debt relief in such cases, this could result in the formulation of a program that would be more stringent than warranted. Therefore, the central question is that any

impact the debt relief assumption in the Fund-supported program may have on the outcome of the debt renegotiations must, from the creditors' point of view, be weighed against the advantage of having an economic program in effect prior to the debt renegotiations.

An alternative would be for Paris Club renegotiations to take place prior to the conclusion of an adjustment program, or subject to the proviso of a subsequent financial arrangement. This might give the creditors greater flexibility but it would have other serious drawbacks. First, the creditors would not have the benefit of the detailed analysis of the debtor country's economy that is regularly undertaken as part of an arrangement with the Fund. Hence, even though they may be able to obtain economic assessments from other sources, they would have a reduced ability to make an assessment of the appropriate level of debt relief consistent with the debtor country's economic situation and prospects. Second, the creditors could have no guarantee that, subsequent to the debt renegotiations exercise, the country and the Fund would be able to reach an understanding. Furthermore, a debt rescheduling agreement, whose implementation depended on a subsequent program between the debtor country and the Fund, would be likely to put pressure on the country concerned to conclude a program, perhaps without sufficient conviction and without the willingness to implement it.

Another approach that has been suggested is that in those cases where a Paris Club meeting is scheduled to take place, the Fund-supported program agreed upon with the debtor country should be of a "tentative" nature; i.e., the program, which in all other respects would be according to established practice, would contain only a notional figure of the amount of debt relief anticipated. If the debt relief actually received as a result of the subsequent Paris Club rescheduling exercise were different from this figure, then other elements of the stand-by would be amended to compensate for the difference.

There would be a number of serious difficulties with this proposal. It would introduce obvious complications and uncertainties into the process of agreement on a program. The principal difficulty would be that the Fund would, in effect, require an amendment of established policies and practices, including the fundamentals of the Fund relations with its members. An adjustment program is based on discussions and understandings between the Fund and a member country and it would seem inappropriate to alter this confidential relationship for purposes of perhaps facilitating debt rescheduling exercises. Another problem with the proposal would be that, if an exception were made for Paris Club debt renegotiations, there could be pressures to introduce other "tentative" aspects into programs, that is to make them conditional upon other developments, such as commercial bank debt restructuring, government assistance, negotiations on a major investment project, etc.

In the staff's view, there is no demonstrated need for a change in Fund procedures and practices regarding the formulation of adjustment programs for the purposes of debt renegotiations. The prerogative of

Paris Club creditors to negotiate the amount of debt relief with the debtor country on the basis of considerations and criteria of their own, is not questioned. But in formulating an adjustment program with a member, it is necessary to consider the amount of debt relief that may be forthcoming as an important element of the program.

It must be recognized that in certain cases programs with the Fund already contain quantitative targets that are subject to adjustment on the basis of subsequent developments, including debt relief received. There are limits, however, to this form of flexibility. Other approaches could also be considered. For example, in those instances where a debt rescheduling exercise is pending, some of the performance criteria in a Fund-supported program could be set for a relatively short period (e.g., six months), to be determined for the remainder of the program period following an early review of the program. In this way, in the course of such a review, an effort could be made to agree on policy measures that would compensate for any significant differences between the actual outcome of the debt renegotiation agreement and the amount of debt relief that was assumed within the overall framework of the program; such a course of action could prove to be quite difficult if there were a large shortfall in actual debt relief below the assumed level.

b. Provisions of the guidelines

The implementation of the guidelines and agreed features for future debt renegotiations described in subsection 3 has certain implications for the Fund. In this connection it may be recalled that while the initiatives toward the formulation of the guidelines were proposed, negotiated, and agreed upon in UNCTAD, the interpretative note to the implementing resolution submitted by the industrial countries made it clear that "debt, as a financial issue, should within the United Nations system, continue to be within the competence of the Bretton Woods Institutions." It moreover stated that the resolution did not imply that UNCTAD would have responsibility for overseeing the activities of organizations outside its formal structure.

The implementing resolution provides for cooperation between the Fund, the Bank, and UNCTAD in giving effect to the objectives of the resolution. The TDB has invited the executive heads of the Fund and the Bank, in consultation with the Secretary-General of UNCTAD, to consider effective procedures for responding in a coordinated manner to requests for debt analyses from developing countries. In this connection, the Secretary-General of UNCTAD is to report back to UNCTAD at the Twenty-Second Session in March 1981.

Under the guidelines, a country may avail itself of the expertise of the "appropriate international institution" for an objective and comprehensive analysis of its economic situation taking into account its economic objectives and developmental prospects. This analysis would be provided to the multilateral forum in which a debt renegotiation takes place so as to assist in arriving at a satisfactory and equitable result.

The substance and coverage of the economic analysis are set forth in the features, as described in the preceding subsection. The specific elements to be incorporated in the comprehensive analysis may be classified into three categories. First, there is one element which is squarely within the Fund's area of competence and responsibility, namely the structure and prospects of the balance of payments, exchange rate, and monetary policies, which are to be given "particular consideration" in the analysis. Secondly, there are three elements which are broadly within the Fund's area of interest but are also relevant to work of the Bank. These are: an analysis of the domestic economic situation, including the use of domestic external resources for "safeguarding [the] development process," the impact of external factors on the development and financial problems of the debtor country, and the prospect of debt-servicing requirements and assessment of the measures taken by the country to avoid debt-servicing difficulties. In these cases, while the Fund would be in a position to undertake the necessary analysis on the general economic situation, it would be for the Bank to make an assessment of the developmental and longer term aspects of the economy. Finally, there is one element which is directly within the Bank's area of competence, namely, estimates of short- and long-term developmental capital requirements and projected resource availabilities. In the analysis of this topic, however, the Bank would benefit from the Fund's views on the shorter term financial aspects of the matters in question.

The implementing resolution also provides that in cases of acute balance of payments difficulties where debt problems figure prominently requiring immediate action, "the debtor country would undertake an economic program designed to strengthen its underlying balance of payments situation having regard to its development prospects. This program would be supported by interested parties. This support would, where necessary, include the reorganization of debts owed to or guaranteed by creditor governments." To the extent that this provision has a bearing on traditional practices regarding debt renegotiations, it would involve the conclusion of an adjustment program between the debtor country and the Fund or, at least, agreement between the country and Fund on certain understandings of particular relevance to its balance of payments situation. In this context, there is also a reference in the implementing resolution to the country's development prospects and here again an assessment of this aspect of the country's problem by the Bank would seem appropriate.

Finally, while the implementing resolution states that in cases of longer run problems the country would undertake appropriate longer term measures--clearly an aspect within the area of the Bank--it also provides for both short-term and long-term measures in a "consistent and mutually reinforcing" manner in cases where both acute balance of payments and longer run difficulties are present. This type of situation would require close cooperation between the Fund and the Bank in the formulation, by the debtor country, of an appropriate program.

c. Proposals regarding the Fund's role in debt rescheduling

The adoption of the guidelines will, as already indicated, have a number of operational implications for the Fund and for Fund-Bank collaboration. While in most respects the Fund's contribution can be accommodated within the framework of existing arrangements for cooperation with the Paris Club, on the one hand, and the World Bank, on the other, in some instances it may be necessary for the Fund to complement its practices so as to meet the operational requirements of the guidelines. It is suggested that the Fund be guided by the proposals set forth below.

(1) Consistent with its traditional role in Paris Club negotiations, the Fund could make a substantive contribution to the resolution of the debt problems in the context of the guidelines.

(2) The core of these guidelines is the comprehensive and objective analysis of the debtor country's economic situation to provide the background to debt rescheduling exercises. This analysis is to be undertaken specifically at the initiative of the debtor country in question; if such a request were made to the Fund, it would respond in a positive manner and stand ready to undertake the analysis.

(3) The analysis called for by the guidelines can contribute to the assessement of debt problems in a broader context and thus provide a factual basis for the process of debt renegotiation. It is not envisaged, however, that such analyses would become, or come to be regarded, as any form of an "early warning" or "credit rating" report. This would not be consistent with the Fund's role. Moreover, specific forecasts of debt problems are fraught with problems; to make assessments of the creditworthiness of particular countries requires judgments that must depend on a multiplicity of factors that are not easy to weigh and to combine, including some that are not amenable to quantification, such as confidence and political stability.

(4) The analysis that would be undertaken could be conducted in the context of a regular Article IV Consultation and be incorporated in the Recent Economic Development report. If, however, the timing of the request did not correspond to scheduled consultation discussions, or if the requesting debtor country so preferred, the analysis would be conducted by a special Fund mission.

(5) The resulting analysis, whether in the form of a special Fund report or as part of the Recent Economic Development report, would be available to member governments participating in the Paris Club, through the normal transmission of documents to member governments that takes place through the offices of Executive Directors. If necessary, however, the Executive Board could be requested to authorize transmittal of this report to the members of the Paris Club. In all cases, transmittals would take place after Board consideration of the paper in question, unless specific authorization were obtained for earlier transmittal.

(6) The Fund and the Bank would continue to cooperate closely within the framework of existing arrangements; specifically, the Fund would continue to avail itself of the Bank's extensive data on debt, while it is expected that the Bank would have access to Fund information on balance of payments and short-term debt. To the extent that the analysis to be undertaken must include assessments bearing on policies and prospects of a developmental or long-term nature, it would be expected that the Bank would provide a separate report on these aspects for the participants.

(7) If the Bank were approached by a debtor country for an assessment of its economic situation and prospects, the Fund staff would stand ready to cooperate with the Bank staff by providing information and analysis on matters within the Fund's competence. If UNCTAD were approached by a debtor country for an analysis of its economic situation, the Fund would cooperate by providing Fund reports on the country in question subject to Board approval.

(8) In cases of acute balance of payments difficulty, the implementing resolution calls for an economic program to strengthen the underlying balance of payments with due regard to its development prospects. It is anticipated that this would normally take the form of an arrangement with the Fund and that the normal procedures for conditions of such a program would be followed.

(9) In all other respects, the Fund would continue its traditional contribution to the resolution of debt problems, including: (a) assistance to a debtor member in the analysis of its debt problem and preparation for Paris Club meetings; (b) more thorough coverage, as indicated earlier, of debt questions in Fund staff reports; (c) provision of assessments of economic conditions in the debtor country to assist both parties in the negotiations; and (d) greater continuity in Fund staff representation in Paris Club meetings so as to coordinate better the Fund's role in such negotiations.

(10) To a large extent, the Fund's role and contribution would have to evolve in the light of experience with the new guidelines. Hence, in its assistance to countries experiencing debt problems, the Fund would continue to follow a flexible approach.

VI. Debt Restructuring by Commercial Banks

As noted in Section II, commercial bank lending to developing countries expanded rapidly during the past decade. Service on such debt was a major component of total debt service in several important cases where debt restructuring was sought during the latter part of the 1970s. While the modalities for the restructuring of official debt were fairly well established (Section V), the restructuring of debt owed to commercial banks involved, to a large extent, the breaking of new ground. In the absence of a set of broadly accepted precedents regarding the organization, terms and conditions for restructuring of bank debt, the consideration of alternative approaches frequently dominated the discussions between banks and debtor countries, which were often prolonged. The efforts to arrive at mutually satisfactory arrangements between the parties in these cases suggest the evolutionary nature of the process. Moreover, in most cases the negotiations took place in the context of, and were influenced by, the debtor country's parallel discussions with other creditors and institutions, particularly the Paris Club and the Fund. The efforts of the various creditors to assist the debtor countries to deal with their balance of payments and debt problems inevitably were linked, raising important questions about appropriate forms of cooperation among all parties concerned and about the responsibilities of each.

A number of countries have approached commercial banks to refinance specific credits in recent years, a process facilitated by the emergence of a "borrower's market" after 1976. But this section is based on the experience of six countries--Jamaica, Nicaragua, Peru, Sudan, Turkey, and Zaire--which approached their bank creditors for a general restructuring of their debt under circumstances of weakened balance of payments and debt repayment capacity. 1/ The background for and experience of these countries is analyzed in a recently issued staff paper. 2/ All six countries had programs supported by Fund resources at some stage of discussions with the banks. In each case, except Jamaica, there also had been a restructuring of official debt or such an arrangement was envisaged (i.e., Nicaragua). The general balance of payments background to debt problems for a number of countries has been summarized in Chapter IV above and in SM/80/274 and SM/80/275. This section thus focuses on the

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1/ The case of Bolivia, which reached agreement with the banks in August 1980 on a short-term postponement of its debt payments, was not included in part because the discussion commenced after the work on the individual case studies was well underway; in addition, there had been no prior rescheduling of official debts. Under this arrangement the banks agreed to postpone until January 1981 all amortization payments scheduled for the last five months of 1980. In January 1981 new negotiations are to take place on a rescheduling of these postponed amortization payments along with maturities due in 1981. Thus the debts have not actually been "restructured" as yet.

2/ "Debt Restructuring by Commercial Banks: Recent Experience of Some Fund Members" (SM/80/275).

role of the banks before, during, and after the debt crisis in these six cases, on the bank debt restructuring process, and on certain issues of relevance for the Fund, and, more broadly, for the international community.

1. Bank lending prior to the debt crisis

In five 1/ of the cases, bank lending expanded very rapidly over the period 1972 to 1975. The growth in outstanding debt to banks during the three years through 1975 ranged from a low of about 300 per cent (Nicaragua and Zaire) to a high of some 700 per cent (Jamaica). In most cases the share of banks in total disbursed foreign debt rose from between one quarter and one third in 1972 to roughly one half by the mid-1970s. In one case (Sudan) the share of bank debt to total debt was lower throughout, rising from roughly 10 per cent to 20 per cent of total external debt over the period. In these cases bank debt not only increased much more than other forms of borrowing, but also generally carried shorter grace periods and maturities and higher interest costs than the official loans which, until the early 1970s, had provided the bulk of foreign finance. The increase in scheduled debt service to banks over the last half of the 1970s thus was even more dramatic than the increase in outstanding indebtedness; in Sudan banks accounted for more than half of scheduled debt service by 1975, reflecting the very short maturities on these loans.

Each of these five countries experienced a sharp deterioration in its external current account in either 1974 or 1975, but the rapid increase in bank commitments generally began before the balance of payments deterioration occurred. Bank financing moved with the commodity price cycle: new commitments from banks to Peru and Zaire soared during the copper price boom of 1973-74, falling off when copper prices collapsed in 1975; bank commitments peaked to Jamaica during 1974-75 when earnings from sugar and alumina rose to very high levels, dropping precipitously by 1976 when earnings from these exports fell sharply. In these countries the increase in imports had kept pace with or outstripped the growth in export earnings during the boom; the subsequent period of slow export growth, combined with continued high levels of imports and reduced net financing from banks, set the framework for a debt crisis. The period of rapid increase in bank commitments to Nicaragua also corresponded to a period of very strong growth of export earnings (1972-74), but export performance was fairly good through 1977 and there was no clear retrenchment by banks until 1978. In Sudan the period of peak commitments from banks (1974 and 1975) coincided with, rather than preceded, the deterioration in the current account, and in this case the deterioration was traceable more to a rapid acceleration of imports than to stagnation of exports.

1/ Turkey differs from the other cases in many respects and is discussed separately below.

The period of rapid expansion of bank lending to Turkey began after the current account of the balance of payments had recorded a marked deterioration and after Turkey's reserves had declined substantially. From 1973 through 1977, exports grew very slowly while imports increased almost threefold, and the current account moved from a surplus of $600 million to a deficit of $3.6 billion. Net financing from banks was primarily in the form of short-term deposits and credits which were encouraged by the Turkish authorities in order to finance the increasing deficit. Beginning in 1975 Turkey turned to foreign banks for short-term funds, and in 1975-76 net borrowing from banks covered more than half of Turkey's current account deficit and was equal to one third of Turkey's current account receipts. Outstanding debt to banks rose from $145 million at the end of 1974 to $2.5 billion two years later.

2. The debt restructuring process

Anywhere from two to five years elapsed between the time a problem clearly emerged 1/ and the time a restructuring agreement was finally signed. In the six cases under review, it is perhaps indicative of how procedures have evolved that the two cases where arrears on bank debt service appeared first (i.e., Zaire and Sudan) took the longest to resolve. On average there was a lag of about one or two years between the time a problem might have been identified, and the date discussions between the country and the banks began. In the case of Sudan, however, formal discussions did not commence until four years after arrears on debt service first emerged (in 1975), while in the case of Nicaragua discussions began only two months after that country fell behind on its interest and principal payments to banks (in 1978). The time between the initiation of discussions between the country and the banks and the signing of a restructuring agreement ranged between 18 months and almost four years. The problems which arose during the often protracted discussions and the solutions which emerged are discussed below.

These debt restructuring exercises, particularly the early cases, involved formidable organizational problems for the banks. The banks generally acknowledge that their interests are best served by avoiding default and, if possible, arrears, once a debt service problem emerges or appears likely, but individual banks have considerable incentives to attempt to reduce exposure to the country concerned. Even where a new loan rather than a restructuring is being considered as a response to emerging debt difficulties, one initial impact is an insistence among the lead creditor banks that responsibility for new funding be parceled out in line with existing exposure and that each bank be accorded "fair treatment" with regard to service on existing debt.

In the cases under consideration between 200 and 300 banks from a wide number of countries were involved so that insistence on "fair treatment" necessitated a massive effort by lead banks to ensure coordination

1/ As indicated by arrears or by the reluctance of the banks themselves to continue lending.

and cooperation among all the creditor banks. In the case of Peru, for example, a group of U.S. banks agreed to try to syndicate a $200-250 million balance of payments support loan in 1976 provided that (a) all U.S. banks having substantial exposure in Peru participate in the syndicate and that (b) Peru raise $100 million from Canadian, European, and Japanese banks on comparable terms. The loan package was eventually put together, but the problems which arose from the requirement that Peru conduct parallel but independent negotiations with various groups of banks led, during subsequent discussions, to the formation of a steering committee of banks representing wide geographical interests. In the case of Turkey, an investment banking firm retained by the Government took responsibility for contacting more than 200 banks which had lent to that country via short-term deposits. The negotiations for restructuring these deposits into a medium-term loan were protracted. In most instances the lead banks themselves took responsibility for trying to bring the other creditor banks along and they faced a difficult task.

The necessity of securing the cooperation of all creditor banks is underscored by the inclusion of cross-default clauses in most loan agreements: if some banks were to declare a country or institution in default in order, for example, to put a lien on its assets, all loans to that borrower covered by cross-default clauses would automatically be classified as in default and become due and payable. The banks as a group (as well as the debtor) have a strong interest in avoiding the enormous difficulties such a chain reaction would create but in three of the six cases under consideration a declaration of default was narrowly averted.

The difficulties encountered in organizing a refinancing or restructuring of bank debt were frequently magnified by a lack of adequate statistical information and the absence of a centralized debt reporting and control system in the debtor country. These problems were particularly acute in Sudan and Zaire and partially explain the lag of more than five years between the date when debt arrears first emerged and the time a restructuring agreement was signed. In the case of Sudan the authorities eventually collected the requisite information by sending a questionnaire to the banks themselves. Following the example of Turkey in 1978, Nicaragua, Zaire, and Sudan all retained the services of investment banking firms. These consultants assisted the countries in sorting out their debt statistics and in preparing for discussions with the banks. In some instances they negotiated with the banks on behalf of the country.

Apart from the general organizational difficulties, the process was often drawn out because of substantive differences in proposals, including those among the banks themselves. One issue for the banks was whether to reschedule existing debt and/or to provide new money. In Zaire and Peru some banks initially took the position that a rescheduling would provide a bad precedent, that the country should remain current on its debt service, and that the banks should undertake to provide new money to assist the process. In the case of Zaire this view ultimately prevailed

and a gentleman's agreement was signed in November 1976. Over the next two years various unsuccessful attempts were made to put together a financing package acceptable to all concerned parties, but the final agreement (April 1980) entails only the restructuring of the massive arrears which had by then accumulated and of the remaining principal on Zaire's debts to the banks. In the case of Peru a balance of payments support package was finally put together, with the complications and provisions discussed above, which helped Peru to remain current on its debt service. After these two earlier experiences, however, the banks appeared more inclined in subsequent cases to consider restructuring rather than a loosely linked "refinancing."

Once rescheduling was accepted by the banks in principle, views often differed with the debtors as to the debt service to be covered by the agreements. One principle to which the banks have consistently attempted to adhere is that the debtor should pay future interest on schedule and this is reflected in most of the agreements under review. The Nicaraguan agreement, however, contains a provision whereby interest payments in excess of 7 per cent are deferred during the early years of the agreement. Where arrears on interest have emerged, the banks have always initially insisted that the country become current on interest before other parts of the rescheduling agreement are implemented. The final agreements for Nicaragua and Sudan do, however, provide for a rescheduling of part of the arrears on interest, albeit on much shorter terms than provided for overdue principal. In the case of Sudan, the debtor's request for such treatment of interest in arrears is known to have been a sticking point in the negotiations for several months.

With the exception of the position initially taken by banks in the case of Zaire, the banks generally have been willing to restructure principal in arrears. The existence of large overdue balances has, however, tended to render the negotiations more difficult and clearly has made the banks less willing to include new money as part of the restructuring package. This stance reflects, at least partly, concern that bank regulators will view negatively increased exposure in a country where debt servicing arrears have accumulated.

With the exception of amounts in arrears, none of the formal agreements covered short-term debt. In some instances problems arose for the debtor as individual banks cut back on trade financing or reduced their short-term lines while a debt restructuring was being pursued or even after the agreements had been signed. Retrenchment on short-term credit facilities not only posed import financing problems for the debtor country, but also undercut the international efforts to find a viable solution to the country's balance of payments problems. Little information is available on discussions between the banks and the debtor countries on short-term finance, but on at least two occasions the authorities did raise this issue with the bank steering committees. At one stage in the discussions with Peru the lead banks agreed to maintain their short-term exposure and to try to get other creditor banks to do likewise, while in the case of Jamaica the banks indicated that they would be willing to

open up new short-term lines as the economy improved. In one case (Turkey) the disbursement of a new medium-term loan--agreed as part of the restructuring package--was tied to letter of credit financing for imports to ensure that new money from one bank was not used to repay short-term borrowing from other banks. Thus the principle of "fair treatment" among creditor banks, as well as the prospects for the debtors' balance of payments recovery, has depended in part on the banks' willingness to maintain shorter term trade finance facilities in these difficult situations. Up to now the results have not always been positive.

Although it is difficult to generalize the diverse experiences of the six country cases, it may be helpful to summarize some common features in the two cases where formal negotiations on restructuring, once begun, were concluded most rapidly. In the cases of Jamaica and Peru: 1/ (a) discussions with the banks began soon after balance of payments and debt servicing problems were identified; (b) there were no arrears on principal or interest on public sector debt; (c) the country had fairly complete information on its scheduled debt service to the banks; (d) the country sought only rescheduling of principal; (e) the country sought, and obtained, an agreement covering two or three future years; (f) a Fund program was in place covering the full period for which rescheduling was sought before negotiations began; and (g) although this was not part of the restructuring agreement itself, the problem of short-term lines was addressed at some stage with the lead banks, at least, agreeing to maintain their exposure. In the cases where discussions were most protracted, one or more of these elements were missing.

3. Linkage to restructuring of official debt

In all of these cases, except Jamaica, a debt restructuring was also sought from official creditors. Peru, Zaire, and Sudan all had reschedulings through the Paris Club and Turkey's official debt was rescheduled within the framework of an OECD Consortium agreement. Nicaragua for the time being is seeking bilateral agreements with creditor countries. Prior to the multilateral debt relief negotiated in the framework of the Paris Club, Peru had negotiated a rescheduling with the U.S.S.R. and Sudan had arranged bilateral debt relief with some official creditors in Europe and the Middle East. In the case of Jamaica the scheduled debt service to normal Paris Club participants was not large in those

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1/ Here and elsewhere in this chapter the rescheduling agreements referred to for Peru and Jamaica are the original agreements. After a marked turnaround in its balance of payments in 1979, Peru subsequently prepaid the 1979 bank rescheduling, negotiated lower spreads on the 1980 bank rescheduling, and decided to forego the second year of its Paris Club rescheduling. Jamaica became ineligible to draw under its extended Fund arrangement in December 1979. Consequently, the banks did not provide the medium-term consolidation of fiscal 1979/80 maturities called for in the original agreement but have continued to roll over those amounts, as well as maturities falling due after April 1, 1980, on a short-term basis.

years for which bank debt restructuring was sought. The banks were, however, fully aware of substantial sums being committed by interested governments through an aid group which were to be disbursed over the same fiscal years as were covered by the agreement with banks.

The banks and Peru reached agreement in principle on all of the terms of the restructuring before the Paris Club meeting was convened, and the two agreements were almost identical--i.e., covering 90 per cent of principal due over the coming two years. The official debt restructurings for Sudan, Turkey, and Zaire were concluded well before final agreement was reached with the banks and, while major differences in form and coverage make precise comparisons difficult, overall the response of official creditors appears to have been somewhat more generous than that of the banks. The Paris Club agreements for Turkey, Zaire, and Sudan all provided for rescheduling of arrears on both principal and interest (regardless of maturity) and for some advance rescheduling of maturities due in the future. The banks have generally insisted that the country remain current on interest but, as noted above, interest payments in arrears were rescheduled in the cases of Nicaragua and Sudan and the agreement with the former provides for automatic rescheduling of interest in excess of 7 per cent. Only arrears on principal were covered by the bank restructurings for Turkey and Zaire. Rescheduling of future maturities was included in the bank agreement for Zaire, but not for Turkey and Sudan. In the cases of both Sudan and Turkey, however, a new medium-term loan was part of the bank package. The terms of the various bank rescheduling agreements are set out in Table 3 of each of the annexes to SM/80/275, while details on the terms of the Paris Club agreements may be found in Appendix II of SM/80/274.

4. Financial impact of the restructuring

Between the time discussions between the banks and the country began and the date when the final restructuring agreements were signed, new commitments from banks and net financing (disbursements minus amortization) both fell off dramatically in all of the cases. If interest payments as well as amortization are taken into account (i.e., a resource transfer definition), net flows vis-à-vis banks turned negative at least a year or two before the agreements took effect. In the case of Zaire, new loan commitments declined precipitously when export earnings fell and arrears emerged in 1975, but disbursements continued at a fairly high level over the following two years largely on the basis of past loan commitments to various projects. In Peru, the special balance of payments support package which was agreed in late 1976 provided a temporary respite, but net financing dropped almost to zero by 1978. In all other cases bank retrenchment began as soon as a problem became "apparent" to the banks, which in several instances coincided with the emergence of arrears on contractual debt service obligations. Although a sharp deterioration in the current account generally precipitated the balance of payments crisis in the first instance, the retrenchment by banks brought additional pressures on the payments situation even in the cases where there was subsequent improvement in other components of the balance of payments.

There are wide differences among the six cases in the terms of the restructuring agreements and in the estimated impact of those agreements on the debt profile and payments situation during the years following the restructuring. In most cases the restructuring agreements on arrears called for grace periods of from zero to three years and total maturities of seven to ten years, while agreements covering future debt service or the provision of new money incorporated grace periods of two to three years and maturities of six to seven years. In most cases the agreements provided for interest at spreads ranging from 1 3/4 to 2 percentage points over LIBOR. However, the agreement with Nicaragua, in particular, stands apart.

Under the Nicaraguan agreement principal in arrears and all future maturities on existing debt due were restructured with, respectively, grace periods of five and six years and maturities of ten and twelve years. Part of interest in arrears was also rescheduled but with no grace period and a maturity of five years. In addition, the agreement, as noted above, incorporated a provision whereby interest actually paid will not exceed 7 per cent per annum before 1986, with payment of the amount resulting from the difference between 7 per cent and LIBOR plus the specified spread being deferred and repaid between 1986 and 1990. While the overall impact of this agreement cannot be determined in advance, it could well keep debt service payments to banks below original amounts for several years. In the case of Zaire the banks also consolidated all future maturities due into one new loan. These are the only two cases of long-term rescheduling arrangements in recent years, either by the banks or by official creditors in a multilateral framework.

For Jamaica and Peru the original agreements also produced a net reduction in debt service to banks over a period of several years, but in the cases of Sudan, Turkey, and Zaire, the net impact of the agreements was to increase interest and amortization to banks within the first or second year after the restructuring.

In the cases other than Nicaragua one of the major reasons for the differences in initial net impact is that Turkey, Zaire, and Sudan all had substantial arrears on debt service to banks, while neither Jamaica nor Peru were in arrears on either principal or interest. In the former three cases interest on the amount in arrears imposed a significant debt service burden from the start. Also, the agreements for Zaire and Sudan called for some repayment of arrears from the first year in which the agreement became effective. Another important difference between these two sets of cases is that the Jamaica and Peru agreements provided for rescheduling of principal at least two years into the future, while the agreements for Turkey and for Sudan did not cover future debt service. As noted above, the Zaire agreement did provide for restructuring of future maturities, but the amount involved, and therefore the net impact, was relatively small.

5. The role of the Fund

In most instances the banks at some stage in the negotiations strongly urged the country to negotiate an upper credit tranche arrangement with the Fund. In all the cases except Nicaragua the final rescheduling agreements were signed only after a stand-by or extended arrangement had been agreed with the Fund. In four of these cases, however, earlier programs had been negotiated but performance had diverged from targets relatively soon after the arrangements were approved and initial attempts by the banks to arrange a refinancing or rescheduling had consequently been temporarily suspended. Sudan also had a first credit tranche stand-by arrangement with the Fund in support of a program which was not fully implemented, but the authorities had not yet made formal contact with the banks for a renegotiation of bank debt. From the time discussions on the first program commenced until the time the second program was agreed, roughly 18 months or so elapsed in each of the cases except Zaire, for which almost three years elapsed. In the case of Peru in 1976 and Nicaragua in 1980 the authorities were not prepared to enter into an arrangement with the Fund. In the former case a stabilization program was agreed between the banks and Peru, which the banks attempted to monitor with limited success. Subsequently, the banks hardened their position on the need for Peru to undertake a stabilization program with the Fund prior to further debt relief.

Under the agreements for Jamaica, Peru, Turkey, and Sudan either the disbursement of new funds or the medium-term consolidation of rescheduled debt was made contingent upon ability to purchase from the Fund under the stand-by or EFF arrangements. The agreement for Sudan was concluded only recently, but in the other three cases the Fund has provided to the authorities on appropriate dates written communications stating that the country has purchased, or was able to purchase, under its Fund arrangement.

Even apart from such formal ties, when the authorities are concurrently conducting discussions both with the Fund staff and with banks, such discussions are necessarily interdependent reflecting not only the commonality of interest but also the need for an exchange of information among all parties concerned. On the one hand, the authorities and the staff need an accurate assessment of potential capital flows, including net financing from banks, in order to formulate a viable stabilization program. On the other hand, the banks need to be apprised of the economic outlook for the country in order to assess the realism of rescheduling or refinancing proposals. In one case, for example, the banks increased somewhat the percentage rescheduling they were proposing after it was learned that certain data revisions would have rendered their earlier proposal inconsistent with the amounts which had been built into a Fund program. In another case, after a Fund program had been agreed but before it was brought to the Board, the staff had participated in a meeting where the banks had agreed in principle to provide the amount of refinancing incorporated in the program. Subsequently, the staff assumed an active role in ensuring that the agreed amount of assistance was in

fact forthcoming, explaining that a shortfall could force a failure of the balance of payments test and might require explanation to the Fund Board.

Given this necessary interdependence, there have been contacts between the Fund staff and the banks in all of the cases under review. Generally, such contacts were informal, entailing telephone conversations or visits by bank personnel to Fund headquarters, and were limited to an exchange of technical information. However, in two instances where there had been important deviations from existing Fund programs at an important stage in discussions between the country and the banks, a more formal appraisal of economic policies was sought. At the request of the country, a statement was drafted by the staff, cleared by both Fund management and the authorities, and communicated verbally to the banks.

In four of the cases under review, the Fund staff participated in meetings between the country and the banks. In some instances the staff also participated in meetings where the debtor was not present, but with the knowledge of the debtor. Generally, the role of the staff was limited to reviewing the economic outlook, explaining the stabilization program, and replying to technical questions. On one occasion, however, when discussions between the country and the banks were at an impasse, at the request of the authorities the Managing Director authorized the staff to assume a mediator role, including the putting forward of proposals to bridge the gap between the two sides.

The Board was generally informed of the staff's participation in these meetings in the context of Board discussions on the requested use of Fund resources or other Board discussions on that country. In addition, individual Executive Directors were kept informed on a more current basis and, in some cases, Directors representing both debtor and creditor countries used their good offices to facilitate the discussions between the countries and the banks.

The Fund also provided technical assistance to some of these countries in preparation for their discussions with the banks. In two cases where statistical problems were an important obstacle to the discussions, the Fund fielded technical assistance missions for this purpose and participated in technical meetings with the consultants which had been retained by the country for the negotiations. In some instances the Fund also assisted the country in preparing its presentation for the banks.

6. An overview of some issues

This section has discussed in summary fashion the role of bank financing in the evolution of the debt problems of six countries, the modalities and financial impact of the restructuring of the bank debt, and the linkage of that process to international efforts--in which the Fund has generally played an important role--to restore the debtor countries to a viable economic path. The experience of the six countries

was almost as diverse as the economies themselves and, thus, in many ways defies generalization. Nevertheless, there were several broadly similar factors--related to internal policy management and external factors--underlying their balance of payments and debt management difficulties, and these were not unlike the factors present in the cases where only official debts were restructured. But there also were some differences between those two categories of countries. Where bank debt proved to be a significant factor, the related private capital flows generally had played a much more active role than did official flows in the period preceding the emergence of the debt servicing difficulties. On average the lag between identification of the problem--sometimes arising from the emergence of debt servicing arrears on bank debt--and a negotiated settlement was much longer in the case of the private debt. Furthermore, the role of the Fund in assisting the parties was less well defined and less systematic than in the case of the multilateral renegotiation of official debt. Finally, difficulties in maintaining or restoring net private bank flows to the debtor country emerged in several of the cases and impaired the ability of the countries concerned to sustain adequate import levels while internationally supported adjustment measures were being implemented.

The important role that banks have played in the international transfer of capital--a role that became crucial in the context of the intermediation of oil exporter surpluses--is well documented, but some of the cases under review characterize instances where such financing flows have tended to be destabilizing. Financing flows from the banks often were overly responsive to increasing debtor demands in the period prior to the emergence of debt servicing difficulties, perhaps reflecting in part competitive market pressures. Such commercially motivated flows frequently accelerated sharply when mineral and other export commodity prices were favorable, even when the viability of the debtors' general policy orientation might have been called into question. Given those policies, the additional external resources from exports and borrowing provided only marginal support for an increase in investment and productive capacity, basic determinants of debt servicing ability over the longer term. The timing and extent of subsequent declines in export prices and other adverse impacts on the terms of trade were difficult, if not impossible, to predict. But there were obvious risks in accelerating bank lending in circumstances where the viability of the borrowers' economic policies depended crucially on the implicit assumption that their primary commodity export prices would continue at the cyclically high levels. By cutting back on new lending when export earnings declined, the banks in fact added to the balance of payments instability. While the ultimate responsibility for the debt servicing problems necessarily lies with the debtors concerned, actions of the creditor banks may reasonably be seen to be one of the factors underlying the problems that ensued. However, the course of the negotiations between the banks and the debtor countries--to the extent these can be reconstructed--for the most part do not reflect even tacit acceptance by the major banks involved that they might bear some of the responsibility for the problem.

Whether or not acknowledged, at least some of the cases reflected mistakes in capital allocation and questions thus arise whether the potential for such problems poses any serious threat to the adjustment process. An important question is whether the market mechanism is self-adjusting, in the sense that "penalties" for misallocation of capital accrue to the lenders in a way that will improve the efficiency of the allocation process. Broadly, the mechanism appears to have allocated capital relatively efficiently as reflected in the distribution of bank lending among a large number of developing countries more or less in line with growth and export performance and potential. But the system (bank management practices, and official regulatory guidelines and supervision) is necessarily geared to protection of the lending institutions involved and not to protection against mismanagement of resources by individual borrowers which by themselves would not jeopardize the stability of the system.

Banks thus formulate internal "exposure limits" based on creditworthiness analysis of individual countries as a tool for management of country risk and portfolio diversification. Bank supervisors assess the quality of international asset management on the basis of whether, inter alia, bank lending decisions are made against the background of adequate economic information on the debtor and are consistent with some broad norms as to reasonable portfolio concentration. But within broad limits banks are free to make their own lending decisions. In the cases under review the sharp increase in bank lending involved a large number of banks and a small portion of bank assets so that the limited degree of portfolio concentration generally would not in itself have attracted the attention of bank management or the regulatory authorities.

The relatively small amounts involved for most of the banks probably was an important factor in the decision of the individual banks to permit the acceleration in the use of the available margins under their internal lending limits for the specific countries. Moreover, market conditions had become increasingly competitive and there is a tendency in such circumstances for an individual bank to accelerate net lending to individual countries in response to the debtors' demands when the particular bank's "share of the market" is not increasing--i.e., the market participants tend to move together. The borrowers may have been in a position to exert leverage over the lending banks because of competitive pressures or because they were prepared to pay a price for bank funding that the market judged to be a sufficient reward in relation to risk. Moreover, the general experience with international lending in recent decades may have demonstrated to the lending banks that the risk of outright loss was fairly negligible.

The banks sustained or even accelerated their net lending to some of these countries even when it was evident that remedial policies were needed to avoid the prospect of future payments difficulties. In general--and in spite of nominal linkage of financing flows to specific projects in some cases--there were often clear signs that domestic savings ratios were declining and that the quality of investment programs was deteriorating.

In some cases the terms which the borrower offered for additional market finance were themselves a strong signal as to the difficulties of the situation. In one case the borrower's capacity to service debt on commercial terms was inherently weak and market access initially was made possible only with the official guarantee of a third party. In all these cases there seems to have been sufficient information available to the banks on the debtors' economies and their economic policies on which to base a judgment on the risks involved.

The experience of these six countries supports the view that excessive transitory inflows of market finance have sometimes delayed needed adjustment efforts and ultimately increased the burden on the debtor concerned. The greatest assurance that these circumstances will be avoided resides in the balance of payments and external debt management policies of the borrowing countries themselves. This underscores the need for the Fund to continue and perhaps intensify its efforts to systematically cover these aspects of economic management in the context of Article IV consultations.

Once payments problems emerged or appeared to be imminent, the borrowers' perceived creditworthiness in the markets deteriorated sharply and the "leverage" shifted toward the creditor banks. In most of the cases under review the member country adopted an adjustment program supported by Fund resources and had achieved an agreement on restructuring of its official debt in a multilateral framework. It generally was in the debtors' interests to come to terms quickly with the banks as an important element in the overall financial package in support of the adjustment program. The debtors faced the need to restructure the bank debt on terms which were a priori consistent with their economic rehabilitation programs but had to take into account the constraint that the settlement had to be sufficiently favorable for the banks so as not to impair the possibility for the resumption of net private inflows to sustain their programs over the medium term. The debtors thus generally faced a trade-off between a solution they found adequate for the shorter term and one which gave greater assurances that the banks would be responsive to their financing requirements over a longer period. The banks, on the other hand, were under pressure to minimize the financial cost to them of a debt restructuring. The possibility that they would withhold or sharply cut new financing--including trade credits--gave them considerable bargaining power in the negotiations. These issues frequently have led to considerable delay in reaching agreement on the terms and scope of restructuring.

On balance, the restructuring terms agreed with the private creditors appear to be somewhat less favorable to the debtors than those agreed in the official renegotiations, although the arrangements are somewhat difficult to compare. The major difference was that the interest rates on official maturities rescheduled or refinanced were below market rates, whereas the bank creditors generally operated on the basis of market interest rates. Moreover, the agreements on official credits generally provided for easier repayment terms on interest in arrears. But the

major differences are not to be found in the agreements themselves, but in their impact on future financial relations between the parties. In the case of official debt restructurings the agreements generally signaled a return to more or less normal financial relations. In some of the private arrangements the debtor sought assurances on new medium-term financing in support of the adjustment program as well as restructuring of existing debt and in some cases this proved to be a bottleneck in reaching an agreement. The question of new short-term bank trade financing was not covered in the agreements and, in retrospect, this also proved to have been a problem both for the debtor and for the Fund in assisting the debtor to formulate and implement an adjustment program.

The banks have a clear incentive to reduce their "exposure" to those countries which are encountering payments difficulties. The most readily available avenue for such adjustment, once it has become necessary to agree to a restructuring of medium-term maturities, is to allow trade credits to run off. Although the available data do not permit a comprehensive assessment of movements in short-term bank financing, it appears that in some instances the banks have sought to reduce their exposure positions in the countries concerned by cutting or withdrawing new short-term trade credit facilities. Such actions have exacerbated the problems of economic management for some of the countries at a time when internationally supported adjustment efforts were being undertaken. The desire of the banks to reduce exposure levels under the conditions of uncertainty are understandable but such actions do raise a serious question both for official creditors and for the Fund, which is supporting an adjustment program with its resources.

In some cases, the net resource transfer (i.e., principal plus interest payments) to the banks by the debtor during the early stages of the adjustment program were sizable in relation to the Fund resources being provided. While it is to the advantage of the debtor to make timely payments of interest on its private obligations to maintain or restore its perceived creditworthiness in the markets, a significant outflow of funds to the banks may undermine the possibilities of implementation of a feasible adjustment program and may give the appearance that the Fund and official creditors are financing the reflows to the banks. For these reasons, it would seem to be important that the agreements generally include understandings at least on the maintenance of the existing level of individual bank exposure (for lending of all types and maturities) and, in especially difficult circumstances, that they provide for new financing flows to help offset the impact of outflows of interest payments. The question arises as to whether in specific circumstances where Fund resources are involved this issue may have to be brought to the attention of the interested parties in the debt restructuring exercise.

It is in the interests of the Fund to assist the parties, as necessary, to come to an agreement which is mutually acceptable, provides a reasonable basis for formulation, and implementation of a viable adjustment program

and does not impair the member's future financial relations with the private creditors. The staff therefore should be prepared to respond flexibly to requests by the parties to assist in the process. Where private debtors are involved, a major principle underlying staff contacts with them will continue to be the need to protect the confidentiality of the Fund's relations with the member involved.

In some of the cases under review the interests of the parties were difficult to reconcile, the negotiations were unduly protracted, and the agreement itself did not provide adequate assurances that private financing flows would be sufficiently responsive to the needs of the program being supported by Fund resources. In some very difficult cases that arise where the use of Fund resources is involved, it may prove useful and appropriate for the Fund to assume informally a role in helping to guide the negotiations to a satisfactory outcome.