External debt, fiscal resources and child welfare;

past trends and proposals for future policy actions

by

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I INTRODUCTION

This paper has two main themes. The first one, explored in Section II, concentrates on the important direct and indirect fiscal effects of the severe external debt crises which shook so many developing countries in the eighties. This is an aspect infrequently analysed in the existing literature on external debt. Though starting from macro-economic analysis, the paper emphasises the impact of resulting fiscal changes on the welfare of the poor. This section finishes with some criteria on how resources freed by debt reduction and/or increases in new flows should be channelled in different categories of countries. This latter theme is applied in Section III, where the policy implications of the previous analysis are drawn out. The need for further debt reduction is discussed, for different categories of severely indebted developing countries (emphasising low-income ones mainly in sub-Saharan Africa and middle-income ones, mainly in Latin America); policy suggestions are made to help assure sufficient debt reduction is achieved, to restore growth and development, and to increase government spending which benefits the poor. In this context, the advantages and possible limitations of debt-for-social spending swaps are examined in some detail, for different categories of developing countries. The need to see those debt-for-development swaps as one of several instruments, though a valuable one, to achieve debt reduction is stressed; simultaneously, it is one of several ways to finance increased government social spending. One of its advantages is that it directly links debt reduction with increased social spending. New opportunities in this field are provided by a special clause in Paris Club reschedulings and by the US Initiative for the Americas.

II THE LINK BETWEEN CHANGES IN NET RESOURCE TRANSFERS ABROAD AND FISCAL RESOURCES

1. Impediments to growth and social development in the 1980s

It is important, before starting our analysis, to differentiate between different debtor categories, differentiation which is both relevant for the analysis of existing links between external debt, fiscal resources and child welfare and particularly for the policy recommendations in Section III.

The severity of the external debt burden and of its impact on countries' economies varies significantly by groups of countries. The severely indebted middle-income countries, mainly in Latin America, whose debt is largely to private creditors, attracted most of the attention of the debt crises. According to World Bank figures (see Table 1), these 20 countries (called SIMICs, or severely indebted middle-income countries), account for about 40 per cent of total external debt of developing countries.

TABLE 1

External Debt of Various Country Groups

	External Debt (US$b) 1980	1990[a]	Official debt (%), 1989
Total	562	1221	42
SILICs[b]	41	116	67
SIMICs[c]	299	588	35
Others	222	517	n.c.

Source: Elaboration of data in World Bank, World Debt Tables, 1990-91, World Bank, Washington, D.C.

[a] Projection.

[b] Severely indebted low-income countries; these include Benin, Burundi, Comoros, Equatorial Guinea, Ghana, Guinea, Guinea-Bissau, Guyana, Kenya, Liberia, Madagascar, Malawi, Mauritania, Mozambique, Myanmar, Niger, Nigeria, Sao Tome and Principe, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Zaïre and Zambia.

[c] Severely indebted middle-income countries; these include Argentina, Bolivia, Brazil, Chile, Congo, People's Republic of, Costa Rica, Côte d'Ivoire, Ecuador, Egypt, Arab Republic of, Honduras, Hungary, Mexico, Morocco, Nicaragua, Peru, Philippines, Poland, Senegal, Uruguay and Venezuela; Chile and Costa Rica are included for the sake of consistent comparisons, even though their debt indicators no longer imply they are in this category.

The 26 severely indebted low-income countries (called SILICs by the World Bank), almost all of them in sub-Saharan Africa, account for a far smaller share (only 9 per cent) of total external debt of LDCs; furthermore, most of this external debt is to official sources. However, because of the low levels of income in these countries, and because the external debt indicators in many of them are extremely critical, their debt overhang causes particularly serious problems for the poor. Our analysis will focus therefore on these two categories of countries, the severely indebted middle-income countries, mainly in Latin America and the severely indebted low-income countries, mainly in sub-Saharan Africa.

Three caveats are important to make, before examining some general features of severely indebted countries, both middle-income and low-income. First, more than half the LDCs, mainly in Asia, and representing, according to Table 1 figures, around 42 per cent of LDC external debt, are not severely indebted; this means that external debt has not been a major impediment to their development in the 1980s. Indeed, a few of them (in particular the Republic of Korea, Malaysia and Thailand) began a deliberate policy of reducing their external debt in the second half of the eighties. South Korea reduced its external debt from US$ 47 billion in 1985 to $33 billion in 1989! Second, countries can move from one category to another, as their external debt situation improves or deteriorates significantly. Thus, both Chile and Costa Rica (due to rapid export growth and significant debt reduction) have seen their debt indicators improve so much in recent years, (so that external debt seems to have ceased to be an important constraint on their development), that they have been moved by the World Bank to the moderately indebted category. Less encouraging is the fact that some countries in Asia, e.g. India, have seen a rapid deterioration in their external debt situation in the second part of the 1980s. Third, increasingly closely linked to the issue of developing country debt, though clearly separate, is the external debt of Eastern European countries and the Soviet Union; according to World Bank figures, their total external debt reaches US$ 156 billion.[1] Particularly as a result of the revolutionary political changes in Eastern Europe in 1989, external debt of some of them (and especially Poland) has received extremely favourable treatment by the international community. This should have mainly a

positive precedent effect for the treatment of LDCs, particularly as income levels in countries like Poland are certainly higher than those of the low-income LDCs and may be higher than that of many middle-income LDCs; however, there is some future risk (which needs to be avoided) that generous debt reduction to Eastern Europe and/or the Soviet Union would be at the cost of debt reduction for LDCs (particularly by official creditors).

Returning to the features of severely indebted countries, we can see in Table 2 that the reductions in the welfare of the poor, and particularly of children, that occurred in the eighties due to factors like the external debt overhang were far more damaging in the low-income severely indebted countries than in the middle-income ones, as income per capita in the latter is around five times higher and child mortality 50 per cent lower.

According to the figures in Table 2, the debt indicators have deteriorated strongly in the SILICs during the 1980s, and even since 1982 both as regards debt service ratios and debt/export performance (with exports declining by 20 per cent p.a. in the 1982-89 period). The debt service ratio for the SILICs has grown from 10 per cent in 1980 to 31 per cent in 1991! For the SIMICs, the scheduled debt service ratios have declined quite significantly, since 1982, reflecting both the slow growth of debt and the very robust growth of exports. Indeed, by 1991, the debt service ratio for the SIMICs (at 30 per cent) was significantly lower than it had been in 1980 (38 per cent). The debt/export ratio was still somewhat higher in 1991 than in 1980, however. Paradoxically, (and showing the problem of changing countries with serious external debt problems), the countries defined by the World Bank as "moderately indebted" have seen quite an important deterioration of their situation in the 1980s, especially since 1982, and by 1991 have a worse debt service ratio than the so-called severely indebted developing countries. Taking all LDCs as a whole, in the eighties, debt/export ratios have remained constant and debt service ratios improved somewhat since 1982. By 1991, debt service ratio of all LDCs was marginally lower than the 1980 level. This indicates clearly that for SIMICs and LDCs as a whole, the debt crisis has eased somewhat, though it is still a

TABLE 2

Structural, external debt and development indicators, for different categories of indebted countries

Categories of countries	Structural features		Debt indicators								Growth and development indicators (Annual growth rates, 1982-89)			
	GNP p/cap (US$, 1988)	Infant mortality Deaths per 1000 live births, (1987)	Debt service ratio 1980	1982	1989	1991	Debt/export ratio 1980	1982	1989	1991	GNP	Exports	Per Capita consumption	Investment
Severely indebted low-income countries (SILICs)	288	109.8	10	20	27	31	96	214	493	441	-5.1	-2.0	-1.5	-4.8
Severely indebted middle-income countries (SIMICs)	1632	55.0	36	49	32	30	196	297	294	280	3.6	3.5	0.4	-0.7
Memo item														
"Moderately" indebted developing countries [a]	n.a.	n.a.	19	22	29	31	128	141	248	266				
All developing countries	n.a.	n.a.	22	28	22	21	134	182	187	176				

Source: Based on data in World Bank, op. cit., in Table 1; and World Bank World Debt Tables 1991-92 Vol.1.

[a] These are: a) moderately indebted low-income countries: Bangladesh, Central African Republic, Ethiopia, The Gambia, Indonesia, Pakistan, Sri Lanka, Uganda, Yemen, Republic of (PDR); b) moderately indebted countries: Algeria, Cameroon, Cape Verde, Colombia, Dominican Republic, Gabon, Guatemala, Jamaica, Paraguay, Syrian Arab Republic, Turkey, Yugoslavia, Zimbabwe.

very serious problem in many of them. For the SILICs, their debt crises is as serious or more so than in 1982!

Finally, from Table 2, we can see the differential growth and development record of SILICs and SIMICs. The SILICs have had an extremely poor economic performance in the 1980s, with very sharp declines in output, investment and consumption. (As is well known, this has led to a deterioration of social indicators in most of those countries). Though the performance of SIMICs was also poor, particularly as regards investment, at least some positive elements emerged, such as a relatively good performance of exports.

2. Changes in net transfers abroad

a) The nature of the problem; a schematic analytical framework

Our analysis starts from the assumption that changes in net resource transfers abroad (resulting from external debt crises) are a cause and not just a consequence of macro-economic imbalances, and of fiscal imbalances, in particular. In the eighties, the external transfer problem became also a budgetary transfer problem. The budgetary transfer problem both affects macro-economic variable, such as inflation, (with indirect effects on child welfare) and affects the level of government expenditure and taxation, with direct effects on the welfare of the poor.[2]

There are three main mechanisms through which increased debt servicing and reduced access to new external flows (linked to the external debt crises of the eighties) affected government finance: 1) direct effects, linked to the need for governments to capture the additional local currency to finance increased external and domestic debt service; 2) effects via adjustment of the balance of payments (to changes in net resource transfers) on public sector finance; and 3) effects of slower economic growth (or output decline) and increased inflation - partly resulting from the debt crises - on public sector finance. The cuts in government spending (implying reductions in "public goods"), the reduction (or slower growth) in output and income and higher inflation all affected levels of income and welfare of the poor. We will address these links systematically in what follows.

For putting this analysis in a broader analytical framework, it seems useful to do so by distinguishing between: i) initial conditions, faced by severely indebted developing countries (early 1980s), ii) main policy responses, and iii) immediate factors affecting the poor. A graphic representation of these links can be found in Figure 1.

Thus, we can see that the initial conditions in severely indebted developing countries were originating both in dramatic changes in net resource transfers and in unsustainable macro-economic imbalances (partly the latter being determined by the former).

Governments of heavily indebted countries responded, especially initially, mainly by continuing servicing most of the external debt, (even though this was causing severe economic, financial and social costs), in some cases even granting ex-post public guarantees to private debt. To be able to accommodate the negative net resource transfer from their economies (or the far lower positive net resource transfer), they undertook packages of adjustment measures. Amongst the most relevant in our context were large exchange rate devaluations, cuts in levels of fiscal expenditures and increases in domestic interest rates (linked to tighter monetary policy, and being both cause and effects of the growth in domestic debt).

The debt and adjustment measures outlined above had a number of problematic effects, such as pre-emption of a large proportion of fiscal resources for debt servicing, import cuts and constant or declining real tax collection. These intermediate effects in their turn led to declines in investment in physical capital, reduced real expenditure on "public goods" (such as health and education), increases in the level of inflation and slower growth or decline of GDP and incomes. Changes in these four variables tended to lead to a decline (or slower growth) of levels of welfare and incomes of the poor in those countries. Though the broad direction of the changes was strongly influenced by the initial conditions, the final impact on the welfare and income of the poor was, as Cornia and Stewart, op. cit., clearly show, strongly influenced in each country experience by the type and balance of policy decisions taken by individual governments.

In the context of this analytical framework, we will focus in more detail on how changes in net resource transfers (linked to the debt crises) affected public sector finance, and thus the ability of the public sector to provide "public goods", essential for the poor. We will start by examining the direct effects of external debt crises on public sector finance, and on the poor, then look at one set of indirect effects of the debt crises, via adjustment of the balance of the payments (via the exchange rate and reduction of imports) on public sector finance and on the poor, and finally look at a second type of indirect effect of the debt crises, linked to slower economic growth (or output decline) and increased inflation, on public sector finance and the poor.

As can be seen from Figure 1, we are focussing here only on some of (albeit hopefully the main) links between debt crises, debt and adjustment measures, public finance and the poor. One important link, in Figure 1, which we do not discuss in detail below (as it is less linked to public finance) is the effect of the debt and adjustment measures on lower levels of investment in physical capital (both public and private) and their effects on the poor, mainly through lower future levels of employment

b. Direct effects of external debt crises on government finance

Practically in all developing countries, a very large part of external debt is serviced by the public sector; the rise in interest payments, occurring in the early eighties - which resulted both from the increase in the value of the stock of external debt in previous years and from the sharp increase in international interest rates - implied therefore an important increase in public deficits; cuts in external lending implied that more domestic finance had to be mobilised. For both these reasons, the external transfer problem became also a serious budgetary transfer problem. As we shall discuss below, this was particularly serious from the perspective of public finance in cases where foreign exchange (via exports) was earned by the private sector, but debt service outflows had to be made mainly by the public sector.

Throughout the 1970s, budget deficits in developing countries, with a few exceptions, were relatively moderate, usually reaching less than 3 per cent of GDP (see Table 3).

For the highly indebted countries included in Table 3, budget deficits were, on average, less than 2 per cent of GDP in the late seventies; these relatively small budget deficits were easily funded in most cases by foreign borrowing. Some heavily indebted low-income countries (such as Tanzania, Ghana and Zaïre) did, on the other hand, have large budget deficits, funded mainly by external resources.

After the external shocks of the early eighties (which first implied increased interest rates and declining terms of trade, and later led to reduced private international lending), budget deficits increased significantly in almost all developing countries; they increased particularly sharply in the highly indebted developing countries. Especially as new external finance dried up for those countries, these large deficits were funded both by: i) increased domestic borrowing by the government in the small national financial markets, and/or ii) by increased money creation. The latter lead eventually to inflation and often to increased capital flight, which further increased the net negative transfer; the former often lead to increased domestic interest rates, and through this to a growing burden for the government to service the domestic debt.

The magnitude of the total budget deficit was increased in many heavily indebted LDCs by the fact that many governments ex-post "socialised" (by taking over responsibility for) the private sector's external debts, thus socialising the transfer burden. This happened in several Latin American countries, as well as in the Philippines, where the private sector had borrowed internationally from private banks without government guarantees; when the debt crises came, in the early eighties, several governments guaranteed ex-post the responsibility of servicing these private debts, and granted exchange rate and other guarantees to help the private sector service its debt. This has led to important Central Bank losses in a number of countries (such as Argentina, Chile, Costa Rica, Philippines and Uruguay).

TABLE 3

BUDGET DEFICITS [a] IN SELECTED DEVELOPING COUNTRIES

(Percentage of GDP)

	Total balance			*Primary balance*		
Country	*1978-1979*	*1981-1982*	*1986-1987*	*1978-1979*	*1981-1982*	*1986-1987*
Argentina	-2.9	-7.8	-5.6	-0.9	-3.8	-3.4
Bolivia	-2.8	-10.4	-2.8	-2.5	-3.5	..
Brazil	-1.1	-2.5	-12.8 [b]	0.9	0.1	-1.2 [b]
Chile	2.4	0.8	1.0	3.8	1.3	3.0
Colombia	-0.1	-3.9	-1.3	0.3	-3.1	0.0
Costa Rica	-5.9	-1.9	-2.7	-4.2	-0.3	-0.1
Ecuador	-0.9	-4.6	-3.4	1.0	-1.0	1.1
Ghana	-9.6	-7.1	0.3	-7.6	-5.2	2.0
Indonesia	-2.6	-1.9	-2.2	-1.5	-1.0	0.6
Jamaica	-12.8	-14.9	-1.4 [b]	..	-6.8	9.0 [b]
Kenya	-5.6	-7.8	-6.5	-3.9	-4.9	-1.9
Malawi	-8.8	-9.7	-7.3 [b]	-6.7	-5.2	-1.1 [b]
Mexico	-3.0	-11.1	-10.5	-1.4	-7.6	3.3
Morocco	-10.1	-12.8	-8.8 [b]	-8.1	-9.1	-3.1 [b]
Nigeria	-1.6	-7.4	-5.4	-0.4	-5.2	1.2
Peru	0.7	-3.5	-4.7	4.9	0.1	-2.7
Philippines	-0.7	-4.1	-4.0	0.1	-3.2	0.4
United Rep. of Tanzania	-11.7	-7.2 [c]	-5.5 [d]	-10.4	-5.1 [c]	-3.5 [d]
Uruguay	-0.3	-5.3	-1.4	0.4	-4.6	0.2
Venezuela	-1.1	-2.9	-0.6	0.3	-0.8	3.0
Zaire	-7.9	-10.1	-7.2	-5.7	-6.2	-2.5

Source: UNCTAD Trade and Development Report, 1989, based on international and national sources.

a Consolidated central government. The primary deficit equals the total deficit less interest payments. A minus sign indicates a deficit.

b 1986.

c 1981.

d 1985

Throughout the 1980s, heavily indebted countries made major efforts at reducing budget deficits, with an important degree of success, as can be seen for example in Table 3. These attempts to cut budget deficits sharply was intimately linked to the need to overcome the problems inherited from previous stages; a smaller budget deficit or a budget surplus was required to generate domestic resources for funding the negative net resource transfer abroad, to help fund the domestic servicing of internal debt and to help cut inflation, which had increased sharply, particularly in the heavily indebted Latin American countries.

As Williamson[3] clearly notes furthermore, especially in Latin America there has been a major change in the attitudes of politicians and economists, from an indifferent attitude to the size of the budget deficit in the seventies and early eighties to a perception that large budget deficits needed to be cut, as an essential pre-condition for stabilisation.

TABLE 4

FISCAL ADJUSTMENT FROM 1981-1982 TO 1986-1987 IN SELECTED DEVELOPING COUNTRIES

(Change as a percentage of GDP)

	Fiscal component					
Country	*Total revenue* [a]	*Tax revenue*	*Total expenditure*	*Interest payments*	*Current non-interest expenditure*	*Capital expenditure*
Public sector [b]						
Argentina	3.1	2.3	-6.7	-6.4	0.9	-1.2
Bolivia [c]	4.5	5.4	-5.0	..	..	-3.0
Brazil [d]	-2.7	-3.4	10.6	17.6	-4.8	-2.2
Chile [e]	1.3	-0.6	1.8	2.0	-2.7	2.5
Colombia	-4.4	1.0	-8.9	2.4	-11.8	0.5
Costa Rica	7.2	0.3	-3.0	..	..	-2.7
Côte d'Ivoire [f]	2.0	-2.3	-6.7	3.8	-2.6	-7.9
Ecuador [e]	-0.7	0.4	-4.9	0.9	-2.9	-2.9
Malawi [d]	0.1	0.1	-6.4	1.8	-1.0	-7.2 [g]
Mexico	5.0	0.6	4.1	10.6	-1.3	-5.2
Peru	-10.5	-3.0	-11.8	-1.6	-6.8	-3.4
Philippines	0.0	0.7	-5.5	5.7	-7.1	-4.1
Uruguay [e]	0.5	0.4	-4.3	..	..	-2.1
Venezuela [e]	-4.0	-2.5 [h]	-3.2	0.4	-1.4	-2.2
Central government						
Ghana	8.7	7.2	1.3	-0.2	0.8	0.7
Indonesia	-1.9	-3.4	-1.6	1.9	0.0	-3.5
Jamaica	3.5	..	-10.0	2.3	-7.4	-4.9
Kenya	-0.7	-1.9	-2.0	1.7	-1.5	-2.2
Morocco	-2.3	0.6	-6.3	2.0	-3.0	-5.3
Nigeria	2.1	..	0.1	4.4	-0.3	-4.0
Zaire	-7.0	-5.4	-9.9	0.8	-7.4	-3.3

Source: UNCTAD, op. cit., based on international and national sources.

a Including grants.
b Excluding the central bank.
c Total revenues and expenditures exclude state economic enterprises.
d Change between 1981-1982 and 1985.
e Change between 1981-1982 and 1986.
f Change between 1981-1982 and 1984.
g Development expenditures.
h Non-oil taxes.

Table 4 describes the fiscal adjustment carried out in selected developing countries during the 1980s; the changes are measured as a percentage of GDP. First, it can be seen that (except for Argentina and Peru) interest payments (domestic and external) rose very significantly, by as much as 17 per cent of GDP in Brazil and 10 per cent of GDP in Mexico, between 1981-82 and 1986-87. Both non-interest current expenditure and capital expenditure fell significantly in practically all the developing countries in Table 4. Indeed, the decline in non-interest public expenditure was much sharper than the increase in revenues; increases in government revenues occurred only in some countries, and were relatively small. Perhaps most disappointing was the fact that tax revenues increased only in slightly more than half the countries examined (11 out of 19), and did so by relatively little. Though external determinants (such as inflation, trade reform and other exogenous processes) as well as political determinants heavily influence a government's ability to carry out a successful tax reform, the case of countries like Ghana and Bolivia (where, for the former, tax revenues, according to Table 4 increased by 7.2 per cent of GDP, although from a very low basis) shows the possibility of increasing tax revenues in difficult circumstances; some heavily indebted countries, like Costa Rica, were able to increase tax revenues, during the 1980s fairly significantly, even though starting from a fairly high basis - 20 per cent of GDP in 1980.

As Cornia and Stewart, op. cit., report, in economies that underwent adjustment and fiscal retrenchment (mainly those in Latin America and Africa), cuts in government expenditure were particularly large in health care and education, with the share of spending on health and education in total government spending declining in both regions. This was in sharp contrast to countries in the Middle East and Asia, where not only total government spending increased, but also the share of spending going to health and education increased in 95 per cent of the countries examined.

This decline in spending on the social sector in many of these adjusting countries in Africa and particularly in Latin America occurred for two reasons: a) government spending fell in most countries as a proportion of GDP; b) the share in total government

expenditure going to the social sectors fell largely because an increased share went to interest payments.

TABLE 5

Highly indebted countries[a]	Inflation: increase in consumer prices (%p.a.)		
	1966-72	1973-82	1983-88
Argentina	26.4	140.8	311.4
Bolivia	5.7	31.3	455.6
Brazil	23.3	54.7	237.8
Chile	31.4	105.1	21.8
Colombia	10.4	24.2	21.6
Côte d'Ivoire	2.9	21.1	18.0
Ecuador	3.6	13.9	4.8
Mexico	3.9	23.9	91.1
Morocco	1.5	10.1	6.6
Nigeria	6.6	16.4	21.1
Peru	8.9	42.8	105.6
Philippines	7.8	14.0	15.0
Uruguay	56.3	57.5	62.8
Venezuela	2.0	10.4	15.9
Memo item:			
World	5.2	12.5	11.1

Source: IMF, International Financial Statistics

[a] All the countries included in the Baker Plan as highly indebted, except for Yugoslavia.

As a result of declining levels of GDP per capita and declining or constant share of total GDP going to government spending, levels of per capita government expenditure fell during the 1980s, in many heavily indebted countries, mainly in Latin America and Africa (see Table 6). In contrast, in many countries in Asia and some in the Middle East, real central government expenditure per capita increased throughout the 1980s. While some of the declines in Latin America and Africa were quite dramatic (for example, 1985-87 levels, in relation to 1980, were 46 per cent lower in Guatemala, 41 per cent in Bolivia, 20 per cent in El Salvador, 24 per cent in Peru and 21 per cent lower in Venezuela and Dominican Republic; they were 37 per cent

lower in Liberia and 33 per cent lower in Tanzania). Some of the increases, for the same period were very significant in the Middle East and Asia (120 per cent in Oman, 108 per cent in Singapore, 61 per cent in India, 47 per cent in Pakistan, 45 per cent in Korea and 42 per cent in Nepal).

As, additional to the above, the share of health and education spending in total central government expenditure also fell in many heavily indebted countries, especially in Latin America and Africa, largely due to the increased share of government spending going to interest payments, (see Table 4, in Ebel op. cit.), levels of real government spending on health and education, particularly if measured in per capita terms, declined fairly dramatically in several of these countries.[4]

For countries undergoing strict structural adjustment programmes in the 1980s, that is generally severely indebted ones, a World Bank study[5] estimated that the real value of per capita expenditure in education and in health, between 1980 and 1986, declined respectively by more than 10 per cent and by nearly 20 per cent. The cuts were particularly drastic in some countries; as Ebel, op. cit., reports, real health care spending per Zaïrian was 70 per cent lower in 1985 than in 1980. In Mexico, average real per capita social spending in 1983-85 was 21 per cent less than in 1977-82; between 1981 and 1988, real education expenditure slumped 35 per cent in Mexico, in spite of a rapidly growing school-age population.

Indeed, the Mexican evolution dramatically illustrated the extent to which rapidly growing debt service displaced resources within the government budget, from spending on the social sectors. In Mexico, the budget share of debt service grew from 23.5 per cent in 1981 to 58.2 per cent by 1988; simultaneously, the budget share of education fell from 9 per cent to 5 per cent; this produced a decline in public resources going to education, as proportion of GDP, from 5.3 per cent in 1981 to 3.5 per cent in 1988.[6] In the case of health,[7] the level of budgetary spending declined by 53 per cent between 1981 and 1987, even though it recovered rapidly in 1988.

TABLE 6

Real Central Government Expenditure per capita
(1980 = 100)

Country	1980-82	1983-84	1985-87
Latin America			
Argentina	101	89	100
Bolivia	112	134	59
Brazil	99	97	134
Chile	105	101	100
Costa Rica	82	84	86
Dom. Rep.	92	81	79
Ecuador	108	88	105
El Salvador	97	85	71
Guatemala	101	71	54
Mexico	132	135	149
Panama	108	107	102
Paraguay	109	100	..
Peru	97	82	76
Uruguay	113	94	89
Venezuela	119	88	79
Middle East North Africa			
Egypt	109	93	83
Iran	97	86	72
Jordan	102	92	92
Kuwait	96	99	99
Morocco	108	97	98
Oman	118	174	220
Tunisia	109	129	125
Yemen Arab	114	114	95
Asia			
Bangladesh	125	116	129
India	104	125	161
Indonesia	103	98	117
Korea	108	122	145
Malaysia	126	118	125
Myanmar	106	110	119
Nepal	109	136	142
Pakistan	106	125	147
Philippines	101	84	93
Singapore	116	157	208
Sri Lanka	88	83	95
Thailand	106	116	128
Sub-Saharan Africa			
Botswana	104	119	148
Burkina F.	104	95	93
Cameroon	133	160	..
Ethiopia	108	139	..
Ghana	93	56	88
Kenya	103	92	93
Liberia	98	79	63
Malawi	91	77	85
Mauritius	103	100	101
Tanzania	98	86	67
Togo	97	90	99
Zimbabwe	102	111	111

In contrast, in the Asian countries, it is noteworthy that not only the share of government spending as proportion of GDP rose in many countries but also within government spending, the share going to health and education rose somewhat, even though interest payments also rose initially somewhat as a share of government spending.

The decline in the level and share of government spending on health and education, mainly in the adjusting countries of Latin America and Africa, clearly directly affects the welfare of the poor; it also may have a negative effect on overall growth and on the overall rate of return of all investment. The World Bank[a] reports that in the severely indebted middle-income countries (SIMICs), the sharp decline in GDP growth in the 1980s (of about 75 per cent, as GDP growth fell from 4.5 per cent in the 70s to about 1 per cent in the 80s) was only partly due to an important decline in the net investment ratio of these countries (which fell around 50 per cent); the rest of the decline has to be explained by declining productivity of the capital stock. Clearly an important element in explaining lower productivity of physical capital is decreasing quality of human capital, linked in those countries to the severe cuts in government spending in health and education in the eighties. Furthermore, both in the eighties and unfortunately also in the future, deteriorated human capital availability tends to depress investment in physical capital, given the high degree of complementarity between human and physical capital. The quality of spending on human capital (in sectors such health, education and nutrition) may also be impaired by the focus placed on cuts and the uncertainty surrounding future levels of expenditure; this makes it relatively far more difficult to focus on long-term policy-making and planning, especially essential in ensuring effectiveness of social services spending.

To reverse both the immediate and the dynamic negative effects of cuts in social service government spending, it is important to reverse past trends rapidly and substantially. Increased action on reducing external debt servicing provides in the nineties precisely a unique opportunity to use some of the leeway generated by lower debt servicing to increase government spending in social services; furthermore, other funding mechanisms need to complement reduced

external debt servicing to finance increased social spending. (We will return to this subject below).

Furthermore, in those countries where external debt servicing burdens have begun to decline, as in many SIMICs (see again Table 2), it is important that a significant part of the additional resulting resources available to governments are channelled to increasing spending in health, education and nutrition. It is essential that in those countries increases in public spending that benefit the poor, which are becoming feasible, are not displaced by reductions of tax revenues or increases in non-essential government spending.

As pointed out, major efforts were made in the eighties at reducing fiscal deficits (and more broadly the public sector borrowing requirement, PSBR) in heavily indebted countries; as a result, according to UNCTAD, op. cit., estimates, by 1986-7 the PSBR in the countries analysed in Tables 3 and 4, was on average only one half of a percentage point of GDP higher than in 1978-79, even though interest payments were higher by three percentage points, of which two-thirds were due to increased interest payments abroad. However, because of the cut-backs in external lending, a greater share than in the past of the PSBR had to be financed domestically, either by increased monetary expansion and/or growing indebtedness of the public sector.

In some heavily indebted countries, like Argentina and Mexico[9] the increase in the budget deficit in the early 1980s was totally financed initially by the consolidated banking system. The situation was different in countries like Korea where public sector financial requirements did not increase much in the early eighties, and these were only partly funded by the domestic banking system, as foreign borrowing did not decline significantly (for data, see Reisen and van Trotsenburg, op. cit.).

The countries like Argentina and Mexico, which significantly increased money printing to fund an increased budget deficit in the early eighties, saw inflation increase rapidly, to an important extent as a result of this expansion in the money supply. As can be seen in Table 5, most of the larger and middle-income highly indebted countries (and especially Argentina, Bolivia, Brazil, Mexico and

Peru) saw their levels of inflation increase significantly in the mid-80s when compared with the early 80s, and even more when compared with the 1965-73 period.

However, it should be stressed that this link was not inevitable for indebted developing countries, as between 1973-82 and 1983-88, inflation fell fairly significantly in Chile and Ecuador, fell moderately in Colombia, Côte d'Ivoire, Morocco and rose only slightly in Nigeria, Philippines, Uruguay and Venezuela.

In those heavily indebted countries where inflation rose significantly in the eighties, both the sharp increases in inflation itself and particularly the attempts at shock stabilisation to brake inflation tended to hurt more the poorer groups in society, as they had fewer defence mechanisms to face major macro-economic changes, and as drastic stabilisation efforts tend to have negative effects on employment and salaries.

TABLE 7

Growth of real GDP per capita in developing countries, 1965-89

Country group	1965-73	1973-80	1980-89
Developing countries	3.9	2.5	1.6
Sub-Saharan Africa	2.1	0.4	-1.2
Latin America	3.8	2.5	-0.4
East Asia	5.3	4.9	6.2
South Asia	1.2	1.7	3.0
Europe, Middle East and North America	5.8	1.9	0.4

Source: World Bank. Global Economic Prospects and the Developing Countries. May 1991. Washington, D.C.

One of the mechanisms through which the wealthy groups in society protect themselves from inflation is through capital flight. As Reisen and van Trotsenburg, op. cit., show statistically, capital flight increased more after the debt crises started from those indebted countries where there was either hyper-inflation or high inflation. This led to a vicious circle, as the increased capital flight increased the net transfer abroad, and thus put even more

pressure on public finance and macro-economic management. The vicious circle operates in the following way: a high net resource transfer due to the debt crisis increases the budget deficit; the higher budget deficit is to an important extent monetised; the resulting inflation shifts money demand (by the wealthy, who have international connections) from local currency, to foreign assets, thus increasing the net financial transfer and the burden on public finances; this will probably lead to further cuts in government spending, which will be particularly harmful to the poor.

In some developing countries, part or most of the increased fiscal deficits were financed by the non-bank private sector, through the issue of government bonds. To attract voluntary private savings, governments had to offer interest rates at least as high or - in countries with an unstable rate of inflation and expectations of devaluation, like Brazil - higher than inflation. These high domestic interest rates in turn imposed a heavy burden on public finances, with interest payments on domestic debt becoming the most important component of the PSBR, reaching or exceeding - in countries like Brazil and Mexico - 15 per cent of GDP in the mid- and late 1980s. In those countries, the increase in domestic debt servicing became the main source of pre-emption of fiscal resources for debt servicing (see again Figure 1) and was therefore a major factor in explaining reductions in government expenditure on "public goods", and on the welfare of the poor.

One of the main indirect effects of debt service reduction packages in the context of the Brady plan (late 1980s) - especially clearly illustrated for the Mexican case - is the rapid decline in domestic interest rates.[10] In such cases, to the reduction in external debt servicing by the government is added a reduction in government domestic debt servicing, further increasing the resources available to governments, which <u>can</u> be used for increased spending in health, education and nutrition. Thus, the vicious circles of the early to mid-eighties could be replaced by virtuous circles in the late eighties, and especially in the early nineties. The case for <u>at least restoring the share of total government spending going to health, education and nutrition, to pre-debt crisis levels</u>, is in present circumstances very strong, in those countries where debt

servicing burdens (both domestic and foreign) have been or are significantly declining.

c. The effect of balance of payments adjustment on public sector finance

It can be concluded that while during the eighties declines in net resource transfers (as well as deterioration in terms of trade) were accommodated by reductions in imports and growth of exports, in many countries the fiscal counterpart of this adjustment was far more problematic to achieve. As a consequence, analytically there was growing focus on the "fiscal constraint", as an important issue (which together with the traditionally analysed "savings constraint" and "foreign exchange constraint") limits the growth and development prospects of heavily indebted developing countries.[11]

The scale of the fiscal challenge posed by the debt crisis was linked to a number of factors, including the relative role of import cuts and export growth in the balance of payments adjustment, and institutional issues, such as the public sector's involvement in export activities.

While cuts in public sector investment and imports generate more foreign exchange, the linked stagflation, change in relative prices (such as devaluation) and import cuts by the private sector tend to affect negatively public sector finance (see again Figure 1). The issue (from a public finance perspective) is how the public sector can capture the domestic currency equivalent of increased trade surpluses or diminished trade deficits.

If trade surpluses are generated mainly through import cuts (as clearly occurred initially in Latin America and in Africa), income transfers from the private sector have to be generated to provide the government with local currency to carry out debt servicing. If the trade balance improves mainly due to growth of exports, and there was important public ownership of the export sector, the government can more easily finance the increased net transfers abroad; however, where export expansion was carried out mainly by the private sector, an extra effort is required by the government to transfer the

additional local currency from the private sector, so it can use it to finance external debt service.

Another mechanism through which adjustment of trade flows affects public finance is via taxes on international trade. According to UNCTAD, op. cit., taxes on international trade on average reach more than a quarter of total tax revenues. As a result, changes in trade volumes and policies (e.g. changes in customs duties or changes from quotas to import duties, as occurs during trade liberalisation, or changes in export taxes) have an important fiscal effect. For the countries in Tables 3 and 4, trade taxes as a proportion of GDP fell by around 1.5 per cent of GDP between 1980-81 and 1985-86, both as a result of reduced imports and due to reductions in customs duties.

A particularly important link between trade policy and public finance performance is the exchange rate. Exchange rate devaluation normally affects public finance, via a series of mechanisms; these include the positive effect of devaluation on increased trade taxes and the negative effect on government spending, as imported inputs and capital goods increase in cost. As regards the net transfer burden, real currency depreciations imply an additional public financial expenditure in local currency for servicing a given amount of interest payments and amortisations in foreign exchange (see again Figure 1).

The impact of exchange rate changes also depends on the level of net borrowing from abroad by the public sector, during a particular period, e.g. a year. In countries where this exceeds interest payments (and therefore where there is a positive net financial transfer, such as occurred during the eighties in most of the low-income countries, especially in sub-Saharan Africa), real devaluations improve the fiscal position; such macro-economic effects may, however, be offset if external aid flows imply provision of counterpart funds.

Thus the net public finance effect of exchange rate devaluation in indebted developing countries will depend on those countries' structural features. The higher the proportion of government revenue coming from the non-traded sector, the higher its spending is in foreign exchange (to service debt and/or purchase imported goods) the

more negative is the effect of a devaluation on the fiscal balance. Because large real devaluations were necessary in the eighties in many severely indebted countries to improve the trade balance, so as to fund increased net transfers abroad (linked to the debt crises), these devaluations have increased the fiscal burden - in local currency - further. One of the indirect advantages of debt relief is therefore that the pressure on real devaluation diminishes (or is reversed), diminishing also its fiscal effect, and thus allowing more margin for manoeuvre for increasing government spending in items such as social services. Indeed, one of the effects of the reduction in external debt servicing of some Latin American countries in the late 1980s, and especially of the return of private capital flows to several countries in that region[12] has been a revaluation of their exchange rates; indeed, it is estimated that during 1991, of 18 Latin American countries, 15 saw their real exchange rates increase between 5 and 20 per cent. This is a third element in our potential virtuous circle, as revaluation (in some countries) joins lower domestic interest rates and lower levels of international debt servicing, as factors determining lower local currency costs for governments of servicing their total debts. As a result, as indicated above, there is still more leeway, at present, for increasing government spending that benefits the poor, without additional inflationary pressures.

d. The effect of slower growth and higher inflation on public finances

As discussed above, public finances have faced additional pressure in heavily indebted countries in the eighties, not just to accommodate the swing in net external transfers, but also due to indirect effects which tended to enlarge budget deficits; these effects have included cuts in imports, tariff reductions and real exchange rate devaluation.

Slower economic growth and higher inflation are another indirect effect of debt crises, which exert pressure on public finance. As can be seen in Table 5 above, inflation accelerated rapidly during the 1980s in the highly indebted countries, particularly in the Latin American ones. This was partly an effect of the debt crises, and partly due to domestic macro-economic mismanagement in some cases

(e.g. Peru). The link between external debt crises (and decline in net positive resource transfers or reversal to negative net transfers) with acceleration of inflation occurred basically via three mechanisms. First, as discussed in some detail above, higher debt servicing and lower capital inflows imply additional pressures on the budget, leading to an increased budget deficit. Second, large nominal devaluations (with the objective of achieving real devaluations) imply additional inflationary pressures on the costs side. Third, sharp declines in imports (and increases in exports) reduce the aggregate supply of goods in the economy, thus also increasing inflationary pressures.

The debt crises, together with other factors, also led to declines or slower growth of GNP in heavily indebted developing countries and in regions (Latin America and Africa) where most of the heavily indebted developing countries concentrated - see Table 2 above and Table 7. It is noteworthy that growth in some other areas of the developing world (East and South Asia) accelerated in the eighties, partly because the external debt overhang was not a major constraint to development. The links between external debt crises, adjustment and evolution of output are varied and complex, but clearly the sharp fall in imports in heavily indebted countries was a major cause of declining output and/or slower growth in the HICs.

As pointed out, both declines (or slower growth of) output and accelerating inflation have a negative effect on fiscal balances, especially via decreased taxation - see again Figure 1.

i) Both direct and indirect taxes tend to fall or stagnate when economic activity does so. This is true partly because, as is increasingly documented,[13] when government investment in key sectors (such as infrastructure, human capital) declines, private sector profitability, output and investment also falls, both in the present and in the future. Therefore, due to this crowding-in feature of public investment, growth potential is eroded by declining government spending, and so is the future tax base. In addition, as the level of several taxes is linked directly to values of production and sales, the decline or slow growth of the latter makes tax revenue fall or stagnate, ceteris paribus.

Furthermore, insufficient efforts have been made by governments to carry out and successfully implement tax reforms in the 1980s. Likewise, the efforts of international financial institutions also seem relatively weak in this field. As the World Bank itself points out,[14] on the basis of its empirical analysis, tax policy is one of the areas where policy implementation (of conditions attached to its Structural Adjustment and Sectoral Loans) was weakest in the mid to late 1980s, with policy implementation on exchange rate and public expenditure (the latter largely referring to expenditure reductions) being the strongest! This may be partly because more "progressive" conditionality (e.g. taxing the wealthy to fund increased social spending and/or lower inflation) is more difficult to implement, due to domestic pressures, for example by wealthy or powerful groups. This would seem to suggest the need for international institutions to take some action which would help overcome the regressive policy implementation bias.[15]

ii) Accelerated inflation (resulting partly from the debt crises) has in many cases reduced real tax revenues due to factors such as collection lags, because of legislative procedures and/or administrative delays.

It is difficult to estimate both the effect of inflation and of successful stabilisation on tax revenues in LDCs, even though there is some evidence that in countries with long collection lags, tax collection is inversely proportional to inflation levels, (this effect is known in the economic literature as the Olivera-Tanzi effect). However, as Lerda[16] shows, lowering of inflation due to successful stabilisation, particularly in countries with a long previous inflationary experience, does not automatically lead to increased tax revenues. As a consequence, to make sure that stabilisation is accompanied by increased tax revenues, it is crucial that stabilisation plans are complemented with an effective tax reform, so as to ensure both inflation reduction and the increased tax revenues.

As we can see from the above analysis, the management of macro-economic and budgetary policy became far more complex as a result of

the debt crises in the eighties, and in particular of the negative financial net transfer burden.

As a result, policy dilemmas became more acute. For example, domestic real interest rates rose in those countries attempting to fund their public deficit on the domestic capital market, and attempting to avoid capital flight; nominal interest rates rose particularly in cases where inflation increased.

These high nominal and real interest rates have two negative effects. At one level, they discouraged private sector investment, thus depressing current and future growth; this had both a direct and indirect (via the fiscal system) effect on the poor. At another level, to avoid a domestic debt explosion, high nominal and real interest rates require a generation of surpluses in the rest of the government budget; if tax revenues do not increase, further government spending cuts are required, with negative effects on social spending, as well as other sectors. This latter impact, though an indirect effect of the external debt crisis, implied an important source of cuts in social services in the eighties.

Another policy dilemma that became more acute as a result of the debt crisis is that of the extent of devaluation. Devaluation (both nominal and real) helped improve the trade balance, which was necessary to increase the negative net transfer abroad. However, this real devaluation not only directly (via costs pressures) accelerated inflation, but also did so indirectly via causing a deterioration of public finance and a likely increase in money issue. High inflation tends to impose a direct costs on the welfare of the poor; attempts at reducing the additional inflationary pressures on public revenues, if carried out via expenditure cuts, also hurt the poor, both because of the recessionary impact and because part of the cuts will lead to a curtailment of social services.

As pointed out above, a reduction in debt service payments taken unilaterally (as has increasingly occurred in the late eighties) or better a decline in debt service payments linked to an agreement with creditors will reverse several of these perverse effects.

In countries where public finance is an important source of macro-economic problems (reflected for example in high inflation and/or high real interest rates), the opportunity of decreased negative net transfers and/or increased positive net transfers should clearly be used both to:

a) Recover previous levels of investment in human and physical capital, as well as increase social spending, and b) Pursue a sensible stabilisation policy, mainly via reduction of money printing, but also via reduction of domestic debt creation and slow-down of rate of real devaluation (or some reversal of it, if compatible with the foreign exchange constraint).

The Mexican experience in the 1990-92 period illustrates well the latter, as both domestic debt and domestic interest rates have declined, partly linked to the Brady debt reduction; furthermore, the real exchange rate has been revalued, contributing to a lowering of inflation.[17]

In this sense, it must be stressed that in very high inflation economies, a reduction of inflation is an important public good, particularly if looked at from the perspective of the poor. A reduction of inflation from high levels will benefit the poor, to the extent that their incomes are not fully indexed; furthermore, a reduction of inflation is likely to create some dynamic positive effects on growth (e.g. via reduction or return of capital flight), which would increase the future income of the poor.

Finally, if stabilisation is accompanied also by increases in public spending, especially on social services and on investment in physical capital, (due to the resources freed via reduction of external debt service and possibly due to reduction of internal debt service), there will be both immediate and long-term benefits to the poor, the latter originating from the dynamic effects on growth of increased investment. The former effect will not happen automatically, but will do so only if clear and ideally absolute priority is given in the increased public spending to areas which favour the poor and/or promote growth.[18] In countries where total debt servicing is declining as a proportion of total government expenditures (e.g. many Latin American countries), it is becoming feasible to significantly

increase government spending that benefits the poor, without necessarily requiring increased taxes to avoid additional inflationary pressures. One formerly heavily indebted country, Chile, has clearly seized the opportunity of significantly increasing social spending (by 30 per cent in real terms); this has been made easier by the declining debt service burden of the government, but has also been funded to an important extent by increases in taxation.[19]

If inflation is not a major problem (as occurs in many low-income economies), and government investment as well as social spending has been largely constrained by scarcity of foreign exchange resources, there is a very strong case for channelling practically all the resources freed by debt reduction to increased social spending and investment in physical capital; to the extent that spending on human and physical capital by governments would in that case crowd in private investment, there will be a further beneficial effect for future growth and for employment, and thus on the poor.

As we shall see in Section III, in these countries, there is quite a strong case for linking directly debt reduction with increased social spending, for example via debt-for-social spending swaps.

III POLICY IMPLICATIONS

1. The need for further debt reduction

Overall the debt crisis of developing countries is somewhat less severe than in the mid-eighties, as a result of measures such as the Brady Initiative, the Toronto Initiative and other programmes of debt relief and restructuring, as well as the improved export performance of some (especially middle-income) developing countries. Above all, it is positive that the principle of the need for debt reduction to free resources for development is widely accepted, though its implementation is both slow and insufficient.

Action has tended to be "too little, too late", particularly for the countries still trapped in serious debt crises. The most urgent and serious problem is that of the severely indebted low-income countries, mainly in sub-Saharan Africa where debt and development

indicators have continued to deteriorate throughout the eighties. In the case of severely indebted middle-income countries, mainly in Latin America, fairly significant progress has been made in debt reduction in several of them, with other countries still facing serious debt overhang and macro-economic imbalances; furthermore, the debt to other creditors (and particularly to official ones), is an important issue that only recently began to be tackled for middle-income countries.

Of particular interest to the issue of increasing social spending and thus increasing child welfare, is the recent growth of special initiatives that link debt reduction to development spending, especially linking debt reduction for nature spending but also debt reduction for social spending.

In what follows, we will briefly assess the need for further debt reduction for different categories of heavily indebted countries, making some general policy suggestions;[20] we will then focus on the link between debt reduction and increased spending in certain sectors. For this, we will draw on the analysis in the previous section.

As pointed out, perhaps the most serious problems, both of debt and development, are in the Sub-Saharan countries. Though these countries have benefited from quite significant debt relief, (particularly from official creditors), this is clearly insufficient. It is in particular disappointing that sub-Saharan countries have as yet <u>not</u> obtained as much official debt relief, as far better off countries (e.g. Poland and Egypt) have achieved fairly effortlessly, apparently mainly for geo-political reasons.

In the case of Sub-Saharan Africa, an important step forward would be an endorsement of British Prime Minister, John Major's, initiative, known as the Trinidad Terms or better the even more far-reaching proposal made by the Dutch Development Minister, Jan Pronk. The Major (or Trinidad) initiative would: a) reschedule the <u>entire stock</u> of Paris Club (official bilateral) debt in one go, instead of the exhausting negotiations falling due in yearly or so intervals, b) increase from one-third to two-thirds the amount of relief provided by cancellation of outstanding stock, c) capitalise all interest

payments (albeit at market rates) on the remaining one-third debt stock for five years, and d) stretch repayments of remaining one-third of debt-stock.

Mistry, op. cit., estimates that if adopted unchanged, the Trinidad Terms would have meant a reduction in the eligible debt stock of the present SSA countries of about $18 billion; it could lower schedules of service payments to levels approaching the present level of actual payments on official flows. This would represent a very important step towards a more comprehensive solution of Africa's debt problem, by overcoming many of the problems in the current approach to the rescheduling of low-income debt-distressed countries in the Paris Club.

Even more far-reaching is the Pronk proposal which would cancel all bilateral official debt (both concessional and non-concessional) to severely debt-distressed, least developed countries and other low-income countries. It would cancel about $40 billion in outstanding debt stocks and make scheduled debt service savings of $3-4 billion, but actual debt service savings of only about $1.5 billion. It would imply a very significant step forward.

Unfortunately, the London Summit (July 1991) did not fully endorse either the Major or even less the Pronk proposal, though it did agree to "additional debt relief measures, on a case-by-case basis, going well beyond debt relief already granted..." Implementation of these ideas were taken up in the Paris Club itself.

The agreement reached within the Paris Club in late 1991 (and already applied to Benin and Nicaragua) was disappointing, as it considerably diluted the Trinidad terms, even though signifying progress over previous Toronto terms. In these "enhanced Toronto terms", creditors can opt for: i) cancellation of 50 per cent of eligible maturities being consolidated, with the remainder consolidated at market rates, to be paid over 23 years with 6 years' grace, ii) halving interest rates on non-concessional debt in NPV terms, to be repaid over 23 years with 6 years' grace, and iii) stretching repayment period, with 14 years' grace and 25 years' total maturity.

To achieve minimum conditions for sub-Saharan African nations to recover and have their income per capita grow by 1 per cent a year, it seems a necessary condition (though obviously not a sufficient one as there are many other constraints to African development, than those posed by external debt):

1) For bilateral debt, at least Trinidad Terms are granted, accompanied by other options to reduce official bilateral debt through different kinds of debt swaps (which would include special programmes for health and education, and/or for protecting the natural environment).

   It should be noted here that since September 1990, the Paris Club has authorised conversion of bilateral official debt into debt-for-nature or other swaps on a voluntary, bilateral basis. By early 1992, these have been granted to several African countries, e.g. Benin, Côte d'Ivoire, Nigeria, Egypt, Morocco, Senegal, Republic of Congo, as well as non-African countries, such as Philippines, Salvador, Honduras, Ecuador, Jamaica, Nicaragua, Peru and Poland. It should be stressed that most activity in this sphere emphasises debt-for-equity and debt-for-nature swaps and not debt-for-social spending, which would be of more direct benefit to the poorest groups in society. It is essential that UNICEF and others concerned with improving the welfare of the poor emphasise the value of debt-for-social spending swaps, as a complement to debt-for-equity and debt-for-nature swaps. We will return to this below.

2) Action is needed on debt to the IMF, to avoid negative net transfers to that institution, aiming for a policy of "zero net transfers" from SSA (and individual countries in it). One technically attractive way forward would be a special, (of which it may be difficult to convince some industrial governments), SDR issue to enable the IMF to write-off its debts to low-income, debt-distressed countries. Furthermore, the African Development Bank should take a lead from the World Bank to create special facilities to reduce debt to it by low-income countries.

3) The problem of SSA African debt to commercial creditors has received insufficient attention and requires urgent action. Although longer-term commercial debt represents less than 16 per cent of SSA debt (excluding Nigeria) it absorbs nearly 30 per cent of total debt service; arrears to these sources are also very problematic.

Commercial banks should agree to debt reduction in SSA similar to debt reductions granted by governments; more agile use should be made of the World Bank Special Debt Reduction Facility, whose resources should be expanded and its tenure extended. Furthermore, where necessary, regulatory and tax regimes in creditor banks' home countries should be modified, so as to encourage banks to actually reduce debt against which extensive provisions have been made.[21] This is particularly relevant for European countries (except for the UK where some steps in this direction have already been taken) and Canada, where current tax provisions encourage provisioning, but discourage debt reduction. Donations of commercial debt, for social and environment purposes, should be further encouraged.

As regards the problems of middle-income countries, some progress has been achieved in the context of the Brady Plan and outside it (an example of the latter is Chile's successful commercial debt restructuring in September 1990). Countries like Mexico, Venezuela, Costa Rica and Philippines have obtained different levels of debt reduction and cash flow relief in the context of the Brady Plan. In some of these cases (e.g. Costa Rica) the level of debt reduction seems sufficient to restore growth (if other necessary conditions are met); in other cases, e.g. Mexico, not only was the debt reduction valuable, though limited, but also the signing of deals lead to indirect benefits - such as increased foreign private capital flows and reversal of capital flight - due largely to greater confidence in the economy partly originated by the debt reduction deal itself. Furthermore, as mentioned briefly above, there has been a dramatic increase (starting in 1989 and 1990, but accelerating in 1991) of new private capital flows to several Latin American countries and to the region as a whole. As a result, according to ECLAC data, for the first time since 1981, net resource transfers to the Latin Americans and Caribbean region are positive, and reaching an estimated $7

billion in 1991. Foreign exchange reserves have as a result increased very sharply in many LAC countries; growth and development are therefore at least at present no longer mainly constrained by foreign exchange availability, as it was during the 1980s and the debt overhang is not perceived in most LAC countries as an important constraint to growth and development. However, it is important to stress that there are potential long-term risks as well as benefits, from these large capital inflows, particularly as the new capital flows add to a still rather high stock of "old debt" and as a large proportion of these flows are relatively short-term, and as there is little monitoring of the final use to which such flows are being applied. From the perspective of the poor, it is important that: 1) the additional range of manoeuvre provided by increased foreign exchange reserves and, particularly, increased space in fiscal budgets, is to an important extent used both for increased social spending by the government and for increased and productive investment in physical capital, the latter mainly by the private sector, but also allowing for increased public investment in physical infrastructure, etc., and 2) supervisory and regulatory effects are undertaken by governments, and international institutions, to avoid future debt crises;[22] the lessons from the past debt crises clearly show that a very high share of its cost is borne by the poorest and most vulnerable within the heavily indebted countries.

Further action, however may be necessary to improve and speed up debt reduction in middle income countries and especially in lower-middle income countries, such as Ecuador and Jamaica. This would include:

1) As discussed above, in the context of SSA debt, it is valuable (and without cost) that tax and regulatory changes are made that encourage commercial debt reduction; these changes should be attractive to creditors governments as they do not require government spending, but on the contrary may imply savings for the fiscal budget.[23] There is a clear alternative tax treatment of provisioning and debt reduction which could provide clearer incentives for European and Canadian banks to participate in debt/debt service reduction. Tax relief would be given at the time of provisioning; however, these tax concessions would only be maintained if the commercial bank accepted debt or debt service reduction, at least equivalent to

the amount of provisioning being accepted for tax concessions; in cases where banks made donations of debt to charities, with proceeds to be used for development spending, the additional tax relief would also be immediately and permanently granted. Such tax and regulatory changes would need to be carefully constructed, so as also to provide encouragement to new lending, for those countries whose debt overhang has been significantly reduced or eliminated.

2) For severely indebted countries, with debt overhang and large macro-economic imbalances, (e.g. Brazil) both debt reduction and continued efforts at improving macro-economic imbalances simultaneously is urgently required. For these countries, macro-economic adjustment should not be a pre-condition for debt reduction; neither, however, should debt reduction be a substitute for parallel continued domestic efforts to reduce macro-economic balances.

3) Continual, and possibly enhanced support, from official resources, for completion of Brady-type deals of debt reduction is required, especially for some of the small countries like Ecuador.

4) The problems of severely indebted middle-income countries with high levels of official debt (e.g. Honduras, Ecuador and Peru) need to be dealt with, on a systematic basis; encouragement for this should be found from the precedent of 50 per cent bilateral official debt reduction already granted to countries like Poland and Egypt. Further encouragement arises from the concessions on bilateral official US debt granted in the Initiative for the Americas launched by the US government, which is partly linked to debt reduction for spending on the environment. This initiative is also positive, because it links debt reduction to development spending, but its scope is excessively narrow in focussing mainly on the natural environment, even though poverty alleviation and preservation of the natural environment are so often intimately linked. However, if imaginative projects are designed and efforts are made to emphasise these links, the Initiative for the Americas

may become a useful vehicle through which the concept of debt reduction for social spending is applied and actions taken which benefit the poor.

More generally, the spread of official debt reduction for middle-income countries, if and when it comes, provides important opportunities for linking debt reduction for increased social spending.

5) In this context, initiatives like that by UNICEF to help reduce commercial debt and use the resources thus obtained, for increased social spending benefiting, children acquire importance. It is in this sense very encouraging that the Dutch government and the Dutch UNICEF Committee has in May 1991 contributed US $6.25 million for a buy-back of commercial debt in Ecuador, Honduras and Jamaica, with up to $13 million of local currency equivalent being released by the debtor governments to finance additional UNICEF programmes in these countries. It is to be hoped that this operation will become a precedent for other such contributions.

6) Furthermore, the broadening of this type of initiative to link official debt reduction with increased social spending in Latin America and Africa is very important; likewise, the potential amounts involved via official debt reduction would seem to be larger than for commercial debt.

In particular, the 10 per cent Paris Club clause, agreed in September 1990 opens very interesting opportunities of debt swaps for social spending on a large scale, for SILICs and SILMICs (severely indebted lower-middle income countries). As total Paris Club debt, which could potentially be subject to the 10 per cent clause, has been estimated by World Bank sources,[24] to reach as much as $130 billion, 10 per cent opens the potential for debt-for-development and debt-for-equity swaps, of up to around $13 billion. This opens a significant potential both for increased social spending and/or for fairly substantial debt relief, should an important proportion of the 10 per cent clause be applied and a significant part of that channelled to social spending.

Specifically, the Paris Club clause states that "creditor countries can, on a voluntary and bilateral basis, swap part of the claims for debt-equity swaps, debt-for-nature swaps and debt-for-development swaps for up to 10 per cent of bilateral official or officially guaranteed non-concessional loans, and (where relevant) for up to 100 per cent of ODA loans; there is also a value limit ($10 million or $20 million, depending on the case), which can be used if it is higher than the 10 per cent of non-concessional bilateral debt".

Initially, debt conversion efforts were focussed on commercial debt, with swaps of official bilateral debt practically non-existent; indeed, there were limitations on creditor governments selling their debt. However, the balance of emphasis is rapidly shifting towards bilateral official debt conversion, both for equity and development. Such operations potentially open debt conversions for other categories of countries (low-income and low- middle-income), for deals whose scale could be large, and which could be negotiated more easily and quickly with creditor governments.

At the time of writing, relatively limited activity had actually taken place in finalising official debt conversions in the framework of the "10 per cent clause". However, a number of transactions are reportedly being considered or about to be implemented, including the following:[25]

- Poland has presented a detailed request to its creditors for funding of a $3bn Environment Fund, with the "10 per cent clause". This was discussed at a large conference with creditor governments in mid-1991. Reportedly, the US, and France have made commitments to such a Fund.

- In Egypt, the French government is reported to have accepted to convert up to $10 million of its bilateral debt, and use it for co-financing (with the World Bank), the Social Emergency Fund. France and other creditor governments are reportedly considering a programme of official debt-equity conversions.

- For Morocco, the Netherlands and other creditor governments are considering the possibility of debt-equity swaps with their Paris Club debt.

- For Nigeria, different creditor governments are reportedly considering using D-E-S conversions to support privatisation.

- Canada is examining the possibility of converting official debt for funding additional UNICEF high priority spending in Bolivia.

It should be noted that certain European and North American creditor governments have, even before September 1990, been selling (or converting) their Paris Club debt, with the aim of improving the balance sheet of their export credit agencies. Because these operations were not allowed in the Paris Club framework, they were not publicised. However, they are interesting because they pioneered debt-equity swap with official debt, showing that it is feasible. Some limited official debt conversions for development have also been done, mainly it seems with official concessional debt.

Before finishing, we will examine the desirability of whether debt reduction should be linked to human and/or green conditionality, via the type of debt-for-development swaps discussed above and particularly those made increasingly feasible by the Paris Club 10 per cent clause and the Initiative for the Americas.[26]

A first general point worth emphasising (see also Section II) is the distinction made between indebted countries with serious inflation problems and those without. In the former, a large proportion of resources freed by debt reduction should be used to pursue a sensible stabilisation policy, as inflation reduction is an important public good, particularly for those poor whose incomes are not fully indexed to consumer price rises. Increases in social spending are desirable in these countries, but should be - where possible - accompanied by tax increases and/or a reduction in other items of public expenditure; if debt reduction is large, some additional increase in social spending and in other desirable spending by the government may

be compatible with a successful stabilisation programme, provided it is in the framework of a consistent fiscal and monetary package. In these situations, the role of debt-for-development swaps may be somewhat constrained by the need for stabilisation. However, fairly small debt-for-development swap operations should not be a cause of concern, unless fiscal deficits and inflation are very high.

To assess the monetary impact of debt-development swaps, a realistic assumption needs to be made of whether the country would have in the next few years, been servicing the relevant part of its official debt, if the debt conversion did not take place. The issue is whether the government could afford (given its other pressing foreign exchange needs) to service that Paris Club debt. Some useful indication can be provided by the country's past record.

If a country would have serviced its debt (had the debt conversion clause not been applied), it is necessary to take a dynamic view of the net impact on monetary expansion over time. As debt is converted, service payments are reduced in that year and in the future, leading to a decline in net monetary expansion . In the first year, there will be (if the debt is swapped for increased government development spending, and this is not compensated) an expansionary monetary effect; however this will be partly compensated by the lower money expansion as government financed debt servicing is reduced; as the years pass (and the "savings" on money expansion grow, with every year's debt servicing, and with the hypothetical need to amortise the debt when it becomes due), the programme of debt conversion can have a net cumulative zero impact on monetary expansion, and later can become negative.

Some of the variables discussed above can perhaps more clearly be presented in diagrammatic form (see Figure 2).

Finally, there is a contractionary indirect effect on the money supply rarely mentioned. If part or all of the foreign exchange saved (because of lower debt servicing) is used to finance imports, then the consolidated banking system will absorb private sector money, reducing the net monetary expansion effect. Furthermore, the imports financed by these foreign exchange savings are likely to

attenuate supply bottlenecks and reduce future inflationary pressures.

If in the initial years of a debt conversion programme, the monetary expansion would be feared to be excessive, the financial authorities can take a number of measures to reduce, neutralise or sterilize the effect. This is illustrated by the case of Chile, where in spite of a major debt-equity programme in the second half of the eighties, inflation remained modest by the country's own historical as well as by regional standards.

The Central Bank can firstly regulate the redenomination rate, to define how much local currency it spends per unit of debt swapped. Second, it can issue long-term bonds in exchange for the debt swapped, with the principal being amortized fully upon maturity. This method delays and distributes the monetary consequences of debt conversions by transferring the cost of servicing the debt to the private financial markets in the short run. However, by competing in the capital markets with the private sector, the government may push up interest rates; furthermore, interest payments on the bonds created for the debt conversion constitutes a drain on fiscal resources. In spite of these long-term costs, such mechanisms do moderate inflationary impact. However it requires a comparatively well developed domestic capital market that can absorb these long term public bond issues and an overall limited fiscal deficit, so government paper is an attractive option. Another mechanism to neutralise monetary impact is the monthly quota of swaps, which limits the amount swapped and thus curbs monetary effects, quotas can be decreased if necessary.

In the case of debt for development swaps, the inflationary impact would usually manifest itself via increased fiscal spending. Such spending can be compensated (if necessary) by reducing other (less high priority) government spending and/or increasing government revenues, (e.g. via higher taxes). Additionally, long-term development bonds can be placed on private capital markets, as was done in countries like Ecuador and Costa Rica.

Particularly if the debt conversion is likely to become large, it is crucial for the debtor government to better budget for their monetary

and fiscal effects in its overall macro-economic programming, and design the programme to reduce or eliminate excessive monetary affects. If these conditions are met, and the rest of the macro-economic programme is feasible, no excessive inflationary impact should result.

If inflation is not a major problem and thus the main constraints to growth are savings and foreign exchange limitations, there is a very strong case for channelling directly an important part of resources freed via debt reduction to increases in social and/or environmental spending. In this case, debt-for-development swaps, which assume that there is some monitoring of the destiny and use of part of the freed resources seems an attractive instrument.

Another important distinction to make is whether the debt buy-back, debt reduction, etc., actually implies a cash saving of foreign exchange flows for the debtor government. If it does (which occurs if the debt reduction achieved is large and/or if the country was likely in the future to service a large or total proportion of scheduled debt service), then the case for using debt-for-development swap type mechanisms becomes stronger. The case for using this instrument is less obvious, if no additional cash flow of foreign exchange is generated for the debtor country as it was previously already not servicing the debt.

However, if the debtor government does not attach very much priority to social spending and international agencies and/or NGOs wish to shift the <u>structure</u> of government spending, e.g. towards more on social services and less on defence, the debt-for-development swap can be a very useful instrument, even if the government is <u>not</u> likely to service the debt in the future, provided the debtor government accepts it, and preferably if the debt is either <u>donated</u> by a commercial bank or if creditor government funding for debt buy-backs or official debt reduction implies <u>additionality to existing aid or other flows</u>. An illustration of a positive case in these latter circumstances are commercial bank debt donations made by commercial banks to UNICEF for increasing social and environmental spending in the Sudan.

The use of debt-for-development swap instruments should in all cases, even if inflation is low, be carefully applied, so they do not lead to a major expansion of money creation and/or fiscal balances. For this purpose, the scale and timing of these operations must be made compatible with existing macro-economic policies and targets, and the instruments used (e.g. environment bonds in Costa Rica) must be tailored to the countries' macro-economic programmes.

Also at a micro-economic level (relating to the nature of the projects or programmes for which local funds will be released) the debt-development swap instrument should be consistent with the project's or programme's funding needs.[27] In this sense, debt-for-development swaps seem better suited for spending (e.g. investment, short-term pilot projects, which are of a once-for-all kind) as the resources released by the debt reduction can be channelled to that specific expenditure. Such swaps are less suited for financing current regular expenditure, e.g. part of the health programme of a specific region; this is because the debt reduction is usually a once-for-all operation and will not provide permanent funding, which should come out of the national government budget. Just as excessive aid dependence of some LDCs government spending has proved problematic, it would be inappropriate that indebted countries' social spending would depend on temporary debt reduction resources. However, the debt-for-development swap instrument can in some cases be adapted to funding spending during several years, as the debt service reduction can be staggered and/or bonds can be issued, with only the domestic servicing of the bond being used for the increased spending (again as has been done in Costa Rica for the environment). Issues of appropriate indexation to inflation also arise here, but can be fairly easily overcome. In all these cases, clear agreements are required between donor and debtor government, on future cash flows in local currency as well as on ensuring additionality by the debtor government in the desired social or other spending. The latter point is important to avoid debtor governments increasing social spending linked to debt reduction, but reducing social spending funded by its own normal resources, given the fungibility of fiscal resources.

Three final points should be made here. First, the debt-for-development swap should not be seen as a panacea; mainly it

contributes by placing priority, both in the country and internationally, to allocating more financial and human resources to priority sectors, such as social spending; it also avoids governments openly misusing resources freed via debt reduction, and thus provides assurances and incentives to creditors for greater efforts at debt reduction. Second, there is internationally a tendency for debt-for-development swaps to be identified with debt-for-nature swaps; it is important to broaden the concept also to debt-for-social spending, either linked or not to improvements in the natural environment (the former may be easier to negotiate given the strength of environmental influence and lobbies). Finally, thought needs to be given to mechanisms for enhancing social spending in countries without severe debt overhang problems, but which have large social and/or environmental needs, partly resulting from a now largely overcome severe debt crisis (e.g. Chile). Though in those cases, debt-for-development mechanisms (especially for commercial debt buy backs) may become too expensive to be worthwhile, it is important to ensure that sufficient resources are found, both domestically and internationally, to fund appropriate levels of social spending in those countries; if such efforts are not made, an undesirable paradox could emerge whereby it is easier for severely indebted LDCs to fund increased social spending (especially internationally) than their more creditworthy neighbours. In some countries that are already returning to creditworthiness (e.g. Mexico), but where the price of commercial debt in the secondary market is still below 100 per cent of its face value, commercial debt-for-development swap operations are possible, particularly if the debtor government is willing to pay full face value in local currency for high priority social spending activities, to make the operation more attractive to international charities, banks, etc. In this sense, it is noteworthy that the Mexican government has become particularly active in this field in recent years, and has successfully encouraged both debt-for-social spending and debt-for-environment spending activities, on a fairly meaningful scale, particularly from the perspective of funding urgently needed social spending, implemented by NGOs and other private institutions. Reportedly,[28] by early 1992, Mexico had carried out debt-for-development swaps for around $300 million, which made it the country with the largest swaps in this field.

TABLE 8

COMPLETED DEBT-FOR-DEVELOPMENT TRANSACTIONS

(As of April 1992)

COUNTRY	COST	FACE VALUE	LOCAL BONDS	AVERAGE PRICE	AVE RATE OF REDEMPTION
BOLIVIA	$100,000	$650,000	$250,000	0.15	38%
BRAZIL	Donation	$2,000,000	n.a.		
COSTA RICA	$12,515,474	$79,853,631	$41,972,904	0.23	64%
DOMINICAN REPUBLIC	$616,400	$2,582,000	$2,582,000	0.23	100%
ECUADOR	$3,372,000	$22,000,000	$18,500,000	0.18	71%
GUINEA	$500,000	$1,000,000	$1,000,000	0.50	n.a.
MADAGASCAR	$1,395,891	$3,030,475	$3,030,475	0.47	100%
DEBT-FOR-EDUCATION	$2,000,000	$3,500,000	$3,500,000		100%
MEXICO	$2,350,000	$7,900,000 (300,000,000)[1]	$6,500,000	0.52	88%
NIGER	$500,000	$1,000,000	$1,000,000 (cash)	0.48	n.a.
NIGERIA	$1,000,000	$3,500,000	£3,050,000 (cash)	0.35	n.a.
PANAMA	$700,000	$30,000,000	$30,000,000		
PHILIPPINES	$638,750	$1,290,000	$1,290,000	0.50	100%
POLAND	$11,500	$50,000	$50,000	0.23	100%
SUDAN	0	$20,000,000	$20,000,000 (cash)	n.a.	n.a.
ZAMBIA	$454,000	$2,270,000	$2,270,000	0.21	100%
LATIN AMERICA (B of A)	$6,000,000	$6,000,000	$6,000,000	1.00	100%
PARAGUAY (IFC)	$2,000,000	$7,000,000	$7,000,000	n.a.	100%
TOTAL	$34,154,015	$193,626,106 ($485,000,000)[1]	$147,995,379	0.34	85%

[1]Though not registered in published statistics, Mexico's completed debt-for-development transactions (in April 1992) reach $300 million. (Based on interview material, with Lic. Angel Gurria, Mexican Under-Secretary of Finance). This would bring the total of face-value for debt swapped to $237 million.

Sources: World Bank. W. Sung and R. Troia Recent developments in debt conversion programmes, Informal Financing Note 42; UNICEF Debt Relief for Children; personal interviews and experience.

In Table 8, we can see the fairly limited size of total reported debt-for-development swaps, as well as the high proportion of them carried out in Mexico and, to a lesser extent, in Costa Rica. It seems worth highlighting that total debt-for-development swaps, for commercial debt, have only represented 1-2 per cent of total commercial debt-for-equity swaps. It is to be hoped that for official debt conversions, which are only just beginning, a far higher proportion of total conversions can be devoted to debt-for-development swaps than occurred in the case of commercial debt. This may be likely as some bilateral official creditors may well seek to fund either public goods in the debtor country and/or international public goods, via official debt conversions.

To conclude, the debt-for-development swap is a useful instrument to achieve both debt reduction and increased social spending simultaneously; it should be seen however, as one of several ways of achieving debt reduction and as one of several ways of funding increased social spending, being especially advantageous in the particular circumstances outlined above. Though it is desirable to use such instruments, both to encourage further debt reduction and to increase the proportion of government spending going to spending which directly benefits the poor, it is important that international agencies and NGOs are careful about excessively conditioning and limiting the actions of already severely constrained debtor LDC governments. Even if as in this case, enlightened and progressive, conditionality by external agents should always be delicately handled, particularly because it will be super-imposed on many other layers of external conditionality.

The 10 per cent Paris Club clause, as well as the Initiative for the Americas opens up potential for action on a meaningful scale in this field.

More broadly, some progress in debt reduction for SILICs and fairly significant progress of debt reduction in many SIMICs (as well as a reversal of net resource transfers to Latin America), open up new opportunities for significant expansion of social spending in many countries where such spending severely declined in the 1980s. The fact that domestic interest rates are coming down in some of the

heavily indebted countries, especially in Latin America, and that exchange rates are in real terms being revalued, due to large inflows of foreign capital, further lowers the costs in domestic currency of servicing government debt, both domestic and foreign. This as a result, allows even more resources to be potentially re-allocated to social spending by those governments. Careful monitoring is required by agencies such as UNICEF to see if the necessary measures are taken, especially on the fiscal front (both via expenditure and revenues), to seize this "window of opportunity".

[1] For other estimates, see, for example, S. Griffith-Jones, Changes in Eastern and Central Europe; their potential implications for developing countries, IDRC, 1990.

[2] For a good discussion of the links, see G. A. Cornia and F. Stewart The Fiscal System, Adjustment and the Poor. Innocenti Occasional Paper, no. 11, November 1990.

[3] J. Williamson The Progress of Policy Reform in Latin America. Institute for International Economics. Policy Analyses in International Economics no.28. January 1990.

[4] This is based on the following equation, which determines Government Expenditure in Health and Education per capita (GEHEdpc), as a function of GDP, CGE (Central Government Expenditure), and Population (Pop.), in the following formula:

$$GEHEdpc = \frac{GDP}{Pop} \times \frac{GCE}{GDP} \times \frac{GEHEd}{CGE}$$

variations of GEHEdpc over time are determined by variations of the above-described variables.

[5] Kakwani, Nanak, Elene Makonnen, van der Gaag Jaques (1989) "Structural Adjustment and Living Conditions in Developing Countries". Mimeo. Washington, D.C. Population and Human Resources Department, World Bank.

[6] Valerio, Fernando (1991) "Fiscal Shock, Wage Compression and Structural Reform: Mexican Adjustment and Educational Policy in the 1980s". Innocenti Occasional Papers, no.17, June. Florence.

[7] C. Rivero, R. Lozano and J. Querol Vinagre (1991) "The Impact of Economic Crisis and Adjustment on Health Care in Mexico". Innocenti Occasional Papers, no.13, February. Florence.

[8] World Bank, World Debt Tables 1990-91, Washington, D.C., Box 7.

[9] See, H. Reisen and A. van Trotsenburg Developing Country Debt; The Budgetary and Transfer Problem. OECD Development Centre Study. Paris, 1988.

[10] See, S. Griffith-Jones "Is there still a Latin American debt crisis?" in G. Bird (ed.) International Perspectives for Development, Academic Press, 1992.

[11] See, for example, E. Bacha "A Three-Gap Model of Foreign Transfers and the GDP Growth Rate in Developing Countries". Paper prepared for UNCTAD and the G-24. Mimeo. 1990.

[12] See, for example, S. Griffith-Jones, with A. Marr and A. Rodriguez "The Return of Private Capital to Latin America: the Facts, an analytical Framework and some Policy Issues". Paper presented at FONDAD workshop, 9-10 June, 1992.

[13] See, for example, L. Taylor Varieties of Stabilisation Experiences. Oxford University Press. 1990.

[14] World Bank Adjustment Lending, Evaluation of Ten Years Experience. Policy Research Series no.1. December 1988. Washington, D.C.

[15] For further discussion, see E. Rodriguez and S. Griffith-Jones (eds.) Cross-conditionality, banking regulation and Third World Debt. Macmillan. 1991.

[16] J. C. Lerda Efecto fiscal de los planes de estabilización deprecios. CEPAL. Santiago de Chile. 1989. Mimeo.

[17] See, S. Griffith-Jones "Is there still a Latin American debt crisis?", op. cit; recent Banco de Mexico information.

[18] See, Cornia and Stewart, op. cit., especially Conclusions section.

[19] See, N. Flaño "On solid ground: Chile's economy today". World Bank, mimeo. 1992.

[20] For a useful broad overview of the debt problem and new desirable steps for debt reduction see World Bank, World Debt Tables 1990-91; for a very complete paper on African countries, see P. Mistry African Debt Revisited: Procrastination or Progress? Prepared for North-South Roundtable in Abidjan, July 8-9, 1991; for Latin American countries, see S. Griffith-Jones and M. Faber (eds.) Approaches to Third World Debt Reduction. IDS Bulletin April 1990, Vol.21, no.2 and ECLAC Latin America and the Caribbean: Options to Reduce the Debt Burden. Santiago, Chile, 1990; see, also, S. Griffith-Jones "Is there still a Latin American debt crisis?", op. cit.

[21] For a detailed discussion of this issue, S. Griffith-Jones and R. van der Hoeven Debt - The Unwanted Heritage of Today's Children. IDS Discussion Paper 280. November 1990; in Spanish, by same authors' La deuda - La herencia no desenda de los niños de hoy. CIEPLAN. Nota técnica 139, May 1991, Santiago.

[22] For a more detailed discussion, see S. Griffith-Jones "The Return of Private Capital to Latin America: the Facts, an analytical Framework and some Policy Issues" op. cit.

[23] See again S. Griffith-Jones and R. van der Hoeven, op. cit. for further information.

[24] Interview material.

[25] Based on interview material.

[26] For more detailed discussion, see, P. Mistry and S. Griffith-Jones Conversion of Official Bilateral Debt. Draft Report for UNCTAD. April 1992.

[27] I thank Beth Ebel for this point.

[28] Interview material; information provided by A. Gurria, Deputy Minister of Finance, Mexico.

FIGURE 1

Debt, Adjustment and the Fiscal Sector (1982-90)
Severely Indebted LDCs

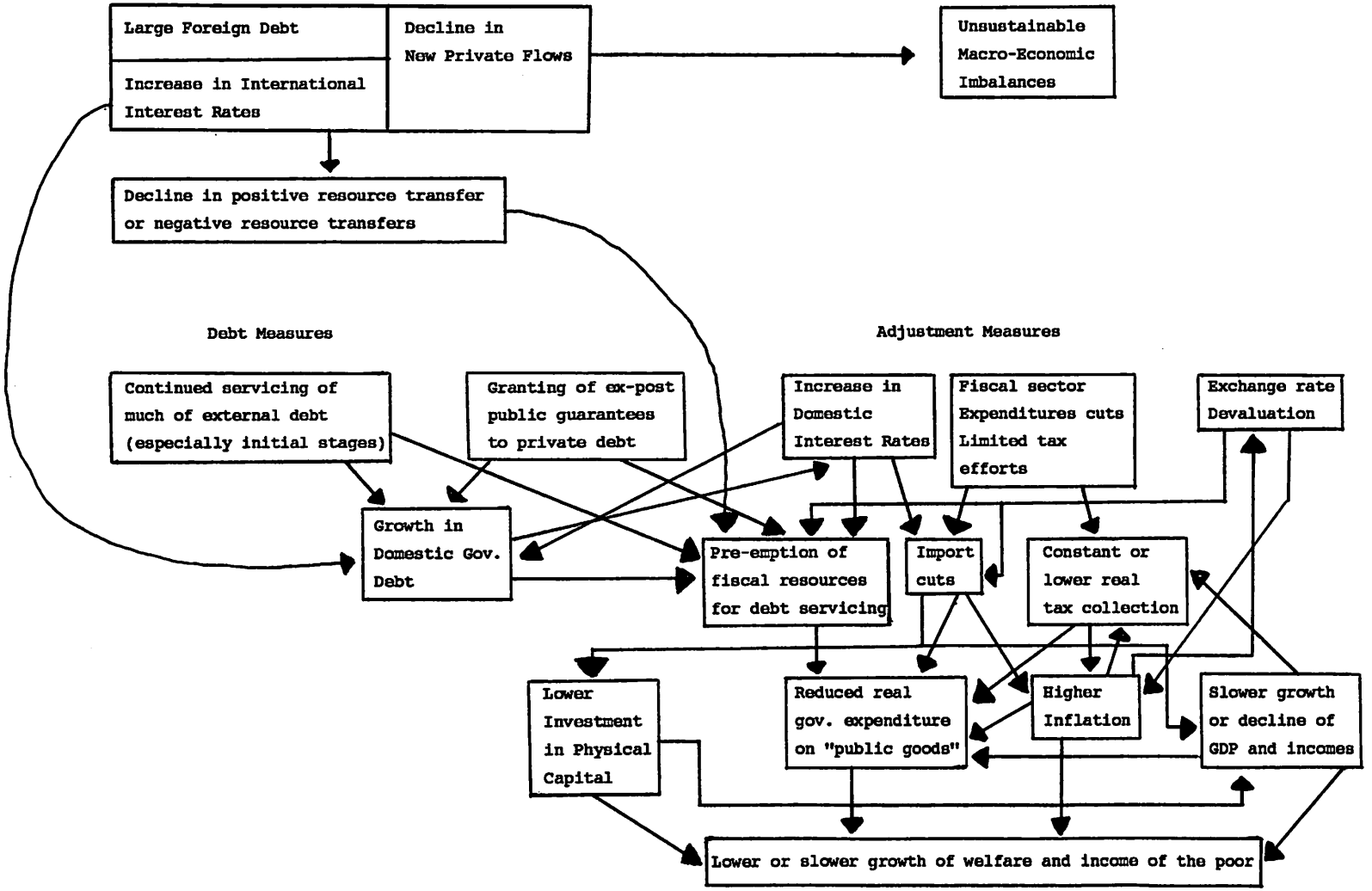

FIGURE 2

Conditions Under Which Debt Conversions are More or Less Desirable

	INITIAL LOW INFLATION I	INITIAL HIGH INFLATION II
Debt that would be serviced	Very desirable	Desirable, but monetary impact needs to be regulated, for large operations.
Debt that would not be serviced	III Desirable, only if spending priority changes essential to justify programme for efficiency gains.	Only desirable if conditions in both II and III are met.