JAWAHARLAL NEHRU UNIVERSITY

ISSUES RELATING TO THE EXTERNAL DEBT OF DEVELOPING COUNTRIES

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MASTER OF PHILOSOPHY

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Certified that the dissertation entitled **ISSUES RELATING TO THE EXTERNAL DEBT OF DEVELOPING COUNTRIES** by Mr. Sitikantha Pattanaik, hasnot been submitted for award of any degree to this or any other University. We recommend that this dissertation may be placed before the examiners for consideration of award of the Degree of Master of Philosophy Economics of the Jawaharlal Nehru University, New Delhi.

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INTRODUCTION: THE DEVELOPMENT OF THE CRISIS:

Third World debt has risen to the top of the agenda of international monetary economics in recent years. This is partly because developing countries have become much more dependent on external funding for their economic development during the past decade than they were previously and partly because a growing number of countries have experienced difficulties in exercising their external debts since 1981. The situations of many developing countries in the throes of debt crisis can be viewed either as the bitter fruit of years of compound errors by borrowers and/or lenders or as largely the unfortunate by product of several coinsiding events in the world economy.

The build up of developing countries debt during the 1970s is often tied to the recycling of petrodollars by large international banks. Within one year of the first oil price shock of 1973-74, the share of fuels in the value of world trade increased from 12 percent to 20 percent and the current account surplus of OPEC increased manifold. These economies lacked sufficient capacity to absorb the new wealth and therefore had to transfer it to the international banking system. There was not then, as there is today, the giant sponge for mopping up such liquidity provided by the budgetary and trade deficits of the U.S. Rather, the initial impact of the OPEC price rises was deflationary on the OECD countries. The OECD growth fell from 6.1 percent in 1973 to 1.7 percent per annum during 1974-76, while the growth of

world trade fell back from 12.5 percent to 5.3 percent over the same period. The international banking community, however, properly managed the financial puzzle by recycling the surpluses of the OPEC to the oil importing developing countries.

In the aftermath period of the first oil crisis, the non-oil developing countries, in general, were struck with massive balance of payments deficits, rising inflation and increasing unemployment. These countries considered tight economic measures rather infeasible in the belief that their economic structures were inflexible in the short-run. On the otherhand, they thought that financing deficits was a relatively easy course because the world economy was flushed with petrodollars and international commercial banks were eager to lend these funds. Therefore, an unparalleled wave of international lending surpassed almost all previous records. It was thus, in the words of R.L. Chawla, an unusual case of "too many international banks chasing too few lending opportunities." In the 1973-75 period developing countries were generally applauded for sustaining growth in the face of world recession by running external deficits financed in the world capital market. In the same period there was excessive dollar creation by the U.S. to finance its own deficits. The result was to export U.S. liquidity and U.S. inflation all over the world and further 'dollarize' the world economy.

Actually the dollarization process started quite

earlier, the consequence of which was the so-called 'dollar crisis' of 1971 due to suspension of convertibility of dollars by the U.S. Even after the failure of the Smithsonian realignment and the move from fixed to floating exchange rate system, the dollarization process still continues and it is in this process, over and above the massive OPEC surpluses in the post 1973 oil price hike period, that created a condition of overliquidity throughout the 1970s.

By 1976 oil prices had stablised and the loans to developing countries should have been cut, but they weren't. During the mid 1970s many developing countries lived beyond their means and did not recognize the reality of debt repayment. Due to an unantncipated high rate of inflation, the real rate of interest on these loans was negative during the mid 1970s, and the loans seemed to be an excellent deal for the developing countries.

The developing countries continued to borrow even after the second oil price shock of 1979-80 and so did the banks to supply them with funds. However, banks had learned a lesson from the unanticipated inflation and negative real rates of return during the mid-1970s and they began lending at a variable rate to reduce their interest rate risk.

In the post second oil-shock period most OECD countries were more concerned with inflation than with the supposed benefits from keynesian type expansionary programmes. In some cases these were the results of changes in governments in

office, such as the Reagan administration in the U.S. and Margaret Thatcher in the U.K. In others they resulted from the reversion to a slightly more conservative stance within what had been in any case relatively conservative governments- such as those in Japan and West Germany.

The second oil price shock pushed the rate of inflation in U.S. to such high levels that the Federal Reserve Board Chairman was almost forced to announce a change to a more restrictive monetary policy. There is always a cost in terms of lost output and higher unemployment when monetary policy is used to reduce inflation. A worldwide recession ensued while the interest rates in the U.S. soared. The worldwide recession caused commodity prices to fall and the developing countries began to have difficulty in raising the foreign exchange revenue needed to repay their debt. High interest rates, and consequent swelling debt service payments turned some developing countries into net exporters of capital. Chapter-II deals in detail with the impact of high U.S. interest rates and rising dollar on the Third World debt.

In the 1980s the international financial system shifted from a condition of overliquidity to one of underliquidity. This shift was mainly due to the steady drying up of OPEC investment of surpluses in the international banking system. The continuation of tight macroeconomic policy and various specific measures of energy conservation led to sharply reduced net oil imports into the OECD countries. Oil imports into the OECD fell from 1173 million tons in 1980 to 890

million tons in 1982. By 1983 the oil exporting countries had a current account deficit of $17.5 billion as against a surplus of $110.4 billion in 1980. Commercial banks accustomed to receiving surplus petrodollars as deposits faced cash flow problems. Some OPEC nations, particularly Saudi Arabia, had been lending to multilateral organisations (Saudi Arabia was a regular purchaser of IBRD bonds and a good source of credit to the IMF); with reduction in their surpluses, this source of finance for the IMF and the World Bank declined. A decline in the supply of petrodollars also has an adverse impact on OPEC aid disbursements. Another effect of the lower petrodollar revenues is the slow down in the internal growth rates of the OPEC countries, particularly in the construction sector. This, in turn, reduced the employment of immigrant labour and hence, the repatriation of income. The restrictive monetary policies of the U.S. also had a ripple effect on the now heavily dollarized world economy. World savings began increasingly to be absorbed by the U.S. which preferred the easy way of financing its huge keynesian deficit spending through the international capital markets in order to avoid domestic inflation.

At this stage we must avoid the fallacy that the current debt problem reflects the irresponsibility of some major indebted nations. We must remember that only a few years ago, McNamara applauded the same nations for their courageous borrowing which contributed to a higher growth rate of the

world economy. One can say rather that the crisis-ridden international banking edifice rests today on the responsibility- rather than the irresponsibility - of indebted nations which have preferred to pay their bills, despite falling real wages and living standards and rising domestic discontent. Hence, if we must find a scapegoat, it must be found as much in the deep world recession, reduced petrodollars, rising interest rates and greater trade protectionism as in domestic mismanagement.

Increased global protectionism is one major contributor to the current debt crisis. By reducing the export earnings of the developing countries it hinders their capacity to import and to service their debt. Policy makers from the developing world generally throw up their hands in despair and frustration everytime one mentions outward looking strategies. They come out with a handful of statistics and a long litany of terrible experiences they have had in gaining access to the markets of the developed countries. The most significant exercises in liberalisation of world trade have been the successive rounds of multilateral tariff reductions under the auspices of GATT. While this liberalisation has been governed by the MFN principle and has, therefore, been free of price discrimination; it has none the less brought about a sort of biased integration between the major industrial countries by restricting tariff cuts to goods primarily traded among them. As a result, there is a marked inconsistency between the global liberalisation of world

trade and the parallel existence of extremely restrictive trade policies affecting the developing countries. The typical profile of tariffs faced by the developing countries these days is one of a pyramid; i.e. low duties on industrial raw materials, gradually escalating tariffs on non-traditional exports of semi-manufactured and manufactured products of higher order processing, and very high duties on labour-intensive products whose international comparative advantage has shifted from the developed countries. While the principle of 'differential and special' treatment of developing countries on international trade is generally acknowledged, there have been no genuine attempts at integrating them into the mainstream of world trade in a manner consistent with efficiency and equity. Chapter III deals in detail how the present drift towards global protectionism affects adversely the major part of the debtor developing countries.

The second oil shock and the policy response to it by the OECD countries thus led to a series of interrelated developments, almost all of which were adverse to the interest of indebted countries. The borrowing countries suffered much higher nominal and real rates of interest on their debt. Oil importing countries had to pay far more for their oil, thus increasing their current account deficits, and requiring, at least temporarily, a more rapid increase in their debt. The response by the OECD countries of pursuing policies of financial orthodoxy, generated a major recession

and a fall in world trade - events which thwarted the efforts of developing countries to export more. As a consequence to the recession the prices of non-oil commodities fell sharply. Protectionism increased in the OECD countries as a result of the rise in unemployment caused in turn by recession. In due course, the recession also weakened the oil market and thus even certain oil exporters emerged as major debtors. None of these factors was primarily caused by policies of the debtor countries. They were caused by the OECD countries first leaving the door open for OPEC to push up the price of oil sharply a second time, and then reacting to that event by adopting policies of strict financial orthodoxy, in stark contrast to the permissive policies adopted after the first oil shock.

It is however quite unjustified to delegate all blame to the economic policies of the developed countries for the present debt anomalies. The refusal of the debtor countries to recognize any flaw in their own behaviour is not only factually incorrect, but could obstruct the search for real and durable solutions to the problem. Some major causes of debt accumulation were endogenous to the debtor countries. In case of Argentina, private capital flight, facilitated by the absence of capital account restrictions was the major contributor to its foreign debt. In case of Brazil, in contrast, huge deficits, consequent upon the massive government subsidies that maintained a low domestic price of oil was the major cause. As a result of the massive

government subsidy programme, while the real price of oil in the 1963-82 period increased six fold in the international market, the domestic price did not even double. Some oil exporting countries like Mexico and Venezuela, on the other hand, borrowed heavily against projected future increases in oil revenues. These loans were funneled into investment projects with low and even negative returns, as well as into consumption by the private and public sectors. They even had mortgaged the future flow of increased oil revenues in order to carry on their unproductive investment and consumption binge. Of course, future oil flows could be mortgaged only once. When the oil prices started slashing down these countries slipped into the debt trap. National causes, such as Mexico's institutionalized corruption or Argentina's excessive military expenditure are also important contributors to the debt proliferation.

An extensive analysis of the macroeconomic mismanagement of the major debtor countries as contributors to the present debt crisis is deliberately omitted, as the main aim of this dissertation is to focus on the faulty economic policies of the developed countries as major contributors to the present debt malaise. It is intended to study how, even though they were significantly responsible for the onset of the debt crisis, a lasting solution to the debt problem would be necessary for sustained growth of their economies in particular and a global recovery in general. One can see that further dollar depreciation is acceptable neither to the

U.S. nor to the major surplus nations as it will mean a fear of higher inflation for the former and a capital loss for the latter, as the latter countries have so much of their foreign exchange assets held in the form of dollar. The only two options to improving the adverse trade account position of the U.S. i.e. a reflation by major surplus countries and a curtailment of huge budget deficits are not feasible as any one of the options favoured by one is not acceptable to the other. As we know, any cut in the U.S. budget deficits only through reduction of surpluses of other developed countries, without any change elsewhere will contribute to recession in the U.S. and elsewhere. Any reduction in U.S. trade and budget deficits can only contribute to recovery if it is in consequence to increases in the deficits of the LDCs. But unless and until a permanent solution to the present debt problems is achieved, they are unlikely to accept ~~to the~~ greater deficits. To enlarge their current account deficits, the present liquidity (not solvency, as often argued) crisis of the LDCs must be eased. However, as argued by Patnaik (1987)[1] it is not necessarily true that the capital, till now sucked into the U.S. on account of her budget deficits, would flow back automatically to the Third World, when the U.S. Budget deficit is curtailed. Since the main controller of capital flows today are the multinational banks, and ~~that~~ they consider the Third World (with certain exceptions) as high-risk areas due to the severity of the present debt crisis, enhancement of capital lending to these countries, in the face of a reduced U.S. budget deficits, seems unlikely.

Hence, what is most necessary for a global recovery is a permanent solution to the debt problem through united effort.

One suggestion for dampening the effects of global instability is often seen in South-south cooperation, that is, cooperation among developing countries. As we know, there has been a gradual retreat from multilateralism over the last decade. There has been an increasing temptation to turn inwards, to find national solutions even when the problems have international dimensions. With the recognition that narrow economic nationalism cannot deal successfully with the problems of economic growth, the debtor developing countries must divert their emphasis for a regional economic integration. Chapter-IV attempts to suggest a partial solution to their debt problem through regional cooperation. Economic integration, even-though is not a panacea and is unlikely alone to generate rapid economic growth, viewed as a policy alternative to the current approaches to the debt problem it holds out the prospects of important potential benefits.

After the Mexican crisis broke in August1982, when so many other developing countries faced difficulties with their debt, the IMF could see ahead of it a role which was likely to be more active than at any time in its history. Very early on, private banks attempted to impose their own conditionalities on problem debtors. By far the most notable case was Peru in 1976. Banks, however, lacked the

information and expertise to develop such plans. They, thus, came to rely on the IMF to design economic programmes that they believed would facilitate debt service often making agreement between the debtors and the IMF a condition for rescheduling. The Fund entered into agreements with a very large number of countries with the result that the funds drawn reached record levels as did the funds committed under future years of the existing programmes. A more detailed analysis of the role of the IMF and the World Bank in the current debt crisis is dealt with in Chapter V. Although the international community generally applauds the IMF's singular efforts, a number of cogent criticisms have been voiced. In any individual case, a debtor country's restrictive policies may work to adjust balance of payments troubles by reducing imports, but a simultaneous application of this policy to a number of countries would result in a reduction of world demand and world growth. As we know, the trade balances of many of the debtor countries have swung sharply into surplus, but not as a result of successful export promotion. Rather, these countries have contracted their imports in response partially to the cutback in commercial lending after 1982 and partially due to the severe austerity measures imposed on them by the IMF. Reviewing history, one remembers that Germany succeeded in generating trade surpluses in 1929 to pay for its post world war I preparations, even at a time when its economy was on the verge of collapse. The trade surplus signaled depression rather than recovery in Germany.

Thus, in our study regarding the issues relating to the debt problem of developing countries, our main aim is to concentrate on the faulty economic policies of the developed countries, particularly the U.S., as major contributors to the development of the present debt crisis. A higher U.S. interest rate, in a regime of floating interest rates, increased the burden of debt repayment. An overvalued dollar, in terms of which a major portion of the present debt is denominated, increased the real burden further. In a situation of global drift towards protectionism and falling commodity prices, our aim is to find a relatively feasible solution. Servicing debt through economic cooperation is just one proposal, with certain inherent limitations of its own. But viewing from the fact that numerous solutions have already been proposed without any substantial success, the proposal of a solution through economic cooperation among major debtor developing countries may be accepted as a better policy alternative.

Prabhat Patnaik, "The current conjuncture in the world capitalist crisis," Social Scientist, 1987, pp.53

CHAPTER-II

THE DOLLAR, U.S. INTEREST RATES, AND THE THIRD WORLD DEBT

The key role of the dollar in the international economic sphere stems from the preeminent position of the U.S. in the world economy and its virtual hegemony over the western industrialised countries. The dollar's important role in the global network of relationships is clear from its various functions in the world economy. The dollar is a transaction currency; the bulk of world trade in goods and services is invoiced in dollars and the dollar is often used as a 'vehicle' currency in the foreign exchange markets. It is also a reserve currency, held by the central banks of the world. Thirdly, it serves as a key currency; numerous countries have tied the parity of their currencies to the dollar. Finally, it is the premier currency for borrowing and lending in the international financial markets, even if the share of Euro-currency transactions in non-dollar currencies has risen to around 50 percent recently on account of the weakness of the dollar.

To what extent can one blame the U.S. for the present Third World debt crisis? Is it right to say that it all started with the foreign debt of the U.S.? Countries all over the world began to borrow a lot of money abroad when the Eurodollar market expanded. The Euro-dollar market expanded because the foreign debt of the U.S. expanded. And the foreign debt of the U.S. expanded because the U.S. has the privilege of being able to pay its debts in an international means of payment which it can print itself, and which is accepted by the international banking system.

How did the U.S. develop a foreign debt? The immediate post-war period was dominated by the idea that to fight international communism effectively, the western economies must be rebuilt at any cost. The rest of the world's shortage of dollars, the so called 'dollar gap' at that time appeared impossible to bridge and Washington's attempt to do so to secure markets for American products led to sundry programmes of grants and loans - the most important being the Marshall Plan. The Korean war, however, was the critical factor in transforming the U.S. postwar balance of payments from surplus to deficit.

After seven years of boom in the economy triggered by the Korean war, the recession seriously shook the confidence of many American capitalists. The formation of the European Economic Community (EEC) in 1958 - which made the European currencies convertible into the dollar-provided the means for entering the more profitable and expanding European market and for repatriating their profits, while the recession at home provided an added incentive. The result was that the period 1958-64 saw the greatest expansion in American foreign investment. The massive influx of dollars through private investment led to boom conditions in Europe while the U.S. was still responding to a recession at home with lower interest rates. The government introduced a few measures to control the outflow of capital in 1963-64, steps that primarily affected the foreign lending of U.S. banks. The controls had little consequence other than to move the

capital market in dollars from New York to Europe, primarily London.

The Vietnam war was indisputably a major factor in enlarging U.S. deficits. The pressure of enlarged government demand on the U.S. industrial capacity, alongwith lengthened delivery times of U.S. industries, increased prices, reducing the competitive edge of American goods. The availability of government contracts and the war induced boom in the home economy led to a loss of interest in export promotion and, finally, to a permanent loss of overseas markets. Placement of U.S. orders with foreign competitors coincided with growing competitiveness of Germany and Japan which subsequently led to the economic miracles in these countries. Politically the war was too unpopular to be financed through increased taxation, and the costs had to be met through deficits.

Why did, then, the expandingforeign debt of the U.S. result in an expanding world money market? The dollars the U.S. printed to cover its foreign debt went to the international banks which jointly represent the world money market. Hence the higher the foreign debt of the U.S., the more the world's money market was swamped with dollars. Countries all over the world had started borrowing money before the 1973 oil crisis. It is so because in the early seventies the World money market was flooded with dollars as a result of the rapidly raising foreign debt of the U.S. The Western banks offered these at very low interest rates, even

at negative rates, if we make allowance for inflation. It was at this stage that most governments recommended the private sector - both the national and multinational companies - to borrow money in this Eurodollar market. Not only was this foreign credit cheaper than the credit offered on the domestic market, but it also suited the orthodox monetary policies governments of both the Third and the First Worlds pursued in general.

It is, however, not all that justified to blame the U.S. alone. Some years after world war-II the U.S. indeed began to run a chronic deficit on its balance of payments, or, in other words, to run a foreign debt, thereby creating substantial dollar surpluses abroad. It was, however, not the fault of the U.S., but rather the fault of the foreign central banks. As the Americans may say that these banks were eager to accumulate dollars as international reserve: nobody forced them to take dollars. They could always bring them back to the U.S. and encash them into gold, or they could always buy American goods. But not doing so, they imposed the need of running this deficit on the U.S.

However, this explanation shifts the responsibility too easily on to the foreign governments and their central banks. By the middle to late fifties European central banks had already started worrying that the United States' gold supply was insufficiet to continue supporting the gold value of the dollar. But, as they had started to hold dollars as

reserves, they were caught in a dilemma: if they all tried to convert their dollars into gold, the value of their reserves would certainly have drastically fallen because the U.S. would then have been forced to change the dollar parity. So, they were stuck. They thought it was better to keep dollars as reserves than convert them into gold, which would have almost destroyed their value.

This meant the U.S. continued to run deficits and the central banks continued to accumulate dollars. Not wanting to buy more unwanted American goods, which was their other option, and eager to invest their locked up dollars, the solution they eventually hit upon was to lend them to private banks. But these banks themselves had to find outlets for them, so they looked for clients who needed long term credits; and the underdeveloped countries seemed to be the best bet.

There would have been another option had the financial authorities created an alternative international reserve asset. ~~During the sixties~~ ~~alternative to dollar reserves. If this had been created in time, the central banks could have replaced their dollar reserves with this new asset. The main opposition to sush a proposal of an alternative international reserve asset.~~ During the sixties there were discussions - the most important being the so called Triffin Plan - on whether the International Monetary Fund should create a new asset as an alternative to dollar reserves. If this had been created in time, the central banks could have replaced their dollar

reserves with this new asset. The main opposition to such a proposal of an alternative currency to dollar came from the U.S. The reasons were many: Firstly, the U.S. would have lost its exorbitant privilege to cover its balance - of payments deficits with its own dollars. Secondly, by holding on to the dollar the U.S. was able to continue spending huge amounts on defense. Although this is never openly said, the Americans, and most Europeans, too, saw the maintenance of the dollar as the reserve urrency as a way of financing their joint defense -- and it is true still today. Lastly, West European and Japanese exporters gained by keeping the dollar as the key currency of the system. Owing to the demand for dollars the American currency remained over valued against the European and Japanese currencies. The exporters in these countries were delighted because if the role of the dollar had been limited, it would certainly have lost in value, and the European and Japanese exporters would have faced increasing competition from American exporters. Any world-wide monetary reform without the Corporation of the U.S. was thus impossible, because, it is, after all, the richest country with the biggest capital market in the world.

The really big problem started at the end of 1978, when the American government of Jimmy Carter decided that it would no longer allow the dollar to decline which had fallen drastically against other hard currencies during 1977 and 1978. The result was a steep rise in the interest rates and the consequent world recession and the accentuation of the

Third World debt problem. Traditionally the U.S. actually has not owned a foreign currency reserve, its international reserves having been almost entirely composed of gold. After gold was demonetized in 1976, the U.S. was virtually left with no reserves to support Carter's goal of stabilizing the dollar. To keep the exchange rate stable, the monetary authorities need to engage in foreign exchange market intervention, for which adequate volume of foreign exchange reserve is necessary. What the U.S. tried to do for a long time, and is again now trying to do, is to manage the dollar without having an adequate volume of foreign reserves.

When the reserve problem came to the surface, the Administration admitted that to run the internaional monetary system the dollar was not enough; it had to be flanked by other currencies. The move towards shared responsibility for management of the world economy through a multi-currency system was accompanied by a policy of continuing detente with the Soviet Union that culminated on the signing of SALT-II in 1979. In retrospect, the Carter years stand out as the only instance when the U.S. tried with serious conviction to solve the problem of the American economy in a Cooperative spirit. He not only tried to convince the major surplus industrial countries to reflate their economies, but even offered West Germany and Japan the possibility of sharing the privilege of issuing international means of payments, in compensation. Presidential victory of Reagan in 1980 and the second oil shock in 1979 shattered the hope for such a framework.

The Kemp-Ruth tax-cut proposal that Reagan had avidly

supported during his presidential campaign was implemented under the banner of 'Reaganomics'. Reducing taxes without cutting government expenditure in the hope that economic growth would generate the needed higher revenue - the so called laffer-curve - did not pay off. High interest rate differential in favour of the U.S. and the catastrophic financial crisis in 1982 in the Third World contributed to a powerful flow of funds into the U.S. in search of save heaven. It was not primarily the acquisition of equities or direct investments in view of the supposedly superior earning power of U.S. business, but simply interest rate-induced capital movements that financed the U.S. current account deficit. The continuous inflight of capital throughout 1980-85 period consequent upon real interest rate differential in favour of the U.S. and the scant attention to exchange rate risks made the dollar strong. The dollar exchange rate climbed from DM 1.73 in 1980 (July) to D.M. 3.47 in 1985 (Feb.). Low growth in Europe and Japan, combined with high growth at home consequent upon the U.S. recovery which started in mid-1982, magnified the balance of payments problems of the U.S., which sucked in imports from her competitors but was unable to sell on declining overseas markets. The restoration of dollar supermacy did not remove the deep causes of America's decline and probably even dealt a mortal blow to its economic hegemony.

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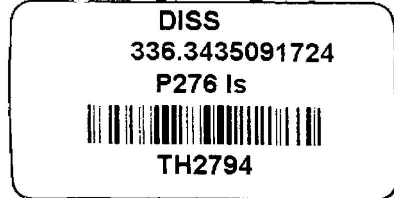
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Debt contracted must be serviced in the form of payments

on amortization and interest and these outflows compel the borrowers to forego some alternative investment and consumption throughout the life of the loan. Debt service is a contractually fixed charge on real income and savings, manifesting itself as a 'rigidity' in a developing nation's balance of payments. While LDCs' imprudence certainly contributed to the present debt crisis, externalities, largely unforeseen factors beyond the debtors', must share part of the blame. The persistence of high real interest rates above inflation, especially for loans denominated in U.S. dollars, along with a strong dollar, is the last in a series of external trends which have hamstrung LDC policy makers in their efforts to simultaneously finance national economic development and meet payments owing to external debt.

While all the non-oil exporting countries were severely affected by the rise in oil prices, the middle income countries, particularly those of the Western Hemisphere, were seriously hurt by the increase in interest rates, because of their significant dependence on borrowing from the international banking system. For the low income countries of Asia and Africa, on the other hand, the interest payments were generally less important as they relied to a greater extent in official sources of financing on concessionary terms. These countries were, however, seriously handicapped by the steep decline in the prices of commodities, which often constituted their only exports. What then led to the

decline in the prices of primary commodities?

A factor that has affected all commodities is the low growth in demand in industrial countries which historically have been the principal consumers of raw materials in the world. The main factor, however, contributing to the fall in prices of primary commodities has been the upsurge in their production in developing countries. In recent years good harvests of staple crops, the emergence of new surplus markets in Asia and distress selling by some debtor countries have all contributed to the collapse of agricultural export prices. The collapse of a number of commodity agreements, as those for tin, cocoa, coffee, rubber, etc. and the upsurge in trade barriers and the associated price support policies of industrial countries were the other factors that exerted a depressing influence in the internaional prices of traded commodities, Table-I depicts the falling prices of major primry commodities in the eighties,

The question now arises how the changes in the value of U.S. dollar affected these commodity prices. International price quotations in homogeneous product markets, especially primary commodities, tend to be in vehicle currencies (i.e. Dollar) while quotations in heterogeneous products tend to be in non-vehicle currencies. One reason for this is the huge market for primary products in the U.S. (previously U.K.) More generally, homogeneity and international comparability of each primary product means that the demand for effective

TABLE-I

Commodity Prices and Price Projections in 1985 Constant Dollars

Commodity	Unit	Actual							Short Run				Long Run		
		1970	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1995	2000
Energy															
Petroleum	$/bbl	3.6	29.1	32.6	29.9	27.9	27.7	26.7	11.9	13.7	15.2	15.1	14.9	17.4	23.5
Coal	$/mt	-	41.0	54.0	50.0	44.0	49.0	47.0	39.0	36.0	37.0	39.0	40.0	42.0	45.0
Food															
Coffee	$/kg	315	329	268	297	287	320	321	390	313	280	281	285	288	295
Cocoa	$/kg	185	249	198	167	210	241	225	185	180	171	167	165	172	182
Tea	$/kg	300	213	192	186	231	348	198	181	197	208	213	217	225	234
Sugar	$/mt	222	604	356	179	185	116	90	136	161	214	264	322	265	253
Beef	$/kg	357	264	235	230	242	229	215	195	197	224	234	246	255	263
Bananas	$/mt	453	362	382	361	425	373	389	359	356	354	352	349	335	321
Oranges	$/mt	460	373	385	371	370	355	398	337	337	348	357	354	338	334
Rice	$/mt	395	414	459	282	274	254	216	185	189	206	224	233	214	206
Wheat	$/mt	172	182	187	160	168	167	173	141	119	130	141	147	136	133
Palm Oil	$/mt	712	557	543	429	496	734	501	243	232	286	329	374	450	420
Coconut Oil	$/mt	1088	643	542	447	723	1163	590	248	236	294	336	428	500	482
Groundnut Oil	$/mt	1037	820	991	564	704	1024	905	518	498	508	540	579	600	530
Soybean Oil	$/mt	841	571	482	431	522	729	572	336	322	352	382	410	475	440
Non-Food															
Cotton	¢/kg	173	196	175	154	184	180	132	85	94	103	124	137	165	165
Jute	$/mt	751	294	262	275	299	535	583	243	258	288	314	331	300	300
Rubber	¢/kg	126	155	119	97	123	111	92	81	84	88	92	96	108	110
Tobacco	$/mt	2706	2197	2234	2322	2223	2004	1906	1681	1700	1740	1790	1850	1845	1744

Metals and Minerals

Copper	$/mt	3871	2084	1656	1426	1576	1387	1417	1268	1288	1349	1380	1416	1601	1601
TIn	¢/kg	984	1570	1337	1247	1291	1254	1192	518	421	509	628	711	743	735
Nickel	$/mt	7798	6226	5659	4660	[illegible]	[illegible]	4899	3575	3820	4038	4141	4220	4015	3715
Aluminum	$/mt	1480	1652	1272	1022	1480	1381	1110	1146	1180	1314	1364	1364	1506	1494
Lead	$/mt	833	865	691	526	421	446	391	345	352	364	368	380	411	382
Zinc	$/mt	808	727	804	718	757	929	783	611	618	661	695	711	795	794
Iron Ore	$/mt	41.6	25.5	23.1	25.0	23.8	23.4	22.7	19.5	18.7	18.4	17.9	17.5	15.9	14.2
Bauxite	$/mt	32.9	39.4	38.0	34.7	34.4	33.2	30.0	24.8	22.3	22.0	23.4	24.8	25.8	25.9

Source: World Bank, Price Prospects for Major Primary Commodities, Vol.1, Report no. 814/86.

communication of price quotations leads to world wide pricing in a common vehicle currency (i.e. dollar). With continuous changes in prices with the arrival of new information and through international arbitrage in primary commodities, it is more economical to transmit price change information in a single currency than through many. In contrast, the geographical span of the market (that is, the area of a uniform price) for each heterogeneous manufactured product usually corresponds to the national economy in which it orginates[2].

The fact that primary commodities are invoiced in dollar, a 78 percent appreciation of dollar till Feb-1985, increased the real prices of primary commodities, even though the nominal prices did not increase. The recessionary condition going on then in the developed countries - in the face of real higher price for such commodities - reduced the demand. It led to both nominal and real decline in primary commodity prices. As is revealed from the Chart-I, with the large appreciation of the U.S. dollar from 1980 through the first quarter of 1985, commodity prices denominated interms of the French franc and the Pound Sterling stood in the

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2. S.P. Magee & R.K.S.Rao, "Vehicle and Non-vehicle currencies in International Trade", American Economic Review, 1980 (May), p.369.

latter period some 86 percent and 65 percent, respectively, above their levels in 1980, while the overall U.S. dollar index declined by 21 percent.

A development that was widely expected to induce a strengthening in the dollar price of primary commodities, although in fact it did not, was the depreciation of the dollar during 1985. The fact that dollar has continuously depreciated since 1985 (Feb.) is no boon rather a curse for the LDCs. Nominal prices remaining same, the depreciation of the dollar reduce the real prices of commodities invoiced in dollar. But, because of the deteriorating international economic order, they are not able to increase the prices of their commodities. Depreciation of the dollar, thus, further deteriorates the terms of trade for the LDCs. Of course, as is evident from Chart-I, as a result of the depreciation of the dollar in the last three quarters of 1985, the differences between the commodity price indices denominated in various currencies had narrowed substantially or were reversed. While the overall dollar price index fell by 6 percent between the first and the fourth quarters of 1985, the reductions in terms of other major currencies ranged from 26 percent to 29 percent. But, the indices for the French france, the Pound Sterling and the Deutsche Mark were still considerably above the dollar price index in late 1985.

The question may now emerge why the U.S. recovery in 1983 and 1984 could not reverse the downward movement in commodity prices. Some NICs with increasing competitive

capacity to export manufactured products could have increased their export volumes to the U.S. because the apparent income elasticity of demand for the exports of the exporters of manufactures is generally quite high in relation to that for primary commodities. The main source of concern was however the growing tariff and non-tariff barriers in the U.S. (as elsewhere), particularly escalating with the degree of processing of the product. Of course, the geographical distribution of a country's exports is an important factor affecting the link between industrial Country's output growth and developing country's export volumes. On that basis, countries whose exports have traditionally been directed to the U.S. market had, not surprisingly, enjoyed a more buoyant export performance than developing countries in general.

The U.S. recovery and the American appetite for imports helped some Latin American debtor countries by absorbing their expanded exports. Virtually all the increase in exports from Latin America between the first quarter of 1983 and the first quarter of 1985 went to the U.S.[3] It is however Japan and West Germany which were benefiting from the strong dollar and the rapid growth of U.S. imports. That part of the U.S. growth which was spilling abroad was providing a major export demand stimulus to countries whose growth of domestic demand had levelled out, if not petered out, after the initial burst of consumer spending. The OECD Secretariat had estimated that, in 1983 and 1984, about one third of the growth in Europe was attributable, directly or indirectly, to

the growth of U.S. imports. Besides, while the recovery in 1983-84 was strong in terms of magnitude of increase, the level of economic activity was still considerably below its potential. This reflects the extremely weak conditions from which the recovery began because of the severity of the 1981-82 recession. Even though the strong dollar reduced inflation in the U.S., the recovery began because of the severity of the 1981-82 recession. Even though the strong dollar reduced inflation in the U.S., the recovery was not strong. Rather to prevent the pressure of real depreciation from initiating a new round of domestic inflation, the governments of Europe and Japan were forced to pursue tighter monetary and fiscal policies than they otherwise would have chosen. These tighter monetary and fiscal policies engulfed the entire Europe in a recessionary condition and contributed to the continually rising rate of unemployment that now plagues all of the major European nations.

All of Europe's current abnormality high unemployment certainly cannot be attributed to the U.S. fiscal situation. Between 1970-80, real earnings per hour actually declined in the U.S., but employment rose more than 25 percent. In Europe, during the same decade, real wages continued to rise at a substantial rate. The rigidity of the European labour markets exacerbated the problems caused by resulting excess real wage levels. Because the rigidities in the European labour markets reduce the sensitivity of inflation to increase in unemployment, it takes a substantial rise in

unemployment in Europe to offset the inflationary pressure that results from a rising dollar. It is not surprising that European political leaders have been frustrated and annoyed by an american budget policy that they see has contributed to America's strong economic expansion while impending their own.

How than a 'high U.S. interest rate accentuates the developing countries' debt problem is a major question to be answered. Interest rate changes have a direct impact on the transactions, inventory, and speculative demand for primary commodities.[4] The transactions demand for a commodity pertain to its use as a raw-material in the production processes of intermediate and finished goods in the consuming countries, or for other direct consumption purposes. An increase in the costs of inputs, resulting, for instance, from an increase in the real interest rate raises the cost of production of the finished product (interest being a cost element). The consequent decrease in quantity produced reduced the derived demand for all inputs used in the production process including primary commodity inputs (unless the producer can fully pass on the higher cost to the consumer).

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3. C.A.B. Bindert, "World Debt: The United States Reconsiders", Foreign Affairs (1986), p.264.

4. Padma Gotur, "Interest Rates and the Developing World", Finance and Development (1983).

The inventory demand stems from the role of raw-material stocks as a buffer against uncertainties about their supply or fluctuations in sales of intermediate and finished products. Higher real interest rates reduce inventory demand by raising the opportunity cost of holding inventories. The speculative demand for commodities arises from the expectations of capital gains or losses from changes in the market value of the commodity net of holding costs. Since the difference between the nominal interest rate and the expected rate of increase in the price of the commodity gives the expected real cost of holding the commodity, an increase in interest rate reduces the speculative as well as the inventory demand for the commodity. Although the increasing importance of manufactured exports has partially mitigated the reduced community export earnings for some middle income countries, the primary sector continues to play a major role in the determination of GNP and generation of foreign exchange resources in many developing countries, particularly in those with low per-capita incomes, and the high dollar and high interest rate induced deterioration in their commodity prices had substantial deleterious effects on their economies.

Although nominal interest rates have declined from their peak in 1980-81, they remain about six percent higher than inflation, making the cost of servicing debt extremely high in real terms. The high proportion of debt denominated in dollars is the main reason of such a high cost impact of high

U.S. interest rate on the debtor countries. As is revealed from Table-II, the share of long-term public and publicly guaranteed debt denominated in dollar rose from 65 percent in 1974 to 76 percent in 1983. Again there were regional differences; in 1983 the ratio was almost 50 percent for Latin America, 68 percent for East Asia, and only 54 percent for sub-Saharan Africa. For many countries, not only the high interest rate, but also the rise in the dollar increased the cost, in terms of domestic goods, of servicing the debt.

Another recent development is that the proportion of commercial bank lending to total debt non-oil developing countries has increased substantially. Such lending is typically linked to a variable interest rate base such as the LIBOR modified for an allowance to compensate for bank exposure and country credit worthiness. The spreads of margins on new funds fluctuate greatly from time to time and from borrower to borrower. As Table-III exhibits, the share of floating rate debt in total outstanding disbursed public debt rose from 16 percent in 1974 to 43 percent in 1983. The increase was concentrated mainly among the middle-income countries, particularly in Latin America, which borrowed heavily from private sources. For low-income countries, however, the share of variable rate debt did not increase much. What is of importance here is that while fixed interest rates for LDC debtors averaged 5 percent until 1977 and rose to 7.9 percent at the end-year 1982, the floating interest rates to LDCs mushroomed from 7.8 percent to 17.5

TABLE – II

Shares of Key currencies in public long-term debt, 1974–83 (percentage)

Currency	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
U.S. Dollar.	65.1	69.0	70.3	67.8	64.8	66.8	68.1	71.8	73.4	76.3
D.Mark	8.8	7.3	7.6	8.2	9.2	8.6	7.3	6.3	6.0	4.8
Japanese Yen	3.8	3.8	4.1	5.4	7.2	5.9	6.9	6.2	6.0	6.0
French Franc	4.3	4.3	4.1	4.4	4.8	4.9	4.6	3.8	3.6	2.9
Pounds-Sterling	5.6	4.3	3.3	3.1	2.7	2.5	2.3	1.9	1.6	1.5
Swiss Franc	0.8	0.7	0.8	1.1	1.6	1.5	1.3	1.4	1.3	1.0
Canadian Dollars	1.5	1.5	1.5	1.3	1.1	1.1	1.1	1.1	1.0	0.9
Others	10.1	8.9	8.4	8.6	8.7	8.8	8.4	7.6	7.2	6.5
Total	100	100	100	100	100	100	100	100	100	100

Source : World Bank, World Development Report, 1985.

Table-III

Floating interest-rate loans as a percentage of public debt in selected years, 1977-83.

Country/Group	1974	1976	1978	1979	1980	1981	1982	1983
Low Income Asia	0.0	0.0	0.4	0.6	1.8	2.8	3.7	3.9
Low Income Africa	8.5	8.1	6.7	6.8	7.0	9.4	9.1	7.6
Middle income countries								
Oil importers	18.5	26.6	30.3	35.2	36.5	40.2	41.4	43.7
Oil Exporters	23.9	30.4	34.9	40.1	41.7	45.2	48.3	54.6
All Developing countries	16.2	23.0	27.3	31.8	33.2	36.7	38.7	42.7
Major Borrowers	18.4	26.8	32.5	39.0	40.5	45.0	46.7	51.2

Source: World Bank, World Development Report, 1985.

percent. To fully appreciate the significance of these trends it is necessary to view these figures in relation to changing rates of inflation. If inflation rates are higher than interest rates over the course of a loan, then the net interest rate is negative and there is real transfer of resources from the creditor to the borrower. With fixed interest rates, then, unanticipated inflation results in a debt bargain for the debtor. In contrast, variable interest rates contain a safeguard against the deterioration of the loan value due to inflation because, overtime interest rates which serve as the basis of LIBOR tend to adjust to inflation rates. However, this automatic adjustment can be delayed, as when dominent financial powers, such as the U.S. institute fiscal and monetary policies that curtail inflation while allowing interest rates to remain high. Quite obviously, if inflation rates are lower than interest rates, a net transfer of resources from the debtor to creditor occurs as the 'real' rate of interest becomes positive. During the fixed rate period of the Seventies, since real interest rates averaged -2 percent, there was a real transfer of capital from creditors to borrowers. In contrary, the fact that the real interest rate has averaged +6 percent in the 1980s, the net resource flow has been reversed to the advantage of the lender and to the detriment of the debtor.

In this context we can also see from Table-IV that when international prices of developing country exports fall, as they did in most part of 1980s, the real cost of servicing

TABLE IV

Real Interest on the external debt of capital importing developing countries (percentage).

	1980	1981	1982	1983	1984
Average Nominal Interest Rate.	9,2	10,6	10,2	8,3	8,5
Average Change in export prices	29,5	−0,9	−8,3	−3,1	−1,5
Implicit average real interest rate	−20,3	11,5	18,5	11,4	10,0

Source: World Bank, World Development Report, 1985.

those countries' external debt rises above the nominal cost, reflecting the increased external debt rises above the nominal cost, reflecting the increased real value of the debt as measured in terms of the volume of exports necessary to repay the debt in full. The real interest rate on total debt outstanding in 1984 was not the nominal average rate of about 8.5 percent but about 10 percent.

Now that the intérest rate is declining and due to dollar depreciation the real value of debt is also low, is no permanent respite for the debtor countries. The high proportion of variable interest rate loans and the high U.S. interest rates compelled the LDCs to borrow more, at a still higher rate, to meet their interest repayments on standing loans and thus slid them into a vicious circle of debt repayment. In this context, the most serious indictment of the American fiscal stance was the way it deliberately diverted capital investment to America (where there would have been none, the incentives being absent) from the rest of the world, depriving particularly the LDCs from their much-needed demand for external capital.

The fact that the interest payments still depend upon the spread on the LIBOR rate, which varies with the appraisal of the general creditworthiness of a country, those countries which already have great difficulties in repayment, are precisely the ones that are highly penalised. High interest rates involving higher risks on commercial loans also has the tendency to reduce average maturities and grace periods,

since maturities and grace periods on loans from private creditors, the proportion of which to total loan is expending fast, are typically shorter than those from official sources.

There is no shortage of suggestions of international policy initiatives which might obviate this scenario. One broad class of suggestions entails instituting a cap on interest rates charged on floating rate debt, for example, capitalizing part of interest obligations when market rates rise above the ceiling. Banks have not favoured such proposals as they are seen to jeopardize bank earnings when interest rates - and thus the cost of their own funds rise. Such innovations might serve to discourage new voluntary bank lending when there is instead a desire to see it expand in better terms.

CHAPTER - III

THE GLOBAL DRIFT TOWARDS PROTECTIONISM: A MAJOR THREAT FOR DEBTORS

In the past several years, increased attention has been given to maintaining a liberal world trading system mainly because of the wide recognition that the multiple trading system is seriously endangered, protectionist pressure have multiplied, disregard for GATT disciplines have increased, and shortcomings in the functioning of the GATT system have been accentuated. A favourable trade environment remains critical for the growth of the world economy and the smooth unravelling of the present debt crisis. But the multilateral trading system itself is under serious stress, and the many national and international proclamations of intention to strengthen the system have not produced any significant result. What is particularly worrisome is the growing conviction in some quarters that some form of managed trade is preferable to an open trading system.

Although nominal tariff rates heve been reduced substantially under successive GATT rounds to an average of 5 percent for imports of manufactured products (excluding oil) into OECD countries, the reductions have not been as significant on products of interest to thè developing countries. After the Tokyo Round, tariffs on clothing imports averaged about 19 percént, those on footwear and

travel goods 13.5 percent, and on textile fabrics about 12.5 percent. The structure of tariffs on industrial countries creates an additional problem in the form of 'tariff escalation' with the degree of processing of the product.

Of particular concern about the drift toward protectionism is the frequent recourse to bilateral, sector-specific trade measures that harm the multilateral trading system based on the GATT and are counter to the principle of comparative advantage, which forms the basis for efficient trade expansion. On one sector after another (for example, in textiles, steel, automobiles and some electronics), the larger trading partners have carved up the market among themselves, often leaving only a token residual to non-traditional suppliers. Such market sharing arrangements not only prevent marginal producers from increasing their market share but effectively lock out potential new suppliers from the market.

Instruments of New Protectionism are the non-tariff barriers (NTBs), such as the 'Multi-Fibver Arrangement' (MFA), bilateral import quotas, import licensing, 'Orderly Market Arrangements (OMAs), 'Voluntary export restraint' arrangements (VERs), anti-dumping laws, countervailing duties, decreed pricing systems, and the granting of subsidies to domestic producers. Some of these measures originally viewed as temporary are becoming more permanent. For example, restrictions on trade in textiles, embodied in

the MFA, strated off as temporary. The MFA has now evolved into a more or less permanent fixture of the international scene regulating almost nine-tenths of total trade on textiles and leaving practically no room for the growth of developing country exports to the developed market economies.

Bilateral protectionism is a serious obstacle to meaningful trade liberalization, because it lacks transperency and creates vested interests among exporters and importers for the preservation of the status quo. At the microeconomic level, bilateral market sharing arrangements are perceived to have many attractive features. For the domestic producer of the import-competing product, a bilateral restriction shelters the producers' market from the more efficient foreign producer and may help to maintain sales and profit margins. For the exporter, a VER arrangement - frequently specified in terms of quantity - provides an assured sales outlet and, depending on the relevant elasticities, may enable the exporter to capture the rents arising from the ability to raise the export price to the extent of the difference between the international price and the higher domestic price on the importing country. Liberalisation of such restrictions may be resisted both in exporting and importing countries, because they can be rationalized as offering greater 'security' on international trade flows than would an unrestricted trade regime. Cartelization of international trade may thus be encouraged. what is frustrating is that while the majority of such

arrangements are among developed market economies, almost a quarter of them concern exports from developing countries.

The incidence of non-tariff measures applied by developed countries in high in sectors where developing countries have an actual or potential comparative advantage. Clear examples, as are revealed from Table-V, are in the textiles and clothing (representing around 25 percent of developing countries total manufactured exports), leather and footwear, and more recently in the iron and steel sectors.

Although the economic recession in the late 1970s contributed towards the shaking up of the multilateral world trading system, the renaissance of foreign trade protectionism is due primarily to unsolved structural problems in the economically advanced countries. The catching up and growth phase of the post-war period - which lasted for approximately 30 years, had concealed structural problems, the solution of which - by means of overdue structural change - is becoming all the more urgent, yet at the same time increasingly difficult, both socially and politically, in the face of the unconvincing performances of the developed market economies.

Indeed, the persistence of high unemployment in many industrial countries made it more difficult to resist protectionist pressures and weakned the impulse for trade liberalization, especially in employment sensitive sectors. The developed countries wish to preserve those traditional

industries which are basically labour-intensive and in which the developing countries have some cost advantage. The exports of these commodities from developing countries, therefore, are often regarded as threatening the job opportunites in the developed market economies and, therefore, provoke protectionist measures by these countries. On the other hand, the developing countries are to a considerable extent precluded from participation in the dynamic sectors of world trade in manufactures because comparative advantage on such lines of production weighs heavily against them in terms of investment in capital, technology, commercial infrastructure, marketing and managerial skills. These countries are also quite unable to pose a realistic retaliatory threat, because of the relatively small size of their markets and their reliance on capital goods imports.

The current problems of international trade clearly poses a serious dent on the developing debtor countries. Consider the long-term structural changes in the world economy. These changes result from shifts that have been taking place in the structure of production and demand and thus have major implications for trade and development policies at both the national and international levels. As Table-VI shows, the share of agricultural commodities in world trade has been halved since 1960, while that of manufacturers has increased by one quarter. The increase in the proportion of trade in minerals is entirely due to the

TABLE - V

Import coverage ratios as a subgroup of NTBs applied by selected industrial market economies (1981 & 1986).

Product Coverage	World		Industrial Countries		Developing Countries	
	1981	1986	1981	1986	1981	1986
Ore and Metals	12.7	24.7	13.1	29.4	8.6	12.8
Iron & Steel	29.0	64.2	26.8	65.2	24.8	54.6
Nonferrous metals	3.8	6.4	1.9	6.0	6.1	6.4
Chemicals	13.2	12.7	13.8	12.9	11.4	12.6
Manufactures (not chemicals)	18.6	20.5	15.4	17.8	31.3	31.0
Leather	8.2	13.9	5.5	17.9	9.9	9.9
Textile Yarn & Fabrics	37.3	39.6	18.6	21.2	57.6	61.4
Clothing	67.3	67.4	40.2	38.9	77.1	77.9
Footwear	71.3	32.5	65.1	24.1	71.0	27.0

The import coverage ratios (the sum of the value of a country's import groups affected by NTBs divided by the total value of its imports of these groups) have been compared using 1981 import trade heights.

Source: World Bank. World Development Report, 1987.

increase in oil prices during the 1970s, which also accounts for the fall in the share of manufactures between 1970 and 1980.

Since the long-term shift in the structure of production is away from primary production to manufactures, the growth of trade is becoming increasingly a matter of the growth of trade in manufactures. The shift from primary products to manufactures is also clearly marked in exports of developing countries. The share of manufactures in their total exports increased from about 18 percent in 1980 to 33 percent in 1984 and 40 percent in 1986.

Since the 1960s trade in manufactures has expanded much faster than trade in agricultural products and minerals, but the rate of growth has dropped in recent years. During the period 1984-85, exports of manufactures grew at 4.8 percent, compared with 7 percent during the 1970s and over 10 percent in the 1960s. Developing countries, however, account for the bulk of the increase in manufactured exports during the period 1980-85, as seen in relative rates of growth from Table-VII. As a result, developing countries increased their share of the world exports of manufactures from about 7 percent in 1970 to 10 percent in 1980, and to about 12 percent in 1985. The share of the developed market economies declined from 85 percent in 1970 to about 80 percent in 1985.

While the exports of manufactures from the developing countries have increased faster than world export of

TABLE - VI

Commodity Composition of International Trade

Product Groups	Share in total Merchandise exports (percentage)				Annual rates of growth in export volume (Percentage)		
	1960	1970	1980	1985	1960-70	1970-80	1980
Agricultural Products	32	21	15	14	3.9	3.5	1.2
Minerals (including fuels)	17	17	29	23	7.2	1.7	-3.7
Manufacturing	51	62	56	63	10.5	7.1	4.8
Total	100	100	100	100	8.6	5.0	2.6

Source: UN World Economic Survey, 1987

TABLE - VII

Growth of manufacturing production and exports by Country Groups

	Manufacturing Production			Manufacturing Expor		
	World	Developed Market economies	Developing countries		Developed market economies	Devel count
1963-70	7.1	6.1	6.8	1965-70	13.4	17
1970-80	4.2	3.1	6.9	1970-80	18.7	23
1980-85	2.5	1.7	4.7	1980-85	0.4	6

Source: U.N., World Economic Survey, 1987.

manufactures, this trade has been highly concentrated in a few developing countries. Ten countries and territories accounted for almost about 80 percent of the total exports of manufactures from the developing countries in 1985. The degree of concentration has also increased. in 1973, the 10 accounted for 70 percent of the total. In particular, four major Asian newly industrializing countries - Hong Kong, the Republic of Korea, Taiwan and Singapore - managed to expand their exports very quickly. Thus, eventhough the developing countries as a whole have performed quite satisfactorily in the manufacturing export sector, it has been of no advantage to most of the major debtor countries.

For the large majority of developing countries, rather, their dependence on the primary products is decisive for their economic conditions. As Table-VIII shows, over 70 percent of the developing countries and territories depend on primary exports for around 65 percent of their export earnings. Thus, prices of primary commodities, especially in terms of prices of manufactures, remain critically important for those developing countries in which primary exports account for a high proportion of their total domestic production and their capacity to import.

The deterioration in the terms of trade for primary commodities of recent years has significant adverse effects on these countries. (Some primary producing developed countries have also suffered to some extent from depressed commodity prices) But on balance, the terms of trade gain to

TABLE - VIII

The Dependence of Developing countries and territories on primary exports.

Share of exports accounted for by primary products	No.of countries	Percentage
Over 75 percent	72	64.3
66 - 75 percent	9	8.0
56 - 65 percent	9	8 0
46 - 55 percent	6	5.4
Less than 45	16	14.3
	112	100

Source: U.N; World Economic Survey 1987.

the developed market economies has been very large. Apart from its indirect contribution to lowering the rate of inflation, the decline in the prices of imports, from the developing countries in 1986 alone meant, as reveals the world economic survey (1987), a gain of about $56 billion for the developed market economies as a whole. Their gains from higher export prices was an additional $38 billion. The total terms of trade gain of these economies for the year was thus of the order of $94 billion.

It must nevertheless be recognized that the sagging of prices of primary commodities in recent years reflects fundamental changes in the use of raw-materials in developed countries. There has been a continuing shift from production of goods to production of services. Similar shifts are taking place in many developing economies also. Services are less material-intensive than the production of goods.

The requirements of traditional raw-materials per unit of physical output has also been declining. For example, the average weights of cars made in U.S. declined from 1,700 kg in 1975 to 1,500 kg. in 1985, and their average iron and steel content declined from 81 percent to 69 percent. Technological innovation has led to substitution and saving of materials and created new products which require less materials for unit of output, as well as materials that are more accessible to industrial countries.

These two types of changes - shifts in the structure of

production and greater economy in the use of raw-materials in the production of goods, along with the global drift towards severe protectionism and weak recovery in developed market economics - have reduced the prices of primary commodities significantly. As economies move towards the post-industrial stage and output becomes less material intensive, the total volume of industrial raw-materials required will not grow unless there is significant increase in the absolute level of industrial production.

It is unrealistic to expect trade in raw materials in general to grow in the foreseeable future at anything like their rates during the 1950s and 1960s. This has grave implications for many developing countries which have not only accumulated a huge debt burden but also have only a narrow industrial base and depend on one or two commodities for the bulk of their export earnings.

Several studies have estimated the costs of protection by using fully integrated models of world trade. Klei and Su[5] (1979) studied the overall effects of 5,10 and 20 percent global tariff increase. The main results under the 5(20) percent increase scenario are: (a) world trade declines by $60 (213) billion; (b) real GNP in developed and developing countries is lower by $6 (22) billion and $2 (6) billion, respectively; and (c) trade balances of the developed and developing nations deteriorate by $45 (158) and &8(28) billion, respectively. Inflation rates and world trade prices rise under all scenarios.

[5,6,7; Shailendra J. Anjaria, Naheed Kirmani & Anne B. Peterse; "Trade Policy Issues and Developments", U.N. Publication, 1984.]

Brown and Whalley (1980)[6], in another study, found that world-wide abolition of all tariffs and non-tariff barriers raises world welfare (as measured by estimated changes in GNP) by $20 billion a year in constant 1973 dollars, of which $9 billion accrues to the developing nations and $8 billion to the Economic Community. Another study by Whalley (1984)[7] incorporates the trade policies of developing countries in estimating the welfare effects of trade liberalization. He finds that the abolition of all tariff and non-tariff barriers in all countries increases world welfare (by $33 billion in 1977 prices), but the welfare of developing countries declines by $31.4 billion. The major reason for this result is that liberalization leads to a decline in the terms of trade of the less developed and NIC groupings by 30 and 23 percent, respectively. This is explained by higher average rates of protection on the developing countries and the smaller size of the trade among developing countries as compared with trade among industrial countries.

Arguing in the same line some view that if all trade barriers will be liquidated, it would lead to gluts in the internationl market. As a result the developing countries would compete against each other thus scoring off gains and preventing the countries from achieving the same extraordinary export performances of the NICs. Such an

argument, however, does not consider the possible resultant global economic recovery from a massive liquidation of trade barriers. Present export pessimism with respect to slow growth of developed countries is mainly due to the perception of fixed links between developed countries' growth and imports from developing countries. In other words, income elasticities are assumed to be more important than price elasticities. Many NICs in the last decade shifted their export supply from pre-inclastic raw commodities to price-elastic manufactures and that is why fixed-income elasticities did not hinder much their export promotion strategies.

There is not likely to be a reversal of the development towards more and more bilateral and selectively regulated areas of world trade in the near future. The present economic situation is not favourable. With stagnating or only slowly growing world trade, the battle for market shares is intensifying. Every trade partner insists on his particular interests and shows little undersanding for the interests of others as a whole. Because of the high degree of industrial dependence, the scale of the subsidy race among the Western industrialised countries leads to an intervention merry-go-round, because one country's domestic market is another country's export market. With such a pattern of action, further trade conflicts between the industrialised countries are inevitable. A trade war between two interventionist governments will leave both countries worse

off than if hands-off approach were adopted by both.

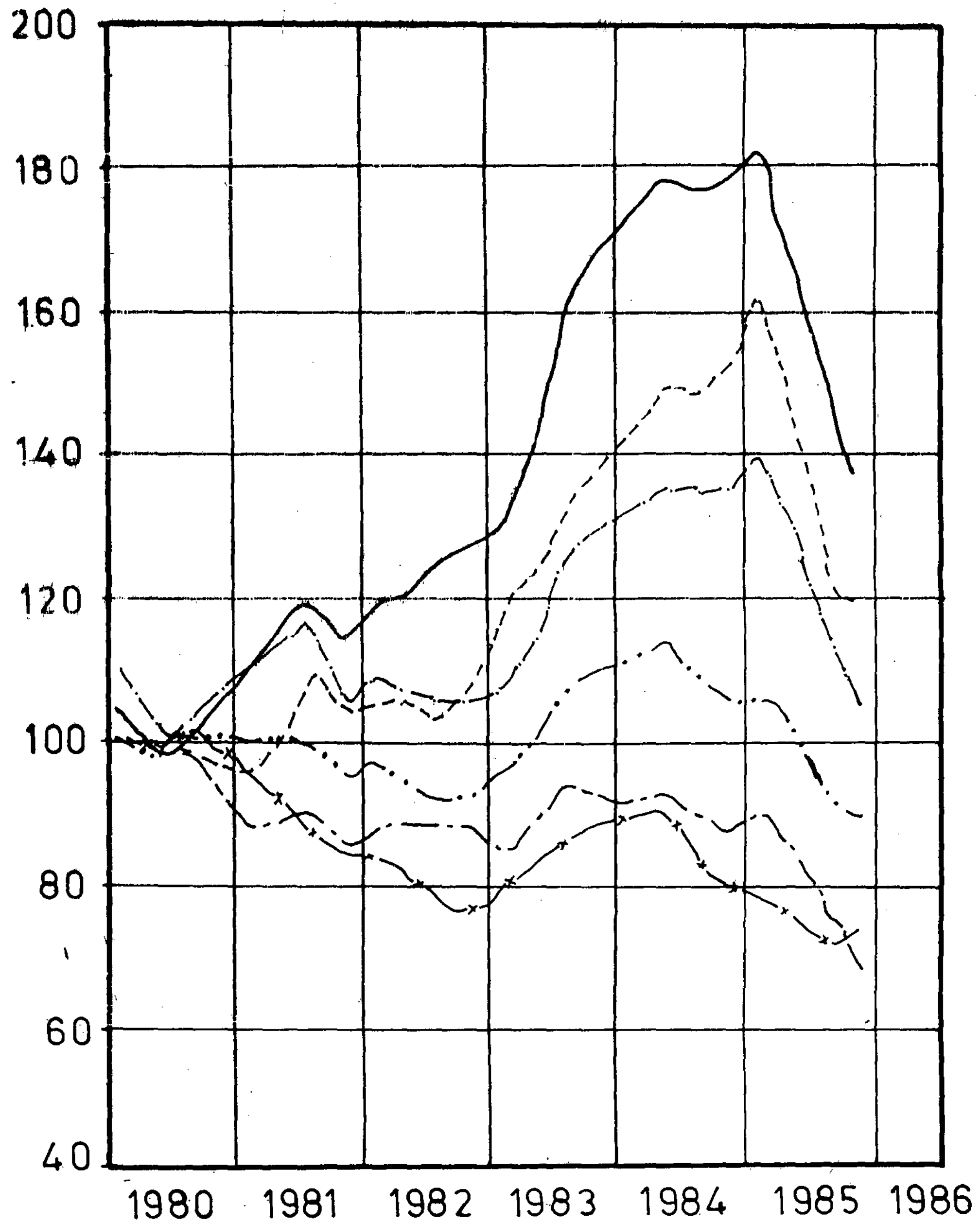
The aim of maintaining domestic employment by the industrial countries, however, pays no attention to the unintended effects of the protection on other industries. If the protected industry is a source of inputs to other industries, then tariffs or other controls on imports will raise costs and reduce employment in the industries which use the protected materials. Their job losses may exceed those temporarily saved in the protected industries. Moreover, if the exchange rate is flexible, an increase in protection which reduces expenditure on imports will, if nothing else changes, cause the exchange rate to appreciate. This will reduce profits in both exporting and import-substituting industries, which would cause employment to fall in all tradable goods industries apart from those due to increased input costs from increased protection. If, in addition, trading partners react through retaliation, the protection to save jobs would be not only self-defeating but potentially disastrous. Protectionism, thus, feeds on itself. By permitting more sluggishness, it is likely to impair the growth of productivity and output. Less growth, in turn, raises the demand for further protection. Thus, if structural adjustment difficulties have been a significant cause of the inadequate current performance of the advanced economies, accepting the view that only a more rigorous growth of their economies will make it possible for them to return to freer trade, the industrial countries might be

.ocking themselves ino a vicious circle.

The perceived failure of major trading nations to resist the dråft toward protectionism has weakened efforts to mobilise domestic support for a more open and rational trading system in developing countries. At the same time, the maintenance of the visibly high trade restrictions in developing countries complicates the argument for trade liberalization in their favour. The progressive fragmentation of trading regime poses a particularly serious threat for developing countries which, in the absence of retaliatory power, rely on multilateral character of the system to guarantee their trade interests. The developing countries themselves have found it increasingly necessary to resort to some form of bilateral arrangement. That is, they have increasingly required countertrade packages under which foreign suppliers of imports receive payment in export goods which is then their responsibility to market while arguably better than no trade at all, such barter arrangements do introduce an additional element of inefficiency and rigidity and contribute to the overall fragmentation of the system. Thus, protectionism in industrial and developing countries tends to feed on itself and compounds the difficulties of forging an international concensus on mutually beneficial trade liberalization.

CHART-I

Comodity Price Indices in Terms of SDRs and Five Major Currencies



— French Franc
--- Pound Sterling
-·- D.Mark
-..- S.D.R.
-·- Japanese Yen
-x- U S Dollar

SOURCE: I.M.F. WORLD ECONOMIC OUTLOOK, 1986, Pp - 141

CHAPTER IV

DEBT SERVICING THROUGH ECONOMIC COOPERATION

From the earlier stages of the debt crisis, there have been two opposing view about the appropriate response of creditors and creditor governments. One - the view that has prevailed so far - holds that the crisis is a temporary one and should be met by adhoc financing arrangements designed to buy time until the situation improves. For the proponents of temporary financing the problem is one of liquidity and not of solvency. In other words, debtor countries may be short of cash now, but they will eventually be able to service their debt, once recovery in the industrial countries, declining interest rates, and the increasing effectiveness of new incentives for export and import substitution take hold.

The proponents of the second view agree that the issue is factual, but disagree about the facts: the OECD recovery will not be sustained enough, real interest rates will remain high, developing country exports will encounter increased protectionist obstacles. The second belief appears to be more real and consistent with the present international economic order and the only thing that makes sense here is to restructure comprehensively and perhaps heavily write down external claims on these countries.

World Bank president Barber Conable has, however, opposed forgiving developing countries' debt because the proposal, if adopted, would lead to a cut off in lending to the heavily indebted countries. As he said "I think (debt) forgiveness will simply create an environment in which no

more money will go into development and a lot of the world will be consigned to poverty and to instability indefinitely."[8]

The dominant view, therefore, has been that while obligations on amortization and interest can be postponed the debt must eventually be paid in full. Rescheduling of the principal and capitalization of interest are often considered as important methods to postpone debt obligations.

The mounting debt burden and consequent large arrears have led some highly indebted countries to default. For example, Peru unilaterally has imposed a debt servicing ceiling equal to a maximum of 10 percent of its export income. Peru's creditors have been forced to roll-ever and capitalise that part of interest and principal due but unpaid. In effect Peru has tied its debt repayment to its ability to pay. Similarly, Brazil has announced that interest payments on debt will be reduced to 2.5 percent of GDP from the 3.0 percent level - accepting the economic indicator's criterion towards debt servicing. The external assets of debtor countries may be seized in case of default, but in the present world they stand as a small fraction of outstanding external debts. The decision to default is, of course, not a wise attempt on the part of debtor countries. While the

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8. Economic Times, Apr-13, 1987.

benefit to the defaulter is the present value of future interest and amortization, which he no longer would be required to repay; the costs include attachment of those assets that are recoverable, exclusion from borrowing in the future, disruption of international trade relations, and, the most important, loss of foreign political goodwill and reputation.

Thus, the expected costs of defaults are enough to induce countries to service their debt, if it is not too large. But the costs of default, in comparison to the volume of debt, do not appear to be so large that default will never happen. In this context, there exists a strong incentive for debtors and creditors to work out a programme of temporary financial relief - rescheduling of debt service or involuntary lending - which prevents a loss of lender confidence from provoking an immediate default.

Rescheduling is, of course, something like throwing good money after bad. However, lending to a problem debtor is always worthwhile as long as the new lending is less than debt service. If this is true, creditors are getting something from their client, more than they would get in the event of a default.

Rescheduling, however, postpones the day of rockoning to the future for the borrowers. It does not necessarily enhance the liquidity and solvency position so as not to default in the future. Hence what is more essential here is the output

growth of the debtor countries which - not only can enhance their capacity to repay but also ease the depressionary conditions in the developed creditor nations. The 48 percent decline in the U.S. exports to the five major Latin American borrowers over 1981-83 was a major factor in the deterioration of the U.S. trade balance over that period. As viewed by Henry Kissinger:

"The United States needs growth in Latin America too, because recessions in developing countries reduce America's export potential. So philosophically, I would like to change the debate from how much interest on debt we can extract in each year to how much these countries can grow."[9]

The new initiatives like the Baker Plan do recognize the fact that unless growth revived in debtor countries, the capacity to service debt would be seriously limited. It is in such an unfavourable international economic order that a policy decision which encompasses both rescheduling measures to avoid risk of default and certain other measures which can enhance the growth of LDCs is required. The sensible way of dealing with a solvency problem, rather than a liquidity problem, is for lenders and borrowers to share the losses so that both would be better off. The following treatment attempts to find such a method.

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9. Economic Times, April 4, 1987.

The proposal of debt servicing through economic Cooperation starts with the idea that the developing countries faced with balance of payments difficulties will not be required to make amortization and interest payments in full to creditor developed countries. Only a fraction of their export earning is to be paid in hard currency and the rest of the debt burden be serviced in their local currencies to some sort of regional development banks (RDBs) which would be considered as a loan by the creditor countries to the RDBs. (This will be acceptable to the creditor countries as partial repayment is better than no repayment in the face of large scale default risk.) The payments liabilities of the debtor developing countries are thus transferred to a RDB such as African Development Bank or Asian Development Bank. In other words, the RDBs would be indebted to the creditor countries to the extent of the amount of repayments transferred. The working fund of these institutions, in that case, would comprise the currencies of the member countries. The RDBs will now utilize these currencies for promoting trade expansion and economic integration among the major countries. To this end, loans given by the RDBs should be used for making purchases in the respective countries in exchange for the original debtor country's currencies. Such purchases would have to be made in such a way that these transactions would not result in Switch operations.

Thus the proposal envisages that the creditor developed countries, instead of asking the debtor developing countries to discharge their repayment commitments through achieving an export surplus with themselves, should allow these countries to do so through additional exports to other developing countries over and above the level of exports which could take place in normal circumstances. This implies that the developing countries which receive these exports would increase their debt liabilities to the creditor developed countries to some extent as the debt liabilities of the developing countries which export these goods are reduced. As far as the creditor developed countries are concerned, this proposal would mean that the repayments due to them from one debtor developing country or countries are re-lent almost simultaneously to another developing country or countries. This process can continue until all the developing countries have built up their competitive industrial structure sufficiently to enable them as a group to raise their exports to the developed creditor countries so as to discharge their debt obligations to them.

But any developing country taking loan in soft currency and fepaying in hard seems unrealistie. Hence a more realistie approach, as was presented by V.C. Shah,[10] is that developing

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10. V.C. Shah, 'Linking Debt Servicing with Economic Corporation', IEJ-1968. p.196

countries receiving local currencies would from the view point of equity be required to repay the loans in their own currencies. This implies that the original debtor developing countries would continue to bear their obligations regarding amortization and interest payments to the creditor developed countries. The repayment obligations of the original debtor developing countries would, however, be discharged after a period of 15-20 years, when they would have achieved a viable balance of payments position.

The basic assumption underlying this scheme is that individual developing countries are at different stages of development or are growing at disparate rates, though all of them are grouped under one common category of 'developing countries'. This implies that the output patterns and consequently the export composition of these countries differ with different degrees of comparative advantages or disadvantages and skill formation. Some of the more industrialsed countries among the developing countries should be enabled to export certain items of their manufactured output to those further down the scale of development against their repayment liabilities. There are, in fact, many industrially advanced countries among developing countries like Argentina, Brazil, Mexico, South Africa, Israel, India, Taiwan, etc. who have the ability to supply captial and intermediate goods provided necessary outlets are opened.

So far as the existing debtor developing countries are concerned, the proposal may have two major implications.

Firstly, given the level of export earnings, a developing country would benefit by the availability of an increased amount of free foreign exchange. The increased amount of foreign exchange would in turn enable a developing country to acquire a greater degree of freedom in its import policy.
The second implication is that a debtor developing country will have to generate additional exportable surplus equivalent to the amount of its local currency which would be utilized by other developing countries. Only then could a debtor country really secure the advantage of having a larger amount of free foreign exchange. In the absence of additional exportable surplus, increased export to other developing countries would take place at the cost of exports to developed countries. It would therefore be desirable to specify the condition that a developing country discharging its debt servicing obligations would take advantage of the scheme as long as it does not accumulate its currency with a RDB above a certain ceiling.

As regards the beneficiary developing countries are concerned the proposal would result in availability of additional amount of tied loan from other developing countries through RDBs. Since net loan from DCs is assumed to be unaffected by the scheme, developing countries will find that there is net addition to the amount of external resources available for financing development programmes.

In addition, debt servicing obligations arising from the

local currency loans will not impose severe strain on the balance of payments of the beneficiary developing countries, because amortization and interest payments by them would be in their own currencies. The extent to which local currency loans will be demanded by the developing countries would, however, depend on the scope for utilization of such aid.

The scheme also solves the problem of appropriate technology that the developing countries face because of heavy dependence on imports of capital and intermediate goods from the developed countries. The capital goods are produced and used in industrially advanced countries because of a certain degree of development of what Prebisch calls "technological density" defined as an accumulation and dispersal of skills and technical knowhow of all sorts among a wide category of population. These goods produced in such a technological and social milieu invariably call for a high proportion of capital per unit of labour. Thus, when such goods are transplanted to the countries which are bereft of technological density and which possess a surfeit of labour, they compel the adoption of techniques of production which are not in conformity with the prevailing resource endowments, leading thereby to uneconomic use of the scarce factors of production. These difficulties, however, will be largely eliminated if the capital goods produced in the more industrially advanced of the developing countries are exported to the industrially less advanced. Thus the flow of goods from the more to the less industrialised developing

countries may be rewarding from the point of view of efficient allocation of factor inputs as the differences in technological density among the developing countries are smaller.

This does not, however, imply that the developing countries should be prevented from using capital goods from the DCs. It only emphasizes the point that a more efficient allocation of resources consistent with factor endowment will be achieved if a smooth transmission of the most modern technology is effected by exporting it first to the industrially more advanced among the developing countries, which in turn can export still less sophisticated technology to the industrially less advanced in the group and so on.

Another important point about the LDCs is that in their attempt for either export-promption or import-substitution industrialization they fail to reap the benefits from the size of the market and economics of scale. This is so because of the splitting up of industrialization process into numerous compartments stemming from the tendency of many of these countries to trade more with the industrial centres on the basis of old tradational patterns, rather than among themselves through refashioning the composition of their exports. The proposal of debt-servicing through economic Cooperation by providing an extensive market among the developing countries for the products of LDCs provides the opportunity to reap the benefits of large scale production, and, thereby, reducing the production costs, enhances the

international competitiveness of the LDCs.

So far as the creditor countries are concerned, to the extent that the repayment liabilities of the developing countries are set off against additional exports to other countries in the same group, exports of the developed countries may not gain directly as in the case of direct assistance. But this objection appears to be superficial. If the debtor developing countries are permitted to liquidate their repayment liabilities against additional exports to other developing countries, they would be in a position to use a part of their normal export earnings, which would have been otherwise directed towards meeting repayment obligations, for financing imports of more sophisticated variety from the developed countries. Increasing exports of the creditor DCs can somehow be guaranteed, as according to Khat Khate,[11] by providing in the agreements between debtor and creditor countries that a proporation of the free foreign exchange resources would be used to buy goods from the creditor countries who have foregone their repayments.

One problem may arise from the side of foreign-aid administration. Since the debtor countries would be given a moratorium for 15 to 20 years, the gross volume of aid flowing from creditor countries to developing countries will decline. Such reduction in bilateral aid might weaken the

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11. Deena R. Khatkhate, "Debt Servicing as an Aid to promotion of Trade of Developing Countries", OEP-1966. p.230.

leverage which developed countries desire to exert on the developing countries for ensuring an effective utilization of aid. The technique of foreign aid administration should be such as to present repeated opportunities to the creditor to furnish technical assistance and policy advice to the LDCs. The shorter the terms for which loans are given, the larger the number of occasions on which LDCs will be compelled to renegotiate their credits. Each such renewal provides an opportunity for creditors to assess the performance of LDCs and stipulate new conditions regarding projects and policies. A virtual moratorium on debt service for, say, 15 to 20 years, envisaged under this proposal, implies a substantial relaxation in the control mechanism implicit in the existing pattern of foreign aid administration.

Whether the creditors will be prepared to relinquish control is doubtful. However, it is clear that the proposal contemplates essentially a delegation of responsibility to RDBs rather than dismantling of all controls. As according to Ravi Gulhati,[12] the expert staff of RDBs will continue, under the proposed arrangements, to play the role of consultants and advisers in identifying investment opportunities, in determining the engineering, financial, administrative, and economic features of specific projects, and in supervising the execution of loan financed schemes. Viewed in perspective, the proposal is not that creditors should retire

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12. Ravi Gulhati, " Servicing debt: A comment", IEJ-1968.

from the scene but rather that they should delegate a part of the administrative routine to RDBs.

Several other objections to this proposal may be well perceived. Firstly, the vexing problem of 'tied-aid' continues to be there. There is growing recognition among LDCs that the real value of 'tied-aid' from creditors is far below the nominal amounts of such transfers, and the most important, it denies them the opportunity of buying in the cheapest market. In this context the idea of getting additional dose of tied loans from each other may not arouse much enthusiasm among the LDCs. The problem, however, is particularly serious when the loans are tied not only geographically but also to commodities which can be purchased with such tied loans. Then the possibility of trade 'switching' by some LDCs at the expense of other LDCs can not be ruled out. For example, country-A may purchase commodity-x from country-B, financed by tied loan, and then sell-x in the developed world obtaining convertible foreign exchange. In this instance, country.B will gain little by the proposed arrangements. This objection, however, can be defended in a way that country-A will be required to compete with country-B in the markets of the developed countries, and that too after adding the cost of transport and storage to the export price. Thus there is no special incentive for country-A to indulge in such switching operations. It is as if country-A is not getting any free foreign exchange through her normal export trade.

Such impediments like trade switching in the way of expanding trade among developing economics can be removed, or at least minimised, through the intervention of RDBs. Their role will be to provide safeguards which reduce the diseconomics of tied loans and which provide effective controls on perverse 'switching' transactions of the kind described above. The only way to reduce the adverse side effects of tied loans is to introduce a measure of competition among LDCs for securing export orders from RDBs. The expert staff of the RDB will advertise lists of goods required for projects or programmes in a particular LDC and all other countries in the region will be eligible to bid for these orders. Through this process of regional competitive bidding, the RDB will protect the interest of the borrowing member and also generate a powerful incentive for improving the quality and efficiency of industrialization in the area. All LDCs will be obliged to make sure that their local currencies held by RDBs do not rise above a specified level. In the event that a particular country is unable to oblige export orders commensurate with the debt obligations it has transferred to the RDB, the latter will be empowered to impose an appropriate penalty (Payable in convertible foreign exchange) or take other disciplinary action.

The solution to the cumulative problem of debt repayment lies in promoting the export of manufacturers among the developing countries by enlarging the scale of operations to

take into account the possibilities of a wider market so as to avoid a splitting up of the industrialization process. For the LDCs, however, to be told that an enlargement of the size of the market would help them to become exporters of manufactures overlooks the additional import demand such a transformation of their internal economies would entail in them. To match the quality and price of the products of the developed countries the import content of industrialization, whether for import-substitution or export promotion, is very high for the LDCs. Hence any proposal for inter-LDC trade expansion does necessarily mean the enlargement of imports of LDCs from the creditor developed countries and thus widens the trade deficits of the debter LDCs further.

Table -IX gives us an idea about the past experience in some major integrated areas among the LDCs. The progress and achievements of integration in many of these cases must be judged to have been less than satisfactory. As is revealed from the Table- for the LDC groupings, intra-trade as a share of the total exports of the integrated area is very modest in the best case (ASEAN 23.1%, CACM 21.8%) and insignificant (less than 10%) in most cases. The value of intra-trade exceeded U.S. $ 1 billion in 1983 only in the cases of ALADI and ASEAN. Compared to the EC or the CMEA (council for Mutual Economic Assistance).

TABLE - IX

Intra-trade as a percentage of total Exports of the Area.*

	1960	1970	1976	1980	1983
ASEAN	21.7	14.9	13.9	17.8	23.1
ALADI	7.7	10.2	12.8	13.5	10.2
ANDEAN	0.7	2.3	4.2	3.5	4.3
ECOWAS	1.2	2.1	3.1	3.9	4.1
CACM	7.5	26.8	21.6	22.0	21.8
CARICOM	4.5	7.3	6.7	6.4	9.3
CEAD	2.0	9.1	6.7	6.9	11.6
UDEAC	1.6	3.4	3.9	4.1	2.0
CEPGL	0.0	0.2	0.1	0.2	0.2
MRU	0.0	0.1	0.2	0.1	0.1
EC	34.6	49.5	49.4	52.8	52.4
EFTA	15.7	21.8	12.8	12.1	11.4
CMEA	62.3	59.4	57.4	51.0	53.7

Source: UNCTAD, Hand Book of International Trade and Development Statistics (1985)

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intra-trade among the LDC groupings has evidently been less important, accounting in both the EC and the CMEA for more than half of total trade. It is clear from the Table that in the early periods of formation of the groupings, elimination of trade restrictions increased the volume of intra-trade - even more than external trade. For the ALADI the intra-trade of the group increased from 7.7% (1960) to 12.2% (1970), while for CACM it increased from 7.5% (1960) to 26.8% (1970). After this successful start the trade stimulating effect became weaker, with the exception of the ASEAN.

The important point here is that while intra-regional trade among developing countries in Asia has been growing, in case of countries belonging to the Western Hemisphere it is declining following the onset of the debt crisis. This is so because that heavily indebted countries have been compelled to shift their exports away from trading partners in regional payments arrangements toward convertible currency markets, inorder to earn the foreign exchange required to service debt.

What is then the possibility of further trade expansion among LDC groupings? Consider, for example, two such groupings: first, perhaps the most successful of all LDCs groupings, the ASEAN; and second, one that has emerged very recently, the SAARC. In each region there is one large country population wise-Indonesia and India. All the countries of the SAARC region belong to low percapita income group while those of the ASEAN region belong to middle per

capita income group (excepting Singapore). Decline in the share of agriculture in GDP in the ASEAN region has been much faster than that of similar share in the SAARC region. Interestingly, the shares of the service sectors have declined in the ASEAN countries (excepting Indonesia), whereas the same has increased in the SAARC countries (excepting SRI LANKA). ASEAN countries are relatively more export dependent than the SAARC countries (excepting Sri Lanka). In recent years the ASEAN countries are being increasingly adversely affected by the recessionary tendencies in the developed world while the SAARC countries being relatively less open, are able to either maintain or even improve their growth performance. In fact, it is due to this relatively greater resilience of the SAARC countries to the external shocks, the ASEAN countries have shown some special interest in having closer trade relations with the South Asian Countries.

As far as revealed comparative advantage of these two groupings is concerned, the SAARC Countries show a strong comparative advantage in crude materials, basic manufacturers and unclassified goods but a strong comparative dis-advantage in mineral fuels, Chemicals and machinery. The ASEAN pattern of comparative advantage seems to be no different from that of the SAARC. With similarities in the patterns of comparative advantage, avenues for trade cooperation could be found in the direction of intra-industry specialization and trade.

Integration implies therefore the disintegration of national structures which have subsequently to be amalgamated to form a new structure at regional level according to uniform criteria. This is the main reason why integration can only be looked upon as a long term process. In this context the scope of the proposal for debt servicing through economic cooperation is likely to be limited in view of the lack of diversity in the manufacturing sectors in the LDCs. The tied-borrowing from a LDC would, therefore, be confined to a fairly narrow range of products which may or may not suit her development requirements. For example, if U.S. assitance to Philippines were to be channelled through India, the former may find that India can offer her every kind of equipment. except that for setting up a tyre industry which she wants to set up. Or that while the Philippines wants insecticides and fertilizers for strengthening her rubber industry India can offer only steel; or when the Philippines wants generators of a given capacity India can offer only small or larger ones; and so on.

The problem here is the same as the one faced by India during the Second and Third Five year plans regarding imports of development goods from East European Countries like Hungery, Czechoslovakia, Poland and Yugoslavia against assistance and bilateral trade agreements. Each country had a certain industrial structure with particular emphasis on

certain industries, with different scarcity situations and with different levels of technologies. India had to use most of this assistance because she had a large number of projects and not enough foreign exchange to import equipment for all of them and she had to minimise the economic disadvantage by adjusting and switching its requirements between these countries. On this context, as viewed by Honavar,[13] "these difficulties would be much greater if developing countries like India were to be a source of imports because the extent of their industrialization is less than that of the East European countries referred to above, and because the importing countries may be smaller and even less sophisticated than India.

The above view appears too extreme. It is evident from the way developing countries have performed in the production and exports of manufactured products recently. The share of developing countries in the total world exports of manufacturers has increased from 4.3 percent in 1963 to 12.4 percent in 1985. No developing economy figured among the world's top thirty exporters of manufactured products in 1965. Twenty years later Hong Kong and Republic of Korea were among the top fifteen, with export shares close to those of Sweden and Switzerland. Singapore and Brazil were among the top twenty, with export shares close to those of Denmark and Finland. Table-X reveals the extent to which the manufacture

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13. R.M. Honavar, "A Comment" IEJ-1968

TABLE-X

Origin and Destination of manufactured exports of some major Developing Countries.

Origin	Manufactured exports (millions of dollars)		Destination (percentage of total) Industrial Market Economics.		Developing Economics.		Dept Service as percentage of exports of goods and services.	
	1965	1985	1965	1985	1965	1985	1970	1985
Mexico	165	7,129	71	90	29	9	44.3	48.2
Brazil	134	8,911	40	52	59	43	21.8	34.8
Argentina	84	1,423	45	45	54	50	21.6*	41.8*
Algeria	24	184	50	77	46	19	3.9	33.3
Chile	28	255	38	35	62	65	24.4	44.1
Costa Rica	18	320	6	41	94	59	19.9	39.8
Peru	5	236	51	72	49	27	40.0	16.8
Turkey	11	3,849	83	56	15	36	22.8	32.1
Singapore	338	13,317	9	52	88	42	0.6*	2.4*
Thailand	30	2,583	39	63	61	31	14.0	25.4
Philippines	43	2,534	93	77	7	21	22.8	19.5
Indonesia	27	2,365	25	50	73	46	-	25.1
Israel	281	5,212	67	71	31	29	6.8	28.6
Korea Rep.	104	27,669	68	68	32	26	20.4	21.5

* Only debt service on public debt.

Source: World Bank, World Development Report, 1987.

production of some major developing countries has expanded. The performance in case of major debtor countries like Mexico, Argentina, Brazil, Peru, Turkey, and South Korea is outstanding. But the need to earn hard currency to repay interest and amertization led many of these countries to divert a large share of their manufacture exports to the markets of developed countries. As is clear from Table- , the share of manufacture exports entering the markets of developed countries increased from 71% in 1965 to 90% in 1985 for Mexico, from 6% to 41% for Costa Rica, and from 51% to 72% for Paru. The table, however, speaks that there is substantial potential for trade expansion in manufactured products among the developing countries. Table-XI also reveals the way the manufactured exports from developing countries have become more sophisticated. The developing countries have diversified from traditional labour-intensive products (such as textiles, footwear) or those based on natural resources (such as crude petrochemicals, Cork, and paper) to Chemicals and engineering products. In this context, exports to other developing countries can rather be considered as the pre-requisite for successful sales efforts to industrial countries. As an example, in the case of the engineering industry of Taiwan the sales efforts of a series of important producers were first directed at the markets of South-East Asia before the attempt was made to enter the markets of the industrial countries.

The growth process of developing countries has run up

TABLE- XI

Structure of manufactured exports from developing countries, 1970-84

Description:	Share of developing Countries' exports.		Growth rate.
	1970	1984	1970-84
Traditional manufactured exports -(Labour intensive) Textiles and apparel	31.3	24.8	11.8
Footwear	1.8	2.9	18.2
Other labour-Intensive.	2.9	2.3	11.6
Total	36.0	30.0	12.4
- (Resource based) Wood and Cork.	3.6	1.5	6.9
Paper manufactures	0.8	1.1	17.6
Other resource-based	0.8	0.9	14.5
Total	5.2	3.5	12.2
Non-traditional Manufactured Exports.			
Electrical machinery.	16.1	16.7	14.1
Chemicals	8.3	9.9	15.3
Non-electrical machinery	4.2	8.7	20.1
Transport equipment	2.6	5.2	20.0
Iron and steel	6.2	6.5	14.2
Other non-traditional	21.4	19.5	12.9
Total.	58.8	66.5	15.1
G.Total.	100.0	100.0	100.0

Source: World Bank, World Development Report, 1987.

against a major obstacle - the acute shortage of foreign exchange. Mounting import requirements, lagging exports, and the rising burden of servicing the outstanding external debt are all symptoms of the some malaise. Some bold and imaginative initiative are now needed to rearrange internaitonal financial relations so that a fresh start may be made in the effort to promote development. The proposal of debt servicing through economic cooperation among the debtor countries is just a proposal to provide a partial solution to the grim international situation. As a final word, we find a major problem for regional economic Cooperation is that nearly every LDC has a separate currency, so that clearing agreements are required. Otherwise traders must do business in one or more DC currencies and are constrained by their relative scarcity. In this context some opine that not only the deposits of governmental and semigovernmental institutions of developing countries, but also a large participation of developing countries should increase in the banks of other developing countries, is needed in the purchase of financial instruments issued by other developing countries in the international capital market. The proposal of partial debt repayment in local currency and its relending to other developing countries for expansion of intra-LDC trade, may solve this problem in a better way.

CHAPTER V

THE I.M.F. AND THE WORLD BANK

WHAT ROLE IN THE DEBT CRISIS?

The role of international monetary organisations has undeniably assumed crucial importance in the aftermath of the global debt crisis of 1982. The IMF- World Bank nexus not only acted as a conduit for the flow of fiancial resources to the cash starved developing countries but also carved out adjustment programmes for the beleagured economies. However, the bitter dose of stabilisation programmes that was contingent on the availability and use of official as well as private funds was to be swallowed by those countries.

Regardless of the severity of the adjustment process, or its success or failure, the implementation of IMF sponsored policies has reshaped the economic and social relationships within national economies and between the national and World economy. As an integral part of Western capitalism the IMF has contributed towards restructuring. Third World economies, opening them to exports and flows of capital in periods of World expansion; extraction and transfer of surplus from the Third World to the West in times of debt crisis; and enforcement of economic obligations in times of declining income and World-wide economic contraction. The IMF does not act independently, nor does its symbolic representation as an international body signify that it is anything less than a political economic instrument for Western Capital. The IMF is a significant actor but its effectiveness is based on the economic interests it represents.

According to the first Articles of Agreement, one of the IMF's basic purposes was to facilitate the expansion of balanced growth in international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members. However, as the world changes the old functions of the international financial institutions may take on new roles and new functions may be desirable. With the onset of the debt crisis, the Funds functions have also changed substantially. In helping to manage the crisis it has contributed in three main ways; first, as a source of exceptional finance; second, as a catalyst for financing from other official and private sources; and, third, as an agent for the design and monitoring of adjustment programmes for the debtor countries.

Fund programmes are usually introduced when a country's economy is in severe imbalance - externally, with large current account deficits in the balance of payments, and internally, with high rates of inflation and deficits in the domestic budget. In order to correct these imbalances, IMF programmes use three types of policy. One is to restrain demand, through cuts in government spending, limits on credit creation, increases in taxation, and restraints on wages and public sector employment.

Another is to encourage the channeling of resources into tradable goods, through devaluation in the country's currency

and through price reforms. The Third is to implement such measures as financial reform and import liberalization intended to, raise the medium - and long-term efficiency of the economy.

The increasing importance of the IMF as a direct lender and catalyst for a growing proportion of the transfer of financial resources to the debtor countries of the Third World has led in recent years to an intensified debate about its policy of conditionality and the underlying concept of an adequate adjustment/financing mix for countries with balance of payments problems. The high conditonality loans of the IMF are composed of the upper credit tranches and the extended facility. The conditionality of the upper credit tranches takes the following form: The recipient and the IMF negotiate a stand-by agreement which consists of preconditions, performance criteria, and a letter of intent specifying a stabilisation programme. So far as the LDCs are concerned, because of their small quotas in the Fund and limited ability to mobilise other sources of crdit outside the Fund, they very soon exhaust unconditional credit and reach the stage of conditional financing. Table-XI reveals how IMF lending under the upper credit tranches has expanded significantly throughout the eighties, consequent upon the onset of the debt crisis.

There is growing agreement that given the structural conditions prevailing in developing countries and the kind of

TABLE - XI

Outstanding Fund Credit by Facility and Policy, 1980-87 (in million of SDRs)

	1980		1981		1982		1983		1984		1985		1986		1987	
	a	b	a	b	a	b	a	b	a	b	a	b	a	b	a	b
Regular Facilities.	1,606	20.0	2,349	24.6	3,206	21.7	4,721	20.0	5,197	16.4	5,511	16.4	6,315	18.2	6,579	20.8
Compensatory Financing Facility.	2,875	35.8	2,617	27.4	3,643	24.6	6,837	29.0	7,304	23.0	7,490	21.4	6,430	18.6	4,779	15.1
Buffer Stock Financing Facility.	74	0.9	-	-	-	-	907	1.3	375	1.2	237	0.7	73	0.2	34	0.1
Oil Facility.	2,494	31.0	1,581	16.6	565	3.8	27	0.1	-	-	-	-	-	-	-	-
Extended Fund Facility.	487	6.1	980	10.3	2,115	14.3	3,317	14.1	5,568	17.5	6,529	18.7	6,498	18.8	6,242	19.7
Supplementary Financing Facility.	502	6.2	2,018	21.1	4,112	27.8	6,039	25.6	6,920	21.8	6,310	18.0	5,276	15.2	3,769	11.9
Enlarged Access Policy	-	-	-	-	1,160	7.8	3,342	9.9	3,378	20.1	8,896	25.4	10047	29.0	10,247	32.4
T O T A L:	8,038	100	9,545	100	14,802	100	23,590	100	31,742	100	34,973	100	34640	100	31,646	100

a- Amount, b- As percentage of total

Source: IMF Annual Report- 1987

external imbalance to which they are subject, an adjustment strategy based solely on restrictive monetary and fiscal policies combined with exchange rate changes entails excessively high costs in the form of lost growth and employment and often also has adverse structural and distribution effects. Thus, the batting average of planned stabilisation programmes, especially in the poorer countries has not been good. A high proportion of such programmes are abandoned in mid-term. Others are technically completed by the facts that performance targets are met and all loan installments drawn, but serious difficulties often recur within a matter of months.

Virtually all Fund programmes involve restrictive monetary policies, especially ceilings on the rate of domestic credit expansion, whether by the banking system as a whole or by the central bank. Inorder to judge the effect of contractionary monetary policy on the growth of output in developing countries, some recent empirical evidence has been assembled in Table-XII. It summarizes the first year effects on the rate of growth of real output(GDP or GNP) of a once for all change of 10 percentage points in the rate of growth of either money or domestic credit, holding everything else constant. The studies listed in the Table indicate that on average a 10 percentage point reduction in the growth of money or domestic credit would reduce the rate of growth of output by less than 1 percentage point over one year. (The median value of the estimates in Table-II being 0.8 percent)

TABLE- XII

Short-run effect on the growth rate of output of a 10 percent change in the growth of money suply or domestic credit.

Study.	Countries	Policy variable (Rate of Growth)	Effect on Growth of output.
Aghevli and Khan (1980)	8 developing countries.	Domestic Credit.	0.8[2]
Barro (1979)	Brazil, Colombia, and Mexico.	Money	0.9[2]
Blejer and Fernanda (1984)	Mexico	Domestic Credit.	0.4
Blejer and Khan (1984)	24 developing countries.	Credit to the private sector.	0.5
Edwards (1983a)	5 Latin American countries.	Money	1.7[2]
Edwards (1983b)	9 Latin American countries.	Money	0.8[2]
Edwards (1983b)	4 Latin American countries.	Domestic Credit	1.2[2]
Hanson (1980)	5 Latin American countries.	Money	1.0[2]
Khan and Knight (1981)	29 developing countries.	Domestic Credit.	0.5[2]

Study.	Countries	Policy variable (Rate of Growth)	Effect on Growth of output.
Leiderman (1984)	Colombia and Mexico.	Money	0.2
Lipschitz	Korea	Money	0.7[3]
Van Wijnbergen (1982)	Korea	Money	4.0[3]

1. Effect on real GDP or GNP (in percent) over one year.

2. Simple average of individual country effects.

3. Cumulated effect over four quarters.

Source: IMF Occasional Paper, No.-41

This result suggests that even the rule of thumb proposed by Hanson (1980) - that in developing countries a 10 percentage point change in the rate of growth of the money supply would alter output in the same direction by about 1 percentage point - seems to be somewhat of an over estimate.

Of all policy measures recommended by the Fund, devaluation has provoked the most criticism. One extreme criticism is that devaluation not only fails to improve the current account of the balance of payments, but also induces stagflation in the process. Even if such a policy is effective in changing trade flows, it is still regarded as too costly in comparison with alternative policies to improve the balance of payments. Another argument to support the view that devaluation exerts an overall adverse effect on growth tend to rely on the assumption that devaluation redistributes income to groups with a relatively low marginal propensity to consume and that the consequent reduction in aggregate domestic demand has a depressing effect on domestic supply, which more than offsets the increase in the country's exports. Some empirical studies, however, exhibit quite contrary viewes. One study by Khan, for example, indicates that the Marshall - Lerner conditions for devaluation to be successful in improving the trade balance were satisfied in 13 of the 15 developing countries included in his sample. Table-XIII exhibits a set of such empirical studies to show the results of a 10 percent

TABLE-XIII

Effects of a 10 percent Devaluation on the Growth of real GDP.[1]

Study.	Country	Effects on growth of real GDP2.
Gylfason and Schmid (1982)	Brazil, India, Pakistan, Philippines, Turkey.	-0.5,1.1,4.2,4.5,3.4 respectively.
Nugint and Glezkos (1982)	16 Latin American countries.	0.4
Khan and Knight (1982)	29 developing countries.	-0.5
Branson (1985)	Kenya.	-0.9 to 1.4[3]
Taylor and Rosensweig (1984)	Thailand.	1.0 to 3.3[4]

1. Over a period of one year,
2. In percent.
3. Depending on the degree of wage indexation; the lower value corresponds to zero indexation and the higher value to full indexation.
4. Corresponding to assumed low and high export price elasticities, respectively.

Source: IMF, occasional paper, No.41.

devaluation on the rate of growth of output in the first year. The dispersion of the estimates depends primarily on the underlying values of the supply-price elosticities, and generally the results indicate that the relative price, or supply, effects outweigh the negative demand-side effects. As a result, output growth would be higher after a devaluation rather than lower.

The IMF policy package actually, however, resulted in a deflationary cycle, increasing unemployment, savage cutbacks in essential imports, and, worst of all, hyper inflation. Since the IMF was guided solely by the performance criteria, the critics contend that the overall direction of the adjustment effort was lost sight of and that, consequently, the mechanical application of criteria turned out to be both ill conceived and counter productive. The IMF conditionality, it is alleged, attacked the institutional framework of member countries. For a number of Latin American countries the IMF officials insisted on a radical and substantial reduction of real wages and reduction of food subsidies for the poorer strata of the population. There is no gain-saying that the IMF imposed stabilization programmes resulted in one of the worst phases of deflation in the Latin American economics in particular and in the economies of the Third World in general. For instance, the IMF's deflationary prescriptions brought about asmuch as a 20 percent reduction in per-capita real income in the worst debt affected countries in 1984, relative to the 1980 level. The import squeeze of some of the

major Latin American economics was yet another debilitating conseuqnce. For example, the level of imports in Mexico declined from $ 24 billion in 1981 to $ 14.4 billion in 1982 and to just $ 7.7 billion in 1983. Imports in Brazil declined from $ 19.4 billion in 1982 to $ 15.4 billion in 1983 and to $ 13.5 billion on an average during 1984-85. The aggregate trade balance of Argentina, Brazil and Mexico together shifted from a deficit of $ 2 billion in 1981 to a surplus of $ 24 billion in 1983. Table-XIV presents the current account transactions of 15 heavily indebted countries. While the overall imports of these countries declined from $ 132.7 billion in 1981 to $ 79.8 billion in 1984, the trade balance improved from a deficit of $ 5.3 billon in 1981 to a surplus of $ 43.4 billion in 1984. However, looking at the import elasticity of demand, the severe cut was responsible for slowing down the GDP growth rates in most of these countries in varying degrees.

Some empirical cross-country studies however exhibit quite contrary ideas on the relationship between Fund Programmes and the growth rate. One such study was by Reichmann and Stillson (1978)[14], who examined the impact of 70 stand by arrangements implemented over the ten-year period 1963-72. They used before-after criterion by examining the growth rates of real GDP for one-year periods before and after each programme and concluded that on balance, Fund programmes exerted no perceptible adverse effects on growth rates as compared with the period

TABLE - XIV

Current Account transactions of 15 heavily indebted countries (in billions of U.S.dollars)

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Exports (f.o.b)	69.1	94.8	128.0	127.4	112.5	111.3	123.2	118.3	112.1	121.0
Imports (f.o.b)	76.9	96.0	122.4	132.7	107.8	82.3	79.8	76.9	80.9	87.7
Trade balance.	-7.9	-1.2	5.6	-5.3	4.7	29.0	43.4	41.4	31.1	33.2
Services, net	-19.7	-26.5	-36.7	-47.8	-56.8	-46.2	-48.0	-45.7	-42.2	-41.5
Unrequited transfers.	2.9	3.2	2.3	3.1	2.1	3.3	3.6	4.3	3.8	3.2
Current Account balance.	-24.7	-24.5	-28.7	-50.0	-50.1	-13.8	-0.9	-0.1	-7.3	-5.1

Source : IMF, World Economic Outlook, 1987.

immediately preceding their implementation. In certain cases growth did decline, after the inception of the programme relative to previous years rate of growth, but this result was matched by a number of instances where the growth rate rose.

Kelly (1982)[15] compared the three year average of the rates of growth beginning with the programme year, with the three year average prior to that year. For the 48 upper credit tranche stand-by arrangements implemented over the period 1971-79 that were examined, in 25 cases a decline in the average growth rate occured, but in the remaining 23 there was an increase. Similarly, the Overseas Development Instituté (ODI) study referred to in Killick(1984) investigated the effects of 38 programmes implemented between 1974 and 1979 and, using variants of the before after test, found that growth rates were largely unaffected. A number of other cross-country studies show an absence of over-whelming negative effects and in fact indicate that in a substantial number of instances growth performance turned out to be better in the course of an adjustment programme than it had been prior to its implementation.

For domestic demand deflation, however, the Fund generally suggests reduction in public expenditure,

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14,15; IMF Occasional Paper, No.41

especially that on welfare-items like food subsidies and social services such as education, housing and medical facilities. As a result the combination of stagnant real investment, rising malnutrition, and falling health and educational standards has adversely affected physical and human capital formation. For example, from 1980-85, the Funds cumulative lending to sub-saharan Africa was approximately $ 4.6 billion. But despite this substantial in-flow of funds, and despite the fact that over this period African countries made a nearly 20 percent cut in imports, the region's current account deficit did not improve and remained negative. And the $ 4.6 billion lent by the IMF was to be repaid, with interest, in the second half of the decade. On such a scenario, as expressed by Francis Stewart.[16] "percapita incomes fell. Progress toward improving health, education, and nutrition was brought to an abrupt halt, and in many countries was reversed. Newly established clinics could not operate effectively because of lack of medicine. Schools had no money for books or paper; low salaries led to high teacher absenteeism; and children dropped out in increasing numbers, since household survival depended on their working. Mal nutrition rates of 50 percent and over among children under five were recorded in many countries in addition to those affected by drought."

16;- "Back to key-nesiansim" by F.Stewart, in "International policy journal", 1987. p.171,

It must be emphasized that these negative developments have not been confined to countries with Fund programmes and therefore can not be wholly attributed to Fund conditionality as such, especially because the external economic environment worsened significantly over this period. It is however clear that the Fund adjustment measures had led to substantial cuts in real wages and social expenditures in the borrowing countries and, thus, substantially hampered human capital formation.

Deflation is not the only way to correct imbalances in external accounts. The alternative would be to correct surpluses through reflation: surplus countries would try to eliminate their surpluses by increasing their spending so that their imports rise. The IMF original charter did include a 'scarce currency' clause designed to encourage symmetry of adjustment by placing pressure on Chronically surplus countries to bring their surpluses down. But that clause has never been invoked, and the Fund's approach has remained highly asymmetrical: The major burden of Policy change and adjustment is imposed on deficit countries.

IMF programmes have also been criticised for the uniformity with which they prescribe the same medicine for countries with apparently different economic structures and economic problems. It considers the entire Third World problems as a common ill, even though the seriousness of the illness and the variety of the symptoms change from country

to country. Countries should be treated in the same manner irrespective of their size, exchange rate regime, or financial position. However, equal treatment can not mean uniformity of prescriptions. In attempting to formulate conditionality along more appropriate lines, one should keep in mind that it must be country specific, geared toward each individual country's economic, social, and political situation and prospects. One can not, therefore, lay out a detailed conditionality programme that could be universally applied. But it is possible to point to the kinds of changes that in most cases are needed.

Any alternative conditonality should ensure that the country's objectives and philosophy are taken into account in forming the package. Secondly, it should make it more likely that the conditions will be adhered to, which is important in view of the large number which are abandoned soon after negotiation. Thirdly, it may introduce some political realism into the programme and thus avoid some of the political problems that have been associated with Fund programmes.

Repeated failures of most of the debtor countries to come to agreement with the IMF on performance criteria raises a fundamental question as to whether the IMF stabilization programme is always politically feasible. The pivotal institution affecting the introduction and implementation of IMF policies is the state, and hence, the collaboration or resistance of national forces is decisive in shaping IMF impact. The most common of all the reasons for failure of

Fund programmes are internal political pressures and politicians' fears of such pressures, which lead governments to postpone corrective action until the economic crisis is acute, and/or to dilute or abandon programmes before the necessary economic adjustments are accomplished. Doubts about the economic benefits of stabilization measures often play a major role in delaying adoption of measures, or in vacillating or half-hearted implementation of measures. Stressing the importance of policy Petras and Brill[17] went even to the extent - on the basis of case studies on Peru under Belaunde, Bolivia under Siles, Jamaica under Manley - that "implementation of IMF austerity programmes is inversely related to electoral success". There are, however, instances where politicans often try to mute oppostion to stabilization by pointing to IMF as a convenient scape goat.

Even where the economic rationale of stabilization is well understood, political leaders often lack confidence in that rationale. - Skepticism flows in part from the linkage of stabilization with economic liberalization. Many IMF supported programmes and all World Bank Structural Adjustment loans stress reduced direct government intervention in the economy and greater reliance on market incentives. One can then say that the Fund's preference for market oriented solutions is aimed indirectly at fostering capitalism in the Third World, which, if developed, would bring it closer to

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17: Petras & Bill; "Third World Quarterly" (1985), pp.446

the West. This being the case, the LDCs following a non-capitalist path of development face special difficulties vis-a-vis IMF. Ghana, for instance, received no loan from the Fund during the first nine years of its independence following the socialist policies of Nkurmah. Since then the fund's attitude towards Ghana has continuously been benevolent. The validity of the Fund's bias in favour of a market-oriented solution however is questionable in the case of LDCs, in view of market imperfections, narrow production base and acute shortage of essential factors of production in these countries. Moreover, the policies based upon the use of market machanism are regressive in their incidence and affect the very poorest in the country.

The claim that it is the poor in the developing countries that carry the main burden of adjustment does not stand up to close analysis. Clearly, any set of economic policy measures will cause some redistribution of income, and wealthy people are often more adept at avoiding the negative effects of new policies. But a recent Fund study suggests that much of the criticism of the Fund in this regard is due to the fact that those who gain from the removal of subsidies and other economic distoritions are often dispersed throughout society, while those who may lose - such as Urban Workers, Civil servants (including the military) and the owners of protected business - are frequently well-organised and Vocal. Most governments are vulnerable to Urban unrest,

and some get their main support from Urban working classes. Policies which particularly affect this group for example, removal of food subsidies, espeically when combined with exchange rate devaluation and control over wages - may completely destabilise the government.

At the start of the debt crisis, many countries sought to draw on the Fund and had therefore to submit Letters of Intent, describing the policies they would pursue to solve their balance of payments problems, and these letters served several purposes. Once the Fund had set its' seal of approval on a country's policies, commercial banks were willing to reschedule the country's debts and to grant new credits in many cases. Further more the Fund's seal of approval was required for a country to reschedule its debts vis-a-vis official creditors to open the doors of the Paris club and for access to Structural Adjustment Loans from the World Bank. In this context IMF can almost be viewed as the major commercial banks' debt collector.

Admittedly, the costs of reschedulings and the lengthening of maturities were important components of multilateral debt renegotiations and influenced debt service ratios till the 1970s. However, they were increasingly subordinated to the objective of achieving changes in economic policies in the 1980s. Necessary changes in economic policies were aimed at helping a country in becoming credit worthy. The rescheduling country was urged to resort to IMF and obtain its 'seal of approval' for a new set of policies.

Nevertheless, it is important to keep in mind that rescheduling does not obviate the financial needs of the developing countries. It is also not certain that repayments postponed by rescheduling are not likely to reappear in a few years' time. More interestingly, in the context of official debt rescheduling, while agreement with the IMF on austerity measures is a prerequisite of the debt that is renegotiated, new aid and credit decisions do not form part of the Paris club procedures. Nor are short-term trade financing arrangements made under such reschedulings.

The multi year rescheduling arrangements (MYRAs) technique goes hand-in-hand with new procedures, known as 'enhanced surveillance' for the on going monitoring of the debtor country's economic performance. Under this approach the debtor country prepares a quantiative financial programme setting out the country's major macro-economic targets and policy objectives for the year ahead. Neither Fund resources nor a formal stand by arrangement is involved, but the Fund assesses the programme, monitors its implementation, and prepares half-yearly reports on the country's performance. These reports are not intended to provide a traffic-light service for commercial financing:creditors must recognize that they are responsible for their own credit risk assessment and lending decisions. In the end, the sucess of the MYRA approach will depend on the commitment of the authorities in the borrowing country to carry out the

programme they set themselves. It will also depend on the wisdom of the creditor banks in using the information available to them.

One new experiment took place in 1986; when Brazil was negotiating to reschedule some of its external debt. Brazil was not willing to draw on the Fund or submit to enhanced surveillance. But Brazil announced dramatic policy changes in early 1986, including the introduction of a new currency pegged to the U.S. dollar, a freeze on prices and wages, and the Managing Director of the Fund gave these policies his personal endorsement. This was of course, a face saving device. Brazil got something like a seal of approval from the Fund without having to ask for it, and the banks could say they had not rescheduled the country's debts without the Fund's approval of the debtor's policies.

Some consider it as an unfortunate precedent. Other debtors are likely to ask for similar treatment, to avoid a more formal review of their policies, but the banks will want the Fund to involve itself more fully. They have mentioned repeatedly that official creditors refuse to settle for any arrangement short of full-fledged conditionality, not even enhanced surveillance. Furthermore, the Fund should not be asked to endorse a country's policies on a take-it or save-it basis, without an opportunity to examine the assumptions and projections on which they are based and a clear understanding with the government concerned that the Fund can rescind its approval if subsequent review in the framework of

surveillance raises doubts about the government's policies.

As a source of liquidity also the IMF plays an important institutional role in the reproduction of the international circulation of capital and commodities. During periods of crisis the ability to reproduce international circulation becomes especially severe since states tend to erect barriers to the movement of commodities and capital. In addition, the concentration and centralization of international capital in transnational banks tends to amplify liquidity crises and has increased the threat of substantial systemic disintegration. The stock of international reserves and the terms and conditions on which they are supplied depend mainly on decisions made by private financial institutions, which are in turn influenced by the policies of the Key currency countries.

An adequate level of reserves is essential to the smooth functioning of the international economy. International reserves allow countries to avoid undertaking abrupt adjustments in their economic policies in response to unanticipated disturbances that may adversely affect or threaten to affect their international payments positions. The demand for international reserves has not been significantly reduced by the advent of floating exchange rates. Countries' have continued to hold reserves as a precaution against unanticipated shocks, as a means of demonstrating credit worthiness, and for exchange market intervention.

In this context many suggestions and proposals are there for strengthening the international monetary system in general, as well as for changing or expanding the role of the SDR in particualar. Moreover, because that credit worthiness has not been restored despite vigorous adjustment policies and sizable improvements in the current account positions of the developing countries - market processes can not alone be relied on to correct an inadequate amount or an uneven distribution of international liqudity. Hence the Fund should be enabled to influence the liquidity needs of the World economy through a more efficient SDR creation and distribution than it has so far been able to do. Some tentative suggestions may be made with a view to making the IMF more relevant to the needs of the LDCs.

The share of LDCs in the IMF quota should be increased from the present 33-35 percent to near about 50 percent so that these countries are able to make adequate use of IMF financing facilities and have an effective say in the Fund's decisions. An increase in quotas will provide significant benefits to LDCs but little cost will be imposed on developed countries in the form of inflation, because the absolute levels involved will be small. Moreover, an increase in quota does not consitute a problem for an LDC because the gold cover of the quota is no longer required. As an extreme view, one can say that the distribution of SDRs should be completely delinked from the allocation of quotas. Or, the

Fund should discriminate between developed and less developed countries regarding the drawing rights under the various financing facilities. LDCs should be given higher drawing rights in relation to quotas, as they have relatively smaller quotas.

Given the fact that IMF's credibility is seriously hurt in the present international economic situation, some stress upgrading the role of the World Bank as a way out. But, the World Bank depends on borrowing money in the World's capital markets for most of the money on lent by its hard-loan component, the IBRD. It is dependent on the support of the U.S. administration, its largest share holder, for increases in subscribed capital which would permit an increase in lending by the IBRD, since its charter does not permit it to make loans in excess of its capital. And it is almost totally dependent on government allocations for its soft-loan component, the IDA.

Several critics suggested, for example, that the Bank should abandon its highly conservative 1:1 ratio of loans to capital. Commercial banks, they suggested, have ratios which are close to 20:1. Changing the articles of agreement to allow just a 2:1 ratio would instantly double the money it could lend without going through the cumber-some process of a capital increase. It all seemed so easy. However, the IBRD raises the bulk of its funds from large investors, state and private, who see it as a good investment, and the guarantee of the Bank's developed member countries is what makes it a

good investment. Raising the gearing ratio of loans to capital would dilute the guarantee that these lenders depend upon and instantly raise the Bank's cost of capital on new borrowings. It would make the Bank much more dependent on the perception of the market, and in the mid-1980s that perception would not be favourable.

The World Bank was the first institution to study the problem of debt repayment and debt crisis seriously and is still the major source of statistics on debt as the publisher of the annual World Debt Tables. Unlike the IMF, however, the loans made or guaranteed by the Bank, except in special circumstances, is for the purpose of specific projects of reconciliation or development.

In a debt crisis, however, the most urgent need of a borrower is not for projects which will have a pay-off, if any, only in five or ten years' time; the country needs the money now, to pay debt service and this year's import bill.

The Bank's innovative mechanism is that of "Structural Adjustment Loans" which are defined as "non-project lending to support programmes of policy and institutional change necessary to modify the structure of the economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term".[18]

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18. Narayanan & Chawla, "Global Debt Renegotiations", International Studies, 1987, Vol-24.

SALs are unlike the usual project lending of the Bank because the funds could be quickly disbursed and used to pay for general imports. The Bank's conditionalities under these loans, however, stretch far ahead of those prescribed by the Fund; trade and exchange rate policies, policies in the energy, agriculture, and industry sectors, the review of national investment priorities, the financial performance and efficiency of public sector enterprises, the budget, tax policy, interest rates, and debt management - no important sector of the borrower's economic life is left untouched.

SALs were not the only vehicle through which the world Bank transferred non-project tied money in exchange for policy changes by the recipient country. Sector policy loans, in which the policy changes were directed at a particular but important sector, also helped to move money.

Another programme with which the Bank tried to meet the new requirements of the post-1982 debt crisis era was its Special Action Programme or SAP. The emphasis in this programme was on speeding up disbursements in order to make money available in a hurry to needy borrowers. But all of these programmes together were only a drop in the bucket compared with the annual outflow of capital from Latin America. Until recently it was agreed that non-project lending should not exceed 10 percent of the Bank's total lending programme, or 30 percent of its lending to a specific borrower.

The World Bank's contributions to managing the debt crisis are not limited to lending its own money. The Bank has always considered its real mission to be the promotion of private loans and investment in the Third World. The conditions attached to its own lending have pushed to improve the climate for private capital. It is, even now, encouraging India and China to get ever deeper into debt. At present it has mainly three new strategies to promote private capital flows: for the banks, new forms of Co-financing; for equity investments, more activity by its International Finance Corporation subsidiary; and a new investment guarantee institution, MIGA (Maltilateral Investment Guarantee Agency). On January 1983 the bank introduced a new type of Co-financing with commercial banks, which they called the B-loans, to distinguish them from the Bank's traditional lending. The B-loan strategy, like most other components of the official management of the debt crisis, assumes that the capital market for the Third World will get back to normal in the near future. But what if it does not, as seems more likely? Guarantees are cheap, as long as they are never used. But if they ever have to be used, if the debt crisis gets worse rather than better, they will be very costly to the guaranter.

The crisis of the 1930s led to the virtual end of international trade and the replacement of economic imperialism with military imperialism. In terms of ensuring

the short term liquidity of capital in international trade, the IMF has been relatively successful, but, as we have seen, the long term impact of the IMF on development has been disastrous. The measures taken to achieve short term liquidity have increased long-term risks to the system by increasing inequalities and reducing the ability of the IMF to implement policies. Calls for a New Bretton Woods and a new international economic order to address the long term needs for equality, stabilization and development have been unsuccessful. No institutional mechansim exists by which the Western Capitalist countries could be forced to reduce their advantages. The interests of international capital are being met by transferring the costs of global instability on to the deficit countries.

Though the recent changes in IMF policies towards LDCs reflect a better appreciation of the needs of LDCs and the prevailing socio-economic conditions there, something more is to be done to formalise the procedure and content of the conditionality framework within which LDCs can make use of IMF facilities. The dependence on devaluation and demand management measures and import liberalization can not solve the balance of payments, which can be over-come over a longer period of time. In any case, the existing balance of payments difficulties are due to external disturbances, such as deterioration in terms of trade, stagnating export markets, and increasing debt burden. Devaluation under such conditions, especially in the case of countries exporting primary goods

with low elasticities, is evidently an inappropriate measure. Rather, one of the consequences of the rapid correction of external imbalances has been the aggravation of domestic inflation as resources available for domestic absorption shrank more rapidly than domestic demand. Hence, for countries that have made substantial progress in reducing their current account deficit, a major priority now will be to curb inflation.

In this context the future of SDRs is becoming a central issue for several reasons: because the U.S. financial authorities are showing an increasing unwillingness to supply dollars to the outside world to meet its liquidity and reserve needs in view of the U.S. domestic budgetary problem and the pressure on its balance of payments; because the authorities of other reserve currency countries, or potential reserve currency countries - the FRG, Japan, Switzerland, the U.K. and Saudia Arabia - are unwilling to play individually or even collectively the role which the U.S. Treasury played for decades. However, the issue of international monetary cooperation is probably most difficult, Conceptually and politically. Without it, exchange rate stabilization is probably impossible; and without the latter, competitive depreciations and trade conflicts will increase sharply. The remedies are either controls over capital movements or reduction of international differences in interest rates. The developing countries have little choice but controls. We thus see that by giving so much priority to international

financial interests and so little to Third World well-being, the international financial institutions have secured a financial stability that is temporary and fragile. Rather than forcing deficit countries to bear the entire burden of adjustment, the IMF should, therefore, work toward Third World prosperity, which would provide a much more secure basis for World economic growth and vitality.

CONCLUSION:

DEVELOPMENT AND DEBT: DILEMMA OF 1980S

The world today faces two major immediate policy challenges: how to enable the emerging recovery in the western industrial countries to proceed smoothly and how to keep the international debt situation within manageable bounds. Obviously, the two problems are interrelated. It is hard to envision a broadly based and lasting recovery in the Western World as long as the fear of the potentially damaging financial consequences of a world debt crisis is not fundamentally allayed. Conversely, it is difficult to find a permanent solution to the present debt crisis in the absence of adequate global recovery.

Can the recovery of the global economy come first to precede a lasting solution to the debt crisis? The answer is not that easy. In the last thirty years or so, economic and financial power has become multipolar. It is no longer monolithic- no longer concentrated around one major economic power, the U.S. (Even though the economic and political monocentrism is being replaced by polycentricism, the military hegemony of American imperialism with its global structure of nuclear bases and occupation forces is still retained throughout the capitalist financial world. As a result of the increasing multipolarity of the financial world, exchange rates and interest rates have become quite unstable. During this period, when the world has been

becoming more diversified, most of the financial and economic policies still revolve around the same monolithic system. At the moment, most world liquidity is created not by an international system, not through the consensus reached among a number of nations, but largely as a reflection of the national policies of the U.S. since the U.S. dollar is the chief international currency. Whether total liquidity is adequate or not, whether it is distributed properly or not, are matters of accident, not matters of planning or good management. The dollarization of the world financial markets was the key result of the Bretton Woods conference of 1944. John Maynard Keynes knew very well why he, at that conference, opposed to the idea of a preponderant U.S. dollar and why he proposed, instead, the creation of a really neutral international reserve currency, the so-called 'bancor'. Unfortunately, he lost the battle.

The postwar economic order was a manifestation of the power and the policies of the U.S. The power is now waning, although far from spent. In the process, rather, a triangular pattern of development has emerged. The U.S. with its massive trade and budget deficits at one corner and Japan and West Germany with substantial trade surplus at the other corner, have left the other corner for the large debtor developing countries. While Japan and the East Asian NICs have accelerated in pace or ahead of the U.S. the EEC has coasted along a low gear, and the large debtor countries of Latin America & Africa have remained derailed.

Because the U.S. is a leading industrial power and the most important source of liquidity to the rest of the world, its monetary and fiscal stances, which determine its inflation rate and interest rate, have a direct and strong impact on other industrial countries, transmitted through capital movement across countries. If other countries fail to respond to these impulses in the U.S. or do not adjust on the scale needed, the growth in the industrial world is thwarted with deleterious repercussions for the non-industrial countries. Thus, a budget deficit or prevalence of high interest rates in the U.S. unaccompanied by accommodating changes in the fiscal and monetary policies of other industrial countries like West Germany & Japan, would slow down the adjustment process in the LDCs.

The U.S., however, attempts to put all blame for the present international financial ambivalence on the major surplus nations, i.e. Japan and West Germany. Frustrated with the persistence of the trade deficits and their failure to improve even after more than two years of falling dollar, the administration has demanded reflation by unwilling German and Japanese Governments. To what extent is then this justified? Japan - the land of the rising yen - because of its national habits of thrift, and the institutional inducements to save, has continued for many years to save more than they invest on Japan. The result has been continued capital outflow to rest of the world and therefore a trade surplus. This is becaus

domestic investment opportunities in Japan are not attractive enough to absorb all of Japans' very high rate of savings. The question then arises - in a world in which capital is scarce, should one not consider this as an advantage rather than a problem? The problem, though lies not so much in Japan's surplus in trade account, as from the fact that virtually every American firm that does business or tries to do business in Japan complains that the combination of tariffs and non-tariff barriers prevents the sale of foreign products and services in Japan even when they are clearly better in price and quality than their Japanese counterparts. American business is frustrated and furious about the way in which the Japanese government protects and nurtures Japanese industry. These same views are echoed by many leading European firms also.

American notions of the 'locomotive' function for Japan & West Germany are, however, mistaken in several respects. The Japanese with an average wage 40% lower than in Europe cannot absorb a big extra flow of commodities. The German market of 60 million consumers does not compare with the size of the U.S. market. It is rather inept to expect an expansionary policy in Germany and Japan to make a decisive difference to the U.S. current account. Besides, what West Germany & Japan are being asked to do is reverse the philosophy on which their macroeconomic management has been based for some years. The proposition that there is no alternative to macroeconomic policies of monetary and fiscal

austerity is one on which the governments of West Germany and Japan have built their political reputations. They will not accept U.S. demand for a reflation without a struggle. Particularly the Germans are adament in refusing to play 'locomotive' for the world economy because they maintain that they had taken on that role once before, in response to the blandishments of the Carter administration, but had weakened their economy in the process and would not do so again. Thus Germany, feeling less threatened by the loss of the American market (a minor part of its export sales) and relatively secure within the European common market (where the bulk of its exports goes) has continuously rejected any proposal for further dollar devaluation.

The European economies rather find a convenient scape-goat in the large U.S. deficits and rising dollar as the cause of their low economic performance. As they argue, just as the stronger dollar has brought reduced inflation to the U.S. during the past several years, the consequent fall in the values of French Franc, the German mark, and the British Pound put upward pressure on prices of these countries. To prevent that process from initiating a new round of domestic inflation, the government in each of these countries was forced to pursue tighter monetary and fiscal policies than it would otherwise have chosen. These tighter monetary and fiscal policies have prevented a stronger recovery in Europe and have contributed to the continually rising rate of unemployment that now plagues most of the major European

nations. Because that the rigidites in the European labour markets reduce the sensitivity of inflation to increases in unemployment, it takes a substantial rise in unemployment in Europe to offset the inflationary pressure that results from a rising dollar. It is not surprising that European political leaders have been frustrated and annoyed by an American budget policy that they see has contributed to America's strong economic expansion while impending their own.

In such a situation, to prove their mettle, the Americans must give stress on fast deficit reduction. It is often said that the U.S. is a very reactive economy. It can go very quickly from over optimisim to thinking the end of the world is around the corner. But when it does, it does something. The U.S. Government is well aware of the seriousness of the problem as is revealed from the statements of Reagan that: "No nation can survive if government becomes like the man who in winter began to burn the wall boards of his house to keep warm until he had no house to keep warm". (Foreign Affairs, 1987, Vol.65, No.3, pp.467). The Gramm-Rudman-Hollings Act of 1985 does provide for a multiyear reduction in new borrowing and deficits to nil by 1991, but it is highly unlikely that the objective will be achieved.

The "J-Curve effect" is often considered as the short-run reason for the non-improvement of U.S. trade balance, even after more than two years of continuous fall in dollar.

While further depreciation of the dollar was opposed by Paul Volcker fearing the risk of inflation, James Baker advocated a cheaper dollar as the means of restoring American competitiveness. Fortunately for Reagan, the falling dollar has upto now had no inflationary consequences as such consequences have been almost exactly matched by the disinflationary effects of the sharp decline in oil prices since the beginning of 1986. It has rather tempted Reagan to threaten a fesh devaluation of the dollar in his attempt to push the main surplus countries into reflation.

The best way to cut the budget deficit is to reduce spending. In the U.S. Defence, Social Security, and interest payments on around $2 trillion Federal debt account for 62 percent of total government spending. Interest rates are heading down, and that will help; they could decline further if the deficit declines further. Big cuts in the defence budget seem unlikely. Hence there is every possibility that the Congress might challenge such working and middle class entitlements as social security, medicine, civil serviced, military retirement benefits, and even certain subsidy programmes. Spending for subsidies to farmers who have gross incomes above $1,80,000 a year amounts to over $8 billion. the Democrat proposal to tax the untaxed part of social security and medicine benefits for upper-income recipients would save more than $30 billion over five years. Congress might aim also for a combination of more targeted

consumption levies, say on energy, telephones, alcohol, and tobacco as it would hardly dent the economy. Increasing the gasoline tax - a proposal that was proposed by Paul Volcker - from 9 cents to 12 cents a gallon could raise $54.4 billion over five years. Doubling the cigarette tax from 16 cents to 32 cents per pack would bring in $15.1 billion.

The argument that a downturn in the U.S. would plunge the entire world economy into the whirlpool of a cumulative recessionary process is misplaced. Some economists, of course, warn that all-out efforts to reduce the budget deficit would repeat the mistakes of the Hoover administration and the early Roosevelt Administration which, in futile efforts to balance the budget, raised tax rates and aggravated the depression. But the general view is that cutting the deficit more will have a more favourable effect on economic growth because it will suggest to the public, both in the U.S. and around the World, that the fundamental problems are coming under control. That would restore confidence.

We see that eventhough the relative size and technological lead of the U.S. have declined in recent years, it is still the world's largest and most advanced economy. Even at the pinnacle of its power in the nineteenth century, Britain did not possess so much potential power. Why then is there little hope for the establishment of a new set of institutions lunder the aegis of a vigorous American leadership?

The answer lies in the peculiarities of the international and especially the domestic circumstances of the U.S. Besieged by huge trade and fiscal deficits and by internal and external forces, it is unable to back its good intentions, if any, with adequate resources and leadership. It has lost its appetite for providing the world with what Kindleberger termed "international economic public goods". These are goods and services which benefit the entire international community such as open markets for the goods of other countries in times of acute shortage, steady flows of capital to developing countries, the coordination of international economic policy, international money, and a willingness to be the lender of the last resort in times of financial crisis.

Thus, without a nation strong enough to play the role of a leader, the international financial system is in peril. The need for an international lender of last resort, a role played by Great Britain through most of the nineteenth and early twentieth centuries, is greater than ever today. Unless the U.S. regains its ability and willingness to sustain nations in danger of default or builds a collective defence with major surplus countries like Japan & West Germany there could be a serious financial disaster. One reason for the curren danger is that U.S. like Great Britain after 1890, has lost economic power relative to the rest of the world. Although it remains the largest and most

important country in the world, the relative loss of power has been causing it to turn inwards and focus on its own imperiled interests. Internationally, the very size of the American economy reduces incentives to bear the costs of maintaing an open system. America in 1980s is not Great Britain in 1880s. Britain was desperately dependent on foreign trade and commerce. The U.S. is not American policy makers have less reason to maintain an open economic system than did their British counterparts a century ago.

From the above analysis what appears, at least for the time being, is that the possibility of a spontaneous and fast global economic recovery is not that strong. How then the debt problem is to be tackled? For any permanent solution to the present crisis what is most necessary is that both debtors and creditors must assume their respective share of the burden of resolving the problem. The present too general practice of putting the burden almost enitrely on the shoulders of the debtors, which for the most part are the poorest nations on the earth, is unsustainable and cannot long continue. The current strategy for the debtor countries operates on the premises that all debt must be serviced at market rates, that interest payment must remain timely, and that any missed payments of principal should be capitalised at market interest rates for later servicing. Such a rigorous condition for repayment has, however, rarely worked in the past.

The fact that most of the increases in countries'

liability has been due to borrowing from banks implies that previous mechanism for sharing difficulties between creditors and debtors have disappeared. The world had very severe debt problems during the great depression of 1930s. But at that time most borrowing by developing countries was done by selling bonds in the markets. When the depression struck and debtor countries faced difficulties in servicing their debts, the price of bonds went down, and borrowers could buy back their debts at a fraction of the original cost. In that sense the cost of recession was being shared between borrowers and lenders.

General interest and concern at the debt crisis has led many people to suggest ways of solving it. But realisitic solutions which will in the event occur depend on what the various participants in the situation are prepared to do. Many of the proposed solutions introduce new and quite unfamiliar concepts which differ from the solutions offered so far. The Geoffrey Bell Scheme advocates that the banks should set up a safety net, that is a pool of approximately US $20 billion from which large new loans could be arranged in conjunction with IMF rescue operations. The Kenen Plan suggests the industrial countries to create an International Debt Discount Corporation to buy up debts from the banks at say a 10 percent discount in return for long-term (10-20 years) bonds with a slightly lower interest rate than that charged to the developing countries on the original loans. The Magnifico proposal viewing the present problem to

excessively high proportions of short-term debt within the total, proposes the World Bank to privately place 10-12 years bonds lwith private and official investors the proceeds of which would be used to refinance the short-term debt under IMF conditionality. The Morgan Grenfell Scheme proposed the creation of a new agency - perhaps officially backed by the IMF - to buy the banks loans at face value, offering low interest bearing bonds in return. These bonds could be held or traded on a secondary market. The Mundell Plan finds the main cause of the crisis in the destabilising impact of the floating exchange rate regime. His plan, therefore, proposed to stabilise the gold price somewhere between $300 and $600, return to the gold standard, and create a World Central Bank as an instrument for centralisation of exchange rates. Wallich's Insurance Scheme proposes that there should be an insurance scheme to provide insurance to bank's portfolio of assets. The Meltzer Plan suggests that the banks should mark the debt down to its market price. Such debt they should be exchanged for at market prices for equity in gonverment owned industries like Mexico's petrochemical plants or Brazil's hydroelectric utilities. Some others suggest the IMF to introduce a facility, much like the compensatory financing facility, to insure borrowers against temporary unexpected interest rate increases. A few others favour debtors placing a cap on interest payments as a percentage of their exports. There are still some, who propose to link debt servicing to bartering and countertrade

arrangements. Some even view that at the start of the First Development Decade, it was the World Council of Churches that initially recommended that the rich countries of the Western Alliance put aside 1 percent of GNP as an allocation for foreign aid. It is now time for those private, non-profit lobbies concerned with Third World poverty to recommend a change in the development pardigam. There exists worldwide literally hundreds of private voluntary organisations or non-governmental organisations directly concerned with Third World poverty. These organisations often times are closer to what actually is happening in the Third World than are the banks and aid agencies that fund the bulk of the development programme. At the extreme, some even propose a mammoth aid programme similar to the Marshall Plan by the industrial countries to bail out the debtor countries.

In the presence of all these varied proposals, the two most important ones that have received considerable attention are the Baker and the Bradley Plans. The Baker Plan hoped to arrange about $29 billion in new commitments ($20b from the commercial banks $9b from the multilateral agencies over three years). This is, however, quite a meagre amount keeping in view the seriousness of the problem. What is important about the Baker Plan is that it recognizes that the debtor countries should grow, not run austerity programmes. This is a drastic reversal from previous U.S. Positions. What also appears in this proposal is to substitute the World Bank for the IMF in managing the crisis over the next few

years and to emphasize microeconomic 'supply-side' considerations, over the austerity of the IMF programmes. But, as we know, budget reductions remain the top adjustment priority of the major debtor countries. There is no real luxury of choosing between IMF austerity and World Bank growth oriented policies, unless the budget constraints of the debtor countries are somehow eased. The current emphasis of the Baker Plan is on conditions for microeconomic efficiency; i.e. liberalization of trade, privatisation of state enterprises, and opening to foreign direct investment. Most observers however view that the macroeconomic goals of price stability and balanced budgets often conflict with the liberalisation goals of undervalued exchange rates and tariff reductions.

The Bradley Plan, often termed as 3-3-3 plan, on the other hand, proposes that for three years commercial banks would cut interest rates paid by developing countries by upto three percentage points, while also writing off 3 percent of the loan principal. The Governments of industrial countries (perhaps U.S. alone) would simultaneously lend upto three billion dollars a year. Thus, we see that Baker's proposal is more hopeful than specific. But the Bradley plan is more specific in terms of reducing the interest burden and also reducing the principal amount of the loans. Secondly, Baker's proposal involves new loans by the banks in order to permit the debtor countries to keep current on their interest payments. But for how many more years will these new loans

be necessary? If there is no real turn for the better for the countries to pay their loans, it is more likely to further expose the banks and the banking system to a crisis of confidence. Bradley Plan, on the other hand, although painful in the short-run for the banks, does lay out a reasonable schedule to reduce the loans. The banks would scream if asked to take losses, but they must recognize that although the actual lack of repayment is not their fault, the excessive sizes of the loans and the inadequate analyses as to the ability of their customer countries to repay are no one's responsibility but their own. We thus see, the Bradley Plan does not go far enough and fast enough, but its basic thrust is correct. There must be a reduction in the loans, and it must take place quickly. How then can it be made feasible?

Firstly we must see how partial debt relief would be much more effective than the present policy of debt rescheduling in eliciting needed structural adjustments from the most heavily indebted countries. Consider the differing incentives for adjustment that arise from a dollar of debt relief versus a dollar of debt postponement. In the event of a debt postponement, the foreign creditors are the ultimate beneficiaries if the country does well, since the amount of eventual debt repayments will thereby rise. On the other hand, if the debt relief is granted, the country keeps the benefits of its better performance in the future. Any debt relieft must, however, involve a complicated deal among the

creditors. While granting relief, the general framework should be an adhoc workout committee for each major debtor country, which includes all of the major creditors, both official and private. The IMF and the World Bank should be key members of the Committee, but should be there to provide funds and expert advice and judgement on a proposed programme, rather than to set terms with the country. It would be most important that the debtor country should approach the creditor committee with its own plan, rather than having the plan dictated or designed from the outside. The country's plan should be evaluated by the IMF, which would provide a technical memorandum in support or opposition to the proposal.[8] However, the IMF's judgement would now just be one voice among many in any final decision to go ahead with a plan. The IMF could certainly decide not to go ahead with its own loan on the basis of an unfavourable review of a programme, but it could no longer effectively veto a relief package or rescheduling agreement agreeable to other creditors.

A major problem with the current arrangement for managing the debt crisis is that the current system puts an undue amount of stress on the IMF. The official creditors and banks wait for the IMF to work out an agreement with the country. Whatever be the merits of Fund programmes, they are not adhered to with any regularity. Only recently, with the Austral Plan in Argentina and Cruzado Plan in Brazil, has the IMF been viewed as acceding to the plans of a debtor

government, rather than imposing its own plan. Thus, in recent years the Fund has found a greatly diminished rate of compliance with its performance criteria, and this drop in compliance has led to a further tightening of fund programmes. Using its power over borrowing countries alone to fulfill its obligations is a case for trying to meet first best conditions in a small part of a second-best world.

In such an atmosphere what is most necessary is that the LDCs should establish or expand economic relationships among themselves aimed at collective self reliance and the creation rather than diversion, of trade. The proposal of debt servicing through economic cooperation will not only provide elbow-room for managing the short-run payments situation through postponement of debt-servicing but also provide the opportunity to nurture infant export industries in a market which is at once competitive in a regional framework and protected vis-a-vis established suppliers in the developed world. The opening up of new assured markets in manufactured producer goods should facilitate the utilisation of existing idle capacity and the establishment of new plants of optimum size. The pattern of industrialization in developing countries, which has tended to be autarkic in many cases, will now have the chance of growing less insular and more efficient. Thus, certainly, some sort of debtors cartel can hope to withstand the international pressure. If the debt crisis provides the impetus for new forms of Third World solidarity, this could turn out to be its most enduring and

important legacy.'

Some recent developments in the world economy like the world-wide fall in interest rates and the depreciation of the dollar against the yen and other European currencies are highly favourable developments for almost all debtor countries. However, the dollar prices of many primary commodities have continued to decline in recent years, offsetting many of the benefits of lower interest rates. We thus see that the future course of the world trading and financial system would be decided essentially in the balance of argument between the major OECD countries. Therefore, the resolution of the U.S. Federal debt. problem - intrinsically a domestic U.S. problem and perhaps the single most possible contributor to world economic recovery - will have to be dealt with not only with resolve, but also with gradualism. It has to be staged in such a way that any deflationary impact on the U.S. economy and the rest of the world will be compensated by improved growth conditions elsewhere, most notably in Europe, where the recovery is younger and weaker. It is a time when the debt crisis, instead of being considered as a problem, should be perceived as an opportunity for progress. That is why the U.S. should contribute additional money to the IMF to bail out the banks. Because in the absence of IMF support, LDCs could be forced to cut back their economic growth and imports even more severely than under IMF programmes. Such cutbacks could be a serious drag on U.S. economic recovery, and could also have

destabilising effects on developing countries.

What is most needed is, thus, a strong will - the will of the U.S. to deal more effectively with its own problems and the will of the major industrial countries to work together for a common end. Creditor countries need to create a commercial and financial environment that is more supportive of the growth objectives of developing countries. They must maintain open markets and pursue policies aimed at non-inflationary growth, creating a financial climate in which further declines in interest rates may be possible. Afterall, a greater display of unity among the Third World countries and a more positive attitude on the part of the developed countries must be treated as a necessary precondition for any successful resolution of the debt problem.

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