

# "FOREIGN DEBTS AND INTERNATIONAL STABILITY"

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The Workshop was attended by 32 participants from 13 countries. They met in Cracow, Poland, during three days, 18-20 June 1990. This report is the sole responsibility of the three rapporteurs; it is based on the group discussions, but it does not necessarily reflect a consensus of views of the group as a whole. All participants attended in their private capacity. The discussion focused on four questions that were deemed to be most relevant with regard to the global debt crisis and its implications for international stability and well-being.

## 1. Is the global debt crisis easing or deteriorating?

There was general consensus that the situation was getting more worrisome for all of the participants, both debtors and creditors alike, except for those creditors that have written off the debts owed to them or who have built very substantial reserves against bad debts.

For the debtors and the remaining creditors, there are many indicators of a deteriorating condition.

(a) The outstanding debts have been increasing and payment arrears have been growing larger (45 billion dollars in 1988, 52 billion dollars in 1989).

(b) The burden of debt (as measured by costs of servicing the debts as a percentage of export earnings) continue to weigh heavily on the debtor community.

(c) The reverse transfer flow from poor to rich countries continues at an ever increasing pace (amounting to over 50 billion dollars in 1989) with very politically destabilizing impact on the many countries that are severely indebted.

(d) The average real income levels of most debtor countries have been declining over the decade of the '80s to a point where there is a political stress of an extreme nature (Latin American debtors by 10%, Africa by 25%, and Poland by a substantial percentage when real wages have fallen by 30% within the last year).

(e) The external environment for servicing the debts has not improved with real interest rates remaining at historically high levels, many commodity prices at historically low levels and little indication of a reverse of these trends in the short to medium-term.

(f) The debt burden encourages unsustainable development as it provides incentives

to the generation of short-term economic effects at the cost of environmental degradation and plundering of the natural resource base. Such a devastation in one locality easily translates into global ecological degradation which will sooner or later entail strict countermeasures.

(g) The financial impact of the current debt muddling through "strategy" is proving inadequate and insofar as the initiatives foster false hope, the effects are harmful.

(i) The Toronto Plan: Its application is limited. The debt forgiveness by a few creditor governments applies only to the official debts of the most desperately poor countries and even if fully implemented will reduce the outstanding Third World debts by no more than 2%.

(ii) Brady Plan: This too has limited application. Banks have proven reluctant to put new money, particularly since they are asked to take losses. They have built up their reserves and are able to be more resistant to pressure to be cooperative.

The discussion indicated that the political aspect is as important as the economic and financial. Without the political will on the part of both creditors and debtors the problem will continue to fester.

## 2. How do the development in Eastern European countries affect the situation?

The discussants observed that there was great variation in the situation of the various Eastern European countries with respect to debt burden. Channeling a high percentage of export earnings to debt servicing exerts intense pressure on debtors but this is especially so when, at the same time, the debtor economy is going through a transformation from a centrally-planned to a more market-oriented economy. This applies with particular relevance to Eastern European countries. During this period of transition they need not only a substantial reduction of the outstanding debts and a lower rate of interest (with a grace period of several years) but also an international environment in which trade and capital flows are favourable (less protectionism, more favourable terms of trade, etc.), and, especially important, new money. Without these the countries will undergo periods of internal instability.

It was pointed out that the debt situation with regards to European members of the

CMEE is not a difficult one to resolve since the question is one of transferable ruble debts, the value of which is difficult to determine in hard currency terms.

The issue of whether the needs of Eastern European countries will divert capital from the Third World debtors was also discussed. In the opinion of many discussants this is a non-issue since it involves a different kind of capital flow; that is, the kind of investments and lending of Eastern Europe would not likely go, in any case, to the Third World except to a minor degree. Others felt it is a matter of considerable concern.

Some of the discussants alluded to the Marshall Plan concept. After the Second World War the United States lent Western Europe for reconstruction purposes 3% of its Gross National Product (or an equivalent in terms of today's dollars of almost 150 billion dollars). The question was asked: why could not this order of magnitude be considered today for similar geopolitical reasons?

## 3. What role is being and could be played by various institutions?

### (A) The role of commercial banks

(i) The commercial banking system is less at risk having built up considerable reserves and it is mainly the US banks that are driving the speed and manner of the debt rescheduling process.

(ii) The Brady Plan is not working out at a speed or to a degree that would make a significant difference, as evidenced by the fact that since it was announced about 18 months ago there have been only three agreements reached, the results of which have not provided much money, nor is such money likely to be forthcoming from commercial banks when they are asked to take the losses and still provide new money.

(iii) The arrears to commercial banks have been mounting and the number of banks willing to play has been falling.

(iv) The debt rescheduling process is breaking down because the few banks remaining in the process have little in common, their willingness to negotiate with concern for global stability is weakening, and the intermediating role of the IMF is not enjoying the requisite confidence (see next section).

It was observed that historically the commercial bank lending was less important with respect to long-term development financing, that their role in the 1970s was the consequence of the mistaken policy of the US to constrain the international financial institutions from being the main intermediators of the petrodollar recycling in the early 1970s. It is expected that the

commercial banks will continue to provide suppliers credit, trade credit and special project financing when the global conditions are "normalized". However, it was pointed out that if conditions were preferable for commercial banks they would consider remaining engaged.

**(B) The role of international financial institutions**

As a result of the pressures exerted by the debt crisis in the Third World the World Bank as a major institution for development financing has been working more closely with the IMF which is the major institution for balance of payment financing. Beginning in 1979, the World Bank moved into "structural adjustment lending" (SAL). Structural adjustment lending now constitutes about 25% of the bank lending programme, displacing to some degree traditional project lending. This has enabled quicker disbursement to help relieve the debt burden to some degree, enough to prevent massive defaults. Some discussants felt their role through SALs is not proving effective in restoring growth without other global changes and that meantime this type of lending has had distressing impact on the poor.

There have been two interesting and relevant changes in the situation:

(i) bank lending for SALs has peaked as a percentage of its overall lending programme;

(ii) the IMF and World Bank have initiated programmes providing additional resources to help support debt reduction agreements reached between debtors and their commercial creditors; and

(iii) these institutions are now prepared to continue lending to debtors who have arrears to other creditors in certain cases where there are economic justifications.

**(C) The United Nations agencies**

The United Nations has only limited resources at its disposal, both in financial and professional terms, but is trying to find a role. Discussants put forward two possibilities:

(i) institution-building for debt management recently a report was put forward that recommended the expenditure of about 300 million dollars over five years to finance the improvement of debt information systems, legislation and negotiating techniques, as well as advice and training in debt management at the national level; and

(ii) the UN provide advisers to help debtors in the debt rescheduling process through Round Table and consultative groups. The UNDP's present role in RT negotiations is not very impressive. But this role should be strengthened given the fact that the UN is seen to be less subject to the pressures and persuasions of the G7 industrialized nations than the World Bank or IMF or regional development banks that presently play the principal advisory role.

**4. Where do we go from here?**

The discussion focused on two levels of discourse: (1) national initiatives, (2) international initiatives.

Re. (1), it was generally agreed that countries negotiating for debt rescheduling

should base their proposal not only on accurate debt data but also on an internal structural adjustment programme within a rigorous analytic framework differentiating between the short-term (5-10 years) and the long-term. Only on the basis of what is needed in the way of debt reduction for long-term sustainability can fruitful negotiations proceed about the immediate - or short-term. The model must incorporate realistic market and interest rate assumptions: if the country cannot export enough to earn foreign exchange to service its debt or if the rate of interest is too high then the country cannot expect to achieve its targeted rate of growth, let alone sustain it over the long term. This brings the spotlight to focus on the international aspect.

Re. (2), the questions were posed: what is the minimal global rate of growth required so that export earning of debtors can expand? How low a real rate of interest is necessary so that the debts can be serviced? It was noted that on the basis of modelling exercises the global rate of growth must be at least 3% but this is not being achieved; and the rate of interest in real terms must be no higher than the 3% level (1-2% being the rate that historically has prevailed), a rate well below those prevailing today - and likely to prevail for some time. This raised the question of the capability and willingness of the major industrialized countries to take the necessary step to grow faster and lower interest rates. At a minimum, all this would require the US to reduce its budget deficit and by a variety of means increase its savings so that it becomes a net supplier of capital rather than a taker; it requires that Germany and the EEC countries open their markets

**THE OTHER PERSPECTIVE**

Problems of education and employment, the problems of housing and nutrition, all those problems get worse, not better in recent years they have grown worse, as a result of the foreign debt crisis. Is there any magician, any genius who can come up with a solution to these problems? I can see that objectively all these problems are getting worse. So we can talk about the abundance of the First World you mentioned sitting on a volcano which can erupt. That volcano is in the Third World and nobody has an answer for these problems. Capitalism won't solve these problems.

There are more than 30 million neglected children in the streets of Latin America, more than 30 million. These figures are very grim. What future is there in all this? I don't see any. And they continue the plunder and the net export of capital. What is the future for all those countries? All this must explode.

That's why, amidst the pessimism, I tell you that the system prevailing in the world has no future;

the models of development they exported to countries of the Third World have no future, there is no future for the consumer habit.

The volcano is there, in the huge humanity that makes up the so-called developing countries, which is a lie because they are not developing countries, they are underdeveloping countries since the gap between the most advanced and the Third World countries is growing, is widening. That's the reality today.

In political terms, for the progressive and revolutionary movement this period is one of the most difficult ever, we can almost say since the turn of the century, and yet we haven't gotten discouraged, on the contrary, it's not a matter of the leaders, it's not I or any of the others - I don't know it's not one man, it's the entire people who express their admirable spirit of struggle and who don't get discouraged. I think that's one of the features of the situation.

**Fidel Castro**  
President of Cuba  
Courtesy - Granma

to debtor countries exports, to a greater degree than heretofore and in particular reform their common agricultural policies and end quotas such as those embodied in the multi-fibre agreement; it requires that Japan divert more of its financial surplus to the Third World and take other steps to keep global interest rates as low as possible.

It was pointed out that if the problem is structural or systemic then its resolution calls for wide-ranging proposals that go beyond the demand that debtors undertake "structural adjustment"; it should be clear that the creditor countries also need to make major shifts in policy that promote structural adjustment in the global economy. Such changes are particularly urgent not only because social stress and political instability continue to mount to dangerous levels but because the gap between developed and developing countries in terms of technological capability is widening. Since trade and capital flows are the carriers in the technological transfer process, it is vital to remove barriers to these flows, particularly the perverse effects of the debt overhang that leads to import strangulation of debtor countries (including cut-off of high technology imports) and a direction of flow from debtors to creditors.

It was observed that such steps will not be politically easy to take since they imply major changes on the part of these countries or, in a phrase, structural adjustments of the global system. Political pressure is necessary since only then will capital be available for debt reduction on a massive scale, for official lending and for investing purposes and, no less importantly, to tackle other global problems such as environmental deterioration (global warming, ozone depletion, etc.). Without congenial international conditions the debtors will find it difficult if not impossible to escape the debt trap.

It was also observed that the debt service burden is now excessive for most indebted countries, hampering their economic growth. In this situation a global solution to the debt problem, aiming at a substantial debt relief, should be sought. An international body, perhaps in the framework of the United Nations, might play a useful role in this respect.

To achieve this global structural adjustment there must be serious consideration given to what institutional changes are necessary such as an up-dated Bretton Woods Agreement and other means sanctioned by international accords to channel substantially more funds to development purposes, funds that would become "available" from arms reduction (the so-called "peace dividend"), from taxing derived from exploitation of "the global commons" (i.e., the high seas, the upper atmosphere, and Antarctica), from a large

increase of Special Drawing Rights, and from other sources beyond the traditional. Whether these funds should be channeled through existing institutions (which seemed to be favoured) or through special funding arrangements is an issue, it was felt, that could be resolved through conferences convened for this purpose or through other modalities. The main thrust of the discussion was, in a phrase, that the prevailing extraordinary circumstances call for bold innovative measures that are global in scope.

The focus of the discussion thus shifted to a consideration of two related themes:

(i) how the national concept of "the peace-divided" could be realised in practice through the allocation of funds for reducing debts on a massive scale, through providing substantial new funding so net flows are once again from the rich to the poor countries, and through the launching of programmes that address the global environmental challenge;

(ii) how the debtor countries can be enabled to adopt policies and programmes that are environmentally helpful both to themselves and to the global community despite the pressures stemming from their need to service their onerous debt burdens that tend to force them to be preoccupied with survival in the short term.

Re. (i), several discussants put forward orders-of-magnitude estimates of the possible amount of funds and real resources that might be envisaged as becoming available. But the main spotlight was turned on the aspect of political action: what forms might it take that would make the cause of debt reduction and of development financing a first-order priority as a claimant for such funds and resources as disarmament proceeds? It was emphasized by most participants that any proposals in this regard would need to be simple to understand and to implement and, at the same time, be able to capture the public's imagination. One such initiative was cited as an example: Jamaican Prime Minister Manley's suggestion of an across-the-board set-aside by all countries of a fixed percentage of all military budgetary savings.

Re. (ii), the discussants also devoted time to considering measures that address the global environmental problems that are exacerbated by the debt overhang pressures. Among the ideas put forward were:

- international funding for research on "stand-alone" energy (i.e., energy sources outside the electrical grid system) that would have an exceptionally important beneficial impact on the environmental by reducing the dependency on fuelwood of those billions of people who live in the rural sectors beyond the reach of national grid systems;

- international funding for enabling multilateral and bilateral aid agencies to assist in debt-for-nature swaps on a much larger scale than heretofore, such funding being required to counteract the inflationary impact of such swaps.

The discussants throughout the five sessions stressed in various ways with numerous examples that the issue under consideration was urgent not only on grounds of compassion but also for the cause of global growth that is marked by peaceful change and is, at the same time, both more equitable and environmentally sustainable. ■