The International Financial System and Developing Country Debt Management: The Process, Problems and Prospects

PAUL SIGUR

As developing countries sink further into debt and lender countries become increasingly aware of the implications of large scale defaults, the international community is devoting greater attention to the question of debt management. In this article, Paul Sigur casts the main actors involved in international lending and borrowing, discusses the mechanism for debt rescheduling and analyzes three representative case studies of debt management. Sigur argues that the international financial system, though imperfect, has successfully dealt with debt crises and will continue to do so despite occasional fears of international financial collapse. The author concludes with some suggested reforms for the debt management process and a forecast of future developments.

The efficient and effective management of the international financial system is a highly complex task in a world of over one hundred and fifty sovereign nations with divergent policies and interests. This management has become increasingly complicated since the mid-1970s, as commercial banks have emerged as the major lenders to developing countries, and as new demands have been placed on the International Monetary Fund (IMF) and the World Bank. Nevertheless, this network of governments, commercial banks and international institutions has survived, and effectively managed the debt burden of many developing countries.

This analysis examines the issues and the institutions involved in Less Developed Country management within the context of the international financial system. It will be seen that the system has developed procedures to deal with debt management crises, and those procedures have evolved to the point where a recognizable framework for the rescheduling of official and private debts has emerged. The mechanisms involved in debt rescheduling are discussed in detail with an analysis of the roles of the various actors in the process. The political, economic, institutional, and other issues that have arisen within the context of debt rescheduling are analyzed.

Paul Sigur received his MALD degree from the Fletcher School of Law and Diplomacy in 1982.

These issues include IMF conditionality, leverage between debtor and creditor, Group of 77 (G-77) reservations concerning the creditor club mechanism, and the emerging roles of the United Nations Conference on Trade and Development (UNCTAD) and investment banks in debt management crises. Three case studies illustrate the debt management process as it occurs in LDCs, and an evaluation of the debt management system is undertaken, along with proposals for reform and the outlook for LDC debt management.

Many of the concerns of those who fear LDC bankruptcy and consequent commercial bank failures are not entirely without foundation. External debt of developing countries has grown enormously on an aggregate level in the years following the oil price increases of 1973-74. Disbursed medium- and long-term debt outstanding (including publicly guaranteed and private non-guaranteed debt) grew from $138.7 billion at the end of 1974 to over $426 billion by the end of 1980.[1] The numbers for the end of 1980 are even larger when short-term private debt and non-disbursed debt are included. There are also fears that major commercial banks in many member countries of the Organization for Economic Cooperation and Development are dangerously overexposed on their international loans and are susceptible to possible financial collapse should a major borrower default.[2] Finally, the frequency of and amounts involved in rescheduling of LDC debt seem to be increasing.

The threat which these fators pose for the international financial system has, however, been exaggerated. As the World Bank has indicated, "not much can be inferred from aggregates."[3] Nevertheless, aggregate figures indicate that the situation at the end of the 1970s is not very different from that at the beginning of the decade in terms of the real debt burden of developing countries. The unanticipated inflation of the early and mid-1970s was largely responsible for reducing the real debt burden of developing countries on an aggregate basis.[4] In recent years, floating rate terms have diminished this possible impact of inflation on the debt burden since interest rates are adjusted periodically to reflect market conditions.

The essential point is that although aggregate figures indicate impressive growth percentages, they obscure the fact that the borrowing and debt servicing position for some LDCs has actually improved. As the Vice Chairman of Citibank, G.A. Costanzo has correctly written, a large debt

1. Richard F. Janssen, "Nations in Hock - Third World's Debts, Totaling $500 Billion, May Pose Big Dangers," *Wall Street Journal*, 28 January 1981, p. 1.
2. Ibid.
3. World Bank, *World Debt Tables, Volume I* (Washington, D.C.: The World Bank, November 1980), p. IX.
4. William R. Cline and Associates, *World Inflation and the Developing Countries* (Washington, D.C.: The Brookings Institution, 1981), pp. 29-34.

number tells you little about the creditworthiness of any group of borrowers.[5] A country's ability to service its external debt is not simply a function of size but also of the quality of its economic management. Furthermore, in some developing countries, balance of payments deficits and an increasing debt burden are indicative of significant growth.

TABLE 1
*Disbursed Medium- and Long-Term Debt Outstanding**
(billions of dollars)

	1974	1975	1976	1977	1978	1979	1980
Official Sources	63.8	76.2	88.4	104.7	124.0	137.1	156.7
Private Sources	74.9	97.9	123.6	158.0	203.4	235.7	269.4
Total	138.7	174.1	212.0	262.7	327.4	372.9	426.1

* Includes the debt of 96 developing countries and the East African community.
Adapted from "World Debt Tables, Volume I", *World Bank,* November 15, 1980. p. II and VIII and "World Debt Tables", *World Bank,* December 1981 p. XV.

TABLE 2
*Debt and Debt Service Indicators**
(percentages)

	1971	1974	1977	1978	1979
Debt service as a percentage of exports of goods and total services					
Public & publicly guaranteed debt	10.4	7.5	9.5	12.6	12.7
Private & non-guaranteed debt	4.2	4.6	4.9	5.4	5.1
Total Debt	14.6	12.1	14.4	17.9	17.8
Interest service as a percentage of exports of goods and total services					
Public & publicly guaranteed debt	3.3	2.6	3.5	4.3	4.8
Private non-guaranteed debt	1.4	1.4	1.2	1.5	1.7
Total Debt	4.7	4.0	4.8	5.8	6.5
Disbursed debt outstanding as a percentage of exports of goods and total services					
Public & publicly guaranteed debt	97.2	63.6	80.4	88.2	77.9
Private non-guaranteed debt	22.7	18.5	20.5	21.5	18.6
Total Debt	119.9	82.1	100.8	109.7	96.6

* Includes the debt of 96 developing countries and the East African community.
Adapted from "World Debt Tables, Volume I", *World Bank,* November 15, 1980. p. II and VIII and "World Debt Tables", *World Bank,* December 1981 p. XV.

The fear of dangerous overexposure on the part of international banks continues to worry some observers.[6] This perceived threat to the system should diminish, however, as these banks adjust to their role as the major

5. G.A. Costanzo, *The Positive Effect of LDC Lending* (New York: Citicorp, 1981), pp. 1-2.
6. Janssen, p. 1.

source of loans to developing countries. To date, "banks' loss ratios on foreign loans are only one-half that of their domestic lending."[7] In addition, banks appear to be paying more attention to credit risk analysis and have available several sources of debt information.[8] They have also expressed renewed optimism about their ability to intermediate in the petro-dollar recycling process. The current oil glut and drop in prices has reduced the OPEC surplus to what many bankers feel is a much more manageable level.[9]

The frequency of LDC debt reschedulings and the amounts involved should not be taken as a precursor of things to come. One U.S. Treasury Department official closely involved in debt reschedulings projected fewer such actions in 1982.[10] Brazil's Minister of Economic Planning, Antonio Delfin Netto, recognizes the cost of rescheduling: "it would cut off the flow of new loans the country desperately needs, and then Brazil will be in a real recession . . . ."[11]

Thus, although individual countries are experiencing debt management crises, it should not be inferred that the system as a whole is in danger of collapse. Each debt management crisis should be considered on an individual basis.

The experiences of Turkey, the Sudan and Gabon are representative of the different circumstances surrounding a particular country facing a debt management crisis and the response of the international financial community to that crisis. The common denominator among the three countries is that all have experienced debt management crises sufficiently severe to require debt rescheduling. In the absence of creditors calling a country in default on its loans, rescheduling has become the last means employed to salvage a severe debt management problem.

Debt Rescheduling Mechanisms

The institutional mechanism that has evolved since 1956 to deal with official debt rescheduling has been the creditor club. Participants in such

7. Jonathan David Aronson, ed., *Debt and the Less Developed Countries* (Boulder, Colorado: Westview Press, 1979), p. 320. As reported in a study prepared by Salomon Brothers, net losses on international loans for the ten largest U.S. banks declined from $300 million in 1976 to $151 million in 1980. As a percentage of total net loan losses, international losses accounted for 23.2 percent in 1976, declining to 15.3 percent in 1980. Report by Thomas H. Hanley, Jeffrey L. Cohn and Raymond C. Stewart, *Bank Securities Department — Industry Analysis* (New York: Salomon Brothers, 1981), p. 27.
8. *See* Irving Friedman's comments in Janssen, p. 1.
9. "Bankers are Feeling Better about Third World Debts," *World Business Weekly*, 22 June 1981, p. 49.
10. Interview with Alexis Rieffel, Deputy Director of Developing Nations Finance, U.S. Department of the Treasury, Washington, D.C., 5 January 1982.
11. Michael Sienlawski, "$60b Foreign Debt Weighs on Brazil," *Boston Globe*, October 1981.

clubs may include the creditor governments, the debtor government and its advisors, the IMF, the World Bank, UNCTAD, and other interested observers.

The most widely known of these clubs is the Paris Club. The Paris Club is not a permanent, ongoing entity but convenes as an ad hoc meeting of creditors. Actions leading to the convening of the club are initiated by the debtor, and are usually undertaken in cases of imminent default. Designed to last for two days, Creditor club sessions permit creditor countries and the debtor to negotiate an "umbrella agreement," known as the Agreed Minute. This non-binding agreement extends equal treatment to all creditors and serves as the basis for subsequent bilateral negotiations between creditor and debtor where amounts and interest rates are determined.[12]

Though the Paris Club has maintained its ad hoc approach to debt rescheduling, certain procedures and understandings have developed among and between the interested parties. These have been followed in most cases and are summarized here.

1. Debt relief is to be treated as an unusual event
2. All participating creditor governments agree to negotiate bilaterally the same or similar terms of repayment, although interest rates are expected to reflect the cost of capital in the creditor country
3. Originally, only private supplier credits insured by creditor governments were subject to renegotiation. Now, however, official export credits and loans for development assistance are also considered on a case-by-case basis
4. Debt relief is not to be associated with development assistance
5. Previously rescheduled debts are not subject to further rescheduling
6. Periods of debt relief are to be relatively short and the terms non-concessional
7. Adoption of a stabilization program with the IMF is required, along with an IMF stand-by arrangement[13]

The fact that "no formal organization based on internationally agreed criteria has been established"[14] does not detract from the reality of a process which is well established and has adapted to an evolving international financial system. An eighth point could easily be added to those above,

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12. Brian G. Crowe, "International Public Lending and American Policy" in *Debt and the Less Developed Countries*, Jonathan Aronson ed. (Boulder, Colorado: Westview Press, 1979), p. 41.
13. Nowzad and Williams, *External Indebtedness of Developing Countries* (Washington, D.C.: International Monetary Fund, May 1981), p. 22; and Albert C. Cizauskas, "International Debt Renegotiation: Lessons from the Past" in *World Development* (Great Britain: Pergamon Press, 1979), p. 202.
14. Nowzad and Williams, p. 22.

indicating that the official creditors now include in the Agreed Minute a clause that the debtor country "seek to secure from private creditors including banks, rescheduling, financing, or refinancing arrangements comparable to those detailed in the Minute, making sure to avoid any discrimination between different categories of creditors."[15] This statement clearly recognizes the significant role of non-guaranteed private debt in total external debt. It is also an acknowledgement that debt relief will not be as effective as it could be if it fails to take account of private debt.

Other mechanisms for the relief of official debt have also been utilized, most notably donor consortiums under World Bank leadership for India and Pakistan, a donor consortium of OECD countries for Turkey, and strictly bilateral renegotiations with Egypt, Yugoslavia, Gabon and others. Guidelines and procedures similar to those of the Paris Club have been utilized under these arrangements.

A well-defined process for the rescheduling of commercial bank debt is not as easily identifiable as it is for official debt. Commercial banks do not participate in creditor clubs because their interests are somewhat different from those of official creditors, and because they have only recently become major lenders to developing countries. Prior to the mid-1970s, very little private debt was rescheduled. This situation is changing, however, and the Paris Club now urges debtor governments to seek renegotiation of debt with commercial banks. Furthermore, a mechanism for the rescheduling of commercial bank debt is evolving.

This mechanism has centered around the establishment of a negotiating team made up of those commercial banks with the greatest exposure in the particular debtor country. This group of banks (sometimes referred to as the London Club) is charged with reaching an agreement with the debtor on behalf of all the commercial banks involved, often numbering in the hundreds. These negotiations have usually taken place following an agreement between the debtor government and its official creditors, who have the political and legal leverage to require a stabilization plan. Two guidelines have emerged from these negotiations. First, commercial banks have linked their willingness to negotiate to the adoption of a stabilization plan by the debtor. In this respect they are following the guidelines established by the Paris Club and recognize the importance of the IMF. Second, commercial banks have been reluctant to reschedule future interest payments and have insisted, though not always successfully, that interest payments in arrears be brought current.[16] The case studies

15. "Agreement Between the United States of America and Turkey," *Treaties and Other International Acts Series 9909* (Washington, D.C.: U.S. Government Printing Office, 1981), p. 19.
16. Nowzad and Williams, pp. 34-36.

will illustrate that these guidelines were followed closely by the banks involved.

The Actors and the Issues

The number of actors in the debt rescheduling process has increased as commercial banks have assumed the major role in lending to LDCs and as the political and economic considerations of the North-South dialogue have come to the fore in the international arena. The following can be considered to have a stake in debt rescheduling — official creditors, the debtor government, the IMF, the World Bank, other development banks, UNCTAD, commercial banks and advisors to the debtor.

Official Creditors

Official creditors are identified as those governments and their agencies which have outstanding loans to the debtor. This definition does not include multilateral lending institutions, such as the IMF and the World Bank, which have somewhat different interests in the debt management process. For example, in the case of the United States, the official creditor would be the United States government as represented by the Agency for International Development, the Export-Import Bank of the United States, and others.

Responsibility for the renegotiation of official debt owed to the United States rests primarily with the Department of the Treasury and the Department of State. United States policy on debt renegotiation, which is States rests primarily with the Department of the Treasury and the Department of State. United States policy on debt renegotiation, which is shared by the other OECD countries, was defined by the interagency National Advisory Council in 1978. Because it contains essential aspects of the debate over debt rescheduling, it is presented here in full:

1. Debt service payments on international debt should be reorganized on a case by case basis only in extraordinary circumstances where reorganization is necessary to ensure repayment. Debt relief should not be given as a form of development assistance.
2. Debt service payments on loans extended or guaranteed by the U.S. government will normally only be reorganized in the framework of a multilateral creditor-club agreement.
3. When a reorganization takes place that involves government credits or government guaranteed credits, the U.S. will participate only if:

a. the reorganization agreement incorporates the principle of nondiscrimination among creditor countries, including those that are not party to the agreement;
b. the debtor country agrees to make all reasonable efforts to reorganize unguaranteed private credits falling due in the period of the reorganization on terms comparable to those covering government or government-guaranteed credits;
c. the debtor country agrees to implement an economic program designed to respond to the underlying conditions and to overcome the deficiencies which led to the need for reorganizing debt-service payments.

4. The amount of principal and interest to be reorganized should be agreed upon only after a thorough analysis of the economic situation and the balance of payments prospects of the debtor country.
5. The payments that are reorganized normally should be limited to payments in arrears and payments falling due not more than one year following the reorganized negotiations.[17]

These U.S. policy guidelines have evolved within the framework of past multilateral debt reschedulings. A Treasury official identified (a) imminent default and (b) a stabilization plan in place as the necessary prerequisites to any renegotiations with the U.S. government. He further indicated that the adjustment process for the debtor would necessarily be unpleasant and painful, as a situation of imminent default often requires drastic measures to correct.[18]

The political realities of U.S. foreign policy also have an impact on the American negotiating position and have, on occasion, been the primary consideration.[19] In the case of Turkey in 1980, the State and Treasury Departments had agreed on an interagency position. However, the Turkish government rejected the U.S. terms, indicating it needed additional relief on previously rescheduled debt. In this situation the White House intervened, improving the terms for Turkey.

The clearest case of political influence in debt relief negotiations, in the view of a Treasury official, was that of Pakistan in January 1981.

17. *Annual Report to the President and to the Congress for Fiscal Year 1978, International Finance*, (Washington, D.C.: The National Advisory Council on International Monetary and Financial Policies, 1979), p. 81.
18. Interview with Mr. Rieffel.
19. This section dealing with the politics of debt rescheduling is largely the result of the interview with Mr. Rieffel.

Since no imminent default decision had been made by the Treasury Department, White House intervention was necessary in order for debt relief negotiations to proceed. White House involvement was prompted by the Soviet invasion of Afghanistan which focused U.S. attention on Pakistan as a bordering nation friendly to Western interests. Justifying its actions on grounds of overriding national interest, the White House overcame legislative constraints limiting U.S. aid to countries manufacturing nuclear weapons. The resultant debt relief was, in effect, a balance of payments loan and was clearly outside standard U.S. operating procedures and guidelines. The case studies illustrate further the highly political nature of most debt reschedulings involving the interests of the United States and other OECD countries.

The Debtor

The debtor government is in quite a different position from that of the creditor. Although it may have some leverage because of its political importance to the creditor government and/or its significant holding of debt from commercial banks, it is still in a tenuous position. Debt relief negotiations indicate that imminent default is at hand and that, quite possibly, arrears have already accumulated.

The debtor government's real problems may only be beginning as it seeks relief, a fact which debtors seem to recognize since they continue to postpone the seeking of debt relief until default becomes the only alternative. A primary reason for this delay is the stabilization program expected by the creditors. By necessity these programs usually require austere economic measures which often spell political trouble for the debtor government. As one author has indicated, "the number of instances of a change in government about six months before a meeting of the Paris Club cannot be considered a mere coincidence."[20] The stabilization program issue will be analyzed in detail when IMF conditionality and stand-by arrangements are discussed.

For the debtor government the ideal relief agreement would total cancellation of the debt. Although this action has occurred in some cases, it has been limited to the poorest countries where the majority of the debt was of a concessional nature. Of course, debtors would also prefer long grace periods and extended repayment periods. In general, however, both multilateral official and commercial bank debt reschedulings have utilized the "short leash" approach, designed to keep a close rein on the debtor to ensure its compliance with the terms of the stabilization program. In

20. Ghandra Hardy, "Rescheduling Developing Country Debts," *The Banker*, July 1981, p. 33.

sum, it is unreasonable to expect the debtor to secure its desired terms and conditions in a debt rescheduling.

Leverage has been an oft used word in the context of debt management and the debtor-creditor relationship. The ongoing difficulty with the Polish debt rescheduling illustrates this concept, though differences between the debtor and creditor are magnified in this case because of the direct interests of the Soviet Union, the United States and Western Europe. This situation clearly poses serious problems for the international financial system. U.S. hardliners continue to urge Western banks and governments to declare Poland in default with the thought that the Soviets would then be forced to pay off the Polish debt.[21] However, even if the Soviets were to respond to this use of leverage by the West, the effect on the creditworthiness of Poland would be devastating. On the other hand, were the Soviets not to back the Polish debt, the effect on some Western banks could be equally devastating. It is almost inevitable that the short term solution to the problem will be the extension of new loans to Poland in conjunction with a rescheduling and some economic reforms. As one journalist put it, "bankers tend to see Poland as just another part of a sensitive, interconnected international financial system in which debt rescheduling programs and refinancing plans are preferable to defaults in dealing with countries in need of financial rescue."[22]

Another aspect of the leverage issue concerns the relationship between official lending and commercial bank lending to developing countries, i.e., the question of whether creditor governments have lost a great deal of their leverage vis-à-vis debtor governments because of the huge increase in lending by commercial banks. Although creditor governments can and do regulate commercial bank lending abroad (e.g. a current U.S. Treasury Department regulation prevents banks from having more than 10 percent of their international exposure in any one country), the recent increase in commercial bank lending relative to official lending has limited the influence of creditor governments. Bank loan decisions are not based on the foreign policy interests of their governments, and the interests of the two may be totally divergent.[23]

In its less political form the leverage issue revolves around two factors: one, a bank's balance sheet exposure in a particular country and the ability of that country to secure additional loans to ensure the servicing of old loans; and two, a country's reliance on financing deficits, which gives the

21. Hobart Rowen, "Poland's Debt Gives the West Economic Lever," *Washington Post* 17 January 1982, p. G1.
22. Dan Morgan, "West Faces Dilemma on Polish Debt," *Washington Post*, 10 January 1982, p. A19.
23. Rowen, p. G1.

bank a certain amount of leverage over the financial and economic policy of the country. There can be no generalization of where the balance of leverage lies in this relationship. Rather, there have been instances where factors favored the banks and instances where the country was favored.

The International Monetary Fund

The most important role in the debt management process is played by the International Monetary Fund. It is also a very controversial and much maligned role. For example, Lawrence Brainard, senior international economist at Banker's Trust Company, criticized the recent lending policies of the IMF, stating that "conditions attached to Fund lending had been relaxed, undermining the confidence of commercial banks involved in developing country lending."[24] Brainard was criticizing the IMF for turning its attention to factors in the international economy, such as high oil prices and worldwide recession, to find reasons for developing country difficulty, rather than maintaining emphasis on a particular country's domestic fiscal and monetary policies. Some U.S. government officials expressed their agreement with this view at the recent 36th annual meeting of the World Bank and IMF.[25]

The developing world sees the issue quite differently, however, as pointed out in the remarks of the then Turkish Finance Minister, Zuya Muezzinoglu:

> The IMF has a certain way of dealing with problems which causes disagreement with the countries with whom it is negotiating. Turkey cannot close its eyes to the IMF, and the IMF cannot close its eyes to Turkey. But it is the job of the Turkish government to control its economy and we will not share the job with anybody.[26]

At issue here are IMF lending regulations and the conditionality requirements under extended arrangements or stand-by arrangements which utilize the upper credit tranches. Conditionality is the key determinant of members' access to Fund financial assistance. There has been general agreement that this assistance "should be conditional on the adoption of adjustment policies."[27]

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24. David Marsh, "Warning on Loans to Deficit Nations," *Financial Times*, 2 December 1981, p. 1.
25. "Washington, the IMF, and the Third World," *World Business Weekly*, 12 October 1981, p. 63.
26. Charles Meynell, "The Euromarket's Biggest Problem," *Euromoney*, March 1978, p. 32.
27. Manuel Guitian, *Conditionality — Access to Fund Resources* (Washington, D.C.: International Monetary Fund, 1981), p. 2.

Manuel Guitian of the IMF has described conditionality as "a means to ensure the efficiency of the international adjustment process . . . , based on an assessment of the *need* for adjustment, which . . . helps to determine the size and the pace of the required adjustment *effort*."[28] Adjustment in the past has meant, *inter alia,* limits on budgetary expenditures, devaluations of a country's currency, other import restraining measures, export promotion measures, the lifting of price and interest rate controls, encouragement of foreign investment, limits on the accumulation of external debt and other measures designed for a country's specific situation. In general, free market mechanisms are encouraged with a concentration on monetary targets. Quantitative policy instruments and targets "become the guideposts to assess whether the program [is] being satisfactorily implemented and consequently whether the Fund's resources [are] being appropriately used and the objectives of the program [are] being attained."[29]

For creditors, the IMF has come to signify a sort of "credit-checking" institution. A country's acceptance of IMF conditionality prescriptions raises the confidence of the international lending community in the country. Such acceptance has become an unwritten prerequisite to convening the creditor club negotiations on debt rescheduling. The rescheduling of private non-guaranteed debt has also been tied indirectly with the acceptance of IMF conditionality on the part of the debtor.

For the debtor, conditionality can have both political and economic repercussions. The economic solvency of the country is at stake in many cases. The adoption of adjustment measures can ensure solvency through the debt rescheduling that may follow and the possibility of additional loans. The political costs to the government, however, may be high. Politically powerful segments of society may be affected negatively by the adjustment measures, and actions such as the lifting of price controls on foodstuffs may cause urban unrest. Furthermore, the fact that an outside authority, the IMF, is seen as dictating terms to a developing country frequently leads the country's leadership to denounce the IMF and its policies. At the same time, a debtor government can use the IMF as a scapegoat for its difficulties, enabling it to institute needed reforms. All of these factors make negotiations very delicate.

An IMF official explained that the need for what are perceived to be harsh adjustment measures results from the institution being faced with countries which have repeatedly delayed adjustment.[30] The Fund is clearly the bearer of bad news in such a situation. The same official stressed,

28. Ibid., p. 2.
29. Ibid., p. 5.
30. Interview with Anthony Lanyi, International Monetary Fund, Washington, D.C., 6 January 1982.

however, that the IMF tries, to the extent possible, to implement a program designed by the country. Nevertheless, the Fund faces the task of persuading countries to live within their means, a difficult objective particularly in developing countries.

J. de Larosière, Managing Director of the IMF, described adjustment in the following way: "Adjustment means that when the Fund lends to deficit countries, it does so on the basis of policies intended to correct such deficits, so that the money is lent wisely and the beneficiary countries are in a position to reimburse the Fund . . . ." He continued, "there can . . . be no escaping the need for adjustment once an economy has become overvexed. And when adjustment is called for, the prime task must rest with the country concerned."[31]

The Fund plays a neutral role within the creditor club mechanism. It prepares an assessment of the economic situation of the debtor, with balance of payments projections being a priority, and arrives at a figure which gives a good indication of the amount of debt relief and additional loans that may be necessary for adjustment. This information is presented at the meeting of creditors where IMF officials sit as observers and are available to clarify any confusing information. The creditors are most interested in ensuring that a stabilization program has been entered into by the debtor. The debtor seeks to ensure that his interests are represented fairly within the context of the stabilization program.

In negotiations between the debtor and commercial banks, the Fund is available to perform similar functions, and it has done so on occasion.[32] As with official creditors, commercial banks often require the debtor to have entered into a stabilization plan with the IMF prior to debt renegotiation.

The World Bank

The World Bank does not play as significant a role as the IMF in debt management. Within the context of determining the amount of debt relief required, the Bank provides information and its views on the long-run needs and capabilities of the country. It also reports on its planned loans to the debtor. The Bank does participate as an observer within the creditor club and, in selected cases, has conducted debt rescheduling negotiations, as mentioned above.

Commercial Banks

Commercial banks obviously have a vital interest in debtor countries managing their debt effectively because such management ensures the

31. Judy Brister, "The Debt Problem and Other Monetary Issues," *Development Issue Paper for the 1980's* (New York: United Nations Development Program), p. 11.
32. Nowzad and Williams, p. 38.

repayment of interest and principal. As the case studies indicate, banks are extremely reluctant to call a default and, although they have not accepted debt rescheduling with open arms, it has certainly been preferable to default. In addition, banks lack the necessary political and legal leverage to impose any sort of conditionality on debtors. That task has been left to the IMF and to creditor governments.

The role of commercial banks in the debt management process has been identified by one expert as resting upon three ground rules.[33] First, banks agree to "stand still," in other words, to refrain from declaring default while holding off on new loans. Second, banks agree to be patient, recognizing the difficulties developing countries face in implementing a stabilization program. And third, the banks agree to support "a viable reform/recovery program," meaning an IMF stabilization plan. It is essential for the commercial banks to maintain these ground rules given the percentage of total credit they now supply to developing countries. Of particular importance has been their willingness to support the efforts of the IMF in bringing about stabilization in countries with debt servicing difficulties. As a Fund report has indicated, "when a debtor country is negotiating concurrently with the Fund and with the banks, the discussions are necessarily interdependent, reflecting . . . the commonality of interests."[34]

LDC Financial Advisors

A criticism of the Paris Club framework from a developing country perspective has been that creditors possess overwhelming strength in their bargaining position because of their knowledge and expertise in financial matters. This criticism envisions the creditor club as a group of developed countries imposing their will on the less developed debtor nation.[35] In an interesting development, many LDCs have now hired investment bankers from some of these very same creditor countries to help them with their financial affairs. UNCTAD has also been critical of the Paris Club framework and has made efforts to increase its participation in the rescheduling process.

A group of three investment banks is by far the most active and successful in advising Third World governments. These three banks are Lehman Brothers Kuhn Loeb of New York, S.G. Warburg of London and Lazard Frères of Paris. They have been known variously as the Technical Assistance

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33. Irving S. Friedman, "The Role of Private Banks" in *Economic Stabilization in Developing Countries*, William R. Cline and Sidney Weintraub, eds. (Washington, D.C.: The Brookings Institution, 1981), p. 258.
34. Nowzad and Williams, pp. 37-38.
35. Crowe, p. 44.

Group, the Triad, and, more generally, as the Advisory Group. The client list for the Advisory Group has included Indonesia, Peru, Panama, Zaire, Turkey, Gabon, Ghana, Sri Lanka, Senegal, Cameroon and most recently Costa Rica. Their activities have included assisting in the rescheduling of a client's debt and advising on such matters as contract negotiations, steps to promote foreign direct investment, project finance and the restructuring of the domestic monetary system.[36]

In the context of debt rescheduling and refinancing, the Advisory Group has been most active as an advisor to its client in dealing with its commercial bank creditors. The group puts together elaborate reports on the balance of payments projections for its client and undertakes a meticulous determination of the nature and extent of its client's debt. It has been known to contact every commercial bank with loans outstanding to its client to verify the amounts. In Gabon, these efforts were reported to have reduced commercial arrears by $169 million.[37]

Given the services that the Advisory Group performs, there would appear to be some duplication of IMF activities and a potential for conflict. The vice president of one of the banks in the group, however, characterized the relationship between the IMF and the Advisory Group as complementary. He indicated that there are regular high level discussions between the IMF and Advisory Group officials and that the advisors are in a position to help smooth out misunderstandings with the Fund. The relationship was said to be excellent, even to the point of the IMF suggesting possible countries which could benefit from the group's services.[38]

The complementary relationship stems from the IMF's orientation towards a macroeconomic analysis of a country. This analysis is presented on a governmental level and is meant to support the lending decisions of the Fund and its members. The Advisory Group, on the other hand, packages its information in a manner acceptable to the world's financial and commercial community. Banks allegedly accept "as gospel" the reports prepared by the Advisory Group.[39] The group prepares what one official called "a believable balance of payments projection" and determines what debt needs to be rescheduled and what terms the country can live with.[40] The group's activities can also aid the financial community with its credit evaluations of sovereign borrowers.

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36. Francis Ghiles, "The Triad," *The Financial Times*, 27 May 1982; and Ann Critenden, "Consultants to the Third World," *New York Times*, 23 September 1980, p. D1.
37. "Gabon — Quarterly Economic Review," *The Economist Intelligence Unit, Ltd.*, 4th Quarter, 1979.
38. Interview with a Vice President of one of the investment banks of the Advisory Group. He requested anonymity. Future references will be Advisory Group interview.
39. Ghiles, p. 1.
40. Advisory Group interview.

As a general rule, the Advisory Group's advice does not conflict with IMF conditionality. It can, however, give its clients a clearer picture of what programs can be implemented. In addition, the group assists countries in obtaining long-term external finance for specific and general development projects, while the IMF provides relatively short-term balance of payments loans.

The activities of the Advisory Group and other investment banks as advisors to LDCs with debt management problems should be seen as a positive development. Debt management is a highly complex undertaking, particularly for developing countries which not only lack technical expertise, but may also have a difficult relationship with the IMF and its commercial bank creditors. Advisors with the knowledge and expertise to deal with the financial community on an equal basis can not only aid their client but also can smooth the whole debt management process. Jacques de Larosière has said debtors can assist themselves in the debt management process "by compiling adequate records of their external debt and scheduled debt service."[41] This is one service the Advisory Group has provided.

The other group which has been of some help to debtor nations is the Trade and Development Board of the United Nations Conference on Trade and Development (UNCTAD). Its actions must be seen within the context of the LDCs' drive for the establishment of a New International Economic Order (NIEO). One author on the NIEO has written, "what is needed is a means to free Third World countries from the need to pay debt-service on a rising mass of accumulated borrowings that are now being refinanced at ever-rising interest rates and ever-shortening debt maturities."[42]

The relevant resolutions of UNCTAD's Trade and Development Board are Resolution 165 (S-IX) of March 11, 1978 and Resolution 222 (XXI) of 27 September 1980. The former resolution establishes the context for international action on debt relief: "International action . . . would take due account of the country's economic and financial situation and performance, and of its development prospects and capabilities and of external factors, bearing in mind internationally agreed objectives for the development of developing countries." It further states that "debt reorganization would protect the interests of both debtors and creditors equitably in the context of international economic co-operation."[43]

In the latter resolution the operational framework for action is spelled out. As a U.S. treasury official indicated, this framework was designed

41. J. de Larosière, "Recycling: Needs of Countries Compared with Market Capacity," *IMF Survey*, 10 November 1981, p. 350.
42. Brister, p. 12.
43. United Nations Council on Trade and Development — Trade and Development Board, *Debt and Development Problems of Developing Countries* (Resolution 165 (S-IX) 11 March 1978).

by the developing countries as a mechanism for case-by-case rescheduling on demand by the LDC and on its terms. He also indicated that it can be interpreted as fitting the framework of the Paris Club, which is the view the United States has taken.[44]

The important question is, what have been the practical results of these efforts by UNCTAD? The most notable has been that UNCTAD has become established as an observer at Paris Club sessions. Its role beyond that is not clear. The United States and other OECD countries, as the major capital exporting countries and the major sources of funding for the United Nations, would object strongly to any efforts by a UN body, such as UNCTAD, to advise LDCs within the context of multilateral debt renegotiations. It is unlikely, therefore, that UNCTAD will move to implement Resolution 222.

The United Nations Development Program (UNDP) has, however, financed projects in both Nicaragua and Zaire designed to assist those countries to reschedule their external debts. Discussions are underway with UNCTAD for a possible interregional project whose main object would be to assist developing countries to prepare for Paris Club meetings.[45] There have also been discussions on a possible cooperative effort between the Advisory Group and UNCTAD, whereby UNCTAD would hire the group to advise a debtor government and pay the fees.[46] Both the UNDP-UNCTAD and UNCTAD–Advisory Group connections are unlikely to bear fruit due to U.S. and OECD objections.

Case Studies

The case studies presented here illustrate how Turkey, the Sudan and Gabon, faced with the need to reschedule their debts, interacted with the international financial community. Although each country faced a unique set of circumstances, the response of the various actors in the system was largely consistent.

Turkey

Turkey, classified by the World Bank as an intermediate middle income oil-importing LDC, underwent debt renegotiations in 1959, 1965, 1978, 1979, 1980 and 1981. This study will concentrate on the renegotiations conducted from 1978 to 1981 as they are comparable to the other case studies and occurred after the oil shock.

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44. Interview with Mr. Rieffel.
45. Brister, p. 11.
46. Advisory Group interview.

For Turkey, the early 1970s was a time of significant progress and growth. Gross domestic product increased at an annual rate of 6.4 percent during the First Plan period (1963-67), 6.7 percent during the Second Plan period (1968-72), and 7.2 percent during the Third Plan period (1973-77). This growth was accomplished with a moderate amount of foreign borrowing prior to 1974. It was also accomplished using import substitution policies, which adversely affected Turkey's ability to respond to the oil price increase of 1973-74.

A significant contributing factor to the growth of the Turkish economy in the early 1970s was the increase in worker remittances. However, an about-face occurred with the onset of the 1974-75 recession in the industrialized world. Worker remittances from the over one million Turks who were working in Common Market countries dropped from the 1974 high of $1.4 billion to well under $1 billion by the late 1970s. In more practical terms, this drop meant a decrease from over a third of Turkey's import bill to less than a sixth. This loss of foreign exchange was particularly hard on the consumer-oriented industry of Turkey which was heavily dependent on imported materials.

Several other factors at this time also adversely affected the Turkish economy and ultimately required Turkey to borrow more extensively. First, the Turkish lira was overvalued. The IMF, during Article IV consultations, urged Turkey to devalue the lira by a minimum of 20 percent in 1977. Prime Minister Ecevit ignored this advice, arguing "it cannot be accepted that Turkey will have to reduce her growth due to the dictates of external powers.[47] This statement provides a clear example of IMF-debtor antagonism, and is representative of the delaying tactics which forced Turkey to adopt more stringent measures at a later date. The overvalued lira kept imports at an artificially high level and hindered the competitiveness of Turkish exports in the world marketplace.

The structural problems of Turkish industry, such as the concentration of industry in the hands of large conglomerates, also hurt Turkish exports. Because of their reliance on imports, these conglomerates effectively eliminated the need for domestic ancillary industries. The overvalued lira also resulted in imports of industrial inputs which could have been manufactured more cheaply at home, which raised the prices of Turkish products, and reduced their competitiveness in the export market.

A second factor adversely affecting the Turkish economy at this time was the black market, which had arisen because of the artificially low exchange rate and the increased demand for foreign exchange on the part of Turkish importers. An expected devaluation further increased the demand

47. Meynell, p. 33.

for foreign exchange, thus aggravating Turkey's deficit. Turkish traders stocked up on basic materials — raising the import bill while holding off on exports — in hope of better prices after the devaluation.

A third factor which had negative effects on the Turkish economy was an 86 percent increase in the money supply from 1976 to 1977. This increase fueled inflationary spending programs by the State Economic Enterprises (SEEs), producers of 40 percent of Turkish industrial output. The price controls imposed on the output of the SEEs further exacerbated this problem. The balance of payments at the end of 1977 showed a $2.34 billion deficit and worsening financial prospects.

External debt problems for Turkey increased as its foreign exchange crisis worsened. In early 1978 Turkey's official arrears amounted to $3.75 billion, with total external debt of around $15 billion (almost half of GNP) and an additional $350–400 million of overdue payments on convertible lira deposit accounts. "These accounts provided a means for foreign credit to be transferred cheaply to the borrower and remain profitable to the depositor."[48] For example, an American bank would make a dollar deposit with a Turkish bank, which could change the dollars into Turkish lira at the central bank. The lira would then be lent to a Turkish importer of U.S. goods.[49] These convertible lira accounts were originally intended to be a form of trade finance, but they evolved into a means for obtaining foreign currency by the central bank without such a link in every case. The original rate of exchange was guaranteed by the central bank, leaving it to cover foreign exchange losses.

There was some criticism directed at the commercial banks which "poured money into Turkey in the mid-1970s, attracted by the wide margins that followed the first oil crisis."[50] However, the primary reason for the worsening short-term debt situation was the convertible lira accounts.

Despite numerous problems, Turkey stubbornly adhered to its projected growth target of 8.2 percent at the beginning of the Fourth Plan in 1978. This action was unrealistic given the economic situation and short-term prospects. The Turks sought additional credit to improve their financial situation, but at this point the international banking community decided that "they would not participate in a major Turkish credit,"[51] until Turkey had agreed to several conditions required by the IMF. These conditions included a devaluation of the lira by at least 20 percent, a halt in deficit

48. Dr. Betty Slade Yaser, "Why Banks Talk Turkey," *Euromoney*, March 1977, p. 105.
49. "Turkey, Austerity Now — And Hopes for IMF Aid," *Business Week*, 17 October 1977, pp. 53-57.
50. "Strong Medicine and a Guarded Prognosis," *World Business Weekly*, 16 March 1981, p. 31.
51. Pamela Clarke, "Will the Banks and the Fund Make an Example of Turkey?" *Euromoney*, September 1977, p. 21.

financing, a reduction in growth, tighter import controls, the promotion of exports and foreign investment, the reduction of inflation and the reduction of consumer demand. The Turkish government feared a devaluation of the lira and a reduction in economic growth would increase unemployment to a level that would threaten the tenure of the government and possibly bring military intervention, a fear grounded in past experience.[52] After a devaluation in 1959, there had been a revolution, and following a devaluation in 1970, military leaders took over in 1971.

The Turkish government, nevertheless, reluctantly realized in the early months of 1978 that to continue its policies of forced growth with an overvalued currency would most likely lead to greater instability in the long run. In mid-February it abolished the exchange rate guarantee on new convertible lira accounts. This, along with a devaluation of the lira by 23 percent against the dollar, meant a pronounced cutback in the inflow of convertible lira funds. Furthermore, to meet IMF loan conditions, the government cut public spending, set import curbs of $4.85 billion for 1978 (the level suggested by the IMF) and increased prices charged by the SEEs. These measures led to an emergency loan by the IMF of $450 million. Turkey was now faced with trying to secure additional credits, preferably long-term in nature, as well as trying to reschedule its short-term debt and payments in arrears.

The first debt rescheduling operation was arranged through the OECD consortium for Turkey in May 1978. The OECD mechanism was used because the creditors as well as Turkey were members of the organization and it had been used for Turkey's reschedulings in 1959 and 1965. Those reschedulings had accorded Turkey liberal terms relative to Paris Club results. However, the results of the 1978-81 reschedulings were similar to those of the Paris Club. This first rescheduling consolidated $600 million in arrears on guaranteed short-term and bilateral medium and long-term debts and rescheduled $400 million of maturing long-term export credits and loans from governments. A second major rescheduling, covering additional arrears, took place in July 1979.

In September 1978, the Advisory Group, known as the Technical Assistance Group, was hired by the Turkish government to help in the rescheduling with commercial banks. The group was able to reach agreement with 221 commercial banks to reschedule convertible lira deposits and other short-term liabilities. Following this success, Turkey was able to secure additional capital; $407 million was pledged by eight commercial banks, with the World Bank and the Saudi Arabian government supplying additional loans.

52. Meynell, p. 33.
53. World Bank, *Turkey: Policies and Prospects for Growth. A World Bank Country Study* (Washington, D.C.: World Bank, March 1980), p. 35.

The strategic importance of Turkey and the importance of maintaining its stability and its attachment to the West led the leaders of the United States, France, Germany and Great Britain to agree to organize a rescue operation for Turkey's economy. This effort led to the pledge of $1.46 billion in special assistance through the OECD in May 1979, involving mostly medium- and long-term bilateral credits, trade financing credits and program loans.[53]

A major new stabilization program was initiated by Prime Minister Demirel in January 1980, in support of which the IMF approved a stand-by arrangement for Turkey for Special Drawing Rights (SDRs) of $1.25 billion. Nonetheless, Turkey continued to have difficulties in meeting its terms for repayment of debt and, in January 1981, sought to ease its payment terms for commercial bank debt. A vice-president of the Advisory Group who participated in this latest rescheduling indicated that it was obvious Turkey could not meet the terms of the 1979 rescheduling and that the terms would have to be renegotiated. The banks utilized the "short leash" approach to maintain a check on Turkey's implementation of its stabilization measures.[54]

The renegotiation of terms also occurred under the auspices of the OECD consortium. As indicated earlier, the Turkish government sought additional relief from its official creditors which required White House intervention in the case of debt owed to the United States.

As banks utilized their "short leash" approach, the IMF assessed Turkey's progress in preparation for disbursement of the second tranche under the 1980 stand-by arrangement. Under such arrangements, IMF disbursements are in several tranches, thus assuring the maximum degree of monitoring of a country's performance. This element is essential in the IMF's efforts to assist LDC management of deficits. In this case, "they did not find that all was to their liking," and payment of the second tranche was delayed.[55]

Apparently there were four areas of concern to the IMF. First, the exchange rate for the lira appeared overvalued against the Deutschemark and thereby reduced the Turkish lira value of Deutschemark-denominated workers' remittances. Second, the IMF called into question the export boom. Although the figures looked impressive, "the Turks seemed to have gone so far overboard for export promotion that the market had become almost as distorted in their favor as it had been against them in the past."[56] The Turks were engaged in a sort of dumping,[57] and their

54. Advisory Group interview.
55. Tim Hindle, "Turkey Walks the Tightrope," *The Banker*, September 1981, p. 137.
56. Ibid., p. 139.
57. Rates for short-term export credits were more than 20 percent below the rates for non-export finance.

exports had benefited greatly from the disruptions of the Iran-Iraq war. The IMF had serious concerns about the duration of the boom. Third, the SEEs continued to lose money. Fourth, the IMF was not pleased with Turkish tax reforms. It was concerned with the government's ability to raise the necessary revenues to reduce the government deficit.

In addition to these concerns, a confidential OECD report indicated Turkey's need for additional financing of between $800 million and $1 billion for 1982, rising to $1.65 billion to $2.7 billion by 1985. The report also expressed many of the same reservations as the IMF.[58]

It is clear that Turkey will require several years to work its way out of the predicament caused by the imprudent policies of the past. Turgut Ozal, the Deputy Prime Minister in charge of the economy, has frequently stressed that he needs at least four to five years "of both outside support and understanding and of internal stability to turn things around."[59] He does enjoy the confidence of the international financial community and, with the help of the Advisory Group, hopes to see Turkey return to the Euromarket. The foreign debt picture has improved considerably with the help of the reschedulings. Total short-term disbursed debts have been reduced from $6.1 billion to $2.4 billion, and medium- and long-term debts have been increased from $5.5 billion to $15.3 billion.[60]

Further improvements in Turkey's economic condition will depend on Turkey's adherence to the provisions of the 1980 stabilization program. It will also depend on external factors, two of which are of primary importance. First, the ongoing recession in the Western industrialized countries will hurt Turkish exports and make it that much more difficult to raise foreign exchange. Second, protectionist trade policies practiced by some countries, particularly those of the EEC, will have similar effects on Turkish exports. The stabilization program is, however, the most important requirement for a move towards recovery and, along with the political stability brought about by the military takeover, should increase investor confidence in Turkey and restore the country's international credibility.

The Sudan

The Sudan, classified as a lower middle income oil importing LDC, underwent reschedulings in 1979 under the auspices of the Paris Club and with commercial banks in 1981. A somewhat different set of circumstances led to the need for rescheduling in the Sudan, but, like Turkey,

58. David Tonge, "Turkey Requires More Aid for Recovery — OECD," *Financial Times*, 7 December 1981, p. 1.
59. Hindle, p. 139.
60. "Turkey's Economy is Recovering Faster than its Credit Rating," *World Business Weekly*, 28 September 1981, p. 1.

the ensuing stabilization plan will require several years and the continued flow of external aid. Also like Turkey, the Sudan is of strategic and political importance to the West, particularly the United States.

A major reason for the Sudan's debt management difficulties has been the large projects it has undertaken which have been subject to enormous cost overruns and poor management, and which have diverted needed resources from more economically efficient and justifiable projects. The Sudan's Six Year Plan, 1977-83, placed a premium on the development of the Sudan's vast agricultural potential, in an effort to turn the Sudan into the Arab world's breadbasket. By turning the economy away from cotton, the traditional cash crop and major foreign exchange earner, the plan hoped to reduce the Sudanese economy's vulnerability to the fluctuations of the cotton market.

By 1978, little action had been taken on the plan; estimates showed that the Sudan would have to borrow amounts approaching $4 billion in order to implement the plan. Foreign debt at that time approached $2 billion and reserves covered only a week's imports. Projected balance of trade figures showed deficits increasing from $412.5 million in 1977-78 to $532.5 million in 1980-81, although actual performance was far better.[61] A Sudanese economic report recognized the country's development problems: "to opt for all out development over a very short time span could well lead to financial, social and regional imbalances . . . . In many cases effective implementation lags far behind the targets set. Many projects are being shelved or simply dropped."[62]

As indicated earlier, cotton had traditionally been the major cash crop of the Sudanese economy. It declined in importance after a fall in world prices in 1974 reduced its percentage of the Sudan's total exports from 58 percent in 1972 to 35 percent in 1974. This shift prompted a change in the government's agricultural policy. A decision was made to expand the production of wheat and rice, to promote self-sufficiency in basic foodstuffs and expand the output of high value cash crops such as groundnuts, in conjunction with a cutback in cotton production. Profit sharing arrangements also favored a shift away from cotton. To the IMF, this was an ill-advised shift of emphasis. An IMF study indicated the Sudan's comparative advantage lay in cotton. The shift away from it, "resulted in a substantial misallocation of resources in the agricultural sector, with a direct impact on Sudan's trade balance."[63]

The Sudan also suffered from other adverse developments at this time.

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61. Embassy of Sudan — Economic Section, *Sudan — The Country and Its Market* (Washington, D.C.: Embassy of Sudan, 1978), p. 52.
62. Ibid., p. 56.
63. Samir el-Khouri, "Sudan Carries out Broad Program of Reform, but Faces Further Problems in Medium Term," *IMF Survey*, September 1980, p. 269.

There was a large inflow of refugees from Ethiopia following the fighting in that country which imposed financial strains on the economy, diverting development funds. In addition, the oil price increase burdened the Sudanese economy. Oil import costs climbed from $2.4 million in 1973 to $92 million in 1974, accounting for approximately 15 percent of the total import bill in the mid-1970s.[64] Another factor was the loss of middle management expertise to higher-paying countries on the Persian Gulf.[65] Finally, foreign aid reached a peak in 1974-75 and then fell sharply for the next three years. With inflation accelerating worldwide following the 1973-74 oil price increase, the Sudan's import bill increased from $334 million in 1973-74 to $743 million in 1974-75.[66]

By late 1977 and early 1978 the Sudan was in arrears to official creditors and commercial banks. Total disbursed external debt was approximately $1.8 billion, with $400 million due to foreign banks and another $1 billion to Arab countries. *Euromoney* reported the situation as one of

> a country that expected too much from the Arab countries; that borrowed too much from banks that were too eager to lend to it without a proper credit analysis; that went on spending on infrastructural development when it did not have the funds to pay for the necessary imports; and that continued to spend, even when foreign funds finally ran out, by running down its reserves to $18 million.[67]

Repayments were said to be running as much as a year late.[68] Banks were reluctant to call a default, however, in part because the Sudan had insufficient assets to attach.[69] Instead, banking representatives traveled to Khartoum to collect whatever interest and principal payments the central bank could make. It also appeared that the banks were waiting for the IMF team in the Sudan to complete its analysis and, they hoped, to implement a stabilization program with the country.

Agreement with the IMF on an extended facility did not come until May 1979.[70] President Nimeiri implemented his own restrictive policies while emphasizing that his development program would continue, "not-

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64. "Economic Prospectus on the Sudan," *Banque Arabe et Internationale d'Investissement*, July 1977, p. 36.
65. Laura Wallace, "Sudan Refinance Hangs in the Balance," *Wall Street Journal*, 27 October 1980.
66. "Economic Prospectus on the Sudan," p. 40.
67. "Sudan, You're Rocking the Boat," *Euromoney*, March 1978, p. 31.
68. Ibid.
69. Wallace.
70. The IMF's extended facility is a program of funding for up to three years designed to overcome structural balance of payments maladjustments. It requires detailed conditionality prescriptions with drawings in the upper credit tranches disbursed on an installment basis.

withstanding the fact that it has exhausted the national economy and disturbed the foreign accounts."[71] The agreement with the Fund, for the transfer of SDR 200 million over three years, contained further restrictive provisions. First, to achieve economic expansion the agricultural sector would be reoriented toward the production of export crops; second, the development program was to be financed by increased domestic savings and capital inflows; and third, domestic credit expansion was to be held down so as to restore domestic financial balance.[72]

The IMF arrangement was apparently enough to start discussions on rescheduling with both official creditors and commercial banks. Talks with the bank group, headed by Citibank, Chemical Bank, Deutsche Bank, Union des Banques Arabes et Françaises and the Arab African International Bank, began in September 1979. The Sudan requested a refinancing loan of $1.2 billion which would allow it to pay off its arrears of interest to all private creditors, to cover the consolidation and postponement of debt servicing payments to the banks for the next three years, and to provide a small amount of new money. The banks would not agree to this proposal. They offered instead to defer repayments of principal for three years as part of an overall seven year arrangement, but stipulated that arrears of interest be paid immediately with future interest payments kept current. The Sudanese had to reject this offer because of a lack of reserves to make the required payments.

Talks were at a standstill. The Sudan turned to the British investment bank, Morgan Grenfell, to begin discussions again. As in Turkey with the Technical Assistance Group, one of Morgan Grenfell's primary tasks was to determine the amount and nature of the Sudan's commercial bank debt. The government did not have accurate figures of what was owed to whom. This required Morgan to contact all of the Sudan's commercial bank creditors, numbering approximately two hundred, and delayed possible agreement until late 1980.

Negotiations with official creditors were going on in the Paris Club at this time. Agreement was reached and signed in Paris on November 13, 1979, involving the repayment of arrears on a sliding scale and the rescheduling of offical credit. Serious problems remained for the Sudan, despite the agreement. Commercial bank debt had not been rescheduled and the outlook for the Sudanese economy was not promising. Incoming loans were being spent on basic consumer goods, and serious exchange shortages still plagued the economy. The World Bank's Consultative Group for the Sudan blamed the high cost of oil, deterioration of the

71. "Development Programme to Continue," *The Banker*, July 1978, p. 143.
72. "Supplementary Financing to be Used for First Time for Purchases by Sudan," *IMF Survey*, 7 May 1979, p. 145.

Sudan's terms of trade, and the high rate of international inflation for the Sudan's negative economic performance. It indicated that the Sudan would need no less than $800 million per year over the next few years to cope with its balance of payments deficits.[73]

The fourth quarter of 1980 brought some hope for improvement. Under IMF pressure, a parallel market had been established by the central bank to try to improve the trade balance.[74] Furthermore, a new act was passed in the Sudan encouraging foreign investment. Two of its objectives were to "assist in the realization of self-sufficiency and creation of surpluses for export" and "assist effectively in the consolidation of balance of payments."[75] There was also some movement in the negotiations with commercial banks. On October 25, 1980, the five major international banks involved in the discussions agreed to a plan for rescheduling. It was largely along the lines of the original proposal offered by the Sudan in the fall of 1979, although a portion of the interest in arrears was to be paid immediately, with the remainder to be rolled over for three years.

The three year extended arrangement with the IMF for SDR 200 million was increased in November 1980 to the equivalent of SDR 427 million at the request of the Sudanese government. The Fund also agreed to a purchase of SDR 21.8 million under the compensatory financing facility after a shortfall in foreign exchange earnings due to a decline in cotton exports.[76] Finally, in October 1981, a one year stand-by arrangement was agreed to by the Fund for SDR 198 million.[77] These arrangements reflected the continuing difficulties faced by the Sudan and illustrate the essential role of the IMF in the debt management process.

It is clear from the foregoing analysis that the Sudan has difficult adjustments to make in order to improve its economic performance. There have been newspaper accounts of students marching to protest President Nimeiri's austere economic measures. The outlook is not completely bleak, however. The commercial value of recent oil finds is the most important factor brightening the long-term economic outlook. In addition, a return

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73. The World Bank, *Fifth Meeting of the Consultative Group for the Sudan* (Washington, D.C.: The World Bank, 14 April 1980), p. 2.
74. Also known as a dual exchange market system, the parallel market arrangement was designed to increase exports and decrease imports by establishing a separate exchange rate for certain goods. Thus, the official market rate at that time was LSd1 = US$2, while the parallel market rate was LSd1 = US$1.25.
75. Government of Sudan, "The Encouragement of Investment Act, 1980" (26 April 1980), p. 3.
76. A short-term financing facility designed mainly for exporters of primary products who experience balance of payments difficulties resulting from export shortfalls that are both temporary and due to factors largely beyond their control.
77. An arrangement for up to three years with the assurance that the member will be able to make drawings on the Fund, up to a specified amount during a given period, without further review of its performance and policies as long as it has observed the performance criteria.

to the export of agricultural goods in which the Sudan has a comparative advantage, and the completion of a number of its major projects, most notably the Kenana sugar project, should help in the long run. Finally, the continued assistance of the IMF, Western and Arab governments, and commercial banks all but ensures that the Sudan will not face economic collapse.

Gabon

Gabon, an upper middle income LDC, is a very different case from both Turkey and the Sudan because it is a net oil exporter, a member of OPEC, and did not undergo multilateral debt rescheduling. Yet, it is a developing country which experienced severe debt management problems, was required to implement a stabilization program to bring about economic recovery, and was obliged to undergo bilateral debt rescheduling.

Gabon has benefitted greatly from an abundance of natural resources, particularly oil. The four-fold increase in oil prices in 1974 more than doubled nominal Gross Domestic Product (GDP) to $1.7 billion and made available an unprecedented flow of financial resources for development goals. GDP continued to grow at an annual average rate of 9 percent in real terms from 1975 to 1977. It then fell dramatically, by 18.1 percent in 1977 and 30.4 percent in 1978, following the implementation of a stabilization program.[78]

Overambitious development programs and extravagant spending in the 1976-80 Development Plan increased external debt and threatened the stability and growth of the Gabonese economy. The principal element of Gabon's development plan was and remains the construction of the Trans-Gabon Railway, designed to enable the exploitation of forest and mineral resources on a larger scale than previously possible. This project remains an essential element in Gabon's development plans and is clearly well conceived and generally well implemented. The same cannot be said of some of President Bongo's other projects, which included launching a national airline, building a luxurious presidential palace, and building a conference center and road network in and around Libreville, the capital, to host the 1977 meeting of the Organization of African Unity.[79]

The level of external debt in late 1977 was estimated at $2 billion, and there were worries in banking circles that Gabon would not be able to pay its commercial bank debt. What distinguishes Gabon from Turkey and the Sudan, however, is that it "recognized the danger at a comparatively

78. *Republic of Gabon — Annual Report*, Kuhn Loeb Lehman Brothers International Inc., Maison Lazard et Compagnie and S.G. Warburg & Co. Ltd., June 1981, p. 7.
79. "Another Oil Miracle Crumbles," *The Economist*, 16 December 1978, p. 102.

early stage," and took decisive action.[80] The Advisory Group of Lehman Brothers Kuhn Loeb, Lazard Frères, and S.G. Warburg was hired by Gabon in early 1978 to help formulate a stabilization plan. Once again this group of investment banks became intimately tied to the debt management of an LDC. The main goal of the stabilization plan was to ensure that Gabon's international commitments were met and that development plans would not have to be altered drastically.[81]

In June 1978, a one year stand-by arrangement of SDR 15 million was agreed upon by the IMF for Gabon in support of the government's stabilization program. There were several desired goals: reduction in the overall balance of payments deficit, curtailment of the rate of domestic inflation, and improvement of the public debt situation, in particular through a progressive liquidation of arrears in government payments. To achieve these objectives, the plan called for a reduction in government expenditure and a tightening of credit policy in order to limit the growth of domestic credit to an amount consistent with the balance of payments target.[82] It was expected that this plan would take at least one year to show positive results, with an expected current account deficit of $217 million in 1978.

Debt rescheduling and new loans were also part of this transition year for Gabon. Rescheduling was conducted on a bilateral basis with European export credit organizations. The United States did not feel that Gabon was in an imminent default situation and therefore did not participate. On the other hand, the French were very active in the effort to salvage the economy. Gabon, a former French colony, remains closely tied to France through trade, political contacts, and as a member of the French Franc Zone through the Central Bank of Central African States. Similar political, strategic and economic factors were evident in Turkey and the Sudan as well, and certainly help an LDC in its debt management.

1979 and 1980 witnessed a recovery for Gabon, due in large part to the doubling of oil prices. There were some arrears to the French export credit agency, debt servicing costs were still high, and some development projects had to be cancelled. With development remaining cautious, the outlook was nevertheless favorable.

The Advisory Group performed a clarification study in Gabon and, "by the simple device of checking actual claims," determined that $169 million of the estimated commercial debt of $661 million did not exist.[83] Total debt at the beginning of 1979 stood at $2.2 billion, with foreign debt accounting for $1.49 billion. This improved picture allowed further bor-

80. "Gabon: In the Nick of Time," *Euromoney*, March 1978, p. 26.
81. Ibid.
82. "Gabon: Stand-by Arrangement," *IMF Press Release No. 78/33*, 1 June 1978.
83. "Gabon — Quarterly Economic Review," *The Economist Intelligence Unit, Ltd.*, 4th Quarter 1979, p. 2.

rowing, with Citicorp arranging a $100 million medium-term Eurocredit in June 1979. Debt service payments for 1980, as estimated by the World Bank, were $408 million; this figure dropped to $340 million in 1981 and $286 million in 1982.[84] Gabon was expected to be able to cover these amounts without difficulty.

An interim development plan was formulated by Gabon, with the support of an IMF extended arrangement, to cover the 1980-82 period. The aim of the plan was to diversify the economy and make more efficient use of the country's resources while maintaining the relative price stability of 1979-80, improving income distribution, reducing the external debt, and reestablishing an adequate reserve position.[85] In the development area, the main project remains the Trans-Gabon Railway.

As can be seen, Gabon is in a very different situation from the other two countries in this study. However, it too was living beyond its means and was unable to finance its extravagant development plans. Like the Sudan, it was forced to drop some plans and limit its spending. It did not build up arrears in the manner of the Sudan or Turkey, however, and its fortunes improved greatly when the real price of oil began to climb in 1979.

An Evaluation

The role of the IMF was critical in all three case studies in that it maintained access to external sources of finance, which was crucial for these three countries. The international financial community, including official and non-official creditors, recognizes the need for an LDC with debt management problems to enter into a stand-by or extended arrangement with the Fund. It is the conditionality and the periodic review built into these arrangements which restore the confidence of lenders, particularly commercial bankers.

The stabilization programs in Turkey and the Sudan had several similarities, while that of Gabon was substantially different. In all three cases, the stabilization programs were governed by factors relevant to that particular country's situation and did not reflect an IMF blueprint. Despite this, Third World countries have criticized the Fund because it appears to ignore the particular circumstances and the external factors relevant to a country's situation.[86] An attempt to meet these criticisms was made in 1979 by changing the guidelines on conditionality. Nonetheless, if a

84. The World Bank, *World Debt Tables, Volume II* (Washington, D.C.: World Bank, October 1980), p. 59.

85. Arne B. Petersen, "Gabon's New Program for Balanced Growth is Based on Supply-Oriented Investments," *IMF Survey*, 10 November 1980, p. 356.

86. Evan Luard, "IMF Loan Conditions: The Case for Income Redistribution," *Financial Times*, 6 January 1982, p. 4.

country waits until virtual economic collapse before seeking assistance, adjustment measures will probably be harsh. This was the case in Turkey and in several other LDCs. Gabon, on the other hand, sought Fund assistance early on and has successfully managed to work its way out of a crisis without the hardship experienced by some LDCs. The onus of adjustment must remain with the debtor, and, in that context, the role of the Fund in overall debt management cannot be overemphasized.

A criticism of the debt management process was expressed in the World Bank's *World Development Report 1981*: "The institutional framework for debt refinancing and rescheduling must be improved so that liquidity problems are dealt with promptly."[87] The key word here is "promptly," because the delaying tactics of debtor countries have often exacerbated the situation. The present debt renegotiation process leaves responsibility to the debtor to seek assistance if and when needed, but there are measures that could be taken by both creditors and debtors to promote promptness. Information sharing between creditors on a more formal basis would be one means of focusing attention on a debt management problem more quickly. The confidentiality surrounding IMF-debtor country relations, as well as those between commercial banks and the debtors, has precluded such formal information sharing. Increased communication between creditors could result in increased international pressure on the debtor to implement adjustment measures before a crisis develops. A committee made up of representatives from the IMF, the World Bank, creditor governments and major non-official creditors could be established to channel this pressure.

With commercial banks, the promptness issue is partly a function of the number of banks involved, which is very often in the hundreds. Though a small group of banks, often the major creditors, will represent all the banks in the debt renegotiation, the agreement has to be accepted by every bank involved, an exceedingly cumbersome and time-consuming task. Given the fact that commercial banks accounted for 64 percent of the total outstanding medium- and long-term debt of developing countries in 1980,[88] priority should be given to resolving commercial bank rescheduling prior to tackling official debt. What now appears to be a part of many reschedulings is actually a very recent occurrence.

The role of investment banks as advisors to LDCs, which now appears to be a part of many reschedulings, is actually a very recent occurrence. A need was clearly filled by these investment banks, and they appear to have had a net positive impact on the debt management process. They addressed one of the fundamental problems faced by LDCs with access to

87. Quoted in "Making the Third World Less Reliant on Foreign Aid Will Not Be Easy," *World Business Weekly*, 24 August 1981, p. 7.
88. Ibid., p. 6.

external finance-collection, and updating accurate debt information as well as balance-of-payments information and projections. Efficient debt management is virtually impossible without a good idea of the resource flows on hand and those expected in the future. Investment banks have also smoothed out the process of negotiation between the debtor government and its commercial bank creditors. In all cases, the advisors worked within the guidelines of the IMF stabilization program and were thereby complementing the Fund's role.

As was evident in all three case studies, political and strategic factors can enhance a country's access to official external finance. Though resource flows not justified on commercial grounds can exacerbate a country's debt position, the political and strategic justifications behind those flows often ensure that the country will not be cut off from future aid. If these resource flows are used to delay adjustment, the economic solvency of the country can become precarious, and future stabilization efforts are likely to be harsher than would otherwise be the case. The continued flow of resources, however, can lend stability to the system if a stabilization plan is in place.

For non-official creditors competing for markets, financial resources may also be disbursed without economic justification. Risks may be taken by individual banks in order for them to maintain access to a market. However, rather than calling a default when arrears occur, renegotiations have taken place and, in most cases, have maintained a country's access to commercial bank loans. Declaring a loan to be in default involves a demand for repayment in full. This action is unrealistic for both the bank and the country. Unless the banks are able to attach assets of the country to match their exposure, there is no gain. For the debtor, the penalty would be a ruined credit rating and the end of access to the international financial markets.

Once the decision to reschedule a country's debt has been made, the next step is the actual negotiations. For the official creditors, these will usually take place within the framework of a creditor club. Several criticisms have emerged concerning the creditor club mechanism, many of which have been discussed in the context of the North-South dialogue. One author has attacked the Paris Club as providing debt relief which is "too late, too little, and too costly."[89] She argues that the response of official creditors is delayed until the debtor's situation has become critical and the end of all debt service payments becomes likely: "the meeting takes place not to avoid a liquidity crisis but in response to one."[90] This statement may be true, but the crisis has usually been developing for many years

89. Hardy, p. 34.
90. Ibid.

and only reaches a climax because of the failure of the debtor to adjust its economic policies. The author goes on to point out that Paris Club relief "is only sufficient to avoid financial chaos for a year or two" and therefore most countries have had to renegotiate debts two or three times.[91] It is difficult to imagine a situation where the debtor would be completely satisfied with the amount of relief it has been given. The process has evolved with mechanisms for periodic review built in, and the amount of relief granted by the Paris Club should be seen in the context of a continuing stabilization plan. A blank check approach is not a realistic alternative.

A final criticism is that "since 1971 there have been no concessional debt reorganizations."[92] Rather, debt has been stretched out at market rates of interest. At issue is the concept of debt relief as a form of aid which was advocated by the Manila Declaration of 1976. As another author has pointed out, however, the middle income developing countries, concerned about their continued access to the private capital markets, disassociated themselves from this issue. The matter then becomes a question of debt relief as aid to the poorest LDCs, which is largely irrelevant because the great majority of their loans are on highly concessional terms. The same author pointed out two additional weaknesses to this argument. First, some donor countries would consider the debt relief as direct aid and would deduct a corresponding amount from their budget for foreign aid, eliminating any net benefit to the LDC. Second, the aid provided by debt relief would be based on past indebtedness and not on the grounds of need or performance.[93]

The fundamental flaw in LDC debt management has been the reluctance on the part of debtors to "bite the bullet" and initiate adjustment measures which might slow development and could lead to the fall of the government. The stability of the international financial system as a whole has nevertheless been maintained through the efforts of several actors, with the IMF of prime importance.

What is needed is a debt management system that does not undermine the debtor-creditor relationship and yet is flexible enough to resolve, on a case-by-case basis, debt management problems that might place a country in technical default. A 1979 Overseas Development Council publication described a proposal designed to minimize the costs of debt management problems for developing countries.[94] The proposal has a great deal of merit and should be given serious consideration.

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91. Ibid.
92. Ibid.
93. William R. Cline, ed., *Policy Alternatives for a New International Economic Order* (New York: Praeger Publishers, Overseas Development Council, 1979), p. 37.
94. Gordon Smith, in Ibid.

The proposal provides for anticipatory rescheduling of official bilateral debt. Countries with debt servicing difficulties, particularly those with continual difficulties, would be the candidates for the rescheduling. The process would stretch out portions of the public debt with the present value of the remaining loan balances maintained, requiring a hardening of interest rates. This plan was envisioned for those countries which had borrowed heavily to finance the imbalances brought about by the oil shock. It was designed to smooth out the debt service burden of 1979 to 1982, and transfer some of this to the mid- and late-1980s. The concept would be valid at any period of time with a careful analysis on a case-by-case basis. The proposal leaves the option for rescheduling with the debtor country and envisions the Paris Club as administering the proceedings.

The element missing from this proposal is the role of commercial banks. Rescheduling official debt would indicate to banks that perhaps the credit ceiling for that country should be lowered. Assuming banks already have significant exposure in the country under consideration, it would do well to seek anticipatory rescheduling with them as well. For countries already headed for trouble, it would be in the banks' interest to spread out the debt service burden, particularly if the terms would not mean a loss for the banks.

The IMF's role would not change greatly in this proposal. It could act as it does now and be the catalyst for the country to seek rescheduling, suggesting such action during Article IV consultations.

Successful implementation of the proposal would require increased information sharing among the creditors, both official and non-official. It would also require an alteration of the perception of debt rescheduling as a last resort measure to avoid default. Rescheduling would have to be accepted by creditors, particularly commercial banks, as an acceptable debt management tool. The proposal is appealing and could possibly be in practice now if these reservations were overcome and if debtors were not so reluctant to enter into stabilization programs.

Other proposals for reform of the debt management process center largely on the role of the IMF. Some observers feel that debt reschedulings should be under the auspices of the IMF.[95] A U.S. Treasury Department official indicated that the United States would be opposed to such a development, arguing that the IMF is not in a position to decide on terms and conditions because its own credits are not subject to rescheduling. The IMF would necessarily be biased towards favoring terms and conditions that would ensure repayment of its own loans.[96]

Another proposal concludes that debtors should not be required to

95. Hardy, p.38.
96. Interview with Mr. Rieffel.

submit to an IMF stabilization program prior to a rescheduling because the IMF does not know the amount or terms and conditions of relief that will emerge from the rescheduling. Instead, it would be left to the debtor to submit its own debt relief requirements.[97] This argument appears to rest on two assumptions which have proven to be false. First, the IMF has an excellent understanding, through consultations, of both the amount of relief and the terms and conditions of the relief that is likely to result from a rescheduling. Second, it is falsely assumed the debtor will be as hard on itself as a neutral actor and will take the necessary austere measures to bring about stabilization.

Finally, a Treasury Department official indicated that he would like to see a less political process. Political considerations can undermine sound economic policies and have adverse effects on necessary adjustment.[98] Such a depoliticization is unlikely to happen.

The present debt management process should continue to function as it has, successfully dealing with those situations where developing countries have been in technical default. The reason for this assessment is based in part on the effective management of past debt servicing difficulties. But in large measure, it is based on the strength of the International Monetary Fund and the unity of interests among the creditors. Furthermore, there are few benefits to either the debtor or the creditor should the latter renounce its debts or the former declare a default. Though a developing country might gain in the short-run by refusing to service its debts, the long-run cost — the exclusion of the LDC from external sources of finance — would likely be far greater than this short-run benefit. Such a result could seriously hinder its development efforts.

For the official creditors, calling a sovereign country in default would likely result in a protracted legal struggle to determine settlement terms. Relations would probably suffer on other levels as well, which would not be desirable from the creditor's perspective.

The benefits for commercial banks of calling a country in default are dubious as well. Banks would have to weigh the dollar amount of the assets they would be able to attach against their total exposure and the loss of a market. Though it is impossible to say that banks will never declare a default, they have thus far been patient and have agreed to reschedule outstanding debt as soon as interest payments are brought up to date. Cross default clauses, which banks incorporate into their loan agreements, provide a strong incentive against a default decision. The clause requires all lending banks to participate in a declaration of default,

97. Hardy, p. 38.
98. Interview with Mr. Rieffel.

which could undermine the solvency of some. Banks, obviously adverse to bringing about instability in the international financial system, are unlikely to call a default.

The International Monetary Fund will continue to play the critical role in developing country debt management. Not only has it supplemented its own resources but it has also been called upon to play the role of a "financial policeman" by the commercial banking community.[99] Both official and non-official creditors recognize the predominant role of the Fund in the debt management process as do debtor governments, albeit reluctantly in some cases. The IMF, having proven itself capable of adjusting to new roles required by the international financial system, should succeed in preserving the stability of that system.

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99. David Marsh, "IMF 'Should be Financial Policeman'," *Financial Times*, 2 December 1981, p. 18.