Since the outbreak of the third world debt crisis in 1982 the official creditors which include the major creditor governments and the multilateral financial institutes responded to it significantly. Official efforts, dwelling upon the management of third world debt burden, is important from two angles. First, without active official intervention commercial bank debt restructuring would have never taken place. In this context, the role of the official sector, especially that of the multilateral financial institutes like the IMF and the World Bank, was that of a key third party agent in resolving the problem between the other two agents - the individual debtor developing countries and the creditor commercial banks. Secondly, after the outbreak of the debt crisis in 1982 the official finances played a crucial role in mitigating the private creditors' problem with the latter's third world debt exposures. In some part of the third world, especially in the low income countries, the need was felt for restructuring the external debts of the highly indebted nations owed to the official creditors, which was also noteworthy.

This chapter offers a critical appraisal of the official
debt restructuring efforts since the emergence of the debt crisis in the early eighties. In Section 1 the conceptual basis of the role played by the official sector in resolving the crisis is dealt with where an attempt has been made to link it up with analytical issues discussed in chapter 3 and 4. In Section 2 we offer a critical appraisal of official role in managing the debt burdens of the severely indebted middle income countries. This is followed by an analysis of official efforts in dealing with the debt obligations of the severely indebted low income countries in Section 3. A detailed evaluation of the official debt restructuring efforts has been taken up in Section 4. The last section offers a summary of the major findings of the chapter.

6.1 : Third Party Role in Debt Management:

The official efforts in restructuring the debts of the highly indebted developing countries remained a major aspect of almost all the debt management strategies during eighties.

In most of the debt negotiation agreements during eighties the official role was that of a third party intermediation. Third party mediation in resolving the debt crisis and preventing its occurrence in future was perceived necessary for the stability of the international financial system. The third party was to force an individual debtor nation pre-commit a set of policy measures as were deemed necessary to correct the imbalances in its external accounts and to recourse the debtor country towards
adopting a domestic adjustment which would ensure a "sustainable" debt process described in chapter 3. It was also supposed to induce private creditors to extend a minimum flow of new money so that immediate debt default could be avoided.

The major creditor countries undertook prominent efforts in mitigating the third world debt crisis immediately after its outbreak. The active role of these creditor countries was due to the need felt by them to save the international financial system from an impending collapse, because most of the activities of international banks were concentrated in these countries. And the possibility of a major bank run, which became real in the context of large exposures of these banks in major debtor countries of Latin America, would have an adverse repercussion on the lender economies. Another reason for the creditor governments, especially the US, undertaking active interest in resolving the crisis was the trading interests of their economies involved with the debtor countries' economies. These interests of the creditor countries prompted the multilateral financial institutes including the IMF to undertake debt restructuring efforts in severely indebted third world countries. The IMF was found suitable to serve the purpose as its decision making process is strongly biased in favour of the major creditor countries because of uneven voting rights of its members, determined by the individual members' quota. As the major creditor countries hold larger than proportion of quota holdings they enjoy larger than

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proportional voting rights than the third world members of the IMF; and hence, they can influence the decisions undertaken at the IMF easily.

In order to save the system from an impending collapse, a set of measures was thought of including extension of new money to the problem-ridden debtors. However, this new flow of fund became contingent upon the creditor banks' willingness to extend new money to the debtor countries where they had large debt exposures already. As noted in chapter 4 and 5, banks became reluctant in lending new money and rather, demanded debt payments in full. The IMF played a crucial role in trying to induce banks to lend some new money and simultaneously, forced the debtor countries to undertake internal adjustment initiatives. It acted as a guarantor to the creditor banks, by making the debtor countries adhere to a certain set of policies aimed at domestic adjustment of the latter's economies. This was supposed to ease out the fear of the creditor banks about the future debt service payments. This third party role of the IMF found an implicit reference in the models developed by Sachs (1982) and Cooper and Sachs (1985).²

The mediatory role of the IMF can be appreciated in the context of avoiding immediate default by inducing the banks as a group to extend new money to the indebted nations. In the words of Krugman (1985): "The danger that the players may establish incompatible bargaining commitments is partly defused

² See Sachs (1982) and Cooper and Sachs (1985); op. cit. Also, see Chapter 4, Section 4.3.
by having the IMF, through its imposition of conditionality, serve as mediator."³

The role of the Bretton Woods twins - the IMF and the World Bank - as lender of last resort in the wake of the crisis became important too in preventing the immediate defaults. During the case-by-case approach period, financial flows from these two institutes in the direction of the debtor countries met the shortfalls in debt payments to the banks. The gross as well as net flows from them were never adequate enough to alter the direction of net outward transfers of financial resources from the debtor countries during eighties.

Let us recall from chapter 3 that lending to an indebted nation was always held worth undertaking from the creditors' perspective as long as:

\[
B \leq R
\]

(6.1)

where B and R stand for new capital inflow and net factor service payments abroad respectively.

i.e. \((B-R) \leq 0\)

(6.2)

This implies a negative or zero net transfer of resources from lender to borrower. The above transfer, in effect, turned out to be the precondition for preventing default in the immediate short and the long run as it featured as a solvency criterion of the OBMs, discussed in chapter 4. The solvency criterion required that the debtor nation should be able to

³ See Krugman (1985); op. cit.
⁴ See Lomax (1987); op. cit.
liquidate debts over time. For this to happen the necessary condition is worked out as:

\[ \frac{\alpha}{\sum (1 + i)^{-j}TB_j} = \frac{\alpha}{\sum (1 + i)^{-j}D(0)} \]  

(6.3)

where \( i, TB_j, D(0) \) refer to the real rate of interest, the trade surplus in period \( j \) and the initial stock of debt respectively.

Equation (6.3) ensures that debt accumulated after the \( j \)-th period is cancelled through trade surpluses and the country is left with no more than the discounted value of the initial stock of debt \( D(0) \). Now \( TB_j \) simply measures the flow of net real resource transfer to the debtor economy i.e.

\[ TB_j = (X - M), \]

(6.4)

where \( X \) and \( M \) denote exports and imports of goods and non-factor services respectively.

Balance of payments accounting requires that

\[ TB_j = (X - M), = (R - B), \]

(6.5)

Using (6.5) in (6.3) it can be noticed that a debt process to be "sustainable" from the creditors' perspectives warrants a continuous negative net transfer of resources after the \( j \)-th period to service the past debt. An interesting point to note is that equation (6.3) also stands for an equivalent fiscal self-sufficiency in the borrowing country over time for:

\[ TB_j = (X - M), \quad Y_j - (C + I + G), \]

(6.6)

where \( Y \) and \( (C + I + G) \) denote real output and real expenditure respectively with \( C, I, G \) referring to real consumption, investment and government expenditure.

Therefore, to ensure a continuous negative net transfer of
resources over time fiscal self-sufficiency of the debtor country must be guaranteed. This constitutes one of the main elements of conditionality contained in the Fund Bank different lending packages.

The third party role of the IMF was found to be also relevant in the context of the trading interest of the creditor countries. As has been discussed in chapter 2, the imposition of penalty on the debtor nation was apprehensible in the wake of default. The nature of the penalties may be of the following three types:

a) seizure of foreign assets of defaulting nation;

b) denial of access to defaulting nation to international capital market; and,

c) a trade embargo.

Interestingly, it can be noted here that the international trade of the US in proportion of its GNP rose from 19% in 1970 to 24% in 1980. Confronted with the long persisting recession in its domestic economy in the post-war era, US exhibited its desperation in expanding its market areas abroad, which in recent time got reflected in its violent trade activism as expressed through its threats of imposition of different punitive measures on its trade partners (Super 301, Special 301 etc.). If debtor economies were severely hit in case of penal actions taken against them owing to debt defaults the trade interests of the

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5 See Chapter 2.

6 This ratio is calculated from the World Tables.
creditor nations including US would suffer. Simultaneously, the
debt crisis of eighties involving the commercial banks' loan
assets in the third world economies dealt a severe blow to the
financial system in the major creditor countries. The interests
of private finance at home along with the trade-creating
interests of the creditor countries were looking for a protective
umbrella of their governments and the international agencies. In
a way, there involved a dilemma for the creditor governments,
especially for the US, in eighties between their trade-creating
and financial interests. Third party involvement in the third
world debt management policies reflected the overwhelming
dominance of the interests of finance over the trade-creating
interests of the creditor governments. On the one hand, the
emphasis was laid upon domestic adjustment of debtor economies
which aimed at reducing debtors' domestic absorption in order to
increase their trade surpluses so that net financial transfers
of resources could be ensured from these economies, as indicated
by (6.3) above. However, the reduced import demand from the
debtor countries following reduction in their domestic absorption
would have adversely affected, on the other hand, the trade-
creating interests of the creditor economies, especially that of
the U.S. For expanding market areas of the creditor countries,
resumption of real economic growth in debtor economies was
essential, explaining the suggested emphasis on debtors' growth
in the official initiatives in dealing with the third world debt
crisis which include the Baker and Brady Plans. However, these
policies met with little success in resuming growth and expanding

real economic activities in the debtor countries during eighties.

A trade embargo on defaulting nation was likely to adversely affect the trade interest of creditor economies, especially when the latter's economies were severely hit by domestic recession. It would only help to dry up export revenues of the creditor governments. This dwindling prospect of their export revenues in the wake of an embargo or a penal action forced the creditor governments to think in terms of financing bank debt payments of the debtor countries. As Bulow and Rogoff (1989) has pointed out: "if the creditor country enjoys gains from bilateral trade on the same order of magnitude as the debtor country, then the creditor country may be induced to make sidepayments to both the debtor and the banks". New loans from the creditor country governments and the multilateral financial institutes reached out the highly indebted economies only to finance their private debt obligations and, thereby, saved the commercial banks from a debt collapse, in turn preventing the collapse of the entire international financial system.

For the private financial intermediaries including the creditor banks this 'sidepayment' from the creditor country governments was a 'public good'. By extending it, investors' confidence in those banks could be restored. Also, it would ensure for the creditor countries gains from trade with debtor nation and would thereby maintain confidence of creditor country's traders in domestic market of the debtor country.

\[\text{See Bulow and Rogoff (1989) which has been discussed at length in chapter 4, Section 4.3.}\]

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However, as 'sidepayment' was conceived as a public good the problem of free riding was bound to arise. When it became a predictable possibility an active intervention of state was deemed necessary. The 'State' appeared to provide the appropriate mechanism required for the provision of this public good. This opportunity for free riding necessitated an active role to be played by an institution which could operate with supra national authority in the international sphere. As for the individual creditor nation a better strategy in the short run could have been not to provide this public good. However, provision of new money to the debtor nations seemingly clinching the threats of defaults entailed the collective interest of all the creditors in preserving the stability of the international financial system, as has been already noted in chapter 2 and 4. This collective interest of the creditor community made the creditor governments entrust a multilateral agency like the IMF to wield the power of a "supra national authority" and a mediator in the international sphere. The IMF initially and the World Bank later came up with the public good i.e. the new funds for the highly indebted nations who were on the brink of default. New finances from the Fund and the Bank were associated with stringent conditionalities for internal adjustment of the debtor's economy. Through their surveillance mechanism the IMF and the World Bank became the joint 'watchdog' of the economic policies of indebted nations to ascertain that the debtors pursue rigorously internal adjustment in their domestic economies which were supposed to

9 See Chapter 4, Section 4.3.

10 See Chapter 4, Section 4.3. Also, see Cullis and Jones (1987); op. cit.
generate trade surpluses to meet their debt payment obligations along with securing "sustainable" debt processes. Achieving "sustainable" debt process in terms of IMF-aided contractionary adjustment programmes meant continuous net outward transfers of financial resources from the debtor economies\(^{11}\) when net flows in their direction were tapered off.

What ensues from the discussion in this section is the fact that third party role including the major creditor governments and multilateral financial institutes following the outbreak of the global debt crisis during eighties was determined by the interests of the private financial intermediaries and, also, the trade-creating interests of the creditor governments. The latter was in conflict with the interests of finance and, official initiatives tried to accomodate both of them. However, official role was primarily concerned with the interests of the private finance in the major creditor countries in terms of saving the private financial intermediaries from an impending debt collapse. The two most prominent roles of the official third party intermediation were (a) to extend new money to the debtor countries to finance shortfalls in their debt payments and (b) to impose conditionality-led adjustment programmes in the debtor economies. The IMF emerged as the supreme commander of the entire game and acceptance of the Fund-Bank adjustment programmes became the lynchpin of all the debt management strategies devised

\(^{11}\) See Chapter 3.
during this period\textsuperscript{12}. Thus the IMF and the World Bank became the state-Leviathan in delivering the public good to the creditor countries in the North and the supra state in forcing debtor countries of the South to strict adherence to their internal adjustment programmes.

6.2 : Official Role in the Middle-income Countries:

The need for debt relief from the official creditors became widespread in the late seventies following the second oil price shock in 1978-79. The developed countries went deep into recession. Prices of non-oil commodities which constituted the export baskets of most of the developing countries collapsed\textsuperscript{13}. The debtor developing countries found it difficult to tap external resources to service their debt and as a result, debt arrears started piling up. The situation became the worst one in the post war era when external gaps of major debtor nations, especially in the middle income countries of Latin America, could not be bridged by simple debt restructuring, IMF credits or other emergency assistances. The problem did not remain as one of simple balance of payments disequilibrium in one country and instead took the form of widespread global event in the early eighties posing a cataclysmic threat to the entire financial

\textsuperscript{12} Article IV is the vehicle through which the IMF exercises surveillance over the economic performance and policies of its member countries. The main procedure for conducting surveillance include periodic consultations with individual members' policies and performances in the context of regular Executive Board discussions of the World Economic Outlook. See the IMF Annual Report (1987).

\textsuperscript{13} See chapter 2.
By that time it became clear to the official creditors including the creditor governments that the debt servicing disruptions of the middle income countries had culminated into a crisis state. To protect the entire financial system as well as the creditor and debtor countries from the onslaught of it, the active intervention of a third party agent, as discussed in the preceding section, was called for. The onus of steering clear an impending banking crisis as a consequence of huge build up of private banks' debts in the debtor developing countries fell upon the multilateral agencies like the IMF and the World Bank along with major initiatives of the creditor governments.

As noted earlier in chapter 2 in the context of the history of the debt build up process in the developing countries of the world, the accumulation of debt in the seventies the servicing of which soon became a major problem facing the debtor countries of Latin America during early eighties was sometimes attributed to the over-prudent expansion of credits by the private commercial banks. Following the first oil price shock in early seventies the transnational banks were afloat with huge petrodollar deposits of the oil-exporting countries. Throughout the decade of seventies the multilateral creditor agencies and OECD countries preferred to remain in the sideline vis-a-vis the rapid expansion of private credit lines in the direction of the middle income countries. Following the quadrupling of oil prices in early seventies there could have been a widespread balance of payments crisis for the entire developing world which would have

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14 See Chapter 2.
its severe repercussion on the world economy as a whole. While multilateral institutes like the IMF were supposed to redress such balance of payments disequilibrium, had the commercial banks' credit lines been not available then, the question that is still unanswered is whether the IMF along with other multilateral agencies would succeed in meeting the challenge of the time. More so the burden of alleviating the balance of payments deficits of the oil importing developing world was, in absence of bank credit, to fall on the IMF only, since OECD countries themself were encountering similar balance of payments crisis due to oil price hikes. The rescue operation of the world economy was undertaken by the private commercial banks, afloat with oil-surplus deposits.

Barring a few low income countries, for developing countries including the middle income countries there was not much official debt build up during seventies. Till 1980 official debt for the entire developing world grew up to $1595.41 billion from $323.48 billion in 1970 - an annual average growth of 36% approximately. Of which credits owed to the multilateral institutes grew by 51% annually (from $74.39 billion in 1970 to $491.95 billion in 1980) and to the bilateral creditors by 31% annually (from $249.09 billion in 1970 to $1103.45 billion in 1980). This period rather showed a moderate increase in the concessional lending by the official creditors, registering an average annual growth of 23% (from multilateral and bilateral sources together). It became $969.14 billion in 1980 from $270.56 billion in 1970. Table 6.1 gives an account of the source
wise change in official credit from 1970 to 1980 to the developing countries as a whole. Most of the increases in official credits during seventies is explained by relatively large increase in the non-concessional credits to the developing world, rising from $17.34 billion credits in 1970 to 280.92 billion in 1980 - an annual average growth of 138% during the period.\(^{15}\)

Table 6.1

Official Debt Stocks of Developing Countries, Severely Indebted Middle Income Countries and Severely Indebted Low Income Countries (1970 & 1980)

(in US $ billion)

<table>
<thead>
<tr>
<th>Sources</th>
<th>1970</th>
<th>1980</th>
<th>Average Annual Growth (in percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing Countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Multilateral</td>
<td>7.4</td>
<td>49.1</td>
<td>51</td>
</tr>
<tr>
<td>Concessional</td>
<td>5.7</td>
<td>21.1</td>
<td></td>
</tr>
<tr>
<td>IDA</td>
<td>1.8</td>
<td>11.8</td>
<td></td>
</tr>
<tr>
<td>Non-concessional</td>
<td>1.7</td>
<td>28.0</td>
<td></td>
</tr>
<tr>
<td>IBRD</td>
<td>4.5</td>
<td>22.3</td>
<td></td>
</tr>
<tr>
<td>Bilateral</td>
<td>24.9</td>
<td>110.3</td>
<td>31</td>
</tr>
<tr>
<td>Concessional</td>
<td>21.3</td>
<td>75.8</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>32.3</td>
<td>159.4</td>
<td></td>
</tr>
</tbody>
</table>

\(^{15}\) Also, see table 2.11 in chapter 2.
Severely Indebted Middle Income Countries

<table>
<thead>
<tr>
<th></th>
<th>Concessional</th>
<th>IDA</th>
<th>Non-concessional</th>
<th>IBRD</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Multilateral</strong></td>
<td>1.8</td>
<td>0.1</td>
<td>0.7</td>
<td>1.3</td>
<td>6.1</td>
</tr>
<tr>
<td>Concessional</td>
<td>1.1</td>
<td></td>
<td></td>
<td></td>
<td>11.4</td>
</tr>
<tr>
<td>IDA</td>
<td>0.1</td>
<td></td>
<td></td>
<td></td>
<td>1.8</td>
</tr>
<tr>
<td>Non-concessional</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>9.5</td>
</tr>
<tr>
<td>IBRD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6.8</td>
</tr>
<tr>
<td><strong>Bilateral</strong></td>
<td>4.3</td>
<td></td>
<td></td>
<td></td>
<td>24.7</td>
</tr>
<tr>
<td>Concessional</td>
<td>3.5</td>
<td></td>
<td></td>
<td></td>
<td>13.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6.1</td>
<td></td>
<td></td>
<td></td>
<td>36.1</td>
</tr>
</tbody>
</table>

Severely Indebted Low Income Countries

<table>
<thead>
<tr>
<th></th>
<th>Concessional</th>
<th>IDA</th>
<th>Non-concessional</th>
<th>IBRD</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Multilateral</strong></td>
<td>0.7</td>
<td>0.2</td>
<td>0.1</td>
<td>0.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Concessional</td>
<td>0.6</td>
<td></td>
<td></td>
<td></td>
<td>5.5</td>
</tr>
<tr>
<td>IDA</td>
<td>0.2</td>
<td></td>
<td></td>
<td></td>
<td>2.3</td>
</tr>
<tr>
<td>Non-concessional</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3.2</td>
</tr>
<tr>
<td>IBRD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2.4</td>
</tr>
<tr>
<td><strong>Bilateral</strong></td>
<td>3.4</td>
<td></td>
<td></td>
<td></td>
<td>25.4</td>
</tr>
<tr>
<td>Concessional</td>
<td>2.8</td>
<td></td>
<td></td>
<td></td>
<td>17.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>4.1</td>
<td></td>
<td></td>
<td></td>
<td>34.1</td>
</tr>
</tbody>
</table>


During seventies official credit lines expanded more in low income countries than in middle income countries, as table 6.1 indicates. The concentration of multilateral and bilateral credits was in those low income nations where banks did not stretch the recycling of their petro-dollar deposits during seventies. Also, noteworthy is the fact that the growth of non-concessional credit lines was more prominent in those areas where official creditors were involved than in those areas where the private creditors were involved.
For the middle income countries the growth in official debt stock was substantially marginal as compared to the growth in the commercial bank debt stock, 269% annually during seventies (from $23.65 billion in 1970 to $724.85 billion in 1980). Commercial bank debt of the low income countries grew at an average annual rate of 329% during seventies from an initial low figure of $1.56 billion in 1970 but their official debt stock was higher than their commercial bank debt stock ($57.86 billion) at the end of the decade.

Neither for the middle income countries nor the low income countries official debts pose any problem in terms of these countries’ inability to meet required debt payments in due time. Interest payments on official debts as percentage of net official debt flow rose marginally by 3.05% during seventies for the developing countries as a whole. For the severely indebted middle income countries the rise was a marginal 4.52% whereas for the severely indebted low income countries it actually fell by 16.86% as table 6.2 indicates. Ratios of interest payments to net debt flows on account of commercial bank credit for the same period were however substantially higher as compared to that for the official debt.

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See table 2.22 and 2.23 in chapter 2.
## Table 6.2


(in billion US $)

<table>
<thead>
<tr>
<th></th>
<th>Net Debt Flows (A)</th>
<th>Interest Payments (B)</th>
<th>( C = \frac{B}{A} ) (in per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Severely Indebted Middle Income Countries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>0.75</td>
<td>0.21</td>
<td>27.85%</td>
</tr>
<tr>
<td>1980</td>
<td>5.91</td>
<td>1.97</td>
<td>33.37%</td>
</tr>
<tr>
<td><strong>Severely Indebted Low Income Countries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>0.34</td>
<td>0.11</td>
<td>33.04%</td>
</tr>
<tr>
<td>1980</td>
<td>4.94</td>
<td>0.80</td>
<td>16.18%</td>
</tr>
<tr>
<td><strong>Developing Countries</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>3.48</td>
<td>0.87</td>
<td>25.01%</td>
</tr>
<tr>
<td>1980</td>
<td>21.12</td>
<td>5.92</td>
<td>28.06%</td>
</tr>
</tbody>
</table>

Source: *World Debt Tables (1983-84)*.

The debt servicing problems of the middle income countries for the debts owed to the commercial banks prompted the official flows from the bilateral and multilateral sources to these countries during early eighties. The official flows reached out the indebted middle countries only to compensate the shortfalls in their debt payments to the commercial banks. As table 6.3 indicates, since 1983 net flows from official sources including the bilateral and multilateral creditors were at least one-third of the total debt service payments of the severely indebted
middle income countries to the commercial banks. Net flows from the official sources declined during 1987-89 but they covered almost one-third of the bank debt obligations of these countries. During 1990-91, the net official flows in the direction of the severely indebted middle income countries again peaked up mainly to support the commercial bank debt conversion programmes in these countries. In fact, in 1991 the net official flows compensated around 70% of the debt payments incurred to the banks. The decline in net flows from official sources during 1987-89 is coincided with shift in debt management policies from case-by-case to market-based approaches. By 1987 banks were bailed out from the threats of potential debt defaults and their exposures in the middle income economies were reduced. Once again, the rise in net official flows was coincided with the official backing of the market-based debt conversions in 1989, spelt out in the Brady Plan.

The response of the official creditors, especially those of the multilateral institutes, in terms of provision of new money during eighties is different from the official flows to the developing countries during sixties and seventies. In the earlier decades the official creditors responded mainly to the needs of the developing world in terms of providing necessary finances either to bridge their external gaps or to cater to their developmental requirements. But the upsurge of the debt crisis during eighties saw their major concern changed from providing developmental assistance to that of rescuing the overexposed individual commercial banks in the developing countries and
thereby, preventing an impending collapse of the financial system. Restoration of voluntary credit flows to the developing world became a secondary agenda for them, which captured their attention again in late eighties when the danger of an imminent breakdown of the financial system was no longer prevailing. However, the official initiatives could actually do little in resuming voluntary flows of private finances during eighties. Chronologically, it is possible to distinguish two phases of the official response to the global debt crisis which erupted in August 1982 with the Mexican Government’s indefinite moratorium on its debt service payments. The first phase consisted of the period 1983-87 when the official creditors expanded their debt financing operations in mitigating the immediate imbroglio as far as the portending future of the financial system was concerned. The second phase, starting from 1987, involved a shift in the debt management policies from case-by-case to market-based approaches marking the shift in nature of involvement of the official creditors.
Table 6.3

(in billions of US $ and per cent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Official Debt Flows (1)</th>
<th>Total Debt Services to the Banks (2)</th>
<th>Percentage of Net Official Flows (3) [(1) as % of (2)]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983</td>
<td>7.03</td>
<td>22.08</td>
<td>31.85</td>
</tr>
<tr>
<td>1984</td>
<td>7.98</td>
<td>22.66</td>
<td>35.21</td>
</tr>
<tr>
<td>1985</td>
<td>7.10</td>
<td>23.53</td>
<td>30.17</td>
</tr>
<tr>
<td>1986</td>
<td>7.49</td>
<td>21.38</td>
<td>35.02</td>
</tr>
<tr>
<td>1987</td>
<td>6.26</td>
<td>20.13</td>
<td>31.10</td>
</tr>
<tr>
<td>1988</td>
<td>5.97</td>
<td>23.20</td>
<td>25.73</td>
</tr>
<tr>
<td>1989</td>
<td>4.59</td>
<td>14.72</td>
<td>31.17</td>
</tr>
<tr>
<td>1990</td>
<td>9.51</td>
<td>21.29</td>
<td>44.70</td>
</tr>
<tr>
<td>1991</td>
<td>11.49</td>
<td>16.42</td>
<td>69.95</td>
</tr>
<tr>
<td>1992</td>
<td>2.32</td>
<td>10.96</td>
<td>21.13</td>
</tr>
</tbody>
</table>


6.2.1: Phase I (1983-87):

The most distinguishable feature of the official role in this phase was financing of middle income countries' bank debt payments along with the extension of the scope of conditionalities enforced on the debtor countries. The gross flows to the severely indebted middle income countries from the official sources rose from $ 9.5 billion in 1980 to $ 11.1
billion in 1983 and $ 17.3 billion in 1986.\textsuperscript{17} The bilateral flows accounted for 46% and multilateral flows 54% (of which, the IMF's contribution was 8.5%) of the gross flows in the direction of the severely indebted middle income countries during 1983-87. As is evident from table 6.3, these flows entered these countries to leave immediately in order to compensate the shortfalls in debt payments to the commercial banks.

The official role was discernible in terms of providing a protective umbrella to the private financial institutes including the creditor commercial banks. In US, the ILSA was implemented in order to ensure the participation of the banks in the debt financing operations in the middle income countries and also, to prevent the possibility of free-riding by the smaller US banks in receiving any prepayment by a debtor.\textsuperscript{18} This, as we have noted in chapter 5, created a creditors' cartel in dealing with the third world debt crisis.

In the first half of eighties, the scope of the Paris Club debt negotiations was widened. Most of the negotiations under the aegis of the Paris Club during the period were held in the wake of large number of commercial bank debt renegotiations. Practically, the Paris Club negotiations complemented the private banks' initiatives.\textsuperscript{19} Banks made it mandatory for the debtors to have an equivalent Paris Club agreement for London Club

\textsuperscript{17} See World Debt Tables (1990-91, 1993-94).

\textsuperscript{18} See Appendix 5.H at the end of Chapter 5.

\textsuperscript{19} See Appendix 6.B at the end of the chapter.
negotiations. For example, the banks' insistence on Chile to undergo a Paris Club negotiation as a pre-condition for its bank debt restructuring is noteworthy. 20 Paris Club debt renegotiations for the middle income countries took place in tandem with their commercial bank debt restructuring efforts. These negotiations provided a set of rules and principles for debtor to undertake internal adjustment efforts and financed some portion of their debt payments to the banks. The latter explains the banks' insistence on debtors to undergo debt negotiations at the Paris Club in parallel with the debt negotiations at the London Club, as the foremost interest of the creditor banks lay in receiving debt payments than in anything else.

The most discerning feature of this phase is concerned with the prominent role played by the IMF in thwarting the impending collapse of the financial system. It co-ordinated between the commercial banks and the debtor in the major debt relief packages for some Latin American countries with the establishment of Fund-supported programmes. By 1984, it was aiding adjustment programmes in 66 countries involving its commitments of new disbursements of about $21 billion, of which nearly over half was withdrawn by that time. Table 6.4 indicates a sharp increase in the use of the IMF reserves during 1982-84 when the potential threat of debt defaults was at its peak. From 1985 onwards, it gradually withdrew from the rescue operations. By then the threat of debt collapse had disappeared. Also, as noted earlier, a strategic shift took place from the IMF to the World

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20 See Appendix 6.8 at the end of the chapter.
Bank as the lead multilateral institute dealing with the third world debt crisis. After 1985, as table 6.4 shows, financial resources were trasferred from the debtor countries to the IMF.

Table 6.4
Use of IMF Resources (1980-89)

<table>
<thead>
<tr>
<th>Year</th>
<th>CT</th>
<th>BSFF</th>
<th>CFF</th>
<th>EFF</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>1.1</td>
<td>-0.1</td>
<td>0.8</td>
<td>0.2</td>
<td>2.2</td>
</tr>
<tr>
<td>1981</td>
<td>2.6</td>
<td>-</td>
<td>0.7</td>
<td>0.9</td>
<td>4.3</td>
</tr>
<tr>
<td>1982</td>
<td>2.7</td>
<td>-</td>
<td>1.6</td>
<td>2.5</td>
<td>6.9</td>
</tr>
<tr>
<td>1983</td>
<td>3.7</td>
<td>0.3</td>
<td>3.7</td>
<td>2.4</td>
<td>10.2</td>
</tr>
<tr>
<td>1984</td>
<td>4.1</td>
<td>0.1</td>
<td>1.1</td>
<td>4.7</td>
<td>10.1</td>
</tr>
<tr>
<td>1985</td>
<td>9.3</td>
<td>-0.1</td>
<td>-0.4</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>1986</td>
<td>6.4</td>
<td>-0.1</td>
<td>-1.5</td>
<td>-0.7</td>
<td>-1.8</td>
</tr>
<tr>
<td>1987</td>
<td>-1.9</td>
<td>-0.1</td>
<td>-0.8</td>
<td>-1.4</td>
<td>-4.3</td>
</tr>
<tr>
<td>1988</td>
<td>-1.2</td>
<td>-0.1</td>
<td>-0.3</td>
<td>-2.0</td>
<td>-3.6</td>
</tr>
<tr>
<td>1989</td>
<td>-1.4</td>
<td>-</td>
<td>-0.1</td>
<td>-1.1</td>
<td>-2.4</td>
</tr>
<tr>
<td>Total</td>
<td>25.2</td>
<td>0.1</td>
<td>4.8</td>
<td>4.9</td>
<td>21.9</td>
</tr>
</tbody>
</table>

Source: IMF Annual Reports (Various Issues).
Note: Total may not add up due to rounding up.

Agreement on an IMF programme often became a lynchpin of the debt rescheduling rules. Along with enhanced access to the IMF resources for the debtors which was used to make debt payments to the banks, it created an indirect pressure on the commercial banks to reschedule debt arrears and extend new money during the debt financing phase. The failure of a country to meet the IMF conditionalities would thus have cut its access not only to sources of credit but also to commercial bank financing. The web of conditions that followed between the banks and a debtor

21 This shift occured in the Baker Plan. See Appendix 5.C at the end of Chapter 5.
country was the following:

(i) The IMF would provide finances to a debtor country with conditionality for debtor's internal adjustment efforts; and, this money, to be used in debt payments to the banks, would be provided subject to the banks agreeing to reschedule debts owed to them and extend new money;

(ii) The borrower would implement an adjustment programme only if it had entered an agreement with the IMF, the latter financing some portion of the borrower's debt payments to the banks; and,

(iii) The banks would extend new money only if debtor nation committed itself to an IMF-aided adjustment programme.

IMF conditionality thus forced the debtor countries to adhere to the internal adjustment of their economies and simultaneously, protected the banks' interests by arranging some finances for the payments made to them by the debtors. Acceptance by the debtor nation of the Fund conditionality was made a pre-condition for financial support by the commercial banks. This kind of conditionality of one financial institution which helps to spread obligatory adjustment in the debtor economies in order to garner financial support for the other creditors is defined as cross-conditionality\(^\text{22}\).

\(^{22}\) See Griffith-Jones and Rodriguez (1991); op. cit.
6.2.2 : Phase II (1987-92):

This phase, as we have seen in the preceding chapter, involved market-based menu-driven approaches in dealing with the commercial bank debt stock reduction in the severely indebted middle income countries. In the mid-term evaluation of the Baker Plan menu options for the commercial banks were allowed and, finally, the Brady Plan attempted to give fillip to the different menu options.

By 1987, case-by-case approach of debt financing and debt rescheduling came to end, and simultaneously, official involvement in terms of debt financing eroded. Banks' third world debt exposure reduction became the sole objective of the debt management policies.

Market-based debt conversion instruments were used to reduce commercial banks' debt outstanding in the middle income countries. But, as we have noted in the preceding chapter, the commercial banks' exposure reduction was effected through the tapering off in the gross as well as net flows in the direction of these countries following the outbreak of the debt crisis. By 1988 banks were in debt trade business. During 1987-88, the major US banks unloaded substantial stocks of their middle income country debts in the secondary market.\(^{23}\) However, a risky trade and low spread caused a low dealer profile in the secondary market.\(^{24}\) In 1989, the Brady Plan was devised to provide boost to the debt-trade business of the commercial banks. It offered

\(^{23}\) See World Debt Tables (1989-90); Vol. I.

different menu options to the banks out of which the latter were supposed to select the menu(s) of their choice. But notable feature of this phase in terms of third party involvement is the large use of third party (official) financial resources to back the Brady-type menu operations in the severely indebted middle income countries. These resources, mostly some secured assets like US zero-coupon Treasury bonds, were used as collateral in the Brady debt exchange operations and secured the creditors' interests against any possible non-payments in future. Moreover, the entire Brady type operations helped those banks which held back debts and thus could act as free-riders. 25 Sometimes, negative pledges in the syndicated loan agreements discouraged sales of the debts. 26 The resources of the IMF and the World Bank were used as collateral in the Brady deals. As table 6.3 indicates, during 1990-91 net flows from the official sources increased abruptly in the direction of the severely indebted middle income countries which basically went to finance debt and debt service reduction operations in these countries. With the banks' interests waning off in debt and debt services reduction after 1991 official net flows were slashed down abruptly. In 1992 it was the lowest during the period 1983-92, as table 6.3 shows.

The overall availability of the new funds from the official sources fell far short of external financing requirements (net of the availability of the private finances) of the middle income

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25 See IMF Working Papers, September 1987; and also, see Sen (1994); op. cit.

countries in terms of resumption of growth therein. Moreover, some funds of the multilateral institutes, used for debt reduction operations, were diverted from the other heads of these institutes which in normal circumstances meant for the balance of payments and developmental needs of the debtor countries. It was estimated by the World Bank that $30 to $35 billion released from the official sources could actually lead to an average reduction of approximately $6 billion only in annual contractual debt services over the period 1990-93. Projections made by the World Bank indicates that the net long-term financing requirements of the severely indebted middle income countries warranted a much larger flow of funds from external sources to these countries than that potentially covered through debt and debt service reduction operation under the Brady deals. Total debt and debt service reduction during the period 1990-92 was only $19 billion while total debt stock at the end of 1992 was $427 billion of which the debts owed to the private creditors was $213 billion (almost 50% of the total debt stock). Actual debt reduction was not substantial as was suggested by the Brady Plan. Thus, it helped little in reducing debtors' outstanding payment obligations and hence, the pressure on financial transfer of resources abroad from the debtors remained. Despite various debt management efforts, net transfers on debt from the severely indebted middle income countries continuously rose and in 1992

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27 See World Debt Tables (1989-90); Vol. I.
28 See World Debt Tables (1989-90); Vol. I.
29 This figure corresponds to total debt reduction minus buy-back. See World Debt Tables (1993-94); Vol. I.
it became the highest ($ -20 billion) during the period 1986-92.\textsuperscript{30} This is, also, noteworthy because in the beginning of nineties few of the severely indebted middle income countries attracted private financial flows from non-bank sources and despite these flows to them net outward transfers from the region grew and attained its highest level in 1992 which, in our view, probably explains why these countries have failed to achieve economic growth, as was expected, in recent time.

It seems that the debt and debt service reduction posed a dilemma for the official creditors, especially to the multilateral creditors, in terms of extending their financial resources to back these operations. This dilemma dwelt upon (a) the increases in exposures of the international financial institutes in the severely indebted middle income countries; (b) the traditional role of the international financial institutes.\textsuperscript{31} In the officially supported market-based menu operations, bank debts were exchanged for inflexible official debts, partially secured bonds and similar instruments, reducing the debtors' flexibility in responding to downward risks in the financial market in future. This might lead to threat of non-payments to the 'preferred creditors' including the IMF and the World Bank - a distinct possibility when a debtor country would face adverse external shocks and would not have a sufficient cushion of contingency financing. Resolution of the dilemmas of the official creditors should have been placed upon resumption of debtors' 

\textsuperscript{30} See World Debt Tables (1993-94); Vol. I.

\textsuperscript{31} See World Debt Tables (1989-90); Vol. I.
real economic growth along with substantial reduction in debt and
debt service obligations which could help the debtors in
responding to an external shock or unfavourable external climate.
But it seems that the official creditors including the
multilateral institutes protected their interests and hence,
reduced their risks by putting themselves off from extending new
financial resources to the severely indebted middle income
countries. As the World Bank has put it: "Official support for
debt and debt service reduction operations may therefore be a
form of equitable burden sharing - where official creditors take
on a larger share of the debt while commercial creditors take a
loss on their existing debt - as long as overall creditworthiness
improves. Too large an assumption of private risks by the
official sector would, however, not constitute an equitable form
of burden sharing. A significant rise in official resources for
debt and debt service reduction operations is therefore
unwarranted, and undue pressures on the international financial
institutions to increase their risk exposure in severely indebted
countries would not be helpful to the longer term objectives of
these institutions."\(^{32}\) Neither the banks were interested in
admitting loss on their existing debt, explaining the low volume
of debt and debt service reduction, nor the multilateral
financial institutes were able to shoulder larger burdens of bank
debts, leaving the debtor countries to muddle through their debt
overhangs.

For their contractual debt obligations, the debtors solely

\(^{32}\) See World Debt Tables (1993-94); Vol. I.
relied on their internal adjustment efforts. The major burden of debt and debt service reduction was actually borne out by the debtors themselves in terms of the losses of stagnating output growth and rising unemployment owing to contractionary stabilisation and adjustment programmes.33 Along with freezing gross as well as net credit flows to the debtors, the official creditors went on increasing the conditionalities for debtors' internal adjustment efforts, each official initiative remained an improvement upon the preceding one in terms of strengthening the scope and nature of conditionalities for internal adjustment. It resulted in availability of lesser amount of credit with higher level of stringent conditionalities. The official role aided the banks to diversify their debt-assets along with protecting the interests of the multilateral creditors while growth recovery in the debtor nations remained still an unfulfilled dream.

6.3: Official Initiatives in the Low Income Countries:

Most of the debts of the severely indebted low income countries is owed to the official creditors including the multilateral institutes. The debt servicing problem of these countries, mostly located in sub-Saharan Africa, is attributable to several factors34. The major factors are: (a) sharp increases in public expenditure following the increases in the non-oil commodity


prices in early seventies which did not fall subsequently when
the commodity prices came down, resulting in rise in public
borrowing to maintain the expenditure levels; (b) the rise in
interest rates which affected the countries like Kenya, Zimbabwe,
Zambia, Zaire and others which had made significant use of
commercial borrowing; (c) the decline in real net capital
inflows, including external assistance in the eighties; (d)
negative real interest rates in many countries discouraged
domestic savings, encouraged capital inflows and contributed to
debt accumulation by requiring substantial borrowing to finance
investment projects; and, (e) developmental projects with
bilateral credit supports - most of these projects were designed
to improve domestic industry and infrastructure rather than to
boost export production directly. In a nutshell, sub-Saharan
Africa which remained more or less insulated from the first oil
shock at the end of 1973 encountered severe balance of payments
problems following the non-oil commodity price collapse due to
global recession in 1975 and second oil price hike in 1979, and
started borrowing heavily from the official creditors.

The aggregate external debt of sub-Saharan African
countries, excluding arrears, grew from an estimated $ 6 billion
in 1970 to more than $ 126 billion at the end of 1987 - an
increase of more than 650% in constant (1980) US dollar terms.
Total debt service payments on medium and long term external debt
for these countries were estimated to have grown from less than
$ 1 billion in 1970 to more than $ 12 billion in 1985 before
falling to $ 9 billion in 1987. Debt service to exports ratio for
the region rose from an estimated 8% in 1970 to 32% in 1985 before declining to 26% in 1987. However, if debt relief (estimated at $11 billion in 1987) and arrears (estimated at $1-2 billion in 1986 and 1987) are considered, scheduled debt service ratio would have been higher than 50% during 1986-87. The above crudely suggests that the region as a whole was far from being able to meet forthcoming debt service obligations without continuing debt relief on a scale more massive than ever before.

Initial responses to the debt problem of sub-Saharan Africa saw many countries of the region adopting adjustment programmes which aimed at bolstering export earnings, curbing domestic absorption and reducing inflation. IMF supported these programmes through stand-by and external arrangements.

The bilateral creditors provided to the financial assistances and debt relief. Thus while the IMF took a lead role in extending new finances to the region whereas bilateral creditors negotiated the debt relief agreements through the Paris Club forum. The World Bank, too, provided assistance through its structural adjustment lending, initiated in 1980-81.

Significant numbers of sub-Saharan African countries began to request for the Fund arrangements in 1980 and 1981. Outstanding use of the Fund credit, excluding the Trust Fund loans, by sub-Saharan african countries increased from SDR 1.3

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35 Structural Adjustment Lending (SAL) was designed to supplement the Bank's project lending and to supplement resources of the Fund by supporting the adjustment programme developed in conjunction with the IMF.
billion at the end of 1979 to SDR 5.4 billion at the end of 1984. Table 6.5 gives an account of use of the Fund resources by the sub-Saharan African countries during eighties.

Table 6.5

Use of Fund Resources by Sub-Saharan African Countries (1970-87)

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Use of Fund Credit¹</th>
<th>Purchase</th>
<th>Repurchase</th>
<th>Fund Charges</th>
<th>Use of Fund Credit in the General Dept.¹,²</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>-</td>
<td>-</td>
<td>-0.1</td>
<td>-</td>
<td>0.1</td>
</tr>
<tr>
<td>1975</td>
<td>0.4</td>
<td>0.5</td>
<td>-0.1</td>
<td>-</td>
<td>0.6</td>
</tr>
<tr>
<td>1980</td>
<td>0.4</td>
<td>0.7</td>
<td>-0.3</td>
<td>0.1</td>
<td>1.5</td>
</tr>
<tr>
<td>1981</td>
<td>1.4</td>
<td>1.7</td>
<td>-0.3</td>
<td>0.1</td>
<td>2.9</td>
</tr>
<tr>
<td>1982</td>
<td>1.0</td>
<td>1.3</td>
<td>-0.2</td>
<td>0.3</td>
<td>3.6</td>
</tr>
<tr>
<td>1983</td>
<td>1.4</td>
<td>1.8</td>
<td>-0.4</td>
<td>0.3</td>
<td>4.9</td>
</tr>
<tr>
<td>1984</td>
<td>0.5</td>
<td>1.0</td>
<td>-0.5</td>
<td>0.4</td>
<td>5.4</td>
</tr>
<tr>
<td>1985</td>
<td>0.1</td>
<td>0.7</td>
<td>-0.6</td>
<td>0.3</td>
<td>5.2</td>
</tr>
<tr>
<td>1986</td>
<td>-0.3</td>
<td>0.6</td>
<td>-0.9</td>
<td>0.3</td>
<td>5.5</td>
</tr>
<tr>
<td>1987</td>
<td>-0.5</td>
<td>0.3</td>
<td>-0.8</td>
<td>0.2</td>
<td>5.0</td>
</tr>
</tbody>
</table>


Note: 1. excluding Trust Fund loans and SAF loans.
2. at the end of the period.

Bilateral creditors as well as commercial banks made Fund arrangement in the upper credit tranches a condition for the approval of debt rescheduling. In this regard Fund arrangements served as a catalyst for obtaining debt relief. Table 6.6 gives a detailed account of debt relief from the Paris Club and the London Club. Over the five years (1980-84) the total debt relief amounted to $9 billion.
### Table 6.6

Sub-Saharan Africa
Debt Restructured in Paris and London Club (1976-87)

<table>
<thead>
<tr>
<th>Year</th>
<th>Paris Club</th>
<th>London Club</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>0.2</td>
<td>-</td>
<td>0.2</td>
</tr>
<tr>
<td>1977</td>
<td>0.2</td>
<td>-</td>
<td>0.2</td>
</tr>
<tr>
<td>1978</td>
<td>0.1</td>
<td>-</td>
<td>0.1</td>
</tr>
<tr>
<td>1979</td>
<td>1.7</td>
<td>-</td>
<td>1.7</td>
</tr>
<tr>
<td>1980</td>
<td>0.1</td>
<td>0.4</td>
<td>0.5</td>
</tr>
<tr>
<td>1981</td>
<td>1.0</td>
<td>0.6</td>
<td>1.7</td>
</tr>
<tr>
<td>1982</td>
<td>0.4</td>
<td>0.1</td>
<td>0.5</td>
</tr>
<tr>
<td>1983</td>
<td>2.8</td>
<td>0.9</td>
<td>3.8</td>
</tr>
<tr>
<td>1984</td>
<td>1.2</td>
<td>1.2</td>
<td>2.4</td>
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<tr>
<td>1985</td>
<td>2.1</td>
<td>0.1</td>
<td>2.1</td>
</tr>
<tr>
<td>1986</td>
<td>9.8</td>
<td>5.2</td>
<td>15.1</td>
</tr>
<tr>
<td>1987</td>
<td>2.5</td>
<td>0.2</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Source: IMF Annual Report (various issues).

Net flow from the Fund to the region started slowing down in 1984, turned negative in 1986 and 1987. The net outflows from the region to the Fund approached SDR 1 billion a year during this period after the inclusion of Fund charges. However, the Fund's catalyst role continued in securing debt relief for the region. As noted in table 6.6, during 1986-87 approximately $17 billion of sub-Saharan African debt was restructured by the private and official creditors.

After 1983 the World Bank's adjustment lending increased from $0.4 billion in 1985 to more than $1 billion a year in 1986 and 1987. The Bank set up an $1 billion sub-Saharan African
Facility in 1985. During 1986-87 a total of $ 0.7 billion was disbursed out of it. Net transfers from the Bank increased from $ 0.5 billion in 1980 to $ 1.4 billion in 1987.

Despite the availability of debt relief and the continuing attention of the OECD countries and multilateral institutions economic situations in these countries worsened during mid-eighties. By 1987, the position of most of the sub-Saharan African countries became vulnerable. At constant (1980) US dollars, real aid flows fell and net capital flows were positive only because of the effect of debt relief. Moreover, even debt rescheduling was of little use to most of the countries like Uganda and Zambia, the larger portion of whose debt was owed to the multilateral institutes, and by convention non-reschedulable.

The Fund in 1986 established its Structural Adjustment Facility (SAF) to provide assistance on very concessional terms - interest rates of half of 1% and repayment period over 10 years including a grace period of 4 and 1/2 years. This facility was meant for the very low income (IDA-eligible only) countries undertaking programmes of comprehensive macroeconomic and structural adjustment. The amount, as was available under the SAF, however, remained fairly low till the end of 1987 - only limiting 63.5% of the quotas of the Fund’s members over a 3 year period under this head.

36 The exports of the region in 1987 stood at 64% of the 1980 level and real per capita income fell from below the 1970-71 level. See World Economic Outlook.
The Paris Club donor countries agreed to consider more generous terms for rescheduling. Thus they were ready to approve such rescheduling for countries having agreements with the Fund, and not necessarily the traditional stand-by arrangement or EFF.

These initiatives, however, failed to reduce the debt burdens of the severely indebted low income countries. The combined funds, made available from SAF and later ESAF, and other sources (mostly bilateral) still left many countries in unmanageable balance of payments positions.

The major burden of the debt restructuring in the low-income countries was shared by the debtor governments in terms of their domestic adjustment efforts. However, the structural bottlenecks which were more acute in the low-income economies made these internal adjustment efforts more difficult. For them difficulty was more than their middle income counterparts in terms of pursuing an export-enhancing and import-restraining adjustment effort in their domestic economies. First of all, their dependence on non-fuel primary commodities for exports was quite high and in the face of dwindling prices of the primary commodities along with their inelastic demand in the world market it was very difficult for the low income countries to increase exports. Secondly, the diversification of their export baskets called for imports of capital goods which was not possible during

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37 In 1988 in the severely indebted low income countries GDP per capita was $268 as compared to the GDP per capita of $1782 in the severely indebted middle income countries. Cross domestic savings was 11% of their GDP whereas in the middle income debtor countries it was 22% of the latter's GDP. Gross domestic investment in the low income debtor economies was 14% of their GDP and that in the severely indebted middle income economies was 19% of their GDP. Annual population growth in the low income severely indebted countries was 3.2% and in the middle income countries it was only 1.4. Exports as percentage of GDP was 18% in the low income countries while in the middle income countries it was 16. Non-fuel primary commodities constituted 50% of the export basket of the severely indebted low income countries and that in the middle income countries was 79%. Source: World Bank data cited in World Debt Tables (1989-90), Vol. 1.
import-restraining adjustment. More importantly, import restraints implied for these countries freezing the supply lines of basic and capital goods needed for the development of infrastructural facilities and basic industries.

The official initiatives in restructuring their debt obligations offered the severely indebted low income countries finances from the official sources which basically went to honour their private debt obligations. Simultaneously, the scope and nature of conditionalities attached with official finances was gradually enhanced. Different official initiatives, spelt out in creditor country summit declarations\(^\text{38}\), sought to enhance the scope for debt relief for the low income countries outside the purview of usual Paris Club framework. However, at the heart of all these initiatives remained the creditor governments' persisting emphasis on debtor's internal adjustment efforts as a pre-condition for access to the official resources as well as greater debt relief.

From Venice to Houston terms the major features of the official initiatives in managing the debt obligations of the severely indebted low income countries can be summarised as follows:

(i) A menu approach was adopted in special circumstances, replacing the case-by-case approach of debt financing. This allowed some debt conversion of official bilateral debts of these countries, effecting some bilateral debt

and debt service reductions therein. However, the total debt reduction for these countries amounted to only $5 billion as against the total outstanding debt of $174 billion held by the region at the end of 1992.

(ii) Bilateral initiatives in restructuring the debt obligations of the low income countries were to protect the multilateral institutes from possible non-payments in future for the debts of these countries owed to the latter institutes. The share of multilateral debt services of the low income countries remained almost two-third of their total debt services. Arrears on scheduled bilateral debts piled up rapidly for these countries.

(iii) Bilateral initiatives, as expressed through different summit declarations, sought to strengthen the IMF/World Bank adjustment efforts. These bilateral initiatives came in parallel with the introduction of SAF and ESAF by the IMF. For the debtors reaching an agreement with the IMF under the SAF and ESAF became pre-condition for availing debt and debt service reduction from the bilateral creditors. Therefore, the scope of cross-conditionality was enhanced through bilateral debt conversion.

6.4: An Evaluation of the Official Debt Restructuring Efforts:

Official debt restructuring efforts in eighties remained by and
large a spontaneous response to the debt servicing problems of the third world. For the severely indebted low income countries official initiatives saw the debt relief being arranged for these countries for the debts owed to the official creditors along with their bank debts. The major part of the official debt management strategies in the severely indebted middle income countries were evolved in the wake of these countries' payment problems for their debts owed to the commercial banks. Debt negotiations were held at the Paris Club in tandem with the commercial banks' debt negotiations at the London Club. Several debt rescheduling agreements including two MYRAs for the Paris Club eligible debt were reached with the individual debtor countries under the case-by-case framework. Similarly, in the wake of the market-based menu approaches the Paris Club debt negotiations too adapted to the new approach and offered to convert official bilateral debts of several indebted nations.

Third party mediation in dealing with the bank debts of the middle income countries bailed the private commercial banks out of the prevailing impasse created by the third world debt crisis and saved them from an impending debt collapse. The implications of the third party role of the official creditors on the debtors, creditors and the international financial system can be ascribed to the following factors:

(a) aversion of immediate threats of default, posed by the severely indebted middle income countries during early eighties;

(b) saving the international financial system from an impending
collapse;
(c) protecting the trade interest of creditor countries;
(d) inducing the banks to participate in the concerted lending for debt financing;
(e) taking care of free riding by individual banks in extending new money to the debtors and in receiving debt payments; and,
(f) compelling the debtors to pre-commit domestic adjustment efforts which would ensure a 'sustainable' debt process.

The most important implication of the third party-mediation on the debtors was the enforcement of severe conditionalities for debtors' internal adjustment efforts. The notion of cross-conditionality gained prominence during this period in the context of a veritable explosion of conditionality associated with the Fund-Bank lending to the debt-ridden developing countries. Earlier cases of conditionality attached lending by the IMF (e.g. upper tranche lending) could not be regarded as one of involving cross-conditionality. This is because there exists a fundamental difference between conditionality in its conventional sense and cross-conditionality. With the former case conditionality was used to ensure the full implementation of projects or utilisation of the fund exclusively for the purposes they were taken. Thus it remained a kind of a memorandum of understanding between a creditor and a debtor in their bilateral

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39 IMF's high conditionality lending, especially lending under stand-by, EFF, SAF and ESAF, is regarded as the most desirable pre-conditions by the other creditors to extend new loans or to provide debt relief to the debtors. Increasingly, the World Bank SAL and SECAL which also involve high conditionality have started assuming the same role. Some bilateral agencies - USAID, ODA and CDA - and regional developmental banks have started enhancing the perceived impacts of their aid programmes via high conditionality.
relationship. A bilateral relationship, however, usually got transformed into a multilateral relationship between creditors, donors and the international financial institutes in the course of third world debt management policies during eighties. As noted by Griffith-Jones\textsuperscript{40}, because of cross-conditionality the number of links between different creditors and internal political and economic agents (outside the national government) and the frequency of interactions among them had increased. This has caused a shrinkage of freedom enjoyed by the debtor governments with respect to national economic policy formulation and also reduced scope for independent manoeverings.

Initially this cross-conditionality, attached by the Fund through its stand-by and EFF lending, served to create a space for concerted lending approach by inducing banks to extend new money and reschedule their developing country debts. Gradually, the nature and scope of cross-conditionality became rigorous for the debtors. The introduction of SAFs and ESAFs reveals the attempts of the Fund in making the conditionalities more stringent for the use of its scarce funds by a debtor country. The Bank, also, through its SAL or SECAL tried to impose stricter vigilance and policy guidelines on debtor economies in order to secure commitments from other official and private creditors\textsuperscript{41}. In mid-eighties with the announcement of the Baker Plan the Bank gained more prominence vis-a-vis the Fund in the sphere of third

\textsuperscript{40} See Griffith-Jones and Rodriguez, (1991); op. cit.

\textsuperscript{41} In fact, the Bank's SAL tried to reinforce the strategies under the IMF agreements and complemented them in areas outside the pursuit of the Fund activities. Since the emergence of the SALs and the SECALs there is great overlaps between the areas of policy reform between the Fund and the Bank. The approval of a SAL calls for an IMF upper tranche credit agreement before hand as a pre-condition.
world debt management. By 1987 it became imminent that banks were no longer interested in extending new money or in arranging debt rescheduling for the indebted nations. With the emergence of the market-based approaches Fund/Bank conditionality-led adjustment (under SAF, ESAF, SAL and SECAL) became mandatory for a debtor country to avail some debt reduction from its creditors including the commercial banks and the bilateral creditors.

SAF was introduced in early 1987. By October 1987, 21 countries entered SAF arrangements with the IMF. To be eligible for the loans under the SAF which was essentially meant for the low income countries, a debtor had to develop medium term policy framework for a three year adjustment programme in consultation with the Fund and the Bank. In that event SAF generated a tendency towards greater coordination of activities between the IMF and the World Bank. Also, it initiated a process of greater institutionalisation of cross-conditionality between the different credit agencies. Widespread use of SAFs, as apprehended by the Group of 24 developing countries (G-24) in 1986, might tend to institutionalise cross-conditionality for all debtors.42

A second important element of cross-conditionality includes the fact of broadening the framework for an extension of high conditionality. During eighties the proportion of lending under the upper credit tranche high conditionality drawings increased sharply. The fact that the low conditional facilities like the CFF and the Trust Fund flows (now transferred to SAF) became less

42 See Griffith-Jones and Rodriguez (1991); op. cit.
automatic than seventies and far closer to traditional upper tranche conditionalities was in conformity with this increase. The objective was to bring a debtor under concerted pressures of the international financial institutes and creditor governments, who dominate the decision making process in the multilateral institutes, to persist with its rigorous adjustment efforts.

Extension of high conditionality clauses is closely linked to a gradual realisation on the part of the Fund and the Bank in the mid-eighties that the debt servicing problems of the developing world were not amenable to the short term solutions. Moreover, the IMF did not have the adequate resources and was lacking in basic approach to redress the debt servicing problem of a large number of its members on its own. This warranted a co-ordinated policy of lending by the IMF and the World Bank. In this regard, the Articles of the IMF and the World Bank provided the legal basis for co-operation between each other as well as with other organisations.\footnote{See Griffith-Jones and Rodriguez (1991): op. cit.} More than this legal basis the sequence of events in the global economy starting from the first oil price shock in the early seventies, world recession thereafter, the collapse of non-oil commodity prices, the second oil price shock to the large scale external payments problems of a vast number of developing countries coupled with periodic bouts of world recession and persistent low growth phenomena all over the world prompted these two Bretton Woods institutes to work in tandem with each other so as to save the global monetary and financial systems from an unprecedented collapse in the post-war
era. The Fund Bank co-operation could be traced back to 1974 when EFF was introduced by the Fund just after the first oil shock in 1973 which became a sort of benchmark pre-condition for the availability of the Bank's assistance. The joint collaboration between the IMF and the World Bank was enhanced further with the latter's growing involvement in late seventies in assisting its member countries with balance of payments difficulties - the task which was entrusted to the Fund at the time of its inception in 1944. With the launching of the Bank's SAL programme in 1980 this role for the Bank, also, became formalised. In addition, there remained the fact that a Fund stand-by agreement was necessary for a member country to approach the Bank for a SAL. There was lot of concurrence between SAL and an agreement with the IMF under EFF/SAF/ESAF. The most common areas of overlap were tariff reform, import liberalisation, and incentives for exports. The underlying objectives of the facilities of both the institutes include export-led growth. This vindicates our view with regard to the third party role of the Fund and the Bank in ensuring a debt process "sustainable" and viable from the creditors' perspectives, as discussed in chapter 3.

The widespread debt crisis in the beginning was perceived as a short-lived phenomena and a fall-out of a typical cyclical downturn in the world economy. The Fund intervened promptly into the debt management process of the commercial banks. But by mid-eighties gradually the perception of the official agencies including the IMF and the World Bank changed regarding the nature and intensity of the crisis. It was realised that case-by-case
approach of debt financing and debt rescheduling could not be sustained for a long time as banks were becoming more and more reluctant in extending new money. This change in perception saw the increases in the rigour of the Fund/Bank cross-conditionality. As a result the prevailing stand-by and EFF arrangements became almost void and were replaced by more rigorous SAF and later by ESAF. These latter two arrangements contain stricter conditionalities than the former. On the other hand, along with the growing realisation of the changed context it was also felt that given the nature and magnitude of the crisis the Fund did not possess adequate resources to back the debt relief operations. The onus then started falling upon the Bank too. Following the Plaza Agreement in September 1985 where the Baker Plan was spelt out there occurred an important shift in emphasis. The debt crisis was seen foremost as an internal problem of the debtor economies and hence, its solution was placed upon the domestic adjustment efforts of the debtor governments which warranted increasing conditionalities as well as greater co-ordination among the Fund and the Bank in effecting them. This shift was implicitly articulated in the Baker Plan in terms of its significant thrust for a move away from short term balance of payments stabilisation to longer term objectives of adjustment in debtor economies which was reflected in SAF and ESAF as well.

There was hardly any case of outright debt forgiveness since the eruption of the debt crisis. But the gross as well as net flows from the private and official sources dried up while actual
debt reduction through market-based approaches remained marginal. Creditors' unwillingness in providing new money entailed the debtor countries into more vulnerable position by cutting them off from the international capital markets for many years despite the premise of restoration of access to voluntary flows. The severely indebted nations were left to find their way out of the debt problem and it was expected that by enhancing their exports and restraining imports over time they would be able to reduce their relative debt burdens to "sustainable" levels comparable with a return to more normal international capital market access.

Between 1982-92, the obligations of many debtor countries for their debts owed to the private and official bilateral creditors was ostensibly made tractable through rescheduling, restructuring, cancellation and conversion of major portions of these debts in terms of the viability of the creditors' loan-asset holding. Table 6.7 indicates the amount of official debt restructuring between 1982-91 for the severely indebted middle income countries and the severely indebted low income countries respectively.
Table 6.7
Debt Scenarios
of the Severely Indebted Middle and Low Income Countries
(1986-92)

(in billion US $)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Severely indebted middle income countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Debt Stock</td>
<td>405</td>
<td>456</td>
<td>440</td>
<td>435</td>
<td>448</td>
<td>454</td>
<td>456</td>
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<tr>
<td>Rescheduling</td>
<td>18</td>
<td>95</td>
<td>63</td>
<td>19</td>
<td>50</td>
<td>17</td>
<td>47</td>
</tr>
<tr>
<td>Reduction</td>
<td>0.6</td>
<td>2.2</td>
<td>11</td>
<td>11</td>
<td>16.7</td>
<td>2</td>
<td>9.1</td>
</tr>
<tr>
<td>Gross Flow</td>
<td>35</td>
<td>34</td>
<td>34</td>
<td>29</td>
<td>32</td>
<td>28</td>
<td>38</td>
</tr>
<tr>
<td>Net Flow</td>
<td>13.4</td>
<td>13.4</td>
<td>10.7</td>
<td>-1.0</td>
<td>5.9</td>
<td>4.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Net Transfer</td>
<td>-11.5</td>
<td>-10.8</td>
<td>-17.8</td>
<td>-22.1</td>
<td>-11.4</td>
<td>-13.6</td>
<td>-13.1</td>
</tr>
</tbody>
</table>

| **Severely indebted low income countries** |      |      |      |      |      |      |      |
| Debt Stock           | 132  | 163  | 167  | 171  | 174  | 180  | 175  |
| Rescheduling         | 7.6  | 14   | 7.7  | 12.5 | 4.0  | 12.9 | 6.2  |
| Reduction            | 0    | 0    | 0.3  | 0.3  | 0.3  | 0.7  | 3.5  |
| Gross Flow           | 12   | 11.4 | 11.7 | 10.3 | 10   | 8    | 6.6  |
| Net Flow             | 7.7  | 8.4  | 7.9  | 6.3  | 5.0  | 3.5  | 1.7  |
| Net Transfer         | 4.8  | 5.8  | 3.9  | 2.3  | 0.5  | -1.0 | -1.9 |


Note: Figures are rounded up for convenience.

Over the period, an increasing volume of official debt and debt service payments had been rescheduled. However, reduction in private and bilateral obligations was partially offset and replaced by far less flexible multilateral debt build-up in the low income countries. By convention these obligations are non-reschedulable or non-reducible. The multilateral debt build-up was owing to a chain of sequential events as follows:
(a) Between 1982-85, the IMF organised a series of involuntary lending packages for debtor countries which resulted in a large amount of new IMF and multilateral bank borrowing by debtor countries largely to repay interest on their commercial obligations.

(b) Between 1986-88 the IMF began to withdraw its resources from debtor countries, exacerbating the problem of net resource withdrawal by banks and leaving essential resources to be financed largely by multilateral banks, mainly the World Bank, and by the debtors' trade surpluses.

(c) Between 1989-92 the World Bank's net transfer to debtor countries turned out negative. This was the time when regional developmental banks came in a big way to provide the last line of defence for refinancing take-outs.

(d) Throughout the ten year period spanning from 1982 to 1992 private and official bilateral creditors withdrew a large amount of resources from the severely indebted middle income countries but allowed their claims on severely indebted low income countries to rise exponentially by making unpaid interest and arrears obligations to be compounded and capitalised.

For the developing area as a whole, the stock of debts owed to the multilateral institutions had tripled from $98 billion in 1982 to $304 billion in 1992, growing at an annual rate of 13% over the decade. By 1992, debts owed to the multilaterals accounted for 18% of the total outstanding debt stock of all the developing countries. Of this, over $43 billion was owed by the
severely indebted low income countries, four times of the amount owed in 1982 and almost 25% of all debts owed by them. Nearly $73 billion was owed by the severely indebted middle income countries, three times of the amount owed in 1982 and accounting for 14% of their total debts. Thus more than one third of the total multilateral debt stock outstanding was owed by the countries which were severely straining by their external debt burdens.

This multilateral debt pile up is a matter of grave concern for the nineties, for one reason that these debts are owed to preferred creditor institutions of which debtor countries are themselves part owners. The penalties for default or delay in meeting scheduled obligations to any multilateral institute are much harsher than for obligations to any other type of creditors. Debtor countries now have in their liability portfolios too large a proportion of hard and rigid debt service obligations to the institutes who are supposed to be the "lenders of last resort". If that is the case then the pertinent question is who will bail these institutes out if a debt crisis of the scale witnessed in eighties breaks out once again in future. The official bilateral initiatives of major creditor country governments' co-ordinated efforts in offering some selective debt relief to some severely indebted countries reflects this fear and actually, sought to provide a protective umbrella to the multilateral institutes.
6.5: Summary:

The major findings of the chapter are the following:

(i) The official creditors, especially the multilateral institutes the IMF and the World Bank, responded promptly in resolving the third world debt crisis. For their active intervention and intermediation creditor commercial banks could be bailed out of the prevailing impasse.

(ii) Over the period following the debt crisis it is observed that commercial bank debt stocks were replaced in most of the cases by the official debt stocks. Debt restructuring took place for the official debt stocks and debt payments as well. But the debts restructured, thereby, were mainly those owed to the bilateral creditors. Multilateral credits were not restructured.

(iii) In case of low income countries, especially those located in sub-Saharan African region, official debt stocks are major causes of concern in the nineties. These countries required special attention of the creditors and the policy-makers. Most importantly, if the debt crisis of the sort experienced with the commercial bank loans in the eighties breaks out with the multilateral credits in nineties who will bail out the lenders of the last resort?

(iv) The most important role the official creditors like the IMF played in the eighties was to subject the indebted
nations to domestic adjustment policies through their lending programmes. This was crucial in effecting a continuous negative flow of resources to these countries, as discussed in chapter 3.
APPENDIX

6.A : Paris Club Debt Negotiations Framework:

(i) Paris Club is the forum for negotiating official bilateral debt restructuring. It includes all the creditor countries which guarantee private export credits against transfer or political risks. The bigger OECD countries are its regular members. But other countries with export credit insurance also take part. Since 1979 the French Treasury has provided the Paris Club with a permanent secretariat and a chairman. But it does not have any charter, by-laws and permanent membership. Decisions are generally made by consensus. Debt relief normally covers debt services due within a short period of time, generally 12 - 18 months. Both principal and interest can be rescheduled. Sometimes it covers arrears on principal and interest payments. Debt rescheduling under the Paris Club includes inter-governmental loans and officially guaranteed export credits; but excludes short term debt and debts incurred after the agreed cut-off date. Paris Club debt negotiation meetings normally last for a day. At the close, an 'Agreed Minute' is signed. An individual debtor country has to reach an agreement separately with the government of every creditor country to whom it owes its debts. These agreements incorporate the terms and conditions of debt relief laid down in the
Agreed Minute of the Paris Club negotiation."

(ii) Between January 1980 and November 1992, 192 agreements have been negotiated under the aegis of the Paris Club. A sum total of $192.19 billion of developing country debts had been rescheduled with the official efforts. Table 6.A.1 gives a summary of the number of agreements negotiated and the total amount rescheduled in these negotiations every year. On an average 14 agreements were signed every year during this period.

Table 6.A.1
Debt Restructuring Agreements with Official Creditors
(January 1980-November 1992)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Agreements</th>
<th>Amount Restructured</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>03</td>
<td>2.6</td>
</tr>
<tr>
<td>1981</td>
<td>09</td>
<td>3.2</td>
</tr>
<tr>
<td>1982</td>
<td>06</td>
<td>0.6</td>
</tr>
<tr>
<td>1983</td>
<td>17</td>
<td>8.7</td>
</tr>
<tr>
<td>1984</td>
<td>14</td>
<td>4.5</td>
</tr>
<tr>
<td>1985</td>
<td>22</td>
<td>17.4</td>
</tr>
<tr>
<td>1986</td>
<td>17</td>
<td>11.7</td>
</tr>
<tr>
<td>1987</td>
<td>17</td>
<td>23.8</td>
</tr>
<tr>
<td>1988</td>
<td>14</td>
<td>7.7</td>
</tr>
<tr>
<td>1989</td>
<td>23</td>
<td>16.7</td>
</tr>
<tr>
<td>1990</td>
<td>18</td>
<td>17.3</td>
</tr>
<tr>
<td>1991</td>
<td>16</td>
<td>65.8</td>
</tr>
<tr>
<td>1992</td>
<td>10</td>
<td>11.5</td>
</tr>
<tr>
<td>Total</td>
<td>192</td>
<td>192</td>
</tr>
</tbody>
</table>

Source: World Debt Tables (various issues).
Note: Total may not add due to rounding up.

Debt Negotiations at the Paris Club:

(i) For middle income countries like Argentina, Brazil and Mexico the Club negotiated debt restructuring agreements during eighties. In the case of Argentina, for instance, a restructuring of debt service falling due between January 1985 and March 1991 on loans contracted before December 10, 1983 was negotiated. This was arranged in terms of three separate agreements signed in January 1985, May 1987 and December 1989. Repayment terms as were agreed upon were of 9 and 1/2 years maturity and 5-6 years' grace period. The Argentine debt restructuring agreements were held in tune with the rescheduling agreements signed with the banks. Official debt relief programmes as continued later also paralleled with a DDSR agreement with commercial banks.

(ii) Examples drawn from the Chilean experiment provide some important observations as far as official debt restructuring effort was concerned. Chile entered the debt restructuring agreements with its official creditors in July 1985 and April 1987 outside the Paris Club forum. In order to protect its creditworthiness, Chile wanted to service outstanding suppliers' credits, reschedule commercial bank debt and was reluctant to participate in the Paris Club processes of debt restructuring. However, the BAC asked Chile to

See World Debt Tables (1992-93).
restructure Paris Club eligible debt as well on a parallel basis. In the end, negotiation took place outside the Paris Club with official creditors. In these arrangements only principal was rescheduled and the amount consolidated was far less (65% in 1985 and 85% in 1987) compared to the amount (90%-100%) generally consolidated in the case of agreement at the Paris Club. Compared to Argentina and Brazil, repayment terms were less soft - 6 and 1/4 years maturity with 2 and 1/2 years grace. Moreover, export credits to the private sector were left out of the purview of the debt relief.

As a contrast it may be noted that in most of the Paris Club agreements with middle income countries signed since 1985, export credits owed by the private sector remained exempted from restructuring.

During 1985-86 the Paris Club signed two MYRAs - one with Ecuador (April 1985) and the other with Cote d’Ivoire (June 1986) in the wake of the MYRAs reached with the banks. The basic features of them were:

(a) Three year consolidation period;
(b) Debt relief in three annual tranches;
(c) Only principal was rescheduled;
(d) The proportion of consolidated principal was to decline each year.

In the face of changing economic circumstances both the agreements were abandoned. After that no more MYRAs were signed under the aegis of the Paris Club.
6.C: Venice Summit, June 1987:

(i) By 1987 it became clear that the existing Paris Club framework for debt relief was not adequate in addressing the severe debt servicing problems of the low income sub-Saharan African countries. Between 1983 and 1986 there were 33 Paris Club follow-up agreements out of which in 19 cases, previously restructured debt was rescheduled. This called for more debt relief, an issue which began to be addressed in the annual G-7 economic summit meetings.

(ii) At the G-7 Venice meeting, held in June 1987, greater debt relief was announced for those low income countries undertaking adjustment efforts. Debt relief, it was stated, should include lower interest rates on the existing debts of these countries and longer repayment. Moreover, grace periods should be allowed to ease the debt burden.

(iii) This communique led to the signing of the Paris Club debt restructuring agreements with 4 sub-Saharan African countries - Mauritania, Mozambique, Somalia and Uganda - in 1987. Repayment period of the rescheduled debt in these agreements was over 20 years with grace period of 10 years in each case. Each of these countries was eligible for special treatment, according to the Paris Club, because of large debt service obligations, poor balance of payments prospects and their low per capita income. In fact, in its June 1987
agreement with Uganda the Paris Club made a rule to support only those countries who had already adopted to the new SAF instead of the conventional upper tranche arrangement.

During the last half of 1987, the IMF and the World Bank adopted additional measures to redress the debt problems of the low income countries. Resources was collected from its members by the Fund to expand its SAF. The new enhanced structural adjustment facility (ESAF) was designed to extend much larger amount of financial assistance to the eligible countries. Between January 1988 and May 1989, ESAFs were approved for 10 sub-Saharan African countries. The Bank, also, enhanced its co-financing substantially for its Special Programme for Africa. By the end of 1988, $2 billion had been allocated, and about $1 billion had been disbursed. For this programme the Bank secured commitments of $5.2 billion from the major donors.

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Financial assistance under the ESAF is in the order of 150% of the members' quotas over a 3 year period. In some cases it is up to 350% when the need arises.
Toronto Terms:

(i) At the annual G-7 meet, held in June 1988 at Toronto, G-7 creditors agreed to provide more generous debt relief for low income countries.

(ii) Rescheduled concessional debt would be repaid with a 25 year maturity, including 14 years' grace. Moratorium interest rates on consolidated concessional debt would continue to be at concessional rates, to be negotiated with each creditor country.

(iii) For non-concessional debt, creditor countries had to choose one of the three options, known as menu:

(a) forgiveness of one-third of the debt service obligations, which were due, by rescheduling through the Paris Club, with the remainder being rescheduled over a 14 year period, including a grace of 8 years;

(b) rescheduling of all eligible obligations over a 14 year period, including 8 years of grace, at interest rates of 3-5% points below market rates, or at one half of market rates if these rates are less than 7%; and,

(c) a rescheduling of all obligations at market interest rates, but over 25 years, including a 14 year grace period.

(iv) Toronto terms were also applicable to the countries which were undertaking IMF-supported adjustment policies, and were passing through severe debt
servicing and balance of payments problems. Basically, it was meant for low income sub-Saharan African nations but were extended to Bolivia and Guyana in 1990. By September 1991, 20 countries had restructured their debts on Toronto terms.

In 1991 there were two exceptional cases of debt restructuring of the two middle income countries - Egypt and Poland. A package was involved in each agreement but not like the one under Toronto terms. The agreements called for debt reduction which sought to reduce the net present value of the scheduled debt service payments by 50% irrespective of the options selected.
In December 1991, some of the features of the exceptional Egyptian and Polish agreements were applied to the severely indebted low income countries. The principle came to be known as enhanced Toronto terms. Debt reduction would take place in three stages. For those countries having initial consolidation periods of nearly three years, two agreements would be sufficient. The enhanced Toronto terms offered creditors two concessional options which equalised burden sharing:

(a) Writing off 50\% of debt and reschedule the remainder at market rates, with repayment over 23 years (following a gradual payments schedule) including a grace period of 6 years; and,

(b) Consolidate at concessional rates in order to reduce by 50\% in net present value terms the payments due on non-ODA debt, with a 23 year repayment schedule (also following a graduated payments schedule) but without a grace period.

There was a third non-concessional option:

(c) Consolidate at market rates, with a repayment period of 25 years, including a 14 year grace period.

This third option was adopted by the US and some smaller creditor countries who were, at the time, unable to provide debt cancellation for non-ODA debt.
Enhanced Toronto terms left out ODA debts for cancellation. However, ODA claims by them were cancelled by many creditors. Table 6.E.1 gives an account of the debt restructuring under enhanced Toronto terms in 12 countries till November 1992.

Under the enhanced Toronto terms as a pre-condition for an agreement with the bilateral creditors the debtor was compelled to undertake an ESAF with the IMF.

A double 'good-will' clause used to be attached with the initial agreement with a debtor which asserted -

(a) a commitment to consider further debt relief on eligible maturities falling due after the initial consolidation period; and,

(b) a commitment to meet at the end of 3 or 4 years to review the stock of debt - the time by which the debtor was supposed to have fully implemented earlier Agreed Minutes, made comparable arrangements with other creditors for debt relief and have maintained eligibility for the IMF resources by successfully sticking to its adjustment programme.
### Table 6.E.1

Paris Club Enhanced Toronto Terms  
(December 1991–November 1992)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Agreement</th>
<th>First Stage Amount Consolidated (US $ bn)</th>
<th>Agreement Consolidation Period (months)</th>
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<tbody>
<tr>
<td>Benin</td>
<td>1991</td>
<td>0.1</td>
<td>19</td>
</tr>
<tr>
<td>Bolivia</td>
<td>1992</td>
<td>0.1</td>
<td>18</td>
</tr>
<tr>
<td>Equatorial Guinea</td>
<td>1992</td>
<td>0.1</td>
<td>12</td>
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<tr>
<td>Honduras</td>
<td>1992</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Mali</td>
<td>1992</td>
<td>n.a.</td>
<td>34</td>
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<tr>
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<tr>
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<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
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6.F: Houston Terms:

(i) A major change in the treatment of the severely indebted lower middle income countries was introduced by the Paris Club at its September 1990 meeting. The principle of it came to be known as Houston terms.

(ii) Houston terms allowed debtor countries to repay consolidated ODA loans with 20 year maturity including 10 year grace. Consolidated export credits and official loans other than ODA would be repaid with 15 year maturity including up to 8 years' grace.

(iv) Table 6.F.1 gives an account of the 13 Paris Club debt restructuring agreements signed till September 1992, for severely indebted lower middle income countries under the Houston terms.

(v) One major innovation was the provision of various types of voluntary debt conversions like debt for nature, debt for aid and debt for equity swaps47. These conversion schemes were to be decided and defined in implementing the bilateral agreements rather than in the Paris Club Agreed Minute.

(vi) The Club had set limits on the amount of the swaps of export credit claims in order to uphold the comparable treatment of creditors' convention. The swap ceiling for each creditor was expressed as 10% of the claims outstanding as of a date just prior to the meetings or $10 million - whichever was higher. No ceiling on the

amount of ODA loans or other inter-governmental debt that might be converted was conferred.

Table 6.F.1

Paris Club Agreements for Highly Indebted Lower Middle Income Countries (September 1990-November 1992)

<table>
<thead>
<tr>
<th>Country</th>
<th>Year of Agreement</th>
<th>Amount Consolidated (US $ bn.)</th>
<th>Consolidation Period (months)</th>
<th>Maturity (year)</th>
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<td>12</td>
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