United Nations A/57/253

General Assembly

Distr.: General
23 July 2002

Original: English

Fifty-seventh session
Item 86 (d) of the provisional agenda*
Macroeconomic policy questions: external debt crisis and development

External debt crisis and development

Report of the Secretary-General**

Contents

* A/57/150.
** Given the request of the General Assembly in resolution A/56/184 that the present report should consider the outcome of the International Conference on Financing for Development, this document was submitted on 23 July 2002.

02-50365 (E) 190902
0250365

I. Introduction

1. The General Assembly, in its resolution A/56/184 of 21 December 2001, requested the Secretary-General to report to it at its fifty-seventh session on the external debt crisis and development, bearing in mind, inter alia, the outcome of the International Conference on Financing for Development (Monterrey, Mexico, 18-22 March 2002). In response to that request, the present report considers issues that deserve consideration in the light of the outcome of the Monterrey Conference, and the relationship between external debt and efforts at the national and international levels to attain the millennium development goals. After presentation of recent developments in the external debt situation of the developing countries and economies in transition, section III deals with debt owed to official creditors, giving particular attention to outstanding issues in the implementation of the Heavily Indebted Poor Countries (HIPC) Initiative. Section IV discusses recent developments regarding obligations of developing countries to private creditors. The report concludes with policy recommendations to enhance international cooperation towards a durable solution to the external debt problems of developing countries.

II. External debt situation of the developing countries

2. Overall, the external debt situation of the developing countries at the end of 2001 showed some improvement compared to 2000. Despite the slowdown in the world economy, all debt indicators for the developing countries and economies in transition as a group showed a slight improvement.[1] Yet many countries, particularly in sub-Saharan Africa, still carry very high external debt burdens relative to their gross national product (GNP) and continue to face important debt-servicing problems that absorb foreign exchange and reduce budgetary flexibility to stimulate growth in the face of weak global demand and to meet the millennium development goals.

3. The total stock of debt of developing countries and economies in transition at the end of 2001 was estimated at $2,442 billion or 38.2 per cent of their gross national income. Long-term debt fell by 2.4 per cent and short-term debt by 3 per cent. At the same time, however, the use of International Monetary Fund (IMF) credit rose by 16 per cent compared to the previous year (see table below). The amount of total paid debt service fell from $399 billion in 2000 to $382 billion in 2001, while arrears on interest and principal payments were reduced from $33 to $31 billion.

4. Within this general picture some developing regions registered deteriorations in some debt indicators. In sub-Saharan Africa, debt service rose as a ratio of both gross national income and exports of goods and services. This deterioration reflects the worsened external environment facing many African debtor countries: falling commodity prices, worsening terms of trade, lower export earnings, and a rise in debt-service payments by almost 18 per cent, despite a reduction in the total stock of debt. Sub-Saharan Africa, the location of most HIPCs, continues to have the highest relative debt burden. Its ratio of external debt to gross national income remains above 70 per cent and exceeds 100 per cent when South Africa is excluded. Latin America is the only region where the stock of total debt increased in 2001 in absolute terms, as well as in relation to gross national income, and where international reserves fell. In the East Asia and Pacific region and in the group of developing and transition economies of Europe and Central Asia, debt service increased as a percentage of exports compared to 2000, but remained below levels of the late 1990s.

5. The general trends in the structure of developing country debt discussed in the Secretary-General's report to the General Assembly at its forty-sixth session (A/46/415) were confirmed in 2001. Private creditors account for almost 60 per cent of the total developing country debt, and more than two thirds of the total debt of the middle-income countries.

III. Official debt

A. Recent developments and outstanding issues under the Heavily Indebted Poor Countries (HIPC) Initiative

1. Debt relief and poverty alleviation

6. The Monterrey Consensus underlined that the enhanced HIPC Initiative provided an opportunity to strengthen the economic prospects and poverty reduction efforts of its beneficiary countries. But it also pointed to elements in its implementation that needed to be addressed to ensure its success: speedy implementation, additional resources, and appropriate

sustainability assessments.[2] It noted with respect to the latter issue: "Future reviews of debt sustainability should also bear in mind the impact of debt relief on progress towards the achievement of the development goals contained in the Millennium Declaration".[3] The importance of continued flexibility with regard to the eligibility criteria was also stressed.

2. Pace of implementation and conditionality

7. Since mid-2001, Ethiopia, Sierra Leone and Ghana have reached the Decision Point. As of July 2002, a total of 26 of the 42 HIPCs had become, in principle, eligible for interim relief. However, since interim relief is conditional on implementation of macroeconomic and structural policy reform programmes, IMF has partially withheld relief for several countries.[4] Only Uganda, Bolivia, the United Republic of Tanzania, Mozambique, Burkina Faso and Mauritania had reached the Completion Point by July 2002, and progress has continued to be slower than expected. Despite the introduction of "floating" Completion Points speedy implementation continues to be hampered by the difficulties that heavily indebted countries encounter in meeting the requirements before and after reaching the Decision Point.

8. The problems of implementation are described in a recent report to the Development Committee.[5] A main reason given for the slow pace of implementation is that a large number of countries have been unable "to stay on track with their macroeconomic and structural reform programmes". But the problems are also related to Fund and Bank conditionality itself. Previous reports of the Secretary-General on the external debt situation of the developing countries have drawn attention to the difficulties of many HIPCs in complying with conditionality, which in many cases exceeds their institutional and administrative capacity.[6]

9. As a prerequisite for debt reduction, every HIPC has to prepare a Poverty Reduction Strategy Paper (PRSP). Typically, such papers cover policy areas that are expected to have a direct bearing on poverty, such as health and education, but also contain policy elements that are very similar to those of macroeconomic and structural adjustment programmes implemented in many low-income countries, especially in Africa, over the past two decades.[7]

10. An important issue in the new emphasis on poverty is how to reconcile ownership with conditionality. The original rationale for conditionality was to protect the financial integrity of the Bretton Woods institutions and to preserve the revolving character of their resources. But as those institutions expanded operations in developing countries their conditionality became tighter and more complex, encompassing areas that were within the purview not only of other international organizations but also of national economic and social development strategies, such as restructuring and privatization of public enterprises, deregulation of markets, trade regimes, prices and marketing policies, the financial sector, and the agricultural and energy sectors. More recently, conditionality has also come to be related to issues of political and economic governance. In 1999, the number of conditions attached to IMF and World Bank support to 13 HIPCs averaged 110 per country, of which 77 were governance related.[8] With the rise in the number of structural conditions the degree of compliance with programmes declined dramatically in the 1990s.[9] Both the International Monetary and Financial Committee and the Managing Director of IMF have expressed concerns about excessive and intrusive conditionality.[10]

11. Although the Bretton Woods institutions have recently increased their efforts to streamline conditionality, progress achieved in this regard has been slow and has not led to acceleration in countries' reaching their Completion Points. HIPC Finance Ministers have recently called for a more dramatic streamlining of conditionality and for judging compliance with conditions against overall trends and efforts rather than individual performance criteria.[11] With a view to allowing HIPCs to define alternative paths to poverty reduction in a context of growth, HIPC Finance Ministers have drawn attention to some elements of macroeconomic conditionality that appear to focus on reducing inflation at the expense of growth and employment. It has therefore been suggested that efforts to design more flexible growth-oriented macroeconomic frameworks be accelerated.

3. Debt sustainability analysis and the scale of debt relief

12. In the HIPC framework, the main indicator for debt sustainability is the 150 per cent threshold ratio of debt to exports in net present value terms. For most HIPCs this ratio determines debt sustainability. Only for countries with a large export base, a 250 per cent

threshold ratio of external debt to fiscal revenue in net present value is considered.

13. Whether the level of public external debt is considered to be sustainable at the Completion Point and beyond basically depends on the assumptions underlying the projections of these variables. There is now ample evidence that the assumptions underlying sustainability assessments for a large number of HIPCs that have already advanced in the process have been unrealistic. Indeed, the question of debt sustainability has gained increased importance in the course of 2001/2002 in view of the worsening situation of the world economy.

14. For the 24 HIPCs that had reached their Decision Points by January 2002, unweighted annual average export growth from 1999 to 2001 was projected to be 9.4 per cent, whereas the actual export growth rate over the two years was only 5.4 per cent. All but six HIPCs experienced lower than projected export growth during those two years, and in Guinea-Bissau, Malawi, Nicaragua, the Niger and Uganda exports in 2001 actually fell, rather than increasing as projected. As a consequence, the World Bank's updated projections for export earnings until 2005 for the 24 countries taken together are now 13 per cent lower than the projections made at the respective Decision Points.[12]

15. Contrary to the initial projections, the average ratio of debt to exports in 2001 for the 24 countries is estimated at 277.7 per cent owing to the shortfall of export earnings growth, almost twice the levels deemed sustainable under the criteria of the Initiative. Moreover, the four countries that had already reached the Completion Point in January 2002 are estimated to have an average debt-to-export ratio of 156 per cent, i.e., higher than the benchmark for debt sustainability. According to IMF and the World Bank's own assessment, of the 20 countries which were between Decision Point and Completion Point in April 2002, Benin, Burkina Faso, Chad, Ethiopia, the Gambia, Guinea-Bissau, Malawi, Rwanda, Senegal and Zambia can no longer be expected to attain a ratio of debt to exports at Completion Point below the benchmark of 150 per cent.

16. It is argued that the failure to reach the projected levels of debt and export earnings is mainly attributable to unsatisfactory implementation of macroeconomic and structural reforms, as well as worsened external market conditions. However, it appears that even discounting the recent deterioration in the external environment, exports and growth projections have been overly optimistic when compared to longer-term trends. While in 1990-1999 average annual export growth in the 24 qualified HIPCs was 4.2 per cent, debt sustainability assessments projected annual export growth for 2000-2010 of 8.5 per cent, based on the assumption that the prices of commodities would sharply recover and remain at high levels throughout the decade. Such an assumption can hardly be justified by past trends. Indeed, in their debt sustainability outlook of April 2002 IMF and the World Bank recognize that 17 of the 24 countries relied for more than half of their export earnings on three main commodities, and that "the prices of these commodities in world markets have been on a secular downward trend".[13]

17. In this regard, as noted in paragraph 49 of the Monterrey Consensus, "The computational procedures and assumptions underlying debt sustainability analysis need to be kept under review. Debt sustainability analysis at the completion point needs to take into account any worsening global growth prospects and declining terms of trade". Paragraph 50 stressed "the need for the International Monetary Fund and the World Bank to consider any fundamental changes in countries' debt sustainability caused by natural catastrophes, severe terms of trade shocks or conflict, when making policy recommendations". The need for review of debt sustainability was also recognized at the Group of Seven (G-7) summit in June 2002, which asked IMF and the World Bank for "an assessment of the methodology for assessing the need for, and amount of, additional assistance (or topping up) at the Completion Point", and "to ensure that forecasts of debt sustainability are made on the basis of prudent and cautious assumptions about growth and exports".[14]

18. To allow Governments to sustain spending for poverty reduction purposes in line with international development targets, sustainability benchmarks should be calculated for both debt service to exports and debt service to budget revenue, and annual reassessments of debt sustainability, taking into account both external and domestic debt, should be undertaken during the period between the Decision and the Completion Point, as well as after reaching the Completion Point, and to augment debt relief whenever necessary.[15]

19. The enhanced HIPC allows for additional debt relief to be granted after a country has reached its

Decision Point in "exceptional cases where exogenous shocks have fundamentally changed the HIPCs' circumstances".[16] So far, one country, Burkina Faso, has benefited. However, for the HIPC Initiative as a whole, the mechanism to determine the amount of additional debt relief in cases where the debt sustainability threshold is exceeded at the Completion Point is not clear.

20. Estimates by IMF and the World Bank on the additional bilateral debt forgiveness required to cover the debt of HIPCs in excess of the threshold at Completion Point amount to $520 to $930 million.[17] The G-7 leaders have acknowledged the need for additional bilateral debt relief and for the provision of additional resources to the HIPC Trust Fund. At their Kananaskis summit they made a commitment to work with other donor countries and the international financial institutions to ensure that the additional financial resources resulting from new estimates of debt sustainability will be available.[18]

4. Debt relief and official development assistance

21. Given that only four countries have so far attained the United Nations aid targets, the Monterrey Consensus urged developed countries that had not already done so to make concrete efforts towards the target of 0.7 per cent of GNP as official development assistance (ODA) to developing countries and 0.15 to 0.20 per cent of GNP of developed countries to least developed countries, as reconfirmed at the Third United Nations Conference on the Least Developed Countries.[19] It encouraged donor countries to take steps to ensure that resources provided for debt relief did not detract from ODA resources intended to be available for developing countries.[20] Concerns in this regard have been expressed since the HIPC Initiative was launched, and recent developments in aid flows indeed seem to confirm such concerns.[21]

22. According to World Bank figures, nominal flows of ODA grants to HIPCs have fallen since the launching of the HIPC Initiative for 27 of the 42 HIPCs.[22] For all HIPCs together, the average annual flow was $8.2 billion in 1997-2000 compared to $9.7 billion in 1990-1996, a drop of 15.7 per cent. The situation is particularly alarming for those HIPCs that have yet to reach their Decision Point. Their average annual receipts of ODA grants were lower by 35.7 per cent in 1997-2000 compared to 1990-1996. Other developing countries did not escape the declining trend in the provision of ODA grants, but their receipts in the form of external financing fell by only 2.8 per cent during the same period.

23. The Monterrey Consensus acknowledged, in paragraph 43, that achievement of long-term debt sustainability could be helped significantly by providing official financing in the form of grants. The agreement among G-7 leaders "on the need for bilateral donors to consider financing HIPCs and HIPC 'graduates' primarily through grants for a sustained period" is an important step in that direction.[23] But it is equally important that debt relief by bilateral and multilateral donors and higher ODA grants to assure long-term debt sustainability to HIPCs will not be at the expense of other poor developing countries.

5. Participation of creditors

24. HIPC Finance Ministers have drawn attention to a problem regarding the comprehensiveness of the Initiative arising from the fact that some creditors have difficulties or are unwilling to participate fully in the Initiative.[24] Participation of these creditors is difficult to secure because the decision of IMF and the World Bank on the HIPC Initiative is not binding on creditors and the Paris Club Agreed Minutes do not create any obligations for non-Paris Club creditors.

25. The HIPC Finance Ministers' Network has suggested convening a conference of HIPCs, international financial institutions and non-Organisation for Economic Cooperation and Development (OECD) and other bilateral and multilateral creditors to agree on innovative mechanisms for debt relief, including an International Development Association (IDA) buy-back facility, HIPC Trust Fund resources and donor grants to relieve debts owed to countries that have themselves received concessional debt relief.[25] The G-7 have called upon the Bretton Woods institutions to intensify efforts in encouraging and facilitating the participation of regional and small multilateral development institutions and in encouraging the participation of non-Paris Club bilateral creditors that are members of the Fund and the Bank. Regarding commercial creditor participation, they have asked the Bank and the Fund to prepare a comprehensive report on legal action brought against HIPCs and the possibility of the provision of technical assistance to HIPCs in this context, and to encourage bilateral creditors not to sell their claims in the secondary debt market.[26]

B. Recent Paris Club contributions to the implementation of the enhanced HIPC Initiative

26. Continued implementation of the enhanced HIPC Initiative has been at the centre of Paris Club activities. During the second half of 2001 and first half of 2002, seven HIPCs concluded new agreements on debt rescheduling or restructuring; three of them at Completion Point obtained debt stock reduction under the Cologne initiative (enhanced HIPC), in principle marking an exit from Paris Club debt rescheduling. After reaching their Completion Points under the Cologne initiative in 2001, Mozambique and the United Republic of Tanzania concluded stock agreements whereby most of their pre-cut-off date non-concessional debts to Paris Club creditors are to be cancelled. Burkina Faso obtained a similar agreement on debt stock reduction in 2002. An exit stock agreement for Mauritania was scheduled for July 2002. Owing to a significant deterioration of Burkina Faso's export performance between the projections made at Decision Point and the outcome at Completion Point, creditors committed to extend further relief, including additional bilateral cancellations to help achieve the target.

27. After reaching Decision Point Rwanda and Ghana obtained flow reschedulings on Cologne terms. Ghana had already concluded an interim agreement on the restructuring of debt service payments on Naples terms in 2001. In the case of Ghana, creditors agreed to modify Ghana's cut-off date, from 1983 to 1999.

28. Sierra Leone and Côte d'Ivoire also received debt relief from the Paris Club, in support of new agreements with IMF under the Poverty Reduction and Growth Facility (PRGF). Sierra Leone obtained restructuring of debt-service payments on Naples terms, and Côte d'Ivoire on Lyon terms. Both countries are expected to receive additional relief to "top up" the debt reduction to 90 per cent according to Cologne terms as soon as they reach their HIPC Decision Points.

29. Although procedures for Paris Club restructuring of HIPCs' debts have been streamlined and simplified, agreements can still be relatively complex and implementation requires — as under other Paris Club agreements — bilateral negotiations claiming substantial technical capacity in the countries concerned. A number of creditor countries are offering debt relief on a bilateral basis in addition to the debt relief extended in the framework of the Paris Club. This means that HIPCs can expect further write-offs of their Paris Club debts. However, these measures have not so far been reflected in the Paris Club agreements, which in this sense represent a minimalist approach.

30. There is some concern among beneficiary countries that the Paris Club has not finalized agreed minutes on interim debt relief for small debtors, and that progress in concluding bilateral agreements is often very slow. Another concern is that some Paris Club creditors may exclude certain types of debt from relief, while some others may provide debt relief in ways that do not free funds for PRSP implementation by the beneficiary Government.[27]

C. Other recent renegotiations of official debt

31. Outside the HIPC framework, Paris Club creditors during 2001 and the first half of 2002 considered the cases of Indonesia, Kyrgyzstan, the Federal Republic of Yugoslavia and Pakistan, the latter two receiving landmark debt-relief agreements.

32. Stock operations in the Paris Club involving substantial debt reduction have so far been mainly reserved for the poorest debtor countries in the context of HIPC, exceptions being the agreements concluded with Egypt and Poland at the beginning of the 1990s that marked their exit from the rescheduling process. A similar agreement was concluded with the Federal Republic of Yugoslavia. The new agreement concluded in support of Pakistan's new three-year PRGF arrangement with IMF broke new ground insofar as the rescheduling applies to the whole stock of outstanding pre-cut-off date debt and involves a substantial lengthening of the repayment period, well beyond standard Houston terms.

33. In April 2002, Indonesia — like Pakistan, a low-income International Bank for Reconstruction and Development (IBRD)/IDA blend country — obtained standard Houston terms, albeit more favourable than under its previous two agreements with its official creditors following the East Asian crisis.

34. A number of transition countries have accumulated large volumes of external debt since independence and are experiencing difficulties in servicing this debt. Several have approached the Paris

Club for assistance. Kyrgyzstan concluded a rescheduling agreement on non-concessional terms broadly similar to those obtained by Georgia one year earlier.

IV. Debt owed to private creditors

A. Private capital flows to developing countries and the restructuring of commercial debt

35. Measured by the external assets of banks reporting to the Bank for International Settlements (BIS), the bank debt of developing and Eastern European countries fell by 23 per cent between 1997 and 2001, bringing the share of those countries in the total lending of banks in the BIS reporting area down from 12.2 per cent in 1997 to 7.4 per cent in 2001. This development is not only due to reduced lending by international banks, but also to the efforts of debtors, particularly in East Asia, to reduce their foreign exposure.

36. The issuance of debt securities by developing and transition economies continued the declining trend begun in 1998. Like the reduction in bank loans, the reduction in the issuance of debt securities was particularly marked in Asia. Gross issues in the region more than halved between 1997 and 2001, and net issues fell even more sharply, turning negative in 2001, as new issues were more than offset by the refinancing of maturing securities. As in the past four years, Latin America accounted for more than half of all new issues in 2001, and its share in net issues in that year exceeded 85 per cent.

37. In 2001 a number of developing countries restructured debt with private creditors via debt buy-back or swap operations.[28] In the case of three HIPCs, the United Republic of Tanzania, Yemen and Honduras, debt buy-backs were funded by official multilateral and bilateral donors.

38. Some middle-income countries also reduced their external liabilities through transactions on the secondary market for Brady bonds. Thus, Jordan was able to retire $44 million of its outstanding Brady bonds in 2001. Mexico continued its swap operations. Overall, Mexico retired more than $1.8 billion of outstanding Brady bonds between April 2001 and May 2002, so that by mid-2002 no more Brady discount bonds were outstanding.

39. Argentina had engaged in several Brady swaps to restructure debt since 1997. In 2001 such operations continued, but though the country's external debt situation was not sustainable the operations did not contain any debt relief element. In June 2001, Argentina launched the biggest-ever debt swap operation covering $30 billion of domestic and external bonds. In its swap operation, the Government of Argentina obtained an extension of maturities, but at the cost of rising interest rates.

B. Financial crises in emerging-market economies

40. Recognizing the potential benefits of external savings as a compliment to domestic savings in financing public and private investment in developing countries, the Monterrey Consensus drew attention to the need for Governments to create domestic conditions for the sustainability of such financing through "national comprehensive strategies to monitor and manage external liabilities" and "sound macroeconomic policies and public resource management". In paragraph 47, the Consensus also drew attention to the co-responsibility of creditors for the build-up of unsustainable debt positions, acknowledging that "Debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations".

41. The management of external liabilities has become more difficult in developing countries with rapid capital account liberalization that has often given rise to surges of capital inflows to emerging markets, creating exchange-rate volatility and deterioration of current account balances. A large proportion of such inflows has been unrelated to real investment and subject to sudden reversals. Recently, two emerging-market countries, Argentina and Turkey, experienced dramatic setbacks in their economic development, which were closely interrelated with their unsustainable debt situations. After several ad hoc interventions by IMF to restore market confidence and to keep adjustment programmes on track, Argentina and Turkey were both forced to float their currencies in the face of rapid outflows of capital. Both experienced deep economic crisis, although in both cases economic policy was designed as part of the programmes

supported by the Bretton Woods institutions. Argentina and Turkey had a number of features in common with crises in other emerging-market countries that used exchange-rate stabilization as the basis for adjustment programmes to combat inflation. These experiences show again that, when joined with liberalization of financial markets, the increase in capital inflows often leads to real appreciation of the currency and growing current account deficits, which require further capital inflows to meet the increasing debt service. The resulting financial vulnerability eventually gives rise to expectations of sharp currency volatility and a rapid exit of capital, resulting in overshooting of the exchange rate and hikes in interest rates. The dimension of the repercussions on other economies of the financial crises in Argentina and Turkey was not yet clear by mid-2002, but there is increasing concern that other economies, especially in Latin America, might encounter difficulties.

42. Some other countries among the so-called “Baker-15” countries of the 1980s have also seen their debt indicators deteriorate since 1997. In Brazil the deterioration has been almost as sharp as in Argentina. Although the deterioration was less pronounced in Algeria, Colombia, Ecuador and Peru, ratios of debt or debt service to exports were worse in 2000 than in the mid-1980s in these countries too.

V. Policy conclusions

43. The Monterrey Consensus confirmed the continuing relevance of the policy proposals made regarding the resolution of the debt problems of developing countries in the two previous reports of the Secretary-General (A/55/422 and A/56/262).

44. Although bilateral creditors have continued to write off official debt of several low-income countries, partly on a scale beyond the commitments made within the framework of the HIPC Initiative, and although the debate on procedures for the resolution of international debt to private creditors has advanced, much progress remains to be made towards the achievement of a lasting solution to the debt problems of different groups of developing countries. In several low- and middle-income countries, unsustainable levels of external debt continue to create a considerable barrier to economic and social development and increase the risk that the millennium goals regarding development and poverty reduction will not be attained.

45. In the light of the continuing slow speed of implementation of the HIPC Initiative, a simplification of the procedures and a review of the content of conditionality should be considered. In particular, performance criteria that are closely linked to poverty reduction targets appear more appropriate than the criteria applied in past adjustment programmes. Consideration should be given to measures that place growth at the centre of reform. Specific measures should be worked out to accelerate the development of poverty and social impact analysis and to equip countries with the necessary tools to conduct such analyses on their own, in order to avoid conflicts of interest.[29]

46. In view of the serious economic problems facing HIPCs, including low savings capacity, aid dependence, export concentration and import dependence, which have been aggravated by the worsening of the external environment, more rapid access to adequate external financing to design and set up a social safety net as well as public and private investment is necessary. As previous reports of the Secretary-General proposed, “front-loading” of debt relief from Decision Point onwards could be given serious consideration. Likewise, a moratorium on debt-service payments by all HIPCs at their Decision Point, as already imposed by some Governments of industrialized countries, also deserves further consideration.

47. The optimistic character of assumptions underlying the debt sustainability assessments is now recognized. Projections of growth and export earnings in these assessments could be rendered more realistic by taking account of past external shocks through volatility and probability analysis. Other measures to secure poverty reduction strategies that deserve careful consideration would be the creation of a safety margin to protect against future shocks and the introduction of contingency financing mechanisms. The first could be achieved if additional bilateral debt cancellations beyond Cologne terms, as pledged by some creditor Governments, were to be fully additional to debt relief under the Initiative. Contingency financing could be put in place through “floating additional tranches” in PRGF programmes that can be disbursed in the event of shocks.[30]

48. Since the success of the HIPC Initiative depends on the additionality of debt relief in comparison with overall pre-debt-relief transfers, it is essential that

donor countries increase efforts to comply with agreed ODA targets and to raise such flows to HIPCs and other poor countries. Given their low domestic savings capacity, debt relief and ODA will have a critical catalytic role in raising growth and attaining the millennium development goals.

49. A number of other low- and middle-income developing countries and economies in transition also face external public debt burdens exceeding the threshold level for sustainability in the HIPC framework. Consideration should therefore be given to greater flexibility in the eligibility criteria for debt relief, so as to improve the poverty reduction efforts undertaken in those countries. In this regard, independent assessment of debt sustainability designed to determine the required level of debt relief, not only of HIPCs, but also of other debt-distressed low- and middle-income countries, could be considered. This could also help to eliminate the need of many heavily indebted countries for repeated rescheduling which has characterized much of the Paris Club process so far.

50. The recent experience of Argentina and Turkey has shown, once again, that the management of the external debt is closely interrelated with the quality of fiscal, macroeconomic and exchange-rate management, and the capital account regime. Official bailouts linked to policies advocated to restore confidence, including fiscal and monetary tightening, failed to check capital flight and the resulting collapse of the currencies. Such bailouts are also difficult to reconcile with the rationale of free markets since it is generally agreed that market discipline will work only if creditors bear the consequences of the risks they take. Their acceptance by the international community has become more difficult given the increasing amounts of finance required. Moreover, there appears to be a lack of coherence and predictability in the international approach to crisis intervention. While Turkey was provided additional funding to meet its external obligations and avoid default, Argentina did not receive such support and had to suspend debt service at the end of 2001 when it failed to meet the conditions for continued disbursement of IMF credits.

51. The international financial system still lacks a coherent and realistic international strategy to deal with financial instability and the debt sustainability of developing countries. In the absence of such a strategy there is a risk that developing countries will return to the "muddling-through" which cost Latin America a lost decade in the 1980s, and for which the build-up to the Argentine default is yet another example. Uncertainty continues to surround the modalities of official intervention in financial crises in emerging-market economies, adding to volatility in market sentiment. It appears more necessary than ever to formulate mechanisms for the restructuring and, where necessary, write-off of international sovereign debt of developing countries owed to private creditors, based on principles similar to those that govern national bankruptcy legislation in developed countries. The introduction of orderly workout procedures could ensure that creditors and investors bear the consequences of the risks they have taken, and that the burden of crises be distributed equitably between debtors and creditors and among different classes of creditors.

52. Against these most recent experiences, the Monterrey Consensus emphasized, in paragraph 51, "the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors". Although the Board of IMF has recognized that countries may find it necessary, as a last resort, to impose a unilateral standstill, it has not so far been able to provide statutory protection to debtors in the form of a stay on litigation. In view of the difficulties encountered in implementing voluntary workouts for the Argentine debt and the failure of IMF interventions to stabilize Argentina and Turkey, proposals for international bankruptcy codes and standstills have been getting a fuller hearing.

53. Temporary suspension of convertibility and standstills on external debt payments are a practical (and in some cases probably the only practical) policy option for an orderly workout of external and domestic debt and for stabilizing the exchange rate in countries facing international liquidity problems.[31] With regard to sovereign debt, standstills involve suspension of payments by Governments themselves, while on private external debt they require the imposition of temporary exchange controls, which restrict payments abroad on specified transactions, including interest payments. Further restrictions may also be needed on the capital-account transactions of both residents and non-residents. While a measure of flexibility may be necessary to accommodate the specific requirements of

different cases, an effective framework would need to involve voluntary and mandatory mechanisms. Such arrangements would need to be accompanied by the predictable provision of official financing, subject to predetermined limits, aiming primarily at helping debtor countries to maintain imports and avoid a sharp decline in economic activity, rather than maintaining open capital accounts. In general, normal access to IMF facilities, appropriately adjusted to the expansion of world output and trade, should meet such needs.

Notes

[1] This assessment is based on World Bank, *Global Development Finance 2002* (Washington, D.C., 2002).

[2] See *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (United Nations publication, Sales No. E.02.II.A.7), chap. I, resolution 1, annex, paras. 49 and 50.

[3] Ibid., para. 49.

[4] See International Monetary Fund and International Development Association, *Heavily Indebted Poor Countries (HIPC) Initiative — Status of Implementation*, p. 25; and the critical comment by R. Greenhill, "Seven HIPCs currently being denied interim relief by the IMF", Jubilee Research, available from http://www.jubileeresearch.org/hipc, accessed 17 May 2002.

[5] IMF and IDA, *The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability*, prepared by the staffs of IMF and the World Bank, 15 April 2002.

[6] See A/55/422, para. 28; and A/56/262, paras. 25-27.

[7] Overseas Development Institute, Poverty Reduction Strategy Paper, Institutionalization Study: Final Report submitted to the Strategy Partnership for Africa, London, 15 October 2001, chap. 1, p. 20, and chap. 6, p. 24.

[8] See D. Kapur and R. Webb, "Governance-related conditionality of the international financial institutions", *G-24 Discussion Papers No. 6*, United Nations, New York and Geneva, August 2000, p. 6.

[9] See M. Mussa and M. Avestan, *The IMF Approach to Stabilization*, IMF Working Paper No. 104, Washington, D.C., 13 September 2000.

[10] See Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, 24 September 2000, Washington, D.C., para. 11; and H. Köhler, Address to the Board of Governors, fifty-fifth annual meeting, Prague, 26 September 2000.

[11] Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 3, available from http://www.dri.org.uk/pdfs/Min_Meeting_March_02.pdf.

[12] IMF and IDA, *The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability*, p. 7, table 1 and appendix table 5.

[13] IMF and IDA, *The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability*, p. 21 and appendix table 1.

[14] "Delivering on the promise of the enhanced HIPC Initiative", Statement by G-7 Leaders, Kananaskis, Canada, 27 June 2002, University of Toronto Library, G-8 Information Centre.

[15] Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 2.

[16] IMF and IDA, *The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability*, p. 24.

[17] Idem, p. 25 and table 4.

[18] See "Delivering on the promise of the enhanced HIPC Initiative".

[19] *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002*, chap. I, resolution 1, annex, para. 42.

[20] Ibid., para. 51.

[21] See World Bank, *Global Development Finance 2002, Analysis and Summary Tables* (Washington, D.C., 2002), p. 106.

[22] World Bank, *Global Development Finance 2002* (Washington, D.C., 2002), CD-ROM.

[23] "Delivering on the promise of the enhanced HIPC Initiative".

[24] See Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 1. The issue has also been discussed in IMF and IDA, *Heavily Indebted Poor Countries (HIPC) Initiative — Status of Implementation*, p. 24.

[25] Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 1.

[26] See "Delivering on the promise of the enhanced HIPC Initiative".

[27] Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 2.

[28] For more detailed information on commercial debt restructuring, see World Bank, *Global Development Finance 2002, Analysis and Summary Tables* (Washington, D.C., 2002), appendix 2.

[29] See the Declaration of the Sixth HIPC Ministerial Meeting, London, 5 March 2002, p. 3.

[30] Idem, p. 2.

[31] This proposal was first made in the context of the debt crisis in the 1980s (UNCTAD, *Trade and Development Report, 1986* (United Nations publication, Sales No. E.86.II.D.5), annex to chap. VI), and more recently, in relation to emerging-market crises (UNCTAD, *Trade and Development Report, 1998* (United Nations publication, Sales No. E.98.II.D.6), pp. 89-93).

Table

External debt of developing countries and countries in transition

(Billions of United States dollars)

	All developing countries			*Sub-Saharan Africa*			*Middle East and North Africa*			*Latin America and the Caribbean*		
	1990	*2000*	*2001*	*1990*	*2000*	*2001*	*1990*	*2000*	*2001*	*1990*	*2000*	*2001*
Total debt stocks	1 458.4	2 490.7	2 442.1	176.9	215.8	208.9	183.5	203.8	196.6	474.7	774.4	787.1
Long-term debt	1 179.3	2 046.4	1 998.7	149.4	175.8	168.7	137.8	153.8	150.3	379.2	661.7	659.7
Public and publicly guaranteed	1 113.8	1 489.1	1 467.6	144.1	163.8	156.5	136.3	147.0	143.7	354.2	415.1	415.7
Private non-guaranteed	65.5	557.3	531.1	5.3	12.0	12.3	1.5	6.8	6.6	25.1	246.7	244.0
Short-term debt	244.4	380.0	368.6	20.9	33.3	33.8	43.9	47.4	43.9	77.2	103.8	103.5
Arrears	112.2	98.0		26.8	40.6		11.1	14.4	14.4	50.0	5.8	5.8
Interest arrears	52.7	33.3	30.8	9.3	14.3	14.2	2.9	2.7	2.7	25.6	1.7	1.7
Principal arrears	59.5	64.7	..	17.5	26.3	..	8.2	11.7	11.7	24.5	4.2	4.2
Debt service paid	163.8	398.6	381.9	10.9	12.3	14.5	24.2	24.9	23.6	45.4	179.2	156.8
Debt indicators (percentage)												
Debt service/Exports[a]	18.1	18.1	17.6	12.8	10.2	12.4	15.0	10.5	10.2	24.4	38.7	33.3
Total debt/Exports	161.0	113.3	112.2	208.3	177.9	178.8	113.9	85.5	85.4	255.4	167.2	167.0
Debt service/Gross national income	3.8	6.3	6.0	3.9	4.1	4.9	6.0	3.9	3.9	4.3	9.5	8.6
Total debt/Gross national income	34.1	39.1	38.2	63.0	71.3	70.9	45.7	31.7	32.8	44.6	40.9	43.3
Short-term/reserves	109.5	45.7	40.8	136.0	126.6	127.2	112.1	54.1	46.3	131.7	65.1	65.4
Memo item:[b]												
Total inward FDI stocks	283.7	1 473.4	..	24.2	63.3	..	48.2	82.2	..	100.5	517.4	..
Total liabilities[c]	1 742.1	3 964.1	..	201.1	254.2	..	231.7	286.0	..	575.2	1 291.8	..
Total liabilities/Gross national income (percentage)	40.8	62.2	..	71.6	141.3	..	57.7	44.4	..	54.0	68.3	..
Total liabilities/Exports (percentage)	192.3	180.3	..	236.9	307.7	..	143.8	119.9	..	309.4	279.0	..
Profit remittances on FDI	17.6	45.4	55.3	1.7	4.8	5.9	1.3	1.3	2.8	6.3	20.7	24.3
Profit remittances/Exports (percentage)	1.9	2.1	2.5	2.0	4.0	5.1	0.8	0.5	1.2	3.4	4.5	5.2

Source: World Bank, *Global Development Finance 2002* (Washington, D.C., 2002), and UNCTAD *Handbook of Statistics*, CD-ROM.

Note: Two dots mean data unavailable.

[a] Exports of goods and services.

[b] Sub-Saharan Africa excludes South Africa; Europe and Central Asia excludes Yugoslavia and Turkmenistan.

[c] Total liabilities is the sum of total debt stocks and inward foreign direct investment (FDI) stocks.

Table (concluded)

External debt of developing countries and countries in transition

(Billions of United States dollars)

	East Asia and the Pacific			*South Asia*			*Europe and Central Asia*		
	1990	*2000*	*2001*	*1990*	*2000*	*2001*	*1990*	*2000*	*2001*
Total debt stocks	274.0	633.0	604.3	129.5	164.4	159.3	219.9	499.3	485.9
Long-term debt	222.7	502.2	483.7	112.6	156.4	151.9	177.7	396.4	384.3
Public and publicly guaranteed	195.7	333.9	326.8	110.8	145.0	140.6	172.8	284.4	284.4
Private non-guaranteed	27.0	168.4	156.9	1.7	11.4	11.4	4.9	112.1	99.9
Short-term debt	49.2	108.4	107.2	12.4	6.0	5.6	40.9	81.0	74.5
Arrears	4.9	12.5	12.5	0.1	0.4	0.4	19.4	24.3	17.8
Interest arrears	1.9	5.2	5.2	0.0	0.1	0.1	13.0	9.3	6.8
Principal arrears	3.0	7.3	7.3	0.0	0.3	0.3	6.3	15.0	11.0
Debt service paid	39.8	92.7	93.8	11.4	14.5	13.8	32.1	74.9	79.4
Debt indicators (percentage)									
Debt service/Exports[a]	15.7	10.8	11.5	28.7	13.6	12.3	..	18.1	18.4
Total debt/Exports	108.4	74.0	74.2	324.7	153.7	141.5	..	120.5	112.5
Debt service/Gross national income	4.3	4.6	4.6	2.9	2.4	2.1	2.6	8.1	8.0
Total debt/Gross national income	29.8	31.2	29.4	32.4	27.0	24.5	17.8	53.9	49.2
Short-term/reserves	57.0	28.5	24.7	139.1	12.8	10.2	..	62.5	55.3
Memo item:[b]									
Total inward FDI stocks	94.0	567.5	..	4.5	33.2	..	..	156.5	..
Total liabilities[c]	368.0	1 200.5	..	134.0	197.5	..	..	643.8	..
Total liabilities/Gross national income (percentage)	40.0	59.3	..	33.5	32.5	..	..	70.4	..
Total liabilities/Exports (percentage)	145.5	140.4	..	335.9	184.7	..	..	156.5	..
Profit remittances on FDI	5.1	15.1	17.3	0.1	0.3	0.9	0.2	3.1	4.1
Profit remittances/Exports (percentage)	2.0	1.8	2.1	0.2	0.3	0.8	..	0.7	0.9

Source: World Bank, *Global Development Finance 2002* (Washington, D.C., 2002), and UNCTAD *Handbook of Statistics*, CD-ROM.

Note: Two dots mean data unavailable.

[a] Exports of goods and services.

[b] Sub-Saharan Africa excludes South Africa; Europe and Central Asia excludes Yugoslavia and Turkmenistan.

[c] Total liabilities is the sum of total debt stocks and inward FDI stocks.