INTERNATIONAL CHILD DEVELOPMENT CENTRE

Innocenti Occasional Papers

Spedale degli Innocenti
Florence, Italy

INNOCENTI OCCASIONAL PAPERS
ECONOMIC POLICY SERIES, NUMBER 31

SPECIAL SUBSERIES
FISCAL POLICY AND THE POOR

EXTERNAL DEBT, FISCAL DRAINAGE AND CHILD WELFARE: TRENDS AND POLICY PROPOSALS

Stephany Griffith-Jones*

EPS 31

September 1992

This paper is part of the background documentation for a forthcoming study on Fiscal Policy and the Poor, edited by Giovanni Andrea Cornia.

* Institute of Development Studies, University of Sussex, Brighton, UK.

The views expressed in this paper are those of the author and do not necessarily represent the views of the UNICEF International Child Development Centre.

The author wishes to express her thanks to the UNICEF International Child Development Centre, especially Giovanni Andrea Cornia for his perceptive and detailed comments on an earlier version of this paper and Robert Zimmermann for editing and the preparation of the text.

CONTENTS

TABLES

EXECUTIVE SUMMARY

Over one-half of all developing countries are not severely indebted. Mainly in Asia, these nations represent about 42 percent of the external debt of the Third World. External debt was clearly not a major impediment to development in these nations in the 1980s.

This paper focuses, instead, on two categories of nations, the severely indebted middle-income countries, mainly in Latin America, and the severely indebted low-income countries, mainly in sub-Saharan Africa. The growth and development records of these two groups of nations during the 1980s were quite different.

The severely indebted middle-income nations, mainly in Latin America, suffered most of the weight of the debt crisis. These 20 nations account for about 40 percent of the external debt of the Third World. Their debts are owed largely to private creditors.

Although the economic performance of this category of nations was rather poor in the 1980s, especially in terms of investment, some positive elements also emerged. For various reasons, the volume of debt servicing went down in these countries. Therefore, less local currency is now needed to purchase foreign exchange for debt servicing, and exchange rates, which were overvalued in the 1980s, have now been revalued. Thus, the vicious circles of the early to mid-1980s have been replaced by "virtuous" ones, and the case for restoring to precrisis levels at least the share of total government spending going to health care, education and nutrition has become stronger.

The 26 severely indebted low-income countries, nearly all of them in sub-Saharan Africa, account for a far smaller share of Third World debt, only 9 percent, most of which is owed to "official" sources. The economic performance of these nations was extremely poor in the 1980s, with very sharp declines in output, investment and consumption. This led to a general deterioration in debt and development indicators throughout the 1980s. Thus, the losses in the welfare of the poor, particularly poor children, that occurred in the 1980s due to debt-related factors, among others, were far more damaging in sub-Saharan Africa than they were in Latin America.

Although the nations of sub-Saharan Africa have benefited from quite significant debt relief (particularly from official creditors), this has clearly not been enough. An important step on behalf of the countries of this region would therefore be an endorsement of the Trinidad Terms, or the even more far-reaching Pronk Proposal.

This study argues that, in order to achieve the minimum necessary basis for the recovery of sub-Saharan nations and assure an annual growth of 1 percent in per capita income, the following conditions would have to be met:

1. At least the Trinidad Terms must be granted for bilateral debt. They should be accompanied by other options to reduce official bilateral debt through various kinds of debt swaps, which would include special programmes for health care, education and environmental protection. It is essential that those organizations concerned with improving the welfare of the poor emphasize the value of swaps of debt for social spending as a complement to other types of debt swaps.
2. Action is needed on the debt to the International Monetary Fund so as to avoid negative net transfers to that institution. The African Development Bank should create special facilities to reduce the debt owed to it by low-income countries.
3. Commercial banks should agree to a debt reduction in favour of sub-Saharan countries that is similar to the debt reductions granted by governments. Donations of commercial debt for social and environmental purposes should be further encouraged.

More broadly, some progress in debt reduction for the severely indebted low-income countries (sub-Saharan Africa) and fairly significant progress in debt reduction in many of the severely indebted middle-income countries (Latin America) can present new opportunities for a serious expansion of social spending in many of the nations in which such spending plunged in the 1980s.

I. INTRODUCTION

This paper has two main themes. The first, explored in Section II, regards the important direct and indirect fiscal effects of the severe external debt crises which shook so many developing countries in the 1980s. This is examined only infrequently in the existing literature on external debt. Starting with a macroeconomic analysis, the paper goes on to emphasize the impact of resulting fiscal changes on the welfare of the poor. This section ends with a list of criteria on how resources freed up by debt reduction or made available through new flows should be channelled in various categories of countries.

This last theme is examined in more detail in Section III, where the policy implications of the previous analysis are drawn out. The need for further debt reduction is discussed for severely indebted developing countries, particularly low-income ones in sub-Saharan Africa and middle-income ones in Latin America. Policy recommendations are offered on ways to assure that sufficient debt reduction is achieved, growth and development are restored and government spending which benefits the poor is boosted. The advantages and possible limitations of swaps of debt for social spending are explored in some detail for various kinds of developing countries. The need to view these debt-for-development swaps as one of several valuable instruments which could be employed to attain debt reduction is stressed, as is the fact that this would be one of several ways to finance more government social spending. An advantage of such swaps is that they directly link debt reduction with higher social spending. New opportunities in this field are provided by a special clause in Paris Club reschedulings and by the US "Initiative for the Americas".

II. FISCAL RESOURCES AND NET RESOURCE TRANSFERS ABROAD

Impediments to Growth and Social Development in the 1980s

Various debtor country categories should be differentiated. This task is relevant for the analysis of existing links among external debt, fiscal resources and child welfare, as well as for the policy recommendations in Section III.

The severity of the external debt burden and of the impact of this burden on an economy differs greatly from one group of nations to another. The severely indebted middle-income countries (called "SIMICs" by the World Bank), mainly those in Latin America, have suffered most of the weight of the debt crises. According to World Bank figures, these 20 nations, the debts of which are owed largely to private creditors, account for about 40 percent of the total external debt of all developing countries (Table 1).

The 26 severely indebted low-income countries (called "SILICs"), almost all of them in sub-Saharan Africa, account for a far smaller share, only 9 percent. Furthermore, most of this external debt is owed to "official" sources. However, because of the low levels of income of these countries and because the external debt indicators in many of them are extremely critical, their debt overhang causes particularly serious problems for the poor.

This paper concentrates on these two categories of countries, the severely indebted middle-income countries, mainly in Latin America, and the severely indebted low-income countries, mainly in sub-Saharan Africa. However, there are three caveats. First, more than one-half of all developing countries are not severely indebted. Mainly in Asia, these nations represent around 42 percent of the external debt of the Third World. This means that external debt was not a major impediment to development in these countries in the 1980s. Indeed, a few of them, in particular the Republic of Korea, Malaysia and Thailand, initiated a deliberate

Table 1: THE EXTERNAL DEBT OF VARIOUS COUNTRY GROUPS
(In Billions Of Dollars And In Percentages, 1980-90)

	External Debt ($ billions)		
	1980	1990[a]	Official Debt (%, 1989)
SILICs[b]	41	116	67
SIMICS[c]	299	588	35
Other	222	517	--
Total	562	1,221	42

Source: Elaboration on data in World Bank (1990).
[a] Projection.
[b] The "severely indebted low-income countries" are Benin, Burundi, Comoros, Equatorial Guinea, Ghana, Guinea, Guinea-Bissau, Guyana, Kenya, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Niger, Nigeria, São Tomé and Príncipe, Sierra Leone, Somalia, Sudan, Tanzania, Togo, Zaire and Zambia.
[c] The "severely indebted middle-income countries" are Argentina, Bolivia, Brazil, Chile, Congo, Costa Rica, Côte d'Ivoire, Ecuador, Egypt, Honduras, Hungary, Mexico, Morocco, Nicaragua, Peru, Philippines, Poland, Senegal, Uruguay and Venezuela. Chile and Costa Rica are included for the sake of consistent comparisons, even though debt indicators no longer imply that they should appear in this category.

policy of reducing external debt in the second half of the 1980s. Thus, South Korea reduced its external debt from $47 billion in 1985 to $33 billion in 1989.

Second, countries can move from one category to another as their external debt situation improves or deteriorates. Thus, due to rapid export growth and significant debt reduction, both Chile and Costa Rica have experienced great advances in their debt indicators in recent years. External debt seems to have ceased being an important constraint on the development of these two countries, so much so that they have been moved by the World Bank to the "moderately indebted" category. Less encouraging is the fact that some countries in Asia, such as India, witnessed a rapid deterioration in their external debt situation in the second part of the 1980s.

Third, the external debt of Eastern European countries and the Soviet Union, though clearly separate, is becoming closely linked to the issue of Third World debt. According to World Bank figures, the total external debt of these nations has reached $156 billion (see also Griffith-Jones 1990). Particularly as a result of the revolutionary political changes in Eastern Europe in 1989, the external debt of some of these countries, but especially Poland, has been handled on extremely favourable terms by the international community. This should have a generally positive effect on the treatment of the debt of developing nations, particularly since the income levels of countries like Poland are certainly higher than those of the low-income developing nations and may be higher than those of many middle-income developing nations. However, there is a potential risk that a generous debt reduction for the benefit of Eastern Europe and the Soviet Union would occur at the expence of debt reduction for developing nations, particularly by official creditors. This risk must be avoided.

The losses in the welfare of the poor, particularly poor children, that occurred in the 1980s due to factors such as the external debt overhang were far more damaging in the severely indebted low-income countries than they were in the severely indebted middle-income ones. Income per capita in the latter was around five times higher, while child mortality was 50 percent lower (Table 2). Debt indicators deteriorated appreciably in the SILICs during the 1980s, both in terms of debt service ratios and the ratio of debt to exports, with exports declining by 20 percent per year between 1982 and 1989. The debt service ratio for the SILICs grew from 10 percent in 1980 to 31 percent in 1991.

For the SIMICs, scheduled debt service ratios have declined quite significantly since 1982, reflecting both the slow growth of debt and the very robust growth of exports. Indeed, by 1991 the debt service ratio for the SIMICs, 30 percent, was significantly lower than it had

Table 2: STRUCTURAL, DEVELOPMENT AND EXTERNAL DEBT INDICATORS (1980-91)

	SILICs[a]	SIMICs[b]	MILICs and MIMICs[c]	Total Third World
			Structural Features	
GNP per capita ($, 1988)	288	1,632	--	--
IMR (1987)[d]	109.8	55.0	--	--
			Debt Indicators	
Debt service ratio				
1980	10	36	19	22
1982	20	49	22	28
1989	27	32	29	22
1991	31	30	31	21
Debt/export ratio				
1980	96	196	128	134
1982	214	297	141	182
1989	493	294	248	187
1991	441	280	266	176
	Growth and Development Indicators (annual growth rates, 1982-9)			
GNP	-5.1	3.6	--	--
Exports	-2.0	3.5	--	--
Per capita consumption	-1.5	0.4	--	--
Investment	-4.8	-0.7	--	--

Sources: World Bank (1990, 1991a).
[a] See Table 1, footnote "b".
[b] See Table 1, footnote "c".
[c] The "moderately indebted low-income countries" (MILICs) are Bangladesh, Central African Republic, Ethiopia, Gambia, Indonesia, Pakistan, Sri Lanka, Uganda and Yemen; the "moderately indebted middle-income countries" (MIMICs) are Algeria, Cameroon, Cape Verde, Colombia, Dominican Republic, Gabon, Guatemala, Jamaica, Paraguay, Syria, Turkey, Yugoslavia and Zimbabwe.
[d] The infant mortality rate (per 1,000 live births).

been in 1980, 38 percent. However, the debt-to-exports ratio was still somewhat higher in 1991 than it had been in 1980. Paradoxically (and illustrative of the problems involved in categorizing countries), the nations identified by the World Bank as "moderately indebted" witnessed a rather important deterioration in the 1980s, but especially after 1982. Indeed, by

1991 their debt service ratios were worse than those of the so-called "severely indebted developing countries".

Taking the Third World as a whole, the ratio of debt to exports remained constant in the 1980s, and debt service ratios improved somewhat after 1982. By 1991 the debt service ratio of all developing nations was marginally lower than it had been in 1980. This clearly indicates that for SIMICs and for the Third World overall the debt crisis eased somewhat, though it is still a very serious problem for many of these countries. For SILICs the debt crisis is now as serious as, or more serious than, it was in 1982.

Finally, SILICs and SIMICs obviously exhibited different growth and development records. The economic performance of SILICs was extremely poor in the 1980s, with very sharp declines in output, investment and consumption. (As is well known, this has led to a deterioration of social indicators in most of these countries.) Although the performance of SIMICs was also poor, particularly in terms of investment, at least some positive elements emerged, such as a relatively good performance in exports.

Changes in Net Transfers Abroad

1. **The Nature of the Problem: A Schematic Analytical Framework**. The following analysis is based on the assumption that changes in net resource transfers abroad resulting from external debt crises are a cause, and not just a consequence, of macroeconomic imbalances, particularly fiscal imbalances. In the 1980s the external transfer problem also became a budgetary transfer problem. The budgetary transfer problem affects macroeconomic variables such as inflation, with an indirect impact on child welfare, and the level of government expenditure and taxation, with a direct impact on the welfare of the poor (see Cornia and Stewart 1990).

There were three main ways in which higher debt servicing and lower access to new external flows (linked to the external debt crises of the 1980s) affected government finance:

- Direct effects, tied to the need for governments to capture the additional local currency to finance increased external and domestic debt service.

- Effects on public sector finance, via the adjustment of the balance of payments (to changes in net resource transfers).

- Effects of slower economic growth (or output decline) and greater inflation, partly resulting from the debt crises, on public sector finance.

The cuts in government spending (implying reductions in "public goods"), the fall (or slower growth) in output and income, and higher inflation all affected the income levels and welfare of the poor.

This analysis can be placed within a broader analytical framework by distinguishing among the initial conditions faced by severely indebted developing nations in the early 1980s, the main policy responses and the immediate factors affecting the poor (see the Figure).

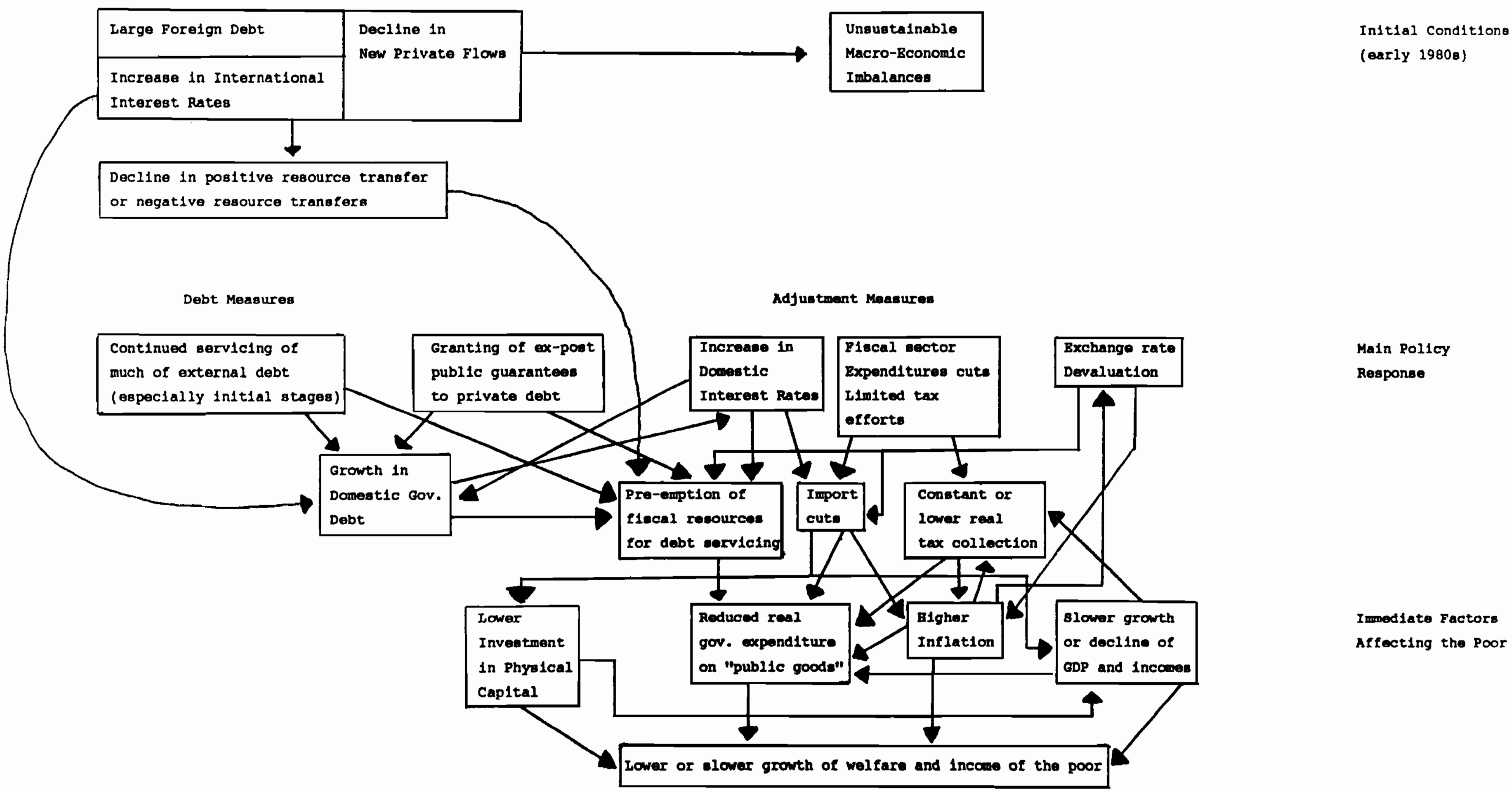
The "initial" conditions in severely indebted developing countries were due both to dramatic changes in net resource transfers and to unsustainable macroeconomic imbalances (the latter being partly determined by the former).

The governments of heavily indebted countries responded, especially initially, mainly by continuing to service most of the external debt (even though this was generating severe economic, financial and social costs), in some cases even granting ex post public guarantees for private debt. To be able to accommodate the negative net resource transfers from their economies (or the far lower positive net resource transfers), they undertook to implement adjustment measures. Among the most relevant in the terms of this paper were big exchange rate devaluations, cuts in levels of fiscal expenditures and rises in domestic interest rates (linked to tighter monetary policy and both cause and effect of the growth in domestic debt).

Such debt and adjustment measures involved a number of problematic impacts, including the preemption of a large proportion of fiscal resources for debt servicing, import cuts and constant or declining real tax collection. These intermediate effects in turn led to declines in investment in physical capital, reduced real expenditure on "public goods" (such as health care and education), higher levels of inflation and slower growth or drops in GDP and incomes. Changes in these four variables tended to lead to a decrease (or slower growth) in the levels of welfare and incomes of the poor in these countries. Though the broad direction of the changes was strongly influenced by the initial conditions, the final impact on the welfare and income of the poor was, as Cornia and Stewart (1990) clearly show, strongly influenced in each country's experience by the type and balance of policy decisions taken by individual governments.

In the context of such an analytical framework, this paper will focus in more detail on how changes in net resource transfers (linked to the debt crises) affected public sector finance and, thus, the ability of the public sector to provide "public goods" essential for the poor. It examines, first, the direct effects of external debt crises on public sector finance and the poor, then the indirect effects of debt crises on these same areas through the adjustment

Figure: DEBT, ADJUSTMENT AND THE FISCAL SECTOR IN SEVERELY INDEBTED COUNTRIES (1982-90)



of the balance of payments (via the exchange rate and the reduction of imports), and finally the indirect effects of debt crises on these areas through slower economic growth (or output decline) and increased inflation.

As can be seen from the Figure, this paper focuses only on some (albeit, hopefully, the main) links among debt crisis, debt and adjustment measures, public finance and the poor. One important link which is not discussed in detail, since it is less tied to public finance, is the effect of debt and adjustment measures through lower levels of investment in physical capital (both public and private) and on the poor, mainly through job losses.

2. **Direct Effects of External Debt Crises on Government Finance**. In almost all developing countries a very large part of external debt is serviced by the public sector. The rise in interest payments that occurred in the early 1980s and that resulted from both the rise in the value of the stock of external debt in previous years and the jump in international interest rates therefore implied a substantial increase in public deficits. Cuts in external lending meant that more domestic finance had to be mobilized. For these reasons, the external transfer problem also became a serious budgetary transfer problem. This was particularly serious from the perspective of public finance in cases where foreign exchange (via exports) was earned by the private sector, but debt service outflows had to be made mainly by the public sector (see later).

Throughout the 1970s budget deficits in developing countries, with a few exceptions, were relatively moderate, usually reaching less than 3 percent of GDP (Table 3). For the highly indebted nations included in Table 3, budget deficits averaged under 2 percent of GDP in the late 1970s; these relatively small budget deficits were easily financed, in most cases by foreign borrowing. On the other hand, some heavily indebted low-income countries like Ghana, Tanzania and Zaire had large budget deficits financed mainly by external resources.

After the external shocks of the early 1980s (which first led to rising interest rates and declining terms of trade and later to reduced private international lending), budget deficits rose significantly in almost all developing countries, but particularly sharply in the highly indebted developing nations. Especially since new external finance was drying up for these countries, the large deficits were financed by both greater domestic borrowing by the government in the small national financial markets and the accelerated creation of money. The latter led eventually to inflation and often to more capital flight, which raised the net negative transfer further; the former often led to higher domestic interest rates and, through

Table 3: BUDGET DEFICITS IN SELECTED DEVELOPING COUNTRIES[a]
(In Percentages Of GDP, 1978-87)

	Total Balance			Primary Balance		
	1978-9	1981-2	1986-7	1978-9	1981-2	1986-7
Argentina	-2.9	-7.8	-5.6	-0.9	-3.8	-3.4
Bolivia	-2.8	-10.4	-2.8	-2.5	-3.5	--
Brazil	-1.1	-2.5	-12.8[b]	0.9	0.1	-1.2[b]
Chile	2.4	0.8	1.0	3.8	1.3	3.0
Colombia	-0.1	-3.9	-1.3	0.3	-3.1	0.0
Costa Rica	-5.9	-1.9	-2.7	-4.2	-0.3	-0.1
Ecuador	-0.9	-4.6	-3.4	1.0	-1.0	1.1
Ghana	-9.6	-7.1	0.3	-7.6	-5.2	2.0
Indonesia	-2.6	-1.9	-2.2	-1.5	-1.0	0.6
Jamaica	-12.8	-14.9	-1.4[b]	--	-6.8	9.0[b]
Kenya	-5.6	-7.8	-6.5	-3.9	-4.9	-1.9
Malawi	-8.8	-9.7	-7.3[b]	-6.7	-5.2	-1.1[b]
Mexico	-3.0	-11.1	-10.5	-1.4	-7.6	3.3
Morocco	-10.1	-12.8	-8.8[b]	-8.1	-9.1	-3.1[b]
Nigeria	-1.6	-7.4	-5.4	-0.4	-5.2	1.2
Peru	0.7	-3.5	-4.7	4.0	0.1	-2.7
Philippines	-0.7	-4.1	-4.0	0.1	-3.2	0.4
Tanzania	-11.7	-7.2[c]	-5.5[d]	-10.4	-5.1[c]	-3.5[d]
Uruguay	-0.3	-5.3	-1.4	0.4	-4.6	0.2
Venezuela	-1.1	-2.9	-0.6	0.3	-0.8	3.0
Zaire	-7.9	-10.1	-7.2	-5.7	-6.2	-2.5

Source: UNCTAD (1989).
[a] Consolidated central government budget deficits. The primary deficit equals the total deficit less interest payments. A minus sign indicates a deficit. [b] 1986. [c] 1981. [d] 1985.

this, to a growing burden on government in the servicing of the domestic debt.

The magnitude of the total budget deficit was pushed up in many heavily indebted developing nations by the fact that governments ex post "socialized" (by taking over responsibility for) the private sector's external debts, thus socializing the transfer burden as well. This occurred in several Latin American countries and in the Philippines, where the private sector had borrowed internationally from private banks without government guarantees; when the debt crisis came in the early 1980s, several governments granted exchange rate and other assurances to help the private sector service its debt. This generated important central bank losses in a number of countries, such as Argentina, Chile, Costa Rica, Philippines and Uruguay.

Throughout the 1980s, heavily indebted countries made major efforts to reduce budget deficits, with an important degree of success. These attempts to cut budget deficits sharply were intimately linked to the need to overcome the problems inherited from previous stages; a smaller budget deficit or a budget surplus was required to generate domestic resources to finance negative net resource transfers abroad, help finance the domestic servicing of internal debt and help cut inflation, which had mounted rapidly, particularly in the heavily indebted Latin American countries.

Furthermore, especially in Latin America, there has been a major change in the views of politicians and economists, from an attitude of indifference toward the size of the budget deficit in the 1970s and early 1980s to a perception that large budget deficits must be cut as an essential precondition for stabilization (see Williamson 1990).

As a result of fiscal adjustment during the 1980s, interest payments (domestic and external) rose substantially in many developing countries (notable exceptions being Argentina and Peru). The change was as much as 10 percent of GDP in Mexico and 17 percent in Brazil between 1981-2 and 1986-7 (Table 4). Both noninterest current expenditure and capital expenditure fell appreciably in many developing nations. Indeed, the decline in noninterest public expenditure was much sharper than was the rise in revenues. Gains in government revenue were registered in only some countries and were relatively small. Perhaps most disappointing was the fact that tax revenue climbed in only slightly more than one-half the countries examined (11 of 19) and did so by relatively little. Though external determinants (such as inflation, trade reform and other exogenous processes), as well as political determinants, greatly influence a government's ability to carry out a successful tax reform, the case of countries like Bolivia and Ghana (where tax revenues were boosted by 7.2 percent of GDP, although from a very low base) demonstrates the potential for expanding tax revenue even in difficult circumstances. Some heavily indebted countries, like Costa Rica, were able to raise tax revenues fairly significantly during the 1980s, even though they started

Table 4: FISCAL ADJUSTMENT IN SELECTED DEVELOPING COUNTRIES
(Changes As A Percentage of GDP, 1981-2 To 1986-7)

	Total Revenue[a]	Tax Revenue	Total Expenditure	Interest Payments	Current Noninterest Expenditure	Capital Expenditure
			Public Sector[b]			
Argentina	3.1	2.3	-6.7	-6.4	0.9	-1.2
Bolivia[c]	4.5	5.4	-5.0	--	--	-3.0
Brazil[d]	-2.7	-3.4	10.6	17.6	-4.8	-2.2
Chile[e]	1.3	-0.6	1.8	2.0	-2.7	2.5
Colombia	-4.4	1.0	-8.9	2.4	-11.8	0.5
Costa Rica	7.2	0.3	-3.0	--	--	-2.7
Côte d'Ivoire[f]	2.0	-2.3	-6.7	3.8	-2.6	-7.9
Ecuador[e]	-0.7	0.4	-4.9	0.9	-2.9	-2.9
Malawi[d]	0.1	0.1	-6.4	1.8	-1.0	-7.2[g]
Mexico	5.0	0.6	4.1	10.6	-1.3	-5.2
Peru	-10.5	-3.0	-11.8	-1.6	-6.8	-3.4
Philippines	0.0	0.7	-5.5	5.7	-7.1	-4.1
Uruguay[e]	0.5	0.4	-4.3	--	--	-2.1
Venezuela[e]	-4.0	-2.5[h]	-3.2	0.4	-1.4	-2.2
			Central Government			
Ghana	8.7	7.2	1.3	-0.2	0.8	0.7
Indonesia	-1.9	-3.4	-1.6	1.9	0.0	-3.5
Jamaica	3.5	--	-10.0	2.3	-7.4	-4.9
Kenya	-0.7	-1.9	-2.0	1.7	-1.5	-2.2
Morocco	-2.3	0.6	-6.3	2.0	-3.0	-5.3
Nigeria	2.1	--	0.1	4.4	-0.3	-4.0
Zaire	-7.0	-5.4	-9.9	0.8	-7.4	-3.3

Source: UNCTAD (1989).
[a] Including grants. [b] Excluding central banks. [c] Total revenues and expenditures exclude state economic enterprises. [d] Changes between 1981-2 and 1985. [e] Changes between 1981-2 and 1986. [f] Changes between 1981-2 and 1984. [g] Development expenditures. [h] Non-oil taxes.

from a fairly high base (20 percent of GDP in 1980).

In economies which underwent adjustment and fiscal retrenchment, mainly those in Latin America and Africa, cuts in government expenditure were particularly large in health care and education, with the proportion of spending on health care and education in total government spending declining in both regions (Cornia and Stewart 1990). This was in sharp contrast to countries in the Middle East and Asia, where not only total government spending climbed, but also the share of spending going to health care and education rose in 95 percent of the nations examined.

This decline in spending on the social sector in many of these adjusting countries in Africa and particularly in Latin America occurred for two reasons: government spending as a proportion of GDP fell in most countries, and the share in total government expenditure going to the social sectors dropped, largely because a higher share went to interest payments.

As a result of the decreasing levels of GDP per capita and the declining or constant share of total GDP going to government spending, per capita government expenditure fell during the 1980s in many heavily indebted countries, mainly in Latin America and Africa (Table 5). Some of these drops were quite dramatic. For example, in relation to those in 1980, the 1985-7 levels were 20 percent lower in El Salvador, 21 percent lower in the Dominican Republic and Venezuela, 24 percent lower in Peru, 41 percent lower in Bolivia and 46 percent lower in Guatemala; they were 33 percent lower in Tanzania and 37 percent lower in Liberia. In contrast, in many countries in Asia and some in the Middle East, real central government expenditure per capita climbed during the same period. Some of these increases were very significant: 42 percent in Nepal, 45 percent in Korea, 47 percent in Pakistan, 61 percent in India, 108 percent in Singapore and 120 percent in Oman.

The share of spending on health care and education in total central government expenditure also dropped in many heavily indebted countries, especially in Africa and Latin America, largely because of the higher share of government spending going to interest payments (see Ebel 1991, Table 4). The level of real government spending on health care and education, particularly if measured in per capita terms, declined fairly dramatically in several of these countries.

For nations undergoing strict structural adjustment programmes in the 1980s, namely, the severely indebted ones for the most part, a World Bank study (Kakwani et al. 1989) has estimated that the real value of per capita expenditures on education and health care between 1980 and 1986 decreased by more than 10 percent and by nearly 20 percent, respectively. The cuts were especially drastic in, for example, Zaire, where real health care spending per capita was 70 percent lower in 1985 than it had been in 1980 (Ebel 1991). In Mexico average real per capita social spending in 1983-5 was 21 percent less than it had been in 1977-82, while real

Table 5: INDEX OF REAL CENTRAL GOVERNMENT EXPENDITURE PER CAPITA
(1980-7, 1980 = 100)

Country	1980-2	1983-4	1985-7	Country	1980-2	1983-4	1985-7
Latin America				*Asia*			
Argentina	101	89	100	Bangladesh	125	116	129
Bolivia	112	134	59	India	104	125	161
Brazil	99	97	134	Indonesia	103	98	117
Chile	105	101	100	Korea	108	122	145
Costa Rica	82	84	86	Malaysia	126	118	125
Dominican Republic	92	81	79	Myanmar	106	110	119
Ecuador	108	88	105	Nepal	109	136	142
El Salvador	97	85	71	Pakistan	106	125	147
Guatemala	101	71	54	Philippines	101	84	93
Mexico	132	135	149	Singapore	116	157	208
Panama	108	107	102	Sri Lanka	88	83	95
Paraguay	109	100	--	Thailand	106	116	128
Peru	97	82	76	*Sub-Saharan Africa*			
Uruguay	113	94	89	Botswana	104	119	148
Venezuela	119	88	79	Burkina Faso	104	95	93
Middle East and North Africa				Cameroon	133	160	--
Egypt	109	93	83	Ethiopia	108	139	--
Iran	97	86	72	Ghana	93	56	88
Jordan	102	92	92	Kenya	103	92	93
Kuwait	96	99	99	Liberia	98	79	63
Morocco	108	97	98	Malawi	91	77	85
Oman	118	174	220	Mauritius	103	100	101
Tunisia	109	129	125	Tanzania	98	86	67
Yemen Arab	114	114	95	Togo	97	90	99
				Zimbabwe	102	111	111

Source: Ebel (1991), Table 3, page 10.

education expenditure slumped 35 percent between 1981 and 1988 despite a quickly expanding school-age population.

Indeed, the Mexican case dramatically illustrates the extent to which rapidly growing debt service displaced resources within the government budget from spending on the social sectors. In Mexico the budget share dedicated to debt servicing jumped from 23.5 percent in 1981 to 58.2 percent in 1988. Simultaneously, the budget share of education fell from 9 percent to 5 percent; this produced a decline in the public resources going to education, in terms of a portion of GDP, from 5.3 percent in 1981 to 3.5 percent in 1988 (Valerio 1991). In health care, although it recovered swiftly in 1988, the level of budgetary spending fell by 53 percent between 1981 and 1987 (Cruz et al. 1991).

In contrast, it is noteworthy that in Asia not only the share of government spending as a share of GDP rose in many countries, but also within government spending the portion going to health care and education increased somewhat, even though interest payments also climbed as a share of government spending, at least initially.

Clearly, the drop in the level and share of government spending on health care and education, mainly in the adjusting countries of Latin America and Africa, directly affected the welfare of the poor. It may also have had a negative impact on overall growth and the rate of return on investment. The World Bank (1990) reports that in the severely indebted middle-income countries, the plunge in GDP growth in the 1980s of about 75 percent (GDP growth fell from 4.5 percent in the 1970s to about 1 percent in the 1980s) was only partly due to a decrease of around 50 percent in the net investment ratio of these countries. The drop was also partly due to the decreasing productivity of the capital stock. A major element in explaining the lower productivity of physical capital is obviously the poorer quality of human capital that was linked in these countries to the severe cuts in government spending in health care and education in the 1980s. Furthermore, in the 1980s (and unfortunately in the future as well) the deteriorated human capital availability tended to depress investment in physical capital, given the high degree of complementarity between human and physical capital. The quality of spending on human capital in areas such as health care, education and nutrition may also have been impaired by the focus placed on cuts and the uncertainty surrounding future levels of expenditure. This made far more difficult a focus on long-term policymaking and planning, especially essential in assuring the effectiveness of social service spending.

To check both the immediate and the dynamic negative effects of cuts in government spending on social services, past trends must be reversed rapidly and substantially. More action on cutting external debt servicing in the 1990s can offer a unique opportunity to create some leeway to raise government spending on social services. Furthermore, other financing mechanisms need to be implemented to complement reduced external debt servicing in funding more social spending (see later).

Moreover, in those countries where the burden of external debt servicing has begun to decline, as is the case in many SIMICs (see Table 2, page 4), a significant portion of the resources being freed up for governments should be channelled to boost spending on health care, education and nutrition. It is essential that in these countries the increases in public spending aimed at the poor that are becoming feasible not be displaced by reductions in tax revenues or the expansion of nonessential government spending.

According to UNCTAD (1989), because of the major efforts undertaken by heavily indebted countries in the 1980s to reduce fiscal deficits and, more broadly, the public sector borrowing requirement, the PSBR in the nations analysed in Tables 3 and 4 (pages 9 and 11) was on average only one-half of a percentage point of GDP higher in 1986-7 than it had been in 1978-9, although interest payments had risen by three percentage points, of which two were due to growing interest payments abroad. However, because of the cutbacks in external lending, a greater share of the PSBR had to be financed domestically either by more monetary expansion or the greater indebtedness of the public sector.

In some heavily indebted countries like Argentina and Mexico the rise in the budget deficit in the early 1980s was totally financed initially by the consolidated banking system (see Reisen and van Trotsenburg 1988). The situation was different in countries like Korea, where public sector financial requirements did not rise much in the early 1980s. There, the requirements were only partly funded by the domestic banking system, and foreign borrowing did not fall appreciably.

The nations like Argentina and Mexico that relied significantly on printing more money in order to finance rising budget deficits in the early 1980s experienced spiralling inflation as a result of this expansion in the money supply. Inflation was very high in most of the larger highly indebted middle-income countries, but especially in Argentina, Bolivia, Brazil, Mexico and Peru (Table 6).

However, this link was not inevitable for indebted developing countries. Indeed, between 1973-82 and 1983-8 inflation fell fairly substantially in Chile and Ecuador and moderately in Colombia, Côte d'Ivoire and Morocco and rose only slightly in Nigeria, Philippines, Uruguay and Venezuela.

In those heavily indebted countries where inflation rose appreciably in the 1980s, the sharp rise in inflation, but especially the use of "shock stabilization" to brake inflation, tended to hurt the poorer groups in society more, because they had fewer defence mechanisms to counter the major macroeconomic changes and because drastic efforts at stabilization usually

Table 6: THE RISE OF CONSUMER PRICES IN SELECTED HIGHLY INDEBTED COUNTRIES
(In Percentages Per Year, 1966-88)

	1966-72	1973-82	1983-8
Argentina	26.4	140.8	311.4
Bolivia	5.7	31.3	455.6
Brazil	23.3	54.7	237.8
Chile	31.4	105.1	21.8
Colombia	10.4	24.2	21.6
Côte d'Ivoire	2.9	21.1	18.0
Ecuador	3.6	13.9	4.8
Mexico	3.9	23.9	91.1
Morocco	1.5	10.1	6.6
Nigeria	6.6	16.4	21.1
Peru	8.9	42.8	105.6
Philippines	7.8	14.0	15.0
Uruguay	56.3	57.5	62.8
Venezuela	2.0	10.4	15.9
Memorandum item: World	5.2	12.5	11.1

Source: IMF (various).

have a negative impact on employment and salaries.

The flight of capital is one of the mechanisms through which wealthier groups in society protect themselves. In those indebted countries where there was either hyperinflation or high inflation, capital flight intensified after the debt crises began (Reisen and van Trotsenburg 1988). This generated a vicious circle, since the expanded flight of capital raised net transfers abroad and thus put even more pressure on public finance and macroeconomic management. The vicious circle operates in the following way. A high net resource transfer due to the debt crisis boosts the budget deficit. The higher budget deficit becomes monetized to an important degree. The resulting inflation shifts money demand (through the wealthy who have international connections) from local currency to foreign assets, thereby augmenting net financial transfers and the burden on public finances. This frequently leads to further cuts in government spending which are particularly harmful to the poor.

In some developing countries part or most of the higher fiscal deficits was financed by the nonbank private sector through the purchase of newly issued government bonds. To attract voluntary private savings, governments had to set interest rates at least as high as the inflation rate. In countries like Brazil, with unstable inflation rates and expectations of devaluation, interest rates had to be higher than the inflation rate. These high domestic interest rates in turn imposed a heavy burden on public finances, with interest payments on domestic debt becoming the most important component of the public sector borrowing requirement and reaching or exceeding, in countries like Brazil and Mexico, 15 percent of GDP in the mid- and late 1980s. In these nations the climb in debt service obligations became the main cause of the preemption of fiscal resources (see the Figure, page 7) and was therefore a major factor behind the reductions in government expenditure on "public goods" and in the welfare of the poor.

A major indirect effect of debt service reduction packages in the context of the Brady plan in the late 1980s, especially well illustrated in the case of Mexico, was the rapid drop in domestic interest rates (see Griffith-Jones 1992). In this instance, a cut in domestic debt servicing by government is added to the reduction in government external debt servicing, further elevating the resources available to governments to boost spending on health care, education and nutrition. The vicious circle of the early to mid-1980s was thus replaced by a "virtuous" circle in the late 1980s and especially in the early 1990s. In the present situation, the case for restoring to pre-debt-crisis levels at least the share of total government spending going to health care, education and nutrition is very strong in those countries where debt servicing burdens (both domestic and foreign) have been falling substantially.

3. **The Effect on Public Sector Finance of Adjustments to the Balance of Payments.** Although declines in net resource transfers, as well as deteriorations in the terms of trade, were accommodated during the 1980s by reductions in imports and growth in exports, the fiscal counterpart of this adjustment was far more problematic in many countries. As a result, there was more analytical focus on the "fiscal constraint" that, together with the traditional "savings constraint" and "foreign exchange constraint", limits the growth and development prospects of heavily indebted developing countries (for example, see Bacha 1990).

The scale of the fiscal challenge posed by the debt crisis was linked to a number of factors, including the relative role of import cuts and export growth in the adjustment of the balance of payments and institutional issues such as the involvement of the public sector in export activities.

While declines in public sector investment and imports generate more foreign exchange, the linked stagflation, changes in relative prices (such as devaluation) and import cuts by the private sector tend to affect public sector finance negatively (see the Figure, page 7). From the prospective of public finance, the issue is how the public sector is to capture the domestic currency equivalent of increased trade surpluses or diminished trade deficits.

If trade surpluses are created mainly through import cuts (as occurred initially in Africa and Latin America), income transfers from the private sector have to be generated to provide the government with local currency to carry out debt servicing. If the trade balance improves mainly due to the growth of exports and there is important public ownership of the export sector, the government can more easily finance the increased net transfers abroad. However, where export expansion is carried out mainly by the private sector, an extra effort is required on the part of government to transfer the additional local currency from the private sector so as to finance external debt servicing.

Taxes on international trade is another mechanism through which the adjustment of trade flows affects public finance. Taxes on international trade average more than one-quarter of total tax revenue (UNCTAD 1989). As a result, changes in trade volumes and policies (for example, changes in customs duties, a switch from quotas to import duties as occurs during trade liberalization, or changes in export taxes) have an important fiscal effect. For the countries in Tables 3 and 4 (pages 9 and 11), taxes on trade fell by around 1.5 percent of GDP between 1980-1 and 1985-6, due both to reduced imports and to lower customs duties.

A particularly important link between trade policy and public finance performance is the exchange rate. Exchange rate devaluation normally affects public finance via a series of mechanisms, which include the positive impact of devaluation achieved through higher revenues from taxes on trade and the negative impact on government spending as imported inputs and capital goods rise in cost. In terms of the net transfer burden, real currency depreciations mean additional public financial expenditures in local currency to service interest payments and amortizations in foreign exchange (see the Figure, page 7).

The impact of changes in the exchange rate also depends on the level of net borrowing from abroad by the public sector during a given period (for example, one year). In countries where this exceeds the level of interest payments (and thus where there is a positive net financial transfer, such as occurred in most of the low-income nations, especially in sub-Saharan Africa, during the 1980s), real devaluations improve the fiscal position. However, such macroeconomic effects may be offset if external aid flows imply the provision of counterpart funds.

Thus, the effect on net public finance of exchange rate devaluations in indebted developing countries will depend on the structural characteristics of these countries. The higher the proportion of government revenue coming from the nontrade sector, the higher the share of government spending in foreign exchange (to service debt or purchase imported goods) and the more negative the effect of a devaluation on the fiscal balance.

Large real devaluations were necessary in many severely indebted countries in the 1980s to improve the balance of trade and finance increased net transfers abroad (linked to the debt crises). These devaluations boosted the fiscal burden in local currency. One of the indirect advantages of debt relief is therefore the fact that the pressure on real devaluation diminishes (or is reversed), thereby also reducing the fiscal impact and, thus, allowing more margin for manoeuvre to raise government spending on items such as social services. Indeed, one of the effects of the fall in external debt servicing in some Latin American countries in the late 1980s, but especially of the return of private capital flows to several countries in that region, was a revaluation of the exchange rates of these nations (for example, see Griffith-Jones et al. 1992). It is estimated that the real exchange rate rose between 5 and 20 percent in 15 of 18 Latin American countries during 1991.

This is a third element in the potential virtuous circle, as revaluation (in some nations) joins lower domestic interest rates and restrained levels of international debt servicing as factors determining the lower local currency costs to governments of servicing total debts. As a result, there is currently even more leeway for raising government spending for the benefit of the poor without additional inflationary pressures.

4. **The Effect of Slower Growth and Higher Inflation on Public Finances**. Public finances were subject to added pressure in heavily indebted countries in the 1980s not just in order to accommodate the swing in net external transfers, but also because of the indirect effects which tended to enlarge budget deficits. These effects included cuts in imports, tariff reductions and real exchange rate devaluations.

Slower economic growth and higher inflation are other indirect effects of the debt crisis that exert pressure on public finance. Inflation accelerated rapidly during the 1980s in the highly indebted countries, but particularly in the Latin American ones (see Table 6, page

16). This was partly the result of the debt crisis and partly the result of domestic macroeconomic mismanagement, at least in the case of Peru, for example.

The link between the external debt crisis (and the decline in net positive resource transfers or the appearance of negative net transfers) and the acceleration of inflation emerged essentially through three mechanisms. First, higher debt servicing and lower capital inflows meant additional budget pressure, leading to greater budget deficits. Second, large nominal devaluations (aimed at achieving real devaluations) meant additional inflationary pressure on costs. Third, plunging imports (and jumps in exports) reduced the aggregate supply of goods in the economy and thereby also pumped up inflationary pressures.

Together with other factors, the debt crisis also led to declines or slower growth of GNP in heavily indebted developing countries and in regions, such as Latin America and sub-Saharan Africa, where most of the heavily indebted developing nations are concentrated (Table 7; see also Table 2, page 4). It is noteworthy that growth in some other areas of the developing world (East and South Asia, for example) accelerated in the 1980s, partly because the external debt overhang was not a major constraint to development. The links among external debt crisis, adjustment and the evolution of output are varied and complex, but clearly the sharp fall in imports in heavily indebted countries was a major cause of declining output or slower growth in these countries.

Declines or slower growth in output and accelerating inflation have a negative impact on fiscal balances, especially through decreased taxation (see the Figure, page 7). Direct and

Table 7: REAL PER CAPITA GDP GROWTH IN DEVELOPING COUNTRIES
(In Percentages, 1965-89)

	1965-73	1973-80	1980-9
Developing countries	3.9	2.5	1.6
Sub-Saharan Africa	2.1	0.4	-1.2
Latin America	3.8	2.5	-0.4
East Asia	5.3	4.9	6.2
South Asia	1.2	1.7	3.0
Europe, Middle East and North America	5.8	1.9	0.4

Source: World Bank (1991b).

indirect taxes tend to fall or stagnate when economic activity does so. This is true partly because, when government investment in key sectors such as infrastructure and human capital drops, private sector profitability, output and investment also fall (Taylor 1990). Due to this "crowding-in" feature of public investment, growth potential and the future tax base are eroded by cuts in government spending. In addition, as the level of several taxes is tied directly to the values of production and sales, the decline or slow growth of the latter two leads, ceteris paribus, to falling or stagnating tax revenue.

Furthermore, the efforts undertaken by governments to implement tax reforms in the 1980s were insufficient. Likewise, the efforts of international financial institutions seem relatively weak in this field. As the World Bank (1988) itself has pointed out on the basis of its empirical analysis, tax policy is one of the areas where the policy implementation of the conditions attached to its structural adjustment and sectoral loans was weakest in the mid- to late 1980s, while policy implementation on exchange rates and public expenditures (the latter largely referring to expenditure reductions) was the strongest. This may be partly due to the fact that more "progressive" conditionality (for example, taxing the rich to pay for higher social spending or lower inflation) is more difficult to implement because of domestic pressures exerted by, among others, wealthy or powerful groups. This would seem to suggest that international institutions should take some steps to help overcome the regressive policy implementation bias (see Rodriguez and Griffith-Jones 1991).

In many cases, accelerated inflation (resulting partly from the debt crisis) has cut into real tax revenues because of collection lags, legislative procedures, administrative delays and other factors. It is difficult to estimate the effect of both inflation and successful stabilization on tax revenues in developing countries, even though there is some evidence that in nations with long collection lags tax collection is inversely proportional to the level of inflation. (This is known as the "Olivera-Tanzi effect".) However, the lowering of inflation through successful stabilization, particularly in countries with a long record of inflation, does not automatically lead to higher tax revenues (Lerda 1989). Therefore, to guarantee that stabilization is accompanied by more tax revenue, the stabilization effort must include effective tax reform.

As is apparent from the above analysis, the management of macroeconomic and budgetary policy became far more complex as a result of the debt crises in the 1980s and particularly of the negative financial net transfer burden. Thus, policy dilemmas became more acute. For example, real domestic interest rates rose in those countries attempting to fund the public deficit on the domestic capital market and avoid capital flight; nominal interest rates rose especially in those cases where inflation increased.

These high real and nominal interest rates had two negative effects. At one level, they discouraged private sector investment, thus depressing current and future growth. This had both a direct and an indirect (via the fiscal system) impact on the poor. At another level, in order to avoid a domestic debt explosion, high real and nominal interest rates require that surpluses be generated in the rest of the government budget. If tax revenue does not increase, government spending must be cut further, leading to negative effects in social spending, as well as in other sectors. This latter impact, though an indirect effect of the external debt crisis, represented an important factor in the cuts in social services in the 1980s.

Another policy dilemma which became more acute as a result of the debt crisis was related to the extent of devaluation. Devaluation (both nominal and real) helped improve the trade balance. This was necessary in order to cut into negative net transfers abroad. However, this real devaluation accelerated inflation not only directly, via cost pressures, but also indirectly through the deterioration of public finance and the probable increase in the printing of money. High inflation tends to generate additional costs which directly impinge on the welfare of the poor. If executed through expenditure cuts, reductions in additional inflationary pressures on public revenues also hurt the poor, because of the recessionary impact and because part of the cuts will involve a curtailment of social services.

A unilateral reduction in debt service payments (as occurred with ever greater frequency in the late 1980s), or (even better) a decline in debt service payments linked to an agreement with creditors, would eliminate several of these perverse effects.

In countries where public finance is an important cause of macroeconomic problems (reflected in high inflation or high real interest rates, for example), the opportunity for fewer negative net transfers or more positive net transfers should be employed to restore previous levels of investment in human and physical capital, as well as raise social spending, and to pursue a sensible stabilization policy, mainly through less reliance on the printing of money, but also through cuts in the creation of domestic debt and in the rate of real devaluation (or a reversal of the latter if this is compatible with the foreign exchange constraint).

The case of Mexico since 1990 is a good illustration. Domestic debt and domestic interest rates have fallen in that nation, partly due to Brady debt reduction. Moreover, the real exchange rate has been revalued, contributing to a curb on inflation (Griffith-Jones 1992).

In economies experiencing very high inflation rates, a cut in inflation is an important public good, especially in terms of the benefits for the poor. A drop in inflation from very high levels will help the poor to the extent that their incomes are not fully indexed. Moreover, such a drop is likely to have some dynamic positive effects on growth (for example, through less capital flight) that would raise the future income of the poor.

Finally, if due to the resources freed up through the reduction of external debt service payments and, possibly, cuts in internal debt service payments stabilization is accompanied by more public spending, especially on social services and investments in physical capital, the benefits for the poor will be both long-term and immediate. The long-term benefits originate from the dynamic impact on growth of higher investment. The immediate benefits will emerge only if clear and, ideally, absolute priority is assigned to higher public spending in areas which favour the poor and promote growth (Cornia and Stewart 1990). In countries where debt servicing is declining as a proportion of total government expenditures (for example, many Latin American countries), it is becoming feasible to add appreciably to government spending which benefits the poor without necessarily requiring higher taxes to avoid extra inflationary pressures. Formerly a heavily indebted country, Chile has seized the opportunity and substantially increased social spending (by 30 percent in real terms). This has been made easier by the declining debt service burden of the government, but it has also been funded to an important extent by more taxation (see Flaño 1992).

If inflation is not a major problem (as in many low-income economies) and if government investment and social spending have been largely constrained by a scarcity of foreign exchange, the case is very strong for channelling nearly all the resources freed by debt reduction toward social spending and investment in physical capital. To the extent that spending on human and physical capital by governments would, in such a case, "crowd in" private investment, there will be a further beneficial effect on future growth and employment and, thus, on the poor. In these countries, the case is rather good for directly linking debt reduction and higher social spending through, for example, debt-for-social spending swaps.

III. POLICY IMPLICATIONS: THE NEED FOR FURTHER DEBT REDUCTION

The debt crisis of developing countries now is somewhat less severe overall than it was in the mid-1980s as a result of measures such as the Brady Initiative, the Toronto Initiative and other programmes for debt relief and restructuring, as well as of the improved export performance of some (especially middle-income) developing countries. Above all, that the need for debt reduction in order to free resources for development has become widely accepted is very positive.

Nonetheless, the implementation of the latter principle has been slow. Actions have tended to be "too little, too late", especially for the countries still trapped in an intense debt crisis. The most urgent and serious problem is that faced by the severely indebted low-income countries, mainly in sub-Saharan Africa, where debt and development indicators deteriorated throughout the 1980s. In the case of severely indebted middle-income countries, mainly in Latin America, fairly significant progress has been made in debt reduction in several of them, with other countries still confronted by serious debt overhang and macroeconomic imbalances. Moreover, the debt to other creditors, particularly official ones, is an important issue which is only recently being tackled for middle-income countries.

Of relevance in the effort to raise social spending and thus improve child welfare is the importance being attached to special initiatives which link debt reduction to development spending, particularly spending on the environment, but also social spending (see World Bank 1990, Mistry 1991, Griffith-Jones and Faber 1990, ECLAC 1990, Griffith-Jones 1992).

Perhaps the most serious problems related to debt and development are found in sub-Saharan Africa. Although the nations of this region have benefited from quite significant debt relief (particularly from official creditors), this has clearly not been enough. Particularly discouraging is the fact that sub-Saharan countries have not been able to obtain as much official debt relief as have much more well-off countries, like Egypt and Poland, with fairly little effort, apparently because of political considerations.

An important step on behalf of sub-Saharan Africa would be an endorsement of Prime Minister John Major's initiative, which is known as "the Trinidad Terms", or, better, the even more far-reaching proposal made by Development Minister Jan Pronk of the Netherlands.

The Trinidad Terms would reschedule the entire stock of Paris Club (official bilateral) debt in one go, rather than continue the exhausting negotiations falling due every year or so. They would increase by one-third to two-thirds the amount of relief provided through the cancellation of outstanding debt stock, capitalize all interest payments (albeit at market rates) on the remaining one-third of debt stock for five years, and stretch the repayment of the remaining one-third of debt stock.

Mistry (1991) estimates that, if adopted unchanged, the Trinidad Terms would mean a cut of about $18 billion in the eligible debt stock of the sub-Saharan countries. The Terms could lower service payment schedules to levels near the current level of the actual payments on official flows. This would represent a major step toward a comprehensive solution of Africa's debt problem, since many of the difficulties involved in the current approach to the rescheduling of low-income debt-distressed countries in the Paris Club would be eliminated.

The Pronk proposal calls for the cancellation of all the official bilateral debt (both concessional and nonconcessional) of the severely debt-distressed, least developed nations, as well as other low-income countries. About $40 billion in outstanding debt stocks would be involved. Moreover, the proposal would include scheduled debt service savings of $3 billion to $4 billion, but actual debt service savings of only about $1.5 billion.

Unfortunately, the London Summit in July 1991 did not fully endorse the Major Initiative or the Pronk proposal, though it did agree to "additional debt relief measures, on a case-by-case basis, going well beyond the debt relief already granted".

These ideas were taken up by the Paris Club. The agreement reached in late 1991 (and already applied to Benin and Nicaragua) was disappointing. It considerably diluted the Trinidad Terms, even though the advances relative to the Toronto Terms were important. Through these "enhanced Toronto Terms", creditors can opt for cancellation of 50 percent of the eligible maturities being consolidated, with the remainder consolidated at market rates, to be paid over 23 years with six years' grace; halving the interest rates on nonconcessional debt in NPV terms, to be repaid over 23 years with six years' grace, or stretching the repayment period, with 14 years' grace and 25 years' total maturity.

To achieve the minimum necessary basis for the recovery of sub-Saharan nations and assure an annual growth of 1 percent in per capita income, the following conditions would have to be met (although they are obviously not all-inclusive, since there are many constraints on African development aside from those tied to the problem of external debt):

1. For bilateral debt, at least the Trinidad Terms must be granted. They should be accompanied by other options to reduce official bilateral debt through various kinds of debt swaps, which would include special programmes for health care, education and environmental protection.

Since September 1990 the Paris Club has authorized the conversion of bilateral official debt through swaps for environmental protection on a voluntary, bilateral basis. By early 1992 such swaps had been arranged for several African countries, including Benin, Congo, Côte d'Ivoire, Egypt, Morocco, Nigeria and Senegal, as well as non-African nations such as Ecuador, El Salvador, Honduras, Jamaica, Nicaragua, Peru, Philippines and Poland.

Most such arrangements involve debt-for-equity swaps or swaps of debt for environmental projects, but not swaps of debt for social spending, which would be of more direct benefit to the poor. It is essential that UNICEF and others concerned with improving the welfare of the poor emphasize the value of swaps of debt for social spending as a complement to other types of debt swaps.

2. Action is needed on the debt to the International Monetary Fund so as to avoid negative net transfers to that institution. The aim must be a policy of "zero net transfers" from sub-Saharan Africa, as well as from the individual countries in that region. One technically appealing approach, though it may be difficult to convince the governments of some industrialized countries to accept it, would be the issuance of Special Drawing Rights that would enable the IMF to write off the debts of low-income, debt-distressed countries. Furthermore, the African Development Bank should create special facilities to reduce the debt owed to it by low-income countries.

3. The debt of sub-Saharan nations to commercial creditors has thus far received scant attention, although urgent action is required. While longer term commercial debt represents less than 16 percent of all sub-Saharan debt (excluding Nigeria), it absorbs nearly 30 percent of total debt service payments. The arrears owed to such sources are also very problematic.

Commercial banks should agree to a debt reduction in favour of sub-Saharan countries that is similar to the debt reductions granted by governments. More agile use should be made of the World Bank Special Debt Reduction Facility. The resources available for the latter should be expanded, and its tenure extended. Moreover, wherever necessary, regulatory and tax regimes in the home countries of the creditor banks should be modified so as to encourage banks actually to reduce those debts against which extensive provisions have been made (see Griffith-Jones and van der Hoeven 1990). This is particularly relevant in the case of European countries (except for the UK, where some steps in this direction have already been taken) and Canada, where current tax regulations encourage provisioning, but discourage debt reduction. Donations of commercial debt for social and environmental purposes should be further encouraged.

For middle-income countries, some progress has been achieved in the context of the Brady Plan, but also outside it (for example, Chile's successful commercial debt restructuring in September 1990). Countries like Costa Rica, Mexico, Philippines and Venezuela have obtained different levels of debt reduction and cash flow relief in the context of the Brady

Plan. In some of these cases (for instance, that of Costa Rica) the level of debt reduction seems sufficient to help restore growth (if other necessary conditions are met); in other cases (for instance, that of Mexico) not only has the debt reduction been valuable, though limited, but also the signing of deals has led to indirect benefits, such as higher foreign private capital flows and the reversal of capital flight, due largely to the greater confidence in the economy originating partly in the debt reduction deal itself. Furthermore, there has been a dramatic rise (starting in 1989-90, but accelerating in 1991) in new private capital flows to several Latin American countries and to the region as a whole. As a result, for the first time since 1981 net resource transfers to the Latin American and Caribbean region are positive, reaching an estimated $7 billion in 1991. Consequently, foreign exchange reserves have jumped in many nations in the region. Growth and development are therefore, at least for the time being, no longer constrained mainly by the lack of foreign exchange availability, as was the case during the 1980s. Moreover, the debt overhang is no longer perceived in most of these countries as an important constraint on growth and development.

However, there are potential long-term risks, as well as benefits, from these large capital inflows, particularly since the new capital flows are adding to a still rather sizeable stock of "old debt" and a large proportion of these flows are relatively short-term. Moreover, there is little monitoring of the final use to which these flows are being put.

From the perspective of the poor, it is important that the additional room for manoeuvre provided by higher foreign exchange reserves and, particularly, by the increased space in fiscal budgets be employed to a large extent for both more social spending by government and more productive investment in physical capital, the latter mainly through the private sector, but also through expanded public investment in physical infrastructure and so on. It is also important that supervisory and regulatory measures be undertaken by governments and international institutions to avoid future debt crises (see Griffith-Jones et al. 1992). A very high share of the costs of past debt crises have been borne by the poorest and most vulnerable within the heavily indebted countries.

However, further action may be necessary to speed up debt reduction in middle-income countries and especially in lower middle-income countries, such as Ecuador and Jamaica. This should include the following.

1. In the context of the debt of sub-Saharan Africa, tax and regulatory changes should be used to encourage commercial debt reduction. Such changes represent a valuable tool and

are without cost. They would be attractive to creditor governments, since they do not require government spending. On the contrary, they may lead to savings in the fiscal budget (see Griffith-Jones and van der Hoeven 1990). A clear alternative tax treatment exists for provisioning and debt reduction that could furnish more incentives for European and Canadian banks to participate in debt and debt service reductions. Tax relief would be given at the time of provisioning. However, these tax concessions would be maintained only if the commercial bank accepted debt or debt service reductions at least equivalent to the amount of provisioning being accepted for tax concessions. In cases where banks make donations of debt to charities, with proceeds to be used for development spending, the additional tax relief would also be immediately and permanently granted. Such tax and regulatory changes would need to be carefully constructed so as also to offer encouragement for new lending to those countries where debt overhang has been significantly cut or eliminated.

2. For severely indebted countries with debt overhang and large macroeconomic imbalances such as Brazil, debt reduction and continued efforts at improving macroeconomic imbalances should be pursued simultaneously. Macroeconomic adjustment should not be a precondition for debt reduction for these countries; nor, however, should it be a substitute for parallel domestic efforts to lower macroeconomic imbalances.

3. Continued and possibly enhanced support from official sources for completion of Brady-type deals for debt reduction is required, especially for smaller countries like Ecuador.

4. The problems of severely indebted middle-income countries with high levels of official debt, such as Ecuador, Honduras and Peru, need to be addressed on a systematic basis. The 50 percent bilateral official debt reduction already granted to countries like Egypt and Poland represents a precedent for this approach. A further precedent is offered by the concessions on bilateral official debt to the US granted in the Initiative for the Americas launched by the US government that are partly linked to higher spending on the environment. This initiative is positive in that it links debt reduction to development spending. However, its scope is excessively narrow in that it focuses mainly on the natural environment. On the other hand, if imaginative projects are developed that emphasize the intimate links between poverty alleviation and environmental conservation, then the Initiative for the Americas may become a useful vehicle for the spread of the concept of debt reduction tied to social spending which benefits the poor. More generally, official debt reduction for middle-income countries, if and when it comes, will provide important opportunities for linking debt reduction to higher social spending.

5. Initiatives such as that being promoted by UNICEF to help reduce commercial debt and use the resources thus obtained for more social spending benefiting children are important. It is very encouraging that the Dutch National Committee for UNICEF and the Dutch Government contributed $6.25 million in May 1991 for a buyback of commercial debt in Ecuador, Honduras and Jamaica in exchange for the release by the debtor governments of up to $13 million in local currency to finance additional UNICEF programmes in these countries. Hopefully, this operation will become a model for future initiatives.

6. The broadening of this sort of initiative to link official debt reduction and higher social spending in Africa and Latin America is very important. The potential sums involved appear to be larger in terms of official debt reduction as opposed to commercial debt reduction. The 10 percent Paris Club clause adopted in September 1990 presents very interesting opportunities for swaps of debt for social spending on a large scale for severely indebted low-income and lower middle-income countries. Because the portion of total Paris Club debt that may be subject to the 10 percent clause has been estimated by World Bank sources to reach as much as $130 billion, the clause offers the potential for debt-for-development and debt-for-equity swaps of up to around $13 billion (based on interview material available to the author).

Specifically, the Paris Club clause states that creditor countries can, on a voluntary and bilateral basis, use part of the claims for debt-equity swaps, debt-for-nature swaps and debt-for-development swaps for up to 10 percent of bilateral official or officially guaranteed nonconcessional loans and, where relevant, for up to 100 percent of official development assistance loans. There is also a value limit, $10 million or $20 million, depending on the case, that can be used if it is higher than the 10 percent of nonconcessional bilateral debt.

Initially, debt conversion efforts were focused on commercial debt, and swaps of official bilateral debt were almost nonexistent. Indeed, limitations were imposed on the selling of debt by creditor governments. However, the emphasis is rapidly shifting toward bilateral official debt conversion for both equity and development. Such operations could potentially include debt conversions for other categories of countries (low-income and lower middle-income) in large deals which could be negotiated more easily and quickly.

Up to now, relatively limited activity has actually taken place in finalizing official debt conversions in the framework of the Paris Club 10 percent clause. However, a number of transactions are reportedly being considered or are about to be implemented, including the following (based on interview material available to the author).

- Poland has presented a detailed request to its creditors for the financing of a $3 billion environment fund through the 10 percent clause. This proposal was discussed at a large conference with creditor governments in mid-1991. Reportedly, France and the US have made commitments to such a fund.

- The French Government is reported to have accepted the conversion of up to $10 million of Egypt's bilateral debt for use in cofinancing (with the World Bank) a social emergency fund. France and other creditor governments are reportedly considering a programme of official debt-equity conversions.

- The Netherlands and other creditor governments are considering the possibility of debt-equity swaps with the Paris Club debt of Morocco to them.

- Various creditor governments are reportedly considering the use of debt-for-equity conversions to support privatization in Nigeria.

- Canada is examining the possibility of converting official debt to finance additional UNICEF high-priority spending in Bolivia.

Certain European and North American creditor governments were, even before September 1990, selling (or converting) Paris Club debt owed to them with the aim of improving the balance sheet of their export credit agencies. Because these operations were not allowed within the Paris Club framework, they were not publicized. However, they are interesting in that they have proved the feasibility of the debt-equity swap for official debt. Some limited official debt-for-development conversions have also been carried out, mainly, it seems, with official concessional debt.

It is worthwhile to analyse the desirability of linking debt reduction to human and "green" conditionality through the type of debt-for-development swaps outlined above, particularly those being made feasible by the Paris Club 10 percent clause and the Initiative for the Americas (see Mistry and Griffith-Jones 1992). A first general point is the distinction between indebted countries with and those without serious inflation problems (see earlier). In the former, a large portion of the resources freed up by debt reduction should be used to pursue a sensible stabilization policy, since a curb on inflation is an important public good, especially for those among the poor whose incomes are not fully indexed to consumer price increases. Greater social spending is desirable in these countries, but wherever possible should be accompanied by higher taxes or cuts in other public expenditure items. If debt reduction is substantial, additional boosts in social spending and similar areas of spending by the government may be compatible with a practical stabilization programme, provided this occurs within a framework of a consistent fiscal and monetary package. In such a situation, the role of debt-for-development swaps may be somewhat constrained by the need for stabilization. However, fairly small swaps should not be a cause of concern unless fiscal deficits and inflation are very high.

In the assessment of the monetary impact of debt-for-development swaps, a realistic appraisal needs to be made concerning the ability of the country to service the relevant portion of its official debt over the next few years had the debt conversion not taken place. The issue is whether the government, given its other pressing foreign exchange needs, could afford to service that part of its Paris Club debt. The country's past record should offer some useful indication.

If a country would have serviced its debt had the debt conversion clause not been applied, a dynamic view of the net impact on monetary expansion over time should be taken. As debt is converted, service payments are reduced for that year and in the future leading to a decline in net monetary expansion. In the first year, if the debt is swapped for greater government development spending and this is not compensated, the monetary effect will be expansionary. However, this will be partly offset by the smaller expansion of the money supply as government financed debt servicing drops. As the years pass and the "savings" on money expansion grow with every year's debt servicing and with the hypothetical need to amortize the debt when it becomes due, the programme of debt conversion may have a net cumulative zero impact on monetary expansion. Later, the impact may become negative.

Some of the variables discussed above can perhaps more clearly be presented in diagrammatic form (Table 8).

Table 8: CONDITIONS UNDER WHICH DEBT CONVERSION IS MORE, OR LESS, DESIRABLE

	A: Initial Low Inflation	B: Initial High Inflation
Debt which would be serviced	*Very* desirable	Desirable, but the monetary impact needs to be regulated for large operations
Debt which would not be serviced	C: Desirable only if spending priority changes are essential for efficiency gains to justify the programme	Only desirable if the conditions in both B and C are met.

Source: Compiled by the author.

Finally, an indirect, contractile effect on the money supply is rarely mentioned. If part or all of the foreign exchange saved through lower debt servicing is used to finance imports, then the consolidated banking system will absorb private sector money, thereby reducing the net monetary expansion effect. Furthermore, the imports financed by these foreign exchange savings are likely to attenuate supply bottlenecks and lower future inflationary pressures.

If it is feared in the initial years of a debt conversion programme that monetary expansion will be excessive, then the financial authorities can take a number of measures to reduce, neutralize or sterilize the effect. This is illustrated in the case of Chile, where inflation remained modest by the country's own historical, as well as by regional, standards despite a major debt-equity programme in the second half of the 1980s.

First, the central bank can regulate the redenomination rate to define how much local currency it spends per unit of debt swapped. Second, in exchange for the debt swapped, it can issue long-term bonds, with the principal fully amortized at maturity. This method delays and softens the monetary consequences of debt conversions by transferring the cost of debt servicing to private financial markets over the short run. However, by competing in capital markets with the private sector, the government may push up interest rates. Furthermore, interest payments on the bonds created for the debt conversion constitute a drain on fiscal resources. Despite these long-term costs, such mechanisms moderate the inflationary impact. However, this requires a comparatively well-developed domestic capital market which can absorb the long-term public bond issues and an overall (limited) fiscal deficit, so that government paper represents an attractive option. Another mechanism to neutralize the monetary impact is the use of a monthly quota on swaps that restricts the amount swapped and thus curbs the monetary effects. The quotas could be diminished if necessary.

In the case of debt-for-development swaps, the inflationary impact would normally become manifest through higher fiscal spending. Such spending can be compensated (if necessary) by lowering other (less high-priority) government spending or raising government revenue via higher taxes, for example. Additionally, long-term development bonds can be placed on private capital markets, as has been done in Costa Rica and Ecuador.

Particularly if the debt conversion is likely to become large, it is crucial that the debtor government improve budgeting in overall macroeconomic programming to compensate for the monetary and fiscal effects. The programme must be designed to lessen or eliminate excessive monetary effects. If these conditions are met and the rest of the macroeconomic programme is feasible, then no excessive inflationary impact should result.

If inflation is not a major problem and the main constraints to growth are limitations on savings and foreign exchange, the case may be very strong for directly channelling a large portion of the resources which have been freed up through debt reduction to higher social and environmental spending. In such a situation, debt-for-development swaps which involve some monitoring of the destiny of the freed up resources seems an attractive tool.

Whether the debt buyback or reduction actually leads to cash savings in foreign exchange flows for the debtor government is another important consideration. If it does (as when the debt reduction is significant or when the country is likely in the future to service a large or preponderant share of the scheduled debt servicing), then the case for using debt-for-development swaps or similar mechanisms becomes more solid. The case for using this instrument is less obvious if no additional cash flow in foreign exchange is generated for the debtor country, since the latter had not previously been servicing the debt.

However, if the debtor government does not attach special priority to social spending, and international agencies or nongovernmental organizations wish to shift the structure of government spending, for example, toward social services and away from defence, then the debt-for-development swap can be a very useful instrument. This is true even if the government is not likely to service the debt in the future, provided the debtor government accepts and implements the swap and, preferably, if the debt is either donated by a commercial bank, or creditor government financing for debt buybacks or official debt reduction is based on "additionality" to existing aid or other flows. An illustration of a positive case in such circumstances is represented by debt donations made by commercial banks to UNICEF in order to raise social and environmental spending in the Sudan.

Debt-for-development swaps should be carefully applied in all cases, including the case when inflation is low, so that they do not lead to a major expansion in fiscal imbalances or in the creation of money. Thus, the scale and timing of these operations must fit in with existing macroeconomic policies and targets, and the tools used (environment bonds in Costa Rica, for example) must be tailored to a country's macroeconomic programmes.

Likewise, at the microeconomic level (relating to the nature of the projects or programmes for which local funds will be released), the debt-for-development swap should be consistent with the financing needs of the project or programme (Ebel 1991). In this sense, debt-for-development swaps seem better suited for spending (for example, investment and short-term pilot projects which are of a once-and-for-all type), since the resources released by the debt reduction can be channelled to a specific expenditure. Such swaps are less well suited for financing current routine expenditure, part of the health care programme of a specific region, for example. This is due to the fact that debt reduction is usually a once-and-for-all operation and will not provide permanent funding, which should come from the national government budget. Just as the excessive dependence on aid of some government spending in developing countries has proved problematic, it would be inappropriate for the social spending of indebted countries to depend on resources freed up by a one-time debt reduction. However, in some cases, the debt-for-development swap can be adapted to finance spending over several years, since the cuts in debt servicing can be staggered and bonds can be issued, with only the domestic servicing of the bond being employed for the higher spending (as has been done in Costa Rica for environmental spending). The problem of the proper inflation indexing also arises here, but this problem can be overcome fairly easily.

In all these cases, clear agreements are required between the donor and the debtor on future cash flows in local currency, as well as to guarantee that "additionality" will be implemented by the debtor government through social or other spending. This guarantee is important, since otherwise debtor governments may raise the social spending linked to debt reduction, but cut the social spending financed by its own normal resources, given the fungibility of fiscal resources.

There are three final points. First, the debt-for-development swap should not be seen as a panacea. It can make a contribution mainly by ordering priorities, both in the debtor country and internationally, toward the allocation of more financial and human resources to key sectors such as social spending. It also helps to prevent governments from misusing the resources freed up through debt reduction and thereby furnishes assurances and incentives to creditors for greater efforts at debt reduction.

Second, internationally there is a tendency for debt-for-development swaps to be identified only with debt-for-nature ("green") swaps. It is important to broaden the concept to also encompass debt-for-social-spending swaps, whether linked or not to improvements in the natural environment, although swaps which are so linked may be easier to negotiate given the political strength of environmental groups.

Finally, mechanisms must be devised to enhance social spending in countries like Chile which do not have severe debt overhang problems, but which do have substantial social or environmental needs left over from a severe debt crisis that has now been overcome. Although in such cases debt-for-development mechanisms (especially for commercial debt buybacks) may become too expensive to be worthwhile, sufficient resources should be assured, both domestically and internationally, to finance appropriate levels of social spending in these countries. If these efforts are not made, a paradox may emerge: it may become easier for severely indebted developing countries to finance higher social spending (especially internationally) than their more creditworthy neighbours. In some countries, such as Mexico, which are already well on the road back to creditworthiness, but in which the price of commercial debt in the secondary market is still below 100 percent of face value, commercial debt-for-development swaps are possible, particularly if the debtor government is willing to pay full face value in local currency for high priority social spending activities to make the operation more attractive to international charities, banks and so on. It is noteworthy that the Mexican government has become especially active in this field in recent years and has successfully encouraged both debt-for-social-spending and debt-for-nature swaps on a fairly meaningful scale, particularly from the perspective of financing urgently needed social spending through nongovernmental and other private institutions. Reportedly, by early 1992 Mexico had carried out debt-for-development swaps valued at around $300 million, which makes it the leading country in this field (Table 9).

Total reported debt-for-development swaps are fairly limited in size. Total debt-for-development swaps for commercial debt have only represented 1-2 percent of all commercial debt-for-equity swaps. Hopefully, the picture will improve for official debt conversions, which are only just beginning to occur. This is not unlikely, since some bilateral official creditors may well seek to finance public goods in the debtor country or international public goods through official debt conversions.

Thus, the debt-for-development swap can be a useful tool in achieving debt reduction and increased social spending simultaneously. However, it should be viewed as only one of several ways available to attain these goals, being especially advantageous in the particular circumstances outlined above. Although such instruments can be used to benefit the poor directly, it is important that international agencies and nongovernmental organizations be careful not to condition or limit excessively the room for manoeuvre of already severely constrained debtor governments. Even if enlightened and progressive, the conditionality imposed by outside agents should always be delicately handled, particularly because it will be added to many other layers of external conditionality.

The Initiative for the Americas and the 10 percent clause of the Paris Club offer room for action on a meaningful scale in this field. More broadly, some progress in debt reduction for the severely indebted low-income countries and fairly substantial breakthroughs in debt

Table 9: COMPLETED DEBT-FOR-DEVELOPMENT TRANSACTIONS
(As Of April 1992)

	Cost	Face Value	Local Bonds	Average Price	Average Rate of Redemption
Bolivia	$100,000	$650,000	$250,000	0.15	38%
Brazil	Donation	$2,000,000	n.a.	--	--
Costa Rica	$12,515,474	$79,853,631	$41,972,904	0.23	64%
Dominican Republic	$616,400	$2,582,000	$2,582,000	0.23	100%
Ecuador	$3,372,000	$22,000,000	$18,500,000	0.18	71%
Guinea	$500,000	$1,000,000	$1,000,000	0.50	n.a.
Madagascar	$1,395,891	$3,030,475	$3,030,475	0.47	100%
Debt-for-education	$2,000,000	$3,500,000	$3,500,000	--	100%
Mexico	$2,350,000	$7,900,000 ($300,000,000)*	$6,500,000	0.52	88%
Niger	$500,000	$1,000,000	$1,000,000 (cash)	0.48	n.a.
Nigeria	$1,000,000	$3,500,000	$3,050,000 (cash)	0.35	n.a.
Panama	$700,000	$30,000,000	$30,000,000	--	--
Philippines	$638,750	$1,290,000	$1,290,000	0.50	100%
Poland	$11,500	$50,000	$50,000	0.23	100%
Sudan	0	$20,000,000	$20,000,000 (cash)	n.a.	n.a.
Zambia	$454,000	$2,270,000	$2,270,000	0.21	100%
Latin America (B of A)**	$6,000,000	$6,000,000	$6,000,000	1.00	100%
Paraguay (IFC)***	$2,000,000	$7,000,000	$7,000,000	n.a.	100%
Total	$34,154,015	$193,626,106 ($485,726,106)*	$147,995,379	0.34	85%

Source: Compiled by the author.
* Though not registered in published statistics, Mexico's debt-for-development transactions reached $300 million (according to interview material available to the author, especially information provided by Angel Gurria, under-secretary of finance, Mexico). This would bring the total face value of debt swapped to over $485 million.
** Represents a donation from the Bank of America.
*** A swap arranged by the International Finance Corporation for debts owed to it.

reduction in many of the severely indebted middle-income countries can present new opportunities for a serious expansion of social spending in many of the nations in which such spending plunged in the 1980s. The fact that domestic interest rates are coming down in some of the heavily indebted countries, especially those in Latin America, and that real exchange rates are being revalued due to large inflows of foreign capital, further lowers the costs in domestic currency of servicing government debt, both domestic and foreign. This provides the potential for allowing even more resources to be reallocated to social spending by these governments. Careful monitoring is required by organizations such as UNICEF to assure that the necessary measures are taken, especially on the fiscal front (via both expenditure and revenues), to seize this "window of opportunity".

BIBLIOGRAPHY

Bacha, E. (1990), "A Three-Gap Model of Foreign Transfers and the GDP Growth Rate in Developing Countries". Paper prepared for UNCTAD and the G-24. Mimeo.

Cornia, G. A., and F. Stewart (1990), "The Fiscal System, Adjustment and the Poor". *Innocenti Occasional Papers*, Economic Policy Series, No. 11 (November). Florence: UNICEF International Child Development Centre.

Cruz Rivero, C., R. Lozano Ascencio and J. Querol Vinagre (1991), "The Impact of Economic Crisis and Adjustment on Health Care in Mexico". *Innocenti Occasional Papers*, Economic Policy Series, No. 13 (February). Florence: UNICEF International Child Development Centre.

Ebel, B. (1991), "Patterns of Government Expenditure in Developing Countries during the 1980s: The Impact on Social Services". *Innocenti Occasional Papers*, Economic Policy Series, No. 18 (July). Florence: UNICEF International Child Development Centre.

ECLAC (1990), *Latin America and the Caribbean: Options to Reduce the Debt Burden*. Santiago de Chile: United Nations Economic Commission for Latin America and the Caribbean.

Flaño, N. (1992), "On Solid Ground: Chile's Economy Today". Washington, DC: World Bank. Mimeo.

Griffith-Jones, S. (1990), *Changes in Eastern and Central Europe: Their Potential Implications for Developing Countries*. Ottawa: International Development Research Centre.

______ (1992), "Is There Still a Latin American Debt Crisis?", in G. Bird (ed.) (1992), *International Perspectives for Development*. San Diego: Academic Press.

Griffith-Jones, S., and M. Faber (eds) (1990), "Approaches to Third World Debt Reduction". *IDS Bulletin*, Vol. 21, No. 2 (April).

Griffith-Jones, S., A. Marr and A. Rodriguez (1992), "The Return of Private Capital to Latin America: The Facts, an Analytical Framework and some Policy Issues". Paper presented at the FONDAD workshop, 9-10 June 1992.

Griffith-Jones, S., and R. van der Hoeven (1990), "Debt: The Unwanted Heritage of Today's Children". *IDS Discussion Paper*, No. 280 (November).

IMF (various), *International Financial Statistics*. Washington, DC: International Monetary Fund.

Kakwani, N., E. Makonnen and J. van der Gaag (1989), "Structural Adjustment and Living Conditions in Developing Countries". Washington, DC: Population and Human Resources Department, Welfare and Human Resources Division, World Bank. Mimeo (September).

Lerda, J.C. (1989), "Efecto fiscal de los planes de estabilización deprecios". Santiago de Chile: United Nations Economic Commission for Latin America and the Caribbean. Mimeo.

Mistry, P. (1991), "African Debt Revisited: Procrastination or Progress?". Paper prepared for the North-South Roundtable, Abidjan, 8-9 July 1991.

Mistry, P., and S. Griffith-Jones (1992), "Conversion of Official Bilateral Debt". Draft Report for UNCTAD. Mimeo. (April).

Reisen, H., and A. van Trotsenburg (1988), "Developing Country Debt: The Budgetary and Transfer Problem". *OECD Development Centre Study*. Paris: OECD Development Centre.

Rodriguez, E., and S. Griffith-Jones (eds) (1991), *Cross-conditionality, Banking Regulation and Third World Debt*. London: Macmillan.

Taylor, L. (1990), *Varieties of Stabilization Experiences*. New York: Oxford University Press.

UNCTAD (1989), *Trade and Development Report, 1989*. Geneva: United Nations Conference on Trade and Development.

Valerio, F. (1991), "Fiscal Shock, Wage Compression and Structural Reform: Mexican Adjustment and Educational Policy in the 1980s". *Innocenti Occasional Papers*, Economic Policy Series, No. 17 (June). Florence: UNICEF International Child Development Centre.

Williamson, J. (1990), "The Progress of Policy Reform in Latin America". *Policy Analyses in International Economics*, No. 28 (January). Washington, DC: Institute for International Economics.

World Bank (1988), "World Bank Adjustment Lending: Evaluation of Ten Years' Experience". *Policy Research Series*, No. 1 (December). Washington, DC: World Bank.

______ (1990), *World Debt Tables, 1990-1: External Debt of Developing Countries*. Vol. 1: *Analysis and Summary Tables*. Washington, DC: World Bank.

______ (1991a), *World Debt Tables, 1991-2: External Debt of Developing Countries*. Vol. 1: *Analysis and Summary Tables*. Washington, DC: World Bank.

______ (1991b), *Global Economic Prospects and the Developing Countries*. Washington, DC: World Bank.

UNICEF INTERNATIONAL CHILD DEVELOPMENT CENTRE
ECONOMIC AND SOCIAL POLICY RESEARCH PROGRAMME

INNOCENTI OCCASIONAL PAPERS
ECONOMIC POLICY SERIES

The Economic Policy Series consists of thorough and self-contained analytical reports that usually serve as background documentation for the four main research projects currently being carried out within the Economic and Social Policy Research Programme of the ICDC.

The papers in the series (ISSN 1014-7837) are all available in English. Price: $6 each.

For more information or to order papers in the Economic Policy Series, write the Economic and Social Policy Research Group, UNICEF-ICDC, Piazza SS. Annunziata 12, 50122 Florence, Italy. Please accompany all orders with a nontransferable cheque made out to UNICEF.

EPS 1 *Economic Decline and Child Survival: The Plight of Latin America in the Eighties.* Teresa Albanez, Eduardo Bustelo, Giovanni Andrea Cornia and Eva Jespersen. Special Subseries: "Fiscal Policy and the Poor". (March 1989).

EPS 2 *Child Poverty and Deprivation in Industrialized Countries: Recent Trends and Policy Options.* Giovanni Andrea Cornia. Special Subseries: "Child Poverty in Industrialized Countries". (March 1990). Also available in French and Spanish.

EPS 3 *Education, Skills and Industrial Development in the Structural Transformation of Africa.* Sanjaya Lall. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (July 1990).

EPS 4 *Rural Differentiation, Poverty and Agricultural Crisis in Sub-Saharan Africa: Toward An Appropriate Policy Response.* Giovanni Andrea Cornia and Richard Strickland. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (July 1990).

EPS 5 *Increased Aid Flows and Human Resource Development in Africa.* Paul Mosley. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (August 1990).

EPS 6 *Child Poverty and Deprivation in Italy: 1950 to the Present.* Chiara Saraceno. Special Subseries: "Child Poverty in Industrialized Countries". (September 1990). Also available in Italian.

EPS 7 *Toward Structural Transformation with a Human Focus: The Economic Programmes and Policies of Zambia in the 1980s.* Venkatesh Seshamani. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (October 1990).

EPS 8 *Child Poverty and Deprivation in the UK.* Jonathan Bradshaw. Special Subseries: "Child Poverty in Industrialized Countries". (October 1990).

EPS 9 *Adjustment Policies in Tanzania, 1981-1989: The Impact on Growth, Structure and Human Welfare.* Jumanne H. Wagao. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (October 1990).

INNOCENTI OCCASIONAL PAPERS
ECONOMIC POLICY SERIES
(Continued From Previous Page)

EPS 10 *The Causes and Consequences of Child Poverty in the United States*. Sheldon Danziger and Jonathan Stern. Special Subseries: "Child Poverty in Industrialized Countries". (November 1990).

EPS 11 *The Fiscal System, Adjustment and the Poor*. Giovanni Andrea Cornia and Frances Stewart. Special Subseries: "Fiscal Policy and the Poor". (November 1990).

EPS 12 *The Health Sector and Social Policy Reform in the Philippines since 1985*. Wilfredo G. Nuqui. Special Subseries: "Fiscal Policy and the Poor". (January 1991).

EPS 13 *The Impact of Economic Crisis and Adjustment on Health Care in Mexico*. Carlos Cruz Rivero, Rafael Lozano Ascencio and Julio Querol Vinagre. Special Subseries: "Fiscal Policy and the Poor". (February 1991).

EPS 14 *Structural Adjustment, Growth and Welfare: The Case of Niger, 1982-1989*. Kiari Liman Tinguiri. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (March 1991).

EPS 15 *The Impact of Self-Imposed Adjustment: The Case of Burkina Faso, 1983-1989*. Kimseyinga Savadogo and Claude Wetta. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (April 1991).

EPS 16 *Liberalization for Development: Zimbabwe's Adjustment without the Fund*. Robert Davies, David Sanders and Timothy Shaw. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (May 1991).

EPS 17 *Fiscal Shock, Wage Compression and Structural Reform: Mexican Adjustment and Educational Policy in the 1980s*. Fernando Valerio. Special Subseries: "Fiscal Policy and the Poor". (June 1991).

EPS 18 *Patterns of Government Expenditure in Developing Countries during the 1980s: The Impact on Social Services*. Beth Ebel. Special Subseries: "Fiscal Policy and the Poor". (July 1991).

EPS 19 *Ecuador: Crisis, Adjustment and Social Policy in the 1980s*. The Ecuadorian Centre of Social Research. Special Subseries: "Fiscal Policy and the Poor". (August 1991).

EPS 20 *Government Expenditures for Children and Their Families in Advanced Industrialized Countries, 1960-85*. Sheila B. Kamerman and Alfred J. Kahn. Special Subseries: "Child Poverty in Industrialized Countries". (September 1991).

EPS 21 *Is Adjustment Conducive to Long-term Development? The Case of Africa in the 1980s*. Giovanni Andrea Cornia. Special Subseries: "Structural Adjustment in Sub-Saharan Africa". (October 1991).

INNOCENTI OCCASIONAL PAPERS
ECONOMIC POLICY SERIES
(Continued From Previous Page)

EPS 22 *Children in the Welfare State: Current Problems and Prospects in Sweden.* Sven E. Olsson and Roland Spånt. Special Subseries: "Child Poverty in Industrialized Countries". (December 1991).

EPS 23 *Eradicating Child Malnutrition: Thailand's Health, Nutrition and Poverty Alleviation Policy in the 1980s.* Thienchay Kiranandana and Kraisid Tontisirin. Special Subseries: "Fiscal Policy and the Poor". (January 1992).

EPS 24 *Child Welfare and the Socialist Experiment: Social and Economic Trends in the USSR, 1950-90.* Alexandr Riazantsev, Sándor Sipos and Oleg Labetsky. Special Subseries: "Child Poverty in Industrialized Countries". (February 1992).

EPS 25 *Improving Nutrition in Tanzania in the 1980s: The Iringa Experience.* Olivia Yambi and Raphael Mlolwa. Special Subseries: "Fiscal Policy and the Poor". (March 1992).

EPS 26 *Growth, Income Distribution and Household Welfare in the Industrialized Countries since the First Oil Shock.* Andrea Boltho. Special Subseries: "Child Poverty in Industrialized Countries". (April 1992).

EPS 27 *Trends in the Structure and Stability of the Family from 1950 to the Present: The Impact on Child Welfare.* Chiara Saraceno. Special Subseries: "Child Poverty in Industrialized Countries". (May 1992).

EPS 28 *Child Poverty and Deprivation in Portugal: A National Case Study.* Manuela Silva. Special Subseries: "Child Poverty in Industrialized Countries". (June 1992).

EPS 29 *Poverty Measurement in Central and Eastern Europe before the Transition to the Market Economy.* Sándor Sipos. Special Subseries: "Child Poverty in Industrialized Countries". (July 1992).

EPS 30 *The Economics of Disarmament: Prospects, Problems and Policies for the Disarmament Dividend.* Saadet Deger. Special Subseries: "Fiscal Policy and the Poor". (August 1992).

EPS 31 *External Debt, Fiscal Drainage and Child Welfare: Trends and Policy Proposals.* Stephany Griffith-Jones. Special Subseries: "Fiscal Policy and the Poor". (September 1992).

International Child Development Centre
Piazza S.S. Annunziata, 12
50122 Florence, Italy
Tel. 3955-234-5258 - Fax 3955-244817
Telex 572297 UNICEF I