THE FLOW OF EXTERNAL RESOURCES TO THE NON OIL DEVELOPING COUNTRIES IN THE SEVENTIES

With Special Reference to the Brazilian Case

by

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SUMMARY

The external debt of the developing countries has become a major issue mainly because of the possible repercussions the debt may have on the international financial system. This situation is a direct function of the changes which have taken place in the international financial system beginning in the late sixties. Before 1975 more than 50% of the external obligations of the developing countries was with the official lenders. There had however, been a shift away to private lenders in the international capital market beginning from the late sixties. The large deficits experienced by the non oil developing countries in 1974 after the first oil price rise as well as the placement of a large percentage of the OPEC revenues in the international capital market encouraged the shift away from official sources of finance to private sources. The banks lent large amounts of finance to a small group of countries so that some individual banks became closely linked with the economic conditions of the borrowing country. The fate of one bank would not necessarily have any effect on the financial system. However, there was the fear that if a country failed to meet its obligations to the detriment of a major bank this would lead to uncertainty in the banking system, leading to some banks moving out from international lending and a decline in interbank lines. The possibility of financial instability was also increased by the possible domino effect which would occur if one large debtor was able to default successfully. As a result of this it was imperative that large debtors which faced payment problems, be helped to resolve these problems so that there was no possibility of a default occurring.

The result of these events has been that the large debtors have been put into the limelight. The small debtors may not have large debts to cause undue worry to the banks, in fact some of them may owe very little to the banks. However, in terms of the effect which this debt may have on their external account and domestic economy, they should be no less important than the large debtors.

Borrowing by the developing countries is not a new phenomena. It is the concentration of a large amount of debt amongst a few countries, as well as the exposure of some of the banks to these countries which is causing concern.
External debt itself is not disadvantageous to an economy. What is important is that the borrowing conditions are such as not to make repayment difficult, and that the external funds obtained are used in such a way as to make repayment possible and not costly to the domestic economy. This implies that an explicit policy may be required before borrowing on a large scale is embarked upon.

In the developing country context, although growth may be a necessary requirement for external borrowing to be successful, it is also important that foreign exchange is available for the country to be able to service and repay the debt in the currency stipulated in the loan terms. This introduces a broader aspect to the issue of external borrowing. (For those currencies whose local currency is accepted in repayment this is not a very important issue.) The role of the international economy in the debt repayment process of the developing countries is important in this context. Even if the country may have a favourable export sector policy, if there is no growth in the income of the major trade partners and there is an increase in protectionism it will be difficult for the debtor to repay the required foreign exchange debts.

The capacity of a country to borrow and not experience repayment problems depends on three variables. The first variable is the conditions existing within the international private capital market. This affects both private and official commercial loans. Higher interest rates and short maturity terms implies that the country will soon have to transfer resources out of the country not long after the loan has been incurred. This is especially important in determining how a country allocates the finance obtained among uses. The allocation of funds amongst possible uses and the management of the domestic economy is the second important variable in determining ability to pay. A mismatch of the loan conditions

and the rate of return of the loan use may cause difficulties, especially if there is no growth in the rest of the economy from which to syphon off resources to service the debt. The third variable is the state of the international economy. The domestic performance of the major economies is reflected in the international economy. This can be illustrated by the effect which the interest rates of the USA due to its domestic monetary and fiscal policy has had in increasing the indebtedness of the developing countries. The prospects for world trade are also dependent on the state of the domestic economies of the OECD countries. This last variable cannot be determined by the developing countries, so it introduces an element of uncertainty into their borrowing programmes. The first and third variable are interlinked since changes in the latter have large effects on the former. All these three variables need to be favourable at the same time in order for borrowing to occur without excess costs being imposed on the borrower.

This thesis is concerned primarily with the first and the third variables. The issues which will be considered are the rapid increase in private lending to the developing countries, which reflects the change which took place in the international financial system in the 1970's, and the emergence of OPEC as a net supplier of funds to the international financial system and the implications which this had for the developing countries.

The external borrowing of the developing countries and the resultant debt is discussed in Chapter One. Chapter Two looks in some depth at the growth of the OPEC surplus and the links between the OPEC and the non oil developing countries which resulted from this. Although the total flow of finance to the developing countries from OPEC grew after the first oil price rise this was concentrated mainly amongst a few developing countries. Even though the oil deficits did have a large impact on the balance of payments of the non oil developing countries, they also, at the same time, experienced large deficits with the industrial countries who are their major trading partners. It is thus not possible in these

circumstances to accept some of the statements which suggested that OPEC be responsible for financing the major part of the non oil developing countries external financial requirements. The relationship between OPEC and the developing countries is considered in detail, because the OPEC action was responsible for some of the changes which took place in the seventies. It is also an attempt to show that the present debt problems of the developing countries is not due only to the action of the OPEC countries as regards the oil prices and that any changes which need to occur should involve all parties in the international economy, namely the non oil developing countries, the OPEC countries and the developed market economies. (The centrally planned economies also have a part to play in the international economy, but will not be discussed here.)

The growth of the Brazilian debt, its structure and the conditions of the loans incurred, as well as the policy towards external borrowing is the subject of the third Chapter. The response to the two large oil price rises in the seventies and the changes in world trade are discussed and suggested as possible explanations for the present large debt outstanding of Brazil as well as the present payment difficulties. Brazil was chosen as a case study of external indebtedness because it is the largest non oil developing country. Secondly a survey of the growth of debt of Brazil over the period 1970 - 1981 illustrates the changes which took place in the international financial system which are discussed in Chapter One. The large debt outstanding of Brazil is itself a reminder of the biased nature of the flows of finance to the developing countries, itself a function of the decisions of the lenders and the borrowers.

Various suggestions have been made to attempt to alleviate the present debt problems of the developing countries. There were suggestions for an increased role of OPEC by directly financing more of the financial needs of the developing countries. The role of OPEC was limited in the past and is even more limited now. Chapter Four looks at various suggestions made, i.e. OPEC participation, and an increase in the efforts of the developed market economies and the official agencies. The possible advantages that these will have for the developing

countries in general and Brazil in particular is evaluated. An increase in the flows with longer maturities going to the developing countries will improve the structure of the debt and help reduce the immediate pressure to repay the debt. Lower interest rates will reduce pressure on the current account. In order for the recent Brazilian policy towards the external sector to be successful there needs also to be a growth in world trade. This may require some change in the domestic policies of the industrial countries and their attitudes towards competitive imports from the developing countries. An increase only in financial flows and an increase in the number of official agencies will not resolve the situation. What is required is a better combination of financing and domestic and international adjustment.

Chapter One

External Borrowing by Developing Countries

1.1 The reasons why developing countries borrow abroad

Developing countries may borrow abroad in order to increase the resources available to embark on their development programmes. In some models of external borrowing for example the gap model, the external resources contribute towards growth in the economy. In the Pearson Report (1969) external resources were recognised as contributing positively to the development of the poor countries. The Brandt Commission Report (1980) eleven years later continued to emphasise this point. It stressed the need for a "massive transfer of resources" from the developed to the developing countries. The benefits which would result from this were considered to affect both groups and not just the developing countries. Borrowing from abroad is not typical of the present day developing countries only[1]. The United States of America also borrowed abroad at the time when it was a colony. It was at the turn of this century that the USA became a net exporter of capital. Western Europe received large sums of finance from the USA in the Marshall Plan at the end of the Second World War for reconstruction purposes. It has been argued that the success of the Marshall Plan contributed to some extent towards the decision to send financial resources to the developing countries in the form of aid [2].

The developing economy is characterised as having constraints which can be overcome with the inflow of external resources:

> " By relieving these constraints, foreign assistance can make possible fuller use of domestic resources and hence accelerate growth. Some of the potential bottlenecks - of skills, savings and foreign exchange - can be temporarily relaxed by adding external resources for which current payment is not required." (Chenery and Strout 1966 pp 690 - 681)

Studies have been made to find out to what extent external borrowing contributes to growth. (Papanek 1973; Pesmazoglu 1972). For instance in Papanek's study a cross country regression showed that net transfers and official long term borrowing explained a large amount of the growth. The reason for the large co-efficient of the foreign savings variable was attributed to the fact that external resources were usually directed towards development projects and filled both the savings and foreign exchange gap. Even in the situation where there was a net repayment of funds, it was claimed that external borrowing still contributed to growth of income (Ball 1962). Growth would be at least equivalent to that which would have occured had there been no net capital inflow in the first place, i.e. similar to the situation of a closed Harrod-Domar model. Ball's analysis was criticized by Massel on the grounds that it failed to distinguish between the Gross Domestic Product (GDP) and the Gross National Product (GNP) as the growth variables (Massel 1964) The difference between these measures of growth is important since by definition it is possible for the inflow of external resources and the repayment process to result in growth in the GDP without there being growth in the GNP [3]. Whether or not external borrowing will lead to growth in the GNP will depend on how the resources were used, i.e. the mix between investment and consumption and on the rates of return on such investments. Even if the resources are not used directly in growth generating activities,but stimulate growth within the economy then borrowing will assist the development process.

The additional resources which external borrowing makes available to the domestic economy, can allow the intertemporal allocation of consumption. Areskoug (1969) explicitly includes borrowing for consumption purposes in his model of external borrowing. A country can borrow today for consumption purposes and accept less consumption in the future to repay the loans. Less consumption need not imply a reduction in the absolute level of consumption. Some of the additional resources could be used for consumption purposes and the rest for investment. The effect which borrowing for consumption purposes will have on the economy in the future depends to quite a large extent on the conditions of borrowing for consumption and also the state of the domestic and world economy at the time of repayment.

Borrowing may also occur for balance of payments purposes. If there is a current account deficit and there is an insufficient amount of autonomous capital flows [4] thecountry can run down it s reserves or borrow abroad to finance the deficit. Borrowing may also occur specifically for the build up of a country's reserves. Reserve building may, however, reduce the potential for growth. This is because instead of the funds received, being used for instance for real investment, they will be lying idle receiving a rate of interest which is less than the cost of borrowing the funds to build up the reserves in the first place.

The decision to borrow for balance of payments purposes reflects the choice of the policy makers between adjusting to the disequilibrium and maintaining it by financing the deficit. The choice of the mix between adjusting and financing can be based on whether the disequilibrium is structural or temporary and the cost in terms of income lost of whatever policy is adopted. Whatever combination is chosen reflects the preference of the decision makers between income stability and growth (Bird 1980 p 152) The devlopment process can be defined as one of structural change and disequilibrium. The resources available to the economy should, ideally be sufficient to facilitate this change. Borrowing should be undertaken in such a way that the country can service the debt without imposing costs on the domestic economy. For example if a country should embark on a borrowing programme, without adjusting to some changes, it will be possible that the burden of servicing the debt in the future, may be so large that the country will have to adopt an adjustment policy with costs in terms of a reduction in growth which it might not have had to incur had it followed a borrowing policy which involved more adjustment than had taken place in the past.

For some developing countries, borrowing for consumption purposes may be a form of investment. For example, borrowing to finance imports of food and medical equipment will help improve the quality of the labour force. In order to differentiate between investment and consumption, the category of consumption needs also to be considered.

Within the developing country context it is difficult to determine whether borrowing is for investment/consumption purposes or

balance of payments purposes. It can be argued that this differentiation is spurious. This is because if the developing country wants to pursue a programme which involves more resources than it has available to it domestically, this will necessarily be reflected in its external account.

The gap models are used to measure the need for borrowing as well as to measure the resources required by the borrowing country. The recognised gaps are the savings gap (i.e. the difference between the domestic savings and the investment requirements given a target growth rate) and the foreign exchange gap (i.e. the difference between the export earnings and the required imports given a target growth rate .) Several models have been developed, based on the savings and foreign exchange gaps (Chenery and Strout 1966; Fei and Paauw 1964; McKinnon 1965) The gap models are criticised on the basis of the rigidity of parameters which make the basic assumptions. These limit the predictive ability of the models as well as their relevance to the real situation. (Bruton 1978; Findlay 1971; Joshi 1970) The models are based on the premis that external borrowing by the developing countries is a finite process and will come to an end when certain conditions have been met. However, external borrowing by any country need not come to an end. The need for external resources may diminish as the economy develops but it is quite possible for the country to have a net capital inflow at some point in time. Avramovic (1964 p 63), in his debtcum growth model, recognises the possible factors which might cause a country to continue being a net importer of capital. The gap models also assume that borrowing is only for investment purposes, but as discussed above this has not always been the case and need not always be the reason why external borrowing occurs. Borrowing for consumption purposes may occur when there is a shortfall in export earnings due to temporary factors, for example bad weather. Borrowing will come to an end when export earnings revert back to the trend. Another shortcoming of the models is that they are demand determined since they assume that once the need for external resources is identified,the resources will automatically become available. However, if there are no willing lenders or the conditions of the loans are very stringent, this will lead to a reduction in the gap by the authorities irrespective of the 'needs' of the domestic economy.

The existence of the gaps per se and the subjective element involved in deciding the size of the gap is also questioned (Bruton 1978; Joshi 1970 and Streeten 1972).

Some writers on the subject do not consider that borrowing contributes to economic growth. There are some countries like China which have experienced growth with the minimum of external resources which might indicate that external resources are not always necessary in the development process. What this might illustrate is that external resources are part of a package which assists a country in its development programme. Evidence is also given to show that external borrowing coincides with a decline in the domestic savings ratio (Griffin 1970). Newlyn (p 121 1977) disproves Griffin's conclusions showing that what may seem to be a reduction in domestic savings may only be a case of foreign savings being used for consumption purposes.

1.2 The External Debt Position of the Developing Countries 1970-1981

The external debt of developing countries reflects capital inflows into these countries in the past [5]. Both the World Bank and the Organisation for Economic Co-operation and Development (OECD) have calculated the figures for debt outstanding and debt service payments for the developing countries in general and individual developing countries. The figures obtained by each of these organisations differ on an aggregate basis because of the different coverage of countries. The World Bank in 1980 was covering 96 countries and the OECD was covering 143. The definition of the external debt differs between the two agencies thus explaining some of the difference in the values obtained. The World Bank's definition covers all publicly guranateed debt whilst the OECD covers all type of debt whether publicly guaranteed or not. They both exclude debt of less than one year to maturity, funds borrowed from the International Monetary Fund (IMF) and debt resulting from military transactions.

Congdon (1982) suggest that the external deficit between private individuals in different countries should not be considered

important in the balance of payments. In this case the exclusion of non guaranteed private debt from the definition of debt by the World Bank would be accepted. On the other hand, since the activities of the private sector are reflected in the visible trade sector, then their financial transactions are also relevant. If the country should experience exchange controls, the foreign exchange demands of the private sector to service the external debt will put pressure on the existing reserve holdings of the authorities. For these reasons due account should be taken of the privately held debt.

The total nominal disbursed debt outstanding of the developing countries rose from 74.1 billion US dollars in 1970 to 524 billion dollars in 1981. In real terms the rise was not as large. The debt rose from 137 billion dollars in 1970 to 331.6 billion dollars in 1981. The nominal figures were deflated by the unit value of exports. This was in order to measure the value of the debt in terms of the earning capacity of the developing countries [6]. The real debt service rose at a slower pace over the period than did the nominal debt service , even though it had a larger value in 1970 compared to the nominal values. The higher values for the real total debt and debt service are due to the low unit value of exports for the period 1970-1973. Between 1973 and 1978 the growth of nominal debt outstanding was on average about 22%. Real debt on the other hand, experienced a fall in annual growth for the years 1973 and 1974. These were the years of high commodity prices. It was not until 1975 which also coincided with the recession in the industrial countries when the prices of commodities declined that real debt and debt service payments rose. During the second oil price rise in 1979/1980 the growth of nominal debt was lower than in the previous two periods and there was a slowdown in growth in real terms. Measuring the growth of debt outstanding in real terms reduced, to some extent, the enormous size of the debt of the developing countries. The difference between the values of the real and nominal debt figures are greater for the debt service than for debt outstanding (See Table 1.1). This can be explained partly by the fact that after 1979 the rate of interest paid on the loans was greater than the rate of growth of export unit values.

The growth in the debt over the period 1973 to 1981 may be explained firstly by the decision as regards how to respond to shocks to the domestic economy, and secondly on the financing of the deficit after any adjustment which had taken place was carried out.

Table 1.1

Total Debt Disbursed at Year End and Total Debt Service of Developing Countries. (In billion US dollars)

Year	Nominal Total Debt	Annual Change %	Real Total Debt	Annual Change %	Nominal Debt Service	Real Debt Service
1970	74.1		137		9.0	16.6
1971	86.6	16	162	18.2	10.9	20
1972	98.2	13	177	9.2	13.5	24
1973	118.9	21	160	-9.6	17.2	23
1974	144.6	22	139	-13.9	22.1	21.2
1975	179.1	24	179.1	29.1	26.2	26.3
1976	216.9	21	204.5	13.9	32.2	30.6
1977	264.6	22	217.3	6.0	41.0	33.7
1978	336.6	27	267.1	22.9	56.9	45.1
1979	397.3	18	272.1	1.8	73.6	49.3
preliminary) 1980	456.2	15	271.5	-0.22	91.2	54.2
estimate) 1981	524.0	15	331.6	22.1	111.7	74.0

Source: OECD (1981) Development Co-operation and Efforts, p 218 Paris.

In 1970 the current account deficit of the low income developing countries was 3.6 billion dollars, in 1978 dollars. This was equivalent to 1.99% of the GNP. By 1975, after the first oil price rise the deficit was 7 billion dollars, in 1978 dollars and equivalent to 3.99% of the GNP. The middle income countries in 1970 had a deficit of 14.9 billion dollars which declined to 6.7 billion dollars in 1973, but rose again to 42.8 billion dollars in 1975 (World Bank 1981). Assuming that a certain amount of adjustment had occurred, the structure of the current account financing can give some explanation for the growth of the debt.

For the non oil developing countries as a group financing of the deficit and reserve building through non debt creating flows has declined since 1973. In 1973 these flows accounted for 47.5% of the total [7]. By 1975 they had declined to 26.4% (IMFd 1982 p.167) For the low income countries there was a decline from 52% in 1973 to 35% in 1975 and 30% in 1982. The exporters of manufacturers, a sub group of the middle income countries had 40% of their flows falling into the non debt category in 1973. By 1975 this had fallen to 17.2%. The non debt creating flows were 26.4% of total flows to all non oil developing countries in 1980 (IMF$_d$ 1982 p 168)

This difference among country groups in the method of financing the current account deficits is to some extent reflected in the distribution of debt held by the non oil developing countries on the basis of income groups (See Table 1.2). In 1971 the low income countries as defined by the OECD held about 24% of the total debt of the non OPEC developing countries. In 1975 their percentage of the total debt had risen to 26%, but by 1980 it had declined to 22.3%. The newly industrialising countries on the other hand had an increasing proportion to the total non OPEC developing country debt. In 1971 they were holding 42.6% of the total debt which rose to 50% of the total in 1980. As a percentage of their GNP the debt of the low income, middle income and newly industrialising developing countries in 1980 was 27%, 28% and 19% respectively (OECD 1982 p35) On the basis of these figures, although the absolute debt of newly industrialising countries was the largest of the three groups of countries, when the debt is considered on the basis of the size of the domestic economy, this group of countries had the least burden of debt compared to the other two groups of countries.

The skewdness in the distribution of the total debt amongst the developing countries can also be explained to some extent by the size of the economies and the absorptive capacity, the choice of the mix of adjusting to or financing of the disequlibrium, as well as access to external funds which to some extent will determine the policy mix of the country concerned.

The burden of debt of a country can be measured using several ratios. The most common one used is the debt service ratio. This is the ratio of debt service payments to the exports of goods and services. It indicates the extent to which export earnings are diverted from other possible uses, for example financing of food imports, or the imports of capital goods to the payment of past loans.

Table 1.2

Total Debt Disbursed at Year End of Non OPEC Developing Countries By Income Group. (Billion US Dollars)

	1971	1975	1977	1980	1981[a]	1982[b]
Low Income Countries	18	40	56	86	95	110
Middle Income Countries	25	40	60	107	124	144
Newly Industrialising Countries	32	72	111	192	226	266
Total	75	152	227	385	445	520

Note: [a] preliminary
[b] estimate

Source: OECD (1982) External Debt of Developing Countries 1982 Survey, Paris. p 34

Table 1.3

Debt Service Ratio On Long Term External Debt of Non Oil Developing Countries

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Debt Service Ratio	14.0	11.5	14.0	13.9	14.0	17.3	18.1	16.3	21.0	22.3
Interest Payments Ratio	4.2	3.8	5.0	4.7	4.6	5.5	6.2	7.2	8.5	8.5
Amortisations Ratio	9.8	7.7	9.0	9.2	9.4	11.8	11.9	9.2	12.5	13.8

Source: IMFd (1982) World Economic Outlook. Washington D.C. p 173

Another measure used is the ratio of interest payments to the export of goods and services. Interest payments need to be met so this indicates the rigidity within the current account. Table 1.3 shows the debt service ratio for the non oil developing countries from 1973 to 1982. Although the debt service ratio has increased over the period it has not done so dramatically. It was below the 20% critical zone until 1981. The 20% mark is usually delineated by some authorities as the point above which a country is expected to face difficulties. Whether a country will soon be facing debt problems cannot be determined on the basis of the debt service ratio figures alone. The debt service ratio only takes into consideration three of the several components which make up the balance of payments position of a country. Avramovic (1964 pp 13-37) outlines these components. Thus, even if there should be a debt service ratio of say 25% for a country which can afford to reduce its imports without imposing undue costs on the domestic economy, then the effect which the debt has on the economy differs from that of a country with a similar debt service ratio but which is able to import only the essentials needed. A decline in the debt service ratio over time may actually be reflecting payments arrears rather than an increase in export earnings (Nagy 1976). This is of particular importance in the present situation where quite a few of the large debtors have arrears in their payments. The maturity structure of the debt also influences the debt service ratio. This can result in inaccurate conclusions being formed when countries are being compared. Inflation causes an upward bias in the ratio (Kincaid 1981 ; Nowzad 1981). Floating interest rates are widely used to protect the creditor during periods of unanticipated inflation. The higher interest rates and interest payments compensate for the reduced value of the principal causing the debt to be amortised faster than it would have in a non inflationary situation. The result of this is that when measuring the ratio of interest payments to the value of the current account deficit the figure obtained is higher than it would have been in the non inflationary situation (Freedman 1979). In discussing the debt service ratios effectively and in order to get an accurate view of the debt burden of a country it would be useful to consider what the

prospects for the country's exports are, and whether they are subject to fluctuation. Other important variables are the maturity structure of the outstanding debt, the extent to which the country is susceptible to a decline in food imports, the extent to which the country can depend on temporary balance of payments of relief and whether imports are compressible (Avramovic op cit; Nagy op cit).

On an aggregate basis apart from making the comment that the debt service ratio has increased for the group of non oil developing countries little more than that can be said. However, to move into the field of speculation it can be said that if the exports position of the countries does not improve in the near future then the rather low debt service ratio may be more of a disadvantage than the figures themselves seem to indicate.

The low income countries debt service ratio was on average smaller than that for all the non oil developing countries during the entire period under review. In 1973 it was 12.6% and in 1982 it had risen to 14.1% (IMF opcit). The major exporters of manufactures on the other hand, had a debt service ratio which was closer to the average for all the non oil developing countries i.e. 14.8% in 1973 and 20.1% in 1982. (IMF op cit). There was a downward trend in the interest payments ratio of the low income countries. In 1978 it was 3.1% This trend may be explained by the fixed interest rate debt of these countries and the concessional loans which they received. This differs from the situation of the 'exporters of manufacturers'. The interest payments ratio rose faster than the amortisation ratio. The former was 4.7% in 1973, rising to 8% in 1982. whereas the amortisation ratio rose from 10.2% to 12.1% during the same period. This reflects the structure of the debt of this group of countries. They have a greater proportion of their debt of floating interest rate terms (see pp 14 - 16).

The low income countries are mainly exporters of primary commodities which are prone to fluctuations on both the supply and demand side. Some of them depend on only one crop for at least 50% of their export earnings. Even though the absolute

value of the debt may be small compared to other groups of countries, the size of the economy is small and the export base is narrow and weak compared to say the newly industrialising countries. On the basis of this it could be assumed that the low income countries are more likely to face debt problems. The middle income countries however, have taken the lime light in the debt arena. This is because they are more dependent on the supply of finance and the conditions affecting the supply of funds. The supply constraint has been a very important ingredient in the present debt crisis faced by the middle income developing countries.

Private sources of finance to the non oil developing countries have overtaken official sources in the seventies. In 1972 less than half the debt was owed to private lenders. By 1979 this had increased to about 60% (see Table 1.4). The average rate of change of private lending over the period was 25.9% compared to 16.8% for official lending. The growth of private market lending to the developing countries has been increasing since the late sixties. It became of increasing importance in the 1970's due to the large current account deficit experienced by the developing countries, as well as the supply of funds by the OPEC countries (which had large surpluses due to the oil price rise) on the international capital market. The supply and demand conditions were thus favourable for the growth of private market lending to the non oil developing countries.

Table 1.4

Debt of 87 Non Oil Developing Countries. By Type of Lender

(Billion US Dollars)

	1972	1973	1974	1975	1976	1977	1978	1979
Debt Outstanding	75.9	91.4	113.5	140.1	173	204.1	254.9	299
Official Lenders	40	46.7	55.3	64.9	75.9	90.5	107.6	118.8
Private Lenders	35.9	44.7	58.2	75.2	97.1	113.6	147.3	180.2

Source: Nowzad, B and Williams R.C. (1981) External Indebtedness of Developing Countires. Occasional Paper No.3 p 7 International Monetary Fund, Washington D.C.

The demand for finance from the private lenders on the part of the non oil developing countries is usually explained by referring to the decline in Official Development Assistance (ODA) from the Development Assistance Committee (DAC) and the multilateral agencies to the developing countries. The percentage of ODA to net resource flows from the DAC countries was calculated on the basis of figures given by the OECD. In 1970 ODA was 44.8% of total net resource flows. It declined to 38.4% in 1973, was 33% in 1975 and declined further to 30.4% in 1978. It rose in 1980 to 37.6% of the total. There is no doubt therefore, that in the seventies there was a downward trend in the proportion of ODA going to the non oil developing countries. There was a decline during the time of the first oil price rise, when the developing countries experienced large current account deficits. On aggregate this might explain why there was a rise in private lending to the non oil developing countries. However, lending from the international private capital market was only restricted to a few developing countries. Only 1% of the debt of the low income developing countries was owed to the private capital markets in 1971. By 1975 it had risen to about 5% of the total and in 1980 had risen only slightly to 5.2% (OECD 1982 p.40). In 1977 Argentina, Brazil, South Korea and Mexico received 44% of the loans extended by the banks. By 1982 this was estimated to be 52% of the total (OECD 1982). Thus, given that the growth in the private market lending was only towards a small group of developing countries, who are unlikely to have received a large percentage of the ODA anyway since they are middle income countries, the increase in private lending cannot be viewed as a substitute for ODA in the case of all developing countries. Given that there was an increase in funds within the private capital market, borrowers were attracted to this market because of the characteristics of the market. The Eurocurrency market is characterised by speed and flexibility. It does not take a long time for the loan to be negotiated and disbursed compared to arrangements with multilateral organisations. Secondly, there are few strings attached concerning the use of the loan. The international capital market is considered to have an advantage over the IMF and World Bank for instance, because it does not have any conditionality terms. This view is contradicted by Friedman (1981) who states that

since the bank lenders screen the potential borrowers to a certain extent (for example credit-worthiness. See Chapter 3 for a discussion of this) a certain amount of conditionality is involved in bank lending. A poor income country would have to improve its export earnings and ensure that foreign exchange would be available to repay the loan in order for it to be considered for a loan by any of the leading international banks. Since some of these countries are unable to meet the criteria laid down by the banks, they are automatically not eligible for loans from the private capital market. On the demand side the terms of lending may be too stringent for some of the poor countries.

The terms of loan incurred by the non oil developing countries have changed over the seventies. This change has been influenced to a great extent by the large amount of borrowing done on the international capital.

Table 1.5

Average Terms of Debt Commitments For 94 Developing Countries

	Interest Rate%			Maturity (Years)		
	Official Creditors	Private Creditors	Average[1]	Official Creditors	Private Creditors	Average[1]
1972	4.3	7.3	5.6	24.2	8.9	17.6
1973	4.2	9.1	6.7	25.4	10.8	18.0
1974	4.4	9.7	7.0	23.4	10.1	16.9
1975	4.9	8.8	6.9	23.5	7.8	15.3
1976	5.5	7.9	6.8	22.1	8.1	14.3
1977	5.2	8.0	6.8	22.6	8.0	14.0
1978	5.0	9.4	7.9	24.8	8.9	14.5
1979	5.0	11.6	9.3	25.0	8.9	14.6
Annual Average	4.8	9.0	7.1	23.9	8.9	15.7

1. Exclude private non guaranteed debt

Source: Nowzad, B and Williams R.C., (1981) External Indebtedness of Developing Countries. Occasional Paper No.3, International Monetary Fund. Washington D.C. p 9

The terms of the private lenders are harder than those of the official lenders (see Table 1.5). Over time, both sources of finance have experienced increasingly harder terms, although the rate of change in terms has been faster for private loans compared to official loans. The situation for individual countries depends on the structure of their debt protfolio. The middle income and newly industrialising countries have more commercial loans with hard terms compared to the low income countries. The changing conditions of the loans, especially those from private sources, can be explained by the conditions within the international capital markets and the world economy. The bank loans and the Eurocredits usually have floating interest rates to protect the creditors against inflation. The high interest rates experienced in the United States and the United Kingdom as a result of domestic polciy are also responsible for the high interest rates which the developing countries had to pay on their loans. In 1982 41% of the debt held by the non oil developing countries had floating interest rates. This had risen from 23% in 1978. The low income countries had 2% of their debt on floating rates in 1982, compared to 55% for the middle income countries. Brazil, Argentina and South Korea and Mexico had 110 billion dollars of their net liabilities on floating interest rate terms at the end of the 1980-1982 period (OECD 1982). Even though the floating interest rates were adopted to take account of the rate of inflation, the real rate of interest was only positive in 1972 and from 1979 onwards. On the average therefore, a large number of the developing countries had negative real interest rates on their loans (see Table 1.6). The nominal fixed interest rates did not change by as much over the period, as did the floating rates. This is to some extent, reflected in the interest rate figures of the private and official lenders in Table 1.5.

Table 1.6

Current (Nominal and Real) Interest Cost to Developing Countries [1]

	Nominal Fixed Interest %	Real[2] Fixed Interest %	Nominal[3] Floating Interest %	Real Floating Interest %	Total Nominal Interest on Debt%	Total Real Debt %
1972	4.2	-1.6	7.9	2.1	4.6	-1.2
1973	4.5	-5.1	9.0	-0.6	5.4	-4.2
1974	4.6	-11.0	10.0	-5.6	6.1	-9.5
1975	4.8	-8.9	11.0	-2.7	6.6	-7.1
1976	4.8	-5.7	8.5	-2.4	6.6	-4.3
1977	5.0	-6.1	7.8	-3.3	6.6	-4.5
1978	5.2	-4.2	9.0	-0.4	7.5	-1.9
1979	5.5	-6.3	12.0	0.2	7.7	-4.1
1980 (preliminary)	5.7	-9.4	15.3	0.2	8.8	-6.3
1981 (estimated)	6.2	-7.3	18.0	4.5	10.2	-3.3

[1] Annual interest payments and other changes as a percentage of the debt outstanding at the beginning of the year, adjusted for exchange rate changes.

[2] Real interest rates were obtained by subtracting nominal rates from the rate of change of industrial country consumer prices obtained from the IMF, International Financial Statistics Yearbook, 1982

[3] Weighted average annual cost to debtors (including spreads and fees) based on average LIBOR during the period July 1st to June 30th; six month average.

Source: OECD (1981) External Debt of Developing Countries, p 21 Paris.

Even though the developing countries had in aggregate shifted to private sources of funds, they need not have incurred such a large percentage of their debt on a floating interest basis. This is because they could have tapped the bond market which loans out funds for longer maturities than does the credit market and on fixed interest rates. Some of the bonds also have floating rates, but they are not in the majority. Unfortunately for the developing countries, they do not have easy access to the bond market, so are restricted mainly to the credit side of the international capital market[8].

The major creditors of the developing countries are the DAC countries. In 1981 about 75% i.e. 332 billion dollars of non oil developing country debt was owed to this group of countries and their capital markets. About 86% i.e. 70.3 billion dollars of the total debt service was paid to these group of countries. The multilateral organisations were the second largest group of creditors. In 1981 the non oil developing countries owed them 60 billion dollars. The Organisation of Petroleum Exporting Countries (OPEC) only became major creditors to the developing countries after the 1973/74 oil price rise. In 1975 the non oil developing countries owed them 6 billion dollars, equivalent to 3% of their total debt outstanding. The debt service payments were 0.2 billion dollars. In 1980 debt outstanding of the non oil developing countries to OPEC was 21 billion dollars which was about 4.4% of the total debt outstanding. The DAC countries have a long history of lending to the developing countries, thus partly explaining the large size of the debt owed to them. A large amount of the OPEC funds which could have been lent directly to the non oil developing countries were deposited in the financial markets of the DAC countries. These funds were thus redirected by the lending agencies within the DAC countries to borrowers thus explaining, to some extent, the growth in lending from this source in the mid seventies.

The framework of the international financial system within which developing countries have participated has changed in the seventies. The post war period up to the 1960's was characterised mainly by the flow of concessional finance to

the developing countries. It cannot be claimed that this was done on an equitable basis, i.e. the poorer countries receiving a greater percentage of the aid. The seventies has seen a shift away from concessional finance and official lenders as the main source of finance to the developing countries. The supply of finance to the developing countries has become more skewed to a few countries. The description of the debt situation of the developing countries illustrates these points fully. This development is due to the prominence of the private lenders in the business of transferring financial resources to the developing countries and the decline of the official lenders. OPEC has added a new dimension to the financial system (see Chapter 2). It was feared that the low absorptive capacity of the OPEC countries would make it difficult for the deficits experienced by the rest of the world after the first oil price rise to be removed without the world economy going into a deep recession. The deep recession did not occur, mainly because OPEC countries increased their absorption by greater than had been expected and also because of the recycling of the OPEC cash surplus by the banks. (This is the part of the cash surplus which had been deposited with industrial countries). The banks thus took up the role of helping the developing countries, to whom they would loan funds to finance their current account deficits and so prevented the deep recession, even if it was not their prime intention. In some quarters the entire cause of the rise in developing country external indebtedness has been blamed on the oil price rises. The disequilibrating effect of the oil price rise cannot be denied. However, the entire cause of the indebtedness cannot be put on the OPEC action because some countries could have adjusted the disequilibrium but had the choice to finance it instead. The possibility or the requirement that OPEC should directly have been responsible for financing the current account deficits is not justified given the profits that the banks made from lending to the developing countries and the fact that the entire deficits were not caused by the oil price rise.

The unit value of manufactured exports from the developed countries was also rising at the same time as was the oil prices. In 1974 the unit value of manufactured exports from the developed countries rose by 31% above the previous year. They rose further by 12% in 1974-1975. Since the industrial countries accounted for at least 60% of the imports of the non oil developing countries, this increase in the price of manufactures would have had a substantial impact on their trade account and terms of trade. The increase in the value of manufactured imports of the non oil developing countries which occurred between 1973 and 1975 was due mainly to price changes than to changes in volume. In the period 1974 - 1975 the value of exports from the non oil developing countries had declined by 2.4% due to volume and unit value changes. The former had declined by 1.4% and the latter by 1%. On the other hand the exports of the industrial countries had increased in value terms by 6.7%. This was mainly due to price changes since the volume had declined 4.2% between 1974 and 1975.

In Chapter 2 the relationship between the non oil developing countries and OPEC will be discussed in some detail. An attempt will be made to link the debt of the developing countries with the growth in the current account surplus of the OPEC countries. The relationship between OPEC and the non oil developing countries is of importance because it firstly illustrates OPEC's place in the international financial system and explains developments which took place there in the seventies.

NOTES

1. For a discussion of this see Abbot (1979; Hughes (1979) and Sampson (1981 p. 50-71)

2. The flow of concessional finance from the developed market economies to the developing countries has also been attributed to the desire on the part of the US, especially to reduce the possible Communist influence within the developing world. (Spero 1982 pp 152-157).

3. The difference between the GNP and the GDP is net factor payments abroad. For external borrowing to generate growth in the GNP, the output capital ratio needs to be greater than the rate of interest (Massel 1964 pp632-33).

4. Autonomous flows are defined as those flows which occur irrespective of the balance of payments position. The difference between autonomous and accommodating flows is rather fudged. This is because the former may be the result of actions taken by domestic authorities, for example interest rate differentials to induce an outflow or inflow of capital.

5. This does not include direct private investment, but includes bonds, financial loans from private and official sources and suppliers credit.

6. An UNCTAD study (1979) has shown that deflating the nominal figures by the export unit value or the import unit value for instance, to take account of inflation does not necessarily indicate the real value of the debt. For instance an increase in export unit values may also coincide with either a reduction in the export volumes or a greater rise in import unit values, so that the burden of debt may not necessarily have been reduced. A model which has the relevant variables to be considered has been developed in the study.

7. In 1973 the current account deficit of the non oil developing countries was 11.6 billion dollars (IMF_d 1982) 10.1 billion dollars was financed through the non debt creating flows. In 1975 11.8 billion dollars of the 46.5 billion dollar current account deficit was financed using non debt creating flows. Over the period 1973-1982 non debt creating flows rose in value from 11 to 27.8 billion dollars. This further explains the growth of debt for the developing countries.

8. See section 4.2.1.

Chapter Two

OPEC and the Non Oil Developing Countries

The flow of financial resources from the OPEC countries to the rest of the world is a novel phenomena in the international financial system. This is the first time that a group of developing countries have been directly responsible through their own actions for such a large flow of finance within the financial system[1]. Sobhan (1980 pp 201), described it as a 'historic transfer in the ownership to investable resources..'. The OPEC countries as capital exporters are considerd to be different from the majority of capital exporters, i.e. the developed economies. They do not have a strong military force to back them up if they should have need to put pressure on any defaulting debtors, they have a weak technological base and do not have a developed industrial base with which to tie aid disbursements. They have limited financial structures of their own and so are forced to put the bulk of their funds outside their national economies, their currencies are not widely used and the wealth from which this surplus finance has been derived is based on a non renewable resource (Bacha and Alejandro 1982 pp 7 - 9). Bacha and Alejandro consider whether the period 1973 - 1981 may be described as Pax Arabica. Although immediately after the oil price rises there was a large amount of funds in the hands of the OPEC countries,due to the characteristics of the OPEC countries as capital exporters and the fact that they were not responsible for the majority of the funds within the financial system, it is doubtful that this description of the era would be an apt one. The OPEC countries, however, did influence or play a large part in how the system functioned. This had repercussions for both the developed and developing countries alike [2].

The increasing links between OPEC and the developing countries can be illustrated by the rise in ODA from OPEC which occurred after 1974. It also illustrates OPEC's growing importance within the sphere of total financial flows to the developing countries. In 1973 ODA flows (net) from OPEC were only 11% of the total ODA going to the developing countries. 79.6% of such flows were from the DAC countries. By 1975 the OPEC ODA was 27.4% of the total going to developing countries and non concessional flows had increased from 1.75% to 7.6% of the total over the same period (OECD 1979)

2.1 The OPEC Cash Surplus

The increase in the financial flows from OPEC to the rest of the world is a direct function of the quadrupling of the oil prices in 1973/74. This increased overnight, the revenues of the oil exporting countries. For example in Kuwait the revenue from oil in 1973 was 1780 million dollars. In 1974 with a fall in the volume of oil exports, oil revenues rose to 6,545 million dollars (Petroleum Economist 1979). Although the quadrupling of the oil prices has been the immediate cause of the financial flows, the extent to which this will continue depends on the size of the ensuing cash surplus, the absorptive capacity of the oil exporters and the way in which the surplus is invested.

The cash surplus is the amount available for government loans, capital investments and additions to reserves after allowance has been made for imports, other current transactions and trade credit given for oil exports. (Bank of England 1975) [3]. There are difficulties involved in calculating the actual size of the surplus and how it has been deployed. The OPEC countries are not eager to divulge the size of the surplus and in the market economies, it is difficult to monitor the flows because of the large size of private flows. Another problem is that some of the funds are not invested directly by an OPEC country, but by investment agents acting on behalf of the OPEC investors (Sobhan 1980 b). Bank of England estimates will be the main source of information on the OPEC surplus, used here.

The size of the cash surplus has varied over the 1974 to 1980 period. The factors which primarily affect the size of the surplus are threefold. The first is the size of the oil revenues, the second is the value of other export revenues and the third is the value of imports of the OPEC countries.

The oil revenues rose dramatically in 1974 because of the price rise. There was a decline in revenues in 1975, mainly because of a decline in the demand for oil mainly from the industrial countries. Exports per day declined from 29.5 million barrels a day in 1974 to 25.7 million per day in 1975. The second dramatic increase in the surplus was in the 1979/80 period when the price of oil doubled. The strength of oil revenues in determining the cash surplus depends also on its weight in total exports. Libya and Saudi Arabia depend totally on fuels, minerals and metals for their merchandise export revenue. Venezuela, Iraq and Algeria depend on this category of exports for at least 95% of their export earnings. Only Ecuador and Gabon depend on oil for less than 50% of their export earnings (World Bank$_c$ 1981). OPEC countries can be categorised on the basis of the extent to which their revenues are abosrbed by imports. The high absorbers i.e. Nigeria, Algeria, Gabon Venezuela, Ecuador and Indonesia spend almost their entire export earnings on imports. They are more populous than the low absorbers i.e. Saudi Arabia, Kuwait, United Arab Emirates and Qatar which spend only a small proportion of their revenues on imports despite their high import growth rates.

Table 2.1

Trade and Current Account Balance for Groups of Oil Exporters
(Billions of US Dollars)

	1973	1974	1975	1976	1977	1978	1979
High Absorbers							
Trade Balance	4	18	7	7	7	-	23
Current Balance	-1	11	-1	-2	-6	-14	9
Middle Tier Absorbers							
Trade Balance	5	24	13	18	21	14	37
Current Balance	1	18	6	11	12	3	29
Low Absorbers							
Trade Balance	10	42	34	39	38	30	60
Current Balance	6	38	24	26	21	10	36

Source: Bank of England (1980) ' The Surplus of Exporters
Bank of England Quarterly Bulletin, June p 154

The low absorbers account for a large amount of the total current account surplus. The high absorbers only experienced a current account surplus in 1974 and 1979. The volume of imports of the oil exporters grew over the period 1974 - 1978, declining in 1979 (Bank of England 1980). The reduction in import volumes in 1979 has been attributed to factors such as the lack of sufficient managerial and technical skill and uncertainty about the future availability of finance to continue the projects (Bank of England 1980 pp 157). The initial absorptive capacity of the OPEC countries, especially the Arab countries, was considered to be very low and gave rise to fears about a world recession since the trade surplus would not be easily reduced by increased imports by the OPEC countries. The low absorptive capacity of OPEC has been attributed to a weak and poorly organised market and the shortage of a skilled work force and technical and managerial skill (Nour 1974). The absorptive capacity as measured by the growth of imports has increased over time. For example the reduced investible surplus

for Saudi Arabia in 1981 is due to the large financial requirements of the development plan. Looking at the merchandise imports alone will give a lower estimate of the ability of OPEC to use it s cash surplus. For instance the services account of the US vis a vis the OPEC countries was in surplus from 1972 to 1977 (Survey of Current Business 1978p.27)This was made up of military transactions which, in the case of Iran and Saudi Arabia, rose from 0.2 billion dollars to 4 billion dollars over the period. The surplus was also made up of income from US direct investments and foreign assets.

The wealth of the OPEC countries differs from that of the developed economies because it depends on a non renewable resource, whilst for the latter group of countries it is due to an industrial capacity and structure which has been developed over several years and can be changed with some costs to adapt to new circumstances. The investment of financial resources derived from this non renewable resource should be such that it will yield returns when the resource is diminished. The investment decisions of individual OPEC countries differ, depending on the circumstances of each country in terms of population and the longevity of oil reserves (Mabro 1982). This will also affect their attitudes towards pricing policy.

Table 2.2

Deployment of Oil Exporters Cash Surplus[a] (Billion US Dollars)

	1974	1975	1976	1977	1978	1979	1980
Bank Deposits of which:	28.6	9.9	12.0	13.0	3.9	37.3	47.3
In currency of issue	7.0	2.0	0.5	2.3	2.8	6.3	
Eurocurrency deposits	21.6	7.9	11.5	10.7	1.1	31.0	
Short Term Government securities (b)	8.0	-0.4	-2.2	-1.1	-0.8	3.3	
Long Term Government securities (b)	1.1	2.4	4.4	4.5	-1.8	-0.7	
Other Capital flows (c)	7.1	12.8	13.2	9.8	5.8	9.0	
IMF and IBRD (d)	3.5	4.0	2.0	0.3	0.1	-2.0	4.9
Flow and funds to developing countries (e)	4.9	6.5	6.4	7.0	6.2	6.9	6.7
Total identified deployed net cash surplus	53.2	35.2	35.8	33.5	13.4	53.8	60.6
Residual of unidentified items	1.9	1.1	2.8	4.1	5.4	25.2	16.4
Total net cash surplus	55.1	36.3	38.6	37.6	18.8	79.0	110.0

Note: Flows are mainly differences between opening and closing stocks, but adjusted to remove the estimated effects of exchange rate movements of currencies other than the US dollar.

Oil exporters comprise of the OPEC member countries, Trinidad and Tobago, Bahrain, Brunei and Oman.

Table 2.2 (continued)

(a) Equal to current account balance, less changes in liabilities and trade credit and oil export.

(b) Coverage of these items is confined to the UK and the US.

(c) Comprises other portfolio investment, direct investment loans and other items.

(d) Comprises investment in the IMF oil facility, supplementary financing facility, holding of SDR's and direct purchasing of IBRD bonds.

(e) Comprises bilateral loans and contributions and subscriptions to regional and international development agencies other than the IMF and IBRD.

Source: Bank of England (1980) The Surplus of the Oil Exporters Bank of England Quarterly Bulletin, p. 152 June.

In 1974, at the time of the first oil price rise, the oil exporters found themselves with large amounts of cash on their hands, greater than what they required. They lacked a developed financial system within their economies or within the rest of the developing world for that matter and had not, except possibly for Kuwait, developed an investment strategy[4].

As a result of this the bulk of the funds was put into financial institutions in the developed market economies ; the bulk of this being deposited in the US and the UK. 53.75% of the identified deployed net cash surplus was put in bank deposits in these two countries (see Table 2.2.). More than half of these bank deposits were placed in the Eurocurrency market. The developing countries directly received 9.2% of the identified deployed surplus and the IMF and IBRD received 6.5%. After 1974 there was a shift away from short term

liquid assets to longer term assets. This diversification of the portfolio was due to an investment strategy being outlined by the countries as well as an awareness of the different instruments available as well as the different rates of return on the different markets. Over the 1974-1978 period, the value of the funds going to the US increased. This was mainly due to the increasing role of the dollar in OPEC trade [5]. The share of funds going to the developing countries has been facilitated by the creation of agencies to disburse funds to these countries. In 1978 when the surplus had declined to 13.2 billion dollars, 6.2 billion dollars was directed towards the developing countries. At the time of the second oil price rise in 1979 there was again a large shift towards short term deposits. This was due primarily to the lack of an identified long term strategy in the face of the increased surplus, as well as the high short term interest rates prevailing at the time (Bank for International Settlement 1980). There was a greater diversification of deposits within the developed markets with a shift away from the UK and the US. In 1979 the share going to the developing countries increased slightly to 11% of the identified deployed surplus. In absolute terms the value of the funds going to the developing countries from OPEC did not vary much, although in relative terms there was a large variation, especially in 1978 when about half the cash surplus was deployed to the developing countries(See Table 2.2).

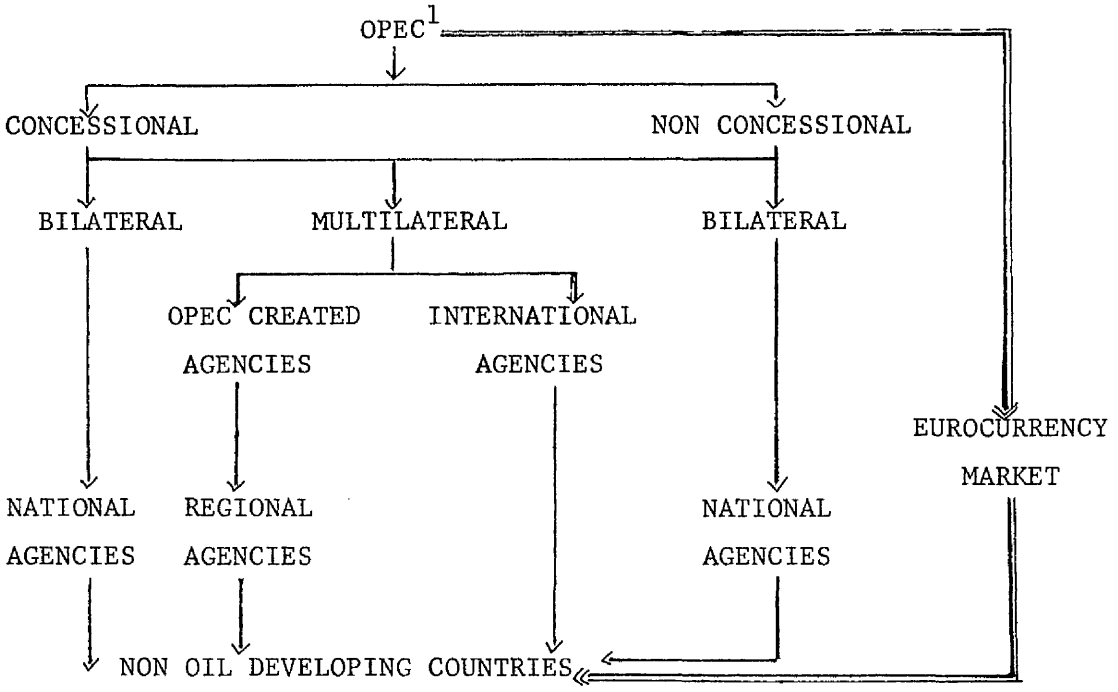
2.2 OPEC Financial Flows to the Non Oil Developing Countries

2.2.1 The Channels

OPEC financial flows to the non oil developing countries are on a bilateral and multilateral basis and on concessional and non concessional terms. Flows through multilateral agencies are either to existing ones or else agencies set up by the OPEC countries. Chart 2.1 shows the channels whereby the funds get to the non oil developing countries.

Chart 2.1

Channels of OPEC Flows to the Non Oil Developing Countries



1. This refers to either all the countries which make up OPEC or else a subsection of countries within OPEC.

2. The single line shows the channels through which funds placed mainly for the benefit of the non oil developing countries pass. The double lines are the flow of funds which get to the developing countries, but not as a result of a policy objective of OPEC

By 1973 the OPEC countries had already achieved the goal set up for the DAC countries by the Pearson Report (1969) i.e. to achieve concessional flows to the developing countries equivalent to 0.7% of the donor country GNP. The disbursement of concessional flows from the OPEC countries is not equally divided amongst the countries and reflects,to a great extent, the distribution of the cash surplus among them. The Arab members of OPEC contributed a large absolute value and a large

percentage of their GNP to concessional flows compared to the non Arab members. In 1973, the Arab donors had allocated 3.46% of their GNP in contrast to 0.04% by the non Arab members. With the increase in the cash surplus in 1974, the non Arab donors increased their contribution by giving away the equivalent of 0.47% of their GNP. This was still far lower than the performace of the Arab donors. In 1975, even with the decline in the current account surplus, there was an increase in the total OPEC commitments. (8405 million dollars from 5949 million dollars in 1974 - OECD 1983). As a percentage of GNP concessional assistance in 1974 was the highest for the period 1973 to 1980 (See Table 2.3).

By 1980 concessional flows had declined to 1.35% of the GNP which was the pre first oil price rise level i.e. in 1973 (See Table 2.3). Total concessional flows had increased in nominal terms through to 1978 when it declined to 4611 million dollars. It however, picked up again in 1979, at the time of the second oil price rise. The low GNP ratio in 1980 was therefore a reflection more of the rise in GNP than a fall in total concessional disbursements.

Bilateral concessional assistance has been the main form through which the concessional loans have been disbursed since 1974. In 1974 it was 3108 million dollars and rose to 6114.7 million dollars in 1980 (OECD$_a$1981). The amount disbursed through the multilateral institutions grew over the period 1974 to 1977. In 1974 about 34.5% of the OPEC contributions to multilateral institutions was to UN agencies. In 1977 the amount disbursed through OPEC created agencies had increased to 89% of the multilateral concessional flows. This was primarily due to the growth in the number of these agencies. However, in 1978 there was a decline in multilateral concessional flows for the first time since 1974. This was mainly due to the reduction in disbursement through the Gulf Organisation for the Development of Egypt (GODE) in 1978 for political reasons. In 1980 disbursements from multilateral agencies was down to 862 million dollars (OECD$_a$ 1981).

Table 2.3

Concessional Assistance by OPEC members to the Non Oil Developing Countries. Net Disbursements

	1973	1974	1975	1976	1977	1978	1979	1980
Arab Donors								
Actual (million dollars)	1283	2974	4878	4670	5585	4187	5968	6802
% of GNP	3.46	3.80	4.99	3.84	3.80	2.56	2.79	2.34
Non Arab Donars Actual (million dollars)	25	482	639	939	338	425	138	175
% of GNP	0.04	0.47	0.55	0.67	0.21	0.24	0.07	0.08
Total OPEC Actual (million dollars)	1308	3456	5516	5609	5923	4611	6106	6978
% of GNP	1.35	1.92	2.59	2.14	1.92	1.37	1.48	1.35

Source: $OECD_a$ (1981) Development Co-operation Efforts and Policies, Paris p. 226

Table 2.4

Non Concessional Flows from OPEC to the Non Oil Developing Countries. (million US Dollars)

	1973	1974	1975	1976	1977	1978
Total Non Concessional flows.	438.1	2442.3	2652.1	2543.9	1593.6	1433.3
Bilateral	143.1		1432.1	1413.2	874.7	1012.5
Multilateral (OPEC finance agencies)	295		1220	1130.7	718.9	420.8

Sources: $OECD_a$ (1979) Development Co-operation Efforts and Policies, Paris. p. 269

UNCTAD (1980) Handbook for International Trade and Development Statistics Supplement, Geneva

Non concessional flows have increased over the period 1973 to 1978, but have always been lower than the concessional flows. Bilateral non concessional flows are also larger than the multilateral flows as is the case for concessional flows (see Table 2.4).

The bulk of OPEC financial flows was therefore on concessional terms and on a bilateral basis. Concessional financial flows to developing countries has been justified on ethical, political and economic grounds (Shihata 1982 pp 54-56). Aid on ethical grounds can be illustrated by the fact that OPEC gives aid to countries which are of no direct political interest to the donors (Shihata op cit). That there is a political reason for giving concessional finance is evidenced by the large amount of aid from OPEC going to non oil Arab countries. Kuwait in 1961, began giving aid to its neighbours as part of its foreign policy. Aid for economic motives is not as strong for the OPEC countries as it is for the DAC countries. On the other hand, funds were poured into Sudan in order to develop it as a bread basket for the Arab countries. Due to the underdeveloped structure of OPEC economies, they cannot benefit from tied aid. This would be a reason for the OPEC countries to increase disbursements of non concessional flows. The ethical reasons for giving aid are somewhat weakened if the disbursement of concessional loans to the developing countries is looked at as an attempt on the part of the OPEC countries to maintain the allegiance of the developing countries in the face of the disequilibrating effect which the oil price rises has had on their economies.

The earliest agency to be set up by a member of OPEC to disburse funds to the developing countries was the Kuwait Fund for Arab Economic Development in 1961. The aim of the Fund was to improve the relations with the neighbouring Arab countries. In 1974, after the first oil price rise, the range of activities of the Fund was extended towards other developing countries. By 1976, the share of non Arab countries receiving finance from the Fund had increased to 62% from 1% in 1974 (Scharf 1978 p.153).

The Abu Dhabi Fund for Arab Economic Development was another national agency set up in 1971 to provide financial flows to the developing countries in the Arab world, Africa and Asia.

After the oil price rise, there was a growth in the number of agencies which were to direct funds, especially concessional finance to the developing countries. The Saudi Fund for Development set up in 1974, acts as the government agency to provide loans to the developing countries. It gives mainly project assistance on concessional terms and sometimes gives loans on a regional basis, provided the countries concerned are willing to co-operate. Another national agency set up to allocate funds to the developing countries is the Iraqi Fund for External Development.

The Arab Fund for Economic and Social Development was set up in 1971 just before the first major oil price rise. Its members are the 21 members of the Arab League and some of its main objectives are to help members remove development constraints, increase their absorptive capacity and achieve higher growth rates. The Fund is also concerned with the administration of the OAPEC Special Account which was established in 1974 to help Arab oil importing countries which had balance of payments difficulties due to the oil price rises. The Arab Bank for Economic Development in Africa was set up by the Arab League countries, but does not include the Yemens, Somalia and Djibouti. It began operating in 1975. The main recipients of the finance are the non Arab African countries and by 1979 Cameroun, Ghana, Mali and Upper Volta had received finance from this bank. The purpose of the bank is to foster financial and technical co-operation between the Arab and African countries. The Special Arab Aid Fund for Africa was set up in 1974 and was later affiliated to the ABEDA in 1976. By 1977, 35 African countries had received assistance from the SAAFA of which 13 fell into the category of most seriously affected countries (Scharf 1978 p.165) Another agency which is concerned primarily with African countries is the Arab Fund for Technical Assistance in Africa which was established in 1974.

The OPEC Fund for International Development [6] established in 1976, is the only agency which has a membership of the thirteen OPEC countries. It had an initial capital base of 800 million dollars. The main function of the Fund is to co-ordinate the joint OPEC members policies and activities in the field of external assistance and to act as collective aid donor (Shihata 1982 p 86). The Fund provides both project lending and balance of payments assistance. When the balance of payments loan is received, the borrower must agree to deposit an equivalent amount in local currency to finance the local costs of development projects. Failure to do this will result in the maturity of the loan being shortened. The philosophy of the Fund is to reduce the possibility of duplicating work already being done by established international agencies. All project financing is done in co-operation with other agencies. The advantage of this, apart from reducing the possibility of duplicating assistance efforts, is that it makes available to the Fund, technical expertise and information which it may not already have. The OPEC Fund has not only financed country projects and balance of payments, but has also contributed to other agencies. In 1977 it committed 435.5 million dollars to the creation of the International Fund for Agricultural Development and it has also granted 20 million dollars to specific UNDP projects (Shihata op cit). The objective of the Fund is to assist the poorer of the developing countries. The sectors which obtain a lot of finance are agriculture and energy. By October 1981, 163 loans had been disbursed and 103 were still in the process of being disbursed. The majority of the funds were allocated to Africa, followed by Asia and then Latin America (Shihata op cit).

Other multilateral agencies for channeling funds to the developing countries are the Islamic Development Bank and the Arab Monetary Fund. The former was set up in 1974 with the objective of channeling funds to all Islamic states world wide. The Arab Monetary Fund was set up on the same basis as the IMF and is to provide credits to member countries to finance their balance of payments. Between 1976 and 1978 GODE was responsible

for more than half of the OPEC disbursements through the multilateral institutions. The fund was set up by Kuwait, Qatar, Saudi Arabia and the United Arab Emeriates to help finance Egypt's five year plan of 1976-1980. However, due to political reasons, disbursements were stopped in 1978. Hence the sharp drop in disbursements throughthe multilateral institutions in 1979.

Table 2.5

Concessional Net Aid Disbursments from OPEC Financed Multi-Lateral Institutions (Million US Dollars)

	1974	1975	1976	1977	1978	1979	1980	1981
Arab Fund for Economic and Social Development	7	40	64	87	183	106	73	89
Arab Technical Assistance Fund		-	1	4	7	4	7	6
Arab Bank for Economic Development in Africa			2	8	29	42	36	29
Gulf Organisation for Development of Egypt			250	825	650	-	-	-
Islamic Development Bank				1	10	15	24	27
Islamic Solidarity Fund			6	7	9	10	10	10
OAPEC Special Account	79	-	37	-	-	-	-	-
OPEC International Fund [1]				162	85	88	144	254
Special Arab Aid for Africa	31	118	59	13	-	-	-	-
Total	117	158	419	1107	973	265	294	415

1. Not including contributions to IFAD, IMF Trust Fund and UNDP through the OPEC Fund

Note: AFESD, ABEDA and Is. Dev. Bank also provide loans on non concessional terms. Net disbursements by these three institutions amounted to 157 million dollars in 1978 and 219 million dollars in 1979 . The OPEC Fund began giving non concessional finance in 1980.

Source: $OECD_a$ (1982) Development Co-operation Efforts and Policies, Paris. p. 160

The Latin American countries have not been well served with agencies compared to say the African and Arab countries. This is mainly because they are not considered to require much concessional assistance. Given that the bulk of countries described as least developed are to be found in Africa and Asia, on an aggregate basis the agencies have been set up to finance the needs of the poorer countries. This will be discussed in detail in a later section.

The OPEC countries have channelled some of their funds through already existing multilateral agencies. For example the OPEC Fund made contributions to the IMF Trust Fund, the UNDP and to IFAD. A wide array of the UN agencies have received funds from OPEC. In 1976, concessional finance to the agencies was 68.4 million dollars. By 1980 this had risen to 120.9 million dollars ($OECD_a$ 1981). Other agencies which the OPEC countries give concessional funds to are the IBRD, IDA, the African Development Bank and African Development Fund. They also give non concessional finance to some of these agencies. The World Bank received $4140.6 million in non concessional flows from OPEC countries over the period 1973 - 1981 ($OECD_p$ 157 1983). Over the period 1973 to 1981, the African, Asian, Inter American and Carribean Development Banks and the Central American Bank for Economic Integration received non concessional loans of 786.9 million the OPEC member countries (OECD 1983$_p$.157)

The developing countries have also had access to some of the OPEC cash surplus which has been placed on the Eurocurrency market. It is quite difficult to determine how much the developing countries have received from this source, since the OPEC countries are just a group out of the several countries and institutions which deposit on this market. About 40.6% of the investible indentified surplus was placed on the Eurocurrency market in 1974. This declined over the period 1974 to 1978 until the second oil price rise in 1979. In 1974 OPEC countries were net suppliers of funds on the market. They deposited about 29.1 billion dollars which was equivalent to about 16.4% of the total supply of funds on the market (BIS 1978).

In December 1980 their deposits were 19% ofthe total supply. Developing countries were net users of funds over the period 1974 to 1980. On the basis of this, it can be concluded that some of the OPEC surplus was redirected to the developing countries. This is especially relevant to the middle income countries, since they had greater access to funds on this market than did the low income countries.

2.2.2. The Direction of Flow of OPEC Resources to the Non Oil Developing Countries ; Based on the Geographical Distribution and Income Groups.

OPEC financial flows are geographically concentrated with a large percentage going to the Arab countries. In 1975 net disbursements of bilateral concessional assistance to Arab countries was equivalent to approximately 78.9% of the total[7], with the largest allocation of 2072.7 million dollars going to Egypt. The large percentage of bilateral assistance going to Africa is heavily weighted by the dominance of the Arab countries. In 1975, 54.5% was allocated to Africa. This declined to 20.2% of the total because of the reduction of disbursements to Egypt. The countries in the Americas only received 0.014% i.e. 0.7 million dollars of the bilateral assistance in 1975. This rose to 1.4 million dollars in 1980 i.e. 0.18% of the total bilateral assistance. In 1979 Oceania received the first allocation of bilateral ODA from OPEC of 2.1 million dollars. (This went to Papua,New Guinea.) The recipients of multilateral assistance were more widely dispersed. The Latin American developing countries received a larger amount of their concessional flows from multilateral sources than from bilateral sources. In 1977 six American developing countries received 7.6 million dollars amongst them (UNCTAD 1980). Even though the Arab countries received more than 50% of the total concessional flows, there was some diversification away from them. In 1973 they received 96.3% of the total concessional flows. By 1976 this had declined to 64.5% of the total (Shihata op cit pp50).

The Latin American countries received more of their flows from OPEC on non concessional terms. In 1975 they received 207 million dollars of bilateral non concessional flows. However, they did not receive any flows from multilateral sources over the period 1974 to 1978 from Arab/OPEC multilateral agencies (UN CTAD 1980). Most of the non concessional flows going to Africa were to Egypt. In 1975 it accounted for about 50% of African non concessional flows from Arab/OPEC agencies.

The skewedness of the geographical distribution of the funds will also affect the distribution on the basis of income. The importance of attempting to describe OPEC flows on the basis of geographical distribution and on the basis of income groups is that it will help in analysing the size of the OPEC flows to non oil developing countries in Section 2.1. The large absolute values of the flows as well as the ratio of the flows to GNP give a very favourable impression of the OPEC efforts to assist the developing countries on a concessional and non concessional basis. However, when the flows are disaggregated, then the relationship between OPEC and the developing countries on a financial basis looks less favourable.

The developing countries will be divided into three main income groups. The first group is the low income countries, LIC, and consists of 61 developing countries (OECD 1982). In 1976 they had a per capita GNP of less than 400 dollars. Within these group of countries there is a sub group of 31 countries, described as the least developed countries, LLDCs. They have a low per capita income (100 dollars or less in 1968), a low share of manufacturing in GNP(10% or less in 1968), and a low literacy rate (20% or less for persons above 15). See OECD (1978) for a discussion of LLDCs. The second main group of countries are the middle income countries with incomes greater than 400 dollars in 1976. The third group are the newly industrialising countries, NIC, which may have per capita incomes similar to some MICs but which are differentiated because of the large percentage of manufactures in their GNP and exports[8].

Between 1976 and 1978 the share of bilateral ODA going to the low income countries was greater than that going to the middle income and the newly industrialising countries. In 1979 the middle income countries received a larger share than did the 61 low income countries. This can be explained by the distribution on a geographical basis and by political reasons. The decline in the allocation of funds to Egypt resulted in an increase in funds going to other Arab countries which can be classified as middle income countries, for example Syria. The NICs did not receive bilateral ODA until 1977. Even then, their allocation was very small compared to the other groups of countries. Given that the bilateral ODA is equivalent to at least 75% of the total concessional assistance it can be said that on an income basis, the distribution was favourable towards the low income countries until 1979 when the middle income countries received more than 50% of the total flows. The flow of concessional finance mainly to the low income countries is considered favourable because, due to the fragile nature of some of the economies they are less likely to repay loans on hard terms , Secondly, it is likely that the low income countries will use some of the external finance they receive for consumption purposes, thus justifying the need for concessional assistance.

In 1975 the low income countries not including the LLDCs, received 1002 million dollars in bilateral non concessional flows (UNCTAD 1980). This can be explained by the large amount going to Egypt in that year. After 1975 the middle income countries had the largest amount of non concessional flows receiving 452 million dollars in 1977 and 209.1 million dollars in 1978. The newly industrialising countries received the least amount over the entire period.

Table 2.6

Bilateral ODA from OPEC to Non Oil Developing Countries On the Basis of Income Groups. (Million US Dollars)

	1976	1977	1978	1979	1980
Least Developed Countries	638.4	774.3	523.8	596.4	822.3
Other Low Income Countries	2546.4	1242.4	1023.3	339.6	823.8
Middle Income Countries	1014.1	1207.1	1305.1	3264.1	4038.4
Newly Industrialising Countries[1]	-	54.5	35	70.1	18.2

1. This includes the European developing countries as defined by OECD.

Source: $OECD_a$ (1981) Development Co-operation Efforts and Policies, Paris p 233

Table 2.7

Total Official Flows from OPEC to Non Oil Developing Countries (Million US Dollars)

	1975	1976	1978
Least Developed Countries	830.2	859.4	580.8
Other Low Income Countries	3855.6	3227.3	1889.4
Middle Income Countries	1478.1	1524.6	1136.2
Newly Industrialising Countries[1]	31.8	67.7	74.9

1. Does not include European developing countries.

Source: $OECD_a$ (1979) Development Co-operation Efforts and Policies, Paris. p 278-79

The lower income countries received the greatest percentage of the OPEC financial flows going directly to the developing countries between 1975 and 1978. As the information on bilateral ODA has shown in Table 2.6, this situation changed after 1978. Given that concessional flows form the bulk of OPEC financial flows to the developing countries, it could be concluded that OPEC flows were assisting the poorer countries in their development programme. However, the information on the geographical flows has shown that only a small number of developing countries actually benefited directly from the OPEC cash surplus and the disbursement of funds.

The decision on how to disburse the OPEC cash surplus was taken mainly on political and economic grounds. The ethical motive for disbursing concessional finance is rather limited after the analysis of the flows on the basis of geographical distribution. The discussion of OPEC financial flows to the developing countries illustrates the extent to which non convergence of interests can affect the international economic scene. The poorer developing countries may have required more OPEC assistance despite the rise in the oil prices since they may have had the need for external finance prior to the rise in the oil prices. The OPEC countries on the other hand have a differing set of variables to use when deciding how to allocate their finance. The lack of a developed money market, as well as the political and economic instability of the developing countries thus increasing the risks of investments, have all beencited as reasons why the bulk of the funds obtained due to the oil price rise were deposited directly within the financial markets of the developed economies. It has also been suggested that the developing countries need for long term project investment, did not necessarily coincide with the portfolio choice of the OPEC countries(Killick and Sutton 1982). These factors thus explain to some extent why the OPEC countries disbursed their cash surplus in the manner that theydid and they give some indication as to what the possibilities are of changing the distribution of future cash surpluses.

2.3 The OPEC Cash Surplus and the External Indebtedness of the Non Oil Developing Countries

The rise in the oil prices in 1974 and in 1979 were associated with sharp increases in the current account deficits of the non oil developing countries. The industrial countries also experienced large oil deficits in both periods. In Chapter 1, it was shown that given that some adjustment did take place on the part of the developing countries to the shock of the oil price rise, the manner in which they financed the rest of the existing deficit, i.e. between debt and non debt creating flows, can explain to some extent the growth of the external debt of the developing countries in the seventies.

To the extent that the oil deficits were not the only deficits experienced by the developing countries, then the growth of external indebtedness cannot be blamed largely on the oil price rises and the OPEC countries do not bear the sole responsibility of financing the deficits of the developing countries. That more direct flows of finance from the OPEC countries to the non oil developing countries (with a less skewed distribution) would have been to the advantage of the developing countries cannot be denied. However, this alone would not necessarily have stopped the growth of indebtedness because in 1978 when the current account surplus of the OPEC countries had declined, the non oil developing countries were still experiencing trade and current account deficits.

The contribution of the oil deficits to the total trade deficit of the non oil developing countries will be measured to show that other variables were at work at the same time. Table 2.8 shows the trade deficit between the OPEC countries and the industrial and non oil developing contries respectively. In absolute terms the industrial countries had a larger trade deficit with the OPEC countries. This is a function of the

size and structure of the economies of the different groups of countries [9]. In 1975 it was calculated that as a percentage of the GNP [10] the OPEC deficit for the industrial countries was 0.3%. At the time of the second oil price rise in 1980 it was 2.3%. The non oil developing countries on the other hand had higher values than this. In aggregate the 1975 oil deficit was equivalent to 1.5% of their GNP and was 4.5% in 1980 after the second oil price rise (see Table 2.9). The impact differed amongst the various categories of developing countries. The impact of the price rise for the LLDCs and the LICs was lower than the average for the non oil developing countries. In 1975 the deficit for these two groups of countries was equivalent to 0.73% of the GNP. In 1980 this was 2.8% and 1.6% respectively. The middle income countries had the largest impact of all the groups of countries (see Table 2.9). This may be explained by the fact that some countries had extremely large imports of oil given the average for that group of countries. The Netherland Antilles imported the value of 2405 million dollars from OPEC and this rose to 6589 million dollars in 1980 (IMF_b 1981). The NICs had a value of 1.02% in 1975 and the impact of the oil deficit rose to 3.92% in 1980.

In 1975 the US managed a trade surplus with the rest of the world equivalent to $4169 million. Thus even though in value terms the oil deficit was large, the impact of this on the current account of the US was reduced by other transactions. The trade deficit of the UK was reduced and became a large surplus by 1980 so that the initial detrimental impact of the oil price rise on the trade and current account was removed. For the developing countries on the other hand the experience differed. The non oil developing countries experienced both a trade deficit with the OPEC countries and with the rest of the world over the entire period of 1974 to 1980. Table 2.10 shows the absolute value of the trade deficit of the non oil developing countries with the rest of the world for the years 1975, 1978 and 1980. It also shows what percentage the oil deficit was of the total trade deficit.

Table 2.8

OPEC Trade Deficit with the Industrial and Non Oil Developing Countries. (Million US Dollars)

	1973	1974	1975	1976	1977	1978	1979	1980
Industrial Countries	-15104	-63102	-37717	-46944	-42805	-25441	-75108	-111775
of which:								
United States	-1668	-8065	-5696	-10019	-15977	-11980	-28267	-35566
United Kingdom	-1446	-7189	-2209	-1907	-780	3599	1545	2346
Non Oil Developing	-4565	-18998	-15025	-19087	-19043	-16365	-28663	-44374
Countries of which:								
LLDCs			-240	-397	-405	-320	-814	-941
LICs			-1596	-1219	-1246	-1501	-2341	-3665
MICs			-6578	-9606	-10362	-7349	-9284	-15726
NICs[1]			-3489	-4230	-4460	-4591	-8731	-13396

1. Not including European developing countries.

Calculated on the basis of IMF Direction of Trade Statistics Yearbook, 1981, 1982

Table 2.9

OPEC Trade Deficit as a Percentage of the GNP of the Industrial and Non Oil Developing Countries

	1975	1977	1980
Industrial Countries	0.3	0.5	2.3
United States	0.3	0.63	1.89
Non Oil Developing Countries	1.5	1.6	4.5
LLDCs	0.73	0.98	2.8
LICs	0.73	0.68	1.68
MICs	2.63	2.9	6.29
NICs	1.02	1.34	3.92

Calculated on the basis of IMF Direction of Trade Statistics Yearbook 1982 and UNCTAD Handbook of International Trade and Development Supplement 1980

Table 2.10

Non Oil Developing Countries Trade Deficit with the rest of the World (million US Dollars) and the Contribution of the OPEC Trade Deficit to the Total Trade Deficit (%)

	1975	1978	1980
Non Oil Developing Countries	-53770 (27.9)	-54140 (30.2)	-95736 (46.3)
LLDCs	-3585.75 (6.69)	-6074.83 (5.26)	-10412.9 (9.03)
LICs	-6774.44 (23.5)	-9276.95 (16.17)	-12515.8 (29.2)
MICs	-13789.2 (47.7)	-16171.4 (45.4)	-30366.3 (51.7)
NICs	-9002 (38.75)	-5642 (81.37)	-16604 (80.6)

Calculated from IMF$_b$ Direction of Trade Statistics Yearbook 1982.

The oil deficit for the non oil developing countries in aggregate was just over a quarter of the total deficit in 1975 and rose to 46.3% of the trade deficit in 1980. There was some relationship between the income group and the size of the oil deficit as a percentage of the total trade deficit. The LLDCs experienced the smallest impact in all the years shown. There was a reduction in the proportion of the deficit as a percentage of the total deficit for the LLDCs in 1978 reflecting the decline in the oil deficit in that year. The extremely large value of the oil deficit of the total deficit for the NICs may be explained partly by the fact that these countries may have to some extent adjusted their balance of payments to the external shock without reducing their oil deficits [11]. The impact of the first oil price rise on the external account of the developing countries on the basis of the evidence in Table 2.10 was smaller than was the second oil price rise. The OPEC countries did have a large impact on

non oil developing countries in the aggregate but as the evidence in the table shows, it was not the only cause for the balance of payments disequilibrium which they experienced. The major trading partners of the non oil developing countries are the industrial countries, thus the oil prices would have had to rise higher than they did for the position of the industrial countries in the trade league of the non oil developing countries to be usurped by the OPEC countries. Michalopoulos (1975) gave figures to show that the deterioration in the current account of the non oil developing countries was due mainly to their trade with the industrial countries. Within the sphere of international adjustment the industrial countries were more likely to reduce their deficit with the OPEC countries because they have a capital goods industry with which to supply the OPEC countries with the needed imports to embark on their development programmes. As evidence earlier in the chapter has shown the industrial countries were even more likely to reduce their deficit with the OPEC countries because they would have a service account surplus with them. For these same reasons the industrial countries were able to maintain surpluses with the developing countries. The industrial countries were able to adjust to the increase in the oil price rise by increasing the export of manufactures to both the oil and non oil developing countries (Gatt 1980). For the group of non oil developing countries this was made possible largely by the external borrowing which they had undertaken during the period. The non oil developing countries on the other hand are less likely to have increased their trade relations with the OPEC countries mainly because the demand for their exports from OPEC would not increase by much since they exported a narrow range of products. The OPEC countries have always had stronger trade links with the industrial countries. It would be the newly industrialising countries which would have a greater opportunity of increasing their trade with the OPEC countries because they produced manufactures for export which have a high income elasticity of demand.

The current account deficit which the non oil developing countries had with the industrial countries was larger than it might have been if the OPEC countries had financed the deficits of the non oil developing countries directly. By depositing the bulk of their cash surplus with private banks in the industrial countries OPEC transferred the function of directly lending to the non oil developing countries to the banks. The recession in the world economy after the first oil price rise was associated with an increase in protectionism by the industrial countries [12]. This made it more difficult for the non oil developing countries as a group to reduce the oil deficit, and hence given the choice between reducing incomes or else financing the deficit, those countries which had access to the international capital market chose to finance most of the deficit thus leading to more indebtedness. In the late seventies, there was a rise in interest rates which was primarily due to the domestic policy adopted by the major industrial countries to fight inflation. This put further pressure on the current account deficits of the non oil developing countries. In discussing the external debt of the developing countries within the international framework of the 1970s these factors need to be considered.

The scenario after the first oil price rise could have been different depending on how countries responded to this shock. If the bulk of the non oil developing countries had decided to adjust more to the shock than they had done it is possible that indebtedness would be less than it is at present but at the cost of a deeper recession. As it happened it was the larger developing countries which decided to adopt more financing than adjustment to the shock, for instance Brazil which is the world's tenth largest economy. The advantage of this for the world economy in general and the industrial countries in particular was that it contributed to some amount of growth in the world economy and was quite important in contributing to the profits of the banks in the industrial countries in particular.

In Chapter One the distribution of the debt amongst creditors was discussed and it was shown that a large percentage of the debt was owed to the private lenders in the DAC countries. The OPEC countries formed only a small part of the group of creditors since the bulk of their surplus was deposited with the banks. Amongst the group of developing countries it was the low income countries which held the largest amount of OPEC debt. In 1975 they owed 4.7 billion dollars to the OPEC countries. By 1980 the amount of the debt owed to OPEC by the low income countries was larger than that owed to the private lenders. This illustrates the skewed nature of the distribution of the private financial flows as well as the OPEC flows. However, given that the private flows were the larger of the two this shows to what extent the low income countries were left out of the new trend in the international financial system. The position was reversed for the newly industrialising countries which in 1975 had less than one billion dollars of debt being owed to the OPEC countries but on the other hand had more than three quarters of their debt owed to the private lenders (OECD 1982).

Since only a percentage of the trade deficit of the non oil developing countries was owed to the OPEC countries, it will not be suggested here as has been done in some areas (see Bhaduri 1982) that the OPEC countries should have taken measures to alleviate the indebtedness of the non oil developing countries [13]. However, an increase in the direct lending by OPEC countries to the developing countries in the past could have been possible. Most of OPEC lending to the non oil developing countries was on concessional terms. It could have been possible to increase lending on non concessional terms to a wider category of developing countries than was done in the past. Several writers have suggested that there should have been a diversification away from the developed countries in the deployment of the OPEC cash surplus (Saddy 1982; Shihata 1982; Sobhan$_C$ 1980). It is possible that direct lending by OPEC on non concessional terms would have benefited the OPEC countries. This is evidenced by the profits of the banks, made by lending

OPEC funds to the developing countries. Secondly, the denomination of a large percentage of OPEC liquid assets in dollars implies that the capital value of the deposits depends on the strength of the dollar. It has been shown that over the period 1974 to 1978 the purchasing power of OPEC assets declined by 42% due to the declining value of the dollar. (Aburdene's evidence mentioned in Petroleum Economist 1979). Sobhan (1980_b) also showed that assuming a certain distribution of OPEC deposits, the current value of OPEC holdings in 1978 fell by 18 billion dollars (p 406). Their evidence shows that some diversification away from liquid assets would benefit OPEC investors. Given the reluctance of the industrial countries to allow the OPEC investors to buy up real estates or else to have substantial holdings in businesses within their economies, the OPEC investors could move to the developing countries and form partnerships with government or local entrepreneurs to set up projects and businesses etc., instead of having middle men do the job for them. The rates of return on commercial investments of OPEC have not kept up with the rate of inflation of OPEC's imports. In 1976 the rates of return on total OPEC investments was 5.04%, it rose to 5.35% in 1977 but declined to 3.72% in December, 1978 (Sobhan 1980_b pp 405 - 406). The experience varied amongst the different member countries. Venezuela had the lowest rate of return in 1976 of 2.44%. By 1978 it had declined to 2% (Sobhan op cit). This would further indicate that a diversification of the OPEC portfolio may have earned it higher rates of return. There is a hesitance to invest in the developing countries because of the economic and political risks. However, given that the World Bank and the IMF have been able to lend to the developing countries without incurring large costs it is possible that the OPEC countries with the co-operation of the former institution could have invested in projects in the developing countries, The political risk of investing in the developing countries may be no greater than investing in the industrial countries as the freezing of the Iranian assets by the Americans in 1979 has shown. The benefits to the developing countries of getting a larger percentage of the OPEC funds directly is that they may have been able to obtain loans with longer maturities to finance their

projects. Secondly by receiving the funds directly from the OPEC countries they may not have had to pay for the costs of intermediation of the private lenders. The diversification of the OPEC portfolio investments does not necessarily imply that the role of the banks would be reduced. This is because the private sectors has the advantage of disbursing funds with speed. It is doubtful that the OPEC agencies would have been much faster than the existing international agencies.

An increase in OPEC direct lending to the non oil developing countries may have changed the structure of the debt. However, this would not necessarily have influenced the growth of developing country indebtedness for the reasons discussed above.

Chapter One and Two have attempted to discuss the external indebtedness of the non oil developing countries within the framework of the international financial system of the seventies. Chapter Three will be a study of the Brazilian indebtedness within this framework. Brazil is chosen because its experience reflects some of the changes which took place over the seventies. Secondly in discussing the external indebtedness in the present situation it is the experience and position of a small group of countries which seems to be of major interest. Brazil is one of the countries within this group which has taken prominence in the present situation.

NOTES

1. The OPEC countries are included amongst the group of countries described as developing despite their large financial wealth due to their oil revenues. This is because the structure of their economies is similar to that of other developing countries. In 1960, the life expectancy at birth for the oil exporters was about 45 years. This was lower than the average for middle income countries which was 51 years. By 1980 the life expectancy at birth for the OPEC countries had risen to 56 years, though it was still lower than the average for the middle income countries which was 60 years (World Bank$_c$1982). The population growth rate is typical of other developing countries. It was 2.6% between 1970 and 1980. 39% of the population lived in urban areas in 1980 although the high income oil exporters (Saudi Arabia, Libya, Kuwait and the UAE) have a percentage of 66%. The percentage of the population with access to safe water in 1975 was 42% which was lower than the average for middle income countries, i.e. 50%. High income OPEC countries had a percentage of 88. 47% of the labour force of the oil exporting countries is still employed in the agricultural sector in 198C although this had declined from 65% in 1960 (World Bank$_c$ 1982).

2. See Sampson (1981 pp 137-142) where he describes the American officials reaction to the large amount of OPEC funds deposited in the large US banks. The officials feared that the OPEC countries might be able to hold the USA to ransom because of this.

3. Sobhan $_c$ (1980 pp204 - 208) criticises the definition of the OPEC cash surplus which is normally given, as being biased to suit the needs of the western banks

   This is because they only consider that part of the OPEC revenues available for investment primarily within the banking system. The result is that the size of the cash surplus is underestimated.

4. Singapore, Hong Kong, and other Asean countries have developed financial centres yet there does not seem to have been any significant shift to these centres over time. The OPEC countries in their investment strategy were typical of other developing countries in maintaining a strong bias in their external relations towards the industrial countries and former colonists, despite the potential for stronger links elsewhere. This may be attributed to lack of information, prestigious reasons or a mixture of both.

5. There was a great investment in dollar holdings because other major currencies were protected from being used by the authorities of the countries concerned. For example the Japanese yen and the German mark (Aburdene and Stoga 1979).

6. It was formerly called the OPEC Special Fund and was set up initially as a temporary institution.

7. These figures have been estimated from OECD tables.

8. This is based on information from OECD sources.

9. The smaller the size of the economy (GDP) ceteris paribus, the smaller the amount of energy used. For example, in Tanzania, one of the LLDCs, fuels and combustibles form 8.5% of its total imports in 1970. This rose to 18.5% in 1974. Brazil, a newly industrialising country had 12.3% of its imports in 1970 as fuels and combustibles. This rose to 33.9% in 1976 (UNCTAD 1980). Thus the large amount of oil already imported by the middle income and newly industrialisation process meant that they would have a proportionately larger oil bill and hence a larger deficit with OPEC. Some countries, for example Brazil experienced large oil deficits because their economies are based on energy derived from petroleum. Large importers of fertilisers would also be more exposed to the rise in oil prices than would other countries.

10. The GNP used was for the year 1977.

11. The large oil deficit also illustrates the extent to which some of these economies are dependent on oil. Brazil, for example, reduced its non oil imports between 1974-1978, whilst the value of it s oil imports was still rising (see Chapter Three) to 51362 million dollars.

12. Change in Exports to and Imports from Industrial Countries of Non Oil Developing Countries. Million Dollars and Percentage

	Exports To		Imports From	
	Actual Value	Percentage Change	Actual Value	Percentage Change
75/76	16313	22	-3318	-2.9
76/77	13714	15.6	17291	15.7
77/78	12556	12.3	28283	22.3
78/79	33323	29.1	34112	22
79/80	30993	20.8	46035	24.3
80/81	3637	2.0	23020	9.7

Source: Calculations based on information from IMF Direction of Trade Statistics Yearbook, 1982

The above table shows that the growth of imports from the industrial countries to the non oil developing countries was greater than was the growth in their exports to the industrial countries except in 1975/76 and in 1978/79 when the growth of exports was greater than that of imports. If it had been possible for the non oil developing countries to increase their exports to the industrial countries (through domestic policies and improved world trade conditions) the trade balance would have improved and there may have been less need for external finance. This is no attempt to put the blame of low export performance of the developing countries only on external sources.

13. On the basis of the absolute size of the trade deficit of the industrial countries the flow of the surplus to these countries may be accepted. However, given the impact of the deficit as measured by the deficit to GNP ratio and the fact that the industrial countries could reduce the impact of the oil deficit by transactions on the services account, a greater amount of the flows could have been directed towards the non oil developing countries.

Chapter Three

The Brazilian Experience 1970-1981

The Brazilian economy has been experiencing a positive real annual rate of change of its GDP since 1968. It was only in 1981 that the Central Bank estimated that there was a negative real annual rate of change of 3.5%. The period 1968-1973 was characterised by rapid growth, with an average annual real growth rate of 10%. In 1973 the real annual rate of change of the GDP was 14% (Central Bank of Brazil 1981). There was an immediate slowdown in the growth rate after the quadrupling of the oil prices. The real annual growth rate declined to 9.5% which was still very high when compared with other countries. On average the real annual rate of change between 1974 and 1978 was about 7%. In 1979 the annual real rate of change was 6.8% rising to 7.9% in 1980. The decline in the growth rate in 1981 was mainly due to a decline in the industrial and services sectors. (Central Bank of Brazil 1981). The high growth rate of Brazil in the seventies compared to other middle income, countries may be attributed partly to a decision by the authorities not to allow a large decline in the growth rate and Brazil's access to large amounts of external finance which reduced the need for adjusting downwards to the balance of payments disequilibrium which occurred after 1974.

The high growth rates experienced in the 1968-1974 period have been attributed partly to the inflow of external finance and the growth of external indebtedness (Cline 1981 p 105; Malan and Bonelli 1977 p 24)[1].

The structure of the Brazilian economy has been changing since 1960. The contribution of agriculture to the GDP has declined from 16% in 1960 to 11% in 1979. Industry and the service sector have been growing rapidly and in 1979 were contributing 39% and 51% each to the GDP. This change in the structure of production is reflected in the export sector. Industrial products formed about 56.5% of total exports in 1980 whereas in 1970 they comprised only 20% (UNECLA 1980).

Brazil's experience has differed from that of a majority of the developing countries, especially those in Africa. For example Tanzania experienced a growth rate of 2.3% over the period 1960-1979 whilst Ghana had a negative growth rate of 0.8% over the same period (World Bank$_c$ 1981). These countries still depend on primary products for more than 60% of their total exports and have a very small industrial sector. Despite the differences in the growth and structure of production Brazil still has some common features with the other developing countries. For example it had a high population growth rate of 2.2% in 1970-1979 compared to 0.7% for the industrial countries. This is lower than Tanzania and Ghana which had population growth rates of 3% and 3.4% respectively over the same period. It has a high infant mortality rate of 92 per thousand comparable to Kenya which has a rate of 91 (World Bank $_c$ 1981).

The World Bank (1981$_c$) categorises Brazil as a middle income country. The Brazilian economy can be described as one in transition. This because it has strong features of growth and its structure of production is changing to become similar to that of the industrial countries. However, it s socioeconomic features are still similar to that of other developing countries, but are likely to change gradually over time. It will be suggested here that describing Brazil as a developing country is quite adequate since the economy has been experiencing growth and structural change. In fact some other countries described as being developing countries may be inappropriately categorised since, despite the fact that they may have low per capita incomes, they are not experiencing any growth or structural change at least within the past ten years.

1 The Brazilian External Debt: Its Size, Structure and Growth 1970-1981

Brazil has a long history of borrowing abroad to finance investments and balance of payments deficits. It has experienced some debt problems in the recent past when in 1961 it had to reschedule it s debt to prevent a declaration of default and again in 1963 (Donnely 1972; Syvrud 1974 p. 182-86)

The size of it s debt outstanding has grown since then so that by 1981 it had the largest outstanding debt disbursed (65.6 billion dollars) and the largest debt service of the non oil developing countries (17.3 million dollars). (OECD 1982). The growth of debt varied over the period under review. Table 3.1 shows the different estimates of disbursed debt outstanding made by the Central Bank of Brazil and the World Bank. The real debt was calculated by deflating the nominal debt figures by Brazil's export unit value.

The Central Bank of Brazil figures include private non guaranteed debt. Between 1970 and 1973 the annual rate of change of nominal debt rose continuously as measured by the World Bank. In 1974 the annual change peaked at 44% over the previous year. It was not until 1978 that there was another sharp rise in the growth of the nominal debt outstanding. This was 49% for World Bank estimates and 35.8% for the Central Bank of Brazil estimates. This increase in 1978 was mainly because the Brazilians were taking advantage of the favourable conditions existing on the international capital market (Central Bank 1978 pp 157-158). Between 1979 and 1981 the annual change in the growth of nominal debt was less than it had been in the previous periods. The real debt rose less fast than did the nominal debt, even though it began from a larger base. The larger real debt figures between 1970 and 1973 is because of the rather low export unit value during this period compared to the following periods.

Table 3.1

Total Outstanding Debt Disbursed of Brazil 1970-1981
Nominal and Real (Million US Dollars)

	World Bank		Central Bank of Brazil	
Year	Nominal	Real	Nominal	Real
1970	3680	6943	5295	9905
1971	4349	8527	6622	12984
1972	5444	9386	9521	16415
1973	7479	9467	12572	15913
1974	10794	10794	17166	17166
1975	13168	13168	21171	21171
1976	17224	14977	25985	22595
1977	21450	15212	32037	22721
1978	32028	24824	43511	33729
1979	35928	25301	49904	35413
1980	39153	25929	53847	35660
1981	43998	30984	61411	43247

Source: World Bank World Debt Tables 1977, 1980, 1982
Washington D.C.

Central Bank of Brazil Annual Reports
Brasilia.

The growth of debt outstanding was not due only to the external shocks experienced by the Brazilians in the seventies. External debt was growing rapidly in the 1970-1973 period before the first oil price rise. Except for the surge in the rate in the 1973-1974 period the average annual rate of change from 1975 to 1977 was less than in the 1970-1973 period.

Debt per capita was rising with the total debt outstanding. Real debt per capita, based on Central Bank of Brazil estimates rose from 107.05 dollars in 1970 to 199.29 dollars in 1975 to 289.94 dollars in 1980. Given that the total population is not of working age and that within the 15-65 age group there is unemployed labour the burden of debt on the actual working population was higher than these figures indicate[2].

During the seventies there has been a gradual shift towards private sources of lending. In 1970 about 42% of the external debt was owed to private lenders, by 1974 this had risen to 68.2% and was 84% of the total in 1981 (World Bank$_b$). Brazil represents those few developing countries which have had access to large amounts of finance from the international private capital market. Very few low income countries were able to borrow large amounts from these sources. For example Tanzania in 1970 had 37% of its debt outstanding owed to private lenders. By 1975 the amount owed to private lenders declined in both absolute and relative terms (World Bank$_b$ 1980). On the other hand there was a continuous disbursement from official sources so that by 1979 about 95% of it s debt outstanding was owed to official lenders. Tanzania may be considered as a special case since even though some countries may have a large percentage of debt owed to official sources they did not have large access to such sources of finance when official debt is measured on the basis of population or GDP [3]. Borrowing from commercial sources was a deliberate policy of the Brazilians. They have been described by Wellons (1977) as 'eager' borrowers on the capital market.

In a pamphlet published by the Central Bank of Brazil, in September 1973 borrowing from the private capital market was justified on the basis of reduced official flows. It could be argued that if the private lenders were not willing

to lend to Brazil on the scale which they did the Brazilians would have had to reduce their targeted resource gap and possibly the external debt would have grown at a slower pace than it did.

Financial (currency) loans were the main types of loans negotiated. In 1973 they accounted for 62.3% of the debt outstanding. This rose steadily to 73.2% in 1981 (Central Bank of Brazil 1981). Suppliers credit accounted for 11% of the debt outstanding. Bond financing became important in the late seventies. The bond market is limited to very few developing countries. Borrowing on the bond market became a deliberate policy of the Brazilians in the mid seventies in an attempt to improve the debt profile because of the relatively favourable conditions of this type of loan (Central Bank 1978 p 159). Very little of the Brazilian debt was owed directly to OPEC. As Chapter Two has shown, the Latin American countries and the newly industrialising countries received a minimal proportion of the direct OPEC flows. Given that Brazil is one of the largest oil importers it would be assumed that there would be a larger flow of non concessional finance to this country. Even if the criterion suggested by Crocket and Ripley (1975) is used Brazil should have received a greater amount of direct OPEC flows. However, as Chapter Two showed, due to political as well as economic and financial considerations, the direct funds from OPEC to the developing countries went to the Arab and Muslim countries and a large percentage of the cash surplus was deposited in the financial markets of the developed market economies. Thus in 1975 Brazil owed 25 million dollars to OPEC which was equivalent to 0.1% of the Brazilian debt. In 1980 debt owed to OPEC rose to 573 million dollars equivalent to 1% of the debt owed (OECD 1982p.58). It is impossible to discover how much of the OPEC funds deposited with the banks got to Brazil. However, Brazil was one of the large recipients of recycled OPEC funds from the banks.

Brazil has a large private sector debt. This is debt which is not guaranteed. In 1978 the public sector accounted for 63% of the total debt outstanding. Private debt was 16 billion dollars in that year and had grown by 25% above the 1977 level. Most of it was currency loans and debt incurred by multinational companies (UNECLA 1978 p 123). The World Bank figures do not take account of this large amount of debt outstanding. In a situation of exchange controls it is important to take account of this type of debt since the holders of this debt will also require foreign exchange to service their debt and so will also have claims on the foreign exchange reserves of the country. This can put additional pressure on the exchange rate.

Debt service payments have been growing with debt outstanding, although after 1977 the annual rate of change of debt service payments was faster than the annual rate of change of debt outstanding. In the period 1978-1979 the nominal debt service payments rose by 32% whilst the debt outstanding rose by only 10% (Central Bank of Brazil 1981). Interest payments have also been growing faster than amortisation of the debt over the period 1973 to 1981. In 1973 interest payments on the debt was 514 million dollars and equivalent to about 20% of the total debt service payments (Central Bank of Brazil 1981). This increase in the weight of interest payments in the total debt service can be explained mainly by the structure of the Brazilian debt. A large percentage of Brazilian debt is owed to the private lenders and at least 60% of the debt has floating interest rates. Thus with the increase in the interest rates in the late seventies as well as increasing spreads above the London Interbank Offer Rate (LIBOR) being put on the Brazilian loans, the interest payments have been increasing rapidly. The increasing interest payments has put some rigidity into the Brazilian current account. This is because the interest payments have to be paid. It indicates that if the export earnings do not rise very fast for some of the interest payments to be made out of these earning it is possible

that the Brazilians will be locked into a long term debt simply to pay off for financing the debt service payments.

The debt service ratio and other indicators of the debt burden have been increasing over the period 1973-1981. The debt service ratio, i.e. the ratio of debt service payments to export earnings, was 42% in 1973 (Central Bank 1981). This is high above the critical level of 20% above which a country is assumed to have debt problems (see Chapter One for a discussion of the effectiveness of these measures as an index of a country's indebtedness). These high debt service figures did not stop the foreign bankers from lending to Brazil indicating that despite the high debt service ratios the bankers still considered Brazil to be a good risk. In 1977 the debt service ratio had risen to 51% and in 1981 it was 72% (Table 3.2). Other indicators of indebtedness for example the ratio of debt outstanding to GNP and debt outstanding to exports were rising over the period. The net flow of funds rose rather slowly over the period 1972-1977 (see Appendix Table 1). It rose sharply in 1978 but there was a continuous decline after that year until 1981. This to some extent may explain the growing ratio of debt outstanding to GNP. This is because even though the debt outstanding and disbursements were growing a large amount of the disbursement was being used to service the debt so that the amount left for investment (assuming that all external funds should be used for investment) to generate growth of income was less than would be expected. The ratio of debt service to disbursement has been increasing over the period and in 1979 this was 70.5%. This growing dependence on external finance to service the debt indicates that if there was a supply constraint given that in the short run exports cannot rise fast enough to make up for the loss, there would be difficulty in meeting debt service payments. The present situation of a large portion of the debt not contributing to either domestic consumption or

investments means that future generations will have to pay for external loans which did nothing to contribute to growth in the economy. They will be working to pay off loans which themselves were incurred to pay off past debts. There is thus an outflow of resources from the economy which should have been retained. This form of indebtedness in the latter part of the 1970's may be described as a dead weight loss.

Table 3.2

Indicators of the Debt Burden of Brazil (Percentage) 1973-1981

	1973	1974	1975	1976	1977	1978	1979	1980	1981
Debt Service 1.	13.2	13.1	16.6	18.1	21.3	31	36.2	34.4	31.9
Debt Service 2.	42.0	33.0	42.0	48.0	51.0	64	70.0	65.0	72.0
Interest Service Ratio		6.3		8.5	8.9	12.8	16.2	18.0	18.5
Debt Outstanding/ GNP		10.1		11.4	12.6	15.0	15.8	16.3	16.0
Debt Outstanding/ Exp		116.7		156.2	163.7	209.7	198.0	168.1	163.0
Reserves/Debt Outstanding		50.0		37.8	33.7	40.2	27.6	17.6	17.0

Source:1. World Bank World Debt Tables 1980, 1982 Washington D.C.
2. Central Bank of Brazil Annual Report 1981 Vol 18 No.2 Brasilia

Brazilian Policy Towards External Borrowing 1970-1981

In 1973 the Central Bank of Brazil published a pamphlet entitled 'The External Sector and National Economic Development' which outlined the authorities policy towards external borrowing. It stated that a country could develop faster when it had access to both domestic and foreign savings. This could be done by maintaining a resource gap with imports larger than exports but with both growing over time (Wellons 1977pp 104). It was also recognised that debt would increase over time since exports

could not grow very fast; but this debt need not be detrimental to the economy. The external resources were also required to finance the debt service and build up international reserves. The purpose of borrowing by Brazil was not to direct all resources so obtained to the export sector, but to ensure growth within the entire economy [4]. Domestic policy would ensure that resources were available for servicing the debt.

The success of the Brazilians in increasing their international reserves as a result of the borrowing policy can be seen from Table 3.3. The decline of the reserves in 1974 and 1975 is due to the large trade and current account deficits experienced by the Brazilians in those years and the lack of sufficient flows from abroad to finance the deficits. At the end of 1972 the authorities had been concerned about the possibility of the large flow of funds contributing to increasing the money supply and inflation; as a result they put restrictions on the inflow of external resources (UNECLA 1975 pp 122) [5]. Thus at the time of large deficits they needed to reduce the barriers to the inflow of external finance as well as draw down on their reserves to finance the deficit.

Table 3.3

International Reserves and Total Change in Reserve Holdings of Brazil 1970-1981 (U.S. Million Dollars)

	1970	1971	1972	1973	1974	1975	1977	1978	1979	1980	1981
ıl Reserves ıs Gold	1142	1696	4133	6360	5216	3980	7192	11826	8966	5769	6604
ıge in erves	-530	556	-2437	-2227	1144	1235	-712	-4638	2860	3321	-752

(-) Increase in reserves over previous year

Source: IMF International Financial Statistics Yearbook 1982, p 124 Washington D.C.

There was another decline in reserves in 1979 and 1980 during the time of the second oil price rise. The large trade deficits at the time as well as reduction in disbursements in 1980 contributed to the decline in reserve holdings. For external borrowing purposes the need to increase international reserves is based on the 'confidence effect'. An increase in international reserve holdings is an index of creditworthiness. Large reserves will encourage an inflow of external resources since it indicates that creditworthiness has improved. This explains the Brazilian policy of holding large reserves. However, international reserves are only one out of several variables which influence creditworthiness [6]. The holding of international reserves also needs to be considered in terms of their opportunity costs. Instead of being held these funds could be invested in projects which would earn a real rate of return. Even when these funds are redeposited in the international capital market there is still a cost in terms of the difference between the rates at which the funds were borrowed and the deposit rate. However, insofar as the creditors realise that their loans are available to be repaid when they fall due this may cause them to continue lending to the borrowers. These costs and benefits need to be considered by the borrower.

The Brazilians borrowed abroad on the basis that there would be a continuous roll over of the debt as well as an adequate debt management policy to ensure that there would be no illiquidity problems. The Central Bank of Brazil in its September 1973 publication used the coefficient of vulnerability [7] to show that despite continuous borrowing and a rising debt service ratio the economy was less vulnerable to illiquidity problems due to interruptions in the inflow of external resources. The coefficient of vulnerability is:

> ' the proportion of annual exports receipts needed to meet any part of the annual debt service remaining after international reserves (reduced by their trade component an amount needed to finance three months imports) have been liquidated to service the debt '
> (Wellons 1977 ,p 104)

In 1972 the coefficient of vulnerability as measured by the Central Bank of Brazil had declined to 35% from 59% in 1968 (Wellons op cit pp 105). The debt service had at the same time risen from 960 million to 2302 million dollars. The coefficient is favourable the higher the export earnings, the lower the trade component of the interntional reserves and the more favourable the loan conditions. Between 1968 and 1972 the imports grew faster than exports. The coefficient became more favourable mainly because of the growth in international reserves reducing the trade component. The coefficient of vulnerability declined further after 1972 until 1976 when it rose again (Central Bank of Brazil 1978 pp 168). It became favourable again in 1977 although it rose in 1978. Over the entire period there was a downward trend in the coefficient thus implying that the policy of borrowing for the Brazilians was a safe one. Although the coefficient may be an indicator of past and present situations it cannot be used to predict future occurrences. For instance the rise in the oil prices increasing the value of imports and the rundown of reserves would cause the coefficient to deteriorate immediately. It also does not take into account the opportunity cost of holding such reserves. Thirdly the improvement in the Brazilian index over the period was more a function of external borrowing itself and the resultant build up of reserves than an improvement in export earnings.

To encourage foreigners to supply working capital to the Brazilian economy Instruction No. 289 was passed by the authorities in 1965. It provided short term credit mainly to subsidiaries of foreign firms in Brazil. The inflow of funds was subject to certain ceilings but it was possible to obtain the equivalent foreign exchange free of restrictions or guaranteed deposits on the spot exchange market with an authorised bank between 60 and 360 days after the inflow of the funds. The Instruction was removed in 1972 because it was found that local Brazilian firms were not benefiting from it. The multinational corporations because of their global operations were more well known in the international private

capital markets, as most likely they were closely linked with the banks. They were therefore more likely to receive the loans from abroad. Secondly the local Brazilian firms required small sums of finance which would not be dealt with on the international capital market (Wellons ibid p 288). The existence of this facility also had an effect on the domestic money supply. This however, was more a function of the management of the exchange rate system than the Instruction itself (Syvrud 1974 p.191) There was another channel whereby external resources could enter the Brazilian economy. In 1967 the National Monetary Council (NMC) issued Resolution No 63 which allowed commercial, investment and development banks to borrow from external sources and then on lend the cruzeiro equivalent to local borrowers with the borrowers bearing the risk. The purpose of the Resolution was to give local industry access to funds from abroad. The amount which the banks could lend to a single borrwer was limited and the conditions of the loans which the banks undertook from abroad was determined by the NMC (Wellons ibid). The ultimate borrowers of the loans were to be enterprises involved in manufacturing or the distribution of goods and services (Wellons ibid). The domestic banks could not provide sufficient funds to meet local demand becuase due to the composition of their assets they could only lend on a short term basis. State institutions were the main source of medium and long term finance. The procedure involved in obtaining these funds however, was very long (Wells 1973). Thus allowing the banks to borrow on the international capital market to on lend to domestic borrowers increased their participation within the domestic economy. The inflow of funds under Resolution No 63 has increased rapidly as Table 3.4 shows. The largest source of external finance and a third channel whereby financial loans enter Brazil is Law 4131 of 1962. Under this law companies can directly negotiate for foreign finance themselves. The outflow of finance under this law is by arrangement made when the loan was registered. The advantage of this is that it encourages the inflow of capital. The

disadvantage is that it does not take into account what the future situation of the balance of payments could be so that it is possible that undue pressure can be put on the balance of payments. All foreign capital which enters Brazil has to be registered with the Central Bank of Brazil in accordance with this Law. Foreign currency loans entering Brazil under Law 4131 account for at least 60% of the total foreign currency loans.

Table 3.4

Foreign Currency Loans in Brazil 1970-1981 (US Million Dollars)

	1970	1972	1973	1974	1975	1977	1978	1980	1981
s. No. 63 of .8.1967	653.2	2018.4	2398	3319	3734	5240	7273	9924	13456
struction No. 9 of 14.1.1965	381.2	207.4	71.1	68.9	46.1	26.8	27	9	8
w No. 4131 3.9.1962	1250.2	3302.5	5379	7823	10781	16262	22200	27886	31520

Source: Central Bank of Brazil Annual Report various issues Brasilia.

Foreign currency loans accounted for 62% of the total foreign debt of Brazil in 1973 (Central Bank of Brazil). By 1981 they accounted for 73.2% of the total. The growth of debt owed to the international private capital market is due to the inflow of finance primarily through these channels. The Brazilian authorities by making these laws encouraged the borrowing from the Eurocurrency markets.

The favourable policy of the Brazilian authorities towards external borrowing especially in the early seventies explains to some extent the large external debt which they presently have as well as some of the debt service problems. This is because loans incurred in the early and mid seventies were due for repayment in the early eighties. The policy of maintaining

a balance of payments surplus to some extent did not have the advantages which one would assume, since it resulted in the growth of indebtedness and made Brazil more vulnerable to the changes in the international environment in the late seventies and early eighties.

The Conditions of the Loans Undertaken by Brazil Between 1970 and 1981

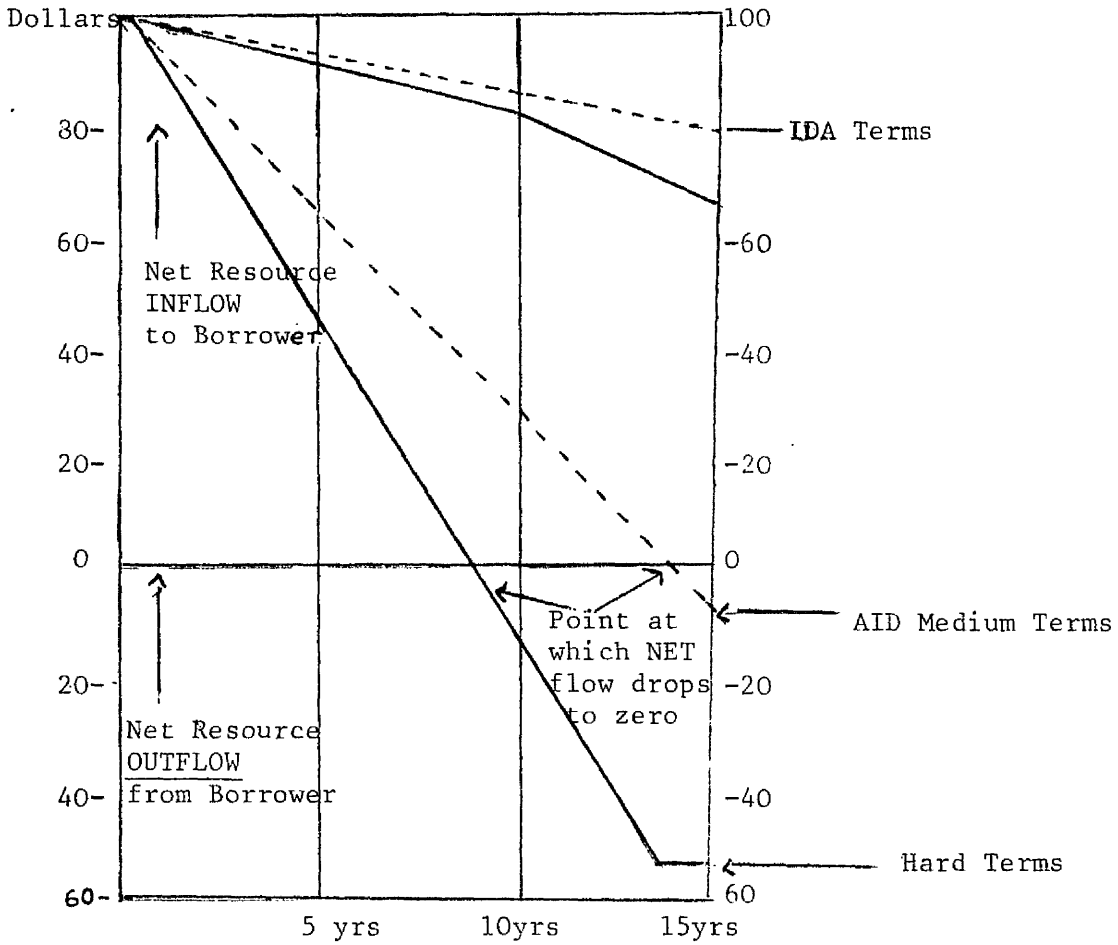
The conditions of the loans borrowed by Brazil over the period is also important in explaining the increasing indebtedness as well as the growing burden of debt measured by the debt burden indicators. It can be shown that unless the period of borrowing is strictly limited and the conditions of the loan favourable, it is doubtful that repayment of debt can occur in the medium term (Ohlin 1966 p.19-2) Reduced loan terms make the period of borrowing longer for a given repayment period. The second advantage of soft loans is that the net flow of resources is larger so that gross borrowing is lower and the growth of debt outstanding reduced. Chart 3.1 illustrates this. Under the softer loan terms of the International Development Association there is about an 83 dollar resource inflow in the fifteenth year. Under the harder terms on the other hand net inflow falls to zero by the ninth year and by the thirteenth year the borrower is making a net outflow of about 47 dollars (see Chart 3.1).

Brazil has been borrowing continuously over the seventies. This would indicate that even if a single lender or loan package is repaid, it will be difficult for the Brazilians to reduce their debt outstanding without there being a large reduction in the growth of income.

The terms of the Brazilian loans from the private capital market were a function mainly of the state of the capital markets and the view which the lenders had of Brazil. Loans from the official

CHART 3.1

Decline in Net Flow of Resources if Gross Lending is Maintained at a Fixed Level of $100 per year



International Dev. Association Terms (IDA) ¾ of 1% interest and 50 yr maturity (including a 10 year grace period.
Medium AID Loan terms 3½% interest and 20 year maturity, including 3 year grace period.
Hard Terms. 5½% interest and 13 years maturity including 3 year grace period.

Source: AID (1965) Loan Terms, Debt Burden and Development AID April

sources would to some extent also be a function of conditions existing on the international capital market.

The International Capital Market 1970-1981

The period 1970-1973 was one of rapid growth in the international capital markets and it saw also the growing participation of the developing countries in the market. The increase in commodity prices of the developing countries during this period increased their creditworthiness. They were also experiencing high growth rates which further improved their creditworthiness. The increasing use of syndication as well as roll over credits further lowered the risk of lending to the developing countries thus encouraging more banks to participate. Conditions of lending were quite favourable during this period. There was not much difference between the rates of interest on the private and official loans, thus making borrowing on the capital markets more attractive to the developing countries. The loans had grace periods and the average maturity of the loans was about 10-12 years with small spreads above the LIBOR [8] (Bird 1980_a, Wionczeck 1979).

Growth in international lending continued until the first half of 1974. The relative excess supply of loans which had previously existed was removed due to large current account deficits and the need for financing resulting from the rise in the oil prices. The supply of funds on the market was increased due to the placement of a large percentage of the OPEC surplus in the Eurocurrency market. On aggregate a greater percentage of the current account deficit of the middle income countries was financedby commercial loans. International net lending from banks to both the developed and developing countries rose from an average of 27 billion dollars in the 1970 to 1973 period to 50 billion dollars in 1974 (Williams 1980 pp 24). Activity on the bond market was low in 1973. This is because there was a situation of inverse yield curves thus making investment in the bond market unattractive (Versluysen 1981 pp 106-108)[9]. This weakness in the bond market contributed to growth in the credit side of the market.

In the second half of 1974 there was a slowdown in the international capital market and conditions hardened considerably. There was a banking crisis in the second half on 1974 due mainly to losses made on the foreign exchange market (Versluysen 1981 pp 104-108). This created uncertainty within the interbank market and it became difficult for banks to obtain funds for refinancing purposes. The premium the banks had to pay on the loans was 2% above the LIBOR which was above the yields they would receive on their own loans (BIS 1975). The uncertainty in the market caused depositors to shift their funds into short term, overnight and call deposits leading to a mismatch in the medium term loans of the banks. Some banks withdrew from the market and there was a shift away from balance of payments financing to project loans (BIS 1975; Williams 1980 p26). The result of these actions was to reduce the supply of funds available on the market for lending, increase the cost of lending and shorten the maturities. The average spreads above the LIBOR rose from the third quarter of 1974 until the third quarter of 1975. Maturities declined over the entire period of 1974 and 1975 (table 3.5). The spread above the LIBOR is a function of several variables. In a study of the factors determining this, Johnston (1980) found that the lending risks, level of the LIBOR, the banks capital asset ratio and the cost of supply of funds from wealth holders were important variables. (Williams 1980) also includes the intensity of interbank competition and the duration of the loan as factors determining the spread above LIBOR.

Table 3.5

Publicised Medium Term Credit Commitments. Evolution of Volume and Terms 1974 and 1975

	Credit Commitments (million US dollars)	Average Spread(%)	Average Maturity(%)
1974			
First Quarter	6450	0.82	8.73
Second "	12392	0.71	7.92
Third "	4575	0.87	7.60
Fourth "	3593	1.25	7.13
1975			
First Quarter	3114	1.44	5.63
Second "	4830	1.51	5.25
Third "	4830	1.53	5.23
Fourth "	7202	1.49	5.10

Source: Williams, R.C. (1980) International Capital Markets. Recent Developments and Short Term Prospects pp 26 International Monetary Fund, Washington D.C.

The maturities of the loans are a function more of the state of the market than of lenders' risk perception (Williams op cit). The contraction in the market is reflected in the decline in commitments made in the third quarter of 1974. The reduction in the supply of finance available on the international capital market coupled with the increased demand due to the balance of payments deficits made the criteria for lending to countries more stringent. Countries with low ratings on the creditworthiness scale which would previously have had access to funds no longer qualified for them.

The impact of the higher spreads was to some extent offset by the decline in the six month Eurodollar rate which fell from 11.2% in 1974 to 7.6% in 1975 (Table 3.6). In 1976 the reduced balance of payments deficit of the industrial countries reduced the pressure of demand for loans and made possible an increase in the funds going to the developing countries. Confidence in the Eurocredit market had been restored due to the Governors of the Central Banks of the Group of Ten promising to give backing to the banks. The Federal Reserve Bank was willing to act as lender of last resort to banks facing illiquidity problems (BIS 1975). The improvement of the bond market at the same time also meant that industrial countries could tap that source of finance, so reducing pressure on the Eurocredit markets.

Table 3.6

Terms on Publicised Medium Term Credit 1973 - 1982

	Six Month Eurodollar	Average Spread (%) Industrial	Developing	All	Average Maturity (yrs) Developing	All
1973	9.32	0.64	0.99	0.78	9.64	
1974	11.20	0.69	1.02	0.83	8.19	
1975	7.61	1.37	1.56	1.47	5.20	
1976	6.13	1.31	1.57	1.47	5.35	
1977	6.42	0.96	1.40	1.22	6.17	
1978	9.36	0.75	1.16	0.98	8.10	8.25
1979	11.99	0.60	0.83	0.75		8.75
1980	14.15	0.55	0.86	0.69		8.0
1981	16.51	0.48	0.93	0.71		7.75
1982 1	15.17	0.49	0.80	0.64		7.0

1: First Quarter

Source: Williams (1980) International Capital Markets. IMF p. 26 Washington D.C.

Williams and Johnson (1982) International Capital Markets IMF p 69 Washington D.C.

In 1976 there was a decline in the average spread above the LIBOR and maturities began to lengthen. There was also a return of banks to the international capital market. Banks were encouraged to move here because of slack in the domestic economies of the industrial countries. Increased competition by the banks for borrowers induced a fall in the spreads above the LIBOR (see Table 3.6). The higher spreads above the LIBOR of the developing countries compared to the industrial countries is an indicator of the higher risk which was attached to the developing countries by the lenders. Commitments and lending increased. Commitments of medium term credit to all countries rose from 34185 million dollars in 1977 to 73724 million dollars in 1978. For the developing countries this increased borrowing was due mainly to a build up of their reserves (Williams 1980). Brazilian reserves peaked in 1978 and borrowing was to take advantage of the increased liquidity (Central Bank of Brazil 1978) Increased lending by the US banks and an easy stance on capital outflows by the industrial countries contributed to the increase in the supply of funds in 1978 (BIS 1979). 1979 saw the re-emergence of the OPEC cash surplus and global balance of payments disequilibrium. The rise in nominal interest rates had a dampening effect on activity on the Eurobond market, thus increasing activity on the Eurocredit market. The high rates had a dampening effect on the growth of demand for finance due to balance of payments disequilibrium. There was scepticism about whether the banks would recycle the OPEC cash surplus on the scale of the first oil price rise (BIS 1979, 1980). This was because banks were already highly exposed to some of the major deficit countries. Medium term commitments declined slightly in 1980 to 32.3 billion dollars, but rose again in 1981. In 1981 maturities shortened slightly and there was a slight rise in the spreads above LIBOR for the developing countries compared to the previous year. Spreads above LIBOR for the industrial countries fell in 1981 (Table 3.6) The increase in spreads of the non oil developing country loans is in response to the increased risk threshold of the lenders vis a vis the developing countries

because of their increased exposure. Concern about bank exposure within the Central Banks resulted in certain guidelines being established by the Central Banks of the UK and the US (Williams and Johnson 1982).

2 Lending to Individual Countries

The interest rate and spreads above the LIBOR are used as measures to protect the lender against the risk of default. There are limits beyond which the spreads can rise. In such circumstances the lender may impose credit rationing (Kapur 1977). The bankers estimation of the creditworthiness of borrowers determines the conditions and the supply of loans. In a study made by Kapur (1977) to find the factors which determined the supply of funds to the developing countries five variables made up his index of creditworthiness. The five variables were the gross claims outstanding of the banks on individual countries at the end of the previous period, the average annual rate of growth of real GNP over the current and previous period, exports of goods and services and the projected debt service ratio. These variables were regressed against the increase in the gross flow of funds to individual countries and were all found to be significant. Non quantifiable variables are also important in determining the supply of funds and the conditions of loans to individual countries. An example of such variables is the relationship between the borrower and the industrial countries and political stability (Cohen 1981 pp 82 - 84; Wellons 1977 pp 67 - 70). The variables used by the bankers to measure the creditworthiness of the country are similar to those discussed by Kapur [10]. For example the check list system is used by bankers to rate or score individual countries using quantifiable and non quantifiable variables (Cohen 1891 pp 86-90; Thornblade 1978). The variabes used in the check list system described by Thornblade fall into three main groups. The first group is a measure of development . The second group is a measure of the rate of development and the third group is a measure of international liquidity.

In a survey of the different methods used in country risk analysis it was found that the banks embarked on this mainly to set country exposure limits and improve the quality of their portfolio. There were certain variables which were used by all banks. These were the GNP per capita or growth, inflation rate or growth of money supply the budgetary balance of the Central Government, the domestic savings ratio and foreign trade related variables (Burton and Inoue 1983). Lomax (1983) has criticised the entire recycling process which occurred in the aftermath of the oil price rises. The attitude of the central banks and governments to this phenomena encouraged low creditworthiness standards. He states that the normal creditworthiness criteria was not adhered to and the lenders only used methods which were subjective to their requirements. Some of the variables used, for example the existence of raw materials has been critised on the basis that the loan will not be repaid in kind. The credit criteria which Lomax suggests is that the country should have reserves which result from export activities and not from borrowing for revenue building purposes. Secondly the debt service ratio should be not more than about 20%. His liquidity criterion is a strengthening of the usual measure of liquidity used by the banks. In fact it is possible that if this measure was used there would have been a large slowdown in the rate of disbursements going to Brazil. However, Lomax's second criterion is subject to the criticism made in Chapter One about the usefulness of the debt service ratios.

Brazil experienced higher spreads than did other developing countries in general (Table 3.7). The high spreads for Brazil reflect the conditions existing on the interntional capital market during the period 1974 and 1975 and after 1979, the risk perception of the lenders and the policy of the Brazilian authorities. On a scale rating Brazil performs better than most developing countries on the basis of the first two of Thornblade's three groups for the checklist system. This explains the continuous supply of funds to Brazil compared to other developing countries say Tanzania and Ghana. However, being one of the largest developing country

borrowers on the capital markets, it would, over time, become of increasing importance in the bank's portfolio. This would explain the higher spreads. In 1977 the ratio of Brazilian loans to bank capital of the 9 largest US banks was 47.9%. For all US banks this ratio was 33.2% (Federal Reserve Bank). By June 1982 Brazil owed 46382 million dollars to the banks (Williams and Johnson 1982). In 1976-1978 when the spreads were falling for all countries in aggregate they were still rising for Brazil. It was not until 1979 that they began to fall but were still higher than the average for the developing countries. Brazilian authorities preferred to trade off longer maturities for higher spreads. This is evident that from Table 3.7 (see also Euromoney 1981 where there is an interview with J.C. Madera Serrano). The extent to which the Brazilians can arrange this depends also on the lenders, since as their exposure to a country rises, they may be less likely to lend for long periods.

The terms of official loans to Brazil were more favourable compared to the private loans. Official loans however, became harder over the period. In 1972 the interest rate of official loans was about 6.8 (World Bank$_b$ 1982).

This rose slowly over the period to 9.8% in 1981. Maturities also declined from 19.5 years in 1972 to 13.8 years in 1981. The value of the grant element on new commitments was 19.7% in 1972 but declined to 2.1% in 1981. This contrasts with the private loan commitments which in 1981 had a grant element of -28.4% (World Bank$_b$ 1982).

The increasing hardness of the Brazilian loans shows that to receive a certain net flow of resources gross borrowing had to rise continuously. This explains partly the growth of debt outstanding. It is however, also a function of the general policy towards external borrowing.

Table 3.7

Lending Conditions for Brazil Compared with Other Countries

	Developing Countries		Brazil		France
	Spread (%)	Maturity(yrs)	Spread(%)	Maturity(yrs)	Spread(%)
1974	1.02	8.19	1.23	10.2	0.58
1975	1.56	5.20	1.70	6.9	1.42
1976	1.57	5.35	1.91	9.1	1.09
1977	1.40	6.17	1.96	8.1	0.92
1978	1.16	8.10	1.59	9.2	0.63
1979	0.83		1.08	11.1	0.39
1980	0.86		1.18	8.9	0.39
1981	0.93		1.92	8.0	

Sources: First two columns are from Table 3.6

Information on Brazil and France obtained from Bacha and Alejandro (1982). International Financial Intermediation : A Long and Tropical View p 19. Essays in International Finance. Princeton University Princeton

The Effect of the Loan Conditions on the External Account of Brazil

The average maturity of the loans and the debt profile is important in its effects on the balance of payments. A bunching of the repayments implies that not long after the loan is negotiated there is a large outflow of funds from the capital account which if there is also a current account deficit needs to be financed as well. In 1968 the debt profile was highly unfavourable. 26% of the debt had to be repaid in the first year. The NMC in 1971 stipulated that the inflow of short term funds in one month should not be greater than those maturing that month. In 1972 minimum maturity requirements of about 8 years was imposed on the loans coming into Brazil to help improve the debt profile (IMF_a 1973).

The percentage distribution of repayments improved, although the value of amortisation increased over the period (Table 3.8). The maturity profile of the currency loans is less favourable compared to other loans (Table 3.8). This reflects the fact that they were obtained from private lenders. In 1979 the debt profile was slightly less favourable compared to other years. 65% of the debt was to be amortised in the following 5 years. It improved slightly after in 1980. The Annual Report (1979) of the Central Bank of Brazil recognised that the growth in amortisation and the condition of the debt profile was the result of

> 'domestic policy with regard to the foreign capital inflow and the degree of liquidity existent on the international market'
> (Central Bank 1978 p 169)

Nominal amortisations increased by about three times over the period 1970 - 1981. This reflects the growth of debt outstanding as well as the maturity structure of the loans. Real amortisations grew less fast than did the nominal amortisation. Real amortisation was equivalent to about 4548 million dollars in 1981 compared to nominal amortisation of about 7690 million dollars (Table 3.9).

Interest payments have been growing rapidly over the period 1973-1981. They grew faster than did amortisation payments over the same period (Table 3.9). The impact of interest payments on the external account is shown by the ratio of interest payments to the current account deficit. This has increased from 23% in 1973 to 78% in 1981 (Table 3.9). This growth in interest payments is due mainly to tne rise in the LIBOR in the late seventies and the high spreads above the LIBOR experienced by Brazil. A reduction in the spreads and the LIBOR would reduce the interest payments and the current account deficit so reducing the need for adjustment and financing of the deficit. The disadvantage of the large interest payments is that they are contractual obligations and thus take priority of the export earning. This indicates that in order for the import requirements to be met, borrowing would be

Table 3.8

Foreign Debt Profile of Brazil [1] - Fixed Maturity Debt

Item	1st yr	2nd yr	3rd yr	4th yr	5th yr	After 5th yr
1968-DEC	26	8	8	6	5	46
Currency	83	7	3	1	1	5
Other	10	9	11	7	6	57
1973-Dec	14	13	12	12	10	39
Currency	17	14	15	14	12	28
Other	10	10	9	8	7	56
1974-Dec	11	12	12	11	11	43
Currency	12	12	13	13	12	38
Other	11	11	10	9	8	51
1979-Dec	13	14	14	11	9	39
Currency	14	16	15	12	8	35
Other	12	11	11	9	10	47
1980-Dec	14	13	12	10	10	41
Currency	15	13	12	10	10	40
Other	14	13	11	10	8	44
1981-Dec	12	11	11	12	13	41
Currency	11	11	11	13	14	40
Other	14	12	12	10	10	42

1. The payment schedule of the principal is distributed on a percentage basis in relation to the balance. The component 'currency' corresponds to financial loan operations carried out under the terms of Resolution No.63 (21.8.67), Instruction No. 289 (14.1.65), and Law 4131 (3.9.62).

Source: Central Bank of Brazil Annual Report 1981 Vol 18 No.2 p 108, Brasilia.

required to cover these payments. Since, in almost all the years between 1973 and 1981 the imports of goods and services was greater than the exports, it indicates that external finance was needed to cover the payment for the imports. The disadvantage of the interest payments of Brazil is that they encourage further indebtedness. Even though the real interest payments as deflated by the consumer price index was lower than the nominal values (Table 3.9) the net barter terms of trade deteriorated in 1974, 1975 and between 1978 and 1980. This indicates that the burden of the debt service payment in those years was greater than the lower real debt service payments would indicate. It would be difficult for the Brazilians to try and maintain their debt service payments by an increase in exports alone. A reduction of imports would be at the cost of a slow down in growth. Some new borrowing would be required if only just to fill the gap left by export earnings. Imports can only be reduced to a certain limit since the slow down in growth of output which would occur should not be such as to reduce the potential for exports.

The decline in the interest payments as a percentage of the current account deficit in 1974 may be attributed to the rise in the deficit due to the rise in the oil prices and the value of non oil imports which occured. Between 1974 and 1975 the value of nominal interest payments more than doubled thus making its impact on the external account equivalent to the 1973 level.

Table 3.9

Net Interest Payments and Amortisation (Nominal and Real) of Brazil (Million US Dollars)

	Nominal Net Interest Payments	(1) as a (%) of the current account deficit	Real Net Interest Payments	Nominal Amortisation	Real Amortisation
	(1)	(2)	(3)	(4)	(5)
1973	514	23	646.5	2063	2594.9
1974	652	8	724.4	1943	2158.8
1975	1498	21	1498.0	2168	2168.0
1976	1810	27	1671.8	3004	2773.7
1977	2103	41	1789.8	4123	3508.9
1978	2696	38	2141.3	5426	4309.7
1979	4186	39	3046.5	6527	5123.2
1980	6311	52	4106.0	6689	4351.9
1981	9170	78	5422.8	7690	4547.6

Real net interest payments is nominal payments deflated by the consumer price index of industrial countries from IMF International Financial Statistics Yearbook, 1982. Columns (1) and (4) were obtained from Central Bank of Brazil Annual Report 1981 Vol 18, No. 2 p 108 Brasilia.

The Central Bank of Brazil includes short term debt in its calculation of the total foreign debt. This comes under the heading of Sundry Loans. (Central Bank of Brazil 1981 p 87). It is however, not the sole component under this heading. Sundry Loans in 1973 were 266 million dollars equivalent 2.2% of the debt. In 1981 this was now 157 million dollars equivalent 0.3% of the debt (Central Bank 1981 p 104). The Grindlay Bank Group estimated that Brazil's short term debt in 1981 was 8 billion dollars. This is larger than the official Brazilian figures..

The Brazilian authorities however, were not very worried about the growth of this debt since it was supposed to be made up mainly of trade credit which was a roll over phenomena and it also reflected the activities of Brazilian banks within the international financial system. There was no firm control over this debt. By 1982 it was found that the Brazilian short term debt was twice that which the authorities claimed it to be. The amount of short term debt for trade financing was 15.5 billion dollars and interbank emergency loans were 4.5 billion dollars which brought the short term debt to 20 billion dollars (The Guardian 1982 pp 18). These emergency loans were required for rolling over the medium term debt and it was found out that a cut by the international banks on short term loans of about 10% would be equivalent to about a 2 billion dollar loss of funds required to roll over the longer term debt (The Guardian 1982). This development had thus made the Brazilians vulnerable to a supply constraint since as current developments have shown reluctance of the international banks to continue their interbank line with Brazil has resulted in arrear in their payment.

3.4 The Oil Price Rises in 1970's

The oil price rise of 1973/74 and 1979/80 also contributed to the growth of the Brazilian external debt. The immediate impact of the first oil price increase was a large trade deficit. The value of oil in total imports took on a larger weight. In 1970 oil imports were equivalent to 12.35% of the total. In 1973 this had risen slightly to 15.07% and doubled after the oil price rise to 31.59% of the total imports (UNCTAD 1980). The second oil price rise did not cause the value of oil imports in total imports to rise by as much. In 1980 they were about 41.2% of the total (IMF_C 1982). Brazil was highly dependent on oil for most of its energy needs, thus making it quite vulnerable to the price rise of the seventies.

To find out the effect of the oil price rise on the external account of Brazil the additional cost of net oil imports was calculated and its relationship with the trade account considered. The trade balance is used here because it is a function of fewer variables than is the current account. The additional cost of net oil imports is the difference in value betweeen a given volume of oil imports at an initial price and the value of the same volume of imports at the new price. It is thus possible to capture the effect of the price change. The analysis was done for two periods 1973-1977 and 1978-1981. In the first period the given volume of oil imports used was that of 1973 and in the second period it was the 1977 net imports. The reason for the division of the 1973-1981 period was to take into account the effect of the two major oil price rises in that period (see Appendix Table Two). The prices of the net oil imports were obtained by dividing the volume of imports by their total value. The ratio of the additional cost to the trade account and the value of imports shows the extent to which the oil price rise contributed to the deterioration of the trade account and the rise in the value of imports.

In 1974 the cost of a metric tonne of oil was about 88.66 dollars rising from 26.57 dollars in 1973. This was a rise of about 233% (see Appendix Table Two). At the same time the volume of imports only rose by 3% so that the 162% increase in the value of oil imports was due mainly to the rise in price. Between 1974 and 1977 the average annual percentage change in the price of oil was about 3.5%

The value of the additional costs was of increasing influence on the trade balance (Table 3.10). The additional cost themselves were rising and the trade balance declining thus increasing the weight of the former. If there had been no oil increase but assuming all other variables to behave as they did after 1974, the trade balance for Brazil would have been more favourable. For example in 1974 the trade deficit would have been 4481 million dollars and would have declined until 1977 when it would become a surplus of 823 million dollars. (This however, is merely

a hypothetical situation. This is because non oil imports could have behaved differently than they did, had there not been an oil price rise causing the trade balance to depreciate or improve more than hypothesised. Variation in export earnings would also affect the trade balance.)

Table 3.10

The Impact of the Oil Price Rises On The Trade Balance and Imports of Brazil

	Additional Cost USm	Trade Balance US dollars m	Additional Cost/Trade Balance (%)	Imports (c.i.f.) US m	Additional Cost/Imports (%)
1974	1854	-6354	29	-14168	13.0
1975	1887	-5100	37	-13592	14.0
1976	2026	-3766	53	-13726	15.0
1977	2155	-1334	161	-13257	16.0
1978	30	-2581	1	-15054	0.2
1979	1321	-4560	29	-19804	6.6
1980	5310	-4829	110	-24961	18.1

Source: Calculated on the basis of:

IMF International Financial Statistics Yearbook 1982 p 125
Washington D.C.

UN Yearbook of International Trade Statistics
various issues, New York.

The oil price rise caused the value of Brazilian imports to rise by 13% in 1974. This progressivley became higher until 1977. The growing influence of oil in the imports was made larger by the decline in the value of non oil imports in the period 1975-1977.

It has been suggested that the deterioration in the trade deficit of 1974 was not due largely to the oil price rise (Balassa 1979 p 1035; Cline 1981 p 107; Malan and Bonelli 1977 pp26). The trade deficit would have been reduced if there had not been a simultaneous rise in the unit value and volume of non oil imports. In 1973 the value of non oil imports was 6013 million dollars. The value of non oil imports rose to 10935 million dollars in 1974 and declined in 1975 until 1977 (IMF_c 1982). Between 1973 and 1974 there was a rise of 82% in the value of Brazilian non oil imports. The volume of total imports rose by 35% over the period and the unit value by 46%. Given that the volume of oil imports rose by only about 3% over the 1973-74 period, the main reason for the rise in total import volumes was due to the non oil imports. It was found that in 1974 oil imports were 28% of the increase in the value of total imports [11] and rose to 35% in 1975. This is corroborated by Cline (1981) who states that a third of the total increase in the value of imports during the period of the first oil price rise was due to the rise in the value of oil imports. According to Balassa (1979 p 1035) in 1974 the increase in the oil prices and 1.5 billion dollars of the increase in the import prices could be offset by the increase in the value of exports. However, the rest of the deterioration in the trade balance was attributed to 'increased imports at high levels of capacity utilisation'. The rise in the value of oil imports has been attributed to speculative stockpiling, the investment requirements of the First National Development Plan, the excessive expansion of domestic credit and failure to allow the exchange rate to depreciate fully (Balassa 1979; Malan and Bonelli 1977 pp 30 and Wells 1979). There was an increase in stocks held between 1972 and 1975. As a percentage of the GNP these were 2.5%, 4.2%. 7.1% and 2.3% for each year respectively (IMF_c 1982). The economy at the time of oil price rise has been described as being overheated (Wells 1979). The potential capacity and actual capacity were almost the same (Malan and Bonelli 1977 pp 27 - 28). To continue with growth imports were required

on a large scale since the demand was larger than domestic supply of capital goods. The oil price rise thus aggravated a very unstable situation.

In the second period 1978 - 1980 although the price of oil only doubled in 1979/80, the impact on the trade balance was similar in effect compared to the first oil price rise (Table 3.10). The value of imports rose by much more in 1980 than they had done in 1974. The situation was similar to that of the first oil price rise because imports had again risen in value. In 1979 non oil imports were 12886 million dollars and 14670 million dollars in 1980. The rise in the oil prices further contributed to a deterioration in the trade balance.

The oil price rise contributed to the growth in the external debt of Brazil because by increasing the trade deficit or reducing a potential surplus, it had reduced the import capacity of export earnings. The oil price rise also affected the external account via the reduction in import demand of the industrial countries. To finance the import requirements external borrowing had to occur. Whether or not the oil price rise would cause the debt to rise by an amount equivalent to the oil deficit depended on several factors. From the Brazilian point of view it depended on their policy decisions and the choice of the mix of adjustment and financing.

Although the oil price rises contributed to an increase in the Brazilian trade deficit, it cannot be expected that the OPEC countries take full responsibility for the disequilibrium which occured in 1974 and again in 1979. This is because any difficulties experienced by any country after the first year of the disequilibrium depends mainly on how the country responded to the initial shock. Secondly the discussion in Chapter Two showed that since the industrial countries are the main trade partners of the developing countries, their actions in the international economy would be of extreme importance to the developing countries. A greater co-operation between the OPEC

countries in terms of financing the deficit through projects and even financial loans would have been to the advantage of the Brazilian economy. Even then domestic policy decisions taken by the Brazilians as well as the actions of the industrial countries would have also been important in determining the success of such co-operation between OPEC and Brazil.

3.4.1 Policy Response to Oil Price Rise

There was a reluctance to allow a large fall in the growth of income in response to the oil price rise of 1973/4. Cline (1981 pp 124) has attributed this to political reasons as well as an attempt on the part of the policy makers to respond to this shock in the same way they had done to internal shocks in the past. The Minister of Planning at the time J.P. dos Reis Valloso, has been quoted as saying that the Brazilian alternative to a recession was to have

> ' moderate deceleration of economic growth, together with measures aimed at limiting imports, promoting diversified exports and reducing oil consumption' (Balassa 1979 p 1028).

Apart from these policies the Brazilians also encouraged an inflow of foreign finance to cover the deficit (Balassa 1981; Lawrence and Dell 1980 p76) Prior to the first oil price rise i.e. 1972 the Brazilians began to restrict the inflow of foreign capital. It was suggested that the increase in reserves was contributing to the expansion of the domestic money supply (Cline 1981 pp 105-6; UNECLA 1975). The NMC issues guidelines which are to be followed as part of the debt management strategy. In 1972 it imposed a minimum maturity requirement of 10 years on loans entering Brazil and a cruzeiro deposit of 25% of the cruzeiro equivalent of the loan. The cruzeiro deposit was raised to 40% in 1973 and the maturity period raised to 12 years (UNECLA 1975 pp 122). However, in 1974 with the large trade deficit and current account deficit experienced the reserves were run down and the authorities reduced the minimum maturity period of the loans to 5 years and removed the cruzeiro deposit. The authorities appealed publicly for the petrodollars to be invested in Brazil, and in August to further encourage

the inflow of finance the Central Bank permitted the banks to deposit with them the loans which the banks had negotiated under Resolution No.63 but which had not been taken up by local borrowers. The interest payment on these deposits was the LIBOR and the loan interest was remitted on the banks' behalf (IMF_a 1975 p.85) The witholding tax on interest was reduced from 25% to 5%. In 1974 disbursements were 3755.6 million dollars and rose to 4978.3 million in 1975 (Appendix Table One). To further encourage the inflow of funds the interest on bank loans under Resolution No.63 held by the Central Bank rose to 1.75% above the LIBOR. The witholding tax was put back at 25%. The willingness of the bankers to lend to the Brazilians made it possible for them to finance the deficit on such a large scale.(See also Cohen 1981 pp 191-5.) In 1978 there was a large rise in disbursements and total commitments. Actually commitments from official lenders in 1978 declined. The international reserves of Brazil rose higher than it had done since 1970 (Table 3.3). 1978 saw the beginning of a period of restrictions placed on the inflow of finance by the NMC. Foreign currency loans had to be deposited with the Central Bank for a mandatory period of 30 days. This was later extended to 120 and then 150 days. The deposits were not earning any interest and the Bank would only release them at stated intervals. The reason for this action was mainly because of the authorities fear that the rise in the international reserves would have an expansionary effect on the domestic money supply (UNECLA 1978 pp 128-130). The minimum maturity period of public or publicly guaranteed currency loans was raised from 5 to 8 years. The implication of this however, was that unguaranteed debt could grow unrestricted. In 1980 there was a reduction in the restrictions placed on the inflow of external finance. This coincided with the large deficits at the time of the second oil price rise. The mandatory deposit of funds by private enterprises was reduced to 75% of the value of the loan and the conditions of release of the loan was improved (IMF_a 1981 p. 85)

The authorities had also followed a policy restricting the amount of finance the commercial banks could lend to publicly owned companies or foreign companies so as to encourage them to borrow from abroad. The cost of domestic borrowing was raised to make external borrowing more attractive and it was required that certain imports be financed by external loans with a maturity of between 3 to 8 years (UNECLA 1980 p 117). In 1980 there was a decline in disbursements from 9511.9 million dollars in 1979 to 7406.6million dollars. This was part of a general decline in net lending in the international capital market (Williams and Johnson 1982).

The Brazilians received the petrodollars indirectly through the international capital market. They were better off than most developing countries which did not have access to such large sources of finance. It is possible that for some developing countries the low debt to GNP ratio or the low absolute of the debt is not so much due initially to domestic policy, but is a reflection of the skewed nature of the flows from the international system.

Balassa (1981 p 84) has calculated that the Brazilians needed an additional net external finance of 4569 million dollars due to the oil price rise in 1974. Given the large flow of disbursements to Brazil it can be assumed that the Brazilians were able to meet a large proportion of their financing requirements.

A system of incentives in the form of subsidies and tax relief as well as easing the bureaucratic procedures was introduced in order to encourage exports (Balassa 1979;UNECLA various issues; IMF_a various issues). For example in 1973 before the oil price rise, a Resolution was passed which allowed the commercial banks to release a certain percentage of their reserve assets to finance the activities of the export firms. In 1974 certain imports which were to be used for the export of manufactures was made exempt from customs tax and the industrial products tax until 1977. A commission for Export Incentives (CIEX) was set up in 1976 to be responsible among other things for administering incentives and financing exports of capital goods and consumer durables. An array of incentives was introduced in 1975

to encourage exports some of these included deducting from profits liable to income tax the foreign exchange earnings arising from a firm's exports and the provision of insurance cover to exporting firms of capital goods and services to protect them against the breaking of contractual obligations. In 1975, about 71% of the value of textiles exported was covered by subsidies amd 66.2% of the value of vehicles exported was also a subsidy. The subsidies and tax credits etc., continued until about 1979 In that year the authorities removed the subsidies and devalued the cruziero dollar exchange rate by 30%. This was mainly due to pressure from the large trading partners. In 1980 there was a further devaluation of 40%

Table 3.11

Brazil's Export Subsidies (% of value exported)

	Exemption from Tax	Subsidies in the Form of Credit	Total
Textiles	29.0	42.2	71.2
Footwear	20.9	30.5	48.5
Machinery	24.0	26.5	50.5
Electronic Equipment	26.5	26.3	52.8
Furniture	5.0	30.9	35.9
Vehicles	28.8	37.4	66.2

Source: UNECLA Economic Survey of Latin America 1978 p 120 Santiago.

The volume of exports grew between 1972 and 1976 in response to the incentives and despite the recession in the world economy in 1975 and 1976. There was a decline in the volume of exports in 1977 although volumes rose again in 1978 to the 1976 level (table 3.12). The unit value of exports did not rise in 1975 so that the increase in the value of exports

in that year was due to the rise in the volume of exports. Prices rose after 1975, although they fell again in 1978. At the time of the second oil price rise both the unit

Table 3.12

Unit Value and Volume Indices of Exports and Imports and Terms of Trade 1972 = 100

	1972	1973	1974	1975	1976	1977	1978	1979	1980
Exports									
Unit Value	100	136.2	172.0	172.0	198.0	243.0	222.4	244.8	260.0
Volume	100	114.8	117.0	129.0	148.1	131.2	148.1	162.1	199.3
Imports									
Unit Value	100	136.9	200.0	217.0	223.9	232.0	247.0	297.8	380.0
Volume	100	120.0	163.4	154.7	153.4	141.9	157.4	168.1	152.6
Net Banker Terms of Trade	100	99.2	86.1	79.3	88.5	103.0	89.6	81.7	68.2
Income Terms of Trade	100	113.8	100.2	102.3	102.3	136.1	132.7	132.4	136.4

Source: Based on IMF International Financial Statistics Yearbook 1982. Washington D.C.,

value and volume of exports were rising. In 1980 just after the first maxi devaluation of 30% the annual growth rate of the volume of exports was the highest that had occured since 1972.

Imports fell continuously after 1974 until 1978 when they rose again. It was the non oil imports which fell since the value of oil imports was rising continuously over the period. To some extent the amount of the adjustment can be overestimated since given the amount of stockpiling undertaken in 1974 it could be assumed that the decline in the value of the 1975 imports is not much below the trend. After the oil price rise, the authorities imposed a wide array of measures to restrict imports. In 1974 Government owned enterprises and enterprises with government majority holdings were mandated to purchase imports only where no domestic alternatives existed.

About 400 items had an import duty of about 100% imposed on them (IMF_a 1975). In 1975 another 2000 items had import duties of about 100% imposed on them. An advanced deposit requirement of 100% of the f.o.b. value of the import was imposed before the import certificate could be obtained and the deposit held for six months. The effect of these measures can be seen in the decline in the volume index of imports in Table 3.12, and the decline in the trade deficit. In 1978 however, there was a resurgence in the volume of imports. This was mainly of the non oil imports. The Central Bank of Brazil in its Annual Report 1978 (p 129) attributes the rise in the value of imports to the growth in industrial production and investment in that year. It is interesting to note that 1978 also experienced a large rise in the disbursement of loans from abroad. It is possible that the availability of finance made it possible for the increase in imports. The reduction in the volume of imports between 1974 and 1978 may have been due not only to the restrictions imposed on imports during that period but due to a running down of the stocks which had been formed during 1974. The upsurge of import demand in that year could have been due to a decline in the stocks held.

The two measures of the terms of trade both declined in 1974. The import prices continued to be higher than the export prices in 1975, thus further maintaining the adverse barter terms of trade (Table 3.12). In 1976 there was an improvement in the barter terms of trade. The unit value of exports rose in 1976 as a result of rising coffee prices. This rise in the coffee prices was maintained in 1977, further improving the barter terms of trade. The result of the decline in import volumes and the rise in export values was that by 1977 the trade deficit was a sixth of its 1974 value. The rise in export volumes in 1975 made it possible for a slight improvement in the income terms of trade compared to 1974. In 1977 however, the improvement in the income terms of trade was the result of the higher export unit values and not the result

of volume effects. At the time of the second oil price rise in 1979 there was a decline in the price of coffee from the high levels of 1977. Even though the unit value of total exports rose this was less than the rise in the unit value of imports thus causing a further reduction in the barter terms of trade from the high levels of 1977. A further decline in the prices of coffee and soybeans in 1980 during the time of the second oil price rise contributed to increasing the impact of this price rise on the external account. The increase in export volumes at the same time however, made it possible for the level of the income terms of trade to be maintained. Immediately after the oil price rise there was a clampdown in the volume of imports causing a decline in import values in 1980 and 1981.

The policy of mini devaluations was continued after the oil price rise of 1974. It has been criticised on the grounds that a real devaluation did not occur in order to encourage the export sector(Cline 1981pp127-30; Wells 1979). The hesitance on the part of the authorities to devalue the currency has been attributed to a reluctance to impose the necessary restraint on monetary and fiscal policy, the need to encourage the continued flow of external finance and a need to protect domestic holders of external liabilities as well as to reduce the domestic cost of servicing the debt (Malan and Bonelli 1977; Bacha 1977; Wells 1979). A real devaluation was not considered necessary by the authorities since it was thought that the incentives in the export sector would make up for the difference.

Despite the incentives which were initiated in 1974 after the first oil price, Brazilian policy towards the external sector has been criticised as being biased against exports. The incentives were not sufficient to make up for the negative effects of the overvalued exchange rate on the export sector. The whole array of incentives towards the export sector and restrictions in the import sector have worked out to the disadvantage of the export sector (Balassa 1979; Tyler 1981 p 19; Tyler 1983). Tyler (1983) argues that commercial policy was

directly responsible for the slow export performance after 1974. He showed that nominal tariffs were significant in explaining the difference in export growth between 1970-1974 and 1974 - 1977.

Despite pursuing a policy of import substitution after the first oil price rise, indebtedness was still growing. This was because of the continued high growth rates relative to other countries and the policy to maintain a balance of payments surplus. Import values rose in 1978 until 1981 at a rate faster than export values. After 1980 the rise in import values was due primarily to price effects.

An attempt to reduce the real growth rate and hence the investment rate and demand for foreign savings and imports could have resulted in a slow down in the growth of gross earnings. Borrowing could have been limited primarily to service the debt. Apart from that greater care in the conditions of the loans incurred would also have reduced future external financing requirements.

3.5 The Recession in the Industrial Countries and its Impact on Brazils External Sector.

The export earnings of the Brazilians are influenced not only by domestic policies but also by the growth in the world economy, especially the industrial countries. The domestic policies provide an initial framework, making it possible for individual firms to decide whether or not to produce for export. Whether or not there is a demand for Brazil's exports and the price for these exports is also important in determining the growth in export earnings and the volume of exports.

The period after the first oil price rise was follwed by a recession in the economy of major trading partners of Brazil. The impact of the oil price rise on Brazil can be considered to be bigger than the additional cost ratios imply, because of the effect of the reduced export earnings due to the recession

in the industrial countries in 1975 and 1976. The recession in the industrial economies affects the rest of the world mainly through trade channels. The reduction in the demand for imports by the industrial countries will be reflected firstly in a decline in the price given that supply is relatively inelastic compared with the speed with which demand changes. This will then be followed by a fall in export volumes.

The growth in income in the industrial countries is important to the developing countries because they are their main trading partners. At least 60% of the trade in goods and services of the developing countries is with the industrial countries. The extent to which a decline in income and hence demand for imports has an impact on the external sector of the developing countries depends on five main variables. The first variable is the share of the industrial countries in the trade of the developing countries. The second is the share of imports from the developing countries in the total imports of the industrial countries; thirdly the structure of the developing country exports; fourthly the price competitiveness of their exports and finally the trade barriers imposed on imports from the developing countries. The link between developing country export performance and growth in the industrial countries is not a direct one because extraneous variables can also affect the relationship. For example supply constraints may reduce export earnings even though the industrial countries are experiencing high income growth rates.

These five variables will be discussed in the context of the Brazilian experience to determine how they were affected by the decline in growth in the industrial countries.

Brazil is typical of most non oil developing countries because the bulk of its exports are to the industrial countries.

Table 3.13

Direction of Brazilian Exports 1974 - 1981 (Percentage)

	1974	1975	1976	1977	1978	1979	1980	1981
Industrial	68.1	60.2	65.7	64.7	65.2	61.3	57.3	63.8
Oil Exporting	7.0	7.6	5.5	6.5	7.2	5.2	7.3	7.3
Non Oil Developing	19.1	23.5	20.7	21.8	21.6	25.9	28.6	21.7
Centrally Planned	4.7	7.5	6.9	6.1	4.7	5.5	5.4	5.5

Source: IMF_b Direction of Trade Statistics Yearbook 1982 p 97
Washington D.C.

There has been a slight decline in the exports going to the industrial countries since 1974. In 1980 the percentage going to these countries was lower than 60% for the first time since 1974. On average the proportion going to the OPEC countries has remained about the same, although there have been slight upsurges during the period of the oil price rise. Whilst reducing the proportion going to industrial countries Brazil has diversified towards other non oil developing countries. Unless it is a direct policy of the OPEC countries to encourage trade with the non oil developing countries they may have some difficulty in competing with the industrial countries for the markets of the OPEC countries. More exports to the OPEC countries could have helped reduce the oil deficit and the need for external financing. However, the fact that finance which the Brazilians received was used mainly to finance imports from the industrial countries would indicate that the recycling of the petrodollars by the banks to Brazil and other developing countries was to the advantage of the industrial countries.

Brazilian imports as a percentage of the total imports of the industrial countries has ranged from 1% to 0.82% over the period 1974 - 1981 (IMF_b 1982). Even though the importance of Brazil to the industrial countries is not as important as these countries are to Brazil, the Brazilians still have a significant proportion of the total industrial country imports compared to non oil

developing countries. This can be considered favourable to Brazil on the basis of a study which showed that the growth in the volume of imports from the non oil developing countries over the period 1973 - 1980 was greater than the growth in the total volume of imports (Goldstein and Khan p 11). However, it could also indicate that when there is a reduction in the demand for imports from the non oil developing countries, the Brazilians will be more seriously affected. The extent to which this can happen depends however, on the structure of Brazil's exports. In 1970, 24.3% of Brazil's exports were manufactures and semi manufactures. By 1980 this category of exports was now 56.5% of the total (UNECLA 1980). Brazil has been diversifying into a growing sector, since imported manufactures has been the fastest growing sector of the industrial country imports. (Goldstein and Khan 1982 p 12). However, since the bulk of the trading in manufactured products of the industrial countries is amongst themselves, the Brazilians face stiff competition in this sector. This may explain the subsidies on the exports of manufactures in Brazil. They would thus reduce the price of the exports to make them more competitive. However, the success of this move depended also on whether trade barriers were imposed by the developed industrial countries. Protectionism grew in the seventies and this was mainly against the import of manufactures coming from the newly industrialised countries. To that extent, therefore, although Brazil's exports were from a growing sector, since this would create competition for markets amongst the industrial countries as well as make some labour in certain sectors of the industrial countries unemployed, a recession in the industrial countries would affect the Brazilians to a large extent. This could explain the diversification towards the non oil developing country markets.

A study was carried out by Balassa (1981) which measured the effect of the recession on the Brazilian exports. It was found that the reduction in export volumes was equivalent to $179 million in 1974, rising to $530 million in 1975 and $770 million in 1977. As a ratio of actual Brazilian exports (p 44-46) this was 3.7% in 1974 and 13.3% in 1977. It is thus possible

to hypothesise from this information that the trade deficit could have been reduced if there had been a continuous demand for Brazilian exports. This would then have contributed to a decline in the current account deficit and the need for external finance. The debt service ratio would also have been reduced and this would have further contributed to a reduction in the need for disbursements for balance of payments purposes.

The potential export earnings of the Brazilians were further reduced because the decline in the growth of the industrial countries was also affecting the exports of other developing countries, hence their demand for imports. Unless they had reserves or else access to external borrowing their import capcity would have declined. Brazil was the seventh largest exporter within the developing countries for non fuel exports in 1963. By 1977 it was the largest exporter within the developing countries (Goldstein and Khan 1982 p 20). A reduction in import demand of these countries would, therefore, reduce its potential export earnings.

The impact of the recession in the industrial countries is reflected in the service account of Brazil. In 1978 debits on the service account were $6991 million. Of this,interest payments were $3342 million and larger than the value of the receipts in the service account (Central Bank of Brazil 1979). In 1980 the debit had risen to $13296 million and interest payments were $7457 million and more than twice the receipts on the services account. The bulk of the interest payments goes to the industrial countries since they are the main lenders to Brazil. In 1979, in order to reduce inflationary pressures within the domestic economy the US and UK embarked on restrictive monetary policies. The effects of these were high interest rates, a slow down in industrial activity and unemployment. The rise in the interest rate was reflected in the LIBOR so that the rise in the interest payments of Brazil was due mainly to these developments. Brazil had at least 60% of its external debt in floating interest rates so that the rise in the nominal rates was reflected in its interest payments. A reduction in the interest rates would have reduced the payments made by Brazil

after it s debt outstanding hence reducing the current account deficit and the need for more finance.

3.6 Evaluation of the Debt Accumulation Process in Brazil

The previous sections of this chapter have described Brazilian policy towards external borrowing and the different factors which worked towards increasing the need for borrowing. It is important that a country be able to manage the growth of its debt. This is because if the debt should grow faster than does the domestic economy, there is the possibility of difficulties in servicing the debt. Unmanageable debt has been defined as that which puts a cost on the economy because the export expansion or import substitution required to service the debtuses up the resources to an extent that there is a decline in aggregate income (Hayes 1964 p 174). It is possible however, that whether a country will reach that stage or not, depends on whether it has sufficient finance to roll over the debt.

For borrowing to be beneficial to a country it is usually required that the cost of borrowing be less than the rate of return on the investment for which the borrowing was carried out. The critical interest rate was suggested as an indicator of this. This is because it was believed that in order to compare the domestic rate of return with the international interest rate it is necessary to measure the shadow exchange rate. There are several problems associated with this, hence the derivation of the critical interest rate (Hayes 1964 p 165). The critical interest rate is that rate at which the rate of growth of debt is equal to the growth of the GDP (Hayes 1964 pp 166 - 173). If loans are negotiated on the basis of interest rates higher than this rate then the possibility of cumulative debt greater than the growth of GDP occurs. The main shortcoming of this indicator is that it does not take into consideration the ability of the country to direct some of the extra GDP into exports so as to earn foreign exchange to service the debt[13]. On the other hand it does indicate that the capacity to service the debt without

incurring a reduction income is being reduced.

Dhonte (1979) developed the concept of the borrowing capacity to indicate how a country should proceed with its borrowing. The borrowing capacity is the highest level of borrowing relative to exports that can be maintained without allowing the debt service ratio to rise above a certain ceiling (p65). The variables which determine the borrowing capacity are the terms of the loans, the continuous supply of loans and the growth of exports. The borrowing capacity is a function of the ceiling on debt and the refinancing ratio. This is the ratio of debt service to disbursements. Lower interest rates and longer maturities will result in a lower refinancing ratio for a given level of exports. The optimal borrowing policy outlined by Dhonte is that which allows for the maximum transfer of resources without allowing the refinancing ratio to decline (p.71). The difficulty with Dhonte's condition is that it is difficult to identify what level the debt service ratio should not rise above. This is because a debt service ratio of 20% may bring about severe problems for one country but not for another.

Avramovic (1964 pp 89 - 90) has suggested six conditions which need to be met for borrowing on hard terms to be done successfully. The conditions cover the Hayes and Dhonte criterion. He groups the conditions under two main headings. The first group are the financial conditions and these comprise of a continuous supply of credit despite the size of debt outstanding, management of the debt,in such a way that payments can be made when required, and a mimimisation of fluctuation of export earnings. The second group of conditions are headed 'growth' and comprise of a rate of return higher than the cost of borrowing, plough back of profits in order for savings to meet the debt service payments and finally that there should be sufficient investment to generate growth.

In sum the conditions of borrowing state that the funds obtained should be utilised in such a way that repayment of the loan is made possible without allowing the income

of the country to be below what it would have been had borrowing not taken place. These conditions thus allow for some consumption to take place. What is important is that the authorities be able to obtain the domestic cost of paying the loan and that the export policy is such that given a favourable international trade environment, the required foreign exchange is obtained.

It is not necessary for external funds to be directed only to the export sector. What is important is that exports are generated within the economy irrespective of whether the particular business is financed by foreign capital or not. Exchange rate policy during a period of borrowing and repayment is important. The advantage of a floating exchange rate. regime is that it does not allow for rigidity in the current account to arise thus generating a balance of payments disequilibrium. What is important however, is the real value of the exchange rate. During the period of net repayment it would be to the advantage of the economy to have a slightly overvalued exchange rate so as to reduce the domestic cost of repaying the loan. The disadvantage of this, however, is that it will be a disincentive to the export sector thus thwarting the attempts by the authorities to service the debt smoothly. The problem may be amended by allowing the effective exchange rate to differ between the trade and service sector. This may be possible by using incentives to encourage exports. This policy was attempted by the Brazilians, however, the export sector was still experiencing a bias against it until the maxi devaluation of 1979 which also coincided with a rise in the growth rate of exports.

The commitments made to the Brazilians over the period 1972 to 1981 rose from $2592.1 million to $12,024.9 million (World Bank$_b$ 1982).[4] There was a reduction in commitments made in 1980, mainly due to a decline in commitments from private lenders which was part of an overall decline in commitments made in the private capital market. The terms under which the Brazilians received their loans hardened

considerably. This meant that the Brazilians were rolling over their debt with loans with harder conditions, implying that a greater flow of funds would be needed in the future. Thus, even though Avramovic's condition was being met, because of the increasing hardness of the loans it implied that the debt burden was increasing as well as the dependence on external finance.

The Brazilian debt management policy was carried out by the NMC. In order to improve the maturity profile of the loans, the authorities had minimum maturity requirements. In 1971 a resolution was passed which stated that the short term loans registered in a particular month should not exceed the value of those maturing in that month. Despite this, there has been a growth in short term debt. Even assuming that the maturity requirements and other stipulations were strictly adhered to, the ability to pay debts in Brazil, increasingly became dependent on the supply of new funds. In 1973 the refinancing ratio was 42%, it improved slightly in 1974 to 33% but rose again until it was 70.5% in 1977. Given also that export earnings were not rising as fast as debt service payments, the ability to pay was declining in the late seventies. The increased hardness of the loans due to the rise in the interest payments did not contribute to help the Brazilians in their debt management. The export earnings of the Brazilians, although growing over the period, were not growing at a constant rate or faster than the debt service payments. The debt outstanding to exports ratio was growing over the period. Thus the third condition of Avramovic was not fully met. The financial conditions facing Brazil were, therefore, not very favourable for it to continue borrowing on hard terms on such a large scale. Higher growth rate in export earnings with less fluctuations and a decline in the interest payments would have made conditions more favourable; especially since to some extent, they would have reduced the gross borrowing required.

The first condition under the growth variables is that the rate of return be greater than the international interest rate. No direct attempt has been made to measure this in the case of Brazil. The ICOR was obtained and will be used as an indication of the efficiency of capital investments[14]. In the 1970-1973 period the ICOR was 1.7. In 1973-76 it was 3.1 and in 1976-1979 it rose to 4.3 (Balassa 1981 p 19). The Brazilians borrowed to finance a lot of large scale and long gestating projects in the 1970's. This might be part of the explanation for the increasing ICOR. It will be suggested that given the nature of the investments and the fact that the ICOR was increasing, borrowing on increasingly harder terms was not the best policy the Brazilians had chosen. What would have been the more favourable borrowing terms would have been loans with long maturities and lower interest rates. Even though the Brazilians had favourable maturity terms compared to other developing country loans, when the use to which some of the loans were being put to is also considered, then one realises that the maturity of the loans was not that favourable. The high interest rate of loans to finance projects which would not be immediatly generating some output meant that extra pressure was being put on the rest of the economy and not enough income would be generated to finance the domestic cost of repayment etc. The second condition was that the plough back of profits on investment be enough to generate savings within the economy. The possibility of this happening would first depend on how the rest of the economy was performing. Foreign savings as a percentage of the gross capital formation rose from 18.8% in 1975 to 24.7% in 1980 declining to 21.4% in 1981. This increase in the participation from foreign loans could indicate that domestic savings were not rising by enough to finance the investment requirements. In fact, between 1974 and 1979 the savings ratio was always lower than the investmnet to GNP ratio. Even though investments were declining, there was an increasing dependence on external sources. This could indicate that the authorities were not fully tapping the savings potential within the economy.

The nominal growth rate of the Brazilian economy rose between 1973 and 1979. In 1973 it was 11% rising to 19% in 1976 and falling slightly to 18.2% in 1979. Although investment as a percentage of GNP was declining, there was some nominal growth within the economy.

External borrowing did contribute to some growth within the domestic Brazilian economy. However, the borrowing conditions, as well as the reduced export potential due to conditions existing within the world and domestic economy, have contributed to some of the present difficulties facing the Brazilians. A reduction in its borrowing during the period of the external shocks would have reduced the growth of debt outstanding and the resulting decline in growth rates would also have reduced the need for investment. Apart from this however, the hardening borrowing conditions, as well as the mismatch in financing projects implied that not enough growth was being generated within the economy to reduce the pressure of the debt.

Over the period the nominal GDP was growing faster than the Eurodollar interest rate, indicating that debt was within managable proportions. However, when the Eurodollar rate is added to the cruzeiro dollar exchange rate to find its equivalent in cruzeiros, it indicates that the growth of the nominal GDP was not as fast as the cruzeiro equivalent of the Eurodollars rate.

A successful attempt to reduce the growth rate would have reduced the foreign exchange requirements of the economy. The rise in the interest rates, as well as the reduction in the export potential, would then have had less of an impact on the Brazilians. However, easy access to funds at increasingly hard terms, as well as the possible belief that there would be a continuing supply of funds, may have contributed to the growth of indebtedness in the Brazilian case. Both the oil price rises contributed to the external disequilibrium faced by the Brazilians. It is possible that if they had received

non concessional finance directly from the OPEC countries the cost of the finance may have been lower and would have reduced the burden. However, given that the OPEC countries would not have financed the entire of the deficit of the Brazilians, it is doubtful that the resulting situation would have been much different from what it is today.

Notes

1. For a discussion of the factors which influenced the high Brazilian growth rates in 1968 - 1973 see Bacha (1977), Malan and Bonelli (1977), Syvrud (1974) and UNECLA (1974 pp 53 - 75).

2. Brazil's nominal debt per capita in 1979 was $302. This is slightly favourable compared to Argentina with $319 and the Ivory Coast. However, compared to Zaire it is very high, $137.4. As a percentage of the GNP Zaire's debt is 60% whilst Brazil's debt was 16%. Brazil then on the basis of these figures, would seem to be capable of holding its debt better than Zaire. In fact Zaire has had more reschedulings of its debt than has Brazil in the seventies.

3. In 1980 official debt per capita for Tanzania was $116.8. Ghana had an official debt per capita of $97.03 whilst Chad, a low income country with a per capita GNP less than that for Tanzania, had an official debt per capita equal to about $47.72 (Calculated on the basis of World Bank figures).

4. It is not a requirement that external finance should go to exporting firms. It is important however, that domestic policy encourage exports in order to earn foreign exchange with which to pay off the debt.

5. The Brazilian money supply is a function of several variables. However, there is the view that growth in reserves has played a large role in increasing the money supply, especially when sterilisation has not occurred (Cline 1981, Lembruger 1979).

6. See Section 3.3.2 where there is a discussion of variables which determine creditworthiness and the flow of private funds to individual countries.

7. Another indicator, the coefficient of protection is also used by the Brazilians. This is the ratio of net flow to disbursements.

8. The LIBOR is determined by the domestic rates of the currency in which the loan is being negotiated (for example the Eurodollar rate). It will be directly related to this assuming that there is a free flow of capital between the domestic and offshore markets. Other costs involved in the loan are the management, negotiation and drawdown fees.

9. This occurs when the short term rate is higher than the long term rate. It is not profitable to buy bonds when this occurs because bonds are financed by the short term market.

10. Some of the methods used by the bankers in country risk analysis are (i) The fully Qualitative System which is a general report of the country's economic, political and social conditions and prospects (11) Structural Quantitative System. This has a uniform format to enable comparison among countries. . . . . (iii) The Checklist System. This involves grading the country on the basis of quantitative criteria.(See Cohen 1981, Thornblade 1978).

11. This was obtained using the following calculation

$$\frac{\Delta P}{\Delta M} = \frac{P_t - P_{t-1}}{M_t - M_{t-1}}$$

where Pt the value of oil at time t
Mt the value of total imports at time t
t-1 the previous period.

13. The critical interest rate is:

$$i = \frac{r(S_o^a - S')}{S_o^a - Kr}$$

where
- i = critical interest rate
- r = rate of growth of GDP
- S_o^a = gross domestic savings as a percentage of GDP in year 0.
- S' = marginal gross domestic savings rate.
- K = gross ICOR, linking the increase of the growth of product between two consecutive years with the rate of investment in the first of these two years (Hayes 1964 pp 171).

13. The critical interest rate concept is limited by the validity of it's assumptions and by the fact that borrowing can become a burden to the domestic economy before the critical rate is reached (Hayes op cit). Solomon (1977) also derives the threshold of borrowing for a group of countries, including Brazil based on Hayes concept.

14. The ICOR does not take into account excess capacity, the contribution of other variables e.g. labour, skilled or unskilled and whether the investments are long gestating or not.

Chapter Four

Review of Possible Solutions to the Present Debt Situation of the Developing Countries

The discussion of the Brazilian debt experience in the 1970's shows that the oil price rises of 1973/74 and 1979/80 were not the only causes of the growth of indebtedness of the non oil developing countries. Sachs (1981) has shown that except for the years immediately after the oil price rises there is no link between oil imports and the current account deficits of oil importers. He explains the distribution of current account deficits and the debt among the non oil developing countries on the basis of their various investment to GNP ratios.

On the basis of his calculation the Brazilian investment ratio actually increased over the 1974-1979 period compared to the 1965-1973 period (Sachs 1981 p.234). The savings ratio on the other hand did not keep up over the period. The results from Sachs would strengthen Avramovic's debt cum growth model (Avramovic 1964) which has as one of its main assumptions an increase in the savings ratio in order for the debt process to come to an end. The reduction in the savings to GNP ratio would also contribute to the growth of indebtedness in Brazil in the seventies.[1] Although the Brazilians experienced large oil deficits, these were not financed directly by financial flows from the OPEC countries to any large extent. The deployment of the OPEC cash surplus has been criticised by Saddy (1981) and Sobhan (1980) who both suggest that a greater amount of direct OPEC financial flows to the non oil developing countries would have benefited both groups of countries to a great extent, compared to the direction of actual flows in the aftermath of the first oil price rise. Alternative suggestions regarding how the OPEC financial resources could be deployed to the advantage of the non oil developing countries have been put forward. The viability of these suggestions is rather limited or non-existent

in the present situation given the current account deficits experienced by most of the OPEC countries due mainly to the fall in the oil prices and the increased absorptive capacity of the OPEC countries. However in the case of Brazil, the reduction in the oil prices has contributed to a decline in the value of its oil imports and other factors remaining constant in the value of its trade deficit.[2] Suggestions towards improving the possibility of the developing countries (with special reference to the Latin American countries) to service their debts have also been made. These will be discussed later in the chapter.

4.1 The use of OPEC financial resources to directly finance the current account deficits of the non oil developing countries

Before the present decline in the nominal oil prices occurred, proposals were put forward to increase the financial resources from OPEC going to the non oil developing countries.

An Iraqi proposal to the OPEC ministerial meeting in June 1979 suggested the creation of a joint development fund comprising OPEC member countries, the industrial countries and the non oil developing countries. OPEC's contribution was to be based on the inflationary component of the oil price increase and the cost of oil exported to the other developing countries. The industrial countries' contribution was also to be based on the inflationary component of their exports to the non oil developing countries (Shihata 1982 p. 32-33) This proposal is no longer viable given the present current account deficits experienced by OPEC countries and the financial problems facing some of them. In the same year the Algerians and Venezuelans also put forward a proposal which involved changing the OPEC Special Fund from its then temporary status into a permanent body with an international legal status.[3] This was accepted and in 1982 the OPEC Fund became a permanent body. However other suggestions regarding the new role of this institution were not accepted. The principal aim of the new Fund as envisaged by the Algerians and Venezuelans was to provide finance directly to the non oil developing countries for project assistance. The agency would provide both concessional and non-concessional assistance and banking facilities.

The funds of both OPEC and the other developing countries would be held by the banking side of the agency and a Third World capital market would be organized to obtain funds from the international capital market. The agency would issue inflation-proof bonds with high rates of return onto the international capital market. Initially the agency would purchase a large amount of the bonds in order to create a market for the bonds as well as gain the confidence of international investors. The agency was also envisaged to act as a guarantor of loans from the industrial countries to the developing countries which would not normally have access to the international capital market (Ahmed 1982). Sobhan (1980a) also recommended the creation of a Third World Agency which was on similar lines to the one suggested by the Algerians and Venezuelans. He justifies the development of the agency on the basis of the shortcomings of the international monetary system vis a vis OPEC and the other developing countries. The skewed nature of the recycling process and the depreciation of OPEC assets deposited in the financial institutions of the developed market economies as well as insufficient funds of the IMF and EEC compensatory facilities were pointed out as some of the disadvantages. He recommended that the new agency be created by channeling a large increment of the funds tied up in the international capital market. This is rather difficult given that the OPEC assets were devaluing and a large shift in funds away from the international capital market could be destabilizing. Most likely the source of finance would have to come from funds which would have been deposited in the international capital market from the sale of oil.

The proposals were quite ambitious and if feasible[4] may have encouraged the redirection of a large amount of the OPEC cash surplus directly to the non oil developing countries. The dependence of the creation of the agency on oil revenues would have made the stability of the agency vulnerable to the development within the oil market as well as to the absorptive capacity and domestic policy decisions of the OPEC countries which would be the main contributors to the agency. This weakness could only be reduced if the initial capital was invested in high yielding projects which would allow the finance available to the agency to be increased and so reduce this dependence.

Secondly, the investors on the international capital market, realizing the dependence of the agency (in the short term at least) on the oil revenues, may themselves be hesitant to lend to the agency even if the loans were guaranteed by OPEC. The main question of importance regarding the creation of the institution is whether it would generate the additional loans. The reluctance of the international investors would reduce this possibility. Even in the case where confidence in OPEC is maintained, additional loans would not be generated if the loans which would have gone to the developing countries through other channels are simply redirected to this one since it reduces the risk. (see p.119 for a discussion of the extent to which guarantees can generate additional loans). On the other hand, by investing in projects which generate high rates of return international investors might be willing to lend more to the agency. In creating the agency the decision makers would have to decide on the mix between project and programme loans and what proportion of the finance is to be allocated to interest subsidies (Stewart 1982).[5]

The decline in the oil prices, thus affecting the size of the OPEC cash surplus, has made these proposals redundant. However there is a limited role which the OPEC countries can play in the present circumstances. Concessional loans of the already established national and international agencies can be continued and directed mainly towards the lower income countries. Whether or not these agencies will continue to be able to disburse funds depends on how the subscribed capital was utilized. Most of the finance from these agencies however was on concessional terms so that it is possible that the rate of disbursement from some of the agencies may decline. Directing the concessional flows which may exist to the low income countries will help alleviate some of their balance of payments problems as well as reduce pressure on other parts of the international financial system. Even though in the present situation the middle income countries, for example, Brazil, have taken the centre of the stage because of their large debt outstanding and payments arrears, the low income countries, especially the least developed countries, are a silent majority whose financial needs should not be forgotten altogether. The middle income countries are eligible for non-concessional flows. Since 1974 the bulk of

OPEC's direct financial flows to the other developing countries has been on concessional tersm, with the bulk of its cash surplus going to the financial markets in the developed countries. The national and international agencies set up by OPEC may try to increase the proportion of funds to the developing countries which are on non-concessinal terms. The advantage of this is that it may widen the coverage of countries as well as encourage governments and private investors within the OPEC countries to allocate some of their budget and portfolio towards these agencies. Loans on non-concessional terms would increase the revolving nature of the agencies and make them less vulnerable to developments in the oil market and domestic policies. Shihata (1982 p.58) was more optimistic regarding the survival of the OPEC agencies in the face of a decline in the price of oil and the OPEC cash surplus. This optimism was based on the existence of authorized capital. However, when there was a large cash surplus some of the agencies were limited in their operations because subscriptions were not fully paid.

The OPEC countries could finance projects with commercial institutions within the developing countries. Some such cooperation has been achieved between Arab and Latin American countries.[6] The possibility of such ventures occuring depends on the extent to which the non OPEC country or commercial institution can make a contribution of substance towards the financing of the project or business. This could act as a guarantee against default since the OPEC member would be assured of the interest of the other partner in making the partnership a growing concern. There needs to be viable projects and opportunities within the other developing country which can be identified to attract the OPEC investor. This is because it is more difficult to attract investors to back up vaguely defined projects or assume that they will be willing to support the balance of payments of the country. The advantage of such cooperation is that it does not necessarily attract only public funds from the OPEC countries but also private investors. Some of the OPEC Arab countries have developed some expertise within the international financial system which may be of some advantage to other developing countries.

These proposals may not be effective in the immediate future, but if attempts are made to set them in motion they should benefit both the OPEC and developing countries in the short to medium term. Had the decline in the oil prices not occured and had there not been a decline in the cash surplus of the OPEC countries, the recommendations would have been just the same, although the scale of the flows may have been appreciably larger.

4.2 The role of the developed countries and the international agencies in alleviating the debt problem

Several suggestions have been put forward regarding the role which the developed economies and international agencies can play in helping the developing countries. Some of these suggestions were made during the time of the first oil price rise, although they continue to be of relevance in the present situation of low oil prices and larger developing country debts.

The proposals can be subdivided into three groups, mainly for the purpose of exposition. These subdivisions however are not mutually exclusive. The first group of proposals is concerned mainly with the use of bonds and guarantees to increase the flow of resources to the developing countries as well as allowing them to have greater access to the international capital market. The second group of proposals deals with the possibility of increasing the roles of the official agencies and the third group of proposals is concerned with the advantages to be obtained by creating a new agency.

4.2.1 Increasing the flow of non-concessional finance to the non oil developing countries

Just after the first oil price rise Michalopoulos (1975) suggested that the financing needs of the middle income developing countries be met by increasing their access to the international capital market - the bond market in particular. The least developed country's needs could be met by food aid and the distribution of SDR s.

Developing country access to the international bond market has been very limited and amongst the group of non oil developing countries it has been restricted to a few of them. In 1975, of a total of $22,821 million worth of international bond issues, the non oil developing countries issued $1,210 million, i.e. 5 per cent. In 1979 the value of their bond issues had risen to $3,120 million, i.e. 7 per cent. Michalopoulos recognized that borrowing on the bond market was preferable to bank loans because most of the bonds were at fixed interest rates and had long maturities. These features of borrowing on the bond market had been appreciated by the Brazilians and in 1976 their policy was directed towards exploiting this source of finance as much as possible. The developing countries have limited access to the bond market because they lack to some extent the technical expertise required to place bonds on the market. This however is a temporary problem. Given the benefits to be achieved from issuing bonds, it is possible that the developing country can purchase the services of some institution or consultancy to issue the bonds on their behalf. With time the developing countries can have nationals trained so that they can issue the bonds on their own. The more long term problem facing the developing countries is that primary investors consider the developing countries to be very high risks and so are reluctant to lend to them. The problem exists mainly because the investors may not be informed about the developing country, and, secondly, the developing country is competing for funds with more well known and highly profitable borrowers. Michalapoulos's recommendation was that in the case when foreign bonds are issued, the host government (the USA government in the case of the US bond market) would guarantee the bond issues. This would remove some of the technical constraints (for example, registering with the Securities and Exchange Commission) which the developing country would have had to face. In the Eurobond market a joint system could be operated between the OECD and OPEC. The advantage of the guarantees is that they would encourage the development of a secondary market. At the present time it is doubtful whether an OPEC guarantee will be recognized by potential investors. However, the idea of a guarantee system was suggested recently by the House of Commons Treasury and Civil Service Committee Report on international lending by banks (1983). This was

based on a scheme suggested by Williamson (1982). It involved indexing the bonds issued by the developing countries against inflation and guaranteeing the bonds by an existing multilateral financial institution, for example, the World Bank or the IMF. The indexed bond would ensure that the lender would receive a real rate of return during the life of the bond. It also protected the developing countires from increased real amortizations due to floating nominal interest rates. The security of the lenders would mean that they would not need to cut off flows from the borrower when it needed it the most. The bonds would be issued by the multilateral financial institution on behalf of the developing country borrower. The bonds would be pooled and no one country would be allowed to dominate an issue so that the risks would be spread amongst the developing countries. It also encourages the potential investors to lend to the pool since the risk is reduced. Bonds would be issued in SDR s with an index based either on the consumer price index or wholesale price index with a 50-year maturity. As envisaged by Williamson, the World Bank and/or IMF would not alone be responsible for providing the loan guarantees. Hopefully as the developing countries graduated to become net capital exporters they would become eligible to contribute to the guarantee. Interest payments on the bonds would be determined by the ability to pay based on the normalised terms of trade and divergences away from this. Michalapoulos saw the advantages of the guarantee system to be three-fold. It would increase the total flow of resources to the developing countries as well as increasing the amount available to the least developed countries on concessionary terms. It would also introduce the developing countries to the international capital market (Michalapoulos 1975). The guarantee system however has been criticized by Stewart and Sengupta (1982 pp.86-89). The disequilibrating effects of the guarantee system have been mentioned (see Section 4.1). The result would be that countries which were not eligible for guarantees would have to pay a higher price to attract these funds. To overcome this problem therefore, all countries would then have to be eligible for guarantees. This would increase the cost of the guarantee system to the guarantors and could result in funds which could have been usefully employed being locked up in the guarantee scheme. This could result in no additional funds being

made available to the developing countries. Stewart and Sengupta (1982) would thus prefer an increase in the gearing ratio of the World Bank to a guarantee scheme. In a Task Force report to the Development Committee of the World Bank and the IMF (1982), a guarantee system similar to the Williamson plan was also put forward although it did not include indexation of the bonds and a separate facility was to be created called the Multilateral Partial Guarantee Framework. It would issue partial guarantees to countries which did not rank high on the credit worthiness scale but which at the same time were eligible to non-concessional flows. When some bankers were consulted about the proposals they were not fully acceptable. It was suggested by the bankers that a new facility or organisation was not required, mainly because it would be difficult to operate. Secondly, some bankers did not consider partial guarantees as being adequate, since there would still be a considerable amount of risk to be covered. The Report had recommended partial guarantees in the belief that these would allow the banks to become more acquainted with the developing country borrower. The bankers on the other hand preferred the full guarantees because they believed this would encourage non-bank lenders. Unfortunately no evidence was given on the extent to which guarantees would cause distortions within the bond market. However, there was some indication, contrary to the views of Stewart and Sengupta, that guarantees would increase the flow of non-concessional flows to the developing countries. The bankers mentioned that the guarantees would allow them to extend longer loans to the developing countries. This would be of particular advantage to countries like Brazil which have relatively shorter term debts. The existence of the guarantee is a safety net in the case of default so would not necessarily have to be drawn upon. However, it would also be important for the guarantors to monitor the loans so as to reduce the possibility of irrational lending. This could meet with some resistance from the borrowing country. The idea of lending to a particular group of countries as defined above was not accepted by the bankers. This was on the grounds that the country would be difficult to identify. Secondly, the bankers considered the purpose and nature of the loans to be more relevant variables. This is quite interesting considering that in the recent past loans have been given to countries on the basis of credit worthiness only. Several

more countries could have been served by the banks if the nature and purpose of the loan was such an important criterion.[7]

Co-financing arrangements have also been recommended as a possible way of increasing flows to the developing countries. In his evidence to the House of Commons Treasury and Civil Service Committee, Llewellyn (1983) recommends that there be a shift of financing away from the banks to official creditors. In his action programme co-financing and parallel financing arrangements between the banks and the World Bank and IMF for example are part of the programme to be used. The World Bank has been involved in co-financing arrangements with the private banks over a period of time.[8] According to the World Bank, co-financing

> "refers in general to any arrangement whereby funds from the World Bank are associated with funds provided by other sources outside the borrowing country in the financing of a particular project." (World Bank 1980, p.1)

At present, co-financing arrangements should form part of a medium term to long term strategy for financial flows to the developing countries. This is because the projects identified may not be sufficient to fill the gap of the immediate financing needs.[9] Table 4.1 on the next page shows the co-financing arrangements undertaken by the World Bank and other financing bodies. This has grown in nominal terms over the period 1973-1980, although in 1980 there was a decline in the number of projects financed. In the Task Force Report already mentioned, an increase in co-financing arrangements was recommended if it would result in an increase in the amount of finance going to the developing countries or if the number of countries benefiting from this increased. In consultation with the bankers concerning the conditions which would attract them to involve themselves in greater co-financing arrangements, four suggestions were made by the bankers. The first suggestion was that the banks should have greater discussions with the potential borrower. Secondly, there was to be a streamlining of the co-financing procedures. Their part of the loan should have more commercial terms and the cross default clauses were to be strengthened

Table 4.1

World Bank Co-financing Operations. Fiscal Years 1973-80

(Amounts in US$ millions)

	Projects with Co-financing		Sources of Co-financing							
			Official		Export Credit		Private		World Bank Controls	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	Bank	IDA
1973	37	496.2	30	313.0	10	183.2	0	0.0	478.9	308.0
1974	48	1463.0	44	788.8	11	589.5	2	84.7	1092.6	184.3
1975	53	1940.3	48	923.3	10	962.0	1	55.0	1033.6	346.1
1976	73	2255.1	61	1079.7	16	902.9	5	272.5	1583.3	403.1
1977	81	2289.1	72	1547.9	9	191.3	9	549.9	1866.2	698.0
1978	87	2426.4	77	1757.2	15	539.3	7	129.9	1827.5	798.8
1979	109	3149.4	88	1976.3	16	659.2	13	513.9	2993.3	1146.2
1980	93	6516.3	68	2458.6	23	2282.3	21	1775.4	3192.9	1605.2

N.B. The information provided on private co-financing is tentative since private loan arrangements are usually completed when funds are required. Arrangements therefore, may be made as long as one to two years after approval of a project by the Banks Executive Directors. Data on private co-financing also include all external private loans that assist in financing World Bank operations, whether or not formal co-financing arrangements are concluded.

Source: World Bank (1980) Co-Financing: Review of World Bank Co-financing with Private Financial Institutions Washington D.C.

(Task Force Report 1982 p.101). The advantage of increased discussion with the potential borrower is that the banks would become more familiar with the countries and may themselves be willing to invest in these countries without the assistance of the World Bank or other official agencies. In the House of Commons Treasury and Civil Service Committee report (1983, p.xxxiv) it was recognized that one of the problems facing the banks whilst lending to the developing countries was lack of information. The co-financing arrangements could make it possible for the banks to havemore up-to-date as well as relevant information to assit them in their decision making before lending to a developing country. Co-financing could have another advantage if the funds which would have been used by the development agency had the other co-lenders not participated, be used either as concessional loans to the least developed countries or else increase the flow of more non-concessional loans to other countries. Table 4.1 shows that the greater bulk of World Bank co-financing arrangements was with other official agencies. It was not until 1977 that co-financing with private institutions was comparable to that with export credit institutions, and even then it was a small percentage of the total. These figures would indicate that if the terms of the co-financing would be such as to attract the lenders and satisfy the borrowers, there would be greater scope for more private bank participation.

4.2.2 Increasing the role of the Official Lending Agencies

The two reports of the Brandt Commission (1980; 1983) have both stressed the need for an increase in the resources of the World Bank and the IMF. In its recommendations for the IMF, the Reports suggest that this objective can be achieved through an increase in the quotas, an enlargement of the Fund's General Agreement to Borrow (which will benefit the developing countries as well), and an increase in the Fund's Subsidy Account (Brandt, 1983). The question of Fund conditionality has become an important one in recent years. Quotas were only equivalent to about 3 per cent of the world's imports in 1980. As a result of this, a country does not need to have a large balance of payments

deficit before it becomes liable to the conditional credit tranche of the IMF. Following on from this, the size of the funds from the higher credit tranches did not seem to justify the increased conditionality from the point of view of the developing country. This resulted in countries resorting to the IMF when there seemed to be no other alternative. These arguments thus justified the need for increased quotas. The need for increased Fund resources has been highlighted recently by the growing number of countries going to the IMF in the face of their debt problems. Brazil has had some negotiations with the Fund recently, the first time in a very long time. The concept of conditionality itself is not questioned here although some changes in the terms of conditionality may make the Fund more acceptable. Williamson (1983) has made some suggestions regarding how IMF conditionality can be modified. (See also Brandt 1983p.65-67)

In the Brandt Report (1983) a substantial increase in the International Development Agency's replenishment was recommended and it was suggested that programme lending should rise to 30 per cent of total World Bank lending. This would increase the rate at which the World Bank disbursed its loans. An increase in the Bank's gearing ratio was also recommended which would increase the resources available for lending. In the Task Force Report (1982) the bankers did not consider that an increase in borrowing by the World Bank on the capital markets would be destabilizing. The indirect result of this is that since the World Bank is rated highly as a borrower on the international capital markets, the increase in funds from this source would increase the access of developing countries to these funds through the Bank.

The House of Commons Report (1983) recognizes that finance from the commercial banks was not always adequate for the developing countries. On the other hand they are doubtful whether some of the recommendations concerning the increase in the resources of the World Bank and the IMF will be possible. They support the recommendation to increase the World Bank's gearing ratio but doubt that the increase in callable capital which may be required will be supported by some of the member governments. (The problems or hesitance to pass through the US

Congress the Bill to increase quotas to the IMF illustrates this point clearly). They thus consider new forms of private lending (for example, Williamson's scheme) which will avoid the problems made in the past, to be the most likely way to increase resources going to the developing countries. Brunner et al (1983) do not consider an increase in the IMF quotas to be necessary. This is because if the problems of the developing countries are temporary, it will be easy to resolve them without a permanent increase in the quotas. All countries for which the problems are considered to be permanent should be allowed to default and any funds available should be directed to those countries in which the problem is temporary and can be solved without giving any benefits to the debtor or creditor. Brunner et al do not seem to share the pessimism of those who believe that the default of one country, especially a large debtor can severely damage the banking system. This problem is overcome by assuming that the central bankers will act as lenders of last resort. This question of the role of the central banks in international lending has become of increasing importance. The *House of Commons* Report (1983) has recommended that there be increased supervision especially for "consortium banks, banks which are subsidiaries of companies registered abroad, banks with head offices located outside the competence of the Cooke Committee and export-import banks." (House of Commons Report 1983, p.xlii).

The Brandt Report (1983) also recommended that the BIS increase its bridging loans. It has extended some such loans during the present debt crisis (Brazil received such a loan). However, there has been some hesitance on the part of the BIS to continue with this policy.

The decision to increase official lending is mainly a result of the desire to shift some of the lending in the international financial system from the banks to the official lenders. Given the terms of reference under which banks traditionally operate their lending to the developing countries was not always to the benefit of the latter. However it may not be possible to force a reduction in the banks' activities in these fields. So far

the banks themselves have reduced their lending to the developing countries. However, as the recent Brazilian experiences show, some finance from the international banks is still required. What is required in the future is a complementary existence between the banks and the official agencies. A move away from ill-defined projects and purposes for which funds are required to well-defined commercial projects should be the domain of the banks. The finance of economic and social infrastructure and balance of payments support programmes should be the main domain of the official lenders. The need for infrastructural projects to be financed by the official agencies is suggested here because these usually have long gestation periods and do not normally directly generate any output with which to repay the debt. The longer maturity of official loans will thus make it possible for the loans for these projects to be financed in the future. Unless the banks are willing to sink their funds in a long term project, it is doubtful that their type of finance will be adequate for such loans.

4.2.3 The creation of a new multilateral agency to channel funds to the developing countries

Brunner et al (1983) state that any losses which should occur as a result of borrowing by the developing countries should be incurred by those who carried out the transaction. They do not therefore support the recommendation that a new institution be set up to buy at a discount the debts of the developing countries owed to the banks. The possibility of there being such an institution is doubtful. There may be little desire on the part of the governments to set up such an institution. There would also be the problem of deciding whether sale of the debt should be voluntary or obligatory. Voluntary sales might distort the future flow of finance to those countries whose debt was sold at a discount. For these reasons the House of Commons Report (1983) did not support the proposal.

In the 1980 Brandt Commission Report the creation of a new international agency called the World Development Fund was suggested and an outline of its objective and functions was set out. It

was envisaged to fill in the gaps which exists in development finance [10], as well as to complement the lending of the World Bank and the IMF. It is doubtful that the political will exists to set up such an institution. There may be no need for this if it is possible to change the lending policies of the World Bank and the IMF. If these institutions are too inflexible to be changed it would be possible for regional agencies, especially those which have been recently created, to expand their resources if possible or else redirect their lending policies. Being regional agencies they may be more aware of the regional needs and so be able to direct policy to meet those needs.

4.3 An Evaluation of the Recommendations

Most of the recommendations put forward to improve the present international financial situation have been financial ones. The debt problems of the developing countries is not merely a financial problem. Policies which only consider this aspect of it will not necessarily lead to the alleviation of the problem in the medium to long term. The period since 1973/74 has been described as one in which response to current account deficits was biased more towards financing than adjustment (Llewellyn 1983 p303). It is the choice in the mix of adjustment and financing in response to the external shock which have been facing domestic economies which can explain to some extent the growth of developing country debt. However, a caveat is necessary here. This observation by Llewellyn though correct in the aggregate, hides the experience of the individual countries. Private financial flows which made up the bulk of the financial flows going to the developing countries during this period has been concentrated amongst a few countries. For the other developing countries which did not have access to these funds, they had to resort to official sources of financing. However, within the same period the OECD countries were experiencing low growth and flows from them were not growing very fast. The IMF resources, as a ratio of world imports, had also declined so that quite apart from the deterring influence of IMF conditionality the IMF would not necessarily have had sufficient funds to finance the deficits. For those countries therefore, they had to adjust

more to the current account deficit than finance it. Financing a current account deficit by either borrowing abroad or running down reserves allows a country to maintain present consumption whilst adjustment implies a reduction in present consumption (Bird 1980_b). In the Brazilian case, the policy was towards a large financing of the deficit, although some adjustment, in terms of reduced imports and incentive policy for exports, was also pursued. This choice of present consumption and an attempt to keep the growth rate from declining very far is evident in the investment to GNP ratio after 1974. On the basis of Sachs (1981) analysis the Brazilian response may be criticised as being sub-optimal. An increase in the current account deficit due to a temporary shock can be financed. In fact if the oil price rise was a temporary phenomena, i.e., the prices would go back to their former level, the country could continue to borrow until the trend had been reversed. However, since the oil price rise could be considered to have been a permanent phenomena on the basis of Sach's analysis, the current account deficit need not have persisted after the first eighteen months since the economy would have adjusted downwards. This, as the evidence in Chapter Three has shown, did not happen in the Brazilian case. It may be that the Brazilians and other large non oil developing countries had chosen the soft option. Given that they had access to large sources of finance they could choose not to adjust fully to the deficit. Sellekaerts and Sellekaerts (1973) have shown that of three possible ways to adjust to a one dollar deficit (i.e. expenditure switching, income changing and capital movement policies) the latter has the least cost of adjustments. This result was obtained from calculations done for fifteen countries, only three of which may be described as developing. Sihag (1982) developed further Sellekaerts and Sellekaerts analysis and showed that depending on what the source of the external disturbance was, the adjustment costs differed if the response was that of introducing capital inflow. He showed that where the disturbance was due to a change in the foreign rate of interest, or the shift in the supply or demand for capital, and where it was due to a change in the demand for imports or exports, the resort to a policy of capital in flow had less adjustment costs compared to an income reducing policy. A disturbance due to a fall in foreign income was hard to determine a

priori since it depended on whether it was felt mainly on the capital or the current account and the size of the foreign income coefficients with respect to exports and capital exports.

These analyses are based mainly on the short term since a country cannot afford to borrow long term. The immediate cost may be low, but if borrowing is not to finance investment which will generate real rates of returns and if the environment should change so that the conditions which existed when borrowing occurred differs from that which exists during the time for repayment, then a country can face serious problems.

Borrowing in the face of an external shock should only be a short time phenomena so that adjustment can take place. A delay in adjustment due to financing may simply delay the costs, if not increase them in the future when the country has no other option.

The point of the previous discussion has been to show that dependence on mainly financial solutions will not necessarily improve the debt position of the developing countries in the medium term. The main requirements to help the external payments situation of the major debtors is for them to embark on an adjustment programme within the domestic economy to reduce the deficit. This should be accompanied by a supply of funds to facilitate the adjustment programme but not in a quantity to further encourage the accumulation of debt. Thirdly, an increase in the growth of output in the industrialised countries which will increase demand for imports from the developing countries to help them pay the debt service is also needed (House of Commons Report 1983). There is also the need for some adjustment within the developed market economies. It is quite difficult for the developing countries which have formed strong financial relations with the rest of the world through the process of debt creation to immediately break down that relationship without defaulting. The external debt of the developing countries ensures that they will necessarily be tied to the developed market economies and to some extent will be required to maintain a policy which will generate foreign exchange to repay the

past obligations before the relationship with the developed countries can be formally reduced. This cannot occur without the developed countries also making certain adjustments to their economies. Firstly the developing countries should have greater access to the markets of the developed economies in order to earn the foreign exchange to pay for their debts. Very little of the trade of the non oil developing countries is amongst themselves and even if this should increase in the short term it still may not generate sufficient funds with which to pay the debt. Thus internal adjustment in terms of shifting labour from industries for which the developed economies may no longer have a comparative advantage should occur. This will enable the developing countries which may have developed the comparative advantage to increase their production and export from these industries. This restructuring of the domestic economy of the developed countries would need to be hand in hand with a decline in protectionism. It is not possible for the developing economies to pursue and benefit from a policy of free trade when the markets of their trading partners are restricted. Secondly the effect of the domestic policies of the developed countries on the world economy needs to be taken into account by the same countries. This is especially so for the USA whose budget deficits and monetary policy has repercussions for both the developed and developing countries.

The growth of the developing country debt illustrates the growing interdependence in the international economy. This is because the indebtedness has caused links between the two parties which negotiated the loan. It is in both their interests to make sure that the ability and willingness to pay the debts exists so that no partner is put at a disadvantage.

4.4 Brazilian Policy Towards Future External Borrowing

There has been a change in the Brazilian policy towards the external sector. This has been outlined in a statement made by the National Monetary Council

" In previous years one would start from export

> goals to determine the probable surplus in the balance of trade, which in turn would define the deficit in current account, leaving a residual which would be the necessary amount of financial loans ....(Now) we try to reconcile the available amount of financial loans, estimated as the feasible increase of exposure of international banks to Brazil with the maximum level of current account deficit which may be financed thus determining the minimum surplus needed in the balance of trade implied by this consideration "
> (National Mon. Council 1982 p1)

The need to switch the policy has been due mainly to the slow down in the growth of Eurocurrency lending during the time of the Mexican crisis in August 1982 and the Brazilian difficulties in December of the same year. On the basis of the new policy the gross volume of loans obtainable has been estimated at $10.6 billion. The growth of external indebtedness has been restricted in 1983 to 8.9%, compared to 17.6% in 1982. A trade surplus of $6 billion was targeted for 1983. This was to be achieved by a growth in exports and a reduction in import growth. Imports in the private and public sector were to be cut down by 21% and 29% respectively. (Bolsa 1982). So far the Brazilian trade surplus appears to be as planned. The reduction in the oil prices has reduced the oil import bills, although they are still faced with problems in that quarter.

The Brazilian policy has finally turned to adjusting the economy so as to fall in line with the amount of finance available. Previously adjustment came secondary to borrowing. Borrowing will still need to occur in the future if only just to help in servicing the debt. Further reductions in the interest rate and no further increases in the oil prices will reduce both the trade and current account deficit. An improvement in world trade will encourage exports further increasing the trade surplus. The supply of accommodating finance is also important. The Brazilians have had some difficulty in maintaining this since they have not fully reached the targets set out for the domestic economy.

The choice of action followed by the Brazilians has been reflected in a decline in the domestic growth rate. This should be expected since this could be seen as the only way in which the balance of payments could be taken care of. Continuous financing of the deficit could not continue forever. The three requirements set out on p are thus relevant to the present Brazilian situation. The hesitance of the authorities to embark on a full adjustment programme is because of the fear of the social costs. The alternative to that would then be a rather slow adjustment process so that the impact can be felt only gradually. Whether or not this will be possible and whether this will be acceptable to the agents lending the finance required to meet the adjustment programme is rather difficult to say. A sharp adjustment programme has been recommended (Kreuger 1981, this is with special reference to liberalisation of the foreign trade regimes) because it gains the confidence of the investors who are at once aware of what is happening. A gradual approach may be interpreted as reluctance thus reducing the response of the economic agents to any incentives which may result.

Although there is pressure on the domestic economy; an improvement in the international economy, especially the economies of the industrialised countries will help in making the adjustment process easier for the Brazilians. An attempt on the part of the USA to manage its fiscal and monetary policy so as to prevent the interest rate from rising very high as well as maintaining the value of the dollar will also help the Brazilians, since a large percentage of their debt was incurred in dollars and floating interest rates. Incidentally the domestic policy of the USA is not of importance only to the developing countries, but also to the developed economies which may be adversely affected due to high interest rates in the US and a very strong dollar.

Notes

1. In a discussion of Sachs paper Stanley Fischer criticises his analysis on the basis that he only emphasises investment as a cause of the current account deficits without also considering the savings ratio to any large extent.

2. In fact, in the first half of 1983 the Brazilians experienced a trade surplus. This is due to a change in policy towards the external borrowing which will be discussed later.

3. Joint Proposal by the Algerian and Venezuelan Delegations on the need for additional Financial Co-operation between OPEC member countries and other developing countries.

4. Quite apart from technical matters relating to the creation of the agency, there is also the problem of the political will. The rejection of the Algerian-Venezuelan proposal strengthens the suggestion that apart from economic and financial reasons OPEC could have increased its flow of resources directly to the developing countries. The direction of the flows mainly to the industrial countries could indicate a limited world view on the part of the OPEC countries (this is also evident amongst other developing countries) which consider links between the 'metropole' and the 'colony' to be more important than links among the 'colonies'. It may have been more prestigious to the investors to own assets in the developed countries, even if the same could be done in other developing countries with the same risks.

5. The mix is important since it decides firstly the rate at which loans will be disbursed and secondly it introduces the issue of conditionality.

6. For example Arlabank International which has both Latin American and Arab interests. It was formerly based in Peru, but has recently moved to Bahrain.

7. In some models which attempt to find out what factors affect lending to the developing countries, the purpose and nature of the loan is not included as a variable.

8. Another agency involved in co-financing arrangements is the Inter American Development Bank. It differs from the World Bank because the borrower and co-lender do not interact whereas in the arrangements of the World Bank, the borrowers and co-lender have loan agreements separate from that between the borrower and the World Bank (Cook 1983).

9. Apart from this it is possible that in some countries which need to undergo a large adjustment programme, there will not be enough projects in the short term to require project loans, especially since there may be a need to reduce the investment to GNP ratio.

10. The gaps in development finance identified by the Brandt Report (1980) were under three main headings. The first set of gaps was on the needs of the different groups of countries. The least developed countries for instance required a large amount of concessional finance. The second gap is in sector needs. In the agricultural sector for instance finance was required to keep with meeting consumption requirements. Thirdly there is a need for more programme loans (pp 227 - 236).

4.5 Conclusion

This thesis has been concerned with an analysis of the financial flows to the non oil developing countries in the seventies with special reference to the Brazilian case. The role of OPEC financial flows has been of interest here since it introduced a new aspect to the international financial system and the decision regarding the deployment of the OPEC financial flows influenced to some extent the direction of flows within the seventies.

The growth of the external debt and distribution of this debt has been discussed within the framework of the choice of the mix between adjustment and financing to shocks on the external account. Those countries like Brazil which preferred to borrow heavily to maintain a real rate of growth did so at the cost of incurring large amounts of external debt. The oil price rises, although causing large external shocks to the individual domestic economies were not alone in causing the growth of the debt outstanding.

It was possible for the OPEC countries to channel more concessional and non concessional finance directly to the developing countries. However, it has been hypothesised that this would not necessarily have made a very great difference to the present situation in terms of the size of the debt outstanding and payments arrears faced by some of the Latin American countries.

For the present, the countries now need to rely more on adjusting to the deficit with sufficient finance to enable them to pursue this process. For the future the decision as regards when and how to borrow needs to be taken with greater care. On the lenders side, caution also needs to be taken.

APPENDIX TABLE I

EXTERNAL DEBT OF BRAZIL

(US$ Millions)

	1972	1974	1976	1977	1978	1979	1980	1981
EBT OUTSTANDING DISBURSED ONLY								
EBT	9,978.6	19,114.1	28,778.9	35,120.0	46,487.8	51,488.0	55,759.1	63,790.5
Publicly Guar.	5,739.8	10,932.2	17,643.6	22,114.2	30,315.8	35,621.9	39,153.8	43,998.9
Non-guaranteed	4,238.8	8,181.9	11,133.3	13,005.8	16,151.8	15,864.1	16,605.3	19,791.6
PUBLICLY GUARANTEED DEBT								
TS. INC. UNDISB.	8,088.8	13,988.0	24,120.5	29,712.9	39,718.7	46,893.3	51,586.8	58,127.5
al Creditors	4,078.3	5,475.7	7,904.5	8,862.3	10,397.4	11,219.8	12,269.4	13,333.8
lateral	1,690.2	2,435.3	3,642.6	4,175.9	5,061.4	5,742.7	6,555.6	7,540.2
	1,341.8	1,625.2	2,554.2	2,765.1	3,366.4	3,952.1	4,584.8	5,459.8
	-	-	-	-	-	-	-	-
eral	2,188.1	3,040.4	4,261.9	4,686.4	5,336.0	5,477.2	5,745.8	5,793.6
e Creditors	4,010.5	8,492.3	16,216.1	20,850.6	29,319.3	35,673.4	39,297.4	44,793.7
iers	1,089.6	1,398.6	2,303.1	2,526.3	3,062.9	4,189.3	4,184.4	2,644.3
cial Markets	2,734.1	6,921.7	13,753.2	18,109.7	26,055.4	31,297.2	34,941.5	40,991.2
TS. DISB. (DOD)	5,739.8	10,932.2	17,643.6	22,114.2	30,315.8	35,621.9	39,153.8	43,998.9
al Creditors	2,372.4	3,473.1	4,566.7	5,105.4	5,822.8	6,160.8	6,800.9	7,221.9
lateral	731.7	1,263.2	1,775.2	2,054.0	2,385.2	2,756.4	3,106.0	3,446.5
	484.6	871.4	1,217.3	1,413.2	1,601.6	1,826.7	2,068.9	2,318.6
	-	-	-	-	-	-	-	-
eral	1,640.8	2,209.9	2,791.4	3,051.4	3,437.6	3,404.4	3,694.9	3,755.4
e Creditors	3,367.3	7,459.0	13,077.0	17,008.8	24,493.0	29,461.1	32,352.9	36,767.0
iers	741.1	973.4	1,164.3	1,548.8	1,989.3	1,756.4	1,646.0	1,284.6
ncial Markets	2,439.4	6,313.6	11,752.8	15,245.4	22,302.7	27,517.8	30,533.4	35,001.5
MENTS	2,592.1	4,089.8	7,531.8	8,362.8	10,778.5	11,485.9	8,982.8	12,024.8
al Creditors	1,040.8	881.9	1,970.7	1,120.4	1,505.6	1,356.4	1,850.4	2,120.0
lateral	681.0	343.3	640.0	687.8	967.4	870.1	1,088.6	1,314.4
	454.7	140.5	486.0	319.0	686.0	674.0	820.0	1,039.0
	-	-	-	-	-	-	-	-
eral	359.8	538.6	1,330.7	432.6	538.1	486.3	761.5	806.3
e Creditors	1,551.3	3,208.0	5,561.1	5,242.4	9,270.9	10,109.5	7,132.3	9,904.3
iers	344.6	340.5	587.2	225.4	501.2	1,637.0	128.3	1.0
ncial Markets	1,206.7	2,867.5	4,973.9	5,017.0	8,769.7	8,272.5	7,004.0	9,903.3
SEMENTS	2,155.8	3,755.8	4,878.3	5,848.3	9,826.7	9,511.9	7,406.6	9,131.0
al Creditors	384.0	898.4	703.5	793.2	900.1	845.7	1,165.2	1,080.4
lateral	230.2	385.5	284.2	391.3	411.4	507.6	534.8	576.0
	161.6	247.3	172.7	298.8	274.9	301.6	343.2	387.0
	-	-	-	-	-	-	-	-
eral	153.8	512.9	419.3	402.0	488.8	338.1	630.4	504.4
e Creditors	1,771.9	2,859.2	4,274.8	4,855.1	8,726.5	8,666.2	6,241.4	8,050.6
iers	360.2	219.5	458.8	492.1	531.6	307.5	148.2	80.9
ncial Markets	1,411.7	2,637.7	3,816.0	4,363.0	8,195.0	8,358.7	6,096.2	8,022.6
IPAL REPAYMENTS	417.4	633.7	1,084.0	1,676.0	2,628.3	3,600.0	3,824.0	3,616.8
al Creditors	102.8	136.4	260.5	363.6	373.2	428.1	511.5	555.0
lateral	44.3	46.9	83.0	146.4	132.1	131.9	166.8	200.5
	24.6	22.7	48.4	103.0	86.4	76.5	101.0	137.3
	-	-	-	-	-	-	-	-
eral	58.5	89.5	177.5	217.2	241.1	296.2	344.7	352.4
e Creditors	314.6	497.3	823.5	1,312.4	2,255.1	3,171.8	3,312.5	3,061.8
iers	74.5	150.5	198.1	230.3	294.2	408.8	324.7	289.6
ncial Markets	233.1	339.5	618.8	1,069.0	1,947.3	2,749.0	2,972.3	2,758.9
LOWS	1,738.5	3,121.9	3,894.3	3,872.3	8,998.4	5,911.9	3,582.6	5,514.2
al Creditors	281.2	762.0	443.0	429.6	526.9	417.6	650.7	525.4
lateral	185.9	338.5	201.3	244.8	279.3	375.7	361.9	370.5
	137.0	224.5	124.2	195.9	188.5	225.1	242.2	249.7
	-	-	-	-	-	-	-	-
eral	95.3	423.5	241.7	184.8	247.7	41.8	285.8	152.0
e Creditors	1,457.4	2,359.9	3,451.3	3,542.7	6,471.5	5,494.4	2,928.9	4,988.7
iers	285.7	69.0	260.7	261.8	237.4	-101.3	-179.5	-226.1
ncial Markets	1,178.6	2,298.2	3,197.2	3,294.0	6,247.7	5,609.7	3,123.9	5,260.8
EST PAYMENTS(INT)	220.7	591.0	980.2	1,203.0	1,846.2	2,920.9	4,196.5	4,999.3
al Creditors	84.3	137.2	227.8	283.4	328.8	389.8	439.4	484.1
lateral	43.3	80.8	132.5	167.1	212.9	235.0	254.5	270.0
	27.3	55.3	88.9	107.4	137.6	163.8	178.8	184.6
	-	-	-	-	-	-	-	-
eral	40.9	56.5	95.3	116.3	115.9	154.8	164.9	217.2
e Creditors	136.5	453.8	732.4	919.7	1,519.4	2,531.0	3,760.0	4,515.1
iers	28.2	54.1	59.3	80.6	112.4	127.4	113.9	110.9
ncial Markets	96.4	388.6	663.6	823.8	1,389.3	2,390.4	3,631.1	4,390.3

contd /-

APPENDIX TABLE I.

EXTERNAL DEBT OF BRAZIL

(US$ Millions)

	1972	1974	1976	1977	1978	1979	1980	1981
NET TRANSFERS	1,517.8	-2,530.9	2,834.0	2,769.3	5,150.2	2,991.1	-816.9	514.9
Official Creditors	196.9	624.8	215.2	146.2	198.1	27.7	214.2	41.2
Multilateral	142.6	257.8	68.8	77.7	66.3	140.7	113.4	106.5
IBRD	109.7	169.2	35.3	88.4	50.8	61.3	63.4	65.0
IDA	-	-	-	-	-	-	-	-
Bilateral	54.3	367.0	146.5	68.5	131.8	-113.0	100.8	-65.2
Private Creditors	1,320.9	1,906.1	2,718.8	2,623.0	4,952.0	2,963.3	-831.1	473.6
Suppliers	257.5	14.9	201.3	181.3	125.0	228.7	-293.4	-374.5
Financial Markets	1,082.3	1,909.8	2,533.5	2,470.1	4,858.3	3,219.4	-507.2	873.4
TOTAL DEBT SERVICE(TDS)	838.2	1,224.7	2,044.2	2,879.1	4,478.5	8,520.9	8,023.5	8,816.1
Official Creditors	187.1	273.7	488.3	647.0	702.0	818.0	951.0	1,039.2
Multilateral	87.7	127.7	215.5	313.5	345.0	366.9	421.4	469.5
IBRD	51.9	78.1	137.4	210.4	224.1	240.4	279.8	321.9
IDA	-	-	-	-	-	-	-	-
Bilateral	99.5	146.0	272.8	333.5	357.0	451.1	529.6	569.6
Private Creditors	451.0	951.1	1,555.9	2,232.1	3,774.5	5,702.9	7,072.5	7,576.9
Suppliers	102.7	204.6	257.5	310.8	406.6	536.1	438.7	402.5
Financial Markets	329.5	728.1	1,282.4	1,892.9	3,336.7	5,139.3	6,603.4	7,149.3
AVERAGE TERMS : PUBLIC DEBT NEW COMMITMENTS								
ALL CREDITORS								
Interest (%)	7.2	10.1	7.6	8.3	9.8	11.2	12.3	15.2
Maturity (years)	12.9	11.2	11.3	9.9	10.0	11.5	9.8	9.2
Grace Period (years)	3.6	3.7	3.8	3.7	4.1	5.2	3.9	3.2
Grant Element (%)	13.6	-0.5	11.7	7.8	0.1	-7.8	-10.1	-20.0
OFFICIAL CREDITORS								
Interest (%)	6.8	6.8	7.9	8.0	7.4	8.3	9.1	9.8
Maturity (years)	19.5	15.2	16.3	15.9	14.7	13.9	12.9	13.8
Grace Period (years)	5.3	3.9	5.3	4.1	3.3	3.7	2.9	2.9
Grant Element (%)	19.7	17.6	12.4	10.9	14.2	10.1	6.9	2.1
PRIVATE CREDITORS								
Interest (%)	7.4	11.0	7.5	8.4	10.2	11.6	13.4	16.4
Maturity (years)	8.4	10.0	9.4	8.4	9.3	11.2	8.7	8.9
Grace Period (years)	2.5	3.7	3.3	3.6	4.3	5.4	3.8	3.3
Grant Element (%)	9.6	-5.7	11.4	6.9	-2.3	-10.2	-15.6	-28.4
MAJOR ECONOMIC AGGREGATES (U.S. $ MILLIONS)								
Gross Nat. Product (GNP)	61,525	108,147	155,102	175,543	201,769	225,522	240,923	274,214
Exports of G. & S. (XGS)	4,508	9,371	11,292	13,511	14,458	17,994	23,291	26,993
Imports of G. & S. (MGS)	6,204	16,934	17,848	18,616	21,561	28,477	36,252	38,920
Int'l Reserves (RES)	4,219	5,463	6,667	7,442	12,190	9,838	6,875	7,480
PRINCIPAL RATIOS								
TDS/XGS (%)	127.3	116.7	156.2	163.7	209.7	198.0	168.1	163.0
TDS/GNP (%)	9.3	10.1	11.4	12.6	15.0	15.8	16.3	16.0
INT/XGS (%)	14.2	13.1	18.1	21.3	31.0	36.2	34.4	31.9
INT/GNP (%)	1.0	1.1	1.3	1.6	2.2	2.9	3.5	3.1
MLT/XGS (%)	4.9	6.3	8.5	8.9	12.8	16.2	16.0	16.5
MLT/GNP (%)	0.4	0.5	0.6	0.7	0.9	1.3	1.7	1.8
RES/DOD (%)	73.5	50.0	37.8	33.7	40.2	27.6	17.6	17.0
RES/MGS (months)	8.2	3.9	4.5	4.8	6.8	4.1	2.3	2.3
MEMORANDA								
Proportion of Disbursed Debt								
Concessional Loans (%)	26.0	15.4	9.9	7.6	5.8	4.9	4.2	3.5
Var. Int. Rate Loans (%)	25.0	43.2	54.8	54.0	56.2	59.2	61.6	68.2
Use of IMF Credit(US$ mil)	-	-	-	-	-	-	-	-

	1982	1983	1984	1985	1986	1987	1988	1989
PROJECTED PUBLIC DEBT SERVICE								
TOTAL DEBT SERVICE	10,574.3	10,136.7	10,731.5	11,064.8	11,022.7	9,824.0	8,771.1	8,282.5
Principal	4,755.8	4,575.4	5,513.8	6,388.9	7,098.2	6,754.2	6,570.4	4,866.8
Interest	5,818.5	5,561.3	5,217.7	4,675.9	3,924.5	3,069.8	2,200.8	1,395.7
OFFICIAL CREDITORS	1,452.7	1,844.0	1,889.8	1,841.2	1,625.7	1,562.3	1,439.7	1,385.0
Principal	883.9	1,037.4	1,081.0	1,022.9	1,029.0	1,012.0	946.8	934.4
Interest	568.8	606.6	618.9	618.3	596.7	550.3	492.9	450.6
PRIVATE CREDITORS	9,121.7	8,492.7	9,031.6	9,423.6	9,397.0	8,261.7	7,331.4	6,897.5
Principal	3,871.9	3,538.0	4,432.8	5,366.0	6,069.2	5,742.2	5,623.5	3,932.4
Interest	5,249.7	4,954.7	4,598.8	4,057.6	3,327.8	2,519.5	1,707.9	965.2

Source: World Bank World Debt Tables 1982 p158-9 Washington D.C.

Appendix Table 2

BRAZIL : NET IMPORTS OF PETROLEUM 1970 - 1980

	Weight (metric tonnes)	Value (Thousand US $)	% Change in Value	Unit Value US $	% Change in Unit Value
1970	15728232	242645			
1971	17863981	352781			
1972	21891600	470568			
1973	30080736	812712	72.0	26.57	25.00
1974	31076626	2129814	162.0	88.66	233.00
1975	33506505	3013728	42.0	89.75	1.23
1976	37467650	3557493	18.0	94.37	5.00
1977	38729034	3829140	7.0	98.66	4.50
1978	44332152	4420829	15.4	99.67	1.02
1979	50158000	6720456	51.6	133.18	34.00
1980	43590000	10200000	51.7	233.99	75.00

Source: Calculated from U.N., Yearbook of International Trade Statistics various issues, New York.

Appendix Table 3

Industrial Countries. Consumer Price Index and Percentage Change 1972 - 1981

	Price Index (1975 = 100)	% Change over Previous Year
1972	73.8	4.7
1973	79.5	7.7
1974	90.0	13.3
1975	100.0	11.1
1976	108.3	8.3
1977	117.5	8.4
1978	125.9	7.2
1979	137.4	9.2
1980	153.7	11.9
1981	169.1	10.00

Source: IMF International Financial Statistics Yearbook 1982 Washington D.C.

Appendix Table 4

Export Unit Value of Non Oil Developing Countries

Year	Export Unit Value	Year	Export Unit Value
1970	54	1976	105
1971	53	1977	121
1972	56	1978	125
1973	74	1979	146
1974	101	1980	169
1975	100	1981	-

Source: IMF International Financial Statistics Yearbook, 1982 Washington D.C.

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