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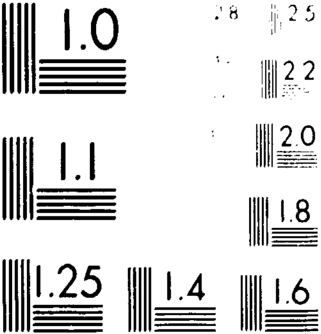
UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION
Vienna International Centre, P.O. Box 300, 1400 Vienna, Austria
Tel: (+43-1) 26026-0 · www.unido.org · unido@unido.org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Distr.
LIMITED

UNIDO/PC.46
12 July 1982
ENGLISH
ORIGINAL: SPANISH

UNITED NATIONS
INDUSTRIAL DEVELOPMENT ORGANIZATION

First Consultation on Industrial Financing

Madrid, Spain, 18-22 October 1982

INFORMATION PAPER

LIMITS AND PROSPECTS OF THE INTERNATIONAL FINANCING SYSTEM*

by

Rosario Green**

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** UNIDO Consultant.

V.82-30683

1. It has in the past been customary to explain, or even to justify, the external indebtedness incurred by the developing countries in terms of the finance requirements arising out of their economic growth and industrial development.

2. It is accepted that one of the factors on which economic growth and diversification of production depend is the process of domestic capital formation. In most developing countries, however, the possibilities of domestic capital formation are limited by low productivity and growing consumer damend, both in the public and in the private sectors, resulting among other things from rapid population growth.

3. In these circumstances and in the face of the real situation that the majority of the developing countries, in order to speed up their economic growth and industrial development, urgently need to import capital goods, raw materials, technical knowledge etc. that cannot be financed entirely out of their exports, because of both their insufficient volume and their lower relative value, it has been necessary to supplement the process of domestic capital formation by a steady and even increasing inflow of resources originating in industrialized countries.[1/]

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*/ Mrs. Green is a full-time professor at El Colegio de México and a research associate at the Centro de Estudios Económicos y Sociales del Tercer Mundo (Economic and Social Research Centre for the Third World).

1/ A more detailed discussion of this argumentation may be found in: Rosario Green, El endeudamiento público externo de México, 1940-1973 (The External public debt of Mexico, 1940-1973), Mexico, El Colegio de México, 1976. V. especially Chapter III, section 1.

4. On the basis of this line of thought, a number of economic models have even been constructed that not only explain the capital imports of the developing countries in the foregoing terms, i.e., as a supplement to domestic savings and as a stabilizing item in the balance of payments, but also attempt to introduce elements to determine which import factor is decisive at any given moment.

5. An outstanding model of this kind is that proposed by Professor Hollis Chenery and better known as the "analysis of the two gaps".[2/] This model assumes that the developing countries are faced with inadequate savings, both domestic and external, and that this situation could become a serious hindrance to their economic growth and industrial development if not corrected. Specifically, it is argued that growth and industrialization are hindered or restricted by the inadequate availability of foreign exchange to finance the imports needed for production and investment and/or by the lack of abundant domestic resources to finance investment.

6. Thus, in the absence of levels of domestic savings, whether public or private, sufficient to finance the country's investments, and in the absence of foreign exchange earned by the export of goods and services sufficient to pay for the imports required by the country's growth, it is only possible to maintain a particular pace of internal expansion by means of foreign capital contributions.[3/]

2/ Hollis B. Chenery and Alan M. Strout, "Foreign Assistance and Economic Development", The American Economic Review, Vol. LVI, No. 4, Part I, September 1966, pp. 679-733.

3/ A critique of this model and other similar ones may be found in: Rosario Green, Estado y banca transnacional en México (The State and the transnational banks in Mexico), Mexico, CEESTEM-Nueva Imâgen, 1981. V. especially Chapter I, section B.

7. In the theory behind models of this type, emphasis is therefore placed on the demand of developing countries for external resources to increase the supply of domestic savings and of imported goods and so to overcome some of the specific limitations on economic growth and industrial development.

8. There are basically two ways in which this demand for external resources is met, by direct foreign investment and by external loans.

9. It is, however, a fact that for a substantial number of developing countries direct foreign investment has in the past proved a much easier way of obtaining external resources than external indebtedness. This greater availability of foreign investment certainly reflected general world economic trends, such as the accelerated spreading of production over national frontiers which enabled goods to be circulated ever more rapidly at the international level and gave rise to a new international division of labour.4/

10. However, direct foreign investment became a problem at the point when the developing countries realized that the "financing" and "complementary" function that these foreign capital contributions were supposed to have did not necessarily work as well in practice as in theory. It emerged that the outgoing payments in respect of capital service - remission of profits, royalties, etc. - were not only substantially reducing the flow of net revenue but had in addition created a kind of "vicious dependence" of the country on these resources in order to improve the balance of payments, which sometimes forced it to incur excessive expenditures.

4/ A fuller discussion of productive transnationalization and its successor, financial transnationalization, may be found in: Jaime Estêvez and Rosario Green, "El resurgimiento del capital financiero en los años setenta: contribución a su análisis" (The resurgence of financial capital in the seventies: a contribution to its analysis), Economía de América Latina, No. 4, March 1980, pp. 59-69.

11. One was even faced with empirical evidence that indicated how, for many developing countries over a certain number of years, the capital outflow in respect of profits repatriation arising out of direct foreign investment, together with payments for royalties, "know-how", technology, etc. amounted to more than the capital inflow. It will suffice as an example to indicate that it can be shown that US $9600 million were channelled to Latin America as direct foreign investment from 1950 to 1967, and that the region made foreign payments over the same period to the extent of US $18 800 million in respect of profits repatriation and payments to shareholders.[5/]

12. The problem of direct foreign investment once again became acute at the time of the production recession in the industrialized countries, and it was found that the recession was reflected in a much reduced flow of resources into direct investment in the developing countries. This situation resulted in further financial difficulties for many of those countries, but also contained a promise, if not of new solutions, at least of fresh possibilities, as we shall see later.

13. It is important to note that in any case an alternative, or rather a supplementary, source to direct foreign investment has been available for many years to a large number of developing countries, consisting in the supply of financial resources of official origin administered by the international organizations that have been established since 1944, at the world, regional and even national levels.

14. It used to be assumed that the requirements for external resources dictated by the economic growth and industrial development of this region of the world would have to be met,

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5/ Orlando Caputo and Roberto Pizarro, Imperialismo, dependencia y relaciones internacionales (Imperialism, dependence and international relations), Buenos Aires, Amorrortu, 1976, p. 135.

parallel with direct foreign investment, by such institutions as the World Bank and the International Monetary Fund, at the multilateral level, by organizations operating at the regional level, such as the Inter-American, Asian, African and Caribbean Development Banks, and also by bilateral bodies, even though, as in the case of the Export-Import Bank of Washington, these were known to be closely linked with United States foreign policy and its perception of that country's national interests.

15. It was soon noted, however, that as the developing world expanded, in consequence of the decolonization movement promoted by the United Nations, and as its expectations of industrialization and growth firmed up, the resources of those organizations became inadequate, just as the net flow towards those countries in respect of direct foreign investment had also proved insufficient.

16. In view of these initial limitations of the international financing system and since the objective was to find any means of overcoming their internal problems (inadequate domestic savings) and external difficulties (insufficient supply of foreign exchange), the developing countries determined to intensify their search for fresh and more ample financial resources from outside. Their opportunity came in the seventies, when the world was faced with the formation of excess international liquidity, which was to the advantage of those countries.

17. In fact, the decade of the seventies witnessed one of the most important worldwide changes in international economic relations, the appearance and growth of a surplus supply of capital on the international markets, available for channelling as loans by the great transnational banks. On the basis of their important and growing role in the redistribution of this surplus, the banks took precedence over all other international

economic agencies, to the point where one could speak of a "bankers' takeover" of the world economy, meaning the domination and even control of the transnational banks and their way of thinking over international economic relations. This way of thinking entails a greater inclination on the part of the bankers not only to finance viable and profitable projects but also to give preference to countries, sectors and projects in which worldwide capitalist integration is possible, without regard to the expectations of the developing countries for economic growth and industrial development of a more indigenous kind, more in accord with their national realities and providing greater independence and sovereignty vis-à-vis their external sources of finance.

18. There are two main explanations for the appearance and development of this excess international liquidity.

19. In the first place there is the whole problem mentioned earlier of the recession in the productive sectors of the industrialized countries: the money not invested in the productive sectors was transferred to the banking sector, in order to maintain the capitalists' profits, which is after all the main object of the system. There then began to develop an excess of liquidity on the international capital markets and the banks started an intensive search for new customers, which gave rise to fierce competition among the banks that expressed itself in increasing pressures on the users of funds, as will be seen.

20. In these circumstances the Governments and public sectors of the developing countries, or at least a large number of them, were seen to be ideal customers. The international bankers took advantage of the needs of those countries and even exaggerated them, and applied pressure for their surplus resources to be invested in them, thus unifying supply and demand.

21. In the light of this new phenomenon, there needs to be a revision of the theories hitherto held as to why developing countries import capital. It is no longer so entirely a question of their demand for external resources to finance their economic growth and industrial development; it is also the supply of resources that in itself swells the already very large initial demand.

22. Thus, in both the financial and the production areas, it may be said that, through a mechanism somewhere between propaganda and pressure from the bankers, any supply (surplus international liquidity) generates its own demand (increased demand for external resources substituting for a set of internal reforms that would reduce the dependence of these economies on foreign capital).

23. Furthermore, this surplus liquidity has been increasing even more since 1973 and what is known as the "energy crisis", which entailed the recycling through the financial system of the "petro-dollars" created by the upwards revaluation of energy supplies. It was no accident that the European-currency market, which originated in the period following the Second World War but reached its true dimensions in the seventies, and is one of the markets into which such surpluses are unloaded, went from a turnover of US $155 000 million in 1973 to one of US $540 000 million net in mid-1980.[6/]

24. The developing countries then began to work on the assumption that the resulting availability of external resources in the form of medium- and short-term loans would mean that their internal imbalance (S - I) and their external imbalance (X - M) would be remedied in an infinitely elastic money supply on the international markets.

6/ David F.V. Ashby, "Will the Eurodollar Market go back home?", The Banker, February 1981.

25. One of the first fruits of this kind of belief was that the reforming endeavours towards closing the domestic savings gap by, for example, improving income distribution and closing the foreign exchange gap by, among other measures, rationalizing imports and making exports more competitive, were to a large extent practically dropped, and external indebtedness became the ideal adjustment mechanism for correcting imbalances, allowing the countries' internal structure, the interplay of economic forces and the internal systems of privileges to remain unchanged.

26. A further consequence was, inevitably, an accelerated expansion of Third World external indebtedness and the appearance and consolidation of certain trends in this indebtedness that persist to the present time.

27. It is well known that the supposedly enormous, indeed inexhaustible, availability of capital resources to finance the economic growth and industrial development of the Third World countries, and the pressures applied to secure their profitable placement, have caused an explosion of their external debt, which went from US $40 000 million in 1970 to around US $520 000 million in 1981. This numerical increase by a factor of 13 over the period in question is considerably in excess of world inflation. It is difficult to determine its growth in real terms, in view of the shortcomings of each of the possible indicators, but it can be stated that the external debt of the developing countries rose from the equivalent of 16 per cent of the gross national product of those countries taken together in 1970 to 23 per cent in 1978. This percentage has since fallen somewhat, but still remains at over 21 per cent.[7/]

7/ Some of these figures may be found summarized in: Jaime Estévez, "Internacionalización financiera y de desarrollo nacional" (Internationalization of financing and national development), 40 pp. mimeo. This paper will shortly appear in Tercer Mundo y Economía Mundial, Vol. I, No. 3, May-August 1982.

28. As might be expected, this expansion of the external indebtedness of the developing countries led in turn to certain consequences. Perhaps the most important of these was the expansion of the debt service. The external debt service of the developing world, defined as the proportion of the total export sales income of the developing countries represented by outgoing payments on account of redemption and interest, has grown faster than its absolute amount. This has been particularly true since 1977, when the service payments increased by 43 per cent and subsequently remained at annual nominal rates of expansion in excess of 30 per cent. Within these enormous external debt-service figures the main factor has been the interest burden, which faithfully reflects the current rising trend.

29. This situation is much more serious for the under-developed countries classified as "non-oil-producing". In their case, the proportion of external debt service to the value of total exports rose from 11.2 per cent in 1974 to 20.8 per cent in 1981, when US $96 400 million were paid on account of redemption and interest; this is equivalent to the entire amount owed by the developing countries in 1973.

30. Apart from the problem of the growing expansion of the external debt of the Third World countries and its manifestation in the ever-increasing burden on account of service, there is also the further question of certain tendencies in its nature. It is a fact that as the debt has expanded it has become increasingly private in origin and increasingly controlled by the great transnational banks. In other words, the debt has become private and bank-dominated.

31. The trend towards private control of the Third World countries' external debt is demonstrated by the fact that, whereas in 1969 70.3 per cent of the loans to governments and

public sectors of the developing world were provided by official suppliers of credit - governments and multilateral organizations - and only 29.8 per cent by private institutions - suppliers, banks, bond issues, etc. - in 1979 only 45.6 per cent of the total was regarded as official and as much as 54.5 per cent as private.8/ It is true that official financing increased in 1980 and 1981, especially that channelled towards non-oil-producing countries, through the issue of fresh Special Drawing Rights free of charge and the greater resources available from the multilateral finance agencies, but this was still not enough to reverse the tendency towards private ownership.9/

32. The tendency towards control by the bankers, in the sense that it is the banks, and especially the great transnational banks, that have gained control of the privately-owned debt and so replaced other creditors, such as suppliers, who had previously been the most important, is demonstrated by the fact that, whereas in 1969 the banks provided only 7.5 per cent of the total finance in comparison with 14.8 per cent represented by suppliers' credits, in 1979 the proportion increased to 41.5 per cent, while the suppliers' share fell to 7.2 per cent. This could be said to apply equally well to today's situation, since the 1979 situation is still valid: financing through banks represents the bulk (76.4 per cent) of private financing and such a large share (41.5 per cent) of total financing that it exceeds the finance supplied either by governments (31.1 per cent) or by multilateral agencies (14.5 per cent), though it does not quite exceed both together. However, this does not alter the

8/ 1969 figures: World Bank, Annual Report 1976, Washington D.C., p. 101; 1979 figures: World Bank, World Debt Tables, Washington D.C., 15 November 1980.

9/ In 1980 the World Bank established a line of credit for structural adjustments and the International Monetary Fund increased the funds for supporting the balance-of-payments deficits of the under-developed countries from 2 200 million SRD's in 1979 to over 14 000 million SRD's in 1981.

channel loans into the developing world, the banks are the main agents.

33. In consequence of the accentuation of these trends in recent times, the external debt of the developing countries is a more serious problem, primarily because it is more burdensome in that the terms of private and bank loans are usually shorter than those set by official financing agencies and the interest is generally appreciably higher. However, it is not only the case that the interest obtained by the private banks rises ever higher, but in addition that the interest is at floating rates, which considerably raises the real cost of finance, since the uncertainty costs must be added to the actual finance costs.

34. Secondly, the external debt problem is more difficult now than it was ten years ago because the most important sources of finance - private sources and banks - are extremely unstable and volatile, as a result of lack of control of the money markets and their trend towards speculation. The proliferation of international financial centres in "tax havens", both in under-developed areas (Bahamas, Barbados, Bermuda, Cayman Islands, Hongkong, Lebanon, Liberia, Netherlands Antilles, New Hebrides, Panama and Singapore; also perhaps in Rio de Janeiro and to a limited extent in Mexico City) and in developed areas (such as the recently established "off-shore" zone in New York), testifies to this speculation and absence of control, not to speak of the uncontrollable European market.

35. Thirdly, today's external indebtedness presents problems because it cannot even be said that, in the course of becoming more subject to private and banking control, it has become less political or more neutral than it was when it depended almost exclusively on official sources of finance. In other words,

there seems to be enough empirical evidence to demonstrate that, although it is certainly much easier to detect the political pressures that governments and even official finance agencies may apply to loan recipients, such pressures are by no means absent in the case of loans made by private banks.[10/] With their resources, these banks can guide the economic growth and industrial development of the receiving countries in the direction that the bankers regard as "suitable", can impose the use of particular technologies and can link their loans with the adoption of a particular policy: provision of facilities for direct investment by their own countries or of a secured supply of particular resources, etc. As has already been demonstrated in a few specific instances, they can also set themselves up as supervisors of the overall working of the ecnoomies of the countries that receive the resources, on the lines of the International Monetary Fund and in some cases even in anticipation of the presence of the Fund itself.[11/]

10/ An interesting view of the problem may be found in: Robert Devlin, "?Es compatible el financiamiento bancario comercial con el desarrollo económico del Tercer Mundo?" (Is commercial bank financing compatible with the economic development of the Third World?) in: Jaime Estévez and Samuel Lichtensztejn (Eds.), Nueva fase del capital financiero. Elementos teóricos y experiencias en América Latina, Mexico, CEESTEM-ILET-Nueva Imágen, 1981, pp. 143-175.

11/ A series of case studies on the political activities of the international banks may be found in: Jaime Estévez and Samuel Lichtensztejn, op. cit., in particular among the articles in the second part by: Roberto Frenkel (Argentina), María de Conceição Tavares (Brazil), Diego Portales (Chile), Richard L. Bernal (Jamaica), Rosario Green (Mexico), Jorge Fontanals (Venezuela). For the case of Peru v.: Robert Devlin, Transnational Banks and their Penetration of the External Finance of the Third World: The Experience of Peru, 1975-1976, ECLA, Santiago, 1978.

36. Another point is that the growing importance of private and banking sources of external finance for the Third World has lately been matched by a growing, though, as will be seen later, unequally distributed importance of the Third World in the international money markets. In particular, an orientation of the European currency market towards the Third World is a phenomenon that has been observed, very clearly at least at the end of the seventies and perhaps less clearly at the present time, and is worth while describing.

37. Until 1969, the main customers for European currencies were United States domestic banks, who started to go outside the domestic market on a massive scale as a result of the capital export controls that the Washington authorities began to impose from 1963 onwards. President Kennedy's administration taxed foreign loans, under Johnson controls were imposed on the export of productive and banking capital ("Program of direct foreign investment" and "Voluntary Program of Restriction of External Credit"), and Nixon's administration kept these controls in force until 1974.

38. The purpose of these controls was to reduce the massive exports of dollars out of the United States and improve the United States balance of payments, which was deteriorating considerably. Their impact was however insignificant in the short run and in the long run the oppostie of what had been intended and a disaster. Instead of falling, capital exports in fact rose considerably, but in a disguised form. Between 1964 and 1974 United States banks moved abroad on a massive scale. In 1965 only 11 U.S. banks had branches abroad, numbering 211 in all. By 1975 there were 126 U.S. banks with a total of 762 branches outside the borders of the United States, and their financial predominance was such that generally speaking they controlled more than two-thirds of all loans world-wide;

this proportion has admittedly decreased substantially recently, as the European and Japanese banks have expanded their business activities.

39. The main objective of United States banks in opening branches abroad on such an impressive scale was to put themselves in a position to follow their important customers, the great transnational companies of United States origin. As these companies became ever more able to finance their own operations, their need for external resources fell, and the public sectors - or even the private sectors - of other industrialized countries began to gain importance on the market. As pointed out earlier, however, when the production recession that characterized the seventies appeared, the demand from the developing world for resources from the industrialized countries as such receded, and the developing countries appeared as important borrowers on the European money market.

40. It is stressed that the appearance of the Third World on this market is due to factors that have already been mentioned, such as, first of all, the growing need for financial resources, of which a large part consisted in the funds needed to finance oil imports at increasing prices, and the impossibility of satisfying that need entirely out of financial resources of an official nature, or even by foreign investment, especially during the recession in the industrialized countries; secondly, the accelerated formation of surplus liquidity on the European money marked due to the world-wide recession but made worse by the recycling of petro-dollars; and thirdly, the pressures placed on the governments of developing countries by the international bankers with a view to placing the surplus funds profitably.

41. Thus, in 1975 the under-developed countries were absorbing 56.5 per cent of the European currency debt of the whole world, and while it is true that this percentage declined somewhat in

the next three years as the demand for funds of the developed countries also increased slightly; it continued in any case to represent more than half the total, even reaching the record figure of 57.4 per cent in 1979.[12/]

42. Attention is drawn to the statement made a few paragraphs ago that, although it is a fact that the European marked became "Third-World-oriented" in the seventies, this does not mean that all developing countries played an equally important part in it. At the end of 1979 around 80 per cent of the loans directed towards the developing world were concentrated in the following 15 countries: Mexico, Brazil, South Korea, Venezuela, Argentina, Algeria, the Philippines, Iran, Indonesia, Chile, Morocco, United Arab Emirates, Malaysia, Taiwan and Peru. Furthermore the six Latin American countries in this group alone accounted for somewhat over 50 per cent of total funds sent to developing countries, so that it would be true to say that the European market was not only "Third-World-oriented" but also "Latin-Americanized" in the seventies.

43. This high level of concentration of European-currency loans to the Third World in a small number of debtor countries is largely explained by the policies of the lenders. Bankers operating on the European currency market and lending to developing countries give first preference to the larger oil-producing and exporting countries. Secondly, they favour relatively large high-income countries. Thirdly, they a[illegible] prefer those with "stable" political regimes, growing ec[illegible]es and plenty of mineral resources, those maintaining permanent sound contacts with the international banking community and, in the case of countries that have recently become independent, those who maintain good political relations with their former mother-countries.

12/ UNCTAD, The Flow of Financial Resources, document TD/B/C.3/150, September 1978, and OECD, "Access by Developing Countries to International Financial Markets", Financial Market Trends, No. 13, 1980.

44. It is the public rather than the private sectors of the developing countries that have made most use of European-currency loans, in particular public enterprises in the extractive and transformation industries. At the end of 1979, for example, practically 90 per cent of all the European-currency loans channelled through the European market to Third World countries (between January 1976 and December 1979, about US $120 000 million were channelled through the European market to the developing countries, a figure which, curiously enough, coincides with the magnitude of the surplus on current account of all OPEC member countries, but for 1980 alone) was absorbed by governments (36 per cent) and public sectors (54 per cent) and only a small part (around 8 per cent) went into the borrowers' private sectors.13/ In such countries as Mexico and Brazil, the largest borrowers on the European market, and others regarded as recently and rapidly industrialized (referred to in development parlance as "newly industrialized countries" /NIC's/), on the other hand, the private sector is beginning to gain importance, though as a general rule the public sector continues to account for at least two-thirds of a country's total indebtedness.

45. In view of such a high degree of concentration of the European-currency loans to the Third World in a small number of countries (oil-producers and non-oil countries with a large industrial potential), in one main sector (the public sector), and in a small number of industries (extraction and transformation), serious doubts arose by the end of the seventies with regard to the international finance system and with regard to the response capacity of a number of debtor countries, some (such

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13/ Some of the figures included in this passage appeared in: Jeff Frieden, "Third World Indebted Industrialization: international finance and State Capital in Mexico, Brazil, Algeria and South Korea", International Organization, Vol. 35, No. 3, Summer, 1981, pp. 407-431.

as Brazil) being regarded as over-indebted and others as non-viable or unable to meet their commitments towards the international banking system.

46. In general, it was becoming clear that the eighties would be fraught with serious financial problems for the developing countries, and this is a forecast that must not be lightly dismissed. While it is true that the danger of bankruptcy and default has not materialized in practice and that the massive renegotiations or global moratoria that had been feared have not taken place, the developing countries have been hard hit by the increased interest rates with which, to start with, the United States administration hoped to solve its monetary problems.

47. The nominal rates of interest in the United States were three times as high in 1980 and 1981 as in 1977: in real terms, they moved from negative values to values varying around 10 per cent annually. As a result, the London inter-bank rate for six-month loans (LIBOR), which applies to the bulk of European-currency loans, increased from an average of 6 per cent in 1977 to 14.4 per cent in 1980 and to over 17 per cent in 1981.[14/]

48. The rise of interest rates in the leading countries has had a severe impact on the Third World nations. First of all, the under-developed countries were faced with reduced options with regard to their domestic monetary policy. A massive transfer of capital to the United States and European market took place, especially from countries with open economies and few restrictions on movements of capital, with negative consequences for the balance of payments and the exchange rate:

14/ Calculated by Jaime Estévez in op. cit. note (7), p.2.

the dollar rose and other currencies weakened. Almost all countries were forced to raise interest rates, which restricted the availability of domestic credit, discouraged investment and reduced consumption, leading to substantial recession effects.

49. Secondly - and this point was discussed in detail a few pages back - the new rates have meant larger payments in respect of external debt service and have helped to end the belief shared by a number of developing countries that their financial needs were covered by an infinitely elastic supply of resources available on acceptable terms. It is, for example, worth mentioning that the under-developed countries are faced with the problem of a hardening of their debt structure through the shortening of the redemption periods. It is estimated that 95 per cent of the debt of the non-oil-producing countries with the European money market is due for repayment in 1982.

50. The hard realization of the falsity of the assumption that resources were infinitely available on acceptable terms, and the light which this throws on the limitations of the existing international finance system, may help to ensure that the Third World countries manage their foreign indebtedness more rationally in future, and may even encourage a search for new mechanisms for acquiring external resources, other than the private and bankers' loans that are at present becoming ever harder to obtain for some countries. In any event, however, it must not be overlooked that, in the short run, while the developing countries are reforming their economies or while the international community is reforming the world's finance system, the rising costs of private and bankers' loans and the hardening of the terms for European-currency loans are having serious repercussions for Third World countries.

51. These factors make it, first of all, ever more difficult to finance desirable levels of economic growth and industrial development and even condemn some countries to playing a marginal role in the international economy or to delivering themselves entirely into the hands of foreign capital or of interests prejudicial to their national identity.

52. Secondly, the harder loan conditions cause efforts intended to acquire external resources for strengthening economic growth and industrial development to be increasingly displaced by efforts to acquire these same external resources but with almost the sole purpose of meeting the service needs of a debt that accumulates and endangers the full sovereignty of the debtor countries if it is not repaid. It is no exaggeration to speak of a vicious circle of external indebtedness of the Third World countries such that, at an increasing pace, fresh debts are incurred for the purpose of redeeming old debts and paying the interest due on them. By way of example, it will suffice to indicate that by the end of the current decade over half the new debts contracted on the European-currency market by non-oil-producing countries will have to be applied to refinancing debts that have fallen due.

53. This situation casts doubt on something that used to be accepted as absolute truth and even worked in practice for many years: The thesis that the generation of international liquidity surpluses in the seventies and their recycling through financial channels by international private banks promoted the economic growth and industrial development of developing countries by making available to them a copious supply of financial resources which enabled them to close their domestic (S - I) and external (X - M) gaps.

54. While recognizing the importance of the fact that between 1973 and 1980 the international banks lent around US $200 000 million to the non-oil-producing countries alone, it must not be forgotten

that over the same period the same countries paid their creditors - mainly international banks - US $102 800 million on account of interest and US $185 700 million in redemptions.15/

55. This situation may quite well be interpreted as a clear indication that the international financial system has gone into a state of sheer exhaustion. At the beginning of the past decade, the limitations of the system were manifested in an inadequate volume of foreign investment and funds from external official sources going to the developing countries. In the current decade, its most striking limitations seem to have to do with the stiffening of the terms of loans from banks, which are the main agents through which external resources are channelled into those countries, in the form of higher interest rates and shorter terms, the growing problems that a large number of debtor countries have in serving the loans they incur and the widespread suspicion that eventually not even the international banks will be in a position to supply the Third World with all the funds it needs for debt service, oil imports, the financing of projects that will secure the economic growth and industrial development of those countries and, where necessary, even covering the costs of consumption and imports of food and other basic products.

56. Faced with prospects of this kind, it seems essential to renew efforts to set up a new international financial order which would be more just, equitable and sound, to continue to press for old solutions but also to suggest bold new ways.

15/ Figures taken from: International Monetary Fund, International Capital Markets (occasional paper No. 7), Washington D.C., August 1981, and International Monetary Fund, World Economic Outlook (occasional paper No. 4), Washington D.C., June 1981.

57. The idea of the transfer of financial resources from the developed countries to the under-developed countries has always been present in some form in the philosophy of the Third World. It has formed part of the inter-American agenda practically since the beginning of the Spanish-American movement at the end of the last century, it is a recurrent theme at Afro-Asian co-operation conferences, a central point of the "non-aligned" movement, a main pillar of the Group of 77's position and a permanent subject of confrontation in the "North-South dialogue". Though it could be stated that formally the idea is covered by the United Nations Charter itself as part of the principle of international co-operation, the general and systematic effort to enshrine it as an obligation to be under-taken by the rich and powerful countries towards weak and poor countries really dates from the seventies, and is particularly to be attributed to the United Nations Conference on Trade and Development (UNCTAD) and its permanent committees.16/

58. When the first UNCTAD was held at Geneva in 1964, the under-developed countries organized around what has ever since been called the "Group of 77" defined their concern on the subject of transfer of resources by indicating - as was also done by the first United Nations Development Decade in establishing the international co-operation objectives to be reached by the world community during the seventies - that the finance that the rich countries should channel to the poor countries (including private capital flows) should amount to at least one per cent of the national income of the developed nations.

16/ A fuller and more systematic treatment of "Third World Strategy" in the political and economic fields may be found in: Rosario Green and Claude Heller, "Surgimiento y proyección del Tercer Mundo: de Bandung a los ochenta" (The emergence of the Third World and its future development: from Bandung to the eighties), Foro Internacional, Vol. XXI, No. 2, October-December 1980.

59. Some years later, in connection with the second UNCTAD held at New Delhi in 1968, there appeared a position paper of the Group of 77 known as the Charter of Algiers, in which emphasis was placed, with regard to external development finance, on the need for developed countries to realize how essential it was for them to participate in the efforts of the under-developed world to industrialize itself by contributing an appropriate and just proportion of their national income. The paper reiterated that it would be desirable for the assistance to be multilateral, so that the loans would not be subject to ties or conditions, for it to be granted on favourable terms, with a view to minimizing its impact on the already weakened ability to pay of many debtor countries, and for it to be applied to the financing of programmes that would be broader in scope than the specific projects thus far preferred by creditors.

60. On the basis of these formulations, the International Development Strategy associated with the Second United Nations Development Decade subsequently defined the objective for the seventies by indicating that the industrialized countries should channel 0.7 per cent of their gross national product to the under-developed countries in the form of official development assistance and on highly favourable terms, such as grants, loans at interest rates not exceeding three per cent annually, long repayment terms and even arrangements for accepting partial repayment in the recipient's national currency. However, the decade ended without this goal being reached. By the end of 1978, the rich countries as a whole had contributed barely 0.35 per cent of their GNP on average, and although a few countries, such as Sweden, which granted 0.86 per cent of its GNP to the Third World on favourable terms, other Scandinavian countries and the Netherlands, more

than met the International Development Strategy target, many others did not even reach the average, such as the United States, which contributed barely 0.27 per cent of its GNP for these purposes, or Japan, with the even smaller percentage of 0.23.

61. At the third UNCTAD, held at Santiago de Chile in 1972, there emerged the famous Resolution 45 urging that a common effort be made at a world-wide level to draft a charter of the economic rights and duties of States, which was eventually adopted by 120 votes in favour, 6 against and 10 abstentions at the 29th Session of the United Nations General Assembly in 1974 and which, with reference to the question of transfer of resources (Article 22) again stressed the need for the resources to reach the under-developed countries in appropriate amounts, on favourable terms and without ties of any kind.

62. Also in 1974, the Sixth Special Session of the General Assembly was held, at which two important documents were adopted: the Declaration and Programme of Action for the Establishment of a New International Economic Order, which set as an essential prerequisite ".... the creation of favourable conditions for the transfer of financial resources to the developing countries".

63. In this same assertive spirit, the fourth UNCTAD, held at Nairobi in 1976, went even further by raising such sensitive and pressing matters as the improvement of multilateral financial mechanisms, and the desirability of including not only private but also official debts in the negotiations, a request which led some countries, including Sweden again, to waive repayment of their official assistance for the development of the poorest countries and convert it into donations. Attention

was also drawn at that Conference to the need to set up machinery to give earlier warning of debt crises so as to avoid the adoption of often non-constructive emergency measures.

64. The Paris Conference on International Economic Co-operation, held 1976-1977 as a consequence of the oil crisis, eventually included in its agenda the question of the real transfer of resources from the rich to the poor countries, as a tactic by which the industrialized countries hoped to gain support and sympathy among the under-developed countries for their true purpose of securing the supply of energy resources which had been endangered since the 1973 crisis. Specifically in the field of the transfer of resources and Third World indebtedness, the Paris Conference only demonstrated more clearly than ever the customary polarity of attitudes of the parties involved in the "North-South dialogue".

65. The developed countries have generally maintained in all international meetings that, while it is true that an accelerated growth of the external indebtedness of the under-developed countries has been observed, this has not been the result of insufficient transfers of official resources from the rich to the poor countries, or of the terms on which these transfers have taken place. In their opinion it is a question of the balance of payments, for which they accept no responsibility, and of matters connected with poor administration and corruption associated with under-development.

66. For their part, the under-developed countries place the problem in the context of medium-term economic development and in the framework of international financial co-operation, emphasizing the inadequacy of available resources, the inflexible terms on which they are made available and the need

to establish a just and equitable world order as an essential prerequisite for the solution of their indebtedness problems and other extremely important questions.

67. From the outset, then, two contrasting points of view were established: that of the "South" seeking to introduce structural changes into the international system, and that of the "North" determined not to alter the world's economic and political balance (which the North regards as neither unjust nor inequitable); this inevitably resulted, throughout the months of negotiation, either in very little progress or even in downright failure, both at the "global package" level and in the case of its individual components.

68. Specifically in the field of financial matters, the Third World suggested several possibilities from consolidating the commercial debts of <u>interested</u> under-developed countries - leaving out those who did not favour this scheme because of their level of commitment and dependence towards foreign private banks - to converting official debts into donations, increasing the resources of the multilateral finance institutions, creating new and bolder financial machinery and adopting international measures to deal with future problems connected with the external indebtedness of the poor countries.

69. The industrialized world, on the other hand, declined to recognize the existence of a general problem of Third World external indebtedness, consequently opposed all global solutions and announced that it was prepared to consider only partial aid machinery, such as the Special Action Programme, to which it allocated US $100 million for the poorest countries of the system to alleviate their balance-of-payments situation. The industrialized countries thus offered a solution that was isolated, in that it was not immersed in the vast problems of

under-development, for which they are largely responsible; partial, in that it considered only one group of developing countries, in the hope of exploiting their differences; and inadequate with respect to two important magnitudes: a total Third World indebtedness that at the time was already approaching US $250 000 million - today it is dangerously close to US $600 000 million, a figure equal, ironically enough, to what the world spends on armaments - and a deficit on current account of the under-developed countries that UNCTAD itself at that time estimated would exceed US $100 000 million in the eighties.

70. Since this failure, the fifth UNCTAD, held at Manila in 1979, and later economic negotiations carried on within the United Nations, such as those held in 1980 to prepare the so-called "global negotiations" that were to take place the following year, have come to an embarrassing standstill that seems to negate the seriousness of the Third World's problems, outstanding among which is that of expanding external debt and its explosive component resulting from the growing dependence of the under-developed countries on finance from abroad to meet the foreign-exchange requirements created by their external sector and by imbalances of a domestic nature.[17/]

71. On 22 and 23 October 1981, the Conference of International Economic Co-operation was held at Cancún, Mexico, with a view to re-opening the North-South dialogue. It was hoped that this

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17/ For a broader study of the obstacles met with by the Third World in its pursuit of a new order in the field of international finance, and in the trade, technological, monetary and other fields, v.: Ervin Laszlo, Jorge A. Lozoya, A.K. Bhattacharya, Jaime Estévez, Rosario Green and Venkata Raman, The Obstacles to the New International Economic Order, New York, Pergamon Press, 1980, 144 pp. For a more specific treatment, see also Jorge A. Lozoya and A.K. Bhattacharya (Eds.): The Financial Issues of the New International Economic Order, New York, Pergamon Press, 1980.

Conference would get the international dialogue between developed and developing countries moving again, after the standstill reached in Paris in 1977, and at the same time overcome the impasse that had befallen international negotiations since the end of the previous decade and which still makes itself very clearly felt in the present decade. The problem is that even less was achieved at Cancún than had been attained in Paris. The financial dialogue simply made no progress. The atmosphere was very tense, among other things because of the impact of the rise in United States interest rates on the economies of other industrialized countries and on the Third World, and the desire, especially on the part of the Mexican hosts, to maintain cordiality at all costs frustrated the exercise even more. Not even an agenda or a date of commencement was set for the eagerly desired global negotiations, in which financial matters would needless to say have occupied a very important place. Thus, the conclusion apparently to be drawn is that the Third World's efforts within and outside the United Nations have so far been unsuccessful, which however does not at all mean that they should be dropped.

72. This obvious lack of progress in the attempts of the Third World to build a new order in the external financing area at the level of international meetings has also been pointed out in practically all global studies produced by the international intellectual community that have sought to contribute, though on occasion from different points of view from those of the Third World countries, towards bringing the positions of North and South closer together in the context of the broadest possible agenda. Studies of this type deserving special mention are those of the "Club of Rome", particularly the report entitled "Reshaping the International Order", the Fundación Bariloche, the Trilateral Commission,

the Hammarskjöld Foundation, and the United States Council on Foreign Relations, to mention only a few of the bodies that concerned themselves with these matters in the seventies.18/

73. The most recent study of this kind, that produced by the Brandt Commission, not only condemned, perhaps more bluntly than others, the above-mentioned lack of progress in the field of international negotiations, but also made proposals specifically in the area of external financing, such as extending the duty of contributing ot the expansion of official development assistance to the Socialist countries and to developing countries, other than the poorest, or introducing international taxation on foreign trade, the production and export of armaments, international travel, the world's resources and especially the exploitation of sea-bed minerals, in order to achieve a substantial increase in the transfer of financial resources to the underdeveloped countries. It remained unclear, however, through which machinery the proposals (ten in all) should be implemented and whether a political will existed on the part of the donors to accept all or at least some of the proposals, this latter point being the cause of past failures to achieve the objectives established by the international community.19/

74. Parallel to the dissatisfaction felt with regard to the discussions in international meetings and in academic and intellectual circles and with the relatively little progress they have made, there is dissatisfaction with regard to the more practical matter of debt renegotiations; these customarily take place on a multilateral basis, with the debtor confronted with

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18/ A detailed analysis of the contents of the various studies mentioned with others, may be found in: Jorge Alberto Lozoya, Jaime Estêvez and Rosario Green, Alternative Views of the New International Economic Order, New York, Pergamon Press, 1979.

19/ Brandt Commission: North-South: a program for survival. Cambridge, Mass., The MIT Press, 1980.

all his creditors, and the commonest negotiation framework is a "debtors' club", like the former ones at The Hague and London and the present one in Paris.

75. Both the mechanics of and the reasons for renegotiation are quite well known: in pursuing its objectives of economic growth and industrial development, a developing country typically imports capital from various sources and thus incurs financial obligations towards a variety of debtors, including governments, governmental agencies, multilateral institutions and private banks, individually or as groups. When the country experiences balance-of-payments difficulties in which the burden of service of its foreign debt is an important factor, the rescheduling or refinancing of the debt to alleviate the burden is an important step in terms of the country's efforts to solve its balance-of-payments problems. In the long run, however, it has unfortunately been observed that countries which have re-negotiated their debts are in practice unable to solve their external-sector problems finally, but instead are doomed to hold an endless series of renegotiations.

76. The evolution of multilateral debt renegotiations can be traced back to 1956, when representatives of a number of European banks met in Paris to renegotiate Argentina's indebtedness.[20/] By the end of 1980 the number of multilateral renegotiations had reached 47, covering loans granted or guaranteed by governments or official agencies to 16 debtor countries. Of these, 32 re-negotiations were held within the framework of the "Club of Paris".

20/ An interesting study of these problems may be found in: International Monetary Fund, External Indebtedness of Developing Countries (occasional paper No. 3), Washington D.C., May 1981.

77. In general, the assistance that a debtor country receives in relieving the debt burden is linked with the pattern of a stabilization programme designed to improve the balance of payments, and it is perhaps there that the main weakness of renegotiation lies, in that it recommends measures that have in many instances proved inadequate from the long-term point of view and have only helped to turn renegotiation into a recurrent process: 47 renegotiations for 16 countries is an example that speaks for itself.

78. In the face of so much frustration, it is evidently essential to seek other ways, some of which might be rather novel while others could retain certain conventional features so long as they are re-invigorated in some form. In any event, however, it must not be forgotten that even though one may speak of a general problem of indebtedness in the Third World countries, there are specific nuances that must be taken into account so as to avoid proposals or solutions that are too general and hence ineffective.

79. In the first place, there are a few countries in which the bulk of the developing world's total external debt is concentrated and for which the great private banks have become the main creditors. It has already been pointed out that these countries are in a way "captive debtors" of the banks, and a large part of their fresh indebtedness to the banks is incurred to serve the accumulated debt commitments towards the same banks. In this vicious circle of indebtedness, there are extreme cases of countries that devote practically the entire nominal growth of their external debt to serving old debts, but there are also extreme cases of foreign banks whose loans to these countries are so vast that they have in the end become "captive creditors" who are forced to lend to them, naturally at ever higher

interest rates and with ever shorter repayment terms, in order to keep collecting the interest.

80. The foregoing can be appreciated more clearly in the light of certain data published by the United States Federal Reserve System and showing, for instance, that the nine largest United States banks, with financial assets of the order of US $21 900 million, had as much as US $38 600 million on loan to Third World countries.[21/]

81. Then there is the case of those countries whose debt is essentially official in origin, having been incurred with bilateral or multilateral finance organizations, but whose burden, in terms of the foreign exchange that must be acquired and devoted to serving the debt, is also heavy. One might, of course, begin by suggesting that pressure for increased net flows of real resources on favourable terms should be kept up in all international economic negotiation meetings. One might also reiterate the case for re-orienting, revitalizing and increasing the resources of such international financing organizations as the World Bank and the regional Development banks, or even the International Monetary Fund, and, as already mentioned, some progress on these lines has in fact been made in recent years.

82. A final point that must be emphasized, however, is that, apart from the inclination to demand a greater commitment on the part of the countries of the North to the development of the South, or to explore the field of greater co-operation between the Socialist countries and the Third World, the urgent need for an enhanced sense of mutual responsibility among the countries of the South should be realized.

21/ The Wall Street Journal, 28 January 1981.

83. It is paradoxical that at a time when one group of under-developed countries has slid into a painful situation of external indebtedness that becomes worse as interest rates increase, repayment terms shorten, oil prices rise, traditional Third World exports fall in price, world-wide inflation increases, and so on, another group of under-developed countries has become a net exporter of capital, and there does not seem to exist any more important bond between them than the extremely costly financial agency of the European-currency market.

84. The member countries of OPEC have deposited more than US $400 000 million on the European-currency market, an amount that is quite close to that of the outstanding external debt of the developing world, and while it is true that the OPEC countries have set up a Sepcial Fund to assist their under-developed sister countries, the general impression remains that an even greater effort could be made. The establishment of a kind of Third World Bank largely supported by OPEC and other capital and providing resources to developing countries to finance their economic growth and industrial development is a worth-while objective that must be vigorously pursued.