

DEBT AND ADJUSTMENT

Reflections on the Discussions
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A presentation by Oumade Singh discussed various measures of debt capacity. The procedure that seems most promising is the development of alternative foreign borrowing scenarios. Although the ingredients of this approach are present in the Singh paper they were not brought together in the most enlightening way.

There are three possible motivations for the buildup of foreign debt:

1. to finance investment needs;
2. to provide balance of payments accommodation; and
3. to finance a fiscal deficit.

I outlined an approach which yields a number of scenarios to deal with the first objective i.e to finance investment. At the end I suggest that a similar procedure should be used to develop additional scenarios to deal with the second and third objectives.

Investment in small economies, particularly for export production, requires foreign enterprise, which often comes

bundled with foreign finance. We may develop a forecast for foreign investment which is linked to the need to promote export oriented growth. We may then project the capacity to service this level of foreign investment, using projections of exports and imports which appear in Singh's paper. To estimate the total foreign exchange available we should add to the foreign investment all exports and of goods and services and miscellaneous foreign currency receipts. From this we subtract projections of imports to yield the foreign currency available for debt servicing. We could then compare this with the estimates of the cost of servicing the projected foreign debt. If the implicit debt service requirement seems greater than the funds available to finance it a new projection would have to be constructed. Alternative scenarios could be written using optimistic and pessimistic forecasts for exports and a similar range of estimates and projections for imports. One might also explore the consequences of interest rate fluctuations.

If the available foreign exchange is in excess of the protected service requirements there is room for foreign borrowing to accommodate a balance of payments deficit. Further scenarios could be developed with varying interest rates and debt maturities.

If Government's deficit exceeds the amounts that will be voluntarily supplied by the private sector, it is preferable to borrow abroad rather than to increase the money supply by

borrowing from the Central Bank. A target for foreign borrowing by Government might be established using this logic, based on projected Government deficits. This might be used instead of the previous targets or as an additional foreign capital requirement to develop a new set of scenarios.

Policy Implications of Regression Results

The policy implications which were drawn from the papers on the Monetary Approach by Gene Leon and the Determinants of Debt by Roland Craigwell left many participants uneasy. Many of us felt that the theoretical underpinnings of the models were not sufficiently well established. Gene felt that his model was one of many which might be constructed consistent with observation. With this in mind one must be careful not to enter firm judgements as to policy implications. Some observers saw a deficiency in Roland's approach because he did not specifically look at demand and supply on the foreign capital market. Though I agreed that the theory was not spelt out, this particular objection seemed to be a little forced in the case of Barbados where there has been no difficulty in securing foreign finance. The growth of debt in Barbados, has up until now, been entirely demand driven.

Roland's conclusions that the most powerful influence on the growth of debt has been Government's current account is counter-intuitive. The balance of payments, which one might have

expected to be a primary consideration, turns out to be much less important. The variable Roland uses to measure the possibility of counter-cyclical fiscal pressures appears unconvincing.

Dr. Courtney Blackman offered an interesting scenario of varying motives for foreign capital inflows in Barbados. Prior to 1973 they were almost all for development purposes. Between 1973 and about 1976 there were some large inflows to enable the country to sustain income in the light of a fall in output. There was not much borrowing during the boom of the late 70's. The borrowing in the early 80's was counter-cyclical and tied up with elections. It continued because of the unusually virulent recession, rising up to the point when another election was imminent.

Apart from the need for a more convincing theoretical specification of single equation models, there is the difficulty of matching the data that the model requires with what actually is available. To a large extent this is a question of definitions, reflected in the proxy that Roland uses to measure the shortfall in real output, for example. The measurement of real variables is a particularly troublesome issue. C.Y. Thomas pointed out the difficulty caused when a considerable proportion of the relevant body of transactions is illegal or concealed. He referred to the importance of the drug trade and the significance of the underground economy. Even if the sophisticated econometric techniques suggest quite robust results we must be

restrained in moving to policy conclusions because of the difficulties of theory, of measurement and of data.

Policy Failures in Trinidad & Tobago

The discussion of policy in Trinidad & Tobago must proceed at greater depth than the criticism "policy failures" levelled by Da Silva. We must discuss the speed, the timing and the amount of adjustment that was necessary at each point in time. It is now generally accepted that the Trinidad & Tobago Government did make a considerable attempt to adjust, beginning from the time of the First Oil Shock. A Capital Development Fund was set up with the express aim of investing in diversification of crude petroleum; debates were entered into in the mid-70's about the "Dutch disease effects" of faster wage increases; and a committee was set up under the chairmanship of Euric Bobb, then Deputy Governor of the Central Bank, to investigate public expenditures. We should address the real problem of why these initiatives had so little success.

I believe a part of the answer lies in the unexplored territory of policy implementation. Policy implementation involves a clear and informed decision base, but committed leadership and conviction on the part of the general population. There are limits to which belt-tightening policies may be carried if the country's citizens are not generally agreed that this is an essential policy. It is this aspect that is missing in many economists' comments about the tardiness of policy makers in securing adjustment to changed economic circumstances.

The Question of Capital Flight

Capital flight proved to be an extremely difficult phenomenon to define. Using the broadest definitions we might end up suggesting that countries such as Japan are the victims of capital flight, clearly a ridiculous notion. It has even been suggested that human capital should be included - the damage to development possibilities from the loss of human capital are unquestionably more severe and far more lasting than any losses from the departure of finance capital.

Mr. Ul Huque of the IMF suggested that one should distinguish normal capital flows from those which caused policy problems and regard only the latter as within the rubric of capital flight. Capital flight, he suggested, creates a problem because it reflects a divergence of private and social utility. The flows may be influenced by the country's policy but they cannot be controlled by the country, an important consideration which policy makers must accept. He suggested that one might examine capital flight in association with exchange rate crises to see whether some generalizations might be found.

Dr. Blackman pointed to capital flows that are associated with migration, suggesting that those were especially heavy.

Desiree Field-Ridley suggested that a policy with respect to capital flight must be based on a clear understanding of the reasons for the loss of capital. They were related to exchange rate and to the relative rates of return. She thought research

should establish the relative significance of various motives. She suggested that foreign currency accounts be permitted in Caribbean countries, a suggestion which is currently under investigation in Jamaica.

Exchanging Debt for Equity in Jamaica

Novellette Davis' presentation pointed out that there were three kinds of debt swaps:

- a. debt-debt swaps where creditors exchanged debt among themselves so as to consolidate a country's portfolio or a bank's portfolio;
- b. debt-'peso' swaps where residents buy foreign loans with funds secured on parallel markets, getting local currency in exchange. This is a device to arrest capital flight;
- c. debt-equity swaps, the kind that Jamaica is pursuing.

Since 1982 about US\$12 billion out of an outstanding foreign debt total of US\$300 billion has been converted by debt equity swaps. Most of these have been for Latin America.

Jamaica has a total debt of US\$3.5 billion of which \$400 million is owed to commercial banks. The current programme aims to convert \$200 million of that to equity. The programme is a five-year one supported by technical advice by the firm of N.M.

Rothschild. The investments being sought are in tourism and export manufacturing. A 20-40% discount is being offered on the debt. Jamaican nationals are not eligible to participate for fear that they might use the opportunity to find ways around exchange controls on capital outflow.

The programme was launched in July this year. So far one project has been approved for \$1½ million of funds to be converted from debt. It is for an 807 garment operation which is not high on the list of priority items the Jamaicans would like to attract.

Guyana's Foreign Debt

Donna Danna's paper dealt with both domestic and foreign debt but my comments will be confined to the foreign debt. At end-1986 it amounted to US\$1.4 billion and 52% of that total was accumulated arrears. Debt service for that year was US\$203 million of which only 16% was actually paid. Total export earnings for the year were \$248 million and imports exceed that by 2%.

Donna identified four phases in the accumulation of debt. Between 1965 and 1970 most of the debt was for infrastructure development. Problems began to emerge with the nationalization between 1971 and 1977 which led to a skyrocketing of debt at a time when economic performance weakened. Between 1978 and 1982 there were a number of reschedulings but the country failed to

get its debt to manageable proportions. From 1983 onwards arrears have been accumulating rapidly.

A note on the domestic side. The Bank of Guyana's outstanding credit to Government at the end of 1986 amounted to GUY\$2.8 billion.

Foreign Debt in the OECS

Most of the OECS foreign debt accumulation has been for infrastructure, including considerable sums for rehabilitation. There has been a large grant element and much of the remainder has been on quite favorable terms. Data presented in the Williams-Augustine paper does not suggest that the grant element has significantly diminished. The existence of arrears of payment by Antigua, Grenada and St. Lucia seems less to be evidence of a debt problem than to reflect administrative failure. The means to repay are available but the countries have not put arrangements in place.

Estimating Capital Flight

Karl Bennett tried to recast the balance of payments statistics to provide an alternative measure of capital flight. It does not appear more convincing than the usual indicator - 'errors and omissions' - of the balance of payments. As was pointed out in the discussion, he also failed to incorporate smuggling and other activities which do not show up in any of the balance of payments accounts. Bennett's approach is quite

similar to that used by myself and Cleviston Haynes. He does not break down financial assets into interest-bearing and non-interest bearing categories, a distinction which we have found fruitful.

The Foreign Debt of Belize

Yvette Alvarez's paper suggested that Belize's debt had been accumulated mainly for infrastructure purposes and through direct foreign private investment. The levels of debt and servicing remain modest and have not in general constituted a problem of any kind. If anything, it seems to be that Belize needs to accelerate borrowing for developmental purposes.

There was one incident in 1984 when the country did fall into debt arrears. Public utility companies had borrowed heavily in previous years using relatively short-term suppliers' credits. Because of their own administrative malfeasance, the debt servicing payments were not promptly identified and payments were not made on time. Once the situation was fully appreciated, the suppliers' credits were converted to longer-term finance and the arrears were paid off.

The main sources of finance between 1980 and 1983 were a 12 million pound golden handshake from the U.K. on Belize's independence, \$9.2 million of balance of payment support under the CBI and a Compensatory Financing Facility Drawing of just over \$7 million.

A Standby Arrangement was concluded at the end of 1984 for \$7 million. It was accompanied by an adjustment programme which stressed monetary adjustment. Reserve requirements, liquidity requirements and interest rates were all raised dramatically and credit was cut back. The programme was not particularly successful. However, in 1986 an increase in sugar revenues, receipts from a US\$5 million movie shot in Belize and the effects of transactions with Mexico restored a healthy external payments position. Fiscal measures including increases in stamp duties and consumption taxes have contained expenditure, while there were increases in public utility rates and divestment of the banana industry.

Borrowing in 1985 and 1986 included US\$14 million in an adjustment facility and SDR7 million in an IMF Standby.

Jamaica's External Debt

My reading of Paula Anderson's analysis is that Jamaica over-borrowed in the 1980's using completely unrealistic growth projections. Because of the cavalier overestimate of growth, the capacity to service foreign borrowing was also set at quite unrealistically optimistic levels.

Paula Anderson's presentation suggests that Jamaica is not yet in sight of a feasible strategy for debt servicing with economic growth. Debt service commitments remained as high as 43% of foreign exchange earnings after rescheduling. Unless

Jamaica is successful in reducing the service burden through refinancing of bilateral loans there is little prospect of a manageable foreign exchange situation.

Debt and Adjustment in the Dominican Republic

Flavia Rodriguez recounted the story of the Dominican adjustment programme which began in January 1983. It was a response to a decline in the terms of trade, increasing debt service because of rising interest rates and bunching of amortizations and a fall-off in Government revenues. The measures taken included devaluation, increases in interest rates and rises in public utility prices. The results were not particularly happy. Aggregate supply fell, domestic prices rose and the contraction in aggregate demand was not sufficient to dampen inflationary pressures. The level of unemployment rose as well.

Flavia entered a number of criticisms of the programme. She felt that the exemption on raw materials was not sufficiently discriminating and encouraged the substitution of imported raw materials for things which might be used locally. She cited the use of local peanut oil as an ingredient which had been displaced by imports.

Flavia also felt that the Government had failed to maintain an appropriate exchange rate after the initial devaluation, allowing the black market rate to fall to more than double the

official rate. A powerful internal pressure group had frustrated necessary fiscal reform designed to raise land taxes and other taxes with an equitable impact. As a result, the fiscal deficit could not be brought under control and there was too much money creation.

Flavia also criticised the wholesale restrictions on outstanding credit imposed by the Dominican authorities. She favours a selective approach to credit restrictions which allows the producing sectors access to bank facilities.

The Next Steps in addressing Debt Issue

It is clear that individual countries will not find a way of restoring healthy economic growth and cutting down the debt over a reasonable time horizon. Caribbean countries will therefore have to lend their voices to proposals for restructuring debt internationally with substantial debt forgiveness. Technicians have yet to identify the package of proposals, from among those which have already been put forward in numerous quarters, which we would recommend for Caribbean governments to endorse and promote. Identifying the best set of proposals and putting them across to governments on a regional basis is a task which technicians must undertake.

A second task is to identify - in quantitative terms - the strategies and options open to individual Caribbean nations. Only two of the papers at the Conference, the opening paper by Bourne

and Oumade Singh and the paper by Danny Boamah, addressed the question of future scenarios for the debt. The methodologies used in those papers are capable of extension and refinement. They do not clearly outline the optimal and worse case scenarios for debt, with the associated growth possibilities. Also they do not address the cost of adjustment, particularly the human cost. These extensions and refinements can be added to the existing methodologies. The Governments might then be presented with a base case scenario for the growth of debt and the growth of output, against which they can evaluate their options. The scenarios may be used to persuade external agencies to change their approach to the debt problem. This is the second assignment to which technicians must address themselves.

Public Administration for Sustained Development

(The Adlith Brown Memorial Lecture)

Mr. Demas began by drawing comparisons between public management and business management. Policy making and the implementation of policy require different orientation and skills in both cases but in either case the dividing line between them is blurred. Top civil servants must be involved in the making of policy.

Objectives are well-defined in the private sector but the goals and targets of the public sector are difficult to quantify. There are more readily available measures of prices and costs in the private sector. In the private sector there is more freedom of action to discriminate among customers and in the use of

prices and costs. In the public sector, the rule must be even-handedness and uniform treatment.

Responsibilities and accountability are more readily demarcated in the private sector, together with the associated rewards and punishments. It is possible to devise similar measures of accountability and reward in the public sector but it is much more difficult.

Demas suggested that we should replace the term "public administration" by "management of development" so as to spur a change in the attitude of civil servants. He criticised the civil service for lack of flexibility, insufficient emphasis on promptness and problem solving. He was particularly harsh on what he called "file fetishism", the tendency to put everything on file and minute from officer to officer.

He thought that civil servants might seek solutions to problems by calling on resources which might be outside the traditional public service - in the university, in other institutions in the private sector and by appeal to colleagues in other countries. Demas made a plea for the re-emphasis on effective planning including social, economic and physical aspects. The civil service must be geared for the tasks of structural adjustment including policies and measures for long-term transformation with an emphasis on the development of the human resource. He stressed that programmes for the development

of skills and educational programmes must be sustained even in the face of retrenchment and that those elements of the society which were most at risk should be protected in some way.

Demas identified vagueness in policy statements among the weaknesses of public administration. The policies of political leaders often are too imprecise to give firm guidance. Technicians must interpret them so as to provide concrete proposals which are in line with the intended policy.

Demas felt that attitudes in the civil service are often too firmly tied to the past and that there is too much emphasis on precedents. He also identified the improper use of checks and balances which are quite properly designed to prevent the abuse of power. Many of these checks are not implemented. He cited the tardiness of reports of Auditor Generals and Public Accounts Committees, the fact that state enterprises are often not included in the public accounts and the failure of Government Departments and Ministries to provide Annual Reports of their stewardship.

Confidential and personal assessment reports in the civil service are badly designed and bear no relation to a person's performance. He suggested that the Public Service Commission should be a court of appeal, not an adjudicator for trivial disciplinary action.

Demas found that insufficient attention was given to institutional arrangements for implementing policies, for monitoring them and for providing feedback. There was also inadequate analysis of the internal consistency of programmes and policies were often poorly designed. He also criticised the failure to establish priorities, particularly in the promotion of industry and industrial development.

In suggesting solutions, Demas called for the implementation of existing checks and balances, performance appraisals which are tied to actual work done, better accountability and reporting systems. He suggested that Ministries should be put together with an eye to greater homogeneity of function so that related activities fell within the same Ministry. He argued for well-defined fiscal policies with a statement of priorities and a consistent set of goals. He thought there should be timetables associated with the fiscal strategy. He argued for qualitative and quantitative revenue and expenditure targets and associated programme budgeting.

Demas also suggested management training specifically targetted at problem solving exercises. He recommended exchanges of public administration personnel among regional countries and the establishment of common services.

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