HOUSE OF COMMONS

CANADA

SECURING OUR GLOBAL FUTURE: CANADA'S STAKE IN THE UNFINISHED BUSINESS OF THIRD WORLD DEBT

Standing Committee on External Affairs and International Trade

June 1990

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June 1990

HOUSE OF COMMONS

Issue No. 55

Thursday, June 7, 1990

Chairman: The Honourable John Bosley, P.C.

CHAMBRE DES COMMUNES

Fascicule nº 55

Le jeudi 7 juin 1990

Président: L'honorable John Bosley, c.p.

Minutes of Proceedings and Evidence of the Standing Committee on

External Affairs and International Trade

Procès-verbaux et témoignages du Comité permanent des

Affaires étrangères et du Commerce extérieur

RESPECTING:

Pursuant to Standing Order 108(2), consideration of the Report of the Sub-Committee on International Debt

INCLUDING:

The FIFTH Report to the House

CONCERNANT:

En vertu de l'article 108(2), du Règlement, une étude du Rapport du Sous-comité de la Dette Internationale

Y COMPRIS:

Le CINQUIÈME Rapport à la Chambre

Second Session of the Thirty-fourth Parliament, 1989-90

Deuxième session de la trente-quatrième législature, 1989-1990

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THE STANDING COMMITTEE ON EXTERNAL AFFAIRS AND INTERNATIONAL TRADE HAS THE HONOR TO PRESENT ITS

FIFTH REPORT

In accordance with its mandate under Standing Order 108(2), your Committee assigned to its Sub-Committee on International Debt the responsibility of inquiring into the effects of the critical debt problems facing many developing countries and the Canadian role in alleviating this international burden, with particular reference to Canadian involvement in debt relief and structural adjustment policies and programs. The Sub-Committee has submitted its Report to the Committee. Your Committee has adopted this Report which reads as follows:

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ACRONYMS AND GLOSSARY OF KEY TERMS

AAF–SAP	African Alternative Framework to Structural Adjustment Programmes for Socio–Economic Recovery and Transformation, adopted by African heads of government in 1989 as an alternative to IMF and World Bank adjustment policies.
ADB	African Development Bank, founded in 1963.
CIDA	Canadian International Development Agency.
CWB	Canadian Wheat Board.
ECA	United Nations Economic Commission for Africa, founded in 1958.
EDC	Export Development Corporation.
ESAF	Enhanced Structural Adjustment Facility of the IMF, established in December 1987 to provide additional assistance for the adjustment efforts of highly–indebted countries.
G–7	Group of seven leading industrialized nations whose heads of government hold annual summits on the international economy.
GATT	General Agreement on Tariffs and Trade, in force since 1948, to which 97 countries are currently contracting parties.
IDA	International Development Association—the arm of the World Bank which makes concessional loans to developing countries. The Bank is the common short name for a group of institutions comprising the original International Bank for Reconstruction and Development (IBRD) established in 1945, and IDA, created in 1960. The Bank has two other affiliates, the International Finance Corporation (IFC) founded in 1956, and the Multilateral Investment Guarantee Agency (MIGA) which began operations in 1988.
IDB	Inter–American Development Bank, founded in 1959.
IDRC	International Development Research Centre.
IFIs	International financial institutions, principally the International Monetary Fund, the World Bank, and the four regional development banks for Africa, Asia, Latin America and the Caribbean.

IMF	International Monetary Fund, established at the same time as the World Bank in 1945 to promote monetary stability and facilitate trade. The Fund and the Bank each have 151 country members.
LDCs	Less developed countries.
LIBOR	London interbank offered rate, which is the rate for short-term dollar deposits which the banks offer each other. This rate has become the international benchmark for interest rate calculations.
MFA	Multifibre Agreement, an arrangement governing trade in textiles and clothing outside of the GATT framework. The current agreement expires in mid-1991.
NGO	Non-governmental organization.
ODA	Official Development Assistance—grants, or loans with a "grant element" of at least 25%—as defined by the Development Assistance Committee of the OECD.
OECD	Organisation for Economic Co-operation and Development, bringing together 24 countries in Europe and North America.
PAMSCAD	Programme of Actions to Mitigate the Social Costs of Adjustment, intended to soften the impact of structural adjustment in the African country of Ghana. It has been held up as a model for others.
SAF	Structural Adjustment Facility of the IMF established in March 1986 to provide balance of payments assistance to low-income developing countries.
SAPs	Structural adjustment programs mandated by the IMF and the World Bank.
SCEAIT	House of Commons Standing Committee on External Affairs and International Trade.
SDRs	Special Drawing Rights, an international unit of account introduced by the IMF in 1970 as a substitute for gold. The value of SDRs is based on the currencies of the five largest exporting member nations—West

Germany, Japan, the U.S., Britain and France. In December 1989 1SDR = $Cdn 1.5215.

UNCTAD United Nations Conference on Trade and Development, established in 1964 to promote the trading interests of developing countries.

UNDP United Nations Development Programme, established in 1965 as the principal UN agency to assist developing nations.

UNICEF United Nations Children's Fund, established in 1946; since 1950 it has focused on the needs of children in developing countries.

UN–PAAERD United Nations Programme of Action for African Economic Recovery and Development, which grew out of the 1986 UN special session on the critical situation in Sub–Saharan Africa.

GLOSSARY OF TERMS

Arrears Accumulated unpaid interest and principal on outstanding loans. Loans which are in arrears are said to be "non–performing." A major problem currently is the number of countries which are in arrears on their loans from the IMF.

Baker Plan An initiative put forward by then United States Treasury Secretary James Baker III at the IMF–World Bank meetings in Seoul in October 1985. It called for additional lending of US$ 29 billion over three years from commercial banks and the IFIs to a group of mostly middle–income debtor countries—the "Baker 15." In return, they would commit themselves to policies of market–oriented adjustment with growth.

Balance of payments The measure of a country's net international position in terms of income from exports of goods and services versus expenditures on imports (the current account), and financial inflows and outflows (the capital account). A "deficit" is when a country is paying out more than it is receiving.

Brady Plan An initiative outlined in a speech by current U.S. Treasury Secretary Nicholas Brady in Washington D.C. in March 1989. In these proposals the U.S. finally embraced the principle of negotiated debt and debt service reduction. The "plan" included a number of other elements, but was directed mainly at countries with large amounts of commercial bank debt. It called for debt reduction schemes to be supported by up to US$ 35 billion over three years from the IFIs and Japan.

Bretton Woods institutions The post-war network of international financial institutions—principally the IMF and world Bank—the groundwork for which was laid at a conference in Bretton Woods, New Hampshire in 1944. The original emphasis on reconstruction in Europe later shifted to the developing nations.

Concessional lending Loans offered to borrowing countries at below-market terms.

Conditionality The requirement that countries agree to certain policies as a condition of receiving financial assistance. A substantial proportion of the IFIs' concessional lending is policy-based—i.e., subject to conditionality.

Country risk provisions Amounts set aside by lenders to cover the risk of potential losses on their loans to sovereign debtors. Canadian commercial banks are required by law to hold provisions up to 45% of their total loan exposure in 42 problem debtor countries as designated by the Superintendent of Financial Institutions.

Debt conversion A debt relief technique whereby old debt that cannot be fully serviced is converted into a new debt instrument that carries a lesser value but supposedly greater security.

Debt forgiveness	The cancellation, either in whole or part, of the face value (principal) of a loan or the debt service (principal repayment plus interest) due.
Debt moratorium	The suspension of debt service on outstanding loans. It may be granted by the creditor or declared by the debtor.
Debt overhang	Refers to the total accumulated stock of debts which countries owe to foreigners, or to the sum total of a country's external liabilities.
Debt rescheduling	A technique of concessional debt restructuring in which debt service payments are deferred with the payback of the loan stretched over a longer period.
Debt service ratio	A country's foreign debt service divided by the value of its exports of goods and services.
Debt swaps	The exchange of debt for another asset. In the case of debt–equity swaps, the creditor receives local currency to invest in assets of the debtor country. In the case of debt for nature or debt for development swaps, the external claim on the country is exchanged for local currency proceeds which are used for environmental conservation or agreed developmental purposes.
Debt write–down	The reduction in the value of a loan on the lender's financial statements. This may be only a prudential action which does not entail any debt forgiveness or cancellation.
Default	Although there are no international "bankruptcy" proceedings for countries, they can be declared to be in default on their loan payments, making them ineligible for new credits and liable to legal actions. This is different from a country formally repudiating its debts. A country which has no possibility of repaying its debts is said to be "insolvent."
Export credits	Concessional finance provided by official lenders, usually government agencies, to promote sales of particular exports.

External debt	Debts owed by a country to foreign creditors—generally referring to long-term public and publicly-guaranteed debt. Measuring the "external debt" of developing nations remains an extremely complicated undertaking.
Gross exposure	The total face-value amount of the loans which a lender has outstanding in a country or group of countries.
Highly-indebted countries	A category used by the World Bank until 1989, since revised, to denote mostly middle-income countries with severe debt servicing problems perceived as posing the greatest risk to the international financial system.
IMF Interim Committee	A 22-member advisory group of high-ranking officeholders which although it has no formal powers is the main policy-making body of the IMF. Canadian Finance Minister Michael Wilson became chairman of the committee in January 1990.
Loan-loss regulations	See country risk provisions above. Canadian banks can claim their provisions for loan losses, up to the mandated 45% level of gross exposure, as a deduction from taxable income.
Net exposure	The value of loans outstanding net of any write-downs which the lender has taken on its financial statements and any provisions which it has set aside to cover possible loan losses.
Official debt	Debt owed to, or loans guaranteed by, governments, their official agencies and the IFIs; as distinct from debts owed to commercial banks or other private creditors.
Paris Club	A negotiating forum, based in Paris and chaired by the French treasury, whereby creditor governments meet to reschedule official debts.
Problem debtors	Countries which are not "creditworthy," or whose debt burden is perceived to pose an excessive financial risk to international creditors.

Sovereign debt Debts owed by national governments and their agencies or which have been publicly guaranteed. Sovereign loans are amounts loaned by government bodies or by private lenders with public guarantees.

Secondary markets Refers to markets where loans outstanding to highly-indebted countries are traded. The buyer pays less than the face value because of the risk of non-payment. By early 1989 the market was discounting debts of the "Baker 15" countries by an average 70%. However, these transactions represent no benefit to the country unless it is able to buy back its own debt at this discount.

Structural adjustment Usually refers to a program of economic policy reforms designed to put a country on a path of sustainable growth. In situations of high external debt, adjustment is often tied to measures to "stabilize" the country's finances. So-called "orthodox" structural adjustment packages prescribed by the IMF and World Bank emphasize the operation of efficient markets.

Terms of trade The relationship between the prices of a country's exports and the prices of its imports. Declining terms of trade has been a major obstacle to overcoming debt for some developing countries.

Toronto terms Named after an agreement reached during the Toronto G-7 summit of 1988; creditor governments subsequently agreed to choose among three debt relief options for low-income African countries rescheduling their official debts in the Paris Club.

Sovereign debt	Debt owed by national governments and their agencies, and private-sector debts which have been publicly guaranteed. Sovereign loans are either made directly by governmental bodies or by private lenders with public guarantees.
Secondary market	Market where creditors' loans to heavily-indebted countries are traded. The buyer pays less than the face value because of the risk of non-payment. By early 1989 the market was discounting the debts of the [illegible] 15" countries by an average [illegible]. However, these discounts confer no benefit to the country unless it is able to buy back its own debt at the discount.
Structural adjustment	Usually refers to a program of economic policy reforms designed to put a country on a path of sustainable growth. In situations of high debt, structural adjustment is often tied to measures to "adjust" the country's finances. So-called "orthodox" structural adjustment packages prescribed by the IMF and World Bank emphasize the importance of efficient markets.
Terms of trade	The relationship between the prices of a country's exports and the prices of its imports. Declining terms of trade has been a major obstacle to overcoming debt for many developing countries.
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I. GETTING DEBT IN PERSPECTIVE: THE COMMITTEE'S APPROACH

Three years ago the Senate Standing Committee on Foreign Affairs released a timely report on *Canada, the International Financial Institutions and the Debt Problem of Developing Countries*. That was followed in May 1987 by a major report of this committee, *For Whose Benefit?*, which warned that Canada's official development assistance efforts could be in vain without urgent action to arrest the spiral of Third World debt and to deal with its crushing effects on the poorest countries and peoples.

In 1989, as we reflected on what had happened since those reports, we observed that the challenges to governments were greater than ever; the imperatives to act just as pressing. The total amount of the debt had continued to climb by about one-third from the level of US$1 trillion that had been reached by 1987. Most developing-country debtors were undertaking painful economic "adjustments," often at the expense of the already poor and vulnerable members of their societies, but with little evidence of sustained recovery being achieved. Despite some modest measures of official debt relief by donor governments, and a positive shift in U.S. policy towards accepting a negotiated reduction of commercial bank claims, the fundamental affliction of the debt burden remained. Moreover, in its far-reaching socio-economic, political, security and environmental ramifications, the unfinished business of Third World debt posed a grave threat to our common future on the planet.

To begin to explore these issues, the full committee benefited from a series of panel discussions which brought together government officials, bankers, academics, independent researchers and NGO representatives. In November of last year, a working group of members held meetings in New York and Washington with UN agencies, international banks, the multilateral financial institutions, U.S. government officials, politicians, and policy analysts. That phase completed, a sub-committee was formally created in December with the following order of reference:

> That the Sub-Committee as constituted be empowered to inquire into the effects of the critical debt problems facing many developing countries and the Canadian role in alleviating this international burden, with particular reference to Canadian involvement in debt relief and structural adjustment policies and programs; the Sub-Committee to report back its findings and recommendations to the full Committee by the end of June 1990.

A Discussion Paper, "The Developing Country Debt Crisis and Canada's Response," was released for public distribution along with a short questionnaire and an op-ed article by the Chairman, "Third World Debt: Why Should Canadians Pay?". That article stated some general goals underlying the Sub-Committee's inquiry: achieving equitable burden-sharing; reversing the capital drain from developing countries and gearing debt service to ability to pay; making sustainable human development a priority of adjustment and reform; asserting a strong Canadian presence in international efforts to resolve the crisis. The Sub-Committee has been encouraged by the hundreds of responses received urging constructive action along these lines.

In 1990, the Sub-Committee held seven public meetings, culminating in the appearance of the Minister of Finance, the Honorable Michael Wilson, in early April. We also received testimony from the Superintendent of Financial Institutions and the Auditor General of Canada, as well as from non-governmental and other expert witnesses. In addition, committee members welcomed several distinguished Third World visitors. Jaime Wright of Brazil appeared through the auspices of the Canadian Churches' Ten Days for World Development campaign. Adebayo Adedeji of the UN Economic Commission for Africa addressed the full committee in October 1989.

We do not claim to be experts in international finance or to have all the answers. But the issues of debt and development are too fundamentally important to global human welfare to be left to the domain of experts and specialists. Moreover, without political commitment and initiative, the plight of the poor, and ultimately the plight of the planet itself, can only be expected to get worse. We have benefited in particular from hearing the voices of our witnesses from Africa and Latin America. They reminded us of the human face of the debt "overhang" and of the need for solidarity with them in whatever we do to help. Today, when we have indeed become one world, turning the corner on the developing-country debt crisis is very much in our long-term interest as well as theirs.

II. ADDRESSING THE GLOBAL POLITICAL CHALLENGES

The past year has truly been an extraordinary one in world history. With walls tumbling in Eastern Europe, it is a time of great opportunity and expectations. Many people are hoping that a winding down of the Cold War and economic renewal in Europe will produce a large "peace dividend" which can be applied to constructive international purposes. We share these hopes for the 1990s, and we take to heart the words the West German foreign minister, Hans-Dietrich Genscher, addressed to the Committee:

After having had the most terrible wars during this century, after having had crimes against humanity that we never had before in human history in this century, now for the last decade we have the chance to create a new world based on human rights, on freedom, on democracy. We have the opportunity to face and to meet the global challenges, to develop the Third World, to meet the great challenge of saving our natural resources and our environment. That is what we should focus on . . .(1)

The reduction in East–West tensions, which will be a primary focus of the Committee's report on Canada's relations with the Soviet Union and Eastern Europe, could open up promising new avenues for Canadian foreign policy initiative. The realization of a peace dividend should allow for increased investment in productive international economic cooperation, social development, environmental protection and other elements of a truly common security for all countries of the globe.

But the welcome optimism that has been generated in East–West relations stands in stark contrast to North–South prospects more weighed down than ever by the burdens of chronic debt and economic depression. For nearly two–thirds of humanity, the walls of ignorance, poverty and disease have yet to be broken down. In some cases they are being raised higher as developmental gains are being lost. UNICEF's report *The State of the World's Children 1990* points out that the proportion of children enrolled in primary schooling in the developing world began to fall in the mid 1980s while the total number of children continued to grow. "As a result, the number of children out of school has increased to 60 million from 50 million in 1986—the first significant rise in 4 decades." (2) The North–South Institute's *Review '89/Outlook '90* observes bluntly that "for most of the people of the South, 1989 was a miserable year." (3)

In a recent speech, Canada's former ambassador for disarmament, Douglas Roche, reminds us of what he refers to as the overwhelming "accumulating backlog of human deprivation in the Third World":

— 1.2 billion absolute poor;
— 870 million without education;
— 1.3 billion without safe water;
— 800 million hungry every night;
— 14 million children under 5 die each year.(4)

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(1) Standing Committee on External Affairs and International Trade (hereinafter cited as SCEAIT), *Minutes of Proceedings and Evidence*, Issue No. 48, 5 April 1990, p. 16.

(2) UNICEF, *The State of the World's Children 1990*, New York: Oxford University Press, 1989, Fig. 2, p. 9.

(3) "The Nervous Nineties: Uncertainties Cloud Decade for the Third World," Ottawa: The North–South Institute, January 1990, p. 1.

(4) Douglas Roche, "Good Economics and Good Ethics: Canada and the Peace Dividend in the 1990s," Keynote Address to Conference on Ethics and Canadian Defence Policy, Acadia University, 22 March 1990, p. 3.

UNICEF's report, noting that debt and interest payments by developing countries of US$ 178 billion in 1988 were more than three times the total amount of aid they received from the North, and that military spending in these countries consumed another $145 billion annually—enough to end absolute poverty on this planet within this decade, concluded: "It is therefore obvious that for much of the world, some significant reduction in debt servicing and defence spending has become the *sine qua non* of a resumption in human progress."(5)

Unfortunately, there is no guarantee that dividends that accrue in one area, for example, through East–West arms cuts, will be translated into progress in areas such as recovery from Third World indebtedness. A surplus of military equipment in the North could lead to even more arms sales in the South. Massive economic assistance to Eastern Europe must come from already stretched budgets in donor nations. These new financial requirements could put upward pressure on interest rates that are already too high. Eastern European countries that are trying to make the transition to market economies may expect preferential debt concessions and access to foreign capital. A preoccupation with exciting developments within the ranks of Northern countries could result in a further marginalization of the developing world's needs and concerns.

Of course this need not happen; indeed it must not happen. But we should take nothing for granted. **We welcome the statements by the government that any financial aid to Eastern Europe will be separate from, and additional to, the budget for official development assistance (ODA). Nevertheless, we are concerned about the impact of cutbacks in the external affairs and aid expenditure envelope, in particular given the retreat from the aid targets established in the government's own 1988 policy paper *Sharing Our Future*. The committee's 1987 report on ODA, *For Whose Benefit?*, had recommended a legislated framework and funding floor for the Canadian aid program. In the light of recent pressures, we believe the case for that is even stronger. Accordingly, we repeat those recommendations and further recommend that the legislation include a provision that ODA funds be used solely to benefit the needy in developing countries.**

It would be quite wrong, however, to create the impression that the debt problem is primarily a matter for aid policy. In fact, as Figure 1 shows, there is now a growing net transfer of funds from the South to the North. At the same time global disparities are widening. We are seeing further impoverishment in the context of severe population and environmental pressures and an unsustainable build-up of debt. The North–South divide is not being bridged. Per capita income in the developed market economies grew at an annual average rate of 2.4% from 1981 to 1987. In Sub-Saharan Africa, the comparable "growth" rate over this period was -4.1%; in Latin America and the Caribbean,

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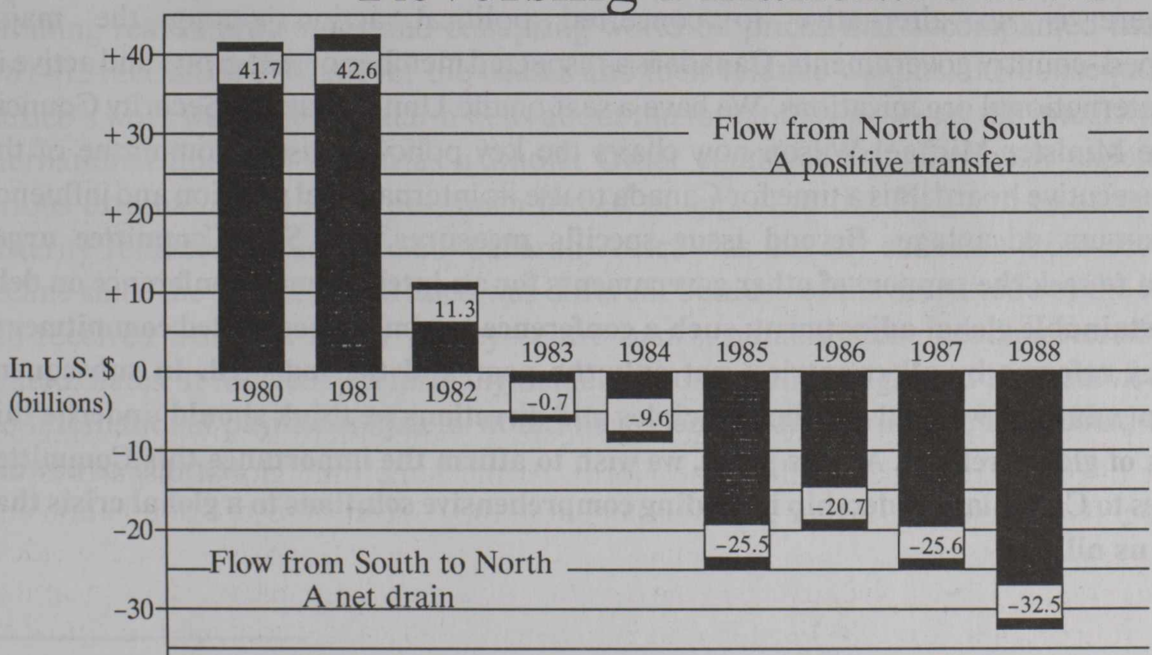
(5) *The State of the World's Children 1990*, p. 1.

it was –1.6%. Small wonder that Africans and Latin Americans refer to the 1980s as a "lost decade." And still, as was noted earlier, debt service by developing countries was three times the level of aid they received in 1988.

This situation cannot continue if there is to be any hope of building a stable, secure international order. Reversing the outflow of resources, and the loss of opportunity, from South to North requires a set of integrated, coherent and coordinated policy responses. The issues of debt, aid and trade must be linked to fundamental reforms in the global political economy that make possible equitable and sustainable development. Whatever the policy failures of individual debtor governments, the persistence of the debt crisis is manifest evidence that the world economy is malfunctioning to the detriment of many of the world's poorest nations. We are all paying a price for that: in terms of lost trade and employment; higher taxes; increased pressures on the natural environment; threats to the political stability of fragile democracies; increased violations of human rights, civil conflicts, and refugee flows;—in short, in the costs of less welfare, security and justice for the global family.

Figure 1

Reversing Financial Flows



Developing Nations: Net Transfer of Resources 1980–1988

Sample of 98 nations – covers private direct investment, private loans, official flows.

Source: United Nations and World Bank data.

In this report the Sub–Committee will be making a number of recommendations in regard to the debts which developing countries owe to Canada and to Canadian banks. However, we want at the outset to emphasize that debt relief in isolation from the broad context of policy reforms is not enough. At most, it would provide a transitory benefit. Fair trade policies, repatriation of flight capital and access to investment capital at reasonable rates of interest, assistance in transferring clean environmental technologies, demilitarization and control of the international arms trade, could be of critical long–term importance. Ways must therefore be found to incorporate these elements into an overall solution to the debt problem.

At this promising yet precarious historical conjuncture, we find ourselves asking whether the passing of the post–war political–security order does not demand as well a basic rethinking and restructuring of the post–war economic order. The Sub–Committee does not offer a blueprint for 'perestroika' in the Bretton Woods institutions such as the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT). But we are convinced of the need for structural adjustments here, not just in developing countries,—and not on the basis of some utopian ideal but as a pragmatic necessity for the future of the planet.

There is no alternative to concerted political action among the major developed–country governments. Canada is a respected member of that group and active in many international organizations. We have a seat on the United Nations Security Council. Finance Minister Michael Wilson now chairs the key policy–advisory committee of the IMF's executive board. It is a time for Canada to use its international position and influence to maximum advantage. **Beyond issue–specific measures, the Sub–Committee urges Canada to seek the support of other governments for an international conference on debt and sustainable global adjustment; such a conference to aim for negotiated commitments to policy reforms by all countries, not only the poor and the indebted. In subsequent recommendations we spell out the principles and directions we think should underlie this process of global reform. At this point, we wish to affirm the importance this Committee attaches to Canadian leadership in finding comprehensive solutions to a global crisis that affects us all.**

III. THE DEBT CRISIS: MYTHS AND REALITIES

A. A Decade of "Muddling Through"

How did we arrive at a situation in which much of the world that is most in need of new investment to provide for rapidly–growing populations should find itself groaning beneath a growing mountain of seemingly impossible debt obligations (see Figure 2) to rich–country creditors? There is no single, simple, or universally–agreed set of answers to that question. An ocean of statistics and analysis has so far produced more meetings and well–intentioned reports than it has concrete relief for the debt–burdened poor. A recent review in *Finance and Development* noted that, since 1982, 435 books and 2,940 articles and working papers had been added to the IMF–World Bank Joint Library under the catalogue entry "external debt."[(6)]

It is in fact rather ironic that it was the near–default of Mexico in August 1982 that officially marked the onset of the current "debt crisis." Mexico was not a resource–poor aid recipient, but an oil–exporting, middle–income country with enormous development potential. Some analysts believe that domestic fiscal mismanagement was at least as important a factor in Mexico's balance of payments crunch as the twin "shocks" of spiralling real interest rates and collapsing world oil prices that accompanied the steep 1981–82 recession.[(7)] Whatever the causes and their relative weights, the consequence of Mexico's woes was to set off alarm bells about the threat they posed to the integrity of the international financial system as a whole. Other countries had previously experienced serious external debt difficulties, been forced to appeal to the IMF and to accept hard austerity remedies. Much of Sub–Saharan Africa was already suffering from economic decline since the 1970s. But Mexico was different because of the magnitude of the loans it had received from the major money–centre banks, notably those headquartered in the United States. If Mexico had formally defaulted some banks might not have survived and the international payments system would have been badly disrupted. That could not be allowed to happen.

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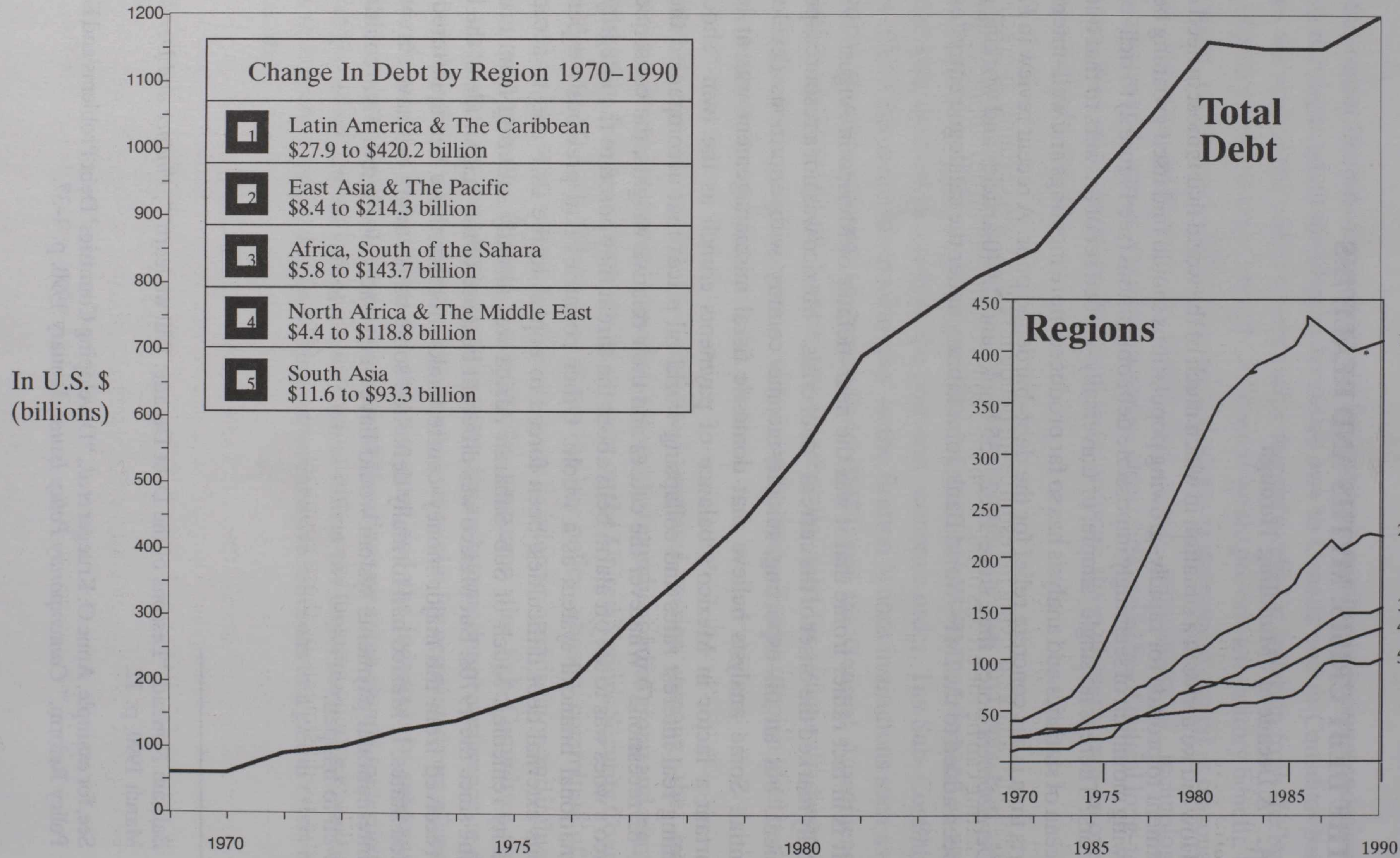
(6) Bahram Nowzad, "Lessons of the Debt Decade: Will we learn?", *Finance and Development*, March 1990, p. 12.

(7) See, for example, Anne O. Krueger *et al.*, "Developing Countries' Debt Problems and Efforts at Policy Reform," *Contemporary Policy Issues*, January 1990, p. 1–37.

Figure 2

Growing Mountain of Debt



Note: 1990 figures are based on World Bank projections.

Source: World Bank (World Debt Tables 1988–89)

Published by the UN Department of Public Information September 1989

At first, this high–profile official debt crisis was thought to be a fairly narrow and temporary financial emergency. Once it had been averted through the expedient of an IMF–mandated "rescue" package of new loans and stabilization measures, there could be a return to "normal" debt servicing as growth resumed in the world economy. That optimistic scenario never materialized. Instead things went from bad to worse. The total stock of outstanding debt continued to rise substantially in all developing–country regions as did the debt–to–GNP ratios (see Figure 3). While countries' obligations to pay increased, new private financial inflows dropped off sharply given the risky economic outlook. Some of the new money was so–called "involuntary lending" which simply went to keep up interest payments on old debt. Countries highly dependent on the export of a few primary commodities also had to cope with some of the worst price declines since the Great Depression. Canadians living in resource–dependent regions will certainly appreciate how devastating can be the effects of this economic conundrum. Not all developing countries, of course, faced an acute debt–revenue squeeze, and some undoubtedly coped better than others. But most of the recovery from the monetary–induced recession which was created in the North in the early 1980s also stayed there; very little "trickled down" to the poorer regions. By the middle of the decade nearly 70 developing countries were in serious debt difficulties. What had been treated as a short–term crisis in one country had become a chronic condition of many.

Several prominent U.S. initiatives, the first in October 1985 and the second in March 1989, have attempted, with at best partial and limited effect, to steer a course through these dangerous international currents. While there have been other important developments (for a chronology since 1982 see Figure 4), these U.S. approaches, named for the successive U.S. Secretaries of the Treasury who put them forward, have tended to mark the stages of evolution in creditors' responses to the protracted developing–country debt crisis. The 1985 "Baker plan" acknowledged that the problem was long–term and called for major new lending by both commercial banks and the international financial institutions (IFIs) to finance market–oriented "adjustment" with growth. Access to loans would be conditional on acceptance of IMF–approved programs. The focus of the Baker plan was on a group of 15 of the largest, mostly middle–income problem debtors.(8) However, Baker did not ignore the plight of smaller, low–income African nations whose foreign debts, owed mainly to donor governments and the IFIs rather than to banks, were in many cases more onerous. The IFIs were encouraged to establish new concessional lending facilities to support structural adjustments by these countries.

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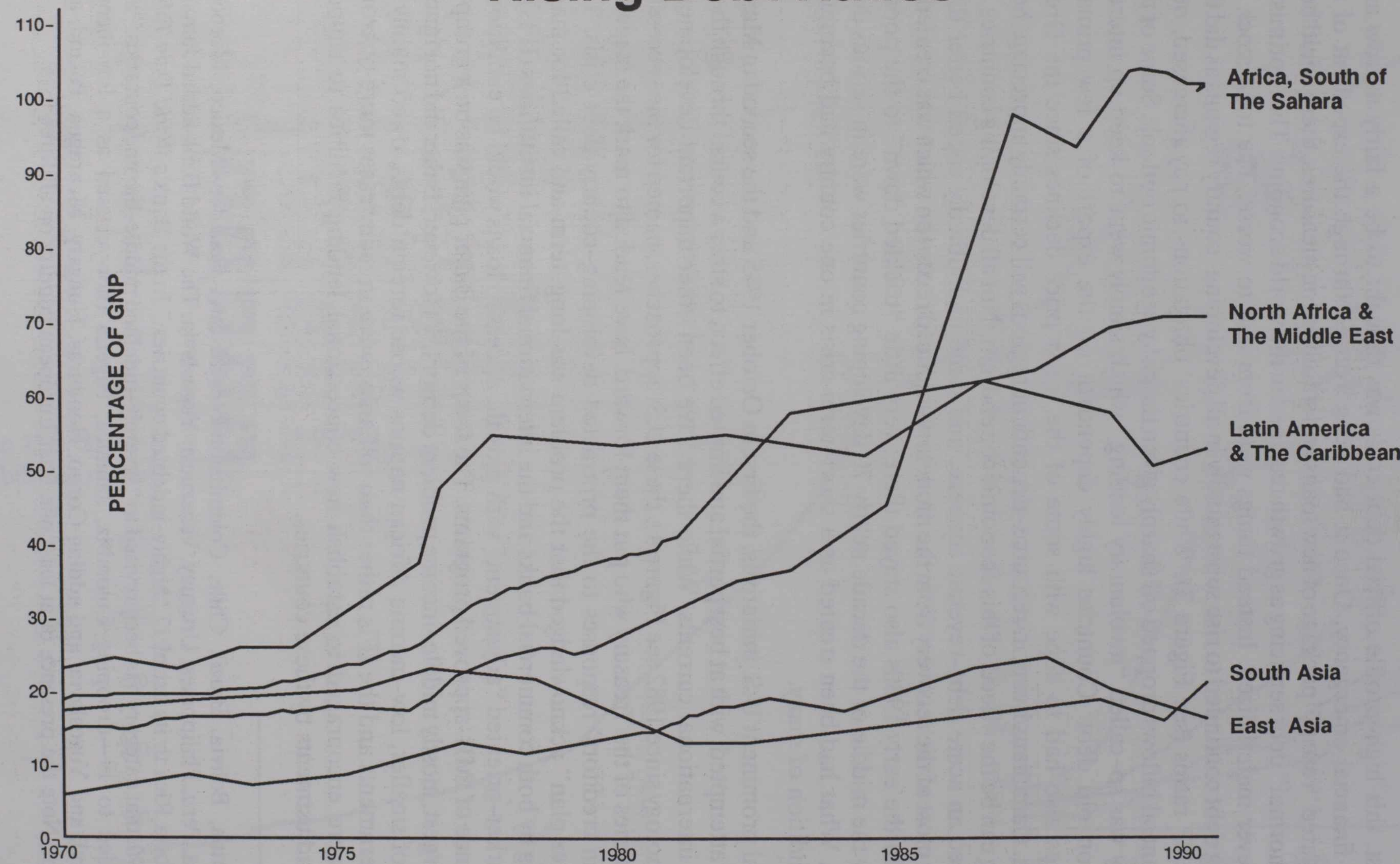
(8) Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia. The World Bank added Jamaica and Costa Rica to its list of 17 "highly–indebted countries." In the Bank's *World Debt Tables 1989–90*, that category has been revised to "severely–indebted middle–income countries," and expanded to 19—dropping Colombia, Jamaica, Nigeria (now classed as a low–income country), and Yugoslavia, and adding Congo, Honduras, Hungary, Nicaragua, Poland, and Sénégal. Note the presence of at least one East European country on all three lists.

Figure 3

Rising Debt Ratios



Debt as a Percentage of GNP by Region 1970–1990

Note : 1990 figures are based on World Bank projections.

Source : World Bank (World Debt Tables 1988-89)

Published by the UN Department of Public Information September 1989

Figure 4
EVOLUTION OF THE DEBT CRISIS 1982–1989

DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧

Prepared by Gita Bhatt

FEBRUARY 1983
Brazil and bank creditors sign an agreement on a financing package including a rescheduling and new money of US $4.5 billion.

AUGUST 1982
The Mexican crisis. Mexico announces it is unable to service external debt obligations.

MARCH 1983
Disbursement of new money to Mexico.

JUNE 1984
London Economic Summit; the leaders of the Group of 7 pledge to pursue a case-by-case strategy.

SEPTEMBER-DECEMBER 1982
Bridge financing from the BIS and bilateral official sources to Mexico.

1982 1983 1984

DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE

FEBRUARY 1987
Brazil declares a moratorium on interest payments to commercial banks

MAY 1987
Citibank announces loan-loss reserves of $3 billion against developing country exposure.

MARCH 1985
The first Multiyear restructuring agreement (MYRA) is signed with Mexico.

JUNE 1987
Venice Economic Summit. The leaders of the Group of 7 recommend extending the maturities on official debt rescheduling for the poorest countries up to 20 years. Mozambique becomes the first country to benefit.

MAY 1985
Chile introduces first comprehensive debt-equity conversion scheme.

OCTOBER 1985
Secretary Baker announces a plan emphasizing adjustment programs with growth, while encouraging new private and public lending.

JULY 1986
Mexico begins to implement growth-oriented adjustment program in the context of the Baker Plan.

JULY 1987
Banks agree with Argentina on a menu approach, with securitized new money and exit bonds.

1985 1986 1987

DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE ➧ DEBTLINE

JANUARY 1988
Bolivia buys back 40 percent of its commercial debt ($335 million) at an average discount of 89 percent.

MARCH 1989
Secretary Brady proposes plan for debt and debt service reduction plan to be supported by the IMF and the World Bank.

FEBRUARY 1988
Mexico exchanges $3.7 billion of public sector medium-term bank debt for $2.6 billion of 20-year Mexican bonds.

JUNE-AUGUST 1988
French President Mitterand proposes a new issue of Special Drawing Rights to back guarantees for new bonds issued by debtor countries. Japan's Minister of Finance suggests that creditor banks swap debt for guaranteed bonds.

APRIL-JUNE 1989
The interim Committee agrees to appropriate Fund financing for debt reduction operations. The Executive Boards of the World Bank and the IMF approve operational guidelines for this.

JUNE 1988
Toronto Summit; the Group of 7 endorses a menu of options, including partial cancellations and concessions on interest rates for the «poorest countries», mostly in Africa, for rescheduling of official bilateral loans.

NOVEMBER 1988
Pans Club agrees to implement the menu of options for the poorest countries. Mali becomes the first case to benefit.

JULY 1989
Mexico and creditor banks agree on a debt financing package, including debt and debt-service reduction.

1988 1989

Source: *Finance & Development*, March 1990, p. 10-12.

The Baker plan quickly lost momentum although it survived on paper until a new policy was enunciated by the Bush administration. IFI resources and support from donor governments fell far short of what was needed in terms of public flows, and some countries were ineligible because they did not meet strict IMF conditions. Private flows continued to drop, becoming negative on a net basis for the highly–indebted group in 1986. Most banks were withdrawing from all but relatively risk–free Third World lending, building up their reserves against loan losses while disposing of some old debt through sales (at a discount) on secondary markets, debt swaps, conversions, and other voluntary market–based transactions. While this was happening the air was thick with proposals to go further to begin actually writing down the face value of much of the Third World debt.[9] Yet the Baker plan was stuck still calling for more loans and maintaining the fiction that previous sovereign debts would be repaid in full.

A modest official breakthrough did occur at the Toronto economic summit of G–7 industrialized countries in June 1988. The major creditor nations accepted the principle of some debt forgiveness for the poorest countries in Sub–Saharan Africa which were obviously unable to keep up payments on their debts. A "menu" of options involving a reduction of claims, interest rate relief, or rescheduling over longer terms, was subsequently worked out by the Paris Club of official creditors. Unfortunately, rising international interest rates cancelled much of the intended benefit. The World Bank estimates that the Toronto terms saved African countries only about 2% of debt service due in 1989.

Meanwhile the situation in the major Latin American debtors was also becoming untenable. Rioting against measures introduced as part of an IMF austerity plan killed hundreds in Venezuela in early 1989. Debt–driven adjustment was seriously undermining political legitimacy and prospects for peaceful democratic social change, *without* really solving the economic crisis. Where was the gain to show for all the pain? Debt was still piling up and more of it was becoming a public–sector risk. Debt–to–exports ratios were unmanageable. More and more countries were falling into arrears, not only to banks, governments and their export credit agencies, but also to the IFIs, debts to which could not be rescheduled. The economic climate encouraged further capital flight rather than new investment. An indication of the lack of confidence is that by the time Secretary Brady outlined a shift in U.S. policy in a speech to the Bretton Woods Committee in March 1989, the average secondary market price of commercial debt owed to the highly–indebted "Baker 15" countries had fallen to just 29 cents on the dollar.

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(9) For a comprehensive survey see Morris Miller, *Resolving the Global Debt Crisis*, New York: UNDP Policy Discussion Paper, 1989.

Accepting, finally, the need for a substantial writedown of old debt, the centrepiece of the "Brady plan" was for up to $US35 billion to be made available over three years (through "set-asides" by the IFIs and up to $10 billion in loans from Japan) to finance debt reduction deals negotiated on a voluntary basis by selected debtor countries and their creditor banks. In effect, this money would act as an "enhancement" to debt forgiveness by guaranteeing the remaining debt or allowing countries to buy back debt at large discounts. The Brady plan was controversial from its inception, but once grudgingly adopted by the IFIs and the G–7 it became, in Dr. Roy Culpeper's words, "the only game in town." Some analysts saw it as a politically-motivated attempt to buy stability in states of strategic importance to the United States with other people's money. Indeed, the debts of only a small number of countries—Mexico, Chile, Costa Rica, Venezuela, Morocco and the Philippines—have so far received consideration under Brady terms. Against approximately $100 billion in annual interest obligations on Third World debt, the World Bank estimates the maximum value of debt service relief under the plan to be about $6 billion. Many highly-indebted countries have little prospect of obtaining relief through an initiative which, moreover, has failed to generate desperately-needed new capital flows.

The Brady plan survives but is unlikely to enjoy a long, satisfying life. Despite the complaints that Western taxpayers' money is being used "to bail out the banks," the international bankers we met with in New York regarded the public enhancements as grossly inadequate to the task. They saw very few banks as willing to commit new money of their own. At the same time, the IFIs are concerned about having their resources tied up backstopping old commercial debt. The World Bank's chief economist, Stanley Fischer, suggested to committee members that banks could be pressed harder to accept losses on bad loans. Several prominent debt analysts, notably Jeffrey Sachs, argue that concerted, involuntary debt reduction will ultimately be necessary. We received a similar message from the North–South Institute's Culpeper, who argued that Brady plan monies would be better employed in financing productive income-earning investments in the debtor countries. And while Mexico finally salvaged a complex settlement with hundreds of creditor banks in February of this year, an analysis submitted to the Sub-Committee by John Dillon of the Ecumenical Coalition for Economic Justice alleged that the modest benefits of the package could not justify the high price paid by Mexicans. Indeed there are concerns that Mexico could emerge in several years with fewer policy options but with its total external public debt virtually unchanged.

The point we wish to make is that although progress has been made in the evolution of the debt strategy, particularly in the acceptance of debt reduction, it is not clear that a viable solution has been reached even in the case of Mexico which was the first major intended beneficiary of the Brady plan. In this report we cannot of course evaluate all of the efforts, as well as the mistakes, made by individual debtors and creditors. We also recognize that because of the great variation in regional and country circumstances there is no single

debt solution to fit all cases. In light of the evidence we have received, we do, however, strongly affirm that there is as yet no adequate long-term approach to overcoming the burden of Third World debt. We cannot afford to muddle along for another decade while that debt exacts an even bigger and more unacceptable toll in human lives, damage to the environment, and lost development hopes. Given the realities of interdependence, we must not be lulled by any myths or excuses which remain. We sense that the enormity of the debt crisis, and the severity of its implications for our global future, have not yet been fully brought home to many Canadians. Without public pressure and support, government policy will only reluctantly move ahead. There is indeed work to be done.

B. Overcoming Some Myths

One of the biggest obstacles to further action is the perception that the debt crisis, if not actually solved, is at least "under control." That may be true in a very narrow, technical sense for some actors—for example, Canada's Toronto Dominion bank which has largely liquidated its portfolio of Third World loans. Today the North American banking system is probably under more threat from unstable, high-risk corporate debt than from sovereign loans to developing countries. Banks may well be in a stronger postition than a few years ago. But is the world better off when not a single problem debtor country of the 1980s (despite the praise in some quarters for Chile and Mexico) is securely on a sustainable path of socio-economic recovery in the 1990s? There is no reason for anyone to feel reassured as more of the risks of the still-growing debt overhang are transferred to governments.

And what of the consequences of debt for people? As described by Dr. Adedeji of the UN Economic Commission for Africa:

> . . . economic decline has had a devastating impact on the well-being of millions of Africans. Since 1980, per capita private consumption has fallen by one-fifth 1and total gainful employment has declined by over 16%; unemployment has reached crisis proportions where the unemployed in the formal wage sector are estimated to number over 30 million (over 13% of the labour force) and another 95 million are underemployed; real wages declined by a quarter; almost three-quarters of Africans are afflicted by poverty; the illiterate population has increased to 162 million in 1985, up from a level of 124 million in 1960; the average share of health and education in public expenditure dropped from over 26% at the beginning of the 1980s to only 19% in 1988; and over 26% of the African population are now undernourished or malnutritioned, while endemic diseases—which had actually been brought under control by the 1970s—have re-emerged on the continent. Some 10,000 children die in Africa every day of causes linked to malnutrition and to the non-availability of rudimentary health care.[10]

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(10) "The African Economic Crisis and the Challenge of the 1990s," SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 18, 24 October 1989, Appendix, p. 4.

Latin America as a whole is wealthier, less aid-dependent, and more likely to be seen as "creditworthy." But here, too, the accumulating costs of the crisis have been staggering. One of the bankers we met in New York worried about "the Africanization of Latin America." Dr. David Pollock of Carleton University illustrated the implications of that scenario for us in extremely telling fashion:

> In Latin America's case, the debt adjustment burden has been severe, austere and prolonged, to the point . . . that in 1989 for Latin America as a whole, according to the United Nations, income per capita on average will be 10% below what it had been back in 1980.
>
> Just imagine for a moment, Mr. Chairman, the political consequences of translating that last statement into a Canadian election, whether provincial or federal. Imagine the turmoil facing incumbents if income per capita on the Prairies, in B.C., in Ontario or in Quebec were on average 10% below the levels of 10 years ago instead of 10% or 20% or 30% higher.(11)

Public opinion surveys have shown that Canadians appear not be very sympathetic to the plight of developing debtor nations. We are concerned that there has been a failure of public communication and education on many aspects of Canada's response to the debt of other countries. For example, when Canada recently forgave a total of $182 million in ODA debts owed by Commonwealth Caribbean countries, there was little public appreciation or understanding of this action. It should have been made clear that these were *aid* loans in the first place, made at rates of interest of from zero to three per cent for terms of up to 50 years. It was never expected that Canada would collect back the full face value of these loans. Because the loans themselves were so concessional, the cost of forgiving them now is much less than the original $182 million. Finance Minister Wilson told us that the actual cash cost had been calculated at about $12 million. It is important, in addition, to explain to Canadians how our own best interests are served by debt reduction that helps countries get back on their feet. The North-South Institute estimates that between 1981 and 1987 Canada lost at least $16 billion worth of potential exports to a dozen Latin American and Caribbean countries because debt had forced them to cut back drastically on imports.

Countries crushed by debt cannot trade more with us or contribute to a healthy global environment. The Sub-Committee is confident that Canadians will support strong actions by their government when they are able to understand those actions, and the mutual interests served by them, in light of the gravity and urgency of the international debt situation.

Because debt is not a one-way street, we must resist the myth that the Third World's debt crisis is only their problem and not also ours. At the same time, we recognize that developing countries are indeed paying most of the direct costs of the debt burden. Apart

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(11) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 15, 12 October 1989, p. 17-18.

from the original principal of the loans, some contracted by corrupt, undemocratic governments, huge sums of interest have been paid to the North. This outflow of capital from South to North comes at a time when the annual increase in per capita incomes in the industrialized world exceeds the total average per capita income in the developing world which is about $US 300. Trade flows, investment in basic infrastructure, human health and education, the capacity of governments to cope economically, politically, socially, and environmentally—all have suffered grievously as a result of this gross and growing imbalance.

This surely is not the sort of world we wish to pass on to future generations. Canadians also are already feeling some of the negative impacts of debtor countries' depression and desperation, at the same time as our aid investments in these countries are put in jeopardy. With respect to trade, their loss of buying power due to debt may have cost up to 50,000 Canadian jobs annually since 1982 in lost export sales. Nor is Canada immune from the effects of environmental degradation which occurs because of economic pressures exacerbated by external debt. These same pressures add to the levels of violence and human rights violations, to the numbers of untreated AIDS cases, to international problems of refugees, drug trafficking, and illicit commerce. In short, the debt crisis is endangering the health and safety of everyone on the planet.

There is another issue of perception which needs to be confronted in overcoming public skepticism: that is the notion that since Canadians have to pay their debts, why should developing nations be allowed to get special treatment on theirs? Under normal circumstances countries, like people, try to repay debts that have been honestly and fairly incurred. This is as it should be or there would be a serious problem of "moral hazard" for lenders. But assertions that we pay and they do not, as well as assumptions of the normality or fairness of much of the Third World debt, need to be challenged and corrected. Northern banks were eager to make sovereign loans during the 1970s. As is now commonly acknowledged, some of these loans were made imprudently or to governments of questionable legitimacy. Banks share some responsibility with borrowers for that abnormal lending spree. Moreover, as Jaime Wright of Brazil told the Sub–Committee, many of his country's debts were illegally contracted by the previous military dictatorship. Even so, Brazil paid $176 billion in interest on its foreign debt from 1972 to 1988; $17 billion in 1988 alone. Between 1980 and 1987 the outflow of capital from Brazil was over $50 billion, yet the debt today stands at a record $113 billion. Much of the build–up in debt payments is because of unilateral hikes in international interest rates which reached historically abnormal levels during the 1980s. How can such an unjust, unhealthy situation be allowed to continue?

It is true that Canada has debt and interest rate problems of its own. Though less dire by far than in most developing countries, we see the negative effects that can be felt nationally, regionally, and individually. It is also true that debt relief is occurring in Canada on compelling grounds. As Finance Minister Wilson testified:

> The banks and the Farm Credit Corporation, through the Farm Debt Review Boards, are doing just that very thing. They are making changes in the debt structure for individual farmers on a case-by-case basis. As an example, last year we wrote off $750 million in the deficit of the Western Grain Stabilization Fund. That was a debt from the fund to the Government of Canada. We have written that off so that farmers in future do not have that as a debt overhang . . .[12]

Meeting the challenges of global debt which Canada can and must do as part of its foreign policy vocation, in no way denies the seriousness of domestic debt issues. On the contrary, it should help to place them in perspective and to make Canadians more conscious of the dilemmas facing less developed nations. If debt is painful for us in the North, how much more must it be for the poor majority in the South?

In addition to confronting the multiple realities of, and myths about, Third World debt, there is a final hurdle to be considered. That is the danger of mistaking the symptoms for the disease and treating only effects not causes. Relieving today's debt burden in developing countries may, or may not, make a lasting contribution to solving the wider global crisis of sustainable development and common security. That is why a few short-term or ad hoc measures do not in themselves constitute a sufficient response. **Immediate action on the debt is imperative. But it must be part of an overall agenda for action on North-South issues—an agenda which aims to put an end to the unacceptable consequences of mass poverty on the threshold of the third millenium.**

C. Towards Continuing Agenda for Action

A primary reason for the creation of the Sub-Committee, and a primary purpose of this report, is to heighten public awareness and to generate political will in Canada for fresh initiatives to deal with the unfinished business of Third World debt. We have earlier supported a renewed Canadian commitment to ODA, and the idea of an international conference on debt and global adjustment to negotiate multilateral policy reforms. In the remainder of the report, we advocate a set of principles to guide Canadian policy and recommend specific steps to be adopted, bearing in mind the actions already taken by the government.

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(12) SCEAIT, Sub-Committee on International Debt, *Minutes of Proceedings and Evidence*, Issue No. 7, 3 April 1990, p. 12.

The government will be tabling a comprehensive response to these recommendations. But the Sub–Committee wants to ensure that matters do not rest there, because the developing world's debt crisis is not going to be solved in the next year, or even the next several years. **There are many things that we will not be able to fully anticipate or sufficiently explore in this report. A continuing political process is therefore needed to review and update Canadian initiatives on the North–South agenda. Accordingly, as one of our first recommendations, we urge the government to establish a high–level advisory task force on international debt and adjustment, to include representatives from government, business, the NGO and academic communities, and from the Third World. In addition to providing expert monitoring of progress on the Sub–Committee's recommendations, such a body should be an ongoing source of ideas for future Canadian action. To ensure continued parliamentary input, we recommend that the task force report its findings at least annually to this Committee.**

IV. LIFTING THE BURDEN OF DEBT AND STRUCTURAL ADJUSTMENT: A FRAMEWORK FOR CANADIAN POLICY IN THE 1990s

A. The Debate Over Adjustment and "Conditionality"

Attaching stringent economic policy conditions to various forms of international financial assistance did not suddenly emerge with the debt crisis of 1982. By then there was already a long-standing debate over the merits of "program aid" and "policy-based" lending. Given the increasing balance of payments difficulties of many developing countries, the IFIs and some donor governments began to devote more of their resources to such macroeconomic transfers in addition to individual projects. Rich-country donors and creditor institutions were usually in a strong position to ask for policy changes in their dealings with developing country governments. But there were hazards, as Albert Hirschman pointed out in a seminal essay several decades ago:

> A country which permits its key economic policies to be determined by this type of international negotiation finds itself in fact in a semicolonial situation and is likely to adopt all the time-honoured methods of stealthy and indirect resistance appropriate to that situation.
>
> The fact that certain commitments have less latitude in implementation and are therefore less prone to sabotage than others has naturally led to a preference of aid negotiators for these types of commitments. In this way we can explain the increasing tendency to make program aid depend on the taking of specific monetary and exchange rate measures and on the "appropriate" behaviour of certain fiscal and monetary indicators, while less and less attention is paid to economic growth and social justice, supposedly the principal objectives of aid.(13)

The debt crisis escalated the demand for balance of payments lending, and the controversies over the "neocolonialism" involved in the orthodox economic "conditionalities" associated with these loans. The IMF in particular came under fire as being more concerned with the manipulation of statistical indicators of external balance than political viability or human welfare. Conditionality seemed to many to impose on the already poor a regimen of more pain and austerity with only a promise of distant gain. When it became obvious that the crisis was neither purely financial nor temporary, the focus extended beyond emergency measures of macroeconomic "stabilization" to the development of broader and longer-term "structural adjustment" lending programs (SAPs). These programs, which became a major element of World Bank activities in Africa and Latin America, aimed to restore a sustainable growth pattern, and thereby debt servicing capability, in the severely-indebted countries. Although ostensibly tailored to each country's circumstances, SAPs have been very similar in insisting on a common menu of market-oriented reforms: currency devaluations, public sector and wage restraint,

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(13) Albert O. Hirschman, "Foreign Aid: A Critique and a Proposal," in *A Bias For Hope: Essays on Development and Latin America*, New Haven and London: Yale University Press, 1971, p. 207.

liberalization of prices and trade, privatization of state enterprises, encouragement of foreign investment, export promotion, and so on.

The standard 1980s model of market-based structural adjustment was in fact developed in the North and not specifically for application to developing countries. But it has become the conventional wisdom about economic policy reform on a nearly world-wide basis.(14) As Minister of External Relations and International Development Monique Landry told a seminar sponsored by the North-South Institute and the Inter-American Development Bank on March 31 of this year: "Structural adjustment is a normal and necessary process for all countries." Marcel Massé, President of CIDA and previously Canadian executive director at the IMF, in his testimony to the Committee cited the Canada-United States free trade agreement as a positive example of structural adjustment by Canada. A recent Commonwealth study, *Engendering Adjustment for the 1990s*, that looked at the negative impacts of structural adjustment policies and programs on women, included cases from Canada as well as developing nations. Adjustment has become a core concept that carries conflicting connotations, both good and bad. The sobering evidence in the Commonwealth report and many others is that economically-driven adjustment too often takes place at the expense of human welfare and the rights of the politically weak and disadvantaged—especially women and children in the poorest countries.

Insofar as structural adjustment reflects a particular economic orthodoxy, it is also contentious in both its theory and practice. We agree that debtor countries must adjust by adopting sound economic policies and that a significant degree of market liberalization is often appropriate and necessary. However, agreement on these policies and social consensus in the debtor countries is often lacking. Hence the difficulty in making such economic prescriptions the only condition of providing loans and financial assistance. Moreover, the structural adjustment model does not address global structural imbalances (e.g., systemic unfairness in trading relationships between rich and poor countries), as the North-South dialogue attempted to do in the 1970s. As a result, critics argue that the rigors of adjustment in many developing countries in fact mean increased hardship for poor people. Professor Michel Chossudovsky testified that IMF programs typically bring about a compression of "internal purchasing power, as well as the marginalization of all that portion of the country's economic activity that serves its domestic market. All this contributes to an unprecedented reduction in the standard of living for the majority of the population."(15) Yet adherence to an IMF-approved plan is generally a condition of both access to new international credits and eligibility for debt relief and rescheduling.

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(14) For an analysis see Abraham Katz, "Le defi mondial de l'ajustement structurel," *Travail et Société*, 14:3, July 1989, p. 221-33.

(15) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 31, 7 December 1989, p. 5.

Frustration with this imposed orthodox approach to structural adjustment and conditionality has led to the search for alternatives that are expansionary, less economistic, and more self-reliant. Africans in particular see the need for a new development model to break the cycle of debt and dependency. There is also recognition that Africa's economic crisis has been worsened by the corruption and mismanagement of some of its governments. Reforms are required in many spheres, not just the economic, and political legitimacy is essential to carry forward these reforms. This can only come through indigenous forms of popular participation. Acknowledging these domestic political and policy challenges, consultant Chisanga Puta-Chekwe nonetheless stressed that misery is unavoidable when the prices for key exports plunge on Northern commodities markets. In the two cases we studied, he contended that "economic trade opportunities for Zambia and Ghana have not improved so far with structural adjustment." Their crises were brought about by a hostile external trading environment more than by domestic policy failings.(16) Still, there is no getting around the responsibilities for reform which developing countries must themselves shoulder if recovery is to be achieved.

We note that African governments last year adopted an "African Alternative Framework to Structural Adjustment Programmes for Socio-Economic Recovery and Transformation" (AAF-SAP), the broad outlines of which were presented to us by Dr. Adedeji of the UN Economic Commission for Africa (ECA). It proposes a different economic emphasis from that of the IMF and World Bank, integrated with social and political reforms, and combined with sharp reductions in debt service so that more resources can be available for domestic investment in the priorities of human resource development and food self-sufficiency. On a global basis, UNICEF has for some years been calling for an alternative model of "adjustment with a human face." UNICEF argues that economic adjustment must focus on long-term sustainable human development and must protect the poor and most vulnerable groups.(17)

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(16) Sub-Committee on International Debt, *Minutes of Proceedings and Evidence*, Issue No. 5, 8 March 1990, p. 15.

(17) For a comparison of the UNICEF and orthodox approaches, see Richard Jolly, "Poverty and Adjustment in the 1990s," in Valeriana Kallab and Richard Feinberg, eds., *Strengthening the Poor: What Have We Learned?*, Overseas Development Council, New Brunswick, N.J., Transaction Books, 1988, p. 168. See also *The State of the World's Children 1990*, p. 10 and passim.

These alternatives, which were strongly supported by spokespersons for Canadian churches and NGOs who appeared before the Committee, have started to have some effect on official thinking. While the preference for economic indicators that are technical and supposedly "neutral" remains, more attention is being given to the importance of income distribution effects, social equity, democratic participation and legitimacy, in the success or failure of adjustment programs. The Committee's discussion paper quoted IMF Managing Director Michel Camdessus as acknowledging that: "Too often in recent years it is the poorest segments of the population that have carried the heaviest burden of adjustment." The World Bank has established a task force on poverty alleviation, and its latest and most comprehensive report on Africa, which includes sections on "sustainable growth with equity" and "investing in people," argues that public expenditures on basic social services must be protected during fiscal crises. The document, and introduction to it by Bank president Barber Conable, is worth citing at some length:

> A central theme of the report is that although sound macroeconomic policies and an efficient infrastructure are essential to provide an enabling environment for the productive use of resources, they alone are not sufficient to transform the structure of African economies. At the same time major efforts are needed to build African capacities—to produce a better trained, more healthy population and to greatly strengthen the institutional framework within which development can take place. This is why the report strongly supports the call for a human-centered development strategy made by the ECA and UNICEF.
>
> [. . .]
>
> History suggests that political legitimacy and consensus are a precondition for sustainable development. A sound strategy for development must take into account Africa's historical traditions and current realities. This implies above all a highly participatory approach—less top-down, more bottom-up than in the past—which effectively involves ordinary people, especially at the village level, in the decisions that directly affect their lives.(18)

Canadian officials, too, argue that we are learning by painful experience how to do structural adjustment better. Tough economic medicine is still often necessary, but the social and political consequences can no longer be treated as an afterthought. In the context of the Sub-Committee's examination of the controversial adjustment process in Guyana, in which Canada is leading an IMF support group to clear that country's arrears to the Fund, Marcel Massé agreed that: "In the case of Canada, our program should have, in almost all structural adjustment cases, a strong component to deal with the social impact. At the same time, we should not forget that the ability of societies to evolve, to take in difficult measures, is based on social acceptance, which implies free elections, respect for human

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(18) *Sub-Saharan Africa: From Crisis to Sustainable Growth, A Long-Term Perspective Study*, Washington, The World Bank, 1989, p. xii and 60. For an application to Latin America, see George Psacharopoulos, "Poverty Alleviation in Latin America," *Finance and Development*, March 1990, p. 17-19.

rights, and private organizations. We should try to ensure that these reforms are done at the same time."[19] Minister Monique Landry, in the address cited earlier, declared: "The last thing we want to see is democracy smothered by structural adjustment."

Nevertheless, there is skepticism that the rhetorical acceptance of a more humane definition of adjustment has as yet been too little borne out in practice. While the economic model is being repackaged, its negative social impacts are still treated with palliatives instead of fundamental changes. The NGO Working Group on the World Bank recently concluded:

> On the issue of mollifying opposition to adjustment policies, the genuine concern of many within the Bank about the social impact of these measures has unfortunately been largely translated into compensatory or social-action programs targeted at specific population groups. While Bank efforts to alleviate poverty should be encouraged, such schemes as the Emergency Social Fund in Bolivia and PAMSCAD in Ghana do not address the root causes of the current economic crisis and deepening poverty. The theory that people need only suffer transitional hardship on the road to economic recovery and growth has yet to be borne out in a decade of experience with adjustment programs. In fact, the negative effects of adjustment, once thought to be temporary, now appear to be at best symptoms and at worst the long-term fallout of dysfunctional policies.[20]

Many witnesses before our Committee urged Canada to adopt a more critical stance in relation to IFI adjustment conditionality. Marjorie Ross of the Taskforce on the Churches and Corporate Responsibility argued that, by tying debt relief to structural adjustment programs, industrialized countries "are creating enormous hardship in the debtor countries." Chris Bryant of CUSO warned that: "The developed countries, including Canada, are forcing poor countries to do things Canada could never accept for its own people. For example, closing large numbers of hospitals and schools, or ending agricultural subsidies on which so many of our farmers depend." Dr. Marcia Burdette of the North-South Institute called on Canada to encourage new thinking within the IFIs, instead of just being "part of the gang."

The Sub-Committee does not endorse any single diagnosis of, or prescription for, all of the ills of debtor countries in the developing world. Probably elements of more than one approach will be needed, adapted to the particular situation of each country. But we have heard enough to be convinced that the status quo is not acceptable. And we believe that despite, or perhaps because of, the complexities of the cases, there ought to be some strong common principles guiding Canadian policy.

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(19) *Minutes of Proceedings and Evidence*, Issue No. 3, 22 February 1990, p. 14–15.

(20) "Position Paper of the NGO Working Group on the World Bank," October 1989, p. 14. See also the testimony before the Sub-Committee of Tim Draimin of the Canadian Council for International Cooperation, *Minutes of Proceedings and Evidence*, Issue No. 6, 13 March 1990.

B. Setting Canadian Goals and Guiding Principles

We believe that Canadian policies towards developing countries on issues of debt and structural adjustment must reflect Canadian values of social justice, respect for human rights, and democratic participation. Our policies must be coherent, ethically as well as economically responsible. This means that conditions must be applied to Canadian actions to assist debtor countries.

As the Committee recognized in its 1987 report on ODA, policy-based interventions inevitably raise sensitive sovereignty questions. The debt crisis presents similar dilemmas. The political problem was put well in a thoughtful submission to the Sub-Committee by R. Keith Jamieson of Toronto:

> In many cases, the Third World debts have been negotiated by oppressive and corrupt receiving governments—autocratic regimes or dictatorships. The common people rarely had anything to do with the negotiations and yet they are the ones that are now suffering under the debts. Moreover, it is a known fact that billions of dollars have been robbed and reinvested abroad by corrupt leaders, an action normally referred to as "Capital Flight." There can be no viable solution as long as such leaders are in power. Has the outside world any right to intervene?

Even if Canada can do little by itself to right political wrongs in other countries, we must ensure that our international policies contribute as much as possible to the promotion of the values stated above. This is as a matter of principle, not unilateral "neocolonial" imposition, as SCEAIT's report *For Whose Benefit?* was careful to point out in a chapter on aid and policy dialogue. That chapter also recommended guidelines for Canadian funding of structural adjustment that are to some extent reflected in CIDA's *Sharing Our Future* strategy. The government should now build on that established consensus so that a truly defensible Canadian approach to adjustment and debtor assistance can be put into practice.

The issue, as we see it, is not conditionality or no conditionality, but what kind of conditionality? Adjustment is necessary, but what kind of adjustment is the goal? How can we help countries to adjust in ways that benefit the poor? George Cram of the Inter-Church Fund on International Development observed: "We have conditionality now. We impose and we insist on certain conditions before we make a good economic decision to make money available." Going beyond that to integrate into negotiations on debt and adjustment social and political objectives that are at least as important will often be very difficult. Yet it must be recognized that human factors, and their environmental contexts, can deny the possibility of real economic success. We agree with Cram that, "even in the name of good economic decision-making, the social needs to be taken far more into account than has been the case until now."[21]

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(21) Sub-Committee on International Debt, *Minutes of Proceedings and Evidence*, Issue No. 3, 22 February 1990, p. 18.

Linking actions on debt and financial flows to the promotion of sustainable, humane conditions for development should be regarded not as a radical proposal but as basic common sense. We note that last year an international expert group chaired by former West German chancellor Helmut Schmidt recommended the following as criteria for financial assistance:

> Donor nations and international financial institutions should give special consideration to countries which:
>
> (a) emphasize poverty reduction programmes;
>
> (b) spend less than 2% of GNP on military expenditure;
>
> (c) apply or take steps toward efficient family planning policies in order to cope with the problem of population growth; or
>
> (d) implement policies aimed at the preservation of the environment.[22]

It is time for Canada to move forward with a clear developmental agenda on Third World debt. The Sub–Committee has benefited in its deliberations from vigorous discussions on appropriate forms of debtor adjustment and policy reform, both multilaterally and within creditor and debtor countries. **In light of what we have learned and heard, we recommend the following as a framework of guiding principles for Canadian policy:**

- **The primary long–term goal of action on Third World debt must be sustainable human development in the debtor countries.**
- **To the extent that adjustment programs are deemed necessary, they should be supported by adequate, reliable resource flows from the IFIs and donor governments. But first, every means should be explored to reduce the debt service burden of old debt, including allowing debt repayments to be made in local currencies for investment in human development projects in the debtor country.**
- **Poverty and debt are the enemies of development, not structural adjustment per se. But adjustment is a major political, social, and environmental challenge, as well as a technical and economic one. Adjustment needs to be accomplished with, not just a "human face," but a transformed human body. Adjustment can only be successful, and should only be supported, as part of a holistic developmental approach in cooperation with the debtor country.**

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(22) *Facing One World*, Report of an Independent Group on Financial Flows to Developing Countries, 1 June 1989, p. 23–4.

— Canada should work to incorporate into existing and future structural adjustment programs economic policies explicitly designed to benefit the poor, to increase the productivity and incomes of small-scale producers, and to achieve basic food self-sufficiency. Reforms must be the product of responsible dialogue with the debtor government and consultation with affected groups, not simply an external imposition from above. The social impacts of adjustment programs must also be assessed, as part of an open, accountable evaluation process, so that basic social minimums are preserved. We agree with the brief of the Taskforce on the Churches and Corporate Responsibility that: "a country should not be so constrained, either by its debt servicing, or by a structural adjustment program, that it cannot maintain its basic social programs. A structural adjustment program should protect such programs, and not rely on outside aid to compensate for its severity."

— It is not enough to take ad hoc actions or to wait for others to lead. Canadian support for debt relief and structural adjustment should be determined case by case, but according to consistent criteria which reflect Canadian values. These include:

(a) The commitment of the debtor country government to reform, especially to development that benefits its poor and vulnerable groups.

(b) Respect for international norms of human rights observance. Regimes that, as SCEAIT recommended in *For Whose Benefit?*, should not receive official bilateral aid because of gross and systematic human rights violations, should also be ineligible for debt relief or adjustment loans.

(c) The encouragement of democratic traditions, including the promotion of popular democratic participation by those affected by the economic reform process.

(d) The linkage of economic recovery from debt to sustainable development that is human-centred, socially equitable, and in harmony with the natural environment.

C. Dealing with Commercial Bank Debt and Private Flows

During the 1970s Canadian banks became important players in international sovereign lending to developing countries. Conditions at that time appeared to justify these loans in terms of market opportunities and prospects for future repayment. Banks also moved beyond their traditional activities of short-term trade and project financing into the arena of balance of payments lending. As a result of the debt crisis of the 1980s, banks' judgements about the wisdom of earlier sovereign lending policies have changed. While spokespersons for major Canadian banks have acknowledged their part in a solution to the international debt problem, they have also stated that their banks must act in the best interests of shareholders and depositers.

For the past several years, therefore, Canadian banks have been actively reducing their sovereign loan exposures in Third World countries. Total gross exposure has fallen below Cdn$16 billion. This is a small fraction of the more than US$ 500 billion in long-term debt that developing nations still owe to private creditors. At the same time, the banks have sharply increased the amounts set aside from net income to cover potential losses on their remaining loans. These loan-loss or country-risk provisions, as they are called, currently are held against more than two-thirds of total Canadian exposure. Net exposure after subtracting the provisions was down from an average 136% of bank common equity in 1986 to only 30% as of the end of 1989 (see Table 1). Moreover, Canadian tax laws permit banks to deduct from taxable income the amount of provisions up to a maximum of 45% of exposure.(23) This is the basis for the level of country risk reserves (35%–45%) which, under present regulations, banks are required to maintain against a "basket" of 42 problem debtor countries as determined and periodically reviewed by the Office of the Superintendent of Financial Institutions. The result of this provisioning and accounting regime is that, as Superintendent Michael Mackenzie testified to the Sub-Committee, Canadian banks now have a good deal of flexibility in disposing of Third World loans without much further risk to themselves or their shareholders.

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(23) Provisions within this range are in effect treated as a "loss" for tax purposes, but taxes would be due in the event that the loans were repaid and the bank got its money back.

Table 1

Changes in the Exposure of Canadian Banks to Designated Problem Debtor Countries, 1986–89*
(Cdn. $ millions)

Bank	Total Assets		Gross Exposure To Designated Countries		Net Sovereign Loan Exposure	Net Exposure As % of Common Equity		Total Country Risk Provisions		Provisions as % of Gross Exposure	
	As of 31 October 1989	As of end of 1986	1989	1986	1989	1989	1986	1989	1986	1989	1986
Royal	114,700	99,600	3,835	5,700	1,233	27	132	2,602	628	68.0	11.0
Montreal	78,900	87,200	4,600	6,000	1,790	57	175	2,800	770	61.0	12.8
Commerce	100,200	80,800	1,504	3,300	375	9	92	1,313	451	87.5	13.7
Scotiabank	81,000	64,000	4,038	4,600	1,407	49	153	2,631	464	65.0	10.1
National	33,900	27,900	1,224	2,500	470	37	174	754	383	62.0	15.7
Toronto Dominion	63,100	64,000	185	3,000	129	3	90	148	300	80.0	10.0
TOTAL	471.8	423.5	15,386	25,100	5,404	30.3	136	10,248	2,996	70.6	12.2

* Refers in 1986 to the 32 countries then designated by the Inspector General of Banks for the purposes of Canadian loan–loss regulations, and in 1989 to the 42 countries currently so designated by his successor, the Superintendent of Financial Institutions.

Source: Office of the Superintendent of Financial Institutions and Annual Reports of the big six Canadian banks for the financial year ending 31 October 1989.

This may be a happy scenario for financial markets, but it leaves some serious problems in its wake. First, the price of reduced loan exposures has been a withdrawal by many banks from Third World lending. We welcome the commitment expressed by several Canadian banks not to abandon their developing-country clients. But we observe that at least one bank already regards loans to these countries as "discontinued business." Globally, net private lending to the highly-indebted group was again negative in 1989.

Second, the reduction in bank exposures has so far provided little debt reduction benefit to the debtor nations themselves. Most secondary-market debt sales have been to third parties so that the full face-value of the claims remains. Debtors only realize substantial relief if they are able to buy back their debt at large discounts, which most are not. Other market-based techniques, such as debt-equity swaps and conversions to new debt instruments, are problematic and of limited value compared to the large-scale reductions in outstanding principal (probably greater than 50%) that would be needed to make a decisive contribution to economic recovery prospects.

Third, in addition to reducing the nominal stock of a country's debt overhang, attention must also be directed to substantially lowering debt service payments, specifically, to interest rate relief. Indeed, the Committee received an ingenious proposal for facilitating such relief from Peter Nicholson of the Bank of Nova Scotia. He suggested that governments and the banks share the costs of converting unpayable old debts into new more secure debt instruments carrying below-market interest rates. Both nominal and real international interest rates have been abnormally high since the early 1980s (see Table 2). This has added enormously to the accumulated debt obligations of developing countries. Lasting benefits from debt reduction will not be fully realized without concerted action by the major industrialized nations to bring down interest costs.

Table 2

Nominal and Real Effective Rates of Interest on Outstanding Debt of Groups of Developing Countries, 1981–1988

(Annual Percentage Rates)

	1981	1982	1983	1984	1985	1986	1987	1988
LIBOR[a]	16.2	16.3	10.1	10.5	10.4	8.0	6.3	7.7
Real effective rate of interest[b]	10.3	19.1	28.9	10.5	14.3	80.7	0.9	9.8[c]
Energy-exporting developing countries	10.3	19.1	28.9	10.5	14.3	80.7	0.9	9.8[c]
Non-energy exporting developing countries	27.1	23.3	11.3	14.8	18.0	6.6	. .	. .
Fifteen heavily indebted countries	21.7	18.9	19.8	12.1	. .	. .	. .	. .
Small low-income developing countries	19.8	30.8	6.8	6.8	23.2	12.3	. .	. .

[a] London interbank offered rate on six-month dollar deposits.
[b] Calculated using LIBOR as the nominal interest rate and the change in the unit value of exports as the inflation rate.
[c] First six months only.

Source : *World Economic Survey 1989,* New York, United Nations Department of International Economic and Social Affairs, 1989, p. 134.

Some banks have indicated that they are prepared to be part of the solution to a debt problem which, in hindsight, they helped to create. But, as private institutions, they also see their responsibilities as confined to a fairly narrow context. Dr. Ed Neufeld, chief economist of the Royal Bank, made the following points in his testimony:

> The first is the emphasis must remain on the sustained application of sound economic policies in the indebted LDCs, encouraged and supported by adequate financial support from the IMF and the World Bank. In this regard, sustaining policies that encourage domestic savings, that restore investor confidence and encourage the return of flight capital, are paramount to a resolution of the debt problem. There is no resolution to the debt problem without sound domestic economic policies.

> The second point . . . is that official funding for the Brady plan should be increased.
>
> (. . .)
>
> The third point is that bank regulators must ensure that regulations do not discourage participation in voluntary market-based transactions.[24]

The banks insist that their participation in debt relief actions must be voluntary, and that the long-term problem should be solved through more public sector resources. Yet this has been questioned by analysts such as Roy Culpeper in Canada and Jeffrey Sachs in the United States. Even with the Brady plan, the pace of debt reduction actually slowed in 1989 from 1988 according to the World Bank's *World Debt Tables, 1989–90*. The face value of debt reduction operations, including voluntary transactions to reduce obligations to commercial banks, was estimated to be only US$ 14 billion in 1989, or barely more than 1% of the total debt outstanding which increased by 0.5% from 1988. Sachs argues that debtor countries should be able to buy back much more of their bank debt at current low secondary-market prices. The IMF could use its leverage to encourage reductions by allowing countries to accumulate commercial arrears if the banks did not cooperate. This is easier said than done, of course, given the numbers of banks, the complexity of lending arrangements, and the lack of any recognized international "bankruptcy" proceedings for countries, not to mention political realities in the creditor countries.[25]

We have received a variety of suggestions for encouraging banks, both to write down old debt in ways that transfer significant benefit to the borrowing country, and to remain in the game in terms of new lending for productive investment in developing countries. An academic economist proposed that banks might be more likely to sell debt back to the countries at its secondary-market value if there were a limit (perhaps three to five years) on the amount of time that banks could hold funds in tax-exempt loan-loss reserves without having to realize actual losses in this way. Consistent with this, researchers on a Third World debt negotiations project financed by Canada's International Development Research Centre (IDRC) have recommended that "commercial banks should retain their tax concessions only if they participate in a debt/debt service reduction scheme." Maureen

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(24) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 15, 12 October 1989, p. 8.

(25) A brief to the Sub-Committee from the Sarnia Ten Days for World Development Committee made the point about the common interest of debtors and creditors in avoiding a bankruptcy outcome. Why should that not apply internationally? Sachs contends that the IMF articles of agreement could be employed to protect debtor countries from legal challenges. (See Sachs, "Strengthening IMF Programs in Highly Indebted Countries," in Catherine Gwin, Richard Feinberg, and contributors, *Pulling Together: The International Monetary Fund in a Multipolar World*, New Brunswick, N.J., Transaction Books, 1989, p. 110–13. Cf. also Stephen Silard, "International Law and the Conditions of Order in International Finance: Lessons of the Debt Crisis," *International Lawyer*, Winter 1989, p. 963–76.)

O'Neil of the North–South Institute described to us some innovative examples of debt reduction that Canadian banks could consider—options such as selling or donating debt to non–profit development agencies which would then receive payments on that claim in local funds to invest in projects in the debtor country. Others agree that these are useful possibilities as long as the various types of debt swaps and sales are carefully monitored to see that they in fact serve public interest and development goals, and do not just provide an easy and attractive exit alternative for banks.

Relying on market responses and good will actions by banks is unlikely, however, to be more than a small part of a solution, so governments will have to use their leverage as well. The churches' taskforce recommended that banks not receive any more generous tax treatment of their loan–loss reserves (tax savings from which are estimated at more than $3 billion to date) unless and until they actually write off the loans. They argued that, in general, banks should only get added tax benefits if the debtor country also benefits. But recognizing also that the requirement to maintain reserves is a cost to the banks as well as to the Canadian treasury, these regulations should be reviewed to see that they are appropriate and do not discourage new bank lending to countries which need it. For example, it can be asked whether, if the Brady plan is in fact working as intended, a "model" country like Mexico should still be on the Superintendent's list of problem countries.

We agree that banks cannot be expected to act as charitable institutions and that there is flexibility in the system now for voluntary debt concessions. The response of Canadian government officials has been cool to the idea of using ostensibly "neutral" tax and regulatory regimes to try to encourage banks to choose specific measures which will benefit developing countries. Nonetheless, we believe there is a place for appropriate government inducements and multilateral concertation to bring about a much more beneficial reduction of commercial debt, and encouragement of new private flows, than has so far occurred. The World Bank has recently observed that: "It may be desirable to differentiate among various debt instruments when mandating loan loss reserve requirements. One possibility is more favourable regulatory treatment of fresh credits extended in connection with officially supported financing programs." The Bank added that G–7 governments have formed "an informal group to review the tax, accounting and regulatory environment to seek ways to reduce the impediments to debt and debt service reduction schemes. Some changes have already occurred in tax, accounting and regulatory rules affecting debt restructurings in major creditor countries . . ."(26)

(26) *World Debt Tables 1989–90*, Vol. I, p. 4 and 28.

The Sub-Committee has received a detailed submission from the North-South Institute which argues that Canada proceed along the lines of recent tax changes in the United Kingdom which provide banks there with an early incentive to take additional losses by selling debt back to debtor countries at a large discount. The complete proposal is included as an appendix to this report.

We realize this is a complex area which does not yield one obvious answer. But we are impressed by the thoughtfulness of the suggestions for reform, and persuaded that the Canadian government should be more active in promoting commercial debt relief that benefits Third World peoples, not just in granting tax relief on bad loans made by our banks. Accordingly, **the Sub-Committee recommends that the current 45% ceiling on reserves against problem sovereign debt exposure eligible for tax purposes remain, but that—as outlined in the appended proposal by the North-South Institute—banks be able to claim an additional tax loss equal to the difference between the 45% level already claimed and the amount of any discounts only when Third World loan assets are written down or sold in ways that reduce the burden on debtor countries. This should encourage faster, larger and more beneficial discounts on remaining commercial bank exposure. In addition, there should be a limit of 5 years or less on the length of time that banks are allowed to hold funds in loan-loss reserves above the level required by the Superintendent of Financial Institutions without acting to discount the portion of the debt applicable to those excess provisions.**

D. Providing Relief on Official Government Debt

The Canadian government is limited in the actions it can take to reduce the commercial debt burden of developing countries. But Canada is also an important creditor of the Third World and, therefore, able directly to make a difference through its own debt relief actions. Indeed, most of the external debt of low-income developing nations is held by donor governments and the IFIs.

While the situation of large middle-income debtors such as Mexico and Brazil has captured more attention and been the focus of initiatives such as the Brady plan, the plight of the least developed countries concentrated in Africa, is in fact more extreme even if less immediately threatening to Northern financial interests. A recent report by the United Nations Conference on Trade and Development (UNCTAD) documents the chronic decline of the world's 42 poorest nations as economic growth rates lag behind soaring populations. These countries' share of world exports was only 0.3% in 1988 compared to 1.4% in 1960. Their external debt doubled from 1982 to 1988 to US$69 billion. The debt of Sub-Saharan Africa reached 369% of the value of its exports in 1988. The UNCTAD report concluded, as have many others, with a call for increased aid flows and further large-scale debt cancellation.

1. Phasing Out Aid Debt

In 1978 an UNCTAD-sponsored initiative in which Canada participated led to some initial conversions of ODA loans to grants at the time. But ten years later the need for a more comprehensive approach to debt forgiveness has become apparent. Much of this will have to be accomplished by political decision. In low-income Africa, for example, fully 85% of the long-term debt is owed to official creditors, both bilateral and multilateral. Canada moved to an all-grant ODA program in 1986 and subsequently cancelled a total of $672 million in ODA debts owed by 13 Commonwealth and Francophone countries in Africa. Canada also took a leadership role in supporting special measures to assist Africa within the United Nations system and the IFIs, as well as through its own bilateral aid programs. As Table 3 shows, from 1980 to the end of 1988, Canada accounted for 35% of debt forgiveness to Sub-Saharan Africa, amounting to 25% of the approximately US$3 billion of debt forgiven to all developing countries. In March of this year, Prime Minister Mulroney announced that the $182 million aid debt of Commonwealth Caribbean countries would also be cancelled, although as we observed earlier the actual cash cost of providing this relief was only about $12 million.

The scope for further ODA debt forgiveness by Canada is quite limited, and the government, unwisely we think, has given up its leverage on bilateral debt concessions by not applying any conditionality such as we have recommended on page 26. The benefits to debtor countries from this kind of relief have been small in any event because of the highly concessional nature of ODA loans. The present value of these loans is only a fraction of their nominal face value. The cost to the Canadian treasury of forgiving $854 million in CIDA loans since 1987 is probably under $80 million. Even if all donors' aid loans to low-income Africa were written off, the region's debt overhang would be reduced by only about 8% and its debt service obligations by less.

Table 3

Debt Forgiveness by Creditor Governments, 1980–88

(U.S. $millions)

Country	Sub–Saharan Africa	Other Developing Countries	Total
Canada	566	0	566
Denmark	206	53	259
Finland[a]	..	..	..
Germany	342	0	342
Italy	12	0	12
Japan	34	314	347
Netherlands	81	76	157
Norway	111	0	111
Sweden[a]	9	0	9
United Kingdom	265	225	489
TOTAL	1,625	668	2,293

[a] While these countries did not report or reported little or no debt forgiveness in 1980–88, they converted a substantial dollar volume of official development assistance loans to grants in 1978–79.

Source: The World Bank, *World Debt Tables* 1989-90, Vol. I, p. 44.

2. Getting Serious About Export Credit Debt

More significant to the recovery prospects of low–income debtors than writing off old aid debt, are actions to reduce the considerably more onerous burden of export credit debt which carries much harder terms. Loans from creditor governments' export promotion agencies constitute more than half of these countries' total debt and the largest part of their annual debt payments. Canada has provided some leadership in this area as well. The 1988 Toronto economic summit achieved important G–7 support for the principle of relief on this non–concessional debt. As of the end of 1989, 13 African countries had received Toronto terms at the Paris Club. Five of these countries have benefited from the reduced interest rate option on debts they owe to Canada's Export Development Corporation (EDC) and the Canadian Wheat Board (CWB).(27) EDC's exposure in Sub–Saharan Africa is about $600 million out of the $2.4 billion that it is owed by indebted developing countries.

(27) Benin, Madagascar, Sénégal, Tanzania, and Zaire, according to information supplied by the Department of Finance.

The problem, as we have already noted, is that rising international interest rates have undercut much of the potential relief from the Toronto initiative. Despite government reservations about the difficulties and costs of cancelling export credit debt, other witnesses argued forcefully that now is the time to take stronger steps. The Royal Bank's Neufeld proposed extending Toronto terms beyond Africa to include other severely-indebted countries. Professor Gerald Helleiner urged a 10-year moratorium on debt service obligations for low-income Africa, in part as well to lift the burden of numerous reschedulings on countries with extremely limited resources. Dr. Adedeji of the UNECA outlined the African countries' case for major write-downs and increased use of options such as allowing repayment in local currencies. The brief of the Taskforce on the Churches and Corporate Responsibility referred to various ways in which the Toronto terms could be enhanced to provide more generous and longer-term relief.

The Sub-Committee believes that the time has come to face facts and to get serious about reducing the burden of export debt owed to Canada by poor countries that are simply unable to pay. We, therefore, recommend that Canada take the lead in advocating the adoption by Paris Club members of substantial additional export debt concessions, in particular for the poorest and most seriously-affected countries. In responding to this recommendation, the government should table detailed proposals showing clearly how they will apply to Canada's export loans to indebted developing countries, either in a multilateral or bilateral context.

There are, in addition, several other problems which need to be confronted. One is the always thorny issue of conditionality. Debtor countries are now only able to get Paris Club relief, or access to IFI facilities such as the IMF's Enhanced Structural Adjustment Facility (ESAF) and the World Bank's Special Program of Assistance for low-income Africa, if they accept the standard structural adjustment programs (SAPs) that have proved so unsatisfactory for many. The UN's Adedeji made a powerful case for a "de-linkage" of official debt reduction and debt service relief from this narrow form of conditionality, adding that:

> Requesting de-linking from the conditionality of SAPs is not tantamount to a call against accountability. On the contrary, accountability is very much called for and could be ensured through adherence to sound development approaches that provide for both adjustment and transformation. Africa's creditors and the multilateral institutions must not compel African countries to adopt SAPs through the lure of resource flows and debt relief, when the limitations of SAPs are glaringly obvious.(28)

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(28) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 18, 24 October 1989, Appendix, p. 21.

We agree that the conditions of accountability are crucial. As a submission by John Dillon of the Ecumenical Coalition for Economic Justice put it, "simply demanding the cancellation of EDC loans begs some important questions." The Coalition joined the churches' taskforce in recommending against making Canadian debt assistance contingent on the acceptance of IMF–World Bank adjustment programs. But the submission also asked: "Who would benefit if, for example, EDC loans to Zaire were written off? President Mobutu who has siphoned so much wealth out of the country? Or the people of Zaire?" **The Sub-Committee is convinced that a new approach is needed in determining eligibility for official bilateral debt relief. We, therefore, recommend that Canadian actions to reduce the burden of official debt neither be done across-the-board or necessarily linked to the adoption of orthodox SAPs. Instead, in each case, there should be an independent Canadian assessment of the debtor country's commitment to serious economic reform and to equitable development that is environmentally sustainable. Respect for human rights, including the right of popular participation in policy decisions, should also be a factor in determining eligibility. Debt reduction should not end up rewarding corrupt elites, and even less should it be tied to measures that make the poor worse off.**

A further related matter of sovereign debt accountability has been raised with the Sub-Committee by the Auditor General of Canada among others. According to Department of Finance figures total Canadian official debt exposure to debt-distressed countries stood at about $6 billion at the end of 1989. Half of this is owed to the CWB, and most of that to the government of Poland. Although the Polish debt is not strictly an issue for this report, it is part of the same problem because it is publicly-guaranteed and unlikely ever to be repaid. Yet government policy is to treat all sovereign loan obligations as ultimately collectible in full. As a result, a Crown agency like EDC, unlike the commercial banks, has set aside only very small reserves against potential losses on its several billion dollars in outstanding loans to indebted developing countries. In his latest annual report, Auditor General Kenneth Dye argues that EDC's loan-loss provisions should be increased by $500 million, which would have seen the Corporation record a $492 million net loss in 1989 instead of its reported $7.8 million surplus.

We are concerned that an incomplete and possibly misleading picture of Canadian sovereign debt exposure could make it more difficult to pursue realistic policies on developing-country debt. Mr. Dye told the Sub-Committee that the "extent of Canada's loan exposure is not readily available to parliamentarians," and that "Canada's accounting for sovereign debt is inadequate and lacks credibility in Canada and internationally."[29] He pointed to more prudent accounting policies being followed by export credit agencies in other countries, and even by the IFIs whose present rules do not permit loan forgiveness or reschedulings of arrears. The government in turn continues to defend its position.

(29) *Minutes of Proceedings and Evidence*, Issue No. 2, 22 February 1990, p. 10.

Our primary focus in this report is on the most appropriate Canadian actions to ease the debt crisis of developing countries. We know that this will not be cost-free, or risk-free. There are costs to inaction as well as to further actions to relieve or write down official debt. To make good policy we need a realistic accounting of sovereign loans that makes it clear what is at stake. We need to avoid both complacent expectations about the prospects of future debt repayment and public confusion about the costs versus the benefits of debt reduction. Ignoring problems in the hope that they will eventually go away is in no one's interest, including that of the Canadian taxpayer. **The Sub-Committee therefore urges the Office of the Auditor General, the Ministry of Finance and the EDC to make best efforts to reach agreement on acceptable accounting principles for Canada's official loan exposure. We also call on the government to annually table in Parliament for referral to this Committee a complete statement of all Canadian official debt exposure in developing countries, including the details of any actions taken by the government to reduce the burden of the debt during that year.**

E. Reviewing Canada's Role in the IFIs

Canada was present at the creation of the Bretton Woods framework of international financial institutions and has remained an important contributor to their lending activities. For some time these have been heavily concentrated in developing countries, although Eastern Europe is now emerging as a potential competitor for funds. Canada's subscription in the financial resources of the various lending facilities of the IMF, the World Bank Group, and the four regional development banks, normally falls within the range of 3 to 5%. While Canada has recently supported large capital increases for these institutions, recent cutbacks in the ODA budget have not exempted the IFIs. Cash payments to them through CIDA and the Department of Finance have declined considerably. Because of the nature of multilateral funding, some fluctuation in contributions from one fiscal year to the next can be expected. But for Canada to maintain its leverage within the IFIs, we must ensure that we maintain our share in the concessional resources that are made available through the multilateral funding mechanisms.

We believe that Canada must work on making its presence felt even more strongly within the IFIs. That does *not* mean just going along and supporting more of the same. Although there has been considerable progress in establishing new multilateral channels of assistance for debtor nations,[30] these remain tied to an imposed orthodox structural adjustment conditionality which is fundamentally unacceptable. We must state clearly that this model of debtor adjustment has been tried and found wanting. It is not working. Canada cannot continue to support in the 1990s policies in the name of adjustment with the disastrous effects on the welfare of the poor, of women, children and other vulnerable social groups, that have been observed with such distressing repetition during the 1980s.

It is not just new means of providing funds that are needed, it is a whole new approach to IFI adjustment and conditionality along the lines we earlier recommended as guidelines for Canadian policy. Otherwise we may end up deluding ourselves and bitterly disappointing, as appears to be the case in Guyana, the very people we claim to be helping. We are concerned that the narrow criteria applied by our Department of Finance seem to be disconnected from the broader foreign policy purposes carried out by the Department of External Affairs and CIDA over which they prevail. We are disturbed as well by recent decisions which seem to reinforce a discredited neocolonial model. The United States has insisted on an even heavier hand with "delinquent" debtor countries in arrears to the IMF as its price for agreeing to a 50% increase in the Fund's resources. Canada accepted this compromise. The U.S. also seems to want to prescribe the form of democratic political system countries must have to receive assistance. Democracy, in the sense of popular legitimacy and participation, is indeed essential to a genuine recovery process, as the unfortunate experience of Guyana confirms. But these rich-country manoeuvres on conditionality constitute regression not progress. It is time to change that.

Accordingly, the Sub-Committee recommends that Canada use its position to advocate major changes in the way that the IFIs respond to the debt crisis of developing countries. These reforms should be a central part of the agenda of the global conference on debt and adjustment we recommended earlier in the report. The challenge goes well beyond

(30) The IMF's Structural Adjustment Facility (SAF) for low-income countries was created in March 1986 in the wake of the Baker plan, financed by reflows to the Fund. An enhanced facility, ESAF, was added in December 1987, and Canada has supported it with a concessional loan of SDR 300 million. (Special Drawing Rights are the IMF's unit of account. SDR 300 million is equal to approximately Cdn$ 450 million.) There are proposals to sell off some of the IMF's gold reserves, to use more of its revolving income flows and part of the new quota increase to provide additional resources for concessional lending. For its part, the World Bank has had a Special Program of Assistance for low-income Africa in place since 1987. Last year the Bank set up a new $100 million facility, funded from its own income, to provide grants to the poorest countries (i.e., those eligible for assistance through its "soft loan window", the International Development Association or IDA) for repurchases at a discount of their commercial debt.

increasing financial flows to support adjustment. It means changing policy structures so that the poor are helped not harmed by adjustment. Canada's contributions to the IFIs should be predicated on such an initiative for North–South reform.

The IFIs' direct and indirect role in debt reduction also needs to be reviewed. First, these institutions, as "lenders of last resort," are themselves major creditors of many poor and highly–indebted countries. In some recent years the Bank and the Fund have actually contributed to the problem of capital outflow from the Third World, becoming net recipients from those they are supposed to be helping. This is unacceptable, yet providing any relief on the terms of their own loans is officially against Fund and Bank policy. About a dozen debtor countries are currently in arrears to the IMF making them pariahs in the international financial system. Canada addressed this "catch–22' in the case of Guyana where the rules were bent in order to get a Fund–approved adjustment program in place while clearing the arrears. Unfortunately, this special treatment has not been good news for Guyanians. Moreover, the policy issue of the IFIs considering changes to allow concessional rescheduling or partial forgiveness of their loans remains unresolved by these ad hoc responses. The Royal Bank's Ed Neufeld argued that the IFIs should practise what they preach to the commercial banks, as long as their ability to borrow is not impaired. Roy Culpeper of the North–South Institute cautioned however, that any policy changes should not rebound against the long–term interests of borrowing countries. **We believe Canadian policy should be that the IFIs must remain on a constant basis net lenders to, not creditors of, the developing nations. We therefore urge the government and Canada's executive directors at the IMF and World Bank to study ways in which this objective can be maintained without jeopardizing multilateral banks' access to financial markets.**

A second controversy revolves around the use of scarce IFI resources to finance debt reduction schemes within the limits of the Brady initiative, about which we encountered considerable skepticism in Washington and New York as well as during our hearings in Ottawa. The brief of the churches' taskforce argued that "this is not the best use of our government dollars aimed at assisting debtor countries. Every dollar of international funds that is used for this purpose (effectively "back–stopping" bad debt as an incentive to the banks to accept reductions) is a dollar which is not available for more productive development purposes in the country concerned." We agree that commercial banks now have the flexibility to participate in debt reduction that will provide real benefits to their developing–country clients, and we earlier recommended that Canadian regulatory and tax policies act as an incentive to achieving this outcome. How much the process of debt reduction should be underwritten by international public funds, or even through the creation of a new international debt restructuring institution for which there have been numerous proposals, nonetheless remains a serious issue. We tend to agree that the best use should be made of existing institutions before time and energy is consumed adding new ones. At the same time, improved coordination of international efforts to reduce the debt overhang and to reverse negative net North–South flows is imperative. We note in this regard the suggestion of the Schmidt independent expert group that:

> This process might be achieved most efficiently through the creation of a new facility sponsored by the World Bank and the IMF. This facility should aim to mobilize substantially greater funds than those now flowing to the developing countries. Such funds, in addition to those provided by the IMF and the World Bank, would be furnished by voluntary contributions from OECD countries, with Japan playing the major role.
>
> In time, it might be desirable for this facility to assume an institutional structure, to raise equity and to borrow from the markets. It could immediately become a focus for leadership in the negotiation and coordination of effective debt relief consistent with development.(31)

Another recommendation of the Schmidt group is that the OECD donor countries establish a $1 billion endowment fund through the African Development Bank to build up professional and managerial skills and institutional capacities in Sub–Saharan Africa. It is critical that the debt crisis be solved in ways that overcome rather than entrench neocolonial dependency. So we take note as well of the important work being financed by Canada's IDRC on technical assistance to developing countries for debt negotiations and debt management. The results of the first phase of this project have been published and were presented to a British parliamentary Committee.(32) The goal, as a UNDP report on the subject put it, is that eventually "each debtor country should be able to reach a satisfactorily sustainable level of external debt management on the basis of its own national resources."(33)

There are other initiatives that merit consideration and support by Canada. One of these is UNICEF's "Debt Relief for Child Development" program to channel savings from debt reduction into concrete assistance to children in poverty and other vulnerable groups who have suffered so much from the ongoing debt crisis. UNICEF is also working

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(31) *Facing One World*, p. 26.

(32) See Stephany Griffith-Jones, ed., *Managing World Debt*, New York, Wheatsheaf and St. Martin's Press, 1988.

(33) *Debt Management and the Developing Countries*, A Report to the United Nations Development Programme by an Independent Group of Experts, New York, July 1989, p. 59.

with the Inter-American Development Bank (IDB) to create a special "Social Investment Trust Fund" for human resource development projects in Latin America. Financed by interested donors, funds would be loaned on concessional terms for secondary-market buybacks by debtor governments who would then agree to set aside an amount of the savings realized in local currency for projects jointly planned with the IDB and UNICEF. We understand that Canada has reservations about supporting the creation of another special fund without also looking at the most effective utilization of existing IDB and UNICEF resources. Combined with budget constraints within CIDA this has lead to a decision not to participate at this time. Nonetheless, because the concept clearly has merit, **the Sub-Committee believes that the government should reconsider its decision not to join the IDB-UNICEF "Debt Relief for Child Development" scheme and should encourage the IFIs to seek other innovative ways of linking debt relief means to human development purposes.**

But finally, the more fundamental area of controversy to which we must return is the one which goes to the very nature of the role played by the IFIs in the current international political economy, especially when more is being asked of these institutions. Roy Culpeper has suggested that, in determining the amount of debt relief and concessional multilateral assistance needed, the World Bank should define serviceable debt levels for each country related to its growth requirements. Yet many debtor countries do not trust the IFIs because of their negative experiences with structural adjustment conditionalities that sometimes operate at cross purposes to each other as well as to domestic development goals. We need to see the IFIs forthrightly addressing these concerns. And as Richard Jolly, Deputy Executive Director of UNICEF, told Committee members in New York, the IFIs should not think they have a "monopoly of ideas." He argued that a human-centred approach to debtor recovery must bring in other parts of the UN system and a much wider range of expertise than that of just economists, finance ministries and central banks. Better social data is needed to monitor adjustment impacts instead of just relying on macroeconomic aggregates. Ministries of health and education should be consulted in the early design of programs and popular participation sought during the design and implementation phases.

Canada should be using its offices to promote policy reform and dialogue within the multilateral system, as well as by and between donors, creditor institutions and debtor countries. We believe there is scope to bring about positive change. While defending the World Bank's involvement in structural adjustment, Vice-President and chief economist Stanley Fischer agreed that the reform process is more than just getting economic policies right. As he stated to Committee members, the "long-term prospects for Africa depend on them getting their politics straight." Assistance for institution-building, management training, public-sector reform and democratic development may be as important as economic aid. The point is that successful debt adjustment cannot be just externally conceived and imposed; it must be socially and politically sustainable within the debtor country. This is a point which now applies as well to the daunting transformations underway in Eastern European debtor countries like Poland and Hungary. Canadian financier Andrew Sarlos told the Committee plainly in this context that:

> . . . the World Bank and International Monetary Fund will have to find a solution, how to do it in a manner in which they preserve fairness and prevent impoverishing the population of these two countries and creating a politically unacceptable climate in which people will resent democracy because democracy will have the connotation of poverty. That is very important.(34)

It is also interesting to note that Jeffrey Sachs, the architect of economic "shock therapies" to stabilize financial crises and cure hyperinflation in Bolivia and lately Poland, has been a strong critic of the IMF for failing to accord sufficient importance to the need for political reforms and action on income redistribution.

The key test of policy for the IFIs will be seeing that debt and adjustment cures do not make things worse for the already poor and vulnerable than the disease itself. In Africa, Ghana is being held up as a political as well as economic model of adjustment, giving it access to comparatively huge amounts of donor assistance. Although the Ghanaian government came to power in a military coup, it is said to be populist and, as John Sinclair of CIDA testified, to have "made a major effort to bring the population into this process of policy reform and structural adjustment." Others familiar with the situation, such as Professor Gerry Helleiner, doubt that the Ghanaian case is replicable or sustainable over the longer term. Sinclair himself acknowledged that, after painful economic "stabilization," the "much more complex and difficult" recovery stage is still just beginning in Ghana. "Even after five or six years of active structural adjustment programs, the country has not progressed very far in that recovery process, which we would call the move back into a sustainable growth scenario."(35) It is noteworthy, too, that the World Bank, which now devotes 25% of its resources to structural adjustment lending, may be reviewing the wisdom of that approach a decade after making its first such loan in 1980. The Bank announced in March 1990 a shift back toward its traditional emphasis on long–term project funding.

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(34) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 41, 15 March 1990, p. 30–31.

(35) Sub–Committee on International Debt, *Minutes of Proceedings and Evidence*, Issue No. 5, 8 March 1990, p. 6 and 8.

The agenda before the IFIs is an extremely challenging one. The Committee believes that Canada should take on the responsibility of working through that agenda with other countries to see that it serves the goals of human-centred, democratic and sustainable development. This means a stronger and different Canadian role rather than pulling back on our participation. It must be clear that Canadian support for multilateral concessional lending and debt relief is linked to a fresh approach to policy-based adjustment and conditionality, such as we have recommended in this report. Canada should be an advocate for reform in the IFIs, including at the highest level.

F. Linking Debt, Environment and Common Security

Early on in the report we made the point that the developing countries' debt crisis is not just someone else's financial problem to be left in the hands of experts in such matters. The crisis looms over our common future. The linkages of debt to global security and saving the environment must be drawn out and acted upon. The position paper of the NGO Working Group on the World Bank is only stating facts when it observes that: "Debt, adjustment and environmental deterioration are all closely related." Charles Lankester, a Canadian working with the UNDP, underlined for us during a meeting in New York how "debts are being serviced by horribly abusive environmental practices." A brief submitted to the Sub-Committee by Patricia Adams, executive director of Probe International, described some of these practices. The brief also warned against pursuing debt reduction without regard to environmental sustainability or democratic accountability:

> Debt relief strategies, like the one proposed by U.S. Secretary of the Treasury Nicholas Brady, are designed not only to relieve pressure on financially strapped governments, but also to revive economic growth by attracting "new money." But environmentalists and other citizens' rights activists throughout the Third World fear this new money—in the absence of democratic reforms needed to ensure prudent borrowing—will only breathe life into their governments' cash-starved mega-plans.

We share the view that strong public environmental assessment criteria should be applied to all international assistance programs, including those focused on debt relief and economic adjustment in developing countries. In meeting with Ken Piddington, director of the World Bank's environment division, we were able to appreciate how much remains to be done as well as the progress that is being made. The inclusion of environmental criteria in standard structural adjustment programs is still in its early stages but is increasingly recognized at the policy level. The Bank is also looking at the possibilities for assisting the transfer of clean technologies to developing countries. In some cases helping them to meet environmental targets might be combined with debt restructuring and adjustment assistance packages.

The issues surrounding so-called "debt-for-nature" swaps were raised at several points in the testimony. So far these have been small transactions involving the sale or donation of debt to a non-profit third party, usually an environmental NGO, which then uses the local currency proceeds from its claim on the debtor country to support environmental protection and conservation projects in the country. Examples include rainforest preservation in Madagascar and Costa Rica. The approach has not been limited to Africa and Latin America. In a panel on East-West environmental issues, Professor Joan de Bardeleben cited the example of the Bankers' Trust of New York giving its Polish debt to a U.S. foundation which then secured an agreement from the government of Poland to commit a certain amount of local funds towards cleaning up a river outside Warsaw.(36) Governments might consider putting up some money to encourage more such transactions.

The World Bank's Piddington and the North-South Institute's Culpeper agreed that debt-nature swaps are an innovative option on the debt relief menu, but argued against regarding them as a main course. No one should have the illusion these can solve either the debt or the environmental crises. Brazilian Jaime Wright also worried about the sovereignty implications of people in the North using debt as a lever to make decisions about the South's natural resources. However, we believe there are ways for North and South to cooperate on achieving environmental goals. Some of these were explored at a conference in Montreal in March which preceded the annual meeting of the IDB. Albert Binger of the Costa Rica-based Biomass Users Network proposed more ambitious initiatives to allow developing countries to devote a portion of their annual debt payments to domestic energy conservation and resource management. This organization is supported by 43 developing countries, indicative of the growing environmental movement in the developing world.(37) Brazils' new government has also recently adopted a more promising attitude towards environmental protection, increasing prospects for constructive international action.

In light of the above, **the Sub-Committee recommends that the government devote greater attention and resources to finding the most effective means of supporting environmental efforts in indebted developing countries, including but not limited to debt-nature transactions.**

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(36) SCEAIT, *Minutes of Proceedings and Evidence*, Issue No. 43, 22 March 1990, p. 12-13.

(37) "Group Proposes Way for Third World to Pay Debts," *Montreal Gazette*, 31 March 1990, p. C3.

The linkages of debt, sustainable development, and common security are as profoundly complex as they are necessary. Even when the technical and economic means exist, and often they do not, the political and social policy challenges of change are immense. We note the conclusion of a recent analysis of Africa's desperate situation in the journal *Conflict Studies*:

> There are many dimensions to the African debt crisis. It is not simply a question of inadequate policies or bad leadership in domestic politics. Nor is it solely a consequence of the declining terms of trade for Africa's primary commodity exports. The many proposals for African debt relief often fail to take in all the dimensions involved. Policy reform in the domestic arena is needed as well as initiatives. The only realistic strategy to deal with Africa's debt would combine an appreciation of all levels of the problem. Debt has undermined both the sovereignty and development efforts of many states, while allowing a corrupt few to enjoy life. The only realistic solution to Africa's debt crisis is a strategy which combines debt relief, further credit, a far more sensitive structural adjustment, and moves to encourage greater democracy within African societies.(38)

We are not discouraged by the scope of the challenges we face as one world because the opportunities for change and reform are also great, and global necessity may be, as the saying goes, the mother of invention. **Ways must be found to convert some of the dividends of East–West peace into North–South cooperation, to convert countries' capacities for war into capacities for human development and conservation that add real security to our shared global environment. This Committee has been concerned in the past with promoting demilitarization and controlling the spread of the arms race in the Third World. We believe it is important that these aims be the object of increased Canadian efforts multilaterally and that they be reflected in our own policies.**

Changes to the multilateral system itself may also be required. Canada should use its respected international position and influence to attempt to shape these changes. We should not resist imperatives to reform or be content to be a follower nation. These are times to consider expanding the bases of North–South cooperation. Who, only a few years ago, would have anticipated the constructive proposals along these lines put forward by Soviet President Gorbachev before the United Nations General Assembly in 1988 and during the economic summit of G–7 countries in Paris last year? At the same time, developing countries are demanding a seat at the tables of the powerful where decisions are made that affect their health and security. **We believe that the debt crisis could serve as a catalyst for reforming the international machinery of coordination and institutions of economic cooperation.** As stated earlier, the Sub–Committee does not have a blueprint for a new global system. But we note, for example, the recommendation of the churches'

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(38) Stephen P. Riley, "African Debt and Western Interests," *Conflict Studies*, No. 223, July 1989, p. 22.

taskforce that the G–7 be enlarged to include the Soviet Union and a developing country such as Brazil. This suggestion may be premature or not feasible in the short term. Nevertheless, we are convinced that, for action on the debt to be truly effective (i.e., lasting and global), we can not afford the luxury of presuming that a handful of Western nations will determine the fate of the planet.

G. Joining Actions on Debt, Development and Trade

If we care about making a difference, Canadian policies on Third World debt should be joined to other elements of our foreign and domestic policies. This has to go beyond rhetoric to begin to eliminate the inconsistencies which exist in practice. Dr. David Pollock observed that the creditor governments always seem to be ready with economic advice for developing countries, but even when the adjustment effort is made, usually at a very high price, the flows of financial assistance to make it work are seldom forthcoming from the West. There is a large commitment–credibility gap which has undermined progress towards recovery in both Africa and Latin America. **The need for more external aid may not be the most important part of a solution in many debtor countries, but the issues of aid quantity and quality should not be minimized either. At the same time, Canadian ODA used, both bilaterally and multilaterally, to support economic adjustment by debtor countries must be subject to a Canadian values–based conditionality. This may be an area for further investigation by the new International Centre for Human Rights and Democratic Development. CIDA should also explore ways in which aid money might appropriately be used to support development–oriented debt reduction transactions.**

Even more important to developing countries than improving ODA transfers, is their crucial long term stake in a better international trading environment. We have to act on the fact that continued protectionism in the North, and instability on world markets for their principal products, makes it virtually impossible that many countries will be able to service their debts, much less finance needed investments in human resources and economic diversification. We were reminded of the major inequities and double standards which persist by Bertram Collins, Coordinator of the United Nations Program of Action for African Economic Recovery and Development (UN–PAAERD). For example, donors preach reliance on international market forces but their own producers are highly subsidized. Debtor countries are urged to boost exports while the barriers to their entry into developed–country markets, such as the Multifibre Agreement (MFA), remain in place. Moreover, the pressure to export can become a "catch–22" by driving down prices, or it can divert scarce resources from investment in areas of pressing domestic need. In turn, as countries become poorer and more desperate, they are less able to buy goods and services from us. In the end we all suffer, but the poorest suffer most.

Canada is committed to freer global trade and has played an active role in the current "Uruguay round" of multilateral trade negotiations under the auspices of the GATT. These crucial negotiations are scheduled to be completed by the end of this year. Developing countries have vital interests at stake in the complex range of subjects under discussion, notably agricultural subsidies, trade in tropical products, and the re-integration of the MFA into the GATT framework. Canada has recently presented proposals to greatly strengthen that framework. We also applaud the research that is being funded in Canada, through the IDRC and the North-South Institute, on debt and trade bargaining between developed and developing countries. Institutional reform and technical assistance are important to redressing the present imbalances. But there is much else to be done before developing-country concerns are adequately addressed.

The Sub-Committee is not in a position to make detailed recommendations with respect to trade policies. However, we affirm their importance and note the intention of SCEAIT to begin this fall a study of Canadian positions in the Uruguay Round. In the interim, we urge the government to take into account the interests of indebted developing nations in the agreements which hopefully will be reached among the GATT contracting parties. In addition, and regardless of what happens in the multilateral negotiations, Canada should be moving to grant liberalized access to developing-country exports, subject to the reformed criteria of conditionality that we have recommended be applied to all forms of Canadian debt relief and development assistance.

H. Promoting Public Participation and Accountability

We believe that an informed citizenry that is moved to act is worth any number of reports which merely gather dust, no matter how heavy with good intentions or laden with statistics. That is the ultimate test, and we hope to have made a small contribution towards meeting it. As a Committee, we have been impressed by the efforts of the churches and NGOs, notably through the Ten Days for World Development campaign, to dialogue with Canadian banks and to bring Third World debt issues to the attention of the public. And we were impressed by the sincerity of those who wrote to tell us of their deep personal concern.

We believe that Canadians are open to hearing the message that the unfinished business of the debt burden challenges us all. It is our business too. Bringing more accountability and democracy to bear on efforts to resolve the debt crisis means also preparing to accept that we may have to change in fairly fundamental ways. Adjustments are required of the rich even more than of the poor who are too weak to resist them. That hard truth is bluntly stated by the position paper of the NGO working group on the World Bank:

> The style of development in the North is highly inefficient and polluting. As 80% of the world's natural resources is currently being used to support 20% of its population, it is clear that a continuation of current lifestyles in the North and the further exportation of its economic systems to the South is a prescription for disaster. It is the ecological crisis implicit in these figures that most clearly shows the worldwide connections among the problems of debt, poverty and environmental degradation. Poverty has proven to be at the heart of the ecological problem, and new approaches are needed to structurally address the root causes of the former and generate a sustainable development process in environmental, social and economic terms.[39]

We hear the concerns of NGOs that much of the debt-driven economic adjustment which is taking place is in fact unsustainable, and their consequent frustration at being asked to help treat the symptoms of a deepening crisis while its causes go largely unaddressed. This is not a model which promotes public participation and political accountability. Instead, it returns voluntary agencies to the role of relief and charity workers. The brief of the churches' taskforce described the result:

> For a century, church missions provided health care and basic education in many parts of Africa. With independence, African governments appropriately took over these functions. Fifteen years later, after the debt crisis and structural adjustment, development agencies in Canada (including the churches) are receiving increasing requests from their partners in these countries to provide aid (medicines, school supplies, food supplements) and Canadian personnel to replace services and jobs which had been provided by their governments.
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> In the churches' view, this is a deplorable step back towards a former era of charity on the one hand and dependence and loss of sovereignty on the other. As such, it is a very sorry outcome for two decades of development.

The Sub-Committee reaffirms its position that dealing with the unfinished business of international debt is a political responsibility shared by the developed and the developing world. It is, moreover, a matter of enlightened mutual interests and public justice not charity, which calls for actions that are democratic, human-centred, and in harmony with the environment. We urge the government to do more to communicate the issues raised by the debt crisis to Canadians, and to engage their support for constructive Canadian policies. The government should consider appointing several members of the public at large to the advisory task force we recommended be created to advance such policies and to monitor their implementation.

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(39) "Position Paper," October 1989, p. 3.

V. EPILOGUE: SEIZING THE OPPORTUNITIES FOR CANADIAN LEADERSHIP

One of the reasons we have called for an ongoing Canadian task force on international debt, and for a global conference to achieve real reforms in the areas of financial flows and sustainable adjustment, is the knowledge that the issues are very complex and long term. At the same time, waiting for some ideal total solution would serve no purpose. It would simply add to the less noble excuses for inaction.

The Sub-Committee believes there will be opportunities over the coming months for Canada to exercise further leadership. These timelines will test the resolve of both creditor and debtor governments. Recently the United Nations General Assembly held a Special Session on International Economic Cooperation, in particular the Reactivation of Growth and Development in Developing Countries. The Canadian draft proposal for the Session reiterated support for the ODA target of 0.7% of GNP. The final declaration by the General Assembly called for urgent attention to be given to "a durable and broad solution of the external debt problems of developing debtor countries." In September, there will be a UN Conference on the Least Developed Countries as well as the first global Summit on Children, organized by the United Nations and UNICEF, which Canada will co-chair. But without concrete action on Third World debt, the first anniversary of the introduction into the General Assembly of the Convention on the Rights of the Child will be darkened by further evidence of the tragic realities which UNICEF has documented so effectively during the 1980s.[40]

We believe that 1990 should be a year to move forward from the "muddling through" approaches and half-measures of the previous decade. The Brady plan was a positive initiative a year ago but offers little to most indebted developing countries, nor does it address the global structural imbalances. We should not wait until it falters, as its predecessor did, to develop new strategies. Canada is well-placed to provide some fresh political impetus to this process on a regular basis within the IFIs, in the major meetings of the IMF and World Bank, as well as through the annual summits of G-7 leaders. In view of the continued build-up of the debt overhang and the damaging world-wide escalation of interest rates, these gatherings must generate momentum for stronger concerted action by the North. Taking the next steps is not just in our own interests. It is a matter of human survival and of securing the global future.

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(40) The Convention will enter into force once it has been ratified by 20 countries. For more details see *The State of the World's Children 1990*, p. 6. Canada signed the convention during the visit to Canada of the UN Secretary General Javier Perez de Cuellar in May 1990.

APPENDIX

TAX RELIEF ON BANKS' DOUBTFUL SOVEREIGN DEBT: RECENT U.K. MEASURES AND A POSSIBLE CANADIAN INITIATIVE

Proposal by the North–South Institute

1. In March 1990 the U.K. Chancellor of the Exchequer brought down a budget which gives U.K. banks tax incentives to sell back debt at a discount to their sovereign borrowers rather than to third parties. The mechanism is intended to encourage banks to reach debt reduction agreements with debtor countries since tax relief will be available earlier under such arrangements than if debt is sold to a third party or held on the banks' books with provisions.

2. Under the U.K. arrangements, in 1990 tax relief on provisions against doubtful sovereign debt will be limited to amounts allowable for 1989 (roughly 50 percent). In 1991 and subsequent years, total tax relief will be increased by an additional 5 percent of the debt per annum, until it is equal <u>either</u> to the total provisions against doubtful debt (as allowable under the Bank of England matrix), <u>or</u> to losses incurred through sales of debt to third parties (where losses for tax purposes equal the difference between the discount on the sale and the provision for which tax relief has already been claimed). Sales of debt to the borrower are exempted from these "phasing" arrangements. U.K. banks incurring losses through sales to their borrowers will thus obtain tax relief immediately, although the total amount of relief will eventually be the same regardless whether the loan is held or sold to a third party.

3. Under present Canadian regulations, the maximum allowable provision against sovereign debt for which tax relief can be claimed is 45 percent of gross exposure. However, in the last half of 1989 most of the major Canadian banks increased their provision to well over this level. If given, tax relief on the $3.3 billion in addditional provisions taken during 1989 could cost the Canadian treasury $1.3 billion. Unlike the new U.K. measures, Canadian banks can currently obtain tax relief if a loss (defined as the difference between the discount on the sale and provisions already claimed) is incurred through a sale to <u>any</u> party. Assuming the maximum allowable provision for tax purposes is kept at 45 percent, the tax system is neutral between a loss incurred through a sale to the borrower and to a third party.

4. Canada is in a position to emulate the U.K. tax measures by giving banks an incentive to engage in debt reduction for debtor countries. There are two reasons for similar measures in Canada. First, the current policy of "no discrimination" will increase tax losses to the treasury, increasing the federal deficit, more than if tax relief were restricted to

favour debt reduction for the borrowing countries. Second, there are important public benefits to be obtained by encouraging debt reduction for debtor countries. Debt reduction will assist debtor countries in their economic recovery efforts. It will also help to recover markets in those countries for Canadian exporters, since those markets have been seriously weakened over the past decade by the burden of heavy debt servicing. Furthermore, ongoing multilateral initiatives to reduce debt and encourage policy reform (notably under the Brady Initiative), will be supported by Canadian tax policy.

5. Canada could imitate the U.K. measures by giving banks a choice between "phasing" tax relief over time or obtaining relief "up front" by incurring losses through direct sales back to borrowers. The outcome would depend partly on sovereign debt provisioning regulations of the Supervisor of Financial Institutions and tax regulations based thereon. In particular, if the Department of Finance were to permit the maximum level of provisions allowable for tax purposes to increase from the current level of 45 percent of gross exposure, there could be an immediate tax loss of over $1 billion if all the additional provisions set aside in 1989 fell under the new ceiling. "Phasing" might spread this tax expenditure over three to five years, unless banks were to realize their losses through direct sales to borrowers, in which case the tax expenditures would be higher.

6. Alternatively, and preferably, debt reduction would be enhanced, and tax losses to the treasury restricted, under the following PROPOSAL:

(a) The current 45 percent ceiling on provisions (allowable for tax purposes) should be retained by the Department of Finance, while Revenue Canada should permit banks to claim as losses the difference between discounts on "eligible" loan sales (see (b) below) and the 45 percent already claimed.

(b) Loan sales "eligible" for the calculation of losses for tax purposes should include (i) sales to the borrowing country or bilateral conversions (e.g. under the Brady Plan); (ii) sales to third parties involved in bilateral debt conversion agreements (debt–equity swaps, debt–for–nature swaps and debt–for–development swaps); (iii) sales to other third parties working to effect debt reduction, such as the UNICEF–IDB Debt Reduction Facility currently under discussion among interested donor countries; (iv) finally, debt donations to organizations such as UNICEF (in its Debt for Child Development program in Africa) or NGOs working in co–operation with the borrowing country. Categories (ii)–(iv) should be added since these third–party transactions all result in some debt reduction, although implementation might prove to be complex.

LIST OF CONCLUSIONS AND RECOMMENDATIONS

II. ADDRESSING THE GLOBAL POLITICAL CHALLENGES

- We welcome the statements by the government that any financial aid to Eastern Europe will be separate from, and additional to, the budget for official development assistance (ODA). Nevertheless, we are concerned about the impact of cutbacks in the external affairs and aid expenditure envelope, in particular given the retreat from the aid targets established in the government's own 1988 policy paper *Sharing Our Future*. The committee's 1987 report on ODA, *For Whose Benefit?*, had recommended a legislated framework and funding floor for the Canadian aid program. In the light of recent pressures, we believe the case for that is even stronger. Accordingly, we repeat those recommendations and further recommend that the legislation include a provision that ODA funds be used solely to benefit the needy in developing countries. (p. 4)

- Beyond issue-specific measures, the Sub-Committee urges Canada to seek the support of other governments for an international conference on debt and sustainable global adjustment; such a conference to aim for negotiated commitments to policy reforms by all countries, not only the poor and the indebted. In subsequent recommendations we spell out the principles and directions we think should underlie this process of global reform. At this point, we wish to affirm the importance this Committee attaches to Canadian leadership in finding comprehensive solutions to a global crisis that affects us all. (p. 6)

III. THE DEBT CRISIS: MYTHS AND REALITIES

A. A Decade of "Muddling Through"

- The point we wish to make is that although progress has been made in the evolution of the debt strategy, particularly in the acceptance of debt reduction, it is not clear that a viable solution has been reached even in the case of Mexico which was the first major intended beneficiary of the Brady plan. In this report we cannot of course evaluate all of the efforts, as well as the mistakes, made by individual debtors and creditors. We also recognize that because of the great variation in regional and country circumstances there is no single debt solution to fit all cases. In light of the evidence we have received, we do, however, strongly affirm that there is as yet no adequate long-term approach to overcoming the burden of Third World debt. (p. 13–14)

B. Overcoming Some Myths

• Countries crushed by debt cannot trade more with us or contribute to a healthy global environment. The Sub–Committee is confident that Canadians will support strong actions by their government when they are able to understand those actions, and the mutual interests served by them, in light of the gravity and urgency of the international debt situation.

• Immediate action on the debt is imperative. But it must be part of an overall agenda for action on North–South issues—an agenda which aims to put an end to the unacceptable consequences of mass poverty on the threshold of the third millenium. (p. 17)

C. Towards a Continuing Agenda for Action

• There are many things that we will not be able to fully anticipate or sufficiently explore in this report. A continuing political process is therefore needed to review and update Canadian initiatives on the North–South agenda. Accordingly, as one of our first recommendations, we urge the government to establish a high–level advisory task force on international debt and adjustment, to include representatives from government, business, the NGO and academic communities, and from the Third World. In addition to providing expert monitoring of progress on the Sub–Committee's recommendations, such a body should be an ongoing source of ideas for future Canadian action. To ensure continued parliamentary input, we recommend that the task force report its findings at least annually to this Committee. (p. 18)

IV. LIFTING THE BURDEN OF DEBT AND STRUCTURAL ADJUSTMENT: A FRAMEWORK FOR CANADIAN POLICY IN THE 1990s

A. The Debate over Adjustment and "Conditionality"

• The Sub–Committee does not endorse any single diagnosis of, or prescription for, all of the ills of debtor countries in the developing world. Probably elements of more than one approach will be needed, adapted to the particular situation of each country. But we have heard enough to be convinced that the status quo is not acceptable. And we believe that despite, or perhaps because of, the complexities of the cases, there ought to be some strong common principles guiding Canadian policy. (p. 23)

B. Setting Canadian goals and guiding principles

- We believe that Canadian policies towards developing countries on issues of debt and structural adjustment must reflect Canadian values of social justice, respect for human rights, and democratic participation. Our policies must be coherent, ethically as well as economically responsible. This means that conditions must be applied to Canadian actions to assist debtor countries. (p. 24)

- In light of what we have heard and learned, we recommend the following as a framework of guiding principles for Canadian policy:

  — The primary long-term goal of action on Third World debt must be sustainable human development in the debtor countries.

  — To the extent that adjustment programs are deemed necessary, they should be supported by adequate, reliable resource flows from the IFIs and donor governments. But first, every means should be explored to reduce the debt service burden of old debt, including allowing debt repayments to be made in local currencies for investment in human development projects in the debtor country.

  — Poverty and debt are the enemies of development, not structural adjustment per se. But adjustment is a major political, social, and environmental challenge, as well as a technical and economic one. Adjustment needs to be accomplished with, not just a "human face," but a transformed human body. Adjustment can only be successful, and should only be supported, as part of a holistic developmental approach in cooperation with the debtor country.

  — Canada should work to incorporate into existing and future structural adjustment programs economic policies explicitly designed to benefit the poor, to increase the productivity and incomes of small-scale producers, and to achieve basic food self-sufficiency. Reforms must be the product of responsible dialogue with the debtor government and consultation with affected groups, not simply an external imposition from above. The social impacts of adjustment programs must also be assessed, as part of an open, accountable evaluation process, so that basic social minimums are preserved. We agree with the brief of the Taskforce on the Churches and Corporate Responsibility that: "a country should not be so constrained, either by its debt servicing, or by a structural adjustment program, that it cannot maintain its basic social programs. A structural adjustment program should protect such programs, and not rely on outside aid to compensate for its severity."

— It is not enough to take ad hoc actions or to wait for others to lead. Canadian support for debt relief and structural adjustment should be determined case by case, but according to consistent criteria which reflect Canadian values. These include:

(a) The commitment of the debtor country government to reform, especially to development that benefits its poor and vulnerable groups.

(b) Respect for international norms of human rights observance. Regimes that, as SCEAIT recommended in *For Whose Benefit?*, should not receive official bilateral aid because of gross and systematic human rights violations, should also be ineligible for debt relief or adjustment loans.

(c) The encouragement of democratic traditions, including the promotion of popular democratic participation by those affected by the economic reform process.

(d) The linkage of economic recovery from debt to sustainable development that is human-centred, socially equitable, and in harmony with the natural environment. (p. 25–26)

C. Dealing with commercial bank debt and private flows

• The Sub-Committee recommends that the current 45% ceiling on reserves against problem sovereign debt exposure eligible for tax purposes remain, but that as outlined in the appended proposal by the North-South Institute—banks be able to claim an additional tax loss equal to the difference between the 45% level already claimed and the amount of any discounts only when Third World loan assets are written down or sold in ways that reduce the burden on debtor countries. This should encourage faster, larger and more beneficial discounts on remaining commercial bank exposure. In addition, there should be a time limit of 5 years or less on the length of time that banks are allowed to hold funds in loan-loss reserves above the level by the Superintendant of Financial Institutions without acting to discount the portion of the debt applicable to those excess provisions. (p. 33)

D. Providing relief on official government debt

• The Sub–Committee believes that the time has come to face facts and to get serious about reducing the burden of export debt owed to Canada by poor countries that are simply unable to pay. We, therefore, recommend that Canada take the lead in advocating the adoption by Paris Club members of substantial additional export debt concessions, in particular for the poorest and most seriously–affected countries. In responding to this recommendation, the government should table detailed proposals showing clearly how they will apply to Canada's export loans to indebted developing countries, either in a multilateral or bilateral context. (p. 36)

• The Sub–Committee is convinced that a new approach is needed in determining eligibility for official bilateral debt relief. We, therefore, recommend that Canadian actions to reduce the burden of official debt neither be done across–the–board or necessarily linked to the adoption of orthodox SAPs. Instead, in each case, there should be an independent Canadian assessment of the debtor country's commitment to serious economic reform and to equitable development that is environmentally sustainable. Respect for human rights, including the right of popular participation in policy decisions should also be a factor in determining eligibility. Debt reduction should not end up rewarding corrupt elites, and even less should it be tied to measures that make the poor worse off. (p. 37)

• We are concerned that an incomplete and possibly misleading picture of Canadian sovereign debt exposure could make it more difficult to pursue realistic policies on developing–country debt. (...) The Sub–Committee therefore urges the Office of the Auditor General, the Ministry of Finance and the EDC to make best efforts to reach agreement on acceptable accounting principles for Canada's official loan exposure. We also call on the government annually to table in Parliament for referral to this committee a complete statement of all Canadian official debt exposure in developing countries, including details of any actions taken by the government to reduce the burden of debt during that year. (p. 37–38)

E. Reviewing Canada's role in the IFIs

• It is not just new means of providing funds that are needed, it is a whole new approach to IFI adjustment and conditionality along the lines we earlier recommended as guidelines for Canadian policy. (...)

• Accordingly, the Sub-Committee recommends that Canada use its position to advocate major changes in the way that the IFIs respond to the debt crisis of developing countries. These reforms should be a central part of the agenda of the global conference on debt and adjustment we recommended earlier in this report. The challenge goes well beyond increasing financial flows to support adjustment. It means changing policy structures so that the poor are helped not harmed by adjustment. Canada's contributions to the IFIs should be predicated on such an initiative for North-South reform. (p. 39-40)

• We believe Canadian policy should be that the IFIs must remain on a constant basis net lenders to, not creditors of, the developing nations. We therefore urge the government and Canada's executive directors at the IMF and World Bank to study ways in which this objective can be maintained without jeopardizing multilateral banks' access to financial markets. (p. 40)

• The Sub-Committee believes that the government should reconsider its decision not to join the IDB-UNICEF "Debt Relief for Child Development" scheme and should encourage the IFIs to seek other innovative ways of linking debt relief means to human development purposes. (p. 42)

• Canada should be using its offices to promote policy reform and dialogue within the multilateral system, as well as by and between donors, creditor institutions and debtor countries. We believe there is scope to bring about positive change. (p. 42)

• The key test of policy for the IFIs will be seeing that debt and adjustment cures do not make things worse for the already poor and vulnerable than the disease itself. (p. 43)

• The agenda before the IFIs is an extremely challenging one. The Sub-Committee believes that Canada should take on the responsibility of working through that agenda with other countries to see that it serves the goals of human-centred, democratic and sustainable development. This means a stronger and different Canadian role rather than pulling back on our participation. It must be clear that Canadian support for multilateral concessional lending and debt relief is linked to a fresh approach to policy-based adjustment and conditionality, such as we have recommended in this report. Canada should be an advocate for reform in the IFIs, including at the highest level. (p. 44)

F. Linking debt, environment and common security

• We share the view that strong public environmental assessment criteria should be applied to all international assistance programs, including those focused on debt relief and economic adjustment in developing countries. (p. 44)

- The Sub–Committee recommends that the government devote greater attention and resources to finding the most effective means of supporting environmental efforts in indebted developing countries, including but not limited to debt–nature transactions. (p. 45)

- Ways must be found to convert some of the dividends of East–West peace into North–South cooperation, to convert countries' capacities for war into capacities for human development and conservation that add real security to our shared global environment. This committee has been concerned in the past with promoting demilitarization and controlling the spread of the arms race in the Third World. We believe it is important that these aims be the object of increased Canadian efforts multilaterally and that they be reflected in our own policies. (p. 46)

- Changes to the multilateral system itself may also be required. Canada should use its respected international position and influence to attempt to shape these changes. We should not resist imperatives to reform or be content to be a follower nation. (...) We believe that the debt crisis could serve as a catalyst for reforming the international machinery of coordination and institutions of economic cooperation. (p. 46)

G. Joining actions on debt, development and trade

- The need for more external aid may not be the most important part of a solution in many debtor countries, but the issues of aid quantity and quality should not be minimized either. At the same time, Canadian ODA used, both bilaterally and multilaterally, to support economic adjustment by debtor countries must be subject to a Canadian values–based conditionality. This may be an area for further investigation by the new International Centre for Human Rights and Democratic Development. CIDA should also explore ways in which aid money might appropriately be used to support development–oriented debt reduction transactions. (p. 47)

- The Sub–Committee is not in a position to make detailed recommendations with respect to trade policies. However, we affirm their importance and note that the intention of SCEAIT to begin this fall a study of Canadian positions in the Uruguay Round. In the interim, we urge the government to take into account the interests of indebted developing nations in the agreements which hopefully will be reached among the GATT contracting parties. In addition, and regardless of what happens in the multilateral negotiations, Canada should be moving to grant liberalized access to developing–country exports, subject to the reformed criteria of conditionality that we have recommended be applied to all forms of Canadian debt relief and development assistance. (p. 48)

H. Promoting public participation and accountability

• The Sub-Committee reaffirms its position that dealing with the unfinished business of international debt is a political responsibility shared by the developed and the developing world. It is, moreover, a matter of enlightened mutual interests and public justice not charity, which calls for actions that are democratic, human-centred, and in harmony with the environment. We urge the government to do more to communicate the issues raised by the debt crisis to Canadians, and to engage their support for constructive Canadian policies. The government should consider appointing several members of the public at large to the advisory task force we recommended be created to advance such policies and to monitor their implementation. (p. 49)

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Maureen O'Neil
Executive Director

Clyde Sanger
Director of Communications

February 22, 1990

Office of the Superintendent of Financial Institutions 2

Michael A. Mackenzie
Superintendent of Financial Institutions

Office of the Auditor General 2

Kenneth Dye
Auditor General

Vinod Sahgal
Principal

John Adshead
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Department of Finance 2

Michael Kelly
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International Trade and Finance Branch

David Holland
Director
Business and Resource Tax
Analysis Division

Ron Simkoner
Business and Resource Tax
Analysis Division

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President

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George Cram
Acting Director

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Jean Moffat
National Coordinator

Jaime Wright
Economist (Brazil)

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Consultant

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John Sinclair
A/ Senior Country Program Director
Anglophone Africa Branch

Ottawa

Chisanga Puta-Chakwg
Consultant

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Jim Draimen
Director, Development Policy

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Assistant Deputy Minister

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Abbott, Peggy

Ajello, Aldo

Allen, Kelly J.

Ashbourne, Lynda

Barrault, Ellen

Battlefords' Ten Days Committee/
Comité dix jours — Battleford

Ballefair United Church

Beretta, Anne

Berner, Louise

Boldt, P.A.

Bond, W.

Bouchier, Evelyn M.

Boyd, Carol

Bradshaw, Margaret

Brady, F.

Breals, Frieda

Brown, Elizabeth

Bunce, Joan

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Campbell, Jennifer

Carrefour Tiers–Monde

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Catton, Sidney

Centennial Rouge, United Church of Canada

Challis, Pat

Chapman, Orval

Charron, Andrée

Chassé, Marie

Childs, Jack and Mary

Childs, Bob and Shirley

Christensen, Beth Lange

Cochrane, Judy

Cochrane, Joan

Coombs, Debby

Coombs, E.N.

Corless, Elva M.

Corneall, Margaret S.

Corney, Dorothy

Covan, Phyllis L.

Dabb, Sallie

Daigle, David J.

de Rooy, Trudy

Dubé, J. Markham and Vilma

Eckert, Tim

Ecumenical Coalition for Economic Justice/
Coalition oecuménique pour la Justice économique

Fear, Margaret

Ford, Stephen T.

Gestmeier, Ethel

Gibson, Elizabeth

Gingles, Barbara

Golas, Irene

Gorrie, Peter

Harpell, Liz

Harrelle, J.

Hepburn, Margaret

Kahser, D.A.

Kerr, Jack and Mary

Kienitz, Dianne

Lander, Jan

Laramée, Jacinthe

Larssen, Eleanor

Macdonald, Myrthe

MacKeigan, Anne

Mc Lachlan, Brian

Mc Millan, Reg

Nelson, Wendy

Newfeld, Martha

North–South Institute/Institut Nord–Sud

O'dell, Knys

Parkhouse, S.M.

Port Alberni–Ten Days for World Development
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Rae, Christine

Rathburn, John B.

Richards, L. & G.

Richards, Tim

Riesberry, Barbara

Riesberry, Rev. J.C.

Robinson, Karin

Salmond, Eric

Sarnia Committee 10 Days for World Development/
Comité de Sarnia

Shirley, Marion H.

Smith, Noran

Smith, Eleanor G.

Sturtan, Jacquelyn J.

Taskforce on the Churches and Corporate Responsibility/
Groupe de travail des Églises sur la responsabilité des sociétés

Thompson, Thelma

Tremblay, Yvonne C.

Van Loor, G.

Waldie, Cara

Walsh, Robin

Waters, Iris B.

Webb, Geoff

Wetmore, Catherine E.

Whittle, Joyce

Wilding, W.F.

Wilkin, R.B.

Witkin, J.

Wits, Bert

Worth, Mary

Yarchert, G.

Yeung, David

Yurkaneck, Phyllis J.

Note: In addition to the above letters and submissions the Sub-Committee also received 288 form letters and 152 responses to its questionnaire.

REQUEST FOR GOVERNMENT RESPONSE

In accordance with Standing Order 109, the Committee requests that the government provide a comprehensive response to this Report within one hundred fifty (150) days.

A copy of the relevant Minutes of Proceedings and Evidence (*Issue Nos. 1, 2, 3, 4, 5, 6 and 7 of the Sub–Committee on International Debt and Issue Nos. 5, 8, 14, 15, 18, 20, 21, 31, 54 and 55, of the Standing Committee on External Affairs and International Trade, which includes this Report*), is tabled.

Respectfully submitted

Honourable John Bosley, P.C.
Chairman

MINUTES OF PROCEEDINGS

THURSDAY, JUNE 7, 1990
(67)

[*Text*]

The Standing Committee on External Affairs and International Trade met *in camera* at 9:37 o'clock a.m. this day, in Room 112-N, Centre Block, the Chairman, John Bosley, presiding.

Members of the Committee present: Lloyd Axworthy, David Barrett, Bill Blaikie, John Bosley, Jesse Flis, Jean-Guy Guilbault, Francis LeBlanc, Walter McLean, Marcel R. Tremblay, Walter Van De Walle.

Other Members present: Dan Heap and Christine Stewart.

In attendance: *From the Library of Parliament:* Gerry Schmitz. *From the Parliamentary Centre for Foreign Affairs and Foreign Trade*: Bob Miller, Michael Kalnay, Consultants.

Witnesses: *From the Centre for Trade Policy and Law*: Michael Hart, Director. *From Common Frontiers*: Scott Sinclair, Project Director. *From the Ecumenical Coalition for Economic Justice*: John Dillon.

In accordance with Standing Order 108(2), the Committee commenced an examination of the status of Canada-U.S.-Mexico trade relations.

The witnesses made statements and answered questions.

At 11:03 o'clock a.m., the sitting was suspended.

At 11:11 o'clock a.m., the sitting was resumed.

The Committee resumed consideration of the draft report on its visit to the Soviet Union and the Germanys and the report of the Sub-Committee on International Debt.

By unanimous consent, it was agreed,—That an Editing Committee composed of: the Chairman; the Vice-Chairman; Lloyd Axworthy; Bill Blaikie and Walter McLean, as well as the Clerk and the responsible researchers be authorized to edit the report of the Sub-Committee on International Debt and the report of the Standing Committee on its visit to the U.S.S.R. and the two Germanys.

By unanimous consent, it was agreed,—That the Committee adopt the draft report entitled "Report of the Committe on its Visit to the Soviet Union and the Germanies" as its Fourth Report to the House subject to changes made by the Editing Committee, and that the Chairman present it to the House.

It was agreed,—That in accordance with Standing Order 109, the Committee request a comprehensive response to its Fourth Report.

On motion of Lloyd Axworthy, it was agreed,—That the Committee authorize the printing of an additional 500 copies of its Fourth Report, and that the Fourth Report be printed with a special cover.

It was agreed,—That the Committee engage the services of a French text reviser to revise the French text of the Fourth Report at an amount not to exceed $2500.

On motion of Walter McLean, it was agreed,—That the Committee adopt the report of the Sub-Committee on International Debt entitled "Securing Our Global Future: Canada's Stake in the Unfinished Business of Third World Debt" as its Fifth Report to the House, subject to changes made by the Editing Committee, and that the Chairman present it to the House.

By unanimous consent, it was agreed,—That in accordance with Standing Order 109, the Committee request a comprehensive response to its Fifth Report to the House.

On motion of Lloyd Axworthy, it was agreed,—That the Committee authorize the printing of 2000 extra copies of its Fifth Report and that, the Fifth Report be printed with a special cover.

At 12:35 o'clock p.m., the Committee adjourned to the call of the Chair.

Carol Chafe
Clerk of the Committee