The Transfer of Wealth

Debt and the making of a Global South

FOCUS on the Global South

October 2000

Focus on the Global South
c/o CUSRI, Chulalongkorn University, Bangkok 10330, THAILAND
Tel : 662 218 7363/7364/7365/7383 • Fax : 662 255 9976
E-mail : admin@focusweb.org • Web page http://www.focusweb.org

CONTENTS

5 Debt and Development in Asia

20 Punishing the Poor : Debt, Corporate Subsidies and the ADB

32 Debt and Impoverishment: The IMF Legacyin Asia

35 Keeping Debtors in Place : Under Enhanced HIPC

44 Cracks in the Honeypot

51 The Prague Castle Debate : Hard Answers, Please, Gentlemen

54 Micro Credit equals Micro Debt

59 Balancing the Power of Money

Debt and Development in Asia

*By C.P. Chandrasekhar**

It is widely accepted that the quantum and pattern of cross-border financial flows have changed substantially during the second-half of the 20th century. Yet from the point of view of the developing countries one persistent and debilitating aspect of such flows has been the accumulation of international debt, which has reduced the economic policy options facing their governments substantially. There are two broad phases in the experience with financial flows to developing countries during these years: that prior to the oil shocks when developing country access to international liquidity was limited to resources available through the development aid network, consisting of bilateral and multilateral donors; and that after the shocks, when private financial flows came to play an increasingly important role in these flows.

The Development Challenge

In the first of these phases, the principal problem of development was to ensure a rate and pattern of growth that would allow these countries to overcome the most extreme forms of income poverty and social deprivation and register significant gains in the average standard of living without running into major balance of payments problems. The balance of payments was an issue because most developing countries were exporters of primary products and traditional manufactures and importers of more sophisticated manufactured goods. The pattern of growth internationally was such that the demand for primary products did not keep pace with the expansion of world incomes and output and the terms of trade facing primary producers were turning adverse and moving in favour of manufactures. This meant that increases in income in the developing countries while accompanied by an increase in import demand would not necessarily be accompanied by export incomes needed to finance the foreign exchange costs of those imports. Widening trade deficits and growing balance of payments vulnerability would be the consequence. The challenge to development policy at that time was to devise a growth strategy that allowed for a reasonable rate of growth without precipitating a balance of payments crisis.

The Strategy

In Asia, India's growth strategy manifested in the Mahalanobis model epitomised that effort. That strategy attempted to pull a developing country out of the morass of backwardness by tugging at its own shoestrings. This it was argued required: (i) raising the rate of savings and investment undertaken by the system, by restraining consumption in the short run; and (ii) allocating a larger share of such savings and investment to the basic and capital goods sectors, especially the machine tools sector. In the event a country would in time be able to generate, largely domestically, the capital stock needed to employ the surplus labour force and increase consumption and the standard of living. These were seen as the prerequisites for raising the rate of growth without generating balance of payments problems.

The economic policy regime erected to execute this strategy had its roots in the struggle against colonialism itself. These economies had been

* C.P. Chandrasekar teaches at the Centre for Economic Studies and Planning, Jawaharlal Nehru University New Delhi

dominated by metropolitan capital and metropolitan commodities in the pre-independence period. Freedom meant freedom from this domination; and this could not be ensured without giving the State a major role in building up infrastructure, expanding and strengthening the productive base of the economy, setting up new financial institutions and regulating and coordinating economic activity. This was necessary for building capitalism itself, though some no doubt entertained the fond hope that all this would add up to a transition to socialism. State capitalism and State intervention in other words were essential instruments for the development of a relatively autonomous capitalism, displacing metropolitan capital from the pre-eminent position it had occupied in the colonial economy.

Needless to say, this strategy was really open only to developing countries that in terms of the size of the domestic market and resource base were above a critical minimum. For the smaller developing countries, especially the least-developed island or land-locked economies, the choice of building an industrial base behind protectionist walls did not exist, making them dependent on aid in the form of concessional debt to sustain even the meagre rates of growth they could achieve. The few exceptions here were those that could earn substantial incomes in foreign exchange by serving as tourist destinations or tax-havens. In all other cases, the level of sustainable growth depended on the level of sustainable capital inflows.

Understanding Failure

An import-substituting strategy aimed at building a self-reliant economy was an option open only to the larger Asian economies. With hindsight we know that a range of internal contradictions resulted in a failure of these strategies even in these contexts, as illustrated by the developments in countries as diverse and India and the Philippines. Three mutually reinforcing and interrelated contradictions need to be noted. First, the State within an import-substituting regime had to simultaneously fulfill two different roles that were incompatible in the long-run. On the one hand it had to maintain growing expenditures, in particular investment expenditure, in order to keep the domestic market expanding. The absence of any radical land redistribution had meant that the domestic market, especially for industrial goods, had remained socially narrowly-based; it had also meant that the growth of agricultural output, though far greater than in the colonial period, remained well below potential, and even such growth as occurred was largely confined to a narrow stratum of landlords-turned-capitalists and sections of rich peasants who had improved their economic status. Under these circumstances, a continuous growth in State spending was essential for the growth of the market; it was the key element in whatever overall dynamics the system displayed. At the same time however the State exchequer was the medium through which large-scale transfers were made to the capitalist and proto-capitalist groups; the State in other words was an instrument for the "primary accumulation of capital".

It was not of course the only instrument; direct means such as the eviction of tenants, private encroachment on common resources and private encroachment on State-owned resources such as forests from whose use the poor were simultaneously excluded, all played their role. But the State exchequer remained the pre-eminent mechanism for "primary accumulation"; through the non-payment of taxes (to which the State generally turned a blind eye), through a variety of subsidies and transfers, and through lucrative State-contracts, private fortunes got built up at the expense of the State exchequer.

The contradiction between these two different roles of the State manifested itself, despite increasing resort to indirect taxation and administered price-hikes, through a growth in the government's revenue deficit. A result of it of course was that the fiscal deficit also went up; this however reflected not a step-up in public investment but a decline in public savings.[i] The implications of this growing fiscal crisis were obvious: the government had either to cut back the tempo of its investment or to maintain this tempo through increased recourse to borrowing. If the borrowing is from abroad, then the building up of pressure for a change in

the policy regime is obvious. If the borrowing is domestic, then (for any given profile of government expenditure and in the absence of any spontaneous increase in private thriftiness) it has an expansionary effect on demand in the economy, which, unless the system happened to be demand-constrained to start with, stimulates inflation. Since rampant inflation cannot be allowed in countries with large populations at the margin of subsistence and with virtually non-existent indexation for the vast bulk of the workers, the State would sooner or later have to cut back its expenditure, especially investment expenditure, which would slow down the economy and eventually arouse capitalists' demands for an alternative policy regime. In short, the regime gets progressively engulfed in a crisis. In its efforts to combine political legitimacy with economic dynamism it increasingly comes a cropper.

Lack of "Discipline"

The second contradiction lay in the inability of the state to impose a minimum measure of " discipline" and "respect for law" among the capitalists, without which no capitalist system anywhere can be tenable. Disregard for the laws of the land, especially tax-laws, was an important component of the primary accumulation of capital. This resulted in the failure noted above to mobilize adequate amounts of resources to finance the role the State had taken upon itself. The inability to discipline the capitalist class was also reflected in the fact that despite the range of concessions provided by the State to private capital, the latter did not contribute to the export effort and enhance the foreign exchange kitty of the nation. Industrialists in most of these countries, excepting those like South Korea where the State did play a disciplining role, chose to exploit the benefits of a protected home market primed by State expenditure, rather than invest time, resources and energy to obtain a foothold in world markets, earn foreign exchange and reduce the balance of payments vulnerability of the system.

Cultural Ambience

The third contradiction had its roots in the cultural ambience of an ex-colonial society. The market for industrial goods was from its very inception, as we have seen, a socially narrowly-based one. Capitalism in its metropolitan centres however is characterised by continuous product innovation, the phenomenon of newer and ever newer goods being thrown on to the market, resulting in alterations of life-styles. In an ex-colonial economy, the comparatively narrow social segment to whose hands additional purchasing power accrues in a large measure and whose growing consumption therefore provides the main source of the growth in demand for industrial consumer goods is also anxious to emulate the life-styles prevailing in the metropolitan centre. It is not satisfied with having more and more of the same goods which are domestically produced, nor is it content merely with expending its additional purchasing power upon such new goods as the domestic economy, on its own, is capable of innovating. Its demand is for the new goods which are being produced and consumed in the metropolitan centres, and which, given the constraints upon the innovative capacity of the domestic economy, are incapable of being locally produced purely on the basis of indigenous resources and indigenous technology.

An imbalance therefore inevitably arises in such economies between what the economy is capable of locally producing purely on its own steam, and what the relatively affluent sections of society who account for much of the growth of potential demand for consumer goods would like to consume. This imbalance may be kept in check by import controls, though such controls inevitably give rise to clandestine imports, through smuggling, which are sold in local " black markets". But even leaving aside such clandestine imports, the more the imbalance, between what is produced and what is sought to be consumed, is kept in check through controls, the more it grows because of further innovations in the metropolitan economies.

The result is a powerful build-up of pressure among the more affluent groups in society for a dismantling of controls. The fact that this would result in substantial sections of domestic producers going under, i.e. in a de-industrialization in the domestic economy, together with an accentuation of the already

precarious balance of payments situation, does not come in the way of such pressures being built up. The inculcation of a desire to emulate the fashionable life-styles prevailing in the metropolitan countries among segments of the underdeveloped economy acts as a powerful instrument in the hands of metropolitan capital in its efforts to prise open the market of such an economy and to wrest back the space which it had yielded as a result of granting political independence. This contradiction between the extant production-pattern and the desired consumption-pattern of the affluent sections of the population, which contributes to a dismantling of the dirigiste economic regime, has been manifest in developing Asia too.

Consequences of Failure

The net result of the working out of all these contradictions was that by the mid-1960s many developing countries in Asia were confronted by the twin problems of periodic balance of payments crises and sluggish growth. Any attempt to raise the rate of growth had inflationary consequences, either in the form of price increases that had to be moderated by reducing government expenditure and growth, or in the form of balance of payments crises when the effects of excessive domestic absorption were allowed to spill over on to the balance of payments in the form of larger imports. In India, for example, after 15 years of rapid industrial expansion in the 1950s and the early 1960s, there occurred a major balance of payments crisis, which was the prelude to a dramatic decline in the rate of manufacturing growth during the next 15 years. Given the sluggish growth of the home market, breaking into export markets could have provided a new stimulus to industrial expansion and a new basis for capital accumulation in productive channels. But export markets were dominated by metropolitan capital. To permit Indian capital a share of this export market as a junior partner, metropolitan capital demanded a price, namely, a share of the Indian market. On the other hand, breaking into export markets on its own required, besides the backing of the Indian State, a massive effort on the part of Indian capital, which it was incapable of making owing inter alia to its unwillingness to accept a certain minimum "discipline", such as underlay the international successes of Japanese capitalism. The export prospects of Indian capital consequently remained bleak. The consequence was the development impasse of the late 1960s and 1970s. There were of course some exceptions in East Asia, where State intervention helped trigger a successful export effort. But even in these countries, as we shall see, subsequent developments led up to renewed debt problems.

Limited Options

In this context, a schism developed within the ranks of the developing country capitalists. A section was willing to make compromises with metropolitan capital on the terms that the latter demanded: it was all for allowing metropolitan capital to capture a share of the domestic market even at the expense of the entrenched capitalists, not to mention the public sector, in the hope of being able to better its own prospects as a junior partner, both in the domestic as well as in the international market. It was thus in favour of import liberalization, a full retreat from dirigisme, and accepting the kind of regime that metropolitan capital generally, and the Bank and the Fund as its chief spokesmen, had been demanding. The more powerful and the more entrenched business groups however were more circumspect. They would not mind import liberalization in areas other than their own, including in areas dominated by the public sector; they would not mind collaborating with foreign capital to add to their empires and hence a degree of relaxation of controls to further facilitate such collaboration; but they would not like encroachments by metropolitan capital upon their own empires. Their attitude towards Fund-Bank style liberalization therefore was more ambiguous.

Support for Fund-Bank style liberalization was growing not just among a section of capital. A whole new category of an altogether different kind of businessmen was coming up, who were more in the nature of upstarts, international racketeers, fixers, middlemen, often of "non-resident" origin, often linked to smuggling and the arms trade; these in any case did not have

much of a production base, and their parasitic intermediary status as well as the international value of their operations naturally inclined them towards an "open economy". On the other side, among the affluent groups of consumers, the desire for an "open economy" where they could have access to a variety of goods available abroad but not at home, had also grown strong. And finally, one should not exclude a section of the top bureaucracy itself, which had close links with the Fund and the Bank, either as ex-employees who might return any time to Washington D.C., or through being engaged in dollar projects of various kinds, or as hopeful aspirants for a lucrative berth in Washington D.C.; the weight of this section in the top bureaucracy had been growing rapidly, and its inclination naturally was in the direction of the Fund-Bank policy regime. Thus, quite apart from the growing leverage exercised by the international agencies in their capacity as "donors", the internal contradictions of the "dirigiste" policy regime, generated increasing support within the powerful and affluent sections of society for changing this regime in the manner desired by these agencies.

However, in the late-1960s such a change was not possible. Efforts to open up the economy immediately widened the trade deficit, necessitating exceptional balance of payments finance. But at that time access to international capital flows was limited to that available through the development-aid network. If the demand for capital inflows exceeded what was available from that source and in the form of foreign direct investment, recourse to the IMF was inevitable. And the IMF's stabilisation strategy necessarily involved curtailing expenditures and growth to make foreign exchange outflows correspond to that warranted by given inflows. The development impasse persisted.

The "Breakthrough"

The first signs of a breakthrough occurred in the late-1970s and early 1980s in the wake of the oil shocks, which saw a change in the nature of world capitalism and the rise to dominance of finance. The oil shocks provided some developing countries an unusual reprieve in the form of OPEC surpluses that found their way to transnational banks located in the developed centres of the international economy. With banks flush with funds and developing countries starved of foreign exchange, an inevitable meeting of the profligate occurred. The banks were eager to lend to the developing countries who were considered creditworthy since they, perforce, had borrowed little from private capital markets. And the developing countries saw in the easy access to international liquidity an opportunity to borrow their way to growth. A number of developing countries, including many in Asia, opened their doors to manufactured imports financed by borrowing from the international banking system. To boot, the new opportunities for 'growth' that this provided was spurred with deficit spending and consumer credit - a strategy most effectively implemented by Mexico in Latin America and India in Asia.

Effects of the "Alternative"

The net effect of that strategy was two fold. First, an explosive increase in developing country debt. And, second, the overexposure of the transnational banking system in a few countries. In 1982, when Mexico declared itself unable to meet its debt servicing obligations, the gravity of a problem that had cumulated over years came to the surface. The external debt of the developing countries stood at around $831 bn at the end of 1982 and is estimated to have touched $1.3 trillion by the end of 1988. But more importantly, the incidence of this debt was unevenly distributed with the Latin American region alone accounting for 40 per cent of it and the 15 largest debtors for around a third.

To these heavily indebted countries, the exploitation of the escape valve that greater international liquidity provided proved disastrous, as the effects of world economic developments in the 1980s proved far more adverse for the indebted countries than they otherwise may have been. Falling export revenues and rising interest rates only worsened the ability of these countries to service their debt, forcing one debt-ridden country after another to seek rescheduling. The countries that had rescheduled debt by the late 1980s included Argentina, Bolivia, Brazil, Chile, Ecuador,

Mexico, Morocco, Nigeria, Peru, Philippines, Poland, South Africa, Uruguay, Venezuela and Yugoslavia.

Though at this time the list was dominated by Latin America, the operation of similar tendencies in Asia and the desire of international banks to find new developing country borrowers resulted in the spread of this tendency to Asia as well, with India once again emerging as the classic example. Massive deficit-financed State expenditures in the 1980s resulted in a sharp increase in the rate of industrial growth in India. But that growth proved non-inflationary because the accompanying imports were financed with external debt, resulting in a near-doubling of the debt-GDP ratio during the 1980s. As the trade and current account deficits went up in the latter half of the 1980s, commercial borrowings were increasingly resorted to, which in turn contributed with a lag to keeping up the current account deficit itself (owing to interest payments) and necessitated further borrowing. Debt has a habit of escalating rapidly, feeding upon itself; and as fresh debt is contracted to pay off old debt, the terms at the margin become stiffer, the maturity period shorter and hence the rate of escalation of debt even steeper. And this is precisely what happened. The debt in dollar terms nearly quadrupled during the 1980s, from $20,582 m. in 1980 to $81,994 m. in 1990; debt to banks and private individuals increased more than 10 times from $1997 m. to $22,387 m. India's debt-service payments absorbed 31.2 percent of her exports in 1990. In the event, India faced a major balance of payments crisis in 1990-91, as the oil import bill rose sharply, interest and amortisation payments fell due and banks turned increasingly reticent to rollover short-term debt.

When increases in debt result in a debt crisis, rescheduling was from the point of view of the banks a way of preventing default, which would necessitate treating loans to defaulters as "bad-debts" to be written off. With exposure in some of these countries working out to a substantial share of their assets and equity, this would have resulted in a virtual collapse of the banking system. In a desperate bid, these banks sought to force under Bank-IMF surveillance a policy package on these countries that could help salvage their balance of payments and hopefully restore their ability to repay debt. The package involved, inter alia, a major liberalization of import policy, a severe squeeze on net credit to the government sector, an across-the-board increase in administered prices, a cut in subsidies, such as those on food, targeted at the less well-to-do and a devaluation of the concerned currency.

Inevitably, the freeing of imports resulted in a fall in capacity utilization in domestic industry and an accentuation of balance of payments difficulties. The squeeze on credit to the government sector necessitated a reduction in government expenditure that aggravated the recession. The increase in administered prices stoked inflation. And the impact of all this on the people was made more severe by measures like the cut in food subsidies.

Thus the fall out of the period of high growth based on liberalization was a deep recession, unemployment and a squeeze on the standards of living of an already beleaguered population. However, reduced growth did not have an equivalent effect on the current account deficit. To start with, devaluation notwithstanding, imports were buoyant, as the pent up demand for import intensive luxuries among the well endowed sections of the population proved inadequately sensitive to prices. Secondly, the positive response of exports to devaluation did not involve an equivalent increase in net foreign exchange earnings, since exports themselves were import intensive, with these imports often available at international prices in order to encourage exports. And finally, since austerity came in the wake of accumulated debt, there was one item, viz. interest payments, on the current account of the balance of payments that was not amenable to reduction through a reduction in the pace of growth.

Unfortunately, this was precisely the time when banks chose to restrict lending to the developing world. This resulted in a situation where debt service payments far exceed new debt provision, leading to the now well-known "flight of capital" from the developing to the developed countries. Thus, the reduction in growth needed to restore a semblance of equilibrium in the balance of payments in the

case of the heavily indebted countries was substantially higher than would otherwise have been the case. This experience of those who attempted to 'exploit' interdependence for the sake of growth establishes, in our view, the case that openness is no means of redressing international inequality.

International Response

The response of the international community to these developments, has been two-fold. In the case of the smaller least developing countries, which are unlikely to continue receiving adequate capital inflows, the response has 'debt-forgiveness' at its core. This was embodied in the watered-down version of the demand for a New International Economic Order being discussed in the corridors of the international agencies. It included debt forgiveness, realising unrealised aid targets, greater preferences for the exports of Least Developed Countries, marginal volumes of 'soft' assistance through the International Development Association, softer 'conditionality' on IMF/Bank loans, and easier debt rescheduling arrangements. From an emphasis on 'taking' their due, most developing countries were asking the developed to 'give' them more. The object of the exercise is not to redress inequality, which is implicitly being accepted as inevitable, but to ameliorate its worst effects.

The HIPC Initiative

The more recent version of such 'debt-forgiveness' initiatives is the HIPC initiative. This called for the reduction of external debt through write offs by official donors, with the proviso that this would be used for poverty reduction and provision of basic social services that had been badly affected by the drain on domestic resources caused by debt repayment. It has to be seen in the context of a continuous decline in official assistance on the part of rich countries, not only in terms of share of GDP, but also in absolute amounts.

The case for such debt reduction is so stark that it really needs no further justification. As the World Bank itself has argued, "The external debt of all HIPCs combined was some $200 billion in external debt at end 1998. Although small in nominal amount compared with the more than $2 trillion owed by developing countries overall, the debt of the HIPC countries was, on average, more than four times their annual export earnings, and 120 percent of GNP. Behind these figures is a deep human dimension that cannot be ignored. HIPCs are among the poorest countries on earth. Of the 600 million people in HIPC countries, more than one-half live in absolute poverty, defined as living on less than one dollar per day. The average person in a HIPC lives some 13 years less than in developing countries overall, and 7 years less than in other low-income countries. Many more infants will die either at birth or before they reach the age of five than in other developing countries, and far fewer will go to school. Unlike much of the rest of the developing world, the vast majority of people living in HIPCs have seen no improvement in their lives for more than two decades." (World Bank, Global Development Finance, page 68)

The basic problem with this initiative has been two-fold: first, the amount of resources effectively released has been minuscule in relation to both overall debt and the actual development requirements of these countries, most of whom access little or nothing in terms of private external financing. Second, and probably more significantly, the initiative has been ruled by conditionalities which are deeply objectionable, since they have been based on so-called "good policies" as determined by the IMF and World Bank, which have usually been largely responsible for the mess these countries find themselves in, in the first place.

Dealing with the more Developed

In the case of the more developed of the developing countries, however, the response to balance of payments difficulties generated by excessive external debt took the form of greater liberalisation, especially financial liberalisation. In fact there were many who argued that by the 1990s debt was a problem only for the least developed of the developing countries because changes in the international financial environment had generated new sources of finance. This was because of the surge in

foreign direct and portfolio investment flows during the early 1990s, which increased developing-country access to international liquidity. That surge was not only seen as making a case for financial liberalisation, but of ensuring that excessive external borrowing of the kind which led up to the debt crises of the 1980s, was an increasingly unlikely phenomenon, especially in the more developed of the developing countries.

There were three arguments provided by the protagonists of financial liberalisation to buttress their case. First, that capital flows needed to finance current account deficits were increasingly available in non-debt forms such as portfolio and direct investments. Second, that debt financing was predominantly resorted to by governments, which in the wake of the debt crisis had been forced to restructure their finances and reduce the quantum of deficit financing, especially that based on external borrowing. Finally, that banks which had over-exposed themselves in a few developing countries and had burnt their fingers, were now far more prudent and cautious when lending to such countries including their governments. Thus, it was argued, a combination of supply- and demand-side factors had made debt-crisis a thing of the past. Liberalising financial controls were once again seen as the means to exploit an opportunity offered by the changed nature of international financial flows.

Financial Liberalization, Debt and the East Asian Crisis

The crisis in Southeast Asia, which affected even a country like South Korea, which was not a country affected by the debt problem in the 1980s, has challenged this complacence with regard financial liberalization. Insofar as it is possible to isolate the original sin in this particular Asian drama, it must lie in the deceleration of export growth that was experienced by the entire region from about the middle of 1995. In the decade preceding this year, as is well known, the Asian region, and particularly East and Southeast Asia, was the most dynamic in the world in terms of economic growth as well as increased trade involvement. Both in terms of the growth rate of GDP and the rate of export growth, the developing economies of Asia together outperformed any other grouping. In addition, the dominant share of capital flows to the developing world was absorbed by Asia, and by a small set of countries (such as China) within Asia, but the jury is still out on whether this was the cause or the effect of high growth.

It is now almost universally accepted that while in terms of the degree of openness and the extent of intervention by the State in the functioning of markets, the East Asian countries pursued widely varying strategies, the common element in those strategies was the crucial role of exports in sustaining their high growth rates. Certainly, one factor in the process leading up to crisis was the fact that most Asian countries experienced deceleration or decline in their manufactured exports since the middle of 1995. While the causes for this sudden drop have still not been adequately explored, the explanation lies in large part in the fact that successful export growth has its costs, especially when it is such rapid growth that it involves continuously increasing international market shares. It invites retaliatory action from countries which are the targets of that export drive, it leads to a loss of GSP Preferences, it triggers a rise in domestic wages, it often results in infrastructural bottlenecks. All of this in fact happened, and it tended to undermine the very export competitiveness that underlay the high rates of growth in these countries.

The loss of export competitiveness showed up in the form of high current account deficits in a number of region's economies (Table 1). And to the extent that these deficits could not be financed in full with "autonomous" flows of foreign direct investment, some debt had to be resorted to. But the actual expansion in debt went far beyond even this requirements for reasons discussed below. In the event, despite evidence of a sharp increase in direct and portfolio inflows into developing countries, debt has remained a major source of external finance. It is now widely accepted that the excessive accumulation of debt, especially short-term debt, served as the trigger for the collapse of confidence that resulted in massive capital outflows and currency depreciation. Even if we take developing countries as a group, Table 2

shows that private long-term debt inflows registered a three-fold increase from $18.6 billion in 1991 to $ 60 billion in 1995 and rose further to touch $100.3 and $105.3 billion respectively in 1996 and 1997. Short-term inflows also registered a similar increase between 1991 and 1995, and only tapered off thereafter as lenders became increasingly wary of rolling short-term funds because of the massive accumulation of debt. Thus debt remained a prominent source of external finance in the 1990s as well.

Table 1: Annual Current Account Balance as % of GDP

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1996	-	-4.4	-4.8	-4.8	-8.1
1997	-2.3	-1.7	-5.3	-5.3	-2.0
1998	2.2	12.6	13.0	2.0	12.7

Source: Asian Development Bank's. Asia Recovery Information Centre Website.

Sources: Based on data from *International Financial Statistics CD-ROM*, International Monetary Fund, October 1999; Asian Development Bank database; *Monthly Statistics of Korea*, National Statistics Office, Republic of Korea, July 1999; web sites of Bank of Indonesia, Bank of Korea, Bank Negara, Badan Pusat Statistik (Central Bureau of Statistics) of Indonesia, Bank of Thailand and National Economic and Social Development Board of Thailand; *The National Accounts of the Philippines*, National Statistical Coordination Board, Philippines, October 1999.

Table 2: Net Resource Flows to Developing Countries, 1990-98

($ billion)

	1991	1992	1995	1996	1997	1998
Net long-term resource flows	123.1	152.3	254.9	308.1	338.1	275.0
Official flows	62.6	54.0	53.4	32.2	39.1	47.9
Private flows	60.5	98.3	201.5	275.9	299.0	227.1
From int. capital mkts.	26.2	52.2	96.1	149.5	135.5	72.1
Private debt flows	18.6	38.1	60.0	100.3	105.3	58.0
Commercial banks	4.8	16.3	32.4	43.7	60.1	25.1
Bonds	10.8	11.1	26.6	53.5	42.6	30.2
Others	3.0	10.7	1.0	3.0	2.6	2.7
Portfolio equity flows	7.6	14.1	36.1	49.2	30.2	14.1
Foreign Direct Invest.	34.4	46.1	105.4	126.4	163.4	155.0
Net short-term flows	22.0	37.6	64.2	30.7	21.6	10.2
Total net flows (liabilities)	145.1	189.9	319.1	338.8	359.7	285.2
Net external finance	89.0	108.7	183.1	169.3	110.8	102.1
Current account deficit	51.2	67.7	87.3	72.2	84.4	53.6
Change in reserves	-37.8	-41.0	-95.8	-97.1	-26.4	-48.5
Capital outflows and E&Oa	-56.1	-81.2	-136.0	-169.5	-248.9	-183.1

a: Errors and Omissions
Source: World Bank, Global Development Finance, Washington D.C.: World Bank, 1999.

This was even truer of the five crisis countries (Indonesia, South Korea, Malaysia, the Philippines and Thailand) in Southeast Asia. In 1996, on the eve of the crisis, these countries accounted for more than a fifth of total long-term resource flows to developing countries and more than half of short-term flows. All of them registered sharp increases in their debt levels and debt-GDP ratios between 1994 and 1997 (Tables 3 and 4). And though absolute debt levels declined in 1998, the contraction in GDP resulted in a sharp increase in debt-GDP ratios.

Table 3: Total External Debt Outstanding, End Year US$ Million

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1994	97191	83691	24023	35338	72777
1995	105932	108258	29191	36742	113902
1996	111743	143360	37846	41968	123005
1997	116342	159842	42654	46153	109685
1998	115952	145514	37784	47545	90772

Source: Joint BIS-IMF-OECD-World Bank statistics on external debt quoted in the Asian Development Bank's. Asia Recovery Information Centre Website.

Table 4: Total External Debt Outstanding as % of GDP

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1994	54.9	20.8	32.3	55.1	50.4
1995	52.4	22.1	32.9	49.6	67.8
1996	49.1	27.6	37.5	50.7	67.6
1997	53.9	33.5	42.6	56.2	72.8
1998	123.1	45.4	52.1	72.9	80.5

Source: Joint BIS-IMF-OECD-World Bank statistics on external debt quoted in the Asian Development Bank's. Asia Recovery Information Centre Website.

Role of Short-term Debt

Clearly short-term debt played a crucial role in debt accumulation (Table 5), with the share of such debt in the total touching between around 25 and 50 per cent in all countries excepting the Philippines as early as 1994 (Table 6). The need to resort to short-term debt arises when lenders are unwilling to risk debt of longer maturity (exceeding one year), either because the borrower concerned has already accumulated large quantities of debt or is not creditworthy. The ratio of short-term to total external debt soon declined, however, as lenders were increasingly unwilling to role over existing short-term debt and advance new loans, presaging a crisis.

Table 5: Short-Term External Debt Outstanding
(End of Period, US$ Million)

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1994	23678	44084	7529	4135	32488
1995	30105	59985	9665	5993	47486
1996	37660	74978	13136	9173	49380
1997	38512	66257	16725	13691	42449
1998	27149	42527	11055	10873	27627

Source: Based on data from Joint BIS-IMF-OECD-World Bank statistics on external debt quoted in the Asian Development Bank' s. Asia Recovery Information Centre Website.

Table 6: Short-Term External Debt Outstanding as % of Total External Debt (End of Period)

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1994	24.4	52.7	31.3	11.7	44.6
1995	28.4	55.4	33.1	16.3	41.7
1996	33.7	52.3	34.7	21.9	40.1
1997	33.1	41.5	39.2	29.7	38.7
1998	23.4	29.2	29.3	22.9	30.4

Source: Based on data from Joint BIS-IMF-OECD-World Bank statistics on external debt quoted in the Asian Development Bank's. Asia Recovery Information Centre Website.

Private and not Public Profligacy

It was not only the importance of debt in external financing that was of significance in the Southeast Asian case. What was more significant was that, the accumulation of such debt was not the result of public profligacy. In fact, as Table 7 shows, in the years leading up to the crisis of 1997, almost all the countries concerned were running surpluses on their budgets, requiring virtually no borrowing. Thus, private profligacy rather than excess debt-financed expenditure of the State must provide the proximate explanation for the accumulation of external debt in the Southeast Asian economies. This challenges the notion that only governments resort to external debt, and that its magnitude would be automatically controlled by a process of fiscal adjustment.

The case of Thailand is particularly instructive, because it shows how misplaced is the general obsession with government deficits as creating the only unsustainable external imbalances. Initially Thai current account deficits - which reflected the excess of private sector investment over private savings, since the government account was typically in surplus - were financed with FDI inflows which also supported the country's export effort and raised the rate of growth. However, the situation changed after 1990. While FDI inflows were slowing, exports were not growing fast enough to finance burgeoning imports. The 'structural deficit' in Thailand's current account stemming from the openness of it economic regime, was no longer accompanied by adequate inflows of private direct foreign investment. To finance its external deficits, therefore, Thailand had to resort to borrowing from international credit markets, implying a rapid increase in external debt. Much of this was necessarily short-term debt, which is very susceptible to the level of investor confidence. Financial markets had been concentrating on the rate of export growth as the single most important indicator of creditworthiness, rather than the external imbalance, and once the export deceleration led to an increase in the projected current account deficit, the decline of the baht began. The initial decline forced domestic operators with foreign exchange service commitments in the near future to rush into the market to acquire dollars and reduce their losses in terms of the domestic currency, triggering a run on the currency fuelled by financial speculators.

Table 7: Annual Fiscal Balance as % of GDP

Year	Indonesia	Rep. of Korea	Malaysia	Philippines	Thailand
1993		0.6	0.2	-1.5	1.8
1994		0.3	2.3	1.1	2.8
1995		0.3	0.8	0.6	3.2
1996		0.03	0.7	0.3	1.0
1997	-0.8	-0.02	2.4	0.1	-0.3
1998	-2.1	-4.2	-1.8	-1.9	-2.8
1999			-3.2	-3.7	

Source : Asian Development Bank's. Asia Recovery Information Centre Website.

Sources: Based on data from International Financial Statistics CD-ROM, International Monetary Fund, August 1999; web sites of Badan Pusat Statistik of Indonesia, Bank of Korea, Ministry of Finance and Economy of Republic of Korea, Bank Negara Malaysia, Department of Statistics Malaysia, Bangko Sentral ng Pilipinas of Philippines, and Bank of Thailand.

Note: Indonesia figures cover general government operations while Republic of Korea, Malaysia, Philippines, and Thailand cover only that of the national government.

The Importance of Financial Liberalization

A prerequisite for such debt-financed profligacy of the private sector was financial liberalization, which allows domestic financial institutions and firms to access directly and with ease capital from international markets. Normally, the case for financial liberalization in the developing countries is that the pyramidal growth of finance in the world economy, which increased the fragility of the system, was an opportunity. Such finance was seen as a means of raising investment and driving growth. It was argued that there was no great danger in developing countries using this opportunity, since in any case the sums they required were seen as a small fraction of the international liquidity being created by the financial system. Thus fluctuations of real or financial variables were unlikely to spur any large outflow of capital. For western finance emerging markets were a hedge, and for developing countries international finance was an opportunity. A cosy relationship seemed easy to build. It appeared that all that was needed was the liberalization of finance and a monetary policy that ensured interest rates were high enough to make capital inflows attractive even after adjusting for risk.

In the case of East Asia, of course, these arguments could be dismissed on the grounds that achieving high growth was hardly a problem. Most of the countries in this region had very high domestic savings rates, in the region of 25 to 30 per cent of GDP, and their accumulation strategies dominantly relied on such internal resources. However, despite their high savings rates, their governments chose to liberalize the financial and allow free capital inflows. This was not only the result of external pressures, such as advice from the multilateral finance institutions or (in South Korea's case) the desire to become a member of the OECD. It could be argued that greater financial openness was at least in part the result of a growing inability in these countries to sustain the export-based miracle growth rates that had made them the favourites of international capital. The inability to sustain the export-dependent growth path soon triggers a search for alternative sources of growth, and in these cases the choice fell on the opportunities generated from being a regional financial centre. In almost all of these countries, financial liberalization was thought to be the route to seize that opportunity. Of course, this choice was not altogether fortuitous. It was encouraged by the willingness, despite the experience with the debt crisis, of foreign lenders and investors to channel large volumes of funds to these locations.

Lack of Prudential Norms

The willingness to place bets on third world governments and corporations stemmed from the belief that the risks involved in such investments were minimal. Ever since the debt crisis and the rescheduling exercises that followed, international banks, while wary of developing-country lending, have been convinced that the losses they can incur in developing-country markets are limited by the implicit sovereign guarantee of loans to private borrowers, both by governments in the developed and developing countries. This is the case even when the loans that are made are not officially guaranteed by the governments of the debtor companies, because of the assumption that in cases of real difficulty governments will be forced to step in and underwrite such loans, with or without IMF pressure. This is a problem that still largely goes unmentioned in most mainstream analyses. As a consequence, none of the standard prudential norms, which would have applied in the home countries were closely followed by creditors or other investors. The fact that the domestic banking and finance sectors in these countries were subject to prudential regulation was not an adequate safeguard against this, which turned out to have extremely dire implications for the borrowing countries.

This points to the futility of believing that capital account convertibility accompanied by domestic prudential regulation will ensure against boom-bust volatility in capital markets. The fact that the IMF-negotiated bailout in South Korea involved banks converting $24 billion of short term debt into medium-term debt guaranteed by the government, at an interest rate ranging from 2.25 to 2.75 percentage points above LIBOR, illustrates once again why such policy mistakes occur. International banks have had to pay little penalty, if anything at all, for their lack of diligence. This makes access to foreign exchange all the easier for developing countries, in their pre-crisis phase.

Consequences of Financial Liberalization

The real question therefore is why the East Asian economies resorted to international financial markets for large inflows of funds despite their high domestic savings rate. The proximate explanation lies in the "autonomous" tendencies generated by financial liberalization in these economies over the past decade. By allowing domestic financial agents to approach foreign financial institutions directly, liberalization had two consequences. First, it provided them a source of "easy finance" when they found themselves overstretched domestically, because corporations or institutions to whom they had overexposed themselves were finding it difficult to service past credit without access to new loans. Second, they had a source of finance, which could be used to fund risky activities (like those accompanying a property or stock market boom), since the 'original' investors asked few questions. Such tendencies can be damaging because of a more fundamental consequence of both trade and financial liberalization: the dissociation of any increase in foreign exchange commitments of individual agents from their ability to contribute to the earnings of foreign exchange needed to service those debts. Simply put, it meant that private agents could easily access foreign exchange without having to generate it, thus breaking a link that is crucial for industrialising economies.

It is true that Indonesia and Malaysia have had open capital accounts for very long periods, but this has generally reflected their ability to access foreign funds because of geopolitical considerations, as well as the close nexus established over this period between domestic capitalists, foreign investors and the state in these countries. Also, earlier these could still be effectively regulated because a large proportion of the transactions until the 1990s were effectively state-controlled. In the 1990s, the external capital transactions of private agents within these economies became much more pronounced, and the freedom regarding commercial borrowing from abroad allowed private companies to completely delink the taking on of foreign exchange obligations from the ability to service them in foreign exchange. It was therefore the fact that financial openness allowed profligacy on the part of private agents that was an important cause of subsequent problems.

The relatively prolonged period of exchange rate stability in these countries, with most currencies pegged to the US dollar, had created complacency about possible changes, and high export growth also lulled policy-makers into believing that continued access to foreign exchange would never be a problem. As a result, the capital account transactions in virtually all of these countries began to reflect substantial market failures in ways that went largely undetected. The most obvious failure, was in terms of foreign exchange balancing, with liberalization allowing domestic agents access to foreign exchange without having to make any commitment to earn for foreign exchange to service those flows, when payments fall due.

One very common conclusion that has been constantly repeated since the start of the Asian crisis in mid-997 is the importance of "sound" macroeconomic policies, once financial flows have been liberalized. It has been suggested that countries like Thailand, South Korea and Indonesia have faced such problems because they allowed their current account deficits to become too large, reflecting too great an excess of private domestic investment over private savings (Table 1). This belated realisation is a change from the earlier obsession with government fiscal deficits as the

only macroeconomic imbalance worth caring about, but it still misses the basic point.

This point is that, with completely unbridled capital flows, it is no longer possible for a country to control the amount of capital inflow or outflow, and both movements can create consequences that are undesirable. If, for example, a country is suddenly chosen as a preferred site for foreign portfolio investment, it can lead to huge inflows which in turn cause the currency to appreciate, thus encouraging investment in non-tradeables rather than tradeables, and altering domestic relative prices and therefore incentives. Simultaneously, unless the inflows of capital are simply (and wastefully) stored up in the form of accumulated foreign exchange reserves, they must necessarily be associated with current account deficits. The large current deficits in Thailand and elsewhere therefore were necessary by-products of the surge in capital inflow, and that was the basic macroeconomic problem. This means that any country that does not exercise some sort of control or moderation over private capital inflows can be subject to very similar pressures. These then create the conditions for their own eventual reversal, when the current account deficits are suddenly perceived to be too large or unsustainable. In other words, what all this means is that once there are completely free capital flows and completely open access to external borrowing by private domestic agents, there can be no " prudent" macroeconomic policy; the overall domestic balances or imbalances will change according to the behaviour of capital flows, which will themselves respond to the economic dynamics that they have set into motion.

Financial Liberalization in Other Contexts

If financial liberalization provides the basis for excessive debt accumulation and external vulnerability even in countries with a successful export record like South Korea, the implications for less successful exporters like India should be obvious. The fact that India managed to survive the turbulence generated by the Southeast Asian crisis is used to argue that this is not true. But that complacence has been shaken by recent signs of vulnerability of the India rupee. The reasons for that vulnerability are not hard to find. Notwithstanding all the hype about direct foreign investment inflows into the economy, the actual inflows under this head have been minuscule, not more than $ 3 billion per year on average. Most of this has also come into activities catering to the domestic market which displace domestic producers and constitute implicit deindustrialisation (owing to the high import content of FDI-based production) rather than into activities, such as export-oriented production, which genuinely add to domestic output and employment.

What has come in larger measure however is speculative finance capital in the form of 'hot money' on the basis of which India's exchange reserves of around $30 billion have been built up. Even though the Indian currency is not fully convertible, there is sufficient scope for such speculative capital to destabilise the economy in a manner reminiscent of what has happened in the East and South-East Asian countries.

This of course underscores the fact that as a result of the liberalization that followed the 1990 debt crisis there is a tendency not so much towards globalisation of production, as towards globalisation of finance. The Fund-Bank structural adjustment package, though advocated on the grounds that its adoption would draw FDI in large quantities, has evolved through time to cater in practice largely to the requirements of international rentier interests. Even when the adoption of this package succeeds in attracting large amounts of "hot money", it cannot generate growth in the economy; and of course when "hot money" flies out, growth suffers through enforced deflation for the sake of creating creditors' confidence. In other words, this package, if conscientiously adopted, binds the economy to stagnation in years of comfortable foreign exchange and retrogression in years of foreign exchange crunch, giving rise to a combination of net retrogression and "denationalisaton" of the nation's assets and natural resources.

To conclude, even though the nature of financial flows has changed substantially over the last two decades, when compared with three decades that preceded them, the problem of

external vulnerability still persists. Such vulnerability is the natural fallout of international inequality and inequalising development, on the one hand and the absence of appropriate policies in developing countries to deal with and counter the debilitating effects of such inequality, on the other. And a consequence of that vulnerability is the recurrence of debt problems and debt crises in countries in developing Asia, as elsewhere in the developing world, independent of the size, the level of development or the export success of the economies concerned.

Endnotes:

[i] In India, for example, in the 1950s and the 1960s the revenue account of the Central Government at least was in surplus, but in the 1970s even this went into a deficit, which climbed steadily from Rs.20,370 million in 1980-81 to Rs.105,140 m. in 1988-89, Rs.119,140 m. in 1989-90, and Rs.185,610 m. in 1990-91.

Punishing the Poor: Debt, Corporate Subsidies and the ADB

*By : Chris Adams**

Introduction

The Asian Development Bank (ADB) is one of the largest providers of development finance to countries in the Asia Pacific region. Since it was established in 1966, the ADB has lent $82 billion dollars to developing countries in the region. Almost three-quarters of these loans were made at or near market interest rates. The ADB, then, is partly responsible for the high level of public debt held by many countries in the region.

The increasing cost of debt servicing in several countries has led to large cuts or deferrals in public expenditure on social services and other basic infrastructure which has had a severe impact on the poor. It has also given lenders such as the ADB, the World Bank and the International Monetary Fund unprecedented power over sovereign governments, particularly through the imposition of structural adjustment programs in crisis-affected countries.

Seen in this light, can the continued debt financing of development strategies by multilateral institutions be justified? Whose strategic and commercial interests are served by these institutions? How are the costs and benefits of debt financing distributed between donor and borrowing countries and between the public and privates sectors? And what are the implications for national sovereignty, development strategies, and program and project design? This paper examines the record of the ADB in this light.

The Hidden Costs of ADB Lending

Since it was founded in 1966, the ADB has approved $82.2 billion in loans to its developing member countries (DMCs). Bank lending averaged around $1 billion per annum in the 1970s and then grew quickly in the 1980s, reaching $5 billion per annum in 1992. It has since stagnated with the exception of a sharp increase in 1997 due to unprecedented lending to crisis-affected countries such as South Korea and Thailand.[i] Approximately 72% of these loans were made at near market interest rates. Since 1966, the Bank has also arranged cofinancing[ii] worth $32 billion for Bank projects. Eleven billion of this was raised from commercial sources.

The bulk of the ADB's financial resources come from capital subscriptions and contributions from its member governments and borrowings on international capital markets. At the end of 1999, the Bank's capital subscriptions totaled $48 billion dollars although only $2.7 billion had actually been paid in to the Bank by member governments. Instead of drawing on the outstanding balance, the Bank borrows money on international capital markets, using the outstanding capital subscriptions as collateral. To date the Bank has borrowed approximately $40 billion, including $5.1 billion in 1999, mostly through issuing bonds with 3 to 15 year terms. If borrowers default on ADB loans, then the ADB can draw on the "callable" component of member subscriptions to cover its losses in international markets. This effectively transfers

* Chris Adams is a visiting researcher at Focus on the Global South. He is currently on leave from his position as Asia Regional Manager at Community Aid Abroad - Oxfam Australia.
C.adams@focusweb.org

the risk of default from investors in global capital markets and from the ADB to taxpayers in donor countries.

The two principal sources of ADB loans are the Bank's Ordinary Capital Resources (OCR) which are funded from borrowings on international capital markets and the Asian Development Fund (ADF), a soft loan facility that is funded by contributions from member governments and from the Bank's operating profits. "Hard" loans from OCR are made at near market interest rates with a repayment period of up to 30 years. "Soft" loans from the ADF are made at 1.5 % interest rates with a repayment period of 30-40 years.

The Bank is gradually increasing the proportion of OCR relative to ADF lending as well as increasing the proportion of commercial relative to official co-financing i.e. the Bank is increasing the proportion of hard loans relative to soft loans. This will have a particular impact on low-income countries that have little or no access to international capital markets and depend on soft loans for the provision of basic social infrastructure. It is also likely to reinforce a pre-existing bias in the ADB for "bankable" projects i.e. projects in the profitable energy, telecommunications and transport sub-sectors or in agro-industry that generate hard currency receipts which can be used to repay ADB hard loans. In more general terms, it will reinforce the export-orientated, capital and resource intensive development model that has traditionally been supported by the multilateral development banks (MDBs) and their bilateral and corporate backers.

The cost of Bank loans has also increased significantly over the last 12 months. The scale of the Bank's emergency assistance to crisis affected countries in 1997 significantly weakened its financial position. In response, borrowing countries asked donors to increase their capital subscriptions and to replenish the ADF. Despite strong opposition from the US, the ADB's Board of Governors agreed to review the Bank's OCR in 2001, the first step in a process which could lead to increased capital subscriptions and hence increased OCR lending[iii] over the next decade. Donors also reached agreement in September 2000 on the seventh replenishment of the ADF covering the period 2001-2004. However, donor countries were successful in forcing the ADB to increase its service charges and interest rates on ADF and OCR loans. The Bank also temporarily halted the transfer of operating profits from its OCR lending operations to the ADF. These changes effectively transfer the burden of refinancing the ADB from donor countries to borrowing countries.

Almost 100% of ADB loans are backed by guarantees from donor governments. To encourage commercial co-financing of Bank supported infrastructure projects, the ADB also offers partial credit and partial risk guarantees[iv] to private investors which reduce their exposure to risk. In most cases, the Bank requires counter-guarantees from borrowing governments and/or attaches conditions to Bank contracts. These often shift responsibility for the social and environmental costs of Bank projects from private companies to the borrowing government. In some instances, market risks are also transferred to the public sector through for example fixing the price of project outputs in advance and prioritising investors and lenders ahead of borrowing governments in the distribution of project revenues. Furthermore, the conditions attached to loan contracts may pre-empt or contradict existing borrower government policies and regulations which undermines national sovereignty and militates against more participatory processes. The details of contracts and counter-guarantees are often kept secret because of their ostensible commercial nature. Moreover, such contracts are often only judicable in third country courts. This reinforces the lack of accountability and transparency that often characterises negotiations and dispute resolution associated with large-scale infrastructure projects.

Debt and Dependency

As of end 1999, outstanding ADB loans totaled $44 billion. If approximately 50% of the co-financed commercial loans are also outstanding, then total ADB-related debt at the end of 1999 was $50 billion, with $33 billion of this at near market interest rates. Whilst this is only 5% of the external debt of the region as a whole,[v]

ADB loans constitute a much higher proportion of the debt of a number of countries as shown in Table 1 below. For example, ADB debt is equal to 27% of the total external debt of Bangladesh, 21% for Pakistan, 20% for Sri Lanka and 48% for Nepal. This gives the ADB significant policy leverage, particularly in those countries where ADB debt is higher then that owed to other multilateral institutions such as the World Bank.[vi]

The Corporate Connection

Most ADB contracts are awarded through internationally advertised competitive bidding with the caveat that bidding is only open to the 58 member countries of the ADB. Between 1966 and 1999, the ADB and its member governments awarded contracts worth $54.3 billion for goods and services financed from OCR and ADF loans. Thirty seven per cent or $20.1 billion of these contracts have gone to companies from donor countries[vii], particularly those from Japan, the US and Germany. Within this, 69% of consulting contracts have gone to companies from donor countries. The ten donor countries, which have won the most ADB contracts in dollar terms, are shown in Table 2 below.

In addition to loans, the ADB has provided approximately $1.8 billion in technical assistance grants, primarily for consulting services. Donor country consulting companies have won 80% of the grant-funded contracts. The 15 donor and borrower countries which have won the most grant-financed technical assistance consulting contracts in dollar terms are shown in Table 3 below. In total, consulting companies from donor countries have won $2.6 billion in loan or grant-financed consulting contracts from the ADB.

Table 1: Outstanding ADB Loans for Selected Countries

Country	Outstanding ADB Loans 1999 $million	Outstanding Official Loans 1996 $ millon	ADB loans as % Official Loans	Total External Debt 1996 $ million	ADB loans as % External Debt
Bangladesh	4,381	15,403	28	16,083	27
Cambodia	154	2,023	8	2,111	7
Indonesia	7,615	60,108	13	129,033	6
Nepal	1,150	2,349	49	2,414	48
Pakistan	6,377	23,694	27	29,901	21
Philippines	3,589	27,937	13	41,214	9
Sri Lanka	1,626	6,818	24	7,995	20

The escalating dependence of developing countries in the region on debt-financed development has a number of negative consequences. These include: a) the neglect of domestic savings as a source of development finance; b) cuts in government expenditure for basic social services and basic infrastructure in order to meet debt servicing requirements; c) an escalation of export-orientated resource extraction to generate hard currency receipts for debt servicing; d) a reorientation of agricultural production from meeting local needs to production for export in highly skewed regional and global markets; e) increased dependence on imported, capital intensive technologies as a consequence of tied procurement and project design processes led by foreign consulting companies; f) increased dependence on and influence of international financial institutions such as the ADB and the World Bank, particularly through the imposition of debt-induced structural adjustment programs and policy based lending.

Table 2: ADB Contracts and Contributions by Donor Country

Country	ADB Contracts $ million (1)	Contributions to ADB $ million (2)	Ratlo (1) / (2)
Japan	6,182	12,970	0.5
US	3,888	3,457	1.1
Germany	2,569	1,303	2.0
UK	1,664	739	2.3
Italy	1,329	528	2.5
Australia	1,067	1,064	1.0
France	1,043	816	1.3
Switzerland	738	251	2.9
Netherlands	620	451	1.4
canada	711	1,268	0.6
Total	**19,811**	**22,847**	**0.9**

Table 3 : Cumulative Procurement Technical Assistance Grants

Country	1967-99				1967-99		
	Paid In $ million	Procurement $ million	%	Rank	Procurement $ million	%	Rank
Japan	569.7	37	2.7	9	8.4	2.1	10
US	1.5	287	21.0	1	92.1	23.1	1
India	2.7	36	2.7	10	9.8	2.5	8
Australia	2.5	160	11.7	3	57.1	14.3	2
Canada	3.3	112	8.0	4	36.1	9.0	4
Germany	3.3	32	2.3	11	9.2	2.3	9
Philippines	-	62	4.6	6	19.2	4.8	6
France	1.7	38	2.8	8	5.8	1.4	12
UK	5.6	220	16.1	2	53.8	13.5	3
Netherlands	1.3	46	3.4	7	15.7	3.9	7
Swizerland	1	19	1.4	14	3.8	1.0	15
Hong Kong	-	22	1.6	13	8.0	2.0	11
Singapore	1.1	14	1.0	17	5.0	1.3	13
New Zealand	1.1	77	5.6	5	25.8	6.5	5
Denmark	2	23	1.7	12	4.7	1.2	14
Sub-total	**596.8**	**1185**	**86.6**		**354.5**	**88.9**	
All countries	**609.0**	**1366**	**100.0**		**398.9**	**100**	

Despite its relatively small size, the ADB is obviously a lucrative source of procurement contracts for companies from donor and borrower countries alike.
The key trends in grant and loan financed procurement are examined in more detail below.

Loan-financed Procurement

The dollar value and proportion of procurement contracts going to donor country contractors has changed substantially over time as shown in Table 4 below. During the first decade of the Bank's operation (1966-76), 79% of contracts for goods, related services and civil works (GRSCW) went to donor country contractors, particularly from Japan (43%), Germany (10%) and the UK (8%). This bias towards donor

countries was even more pronounced for consulting services with donor country companies winning 93% of contracts, particularly companies from the US (31%), Germany (15%) and Canada (7%).

countries have received 84% of the loans. Countries such as South Korea, Thailand, Pakistan, the Philippines and Indonesia were key strategic allies of the US during the Cold War and received substantial bilateral and

Table 4: Value and Proportion of GRSCW and Consulting Contracts Awarded to Donor Country Companies (OCR and ADF combined)

Years	GRSCW			Consulting			GRSCW + Consulting		
	Total Value $ million	$ to donor million	% to donor	Total Value $ million	$ to donor	%	Total value	$ to donor	% to donor
1966-76	1,412	1,114	79	94	87	93	1,506	1,201	80
1976-86	7,453	3,804	51	482	385	80	7,935	4,189	53
1986-96	27,068	9,457	35	1,394	892	64	28,462	10,349	36
1997-99	15,884	4,006	25	492	344	70	16,376	4,350	27
Total	**51,817**	**18,381**	**35**	**2,462**	**1,708**	**69**	**54,279**	**20,089**	**37**

Over the next two decades, the proportion of GRSCW and consulting contracts won by donor countries dropped from 79% and 93% to 35% and 64% respectively. However, the dollar value of these contracts actually increased dramatically, in line with increased Bank lending overall. For example, the value of GRSCW contracts going to donor country companies increased almost nine-fold between 1966-76 and 1986-96, jumping from $1,114 million to $9,457 million.

Over the last three years (1996-99) the proportion of GRSCW contracts going to donor country companies has fallen further to 25% but the proportion of loan-financed consulting contracts has actually increased from 64% to 70%.

These contracts are concentrated in a relatively small number of countries. For example, 83% of Japanese, 83% of German and 91% of US procurement contracts for loan-financed GRSCW between 1966 and 1995[viii] were for projects in just 8 of the 38 DMCs - Bangladesh, China, India, Indonesia, Korea, Pakistan, Philippines and Thailand.

This reflects the highly skewed geographic distribution of ADB lending. As shown in Table 5 below, these eight DMCs account for $69.1 billion of the ADB's $82.2 lending between 1967 and 1999. That is, 21% of the borrowing

multilateral aid as a result. Large-scale lending to countries such as India and China and smaller-scale lending to Vietnam and Cambodia is either a relatively recent phenomena or has been suspended or reduced at different points under pressure from the US. Only one of the top eight, Bangladesh, is categorised as a Least Developed Country (LDC). The other 12 LDCs that are members of the ADB[ix] have received just $3 billion in loans, less then 4% of total ADB lending to date. In contrast, seven of the top eight borrowing countries are included in the UNDP medium human development category.

Table 5: ADB Projects and Loans for Borrowing Countries

Country	Number of Projects	Value Loans $ million	% of Total Lending
Indonesia	222	17,028	20.7
Pakistan	155	9,804	11.9
China	77	9,425	11.5
India	50	7,878	9.6
Philippines	149	7,374	9.0
Korea	80	6,338	7.7
Bangladesh	128	5,915	7.2
Thailand	79	5,348	6.5
Total	**940**	**69,110**	**84.1**

This means that private companies from Japan and America have between them won ADB

contracts worth more then all ADB lending to the thirteen least developed countries in the region. Moreover, private companies from the top ten donor countries have won ADB contracts worth more then all ADB lending to 30 of its 38 DMCs.

ADB lending to the largest borrowers is also concentrated in a relatively small number of projects. The top eight borrowers have received $69.1 billion for 940 projects over the last 34 years, an average of $73 million dollars per project. In contrast, the average ADB loan for combined OCR and ADF lending to all 38 DMCs is $52 million.

This larger then average project size is consistent with an emphasis on large-scale infrastructure which can usually only be undertaken by large private sector companies or state-owned enterprises (SOEs). Unfortunately, the ADB is unable or unwilling to provide cumulative data on companies that have won ADB contracts by country of origin, country of operation or by sector. However, ADB Country Fact Sheets do identify the top 10 companies that have won large[x] procurement contracts for GRSCW for the period 1995-1999.

The companies from the top four donor countries that have won the most GRSCW contracts over the last five years are: i) Japan: Mitsui and Co, Mitsubishi, Mitsui Engineering and Shipbuilding, Itochu and Marubeni ($342 million); ii) US: Cooper Rolls, Westinghouse International, AT& T, Raytheon Company Electronic Systems and Cargill Fertiliser ($209 million); iii) Germany: Siemens AG, Man B&W Diesel AG, KGH Sculze, Dyckerhoff & Widmann and UNICO ($166 million); iv) UK: NVPSKG, Balfour Beatty, Acme Maris (China) Ltd, Siemens PLC and British Steel ($43 million).

These include some of the biggest companies in the world. For example, Mitsubishi, Mitsui and Itochu are 3 of the 4 largest companies in the world with sales for each topping $160 billion in 1994.[xi] Joseph Karliner, author of "The Corporate Planet: Ecology and Politics in the Age of Globalisation", describes Mitsubishi as "possibly the single most environmentally destructive corporate force on Earth" because of its extensive involvement in globalised heavy industry, resource extraction, chemicals and agro-industry.[xii] Balfour Beatty, one of the largest construction companies in the UK, is linked to two highly controversial dam projects, the Pergau dam in Malaysia and the Ilisu dam in Turkey. The Ilisu dam, if it proceeds, will displace 15,000 Kurds in the politically sensitive Syria-Iraq border region and radically alter downstream flows in Iraq. Westinghouse Corporation and Mitsubishi have built 20 of Japan's 47 nuclear reactors, including five of the eight oldest reactors that now have a deteriorating safety record. Popular opposition has virtually halted plans to build new reactors in both the US and Japan and these companies are now seeking to export their technology to countries such as China and Indonesia.[xiii]

Many of these companies are involved in large-scale infrastructure projects using technologies that are either no longer politically acceptable or commercially viable in developed countries. This is due to a combination of factors including strengthened social and environmental regulation, technological redundancy, diminishing opportunities to exploit an already degraded natural resource base, higher costs and hence lower profits and, most importantly, increasing opposition from citizen groups. These companies are still politically powerful, however, and as a result bilateral and multilateral agencies such as the ADB have supported their aggressive push into developing countries in search of new markets and investment sites. These countries offer low wages, low priced natural resources, weak or poorly enforced social and environmental regulation and tax incentives. The countervailing power of civil society organisations and democratic institutions is often weak or non-existent.

The consulting companies from the top four donor countries that have won the most contracts over the last five years are: i)UK: Mott McDonald, Scott Wilson Kirkpatrick, Ryder John Taylor, WS Atkins International and Cambridge Education Consultants (11 projects, $35 million); ii) US: Morrison Knudsen, Louis Berger Group, Upham International, Everest International Consulting; Development Alternatives ($44 million); iii) Japan: Japanese

Overseas Consultants, Nippon Koei, Pacific Consultants International; Nippon Jogessuido Sekkei and Electric Power Development Co (13 projects, $44 million) and the iv) Netherlands: DHV Consultants, Euroconsult, BMB Mgt Consultants, BKH Consulting Engineers, Infrastructure Hydraulics (24 projects, $31 million).

In summary, the immediate beneficiaries of ADB lending over the last 34 years have been: a) private companies and SOEs in 8 developing countries that, with the exception of Bangladesh, are in the UNDP medium human development category; b) large engineering and construction companies in donor countries, particularly those in Japan, the US and Germany and c) consulting companies in donor countries, particularly those in the UK, US, Japan and the Netherlands.

Technical Assistance Grants

Over the last 34 years, the ADB has provided grants for 4,223 technical assistance projects worth $1.8 billion. These grants are mostly funded from the ADB's Technical Assistance Special Fund (TASF) and the Japan Special Fund (JSF). Japan is the sole contributor to the JSF and has provided more then 50% of the funds for the TASF. Only companies from countries that have contributed to the Special Funds can bid for these technical assistance contracts.

Between 1967 and 1999, 80% of approximately $1.4 billion in technical assistance contracts were won by donor country consulting companies. As shown in Table 3 below, companies from the top ten countries have won 75% of all contracts in $ terms and companies from just six countries - the US, UK, Australia, Canada, New Zealand and the Philippines - have won 67% per cent of all contracts. Only India and the Philippines - countries with large English speaking populations and relatively large domestic consulting industries - make it into the top ten. Unlike with loan financed contracts, the proportion of technical assistance contracts won by companies from the top ten donor countries has actually increased over the last three years, rising from 75% for the whole period of ADB operations (1966-99) to 77% in for the period 1996-99. The US (23%), Australia (14%), Canada (9%) and New Zealand (6.5%) have all increased their share of contracts over the last three years.

As with GRSCW projects, the number and cumulative value of TA projects has increased significantly over the last ten years, rising from 187 projects worth $59 million in 1988 to 315 projects worth $173 million in 1999. The value of each project has increased from an average of $315,000 in 1988 to $549,000 in 1999.

As with loan-financed contracts, the ADB is unable to provide cumulative data on consulting companies which have won technical assistance grants broken out by time, country or sector. However, the ADB Country Fact Sheets referred to earlier in this paper list the top ten contractors for each country over the last five years.

The five contractors from each of the top four donor countries which have won the most contracts over the last five years are: i) US: Boston Institute for Developing Economies; Hagler Bailly Consulting, PricewaterhouseCoopers, Associates in Rural Development and Development Alternatives ($25 million); ii) UK: Biotechnology Consultants, Halcrow Fox and Associates, Scott Wilson Kirkpatrick, British Council and Maxwell Stamp (35 projects, $21 million); iii) Australia: SMEC International, EGIS Consulting, Hawthorn International Education, Maunsell, PDP Australia (34 projects, $20 million); iv) Canada: Northwest Hydraulic Consultants, Association of Canadian Community Colleges, Agrodev Canada, Cowater International, Global Environmental Consultant (21 projects, $22 million).

Whilst the distribution of TA grants by borrowing country is not as skewed as that for ADB lending, more then 50% of all grants made by the ADB between 1966-99 have gone to just 21% of the developing member countries - China, Indonesia, Bangladesh, Philippines, Pakistan, Nepal, Vietnam and Lao PDR. In 1999, 70% of grants went to just 26% of DMCs.

In effect, the ADB's technical assistance program channels donor country taxpayer

funds, particularly from Japan, to consulting companies from a small number of Anglo-American countries, particularly the US, Australia, Canada, the UK and New Zealand, for projects in small proportion of ADB member countries. This is of concern for a number of reasons, including the close link between technical assistance grants and subsequent GRSCW loans; the Bank's increasing emphasis on policy advice and program lending and the increasing number of conditions attached to Bank loans.

To date, the Bank's technical assistance grants have resulted in 813 loans worth $40 billion, around half of the Bank's total lending. This nexus between technical assistance grants and subsequent lending calls into question the objectivity of feasibility and design studies, particularly when consulting companies are drawn from a small number of countries and often have close links to engineering and construction firms which bid for Bank projects.

The continued - and increasing - use of consulting companies from donor countries precludes the development of a local consulting industry. It often leads to project and program designs that fail to take into account complex, local socio-cultural and political realities, as well as designs that rely on inappropriate imported technologies and expertise. This often drives up project costs, marginalises indigenous knowledge and technologies and undermines local institutional capacity.

Furthermore, many consulting firms in the US, the UK, NZ and Australia were established to take advantage of the ideologically driven processes of deregulation and privatisation which were championed by conservative governments in the 80s and 90s. Taken in conjunction with the Bank's own overarching emphasis on the private sector and market-led growth, this severely circumscribes the policy options and program designs presented to borrower governments as the result of technical assistance project. This is of particular concern because, along with other multilateral development banks, the ADB is increasingly involved in the development of sectoral strategies and overarching poverty reduction strategies. Since the 1980s, the ADB has increasingly linked new lending to these ideologically proscribed policy/sectoral reforms.

Development Finance or Corporate Subsidies?

Most donor countries get more money from the ADB in the form of procurement contracts then they give to the Bank in the form of contributions to its ordinary capital resources and special funds combined. The ratio of procurement to contributions for the ten donor countries that have won the most contracts in dollar terms from the ADB is shown in the last column in Table 2 above.

Eight of the top ten countries received at least $1 in procurement contracts for every $1 they have contributed to the ADB over the last 34 years. Swiss, British, German and Italian companies do best, winning at least $2 in contracts for every $1 in taxpayer-funded contributions made to the ADB by their respective governments. The Swiss and the Italians top the table at $2.90 and $2.50 respectively. French, Australian, New Zealand and Dutch companies received at least $1 in contracts for every $1 in contributions made by their governments. Only Japanese and Canadian companies receive less.

In effect, governments are using the rubric of poverty reduction to channel taxpayer funds to their private sector companies via the ADB. This is occurring with little or no pubic scrutiny although government representatives will, if necessary, appeal to commercial self-interest to justify continued contributions to the ADB and other multilateral development banks.

Speaking before a hostile House Appropriations Subcommittee on Foreign Operations in April 2000, US Treasury Secretary Lawrence Summers said: "in 1998 alone, US firms received $4.8 billion from contracts arising from MDB investment and adjustment programs"[xiv]. In a similar vein, the Australian Treasurer's report to Parliament on the ADB for 1998-99 states that "ADB-financed contracts provide sizable commercial opportunities for Australian firms and can be stepping stones to

further work in developing countries in Asia and the Pacific". It also states that "in 1998, Australia's procurement with the ADB totalled $270 million, higher then Australia's $148 million capital contribution to the ADB over the same period"[xv].

Japan and the ADB

Japan's role in the ADB is illustrative of many of the larger issues associated with debt financing and is considered in some detail below.

As noted previously, Japanese companies have won $6.2 billion in ADB contracts whereas the Japanese government has contributed $12.9 billion to the ADB's OCR and special funds. These figures probably understate the value of contracts won by Japanese companies because contracts won by Japanese subsidiaries or joint venture partners in DMCs are not included in the Japanese data. Whilst the same applies to companies from other donor countries, it is more likely to affect the Japanese figures because of the extensive network of Japanese affiliates throughout Asia.

As noted above, Japanese companies were particularly successful in capturing Bank GRSCW contracts in the first two decades of the Bank's operation. The subsequent decline in the proportion of contracts won by Japanese companies is probably due to a range of factors including: increased engineering and construction capacity in borrowing countries; a small decline in the proportion of Bank funds going to large-scale infrastructure projects in which Japanese companies have a competitive advantage; improved bidding processes; increased competition from European and US companies and institutional pressure from other donor countries seeking a greater proportion of ADB contracts.

In any case, the decline in the proportion of contracts won by Japanese companies was more then offset by the increase in the value of contracts in dollar terms due to the increase in Bank lending overall. As a result, Japanese companies have still received more money from the ADB in absolute terms then companies from any other country. Over the last 34 years, Japanese companies have won ADB contracts worth $6.2 billion, well ahead of their nearest competitors from Indonesia ($5.75 billion), China ($4.26 billion), the US ($3.88 billion), India ($3.57 billion), Pakistan ($2.86 billion) and Germany ($2.55 billion).

The relative success of Japanese companies in capturing ADB contracts, at least in the Bank's first two decades, mirrors the key role played by Japanese companies in the Japanese bilateral aid program. Japanese ODA totalled 10.7 billion in 1998, roughly twice the size of the ADB's lending program in the same year. In addition, more then 50% of Japanese ODA is allocated to Asia where Japanese companies have a comparative advantage[xvi]. Despite the gradual untying of Japanese aid since the 1970s, Japanese companies still bid for 80% of Japanese ODA funded large-scale infrastructure projects and win about 60% of all contracts in dollar terms.[xvii] Whilst this to some extent reflects the "natural" advantages enjoyed by Japanese companies for reasons of proximity, scale, technological expertise and the high degree of horizontal and vertical integration which characterises the Japanese corporate sector, other factors are obviously at play as well.

These include: the explicit commercial focus in the Japanese aid program; the economic and political power of the construction and engineering industries in Japan; effective lobbying by government-funded industry associations; the support provided by the overseas offices of Japanese companies to the under-staffed Japanese aid bureaucracy as well as their links to aid-dependant southern governments; the interchange of personnel between the aid bureaucracy and the corporate sector (a practice known in Japan as "descending from heaven") and the close links between consulting companies undertaking feasibility and design projects and construction and engineering firms which then bid for GRSCW contracts.

Japanese investment in the ADB has also served a number of purposes other then immediate commercial gain. These reflect the changing strategic objectives of Japan's aid program

overall. Since its aid program was established in the 1960s, Japan has successfully used ODA to: i) secure access to natural resources and food supplies from Southeast Asia in the 1950s and 1960s; ii) to rebuild and enhance diplomatic links with energy producing countries and countries bordering critical supply routes in the wake of the oil price shocks in the mid to late1970s; iii) to support the orderly relocation of Japanese low-end manufacturing to low-wage assembly platforms in Southeast Asia through the provision of infrastructure such as roads, ports and power facilities first in the 1960s and then again in the 1980s; iv) to facilitate regional economic integration on terms favourable to Japan; v) to protect Japanese banks which were heavily exposed in crisis-affected countries in 1997/98;[xviii] vi) to further internationalise the yen through the provision of yen denominated loans which, if successful, would reduce exchange rate risks for Japanese companies and facilitate the repayment of yen denominated private sector loans; vii) to support variants of the Japanese backed proposal for an Asian Monetary Fund and finally, viii) to promote an Asian, particularly Japanese, development model as an alternative to the Anglo-American neo-liberal orthodoxy which has held sway in the IMF and the WB since the 1980s.

These broader strategic objectives were/are reflected in the ADB's emphasis on food security and energy lending in the 1970s and 80s; the continuing emphasis on large-scale infrastructure, particularly in countries supplying natural resources to Japan or those targeted by Japanese manufacturing interests; the key role played by the ADB in facilitating regional economic integration through mechanisms such as the Greater Mekong Subregion Initiative; the ADB's unprecedented support for the bail-out package for Korea; the establishment of the ADB Research Institute in Tokyo in 1997 and the ADB's support for regional currency swap arrangement pushed by Japan at the ADB AGM in May 2000.

How then does Japan exert influence over the ADB? Japan developed the first proposal for a regional development bank in the early 1960s and subsequently played a key role in drafting the charter[xix] for the ADB. It fought to have the ADB headquarters in Tokyo but, in the face of opposition from other Asian countries, it was forced to settle for the Presidency. All seven Presidents have been Japanese and all bar one have been from the Japanese Ministry of Finance. Japan has also traditionally filled other key posts in the Bank including the head of Budget and Management Systems and the head of Personnel. Unlike other MDBs, the percentage of Japanese staff in the Bank overall is on a par with Japan's financial contributions. The Japanese staff are increasingly drawn from both government and the private sector, which opens up opportunities for Japanese corporate as well bureaucratic influence over the Bank's lending program. Japan matched the initial capital subscription by the US to the ADB, the first time that any country had matched a US contribution to an international organisation. This gives Japan and the US the largest voting power on the ADB's Board of Directors. Japan is also the principal contributor to the ADB's special funds and the sole funder of the ADB Research Institute.

Japan has used its influence largely to shape the financial and human resource policies and practices of the ADB. Japanese influence over country and regional strategies is moderated by the US and to a lesser extent by the combined voice of other Asian countries that are wary of a Japanese dominated regional institution. On key strategic issues, Japan has usually fallen into line with the US position.

For example, despite support from Japan, the US forced the ADB to maintain the embargo on lending to Vietnam until 1993; to suspend lending to China post Tiananmen and to exclude China and India from ADF lending. The US also prevented Japan from increasing its subscribed capital and hence its voting power in the Bank. The US, particularly under the Reagan and Bush administrations, aggressively promoted private sector development, private capital flows as an alternative to ODA, a reduced role for the state, policy based lending and structural adjustment in the ADB and other MDBs. This has increasingly taken priority over Japan's preferred emphasis on project lending, infrastructure development, protection for infant industries and a strong regulatory role for the state. Most recently, the US blocked the Japanese proposal to establish an Asian

Monetary Fund which would have provided quick disbursing loans to crisis-affected countries without the harsh conditions attached to IMF adjustment programs.

The preeminent role played by the US in policy making has occurred despite declining US financial contributions and protracted delays in US payments to the ADB. This reflects the priority given by the Japanese to the maintenance of the Japan-US relationship and the slow-down in the Japanese economy in the 1990s which has undermined the appeal of the Japanese development model. It also reflects the high degree of integration between regional economies and the US economy and continuing concerns held by smaller Asian states about a Japanese dominated ADB.

Conclusion

The principal beneficiaries of ADB lending are a relatively small number of developing countries that are of strategic and commercial importance to the US and Japan. Donor countries, hold more then 50% of the voting power in the ADB. Most of these developing countries are in the UNDP medium human development category. The least developed countries in the region, with the exception of Bangladesh, receive only a small proportion of ADB funds.

The other principal beneficiaries of ADB lending have been private sector companies and state-owned enterprises in large borrowing countries such as India and China and private companies in donor countries, particularly Japan, the US, Germany and the UK. Most donor countries win more in contracts from the ADB then they give in the form of subscriptions and contributions to special funds. Large resource exploitation, construction and engineering companies have been particularly successful in winning ADB contracts, often for projects using technologies that are no longer politically acceptable or commercially viable in developed countries. The ADB and other MDBs have supported the aggressive push by these companies into developing countries in search of new markets and investment sites.

Consulting companies from a small number of donor countries, particularly the US, UK, Australia, New Zealand and Canada, win most of the ADB's technical assistance contracts. These companies have often emerged during or benefited from the ideologically driven processes of privatisation and deregulation set in train by conservative governments in these countries during the 1980s and 1990s. This, taken together with the ADB's overarching emphasis on private sector development and market-based reforms, severely limits the policy options and project and program designs presented to borrower government as a result of ADB funded technical assistance projects. The use of donor country consulting companies militates against participatory approaches to project and program design which are responsive to local needs, which incorporate local technologies and expertise and are consistent with institutional capacity at the local and sub-national level. Instead, this has reinforced a dependence on an inappropriate Anglo-American development model, increased dependency on imported technologies and expertise and reduced transparency and accountability in project and program design processes.

" The US and Japan, together with other donor countries, hold more then 50% of the voting power in the ADB". Although Japan is the largest financial contributor to the ADB, its policy positions are usually framed within the parameters set by the US-Japan relationship. The combined voice of other Asian countries that are closely integrated with the US economy and/or continue to view Japan's strategic and commercial interests in the region with some suspicion also moderate Japan's influence. As a result, the US and its European allies play a pre-eminent role in strategic decision making whilst Japan plays the key role in financial and human resource management. Under US influence, the ADB has increasingly supported processes of privatisation, deregulation and liberalisation; shifted gradually from project to program lending and increased the number of conditions attached to Bank loans. Japan's still significant influence, however, accounts for the continued emphasis on large-scale infrastructure, regional economic integration, banking sector reform in crisis-affected countries and regional financial

mechanisms such as the regional currency swap arrangement proposed at the ADB AGM in 2000.

In effect, donor country governments are using the ADB to deliver taxpayer funded subsidies to the private sector. The ADB itself and the global investment firms which purchase ADB bonds are protected from commercial risk by donor country guarantees and counter-guarantees provided by borrowing governments. In the post-crisis context, donor countries have forced the ADB to increase charges on its lending operations, increase repayment rates and defer the transfer of operating profits from OCR lending to the ADF, effectively transferring the burden of refinancing the Bank from donor countries to borrowing countries. Bank contract conditions externalise social and environmental costs or transfer these as well as market risk to borrowing governments. Again, the costs are borne by taxpayers in donor countries or the poor in borrowing countries.

In sum, the debt financed development model delivered through multilateral institutions such as the ADB privileges those countries that are of strategic and commercial importance to powerful donor governments. It also privileges large corporations and consulting companies in search of new markets and investment sites in southern countries that offer higher rates of return and a more accommodating regulatory and political environment. It promotes resource and capital intensive approaches using non-indigenous and often inappropriate technologies, usually framed within an Anglo-American macro-economic orthodoxy. Ultimately, it is the poor in the south and taxpayers in the north that pay the price.

Endnotes:

[i] Edward J Lincoln, *"The Asian Development Bank",* in a paper presented at "Reconfiguring East Asia: Regional Institutions and Organisations After the Crisis", p.13, Brisbane, Australia, August 2000.

[ii] Cofinancing refers to funds raised by the ADB from other sources such as bilateral donors, export credit agencies and UN agencies for Bank supported projects.

[iii] The ADB's charter provides that the total amount of loans, equity investments and guarantees cannot exceed its subscribed capital, reserves and surplus.

[iv] A partial credit guarantee covers part of the interest payment and/or repayment of the principal irrespective of the cause of default. A partial risk guarantee protects investors against specific risks such as nationalisation, currency convertibility, strikes and civil disturbances etc.

[v] The total external debt of the region at the end of 1998 was $826 billion. *Human Development Report 1999*, UNDP

[vi] For example, outstanding ADB loans exceed outstanding WB loans in Pakistan, Philippines, Thailand and Vietnan.

[vii] Donor country members of the ADB are Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, Turkey, United Kingdom, United States.

[viii] The ADB ceased providing cumulative procurement data of this type from 1996 onwards.

[ix] Bangladesh, Nepal, Cambodia, Afghanistan, Lao PDR, Myanmar, Bhutan, Solomon Islands, Samoa, Vanuatu, Maldives, Kiribati, Tuvalu

[x] Contracts with values above US$1,000,000

[xi] Joshua Karliner, *"The Corporate Planet: Ecology and Politics in the Age of Globalisation"*, Sierra Club Books, 1997, Chapter 4, p. 4.

[xii] Ibid, Chapter 4, p. 6.

[xiii] Ibid, Chapter 4, p.13

[xiv] US Treasury Press Release April 13, 2000.

[xv] Australia and the Asian Development Bank 1998-99, p.27

[xvi] Asian countries received 54% of Japanese ODA in 1996 and Japan provided 50% of all ODA to Asia in that year.

[xvii] Japan's ODA Annual Report 1999, p. 2

[xviii] Japanese banks had $256 billion in outstanding loans in East Asia in 1997 including $84 billion in Thailand, Korea and Indonesia.

[xix] Tadao Chino, the current President of the ADB, played a key role in the drafting process.

Debt and Impoverishment: The IMF Legacy in Asia

*By Jacques-chai Chomthongdi***

Despite clear evidence linking IMF intervention to the crisis in the social sector in each country, the man most responsible for the IMF bail-outs in Asia, IMF Managing Director Michel Camdessus, still felt able to claim that "the IMF response to the Asian crisis has been an outstanding success...not only in Korea and Thailand but also in Indonesia".[i] Moreover, speaking at the final review of the rescue package for Thailand, Stanley Fischer, the IMF's First Deputy Managing Director also hailed the IMF's success: "indeed, the recovery has turned out to be impressive: output growth this year is set once again to exceed four per cent, exports are growing rapidly, the balance of payments position remains strong and inflation is well under control".[ii]

The IMF's upbeat assessment conveniently overlooks soaring public debt, big increases in unemployment, rising poverty and a deterioration in other social indicators such as education retention rates and maternal and children health. Why doesn't the IMF use these indicators in an assessment of a country's well being?

The IMF came to the rescue of the three economies hid hardest by the financial crisis - Thailand, Indonesia, and South Korea - with an almost identical economic policy prescription. Strict adherence to tight macro-economic policy and far reaching structural reforms were the order of the day.

The IMF's macroeconomic shock therapy - a tight fiscal stance and increased interest rates - squeezed the domestic economy and transformed the financial crisis in each country into an economic and social crisis. High levels of business bankruptcy led to a sharp increase in unemployment and underemployment. In South Korea in particular, unemployment jumped to unprecedented levels in a very short period of time. In Indonesia and Thailand, increases in unemployment were accompanied by a major shift in employment from the formal to the informal sector; the latter characterised by low wages, poor job security and inadequate or non-existent welfare benefits and legal protection. Those who were lucky enough to keep their jobs typically experienced a drop in real wages. Furthermore, as a consequence of the financial crisis and, more significantly, as a result of the IMF prescribed macroeconomic policy, more than 20 million people in the three countries dropped below the poverty line in less than two years.

This increasing severity of the social crisis in each country and the IMF's insistence on budget cuts forced governments to borrow money in order to support the growing number of poor people, further increasing public debt. The World Bank and other international financial institutions were, meanwhile, ready to lend to these cash strapped countries at profitable interest rates (higher than the average domestic rate). For example, the Thai government has

---

* Debt and Impoverishment: The IMF Legacy in Asia was extracted and adapted from part of "The IMF's Asian Legacy", printed in the Focus on the Global south publication, Prague 2000: Why we need to decommission the IMF and the World Bank, released in September 2000.

**Jacques-chai Chomthongdi is a research associate at Focus on the Global South, a policy research and advocacy organisation based in Bangkok, Thailand. Jacques-chai@focusweb.org

borrowed US$2,250 billion to date for social sector programs.

The IMF transformed a financial crisis into an economic and social crisis not only by demanding tight macroeconomic policy but also by ensuring that the cost of financial sector restructuring was transferred from predominantly private institutions to the public purse. Private debt became public debt.

Governments, under the guidance of the IMF, have led the restructuring of the financial sector in each of the three countries. The key components of the strategy in each case were the closure of weak institutions and increased government support for the surviving institutions. For example, the Korean and Indonesian governments have spent US$ 58.7 billion and US$ 90 billion respectively bailing out private financial institutions.

Not only did the IMF strategy create "moral hazard" by sanctioning the use of taxpayer funds to solve problems arising from the malfunction of the private banking system and inappropriate financial sector liberalisation, its macro-economic policies also increased the public cost of the bail outs. This is because the IMF-prescribed high interest rates and its insistence that local financial institutions meet Bank of International Settlements (BIS) capital adequacy ratios within a short period of time, drove both healthy as well as insolvent companies into bankruptcy in the first half of 1998. This significantly increased the volume of non-performing loans (NPLs) and hence the cost of recapitalising the banking sector.

As a result, while private debt has decreased in South Korea and Thailand, public debt has increased dramatically in both these countries as well as in Indonesia. In South Korea, the ratio of public debt to GDP increased from 12.0 percent in 1997 to 22.2 percent at the end of 1999. On the eve of the crisis, public debt in Thailand was US$ 26.7 billion or 15.7 per cent of GDP; by the end of April 2000, it had jumped to US$ 70.6 billion or 51.9 per cent of GDP. The Thai government has admitted that if the losses of the Financial Institution Development Fund (the main government mechanism for restructuring the financial sector) and the debt of the Bank of Thailand were included as well, then public debt would jump to around US$ 94.6 billion.

The IMF-prescribed program has also left Indonesia deeply in debt. Total public debt has risen sharply in the past three years. At end-June 1997, public debt totalled US$ 51 billion, a manageable 23 percent of GDP. However, debt levels jumped to 60 percent of GDP by the end of 1998 and to 93 percent by April 2000 when total public debt reached US$152 billion. This dramatic increase was due primarily to the issuance of bank restructuring bonds worth US$ 85 billion, equivalent to about 52 percent of GDP. Debt servicing now accounts for 27 percent of FY2000 expenditures, more then the total development expenditure that makes up 21 percent of the budget.

Table 1: Public debt as percentage of GDP

Country	1997 (pre-crisis)	April 2000
Thailand	15.7	51.9
Indonesia	23.0	93.0
South Korea	12.0	22.2 (end-1999)

The IMF recognised that public debt would increase as a result of its financial sector reform package but assumed that it could be quickly repaid through the privatisation of state-owned enterprises (SOEs). This proved hopelessly unrealistic, particularly in Thailand and Indonesia.

The cost of debt servicing will increase in the future, requiring further cuts or deferrals in public expenditure as well as increased revenue mobilisation. This debt service burden will cripple the capacity of these governments to mitigate the impact of the crisis on vulnerable groups for the foreseeable future.

Not only does debt servicing diminish the countries already limited capacity to mitigate unemployment and other social problems, it also severely constrains policy choices. Under the direction of the IMF, countries are forced to both maintain and expand exports in order to generate hard currency receipts as well as to adhere to the prevailing economic orthodoxy that prescribes further liberalisation,

privatisation and deregulation.
As Joseph Stiglitz, the former World Bank Chief Economist from 1996 until November 1999, clearly put it: "IMF boosters suggest that the recession's end is a testament to the effectiveness of the agency's policies. Nonsense. Every recession eventually ends. All the IMF did was to make East Asia's recessions deeper, longer and harder".[iii]

It is now more important then ever that countries negotiate a debt stand still and halt the transfer of private sector debt to the public sector before further damage is done. Only then can Indonesia, Korea and Thailand return to a more sustainable and equitable development strategy.

Endnotes :

[i] Camdessus, quoted in *Bangkok Post*, September 24, 2000.
[ii] Fischer, quoted in *The Nation*, May 10, 2000.
[iii] Stiglitz, "Protesters Are Right on the IMF," *The New Republic*, April 17, 2000.

Keeping Debtors in Place: Debt Relief under the Enhanced HIPC Initiative

By Shalmali Guttal*

The most glaring problem with the Heavily Indebted Poor Country (HIPC) initiative for debt relief is that it will not provide lasting relief from debt for the highly indebted countries of the south. The HIPC process is aimed not at canceling debts, but at ensuring that they can be repaid. It has little to do with enhancing human development, reducing poverty, or even increasing economic growth in the debtor countries. Rather, it is designed to massage debt figures down to a level where they would be deemed "sustainable" again according to the criteria of the International Monetary Fund (IMF).

Enhanced HIPC (the born-again version of HIPC) is not much different from a bribe forced on poor, highly indebted nations to convince them to stay within the debt-finance system. It seeks to make and keep poor countries solvent enough so that they can continue paying their debts to international creditors. The so called easing of eligibility conditions for debt reduction, interim strategies for providing credits and grants, and announcements of a multi-billion dollar trust fund for fighting poverty, are all ways to soothe frustrated debtor governments, who are fed up with the conditioning of meagre debt relief benefits on continued adherence to structural adjustment type policies.

Where one door is opened, another is closed. Through Enhanced HIPC, its architects and sponsors (the World Bank, IMF, G-8 governments and Paris Club creditors) have agreed to ease the criteria by which countries qualify for debt relief. But at the same time, they have also introduced a number of new hurdles into the process, from pre-entry requirements to the ways in which resources eventually freed up through debt relief will be used. Enhanced HIPC thus represents a season of high conditionality: the macroeconomic, structural and institutional conditions already familiar in Bank-Fund adjustment programmes will be fully retained, with additional rigorous requirements in the areas of governance, public expenditure, planning, private sector expansion, and the linking of any debt relief made available with Bank-Fund approved poverty reduction strategies.

From Rhetoric to Reality

The HIPC initiative was first proposed in 1996 by the World Bank and the IMF as an ostensibly comprehensive approach towards reducing the external debt of the world's poorest and most heavily indebted countries. At its launch, the World Bank and IMF assured the international aid community that under the HIPC initiative, between 20 and 30 of the world's poorest countries would have significant portions of their debts reduced by the year 2000, paving the way for their eventual exit from endless debt restructuring towards lasting debt relief. [i]

* Shalmali Guttal is Coordinator of the Micro-Macro Issues Linking Programme at Focus on the Global South
S.guttal@focusweb.org

By the end of 1998, HIPC had made little progress and only four countries (Bolivia, Uganda, Guyana and Mozambique) had qualified for extremely small amounts of debt reduction. In September, 1999, based on a global review of the initiative, growing pressure from civil society organisations and proposals discussed at the G-7 summit in Cologne, the World Bank and IMF announced changes to the HIPC initiative. The new, Enhanced HIPC would use more flexible criteria to assess debt sustainability and eligibility for debt relief, and offer quicker, greater support to more countries. Forty-one countries were identified as eligible for support under the new HIPC, and the G-7 countries at the Cologne summit announced debt relief of up to 90 percent for 20 of the world's poorest countries by the end of the year 2000.

In the same meetings, in order to demonstrate their commitment to poverty elimination, the World Bank and IMF also announced that debt relief would now be directly tied with poverty reduction programmes. The IMF's old Enhanced Structural Adjustment Facility (ESAF) was renamed the Poverty Reduction and Growth Facility (PRGF), and its old Policy Framework Papers (PFPs) were replaced by Poverty Reduction Strategy Papers (PRSPs)s. The PRGF constitutes the central mechanism through which the IMF will provide assistance to the HIPC and in order to reach the "completion point" (i.e., the point at which debt stocks are cancelled), countries must prepare PRSPs that are acceptable to the Boards of the Bank and the Fund.

The World Bank and the IMF have widely promoted the Enhanced HIPC as an innovative and groundbreaking initiative towards debt relief. Not surprisingly, the key benefits that the initiative promises are emptied of meaning when we compare the rhetoric with reality.

1. ***Deeper and broader debt Relief***:[ii] The World Bank claims that through the new HIPC framework, external debt servicing will be cut by approximately $ 50 billion, and that the World Bank itself will reduce its debt claims by nearly $ 11 billion.

In reality, the current relief amounts proposed by the major multilateral creditors is a far cry from the promised $ 50 billion reduction. The World Bank itself only proposes to reduce $ 5.7 billion through the International Development Association (IDA) and $ 600 million through the International Bank for Reconstruction and Development (IBRD). It has a long way to go to make good its $ 11 billion promise.[iii]

Further, the relief provided through the Enhanced HIPC initiative is neither deep, nor broad. After debt relief, many countries will spend more on debt servicing than on priority areas such as health, food security and education.[iv] The current method used to assess debt sustainability is deeply flawed: it is based purely on econometric and financial indicators (debt /export and debt/government revenue ratios) and does not take into account the chronic levels of poverty in the HIPC, or what debt servicing would cost the population of a chronically poor country even if its financial indicators showed that it was debt "sustainable." Research conducted by Jubilee 2000 shows that the first five recipients of HIPC assistance will still be paying more than half a billion dollars every year to external creditors, and overall, countries already in the pipeline for HIPC assistance will pay more in debt servicing than they will in public healthcare and education.[v] The cruelest cut of all is that 15 of the 41 HIPC countries will end up paying more after so called debt relief than they were paying earlier.

Despite claims that the funds "freed up" from debt reduction will now be redirected towards social spending, reports from Africa show that increased expenditures in areas such as health and education are miniscule in light of the combined cutbacks in these areas over fifteen years of structural adjustment programmes (SAPs). At this rate, it will be 2010 before levels of expenditure in health and education in most African countries can reach pre-1985 (pre-SAP) levels.[vi]

2. ***Faster debt relief*** : The World Bank claims that both the Bank and Fund will start providing assistance immediately at the point at which HIPC assistance is approved.

In reality, gaining approval for HIPC assistance is in itself a time consuming process, complicated by a number of conditionalities that a debtor country must satisfy.[vii] First there are the eligibility requirements: a country should have successfully (in Bank-Fund terms) applied a structural adjustment programme for three to six years and must have a level of debt considered unsupportable by the two institutions.[viii] If the Bank and Fund are convinced of the country's good faith intentions to continue with the Bank-Fund package of neoliberal reforms, the country must begin its negotiations with the Paris Club of Creditors. If this proves successful, it must then return to the Bank-Fund negotiating table to hammer out the details of a HIPC relief package. Since 1999, a new conditionality has been added: the preparation of poverty reduction strategies (PRSPs) that outline measures that the debtor country will take to counter poverty.

The process does not become any faster once the above hurdles have been crossed and HIPC assistance begins. HIPC assistance is predicated on the recipient country putting into place the usual assortment of neo-liberal reforms. Experience from Guyana, Honduras and Mozambique show that assistance can be stalled or delayed because of negotiations over conditionalities and the time required by Bank-Fund internal approval processes. The Bank and Fund themselves state that full debt relief will be spread over 20 years. Having seen what simply ten years of structural adjustment and debt servicing can do to developing and transition countries, the pace of debt relief promised through Enhanced HIPC is unlikely to make any positive impacts on the well being of the HIPC.

In order to "expedite" the debt relief process, the Enhanced HIPC allows for interim relief measures, provided that the debtor government demonstrates full commitment to future implementation of the HIPC framework. To this end, "floating completion points" were introduced in 1999, which assess a country's eligibility for debt relief based on its performance on specific reform programmes, rather than its overall track record. "Floating completion points" are intended to provide an incentive to HIPCs to implement macroeconomic and sectoral reforms quickly, and also provide avenues by which the Bank and Fund can introduce new conditionalities along the way. Country specific requirements for the ten HIPC who have reached completion points show that seven are required to introduce further privatisation and sectoral reform programmes on top of already existing structural adjustment programmes.[ix]

To date, only ten countries have started to receive any type assistance under the HIPC initiative and not even one has received real debt reduction.[x]

Stronger links between debt relief and poverty reduction: The World Bank and IMF claim that resources freed up from debt relief will be used to support poverty reduction strategies, developed with civil society.

In reality, the structural adjustment programmes imposed by the Bank and the Fund have created and entrenched poverty to unprecedented levels in over 90 developing and transition countries worldwide. Despite ample documentation and evidence of the disastrous effects of Bank-Fund programmes, the two institutions have been unwilling to introduce any fundamental changes in their thinking or approach. Their latest commitment to poverty reduction is proving to be another expensive, renaming exercise, and structural adjustment policies continue to form the bottom-line of the Enhanced HIPC framework.

The Bank and Fund claim that the bad days of structural adjustment are over and debt relief will be accompanied by nationally owned poverty reduction strategies and papers (PRSs and PRSPs). Experience thus far shows that the PRSPs are yet another resource-intensive conditionality that debtor countries must cross in order to qualify for any multilateral assistance at all. The poverty reduction strategies are certainly not nationally owned: they must be prepared according to Bank-Fund guidelines, with predetermined policy matrices that perpetuate old style Bank-Fund adjustment and reform programmes, and often conflict with nationally developed anti-poverty strategies. A senior Bank official described the PRSP-PRGF as a "compulsory programme, so that those with

the money can tell those without the money what they need in order to get the money."

Civil society participation in the formulation of these poverty reduction strategies has largely consisted of consultation meetings with prominent and well-resourced NGOs. Labour unions, peasant and fishers associations, indigenous people's organisations and social movements have been conspicuous in their absence. Apart from over-orchestrated meetings with civil society representatives at high profile international meetings, the Bank and Fund have made few attempts to engage with ordinary people who will bear the brunt of their so called poverty reduction programmes.

Interestingly, honest assessments of the role of external debt, the impacts of past debt servicing and SAPs on highly indebted countries do not seem to be on the Bank's and Fund's PRSP agendas. There is much talk about debt to export ratios, the need for greater trade and investment liberalisation and competitiveness, but no mention of the need to amend international terms of trade in favour of highly indebted countries, or the need for preferential market access in industrialised economies for the poorest countries. There is plenty of rhetoric about good governance and the need to fight corruption in debtor countries, but there are no proposals to penalise irresponsible lending on the part of international creditors, or to curb the "corporate creep" that is increasingly evident in bilateral and multilateral development assistance and credits.

The Promise Unravels

During the G-8 meetings in Cologne in 1999, members pledged $ 100 billion to finance the HIPC Trust Fund, the primary pot from which multilateral debt reductions would be made. Then in September, 1999, U.S. President Bill Clinton announced that the United States (U.S.) would write off a 100 percent of the bilateral debts owed to the U.S. by 30 of the poorest countries. This was followed by similar announcements by Britain, France, Italy, Germany Canada and Japan. Shortly thereafter, non G-8 governments also declared their commitment to debt cancellation: Australia, Belgium, Netherlands, Norway, Spain and Switzerland all announced their readiness to go beyond what HIPC promised, and cancel a 100 percent of the bilateral debt owed to them by some of the poorest countries.

Today, the promises made in Cologne ring hollow. Barely $ 3 billion of the $ 100 billion pledged to the HIPC Trust Fund has materialised and northern governments are dragging their feet on making good their pledges of full cancellation of the bilateral debts owed to them by their poorest debtors. The worst offender is the U.S., which promised $ 600 million towards multilateral debt relief, but has come up with less than $ 70 million. The European Union (EU) and Japan are conveniently using the U.S.'s failure to delay their own contributions.

In all, there are 27 multilateral institutions that are creditors to the HIPC and have agreed to participate in the HIPC initiative. These institutions hold a total of $ 70.2 billion (about 33 percent) of HIPC outstanding debt.[xi] The World Bank group is the largest creditor with $ 39.4 billion: $ 37.1 billion owed to the IDA and $ 2.3 billion owed to the IBRD. This is followed by the African Development Bank (AfDB) which is owed $ 10.4 billion; the IMF, which is owed $ 8.2 billion; and the Inter-American Development Bank (IADB) which is owed $ 3.8 billion. The Asian Development Bank (AsDB) despite being the largest creditor in Asia, holds only $ 892 million of HIPC debt.[xii]

Among the IFIs, the World Bank and the IMF enjoy preferential status compared to bilateral and other multilateral creditors in debt repayments and scheduling. They are owed almost $ 48 billion by the HIPC countries, and this debt, unlike bilateral debts, cannot be rescheduled or defaulted on by borrowing countries. The debts must be paid, and servicing them has cost debtor countries far more than the original sums borrowed, both in terms of the actual sums repaid as well as in terms of shouldering the social, economic and environmental impacts that debt servicing has entailed.

The World Bank and IMF have no plans whatsoever to write off even 50 percent of the debt owed to them by the poorest countries. Under Enhanced HIPC, the World Bank plans to provide relief of 25 percent ($ 600 million) of the debt owed to its non-concessionary arm, the International Bank for Reconstruction and Development (IBRD), and for 32 percent (5.7 billion) of the debt owed to its concessionary arm, the International Development Association (IDA). The IMF has proposed to relieve 37 percent ($ 2.3 billion) of the debt owed to it. The AfDB proposes to relieve 31 percent ($ 2.2 billion) of debt owed to it. The IADB proposes to relieve 39 percent ($ 1.1 billion), and the AsDB proposes to provide relief for 24 percent ($ 103 million) of the debt owed to it.[xiii]

Research conducted by Jubilee 2000 shows that the IMF, the IBRD, the IADB and the AsDB could easily write off 100 percent of the debts owed to them by the HIPC through their own resources, and neither lose their triple A credit ratings, nor suffer significant losses in usable equity. Through its own resources, the World Bank could also write off two-thirds of the HIPC debts owed to IDA, and with donor funding of $ 6 billion, it could fully cancel its HIPC debt. The AfDB, with its own resources and modest donor support, could also write of a 100 percent of the HIPC debt owed to it.

Measurements of debt relief already carried out since 1996 show that the reductions obtained by the HIPC to date do not exceed 5 percent of HIPC debt in 1996, or 0.25 percent of the total debt of developing countries.[xiv] The sum allocated by U.S. Congress towards the reduction of HIPC debt owed to it amounts to less than 0.05 percent of its annual spending on defense. The amount pledged by the United Kingdom (UK) over a 20-23 year period (635 million pounds) represents approximately two thousandths of the UK defense budget. According to some calculations, even if the creditor nations of the North made good on their 1999 pledges, none of them will contribute more than one percent of their defense budgets towards debt relief.[xv]

Clearly, the financial resources to fully cancel the multilateral debt owed by the 41 HIPC countries does exist among the International Financial Institutions (IFIs) and the northern donor community. What does not exist, however, is the political will to let go of debt servicing as an instrument of economic domination, regardless of its consequences on an increasing number of marginalised populations in the HIPC.

Debt Relief in Perspective

In February, 2000, World Bank President James Wolfensohn claimed that outright cancellation of the debt of the poorest countries would “screw up” the market for debt instruments. The “costs” of debt reduction and cancellation are highlighted by both, multilateral and bilateral credit agencies as the reasons for delay in implementing the HIPC initiative. But a quick look at the world debt situation shows that the debt of developing countries and among them, those of the HIPC, are miniscule compared to the debt of wealthy, industrialised countries.

In 1999, developing country debt (not counting the former Eastern Bloc) was placed by the World Bank at $ 2,060 billion, less than 6 percent of total world debt ($ 37,000 billion). The debt of former Eastern bloc countries was calculated at another $ 465 billion. The public debt of Belgium is approximately $ 250 billion, the public debt of France is $ 750 billion, the national debt of the United States is $ 5,000 billion, U.S. household debt is $ 6,000 billion, and the national debt of Japan at $ 2,000 billion.[xvi] In contrast, the total debt of the 41 HIPC countries is approximately $ 200 billion (less than one percent of world debt). It is difficult to imagine how canceling the $ 200 billion owed by the HIPC would seriously affect the market that Mr. Wolfensohn is so worried about.

The debt management strategies enforced by the G-8 countries and their watchdog institutions (the World Bank and the IMF) are classic examples of how northern financial institutions and economic interests can be protected, with scant attention to the long-term impacts of these strategies on majority populations in debtor countries. Since the debt crisis exploded in the early nineteen eighties, countries in the south

have paid their external creditors at least four times what was originally owed. The debt crisis heralded a new era of massive resource transfers from developing countries to the wealthy, industrialised countries not only through higher interest rates on debts, but also through a simultaneous fall in commodity prices which constituted the primary exports of many developing countries.

One of the major worries in the U.S. and Europe when the debt crisis broke out was that many of their largest banks were overexposed to debtors many times over total bank capital. Motivated by the desire to protect their banking systems and financial institutions, western governments (particularly the U.S.) used their control of the IMF and the World Bank to not only ensure full repayment of past loans, but to also lay the ground for a continued scenario of debt dependency through IMF-World Bank SAPs and austerity measures. Public debts incurred by developing countries to northern private banks were transformed into "official debts" to northern governments and multilateral institutions.[xvii] Private banks not only got away with irresponsible lending, but were encouraged to keep lending with new guarantees and protections from institutions such as the Multinational Investment Guarantee Association (MIGA), export credit agencies and other IFIs. The entire gamut of debt reduction measures since then, from the Brady Bonds to the current Enhanced HIPC initiative, have invariably resulted in many more gains for the creditors with little and dubious gains for indebted countries. The solution to the indebtedness of developing countries continues to be more debt, which has ballooned drastically as interest is charged on unpaid interest, and the principal remains untouched.

Who Really Pays?

In the period from 1984 - 1991, developing countries paid northern creditors $ 209 billion more in interest payments and principle repayments than they received in new loans. Among the 38 countries that were identified by the World Bank as 'severely indebted low income countries,' total debt rose from 5 percent of GNP in 1970 to 139 percent of GNP in the late nineties. In 1999, all the developing countries combined transferred a net sum of $ 1146.6 million to the creditor nations in the North.[xviii]

In 1998 alone, the 41 HIPC transferred $ 1,680 million more to the North than they received in credits.[xix] From 1992 - 1998, the World Bank and the IMF extracted more from the HIPC than they offered in loans and credits. Research conducted by Jubilee 2000 shows that 22 of the poorest HIPC transferred $ 6.8 billion to the IMF and IBRD during this period, $ 5.8 billion of which went to the IBRD. IDA transfers to these countries during this period amounted to $ 7.8 billion, with no new credits from either the IMF or the IBRD. Further, these 22 countries have had zero or negative per capita income growth over the last 35 years as a result of SAPs and debt servicing. In each of these countries, the debt owed per person is significantly higher than the annual public health spending per person. For example, in the Central African Republic, debt owed per person in $ 263, while annual public health spending per person is only $ 6; in Ghana, the debt owed per person is $ 319, while annual public health spending is only $ 7.3; in Nicaragua, debt owed per person is $ 1243, while annual public health spending is $ 18.3.[xx]

The amount of debt that the World Bank and IMF "forgive" is not simply forgotten, or absorbed as "losses" by the Bank and the Fund. The institutions have a plan to get their money back, except not directly from the debtor countries. They would be repaid from the HIPC trust fund, established specifically to finance the reductions that the Bank and Fund claim so generously. Creditor countries (who are members of the IMF and World Bank anyway) are expected to make contributions to this trust fund, which are invested by the Bank and Fund on the international financial markets. Returns from these investments would be then used to pay back the so-called "forgiven amount" to the IMF and the World Bank.

Bilateral funds allocated for debt reduction under the Enhanced HIPC initiative will not go directly to the debtor countries. In many cases, these funds will come out of the development aid budgets of creditor countries, and be used to

relieve debts incurred by debtor governments to private investors and companies in the north. Many of these companies are already insured against non-payment risks through guarantees by institutions such as the Exim Bank in the U.S. and COFACE in France. Creditor countries will use portions of public funds earmarked for ODA to pay these guarantor institutions to compensate the private companies for the debts to be "forgiven." Debt to private financial institutions, then, will be paid for by ordinary citizens in both the creditor and debtor countries, while private companies get away with profits and incentives to continue with business as before.[xxi] In some countries (for example, Sierra Leone, Honduras, Zambia, and Tanzania), a significant portion of foreign aid is already being used to repay debts to the World Bank and the IMF.

France and Japan have demanded that the debts owed to them must be repaid and they will then donate the funds back to the debtor countries. However, Japan specifically requires that funds handed back to debtor countries be used to purchase goods and services supplied by Japanese companies. Similarly, France has been offering debt "relief" to the HIPC for several years on the condition that debtor countries privatise their public sectors to benefit French private corporations. Research conducted by the Committee for the Abolition of Third World Debt, a Belgian NGO, shows that French multinationals such as Bouygues and Vivendi have been able to purchase entire sectors of economies in the former French colonies as a result of France's debt "relief" policies.[xxii]

Thus, one way or another, through cash transfers, or through transfers of their economic and environmental resources, the HIPC themselves will repay their own debts, barely disguised as debt reduction and relief. Maintaining consistency with the earlier debt management strategies of northern financial powers, the so-called "relief" provided under HIPC will benefit the governments and private corporations of the north, rather than the people in debtor countries.

The Myth of Debt Sustainability

Debt sustainability assessments made by the World Bank and IMF have more to do with how much debt servicing can be squeezed out of a debtor country than the country's actual ability to pay without sacrificing human and social development objectives. Under the first HIPC initiative, a country's debt was considered sustainable if it was able "...in all likelihood to meet its current and future external obligations in full without resorting to rescheduling in the future or accumulation of arrears."[xxiii] A HIPC sustainability criterion in 1996 claimed that annual debt service should be between 20 - 25 percent of export earnings. In the 1999 G-8 summit in Cologne, it was agreed the debt sustainability criteria should be modified to provide "deeper debt relief" and therefore lowered. However, these criteria apply to the debt stocks of the countries, and not to the amounts that actually go towards debt servicing. As such, they are both, inappropriate and inaccurate methods by which to assess the debt burdens of the HIPC.[xxiv]

Nowhere in the Bank-Fund descriptions of debt sustainability do we find any substantial discussion about the economic and human development challenges faced by countries that have been servicing heavy debts for long periods of time. Debt reduction is directed towards reducing debt stocks rather than debt servicing amounts. Although debt stocks determine the amounts that go towards servicing, many HIPC have such large debts (in principal, compound interest and arrears) that only a fraction of it is actually being serviced. The impact of heavy indebtedness is felt not through these stocks, but through active debt servicing, which redirects national resources away from essential domestic needs towards debt repayment.

Debt sustainability is not simply an issue of econometric and financial indicators by which financial technocrats can determine whether or not a country qualifies for debt relief. Countries that have undergone almost 20 years of structural adjustment and heavy debt servicing obligations face not only worsening poverty conditions, but also massive backlogs of social, human, technological and economic capacity

that call for a complete rethinking of the debt sustainability criteria. According to Jeffrey Sachs:

> The IMF and World Bank have been mouthpieces of this deceit, with their charade of analysing the "debt sustainability" of the poorest countries. These analyses have nothing to do with debt sustainability in any real sense, since they ignore the needless deaths of millions of people for want of access to basic medicines and nutrition. Money that could be directed towards public health is instead siphoned off to pay debts owed to western governments and to the IMF and World Bank themselves. [xxv]

In truth, debt will never be sustainable unless the wealthy and powerful countries stop demanding in trade and investment privileges the miniscule amounts of debt that they "forgive." Nor can these countries, or their collection agencies talk about debt sustainability when money that is urgently needed for strengthening public health systems, national food stocks and distribution systems, and clean water is diverted to servicing debts that have already been paid many times over. Talk about debtor countries needing to increase exports as a way of "growing out of indebtedness" are meaningless in the face of economic manipulations that control the prices and demand of the goods that these countries export. Rhetoric about debt sustainability becomes particularly ridiculous when on one hand a country like the U.S. trumpets its contribution towards the fight against HIV/AIDs in Africa, but at the same time, aggressively promotes the patenting of drugs by its pharmaceutical companies, thus raising the costs of essential drugs to those who need them most.

Possible Alternatives

The Enhanced HIPC is certainly not going to provide any kind of solution to the debt and poverty problems of highly indebted poor countries. Poverty is created not by debt perse (many northern countries have much higher levels of public debt than the HIPC), but by debt servicing under specific economic and political terms, which the World Bank and the IMF have mastered to perfection. It is this aspect of debt " relief" that the Enhanced HIPC misses entirely. No matter how one puts the pieces together, the final picture that emerges from the jigsaw of Bank-Fund debt relief measures is one of continuing domination of the global economy by a handful of northern countries. The HIPC initiative is simply the most recent of a long line of instruments that the World Bank and IMF have used to ensure this domination.

A more effective way of dealing with the chronic and expanding debt problems in the south would be to do away with instruments such as the HIPC and Enhanced HIPC altogether. If there is indeed genuine worldwide concern about growing poverty, inequality, social disintegration and environmental destruction in the world' poorest countries, many positive steps can be taken that go well beyond the Enhanced HIPC in achieving long term freedom from the debt overhang.

The first positive step would be the unconditional cancellation of the external debt of the poorest countries of the world. The need to reduce poverty is urgent, but it will not be achieved by pro-rating debt reduction on externally imposed anti-poverty measures. Years of SAPs and debt servicing have weakened the social and economic bases of many of the world's poorest debtors. Rebuilding this capacity is crucial for lasting solutions towards poverty elimination, but this will not happen as long as the debtor countries are increasingly strapped with debt service payments and further structural adjustment in the name of debt relief. Methods by which countries can redirect resources previously used for debt servicing towards human, social and economic development goals should be decided by citizens and their selected representative and not by foreign creditors, donors or multilateral agencies

The second positive step would be to abandon the neo-liberal reform agenda that currently underwrites north-south development assistance through grants and credits. Trade and financial liberalisation must be curbed because of their negative impacts on the local and national economies of poor, indebted countries.

The third positive step would be to end the impunity of those who have become illegally rich on the backs of their citizens (such as Mobutu and Suharto) and their accomplices in the World Bank, IMF, private banks and other international institutions. Proceedings should be started to return to the respective populations their stolen wealth, much of which is earning hefty profits in northern financial institutions. This step should be accompanied by the introduction of mechanisms that allow creditors to be held equally responsible and penalised to the same degree as debtors, for bad and irresponsible loans.

The fourth positive step would be to impose taxes on foreign exchange transactions (such as the Tobin Tax) in order to protect poor countries from sudden financial shocks and discourage the disastrous impacts of speculative capital.

The fifth and most enduring step would be to reduce the dependency on foreign financing, especially loans, in local and national development. Most development priorities (for example, food security, education, healthcare, environmental protection, clean water, etc.) can be supported through domestic resources, and the use of foreign financing can be limited to those goods and services that are as yet unavailable at reasonable cost domestically. But this would then entail the reorientation of our economies from production for export to production for local/national markets, and the redistribution of land, income, and other productive assets to strengthen local and national economic capacities.

Most important, the above steps would require that we subject economic policy decisions and economic transactions to the service of people, community and society, rather than vice versa, as exists now. While the above steps would not redress all the past economic imbalances of the past, they would be a start towards achieving long term social, economic and political justice, and towards preventing the use of debt as a tool of domination by the wealthy.

Endnotes :

[i] *The HIPC Debt Initiative*, www.worldbank.org/hipc/about/hipcbr/hipcbr.htm

[ii] *The HIPC Initiative: Background and Progress Through August 2000*, www.worldbank.org/hipc/

[iii] *Shadowy Figures, The G-7, IMF and World Bank - Globalisation and Debt*, Pettifor, Ann and John Garrett; Jubilee 2000 Coalition, September, 2000.

[iv] *What's Wrong with the HIPC Initiative*? European Network on Debt and Development (EURODAD), September, 2000.

[v] *Betraying the Poor: the failure of the G 8 to deliver a new deal on debt at the Okinawa Summit*, Jubilee 2000 Coalition, 2000.

[vi] *Debt Relief: Much ado about nothing*, Comanne, Denise and Eric Toussaint, Committee for the Abolition of Third World Debt, July 2000

[vii] *HIPC II and Conditionality: Business as before or a New Beginning?* Killick, Tony; Paper commissioned by the Commonwealth Secretariat, July, 2000.

[viii] Entry requirements are concisely articulated in the section on "Sunset Clause" in *The Enhanced Initiative for Heavily Indebted Poor Countries - Review of Implementation,* The World Bank and IM, September 7, 2000.

[ix] Ibid.

[x] These countries are: Benin, Bolivia, Burkina Faso, Honduras, Mali, Mauritania, Mozambique, Senegal, Tanzania and Uganda.

[xi] *Shadowy Figures, The G-7, IMF and World Bank - Globalisation and Debt,* Pettifor, Ann and John Garrett; Jubilee 2000 Coalition, September, 2000.

[xii] One reason for this is that only three countries have been identified as qualifying for the HIPC initiative in Asia: Myanmar, the Lao PDR and Vietnam. Among these, Myanmar is considered a conflict country and not in consideration at present. The Lao PDR has informed the World Bank and the IMF that it will not be seeking debt relief under this initiative.

[xiii] *Shadowy Figures, The G-7, IMF and World Bank - Globalisation and Debt,* Pettifor, Ann and John Garrett; Jubilee 2000 Coalition, September, 2000.

[xiv] ibid

[xv] *The Third World Debt after Okinawa: The G-7 is unmasked!* Toussaint, Eric; Committee for the Abolition of Third World Debt, August, 2000.

[xvi] All figures for 1999; Debt Relief: *Much ado about nothing,* Comanne, Denise and Eric Toussaint; Committee for the Abolition of Third World Debt, July 2000.

[xvii] For a concise discussion of debt management strategies, see, *How Much Debt Must be Cancelled?* Hanlon, John; Development Policy and Practice, Technological Faculty, Open University, 2000

[xviii] *How Much Debt Must be Cancelled?* Hanlon, John; Development Policy and Practice, Technological Faculty, Open University, 2000.

[xix] *The Third World Debt after Okinawa: The G-7 is unmasked!* Toussaint, Eric; Committee for the Abolition of Third World Debt, August, 2000.

[xx] *Shadowy Figures, The G-7, IMF and World Bank - Globalisation and Debt,* Pettifor, Ann and John Garrett; Jubilee 2000 Coalition, September, 2000.

[xxi] *Debt Relief: Much ado about nothing,* Comanne, Denise and Eric Toussaint; Committee for the Abolition of Third World Debt, July 2000.

[xxii] *The Third World Debt after Okinawa: The G-7 is unmasked!* Toussaint, Eric; Committee for the Abolition of Third World Debt, August, 2000.

[xxiii] The World Bank 1998a, Volume 2

[xxiv] For a comprehensive discussion of debt sustainability criteria, see Rethinking *HIPC Debt Sustainability,* Eurodad, July, 2000.

[xxv] *The Charade of Debt Sustainability,* Jeffrey Sachs; Financial Times, September 25, 2000.

Cracks in the Honeypot* Debt and Sustainability in Cambodia, Laos and Vietnam

By Jenina Joy Chavez-Malaluan

Cambodia, Laos, and Vietnam are collectively called the Southeast Asian transitional economies (SEATEs) because they have embarked on market-oriented reforms starting the mid-1980s.

The SEATEs are also part of the Greater Mekong Sub-regional Economic Programme (GMS) established in 1992 with support from the Asian Development Bank. The GMS Programme is supposed to be one major vehicle for growth in the sub-region, encompassing activities from project identification to resource mobilization. The design of projects under the GMS Program, and the philosophy that underlies it, is reminiscent of the conventional export-oriented growth strategy prescribed to Third World countries: export natural resources to earn foreign exchange to pay for loans and imports.

A big part of the interest in the sub-region focuses on its vast and largely untapped natural resources. There is great promise in agriculture, fisheries and forest (especially timber) production. Multilateral institutions and private investors alike see the potential of the sub-region's rich coal, gas, petroleum and hydropower reserves. Current energy production and consumption are way below capacity. The sub-region's population base has also been cited as one of the sub-region's strengths. Young, growing, cheap and highly trainable, it is a good foundation to build upon future market and workforce.

All these plus the political will to pursue sub-regional cooperation make the SEATEs a honey pot of sorts, with opportunities and possibilities for expansion.

Cambodia and Laos are the smallest economies in the Greater Mekong sub-region and by far the poorest. Vietnam is a mid-sized economy that is also a favorite trade platform for many international investors. These three countries started expanding trade activities outside their traditional trade partners (the Soviet Union for instance) in the late 1980s, and posted respectable economic growth from that time. Starting from very low levels highlighted the good prospects ahead of the SEATEs. Aid and investments that came in were readily absorbed and translated to growth. The SEATEs grew fastest in the early 1990s, growing at an average of at least 6 percent (8.2% for Vietnam) between 1991 and 1995.

Much of the gains posted by the SEATEs were affected by the Asian crisis. By 1998, Cambodia grew by only 1.3 percent, Vietnam by 4.4 percent and Laos by 4 percent. In 1999, the Lao economy slowed down further, growing at only 0.2 percent.

---

* Jenina Joy Chavez-Malaluan is a Research Associate at Focus on the Global South based at Manila, Phillipines
J.chavez@focusweb.org

Still the high growth period resulted in improvements in the SEATEs' income and social indicators. Between 1990 and 1998 income per capita in Vietnam grew by 61 percent (US$206 to 331), in Laos by 31 percent (US$321 to 421), and in Cambodia 16 percent (US$240 to 279). Export performance grew more than 65 percent in Vietnam (26.4% to 43.6% of GDP) and grew almost five times in Cambodia (6.1% to 34.1% of GDP) between 1990 and 1998. Lao exports grew in the first half of the 1990s (11.3% of GDP in 1990) only to slow down sharply due to the crisis (3.7% of GDP in 1998).

In 20 years from 1970-75, life expectancy in the three countries improved by an average of 14.3 years. Infant mortality and under-five mortality rates have also been cut substantially during the same period. All this was made possible by increases in social expenditure (health and education) to a combined total of 3.5 percent of GNP in 1995-97.

Despite these gains, the development challenge in the SEATEs is enormous. Adult illiteracy is a high 29 percent in Laos, while in Vietnam 55 percent of the population have no access to safe water. More than half of the Vietnamese population lives in poverty. Income gap is widest in Cambodia, the poorest 20 percent of the population sharing but 6.9 percent of total income.

It is in the context of this challenge that the issue of debt becomes important. Debt is seen as crucial in augmenting domestic resources in financing socially desirable projects and programs. However, beyond the mainstream counter-arguments that debt represents future claims on resources and has impact on inter-generational equity, a more serious concern is the use of debt as an instrument of domination by creditor countries.

The Debt Picture

From Aid to Debt. In the SEATEs, tax and other revenues are unable to cover current expenditures. Tax revenues are too small to enable government to finance development efforts, and per capita income is low resulting in low domestic savings making the private sector unable to finance productive investments. Official development assistance remains an important financing source for the SEATEs, particularly for Laos and Cambodia. The Asian Development Bank and the World Bank give the biggest contributions, accounting between them from 35 to 80 percent of total commitments from multilateral sources in 1998. Japan, France and Germany account for the biggest bilateral pledges.[i]

Aid money covers the resource gap inside the SEATEs. In Laos, for instance, foreign assistance accounted for a little over six percent of GDP in 1985-86. In 1998, the three countries received a net total of US$1.8 billion in official development assistance. The importance of ODA ranges from 4.7 percent of GNP (for Vietnam) to 21.8 percent of GNP (for Laos).[ii]

While the data on net ODA disbursements indicate that SEATEs receive increasing aid, the picture is incomplete since ODA data include both grants and loans. Most finances coming into the SEATEs are official money, only a very small amount of private finance comes in mostly to Vietnam. And of this official money, less than ten percent are given out as grants, although loans carry concessional terms.

Heavily Indebted. Table 1 shows the different debt indicators for Cambodia, Laos and Vietnam. The three SEATEs' total debt stock stood at US$27 billion in 1998, up 38-fold from just US$687 million in 1985. Vietnam experienced the biggest increase in debt stock, followed by Cambodia. But it is Laos that displayed the worst debt indicators in 1998. Laos has a debt stock to GNP ratio of 199 percent, but a low debt service ratio of 6.3 percent. Each Lao person owed more than he earned on average, US$520 versus US$421, in 1998.

At first glance, except for Laos (and even Laos pays so little), the debt situation in the SEATEs does not look bad. But looking at it from the fiscal window defined by the World Bank, the picture changes. Exports to GDP ratio for Laos is a mere 3.7 percent. Cambodia and Vietnam perform better at 34.1 percent and 43.6 percent, respectively. Tax revenue meanwhile is only

15.8 percent of GNP for Vietnam. Laos and Cambodia expectedly perform worse here. The fiscal window gives rough indicators of a country's ability to pay off its obligations. Cambodia, Laos and Vietnam neither have the dollars to service foreign liabilities, nor good records of internal resource mobilization. Except for Cambodia, what little the SEATEs pay in debt service at the moment already represents almost double their combined expenditures for health and education.

Table 1 : Indicators of Indebtedness: Cambodia, Laos and Vietnam 1985, 1993 and 1998

	Cambodia	Lao PDR	Vietnam
Total Debt Stock (US$ million)			
1985	7	619	61
1993	1,829	1,985	24,168
1998	2,210	2,437	22,359
As % of GNP			
1985		26	
1993	91	150	188
1998	78	199	82
Total Debt Service (% of exports)			
1985		9.2	
1998	1.5	6.3	8.9
Per Capita Debt (US$, 1998)	200	520	290
Income Per Capita (1998, in 1995 US$)	279	421	331

Sources: World Bank, Global Development Finance 2000; United Nations Development Programme, Human Development Report 2000.

The Ruble Debt. In 1997, Russia was admitted to the Paris Club as a creditor country in what was called the Denver Summit of the Eight, indicating Russia's 8th seat in the erstwhile G-7. While itself seeking to reschedule its own debt, Russia's inclusion in the Paris Club revived negotiations for the US$120 billion debt owed to it by developing countries.[iii] Much of this credit was given in the form of commodities, mostly arms.[iv]

The ratios of ruble debt to total debt stock are 50 percent for Vietnam, 55 percent for Laos and 60 percent for Cambodia. None of these debts have been or are being serviced in any substantial amounts, but all three governments have reached agreements with the major ruble creditor to suspend payments until the resolution of the conversion (of rubles to dollars) issue.

Presently, the ruble debt is categorized as nonconvertible debt, although it is given a dollar value in most documents. This status gives rise to conflicting debt figures for the SEATEs, and makes collective analysis difficult. Below are some details of SEATEs ruble debt:

Cambodia: Almost 99 percent of Cambodia's ruble debts are owed to Russia. Other CMEA countries that lent to Cambodia included the Czech Republic, Poland, and the Slovak Republic, with total claims of SUR 11.1 million. The Russian and Cambodian governments have conflicting figures on how much the RCG's ruble debt is. In May 1991, Russia consolidated its 15 previous credits to Cambodia into one new credit at no interest. The agreed amount was SUR 796.6 million. No payments have been made on this consolidated debt, and conversion rates to US dollars remain unresolved. In September 1997, it submitted a total claim on Cambodia in the higher amount of SUR 832.8 million.[v] Starting in 1997, Cambodian foreign debt data included $1,346 million owed to countries of the former Council of Mutual Economic Assistance (CMEA), reflected in official Cambodian debt statistics as rescheduled bilateral debt, and is subject to negotiation and rescheduling.[vi]

Laos: Non-convertible currency debt amounted to 1.4 billion transferable ruble debt owed mostly to Russia (98%), and to

	Bulgaria, (former) Czechoslovakia, (former) German D.R., Hungary, and Poland (collectively, 2%). For a small portion of this debt, payments in kind were made until 1998. After which, the Lao government struck an agreement with the Russian government to suspend payments until the issue of currency conversion of the ruble debt is resolved. [vii]
Vietnam:	Non-convertible debt stood at 10.5 billion transferable rubles in 1998.[viii]

Needless to say, a favorable resolution of issues around the ruble debt is crucial for the SEATEs' debt to remain sustainable, specifically for Laos and Cambodia. The debt burdens of the SEATEs have not been as severe as no payments have been made on the ruble debt that make up half the total debt stock. As long as the ruble debt remains within the purview of bilateral talks, rather than tied to a specific debt relief package such as the HIPC framework, the SEATEs would enjoy greater flexibility in managing their indebtedness.

Increasing Multilateral Debt. Prior to the decision to embark on market-oriented reforms, the SEATEs' indebtedness consisted almost entirely of debts to bilateral sources. Lao PDR was one of the earliest to tap into multilateral credit, with 23 percent of its long-term debt owed to multilateral sources by 1993. Up until that point multilateral credits have not been significant in Cambodia and Vietnam. By 1998, Vietnam had six percent of its long-term debt owed to multilateral creditors, Cambodia 13 percent, while Laos debt to multilateral sources jumped to 40 percent of total debt stock. (See Table 2.) If the non-convertible ruble debts are excluded, multilateral debt becomes bulk of the total debt stock, representing around 90 percent in the case of Laos. The Asian Development Bank and the World Bank (IDA credits) are the most important multilateral sources for the SEATEs. In the three countries, the IMF's exposure is biggest in Vietnam and least in Laos.

Multilateral debt is always a concern given the policy conditionality implied. Unfortunately, the multilateral institutions operating in the SEATEs are not known for imagination and tailored approaches. Instead, generic policy conditions are prescribed to SEATEs which obviously have undergone a totally different economic system for two decades.

For instance, the urging of multilateral institutions resulted in the decimation of the state sector in the SEATEs. At the end of 1998, 160 Cambodian SOEs have been privatized, while 24 others were being prepared for privatization. Only 12 of the original SOEs were retained by the state.[ix] Such is also the case for Laos. All but 33 of the 800 state enterprises the existing by the early 1990s have been privatized. Most of the remaining SOEs are not viable and are in the process of liquidation, while the more viable ones are being commercialized.[x] Only Vietnam has so far been very wary about and quite slow with privatization, managing to retain more than 5,000 SOEs. Still, the Vietnamese government is under pressure to reform and privatize citing huge debt liabilities of the SOEs.[xi]

Financial openness is also a key policy condition attached to multilateral credits. Such openness proved quite painful in the wake of the Asian financial crisis when currencies fell following the regional tenor. Laos registered the deepest plunge in currency value in all of Southeast Asia.

Table 2 : Distribution of Long-Term Debt, 1993 and 1998

	Cambodia	Laos	Vietnam
Long-Term Debt/ Total Debt (%)			
1993	92	98	89
1998	95	97	88
Of which (%):			
Multilateral			
1993	0	23	0
1998	13	40	6
Bilateral			
1993	100	77	95
1998	87	60	71
Private			
1993	0	0	4
1998	0	0	22

Source: World Bank, Global Development Finance 2000

The HIPC Initiative and the PRSP.[xii] Perhaps an unintended result of the big exposure (relative to total debt) of multilateral institutions in the SEATEs is the jockeying up of these institutions for the lead role in policy reforms. More and more these institutions have overlapping mandates, and because the SEATEs (with the exception of Vietnam) are small economies, the development scene get crowded. The race for primacy among the multilateral institutions operating in the SEATEs reaches its ludicrous peak in the implementation of the Poverty Reduction Strategy Paper (PRSP) and similar processes.

In 1996, the major bilateral creditors agreed to embark on yet another debt reduction scheme. The Highly Indebted Poor Countries (HIPC) Initiative is purportedly the most comprehensive thus far because it tackles commercial, official bilateral, and official debt owed to multilateral creditors like the International Monetary Fund, the World Bank, and the regional development banks. The amount of debt relief extended under the Initiative depends on the debt sustainability analysis following the World Bank formula. In September 1999, the Enhanced HIPC[xiii] was launched, basically expanding the linkage between debt relief and policy conditions, this time including the current mantra of poverty reduction and social policies.

The PRSP is necessary for qualified debtors to access onto the HIPC Initiative. It is supposed to be used as the basis of all WB/IMF lending and would serve as the guide for debt relief under the enhanced HIPC initiative. Laos and Vietnam qualify for the HIPC, but neither is interested in seeking debt relief, bulk of their qualified debts being ruble debt that they want to renegotiate bilaterally. Still, both Laos and Vietnam have to undergo the PRSP process since they tap into the Enhanced Structural Adjustment Facility (ESAF), now repackaged into the Poverty Reduction and Growth Facility (PRGF), of the IMF.

Cambodia is now in the thick of PRSP preparations, and with different processes at that. The World Bank assists in the Interim-PRSP, while the ADB provides a technical assistance grant for the preparation of Socio-Economic Development Plan (SEDP II) for the next five years. The two agencies are now in competition as to whose poverty reduction strategy the Cambodian Government will finally adopt. Cambodia has initially declared a “one process, one product” policy.[xiv]
It is ironic that the competition among multilateral institutions for policy leadership in the SEATEs is at least creating potential venues for civil society intervention in policy making. Yet there is little indication that, aside from the declared policy of an open process where civil society can participate, the PRSP is substantially different from old structural adjustment and similar packages that found their way into different governments’ letters of intent and memoranda of economic policy submitted to the multilateral institutions until not so long ago.

The bottomline of most multilateral policy designs is to hasten the integration of the SEATEs in global economy. The SEATE’s better exercise extra care and serious rethinking in taking this path, especially in light of the serious challenges being posed to globalization. Serious consideration should be accorded to the acknowledged failure of SAPs (which sadly the PRSP suspiciously sounds like), the lessons of the East Asian and global financial crises, and the achievements made by the SEATEs before they decided to be more market-friendly.

The determination of the macroeconomic framework prior to the actual PRSP fans the suspicion that the process is nothing new. The predetermined stance for state enterprise reform and privatization is a case in point. A one-track minded analysis of SOEs and state involvement in direct production as being inefficient ignores the gains planned economies have registered in the past. Focusing on the huge debt burdens of Vietnamese SOEs for instance, brushes over the reality that these SOEs make up a third of Vietnam’s GDP, 20 percent of total investments, and 15 percent of total employment outside agriculture.[xv] Indiscriminate privatization, against a backdrop of weak internal demand and underdeveloped institutional mechanisms, sometimes also leads to asset- (or capital-) stripping in the privatized SOEs that government officials decry.[xvi]

New Indebtedness. The ambitious design of the ADB-supported GMS Framework renders available official funds insufficient. To make up for the gap, the ADB facilitates the flow of private finance into the sub-region, notably to Laos and Cambodia where private funds for projects have been negligible. In many projects, governments retain majority stakes, and bulk of the responsibility for the private debts incurred by such projects. Access to commercial credit, while laudable, becomes more controversial in light of the wider context of project choice and design. Often, projects for which private financing are possible carry huge social and environmental impacts (energy projects), and questionable income projections (e.g. export earnings). Yet commercial credits carry higher interest rates and shorter grace periods. This means that debt service obligations become current even as projected income streams have longer gestation periods.

Laos provides a vivid example. Most of Laos' debt is owed to official (bilateral and/or multilateral) sources. But when the government started to enter into joint ventures and build-operate-transfer schemes, it was able to tap into commercial sources as well. This was the case with the Theun Hinboun Power Company where the Lao government is majority owner. The THPC incurred a debt stock of US$160 million. This meant sharp increases in external debt service payments made by the country since 1996. Principal payments increased by almost 20 percent from US$9.6 million in 1996 to US$11.3 million in 1997. Interest payments more than tripled from US$5.9 million to US$18.8 million for the same period. Debt service payments totaled to US$38 million in 1998.[xvii]

Re-Orienting Indebtedness

Unless the SEATEs dramatically improve domestic revenue collections, and attract sizeable productive investments, their coffers will continue to be in deficit. Earlier in their transition bid, this deficit was covered by generous external aid, but is being slowly replaced by indebtedness.

Indebtedness per se is not bad, but there should be serious rethinking of what indebtedness should be incurred for. Policy leadership should not be a monopoly of big creditors and multilateral institutions. It need not be anybody' s sole charge at all. It should be recognized that the SEATEs' decision to open up to the market is not automatically a censure of their previous predisposition. Transition, therefore, should not be construed as a complete reversal of what they were before. Development should be a more broad-based and open process where past property regimes, relations of production, and government planning, need not be demonized nor uncritically praised. Appropriate government planning, critical and informed civil society involvement, and the cooperation of the international community are needed if indebtedness is to become a tool for development. In this context, the way indebtedness is shaping up in the SEATEs is sadly not the sustainable way to go.

Endnotes:

[i] Jenina Joy Chavez-Malaluan, *Development and Dilemma in the Mekong*, 1998 (unpublished discussion paper)

[ii] UNDP, Human Development Report 2000

[iii] Dallas Morning News, Russia joins the (Paris) Club (http://seattletimes.nwsource.com/extra/browse/html97/econ_062197.html)

[iv] Eric Margolis, Bad Debts Keep Russia Broke, 10 Apr 1997 (http://msanews.mynet.net/MSANEWS/199704/19970412.8.html)

[v] IMF, Cambodia: Recent Economic Developments (IMF Staff Country Report No. 98/54), June 1998

[vi] IMF, Cambodia: Statistical Annex (IMF Staff Country Report No.99/33), April 1999

[vii] IMF, Lao People's Democratic Republic: Recent Economic Developments (IMF Staff Country Report No. 3), January 2000

[viii] IMF, Vietnam: Statistical Appendix and Background Notes (IMF Staff Country Report No. 00/116), August 2000

[ix] IMF, Cambodia: Statistical Annex (IMF Staff Country Report No.99/33), April 1999

[x] IMF, Lao People's Democratic Republic: Recent Economic Developments (IMF Staff Country Report No. 98/77), August 1998

[xi] IMF, Vietnam: Selected Issues (IMF Staff Country Report No. 99/55), July 1999

[xii] Background information for this section was taken from Naina Shakya, *Progress on the PRSP*, September 2000 (unpublished discussion paper)

[xiii] The principal changes to the targets and thresholds between the original and enhanced HIPC Initiative are as follows: NPV debt/exports, from 200-250% to 150%; NPV debt/revenue, from 280 to 250%; export/GDP, from

40 to 30%; and revenue/GDP, from 20 to 15%.

[xiv] Chris Adams, *Draft Report on the PRSP Process in Cambodia*, August 2000

xv IMF, Vietnam: Selected Issues (IMF Staff Country Report No. 99/55), July 1999

[xvi] The Russian experience is very instructive.

[xvii] IMF, Lao People's Democratic Republic: Recent Economic Developments (IMF Staff Country report No. 3), January 2000

The Prague Castle Debate: Hard Answers, Please, Gentlemen

*By Walden Bello**

On September 23, 2000, President Vaclav Havel of the Czech Republic hosted an historic debate between the heads of the Bretton Woods institutions and their civil society critics. The event took place at the historic Prague Castle-immortalized in Franz Kafka's allegoric tale The Castle-a few days before the World Bank-IMF annual meeting in the Czech capital. Attended by about 300 invited guests from governments, the multilateral institutions, the academy, and civil society, the event quickly turned into a heated exchange. The Washington Post reported that "although [the NGO's] complaints have been heard before, they rarely have been delivered in a setting at once so intimate and so public. And not surprisingly, Wolfensohn and Koehler took it all a bit personally." On one side were Horst Kohler, IMF managing director, World Bank President James Wolfensohn, George Soros, the financier, and Trevor Manuel, South Africa's finance minister. On the other side were Katrina Liskova, a representative of militant Czech NGO's, Ann Pettifor, head of Jubilee 2000 in the United Kingdom, and Walden Bello, executive director of Focus on the Global South. The debate was chaired by Mary Robinson, the United Nations Human Rights Commissioner and former President of Ireland.

The following is an edited composite version of the Focus director's two lengthy interventions during the debate. Data presented by Dr. Bello to support his points were taken from a variety of publications and reports.

I would like, first of all, to thank President Havel for staging this debate today, and President Robinson for chairing it.

I never thought I would be sitting so close to Jim Wolfensohn. I guess this is what you call combat in close quarters.

The International Monetary Fund and the World Bank have avoided a real debate with their critics in civil society for a long time. Today, the representatives of these two institutions are here, partly because of President Havel's moral suasion, partly because they realize that, with their two institutions suffering an unparalleled crisis of legitimacy-the worst in their 56-year history, in fact-the old strategy of denial and non-confrontation no longer works.

In this brief presentation, let me tackle four myths propagated by the Bank and the Fund, and end with questions to Mr. Kohler and Mr. Wolfensohn:

Myth No. 1: The World Bank and IMF are proponents of "good governance."

Fact: For the greater part of the last 30 years, the Fund and the Bank have been intimately associated with very corrupt governments and human rights violators. What did the Brazilian military dictatorship, Ferdinand Marcos, Gen. Pinochet, the PRI government in Mexico, and the Suharto regime have in common?

They were all governments or heads of governments that were designated by the World Bank as "countries of concentration"—that is, countries to which the flow of Bank resources was greater than to other countries of similar

*Walden Bello is the Executive Director of Focus on the Global South
walden@focusweb.org , waldenbello@hotmail.com

size and income.

Over the last 30 years, over $30 billion in World Bank funds found its way to the Suharto dictatorship. According to several reports, including a World Bank internal report in 1999, the Bank tolerated corruption, accorded factual status to false government statistics, legitimized the dictatorship by passing it off as a model for other countries, and was complacent about the state of human rights and the economy. This happened under your watch, Mr. Wolfensohn, and the people of Indonesia will never forgive the Bank.

Myth No. 2: The IMF and the World Bank are concerned with the degradation of the environment.

Fact: Again and again, studies of the impact of IMF-World Bank structural adjustment programs have shown that, by institutionalizing stagnation and high poverty levels, they have been among the biggest contributors to environmental degradation in developing countries. In my country, the Philippines, for instance, so deep was the crisis triggered in the mid-1980's by structural adjustment in both the countryside and the cities that the population flow shifted away from the cities to open access forests, watersheds, and artisanal fisheries, severely destabilizing them in the process. Studies show that by the early nineties, the top 15 Third World debtors—all of which were subjected to structural adjustment—had tripled the rate of the exploitation of their forests since the late 1970s, a phenomenon that was undoubtedly caused by the adjustment program' s pushing countries to rapidly increase their export earnings to pay off the foreign debt.

It is not sensitivity to the environment that is demonstrated by Mr. Wolfensohn and the World Bank management's unyielding support for the Chad-Cameroon Pipeline, which will seriously damage ecologically sensitive rainforests like Cameroon's Atlantic Littoral Forest. It is not concern for the environment that was revealed by the World Bank's violation of its own rules on environmental assessment, involuntary resettlement, indigenous peoples, and environmental assessment in its failed attempt to push through the China Western Poverty Project that would have transformed an arid ecosystem supporting Tibetan and Mongolian sheepherders into land for settled agriculture for Chinese migrants.

A look at the Bank's loan portfolio would reveal the reality behind the rhetoric: loans for the environment as a total of the Bank's total loan portfolio declined from 3.6 per cent in FY 1994 to 1.02 per cent in 1998; funds allocated to environmental projects declined by 32.7 per cent between 1998 and 1999; and more than half of all lending by the World Bank's private sector divisions in 1998 was for environmentally harmful projects like mining, roads, and power.

Indeed, so marginalized is the Bank's environmental staff within the bureaucracy that Herman Daly, the distinguished ecological economist, left the Bank staff because he felt he and other in-house environmentalists were having very little impact on Bank policy.

Myth No. 3: The Fund and the Bank are dedicated to combating poverty.

Fact: The opposite is true: the IMF and the Bank are central to creating poverty.

Structural adjustment programs imposed on over 90 developing and transition economies in the last 20 years have institutionalized economic stagnation, increased poverty, and exacerbated inequality in these areas. A recent World Bank study, in fact, admits that poverty worsened in the 1990's in Eastern Europe, Subsaharan Africa, Latin America and the Caribbean, and South Asia-all regions which have come under the sway of World Bank-IMF adjustment programs. Indeed, so bad was the record of adjustment programs that the IMF renamed the Extended Structural Adjustment Facility (ESAF) the Poverty Reduction and Growth Facility during the World Bank-IMF meeting in September 1999. So devoid of success was the structural adjustment approach that Larry Summers, the US Treasury Secretary, who, as chief economist of the Bank in the early 1990's, was a partisan of adjusment, admitted to the US Congress last year that it was time to shelve the "IMF-centered" macroeconomic approach because it just was not working.

Recently, the IMF has been busy creating poverty in East Asia. There is now a consensus that the harsh program of high interest rates and budget cutbacks imposed by the Fund turned an economic crisis into a full-blown recession that saw negative growth rates in Thailand, Indonesia, and South Korea accompanied by a sharp rise in unemployment and the poverty rate. At least 1 million people fell into poverty in Thailand and 21 million in Indonesia. In Korea, the trend of declining poverty rates between 1975 and 1995 was sharply reversed in 1998, and the recession led to a suicide rate in 1998 that was 59.4 higher than in 1997.

As for the World Bank, the truth about Mr. Wolfensohn's crusade to end global poverty was revealed by the findings of the bipartisan Meltzer Commission mandated by the US Congress to look at the record of the Bretton Woods institutions: 70 per cent of the Bank's non-grant lending is concentrated in 11 countries, with 145 other member countries left to scramble for the remaining 30 per cent; 80 per cent of the Bank's resources are devoted not to the poorest developing countries but to the better off countries that have positive credit ratings and can raise their funds in private capital markets; the failure rate of Bank projects is 65-70 per cent in the poorest countries and 55-60 per cent in all developing countries.

So why does the Bank continue to pontificate about going about its "noble mission" to end poverty? Because it has learned from Joseph Goebbels that a lie repeated often enough eventually attains the status of truth.

Myth No. 4. The Fund and the World Bank are actively soliciting the help of civil society.

The truth is that the World Bank and IMF are mainly interested in using civil society to legitimize their unchanged approaches via consultations that are really monologues. The Bank and the Fund are more interested in splitting civil society opposition to their projects, and they do this by branding some civil society groups as "reasonable NGO's" and their more militant critics as "unreasonable NGO's" interested only in "closing down discussion." Certainly, dialogue with NGO's was not the intent of Mr.Wolfensohn when he avoided debate on the merits and demerits of the Chad Cameroon Pipeline in favor of a strategy of name-calling by branding opponents of the project as the "Berkeley Mafia."

Let me end by addressing the question: Are the Fund and the Bank capable of reform? I think we will know the answer from Mr. Kohler and Mr. Wolfensohn's answers to the following questions:

- Mr. Kohler, do you propose to give greater decision making power in the IMF Board to the developing countries? Will you do this by diluting the voting power of the United States and the European Union countries that now dominate the board?

- Mr. Kohler, will you propose ending the medieval and non-transparent practice of the IMF always being headed by a European?

- Mr. Wolfensohn, will you advocate doing away with the equally medieval and non-transparent tradition of always having an American head the World Bank? I would like to remind the audience that had Mr. Wolfensohn not given up his Australian citizenship to become an American, he would never have become head of the Bank.

- Mr. Wolfensohn, why did you not stand by your chief economist Joe Stiglitz and allow that powerful voice of reform to be pushed out of his staff position and later from his advisory role by influential conservative forces both within and without the Bank?

- Mr. Wolfensohn, what about Ravi Kanbur, who headed the World Development Report Project? Why did you not stand by this advocate of reform and allow the conservative forces in the Bank to stonewall him and leave him no other option but resignation?

So far, what we have been told here today is that Mr. Wolfensohn feels good about going to work everyday and that Mr. Kohler also has a heart. This frothy stuff is not the response that we in civil society are looking for today. We want hard answers to hard questions. Please.

Micro Credit equals Micro Debt

*By Chanida Chanyapate Bamford**

One of the outcomes of the economic crisis in Thailand has been a closer public scrutiny of the issue of who should have the right to be bailed out by public funds. It has become apparent that apart from losing the 500 billion Baht in loans that were extended to ailing financial firms, the government now stands to lose another 1-2 trillion Baht after closing down 56 firms and becoming responsible for the liquidation of their assets and liabilities. All because a law had been passed by the previous government that provides a 100% state guarantee for all depositors.

Among the most vocal protestors of this process of nationalization of private debt (which is running along side an IMF-promoted policy of privatization of state assets) are the 5 million farming households who are indebted to the state-owned Bank for Agriculture and Agricultural Cooperatives (BAAC) to the tune of 400 billion Baht. With the decline of all major agricultural produce prices to levels below production costs this year and the current extensive damage of farmland by floods which will effect the prospects for next year's harvest, their voices are becoming louder. They are asking the government why they are expected to shoulder the losses themselves and still pay back their BAAC loans promptly when the circumstances of the losses, as anyone can see, are beyond their control. The injustice seems plain.

The general public perception is, as stated by the BAAC, that "the agricultural sector has not been very sensitive to the impact of the economic crisis; on the other hand, it has helped absorb the impact on other sectors to a certain degree." However, "there are constraints in the structure of production and productivity, that is farmers are engaged in only a few varieties of crops without much change, with lower productivity levels than other countries."[1]

A local BAAC official boasted that while customers of commercial banks were going bankrupt, BAAC customers still survived the economic crisis because they are mainly small debtors. The figures provided by BAAC on non-performing loans (NPLs) confirm this. BAAC NPLs total only 15-16% of the loan portfolio, compared with an average of 30-40% for commercial banks, even though this represents an increase of 60% when compared to the years before the crisis.

A 'Debt-Bonding' Process

The same official reported that in his sub-district, where most farmers are engaged in growing baby corn on contract for export, the average BAAC loan per household was 60,000 Baht. It is well known that 20 Baht out of every 100 Baht loan is used for purposes other than agricultural production, but officials have good relationships with the customers and are conciliatory toward their needs. Overdue loans account for only 6.8% of the total, which implies that growing baby corn is still viable even with lower prices. In another sub-district where farmers try everything such as garlic and white, red and green onions, the overdue rate is higher at 14%.[2]

The sub-district chief, however, told a different

* Chanida Chanyapate Bamford is a Senior Associate at Focus on the Global South
c.bamford@focusweb.org

story. At the time when the BAAC loan is due, most farmers do not have the cash to pay back. The usual practice is to take another loan at a higher amount so that they can pay back the old loan principal plus the 12% interest and still have some cash left to spend, particularly to cover the expenses of sending their children to school. He noted the danger in such increasing indebtedness, but said that families with children of schooling age do not have much choice. Another village chief in the same sub-district, though, pointed to the current proliferation of washing machines in people's homes after televisions and refrigerators as an example of increasing consumption which is accompanying increasing indebtedness.[3]

In fact, the usual practice reported by farmers is to take a loan from local loan sharks at 5-10% per month interest rate to pay back their BAAC debts when they become due in March of every year. They then wait a couple of months to get new loans from BAAC for the next planting season. This is then used to pay back the loan sharks. This, of course, makes it even less likely that the BAAC loan will be used to improve productivity.

Apart from the fact that BAAC's interest rates are usually slightly lower than commercial banks' rates, and much lower than the going local informal rates, farmers want to keep on its good side because of the condition that a new loan will not be given unless the old one is paid back. More importantly, a good customer can get a larger loan every time he pays back promptly. This probably explains why a survey carried out by two academic institutes in 1998 and 1999 found that 75% and 80% of BAAC customers believe their household conditions have improved since their joining BAAC loan schemes.[4]

A local BAAC official was asked whether he thought there was a chance farmers could get out of debt. "Being in debt is a natural thing, you can get out of it when you die," he answered. This is because the BAAC has ensured that debtors become members of funeral clubs, thus effectively making debtors insure their BAAC loans. When the debtor dies, family members receive a lump sum of money. This is intended to cover not just the funeral costs, but the outstanding BAAC debt as well.

Worrying Trends

A study by the Office of Agricultural Economics, Ministry of Agriculture and Cooperatives, clearly shows the trend of debt accumulation among farming households. During the 30 year period from the first to the sixth National Economic and Social Development Plans (1961-1991), the average amount of debt per farming household increased 10 times, just about the same level as the increase of net income per household. The debt increase, however, continues at a higher rate of 40-60% a year from 1991-1999, while available figures from the same source show that the average net income from agriculture per household actually decreased by 6% between 1992-1997.[5]

The study looked into the impact of the economic crisis on the farmers' capacity to service their debt by comparing the average assets and liabilities per household between the 1995/96 and 1998/99 farming seasons. This study found that the ratio of agricultural assets to liabilities decreased by 47% within 2 years, which is in line with the impact on other sectors of production. This is based on the fact that while household assets decreased by about 20% during this period, the amount of debt increased by 50%. The Office of Agricultural Economics expressed a warning that if this trend continues, the agricultural sector will face insolvency like businesses in other sectors. They were concerned that this will have a long-term impact on the country's agricultural productivity because "unpayable accumulated debt is a barrier to productivity improvement as the opportunity to seek new resources to improve productivity for this sector is limited".[6]

Another worrying trend is the increase in the reliance on informal creditors. Before the crisis, statistics showed that 91% of farmers' loans are from formal institutions; in fact, reducing farmers' dependence on loan sharks was one of the achievements claimed by the Bank for Agriculture and Agricultural Cooperatives. After the crisis, however, the proportion of informal sector debt rose to 17% of the total debt.[7]

A Bank is a Bank

In the context of these worrying trends, however, the Bank of Agriculture and Agricultural Cooperatives seems to be changing its conciliatory practice towards their clients. At the local level, one official reported that they have been receiving orders to ensure their lending adheres more strictly to rules and regulations and to resort to legal action when necessary. Many farmers who gathered at a recent seminar on public debt and farmers' debt, while joking about how they jumped every time a visitor appeared at their doors, were apparently under a great deal of stress. One woman, a single mother, narrated how she was hounded by BAAC officials to pay 15,000 Baht which was a part of a group guarantee for one member who had defaulted while she herself had trouble paying back her own 10,000 Baht loan. One man took a 10-year loan contract to replace cassava with a rubber plantation and managed to pay back 200,000 Baht so far. But his loan principal of 400,000 Baht had accrued another 430,000 Baht in interest; with lower rubber prices, his prospects of clearing his debt burden were indeed dim. What made him rather bitter about this situation was that the cassava replacement scheme was funded by a grant from the European Union, which the BAAC turned into interest-bearing loans. Thus, farmers alone are responsible for the risks involved while the BAAC reaps all the benefits in the form of interest.

The BAAC has certainly been a successful bank throughout its 33 years of operation. It was able to utilize low-interest (less than 1%) loans from the Japanese government to build up its capital and turned into a full-fledged bank currently with 60% of capital coming from customers' deposits. Its 600 branches are housed in modern buildings and a work force of 13,000 strong have become the epitome of prospering capitalist institutions in the rural landscape to many of its debtors.

From a theoretical perspective, higher levels of farmer indebtedness point to a higher level of investment in agricultural production, which should be 'a good thing'. Many businesses go into debt to expand; progressive, commercial agricultural production would fall into the same pattern. Agricultural credit has been the government's instrument to stimulate adoption of new technology which, according to plans, should increase yields and, therefore, raise farmers' income from the sale of products. From the business point of view, the ratio of farmers' assets to liabilities, at 20.86 in 1998/99 cultivation year, is not problematic; in fact, an academic confirms that it still shows a fairly high level of financial security according to accepted standards.

At the policy level, BAAC announced expansion in 1999 of its credit line "in support of the government's policies of accelerating economic recovery through increasing the productivity of the agricultural sector, reducing unemployment in the rural areas, including credit extension to the non-farm sector, in order to increase the income of the farming households" while at the same time maintaining "appropriate levels of financial stability, liquidity and profit margins". Its vision is to transform itself into a "Green Bank", whatever that means.[8]

The Real Costs of Credit

A large proportion of BAAC loans were one component of agricultural extension packages for particular new crops and technology that the government wanted to promote and experiment with. In these cases, loans were often given, not in cash but in inputs (seeds, fertilizer and insecticide), although repayment always had to be in cash. However the majority of these extension projects failed in the 3 decades of such agricultural credit policies. Only through farmers' concerted and continued pressure on the government to recognize its responsibility for the failures did it seriously consider writing off the 10 billion Baht debt for projects as cashew nuts, sericulture, bamboo shoots and beef and dairy cattle. This, however, has not stopped the government from building BAAC loans into extension projects, most recently into projects funded by a 600 million dollar loan from the Asian Development Bank, that was negotiated as part of the restructuring process after the 1997 economic collapse. There are reasons to believe that the government is effectively transforming its ADB loan into farmer debt.

In terms of farmers' income from agricultural production for which credit has been extended, there seems to be no report available on any follow-up or assessment of the direct effect of credit policies on debtors' agricultural income. It is granted that a bank is not normally required to monitor their customers' earnings as long as the loans are being repaid. But apart from macro-level statistics showing a decline in average net income from agriculture from even before the crisis, the growing number of protests against falling prices of produce this year testifies to the desperate position of the majority of farmers. It is common sense that to be able to pay back debt, farmers have to earn a profit at least equal to the interest that they have to pay on their investment, which means 9-12% for most farmers. Some agronomists doubt that soil fertility levels in the poorer parts of the country could ever achieve this, even under the best of conditions, and current newspaper reports indicate that farmers are operating at a loss in all major crops: rice, corn, rubber, sugarcane and cassava. With the economy still stagnant after the recession, non-farm income, which used to see farmers through the year of borrowings and repayments, has shrunk by as much as 20% according to some estimates. This removes a rural cashflow 'cushion' and exacerbates the debt problem.

In this economy, farmers have virtually no control over market prices, either for inputs or their produce. What they produce, however, has been very much influenced by government policy, which has consistently promoted cash crops, many targeted at the export market. These crops typically require higher levels of input than traditional subsistence crops, increasing the farmers' need for credit to finance each production cycle. Once enmeshed in the debt net, it is extremely difficult for farmers to extricate themselves. One bad harvest, or collapse in crop prices, can produce a debt crisis.

What is worse that over the long-term, the high-input agriculture promoted by government policies reveals long-term environmental problems. Repeated application of pesticides increases the likelihood of pest resistance, leading to even greater use of pesticides and/or crop losses, i.e. higher costs and/or lower income. Artificial fertilizer (often provided in lieu of cash as part of a BAAC loan) can often reduce long-term soil fertility. Agriculture in many parts of the country is approaching an environmental crisis.

Many farmers therefore have expressed an interest in moving towards low-input agriculture, based on indigenous crops, self-reliant systems of pest control, soil fertility conservation and water conservation, and production primarily for home consumption rather than for the market. The means for achieving this in the major agro-ecological conditions in Thailand are now fairly well known, the result of work by 'guru' farmers and NGOs, rather than by government agencies.

However, many farmers find that their existing debt is an insurmountable barrier to conversion to sustainable, low-input, or organic farming systems, which at the beginning cannot guarantee them sufficient cash income to repay their debt. Ironically, by linking credit to misguided extension projects, by giving credit in the form of artificial fertilizers and pesticides, and by promoting agriculture that is almost exclusively oriented to production for the cash economy, the Thai government, through the BAAC, has been the major architect of the current crisis in the rural economy and environment.

The one thing that the government-conceived rural credit system has been without doubt most successful is the total integration of rural households' production and consumption patterns into the market-oriented cash economy. The least the government could do is to repair the damages is to allow those enlightened farmers to start anew a life without debt and provide appropriate support for truly sustainable agricultural systems to take root and grow.

Endnotes

[1] Bank for Agriculture and Agricultural Cooperatives. "Farmers Assistance Measures of the Ministry of Finance through the BAAC Systems", a background paper circulated at the Seminar on the Solutions for Public Debt and Farmers' Debt, organized by the Thai NGO Coordinating Committee on Development (NGO-COD) at Credit Union League of Thailand, Bangkok, 19-20 September, 2000.

[2] Ranee Hassarungsee. "Field Study Report: the Impact of the Economic Crisis on Villagers", Focus on the Global South, Bangkok, September 2000, p.2

[3] Ibid, p.3

[4] Bank for Agriculture and Agricultural Cooperatives. "Results of Surveys of BAAC Customers' Economic Status", a one page handout distributed at the Seminar on the Solutions for Public and Farmers' Debt, 19-20 September 2000.

[5] Office of Agricultural Economics. "Table 1: Summary of Cash Income and Expenses of Farming Households", a faxed message upon request.

[6] Office of Agricultural Economics. "Agricultural Credit and Farmers' Debt Situations", a background paper for a seminar entitled 'Who is looking after farmers' debt?' organized by the Agronomists' Association of Thailand and the Ministry of Agriculture and cooperatives, held at Central Grand Plaza Hotel, Bangkok, on 7 September, 2000.

[7] The informal credit system appears to be somewhat independent of the mainstream system. In the aftermath of the 1997 credit, formal sector interest rates at first rose sharply, in line with IMF recommendations. When this credit squeeze was shown to be aggravating the effects of the crisis, this IMF prescription was relaxed and market forces came back into play. By this time, demand for formal credit was very low and banks, already carrying large NPLs, were reluctant to lend at all. Liquidity rose and interest rates plummeted to levels lower than before the crisis. In the rural informal sector, where local variations can be very large, interest rates did not seem to vary much. So while interest rates in the formal economy are at historically low levels, the informal sector can still charge monthly rates that, when compounded, easily reach 100% per annum.

[8] Bank for Agriculture and Agricultural Cooperatives. Business Report: Balance Sheet and Statement of Incomes and Expenditures for the Period of 1 April 1998 - 1 March 1999, BAAC, Bangkok,

Balancing the Power of Money

*By Menno Salverda***

We know that we can not always express ' value' in terms of money; some activities or objects could be valued higher and some lower than the 'price' they bear. Nevertheless, our decision making processes with impacts on our economic and social lives, are rooted almost solely in the monetary sphere.

According to the 1998 United Nations Human Development Report, the income disparity between the top 20 and the bottom 20 percent of the world's population is now 150 to 1, double what it was 30 years ago. The 225 richest individuals on this planet, have a combined wealth equal to the annual income of half of humanity[1]. Income inequality of Thailand is one of the highest in the world[2], whilst Indonesia faces rising income inequalities since the onset of the crisis.[3]

The national debt has, in many countries, exceeded what countries earn in the real economy, making it virtually impossible to repay those debts. The debt problem is not just prominent on a macro level; In Thailand, 4.7 out of the 5.7 million farming families in the country face long life cycles of debt[4].

Goods are transported enormous distances before they reach us as consumers. Britain for example will this year export 111 million litres of milk and 47 million kilograms of butter, while simultaneously importing 173 million of litres of milk and 49 million kilograms of butter[5]. Why? We have arranged our pricing system such that this makes economic sense.

The role that money plays in causing these problems cannot be underestimated. This article claims that reducing the power of money, is required to reverse the trend of alienation from the social and cultural settings in which our economic production takes place and to re-adjust the allocation mechanisms in order for resources to be distributed more fairly . Too often, we simply accept the current monetary system as a given - an immutable fact of nature. In fact, the monetary system is a fallible human creation. This article will look into some of the economic alternatives currently at practice. 'Islamic Banking', 'demurrage' or, the enactment of a tax on money, and Community Currency Systems, will allow us to re-examine what function money can and should play. But before this discussion, let's start by taking a closer look at some traditional characteristics of money.

Credit and Interest Rates

Credit functions as a way to allocate financial resources to those in need of capital ...money. At the same time we are led to believe that credit is not something which should be given for free. Hence, interest rates!

But why can credit not be free? Economists claim that interest rates are justified because of the 'time preference of money'. This is a difficult term for a theory which tells us that people who are willing to give up consumption today by saving money, should be compensated for this (temporary lack of money) so they can consume tomorrow.

With positive interest rates people with money

---

* This paper has been produced as a follow up to the seminar "The Financial Crisis; Alternatives in Action" held in Bandung, Indonesia, September, 19-24, 1999, organised by Arena (Hong Kong), Akatiga (Bandung) and Selendang Lila (Jakarta). The writing of the article is based on 2 years work experience in Thailand with NGOs and People's Organisations, seeking alternatives to the current monetary system.

* Menno Salverda is a member of the Thai Community Currency Systems Project (TCCS), a joint initiative of the Japan Foundation Asia Centre (JFAC), the Local Development Institute (LDI), Focus on the Global South, CUSO and VSO. For more information about community currencies, or the project, contact tccs@loxinfo.co.th, or visit http:\\ccdev.lets.net\.

can *make* money without doing anything for it in return. People in need of credit, and the poorer parts of the population always are, borrow money provided by creditors. In order to repay this money *plus* an interest rate payment, borrowers obviously have to work. If their harvest is destroyed by a rainstorm or trampled by an elephant—risk factors in real life— they have to work even harder. The rules of the game do not change of course-the debt only increases with time, so repay your debt or lose your land (collateral). Ubon Uwaa, an NGO leader in Northeastern Thailand, pointed out that the 'cheap' loans to farmers, through a government agricultural bank, with double digit interest rates, are unrealistic compared to the physical capacity of the climate, soil quality and suitable crops and inputs that are available to the farmers to repay the loan and interest[6]. Creditors do *not* face the risk of a harvest loss, or have to pay the cost of depreciation of machines (rust), stored seed (mildew), etc. Creditors protect themselves from risk by reserving the power to deny a loan to a farmer who is not 'creditworthy'. With interest rates, money keeps its value and the creditor can sit back, relax and wait until the most profitable borrower walks in. The borrower does not have this same luxury; the rains are coming, the seeds need to be bought, and the buffaloes need fodder to gain enough strength to pull the plough. Remember, with a time preference of money there is an incentive to sell all your goods and stocks, you do not need immediately; after all, it is better to have money which you can put on a bank where it makes money, rather than to be stuck with goods, which *reduce* in value. More likely however, the farmer will have sold his/her goods already directly after harvest, in order to pay off debt (also termed ' distress sale' or 'forced commerce')[7]. The same NGO leader I referred to above, said that loan repayment schedules exceed income and expenditures of a farming unit. In effect, once a farmer goes into debt, he never comes out.

Box 1: Local Savings Groups in Southern Thailand

Some popular local savings groups in Southern Thailand aim to increase the welfare of their communities through reducing the reliance on the mainstream banking system. They charge very high interest rates on money lent to their members (interest rates higher than the mainstream banks!). The profits from these interest payments are used to create welfare funds, to which all members of the savings group (borrowers and savers) have equal access. True, this is a much better arrangement than borrowing from a mainstream bank, as profits paid in the form of interest are kept within the community.

But there are some other consequences. First of all, with a pre-fixed interest rate, it is the borrower and not the saver carrying the risks of production. The borrower is after all not sure about the productivity of the money invested, while the amount of money to be repaid is pre-fixed. The interest rates being very high, they create even a bigger burden to the borrower. True, interest rates are a method to connect savings with investments as well as to create welfare funds, but not clear is why the burden of making these 'community merits' should be with the borrower and not the saver. Regulations, like limitations to the amount saved per member, would mitigate the increase of income inequality the levying of high interest rates could generate between borrowers and savers.

Another important effect of the levying of artificial high interest rates, is, that it implies that money needs to come from outside the community. This results in households focusing on selling goods and services for the outside market. Apart from being increasingly dependent on the outside market on which community members have no control, this will also lead to unsustainable production methods.

This article claims there are ways of connecting savings and investments more fairly and sustainably, for example through sharing profits instead of using interest rates .

One of the questions we should ask ourselves is the following. Why should people without any money be happy to pay interest to the people with money who lend it? Let's turn this rationale on its head. *Why don't the lenders pay the borrowers a fee for using the money,*

because, without any borrowers, what would they do with their money?

Creating Money without Value

With money we buy goods and services. As such, money represents a 'claim' or 'demand' on the real economy. If we claim too much, the real economy can not cope with the pressure; it causes prices to increase or it leads to undervaluation of environmental or social capital. A balance is required between the real economy and the money economy, through which the claims are generated. We have seen that the levying of an interest rate is one factor causing the balance to be disturbed. But, it is not the only factor.

Since 1971, when the gold standard was abandoned, money has been created by fiat; it is not backed by anything material. Governments create money by issuing bonds. These are claims on the real economy; claims on taxpayers of the current and of the future generation. Often, debt figures of countries have exceeded the total annual income of the real economy in those countries[8].

The money creation process (read 'debt-creating process') is propelled through fractional reserve banking, practised by commercial banks. Through this mechanism, commercial banks are required to keep a certain percentage of deposits as reserves. With a fractional reserve requirement of 10 percent, commercial banks can issue 10 dollars in loans for every dollar deposit. These loans are then used to purchase goods and services, winding up as a deposit in another bank. Then the process starts all over again[9]. In this way, most of the money we see in our pockets, or in our bankbooks, was created by commercial banks as debt — not covered by gold or any other real resource or real value base. Its value is dependent on the trust people put in it. Nobody knows why people still do. Inevitably these increasing debts have to be serviced at some point — by the real sector! This requires the real economy to grow faster and faster, inevitably at the expense of our stock of social, cultural and physical capital[11].

The madness of the monetary system is further illustrated by the fact that worldwide, for every $1 circulating in the productive economy, $20 to $50 circulates in the economy of 'pure finance'- though no one knows the ratios for sure[10]. The bidding of assets is another way of creating money without value: "As this growth [of money flows] occurs, the financial or buying power of those who control the newly created money expands, compared with other members of society who are creating value, but whose real and relative compensation is declining"[12]. The Asian crisis of 1997, was created by a decade of excessive monetary inflows. The crash came with the realisation that the real economy could not possibly cope with this growth. Fingers were pointed at crony capitalists and foreign speculators, but not at a global money creation system, which drives this cycle of boom and bust[13].

Profits

Farms or any kind of business under the pressure of repaying debt, focus on activities which expedite profits[14]. Profits which arise out of these kind of activities may often be made at the expense of the environment and social / cultural relationships. Cassava and eucalyptus trees are not popular because they are highly valued. On the contrary, they cause soil depletion. They are popular because they make money. Factors such as soil quality can not easily be quantified and are, therefore, externalised from the resource allocation equations of the money system.

Social relationships and cultural factors underlie many of our economic activities: like helping your old neighbour on the farm with weeding, or donating rice to the temple for the support of the poor. In mainstream thought, the time devoted to these activities is considered as money 'lost', and is, therefore, a threat to the capacity to repay debt. This implies that it is the cultural factors that *prevent* businesses making profit, or, in other words, *the existing social system with its cultural factors should abide by the rules of money!* (See also box 2)

Box 2: Urban Poor Women in Cicadas, Bandung, Indonesia[15].

During my stay in Bandung, I was fortunate to visit a group of women, who live in the slum area of Cicadas. Akatiga, one of the NGO hosts in Bandung of the seminar I attended, studied the impact of the crisis on poor urban women in this area. Traditionally women manage the household and are responsible for the daily sustenance of the family. Men are responsible for the monetary expenses, which they earned in the textile factory. These traditional 'male' jobs have disappeared and only some, find, occasionally, work as a driver on a bicycle taxi, a *becak*. With no money income, women were forced to seek additional income from 'female' (low-paid) jobs such as laundry, cooking, nursing, delivery services or opening a store. Women's obligations as homemakers are not considered as 'work', and are therefore not valued. Other than, loss of (men's) income and increased pressure on women's labour, a hike in prices of basic needs (i.e. rice 300 %) has further increased the burden on women.

Some women's groups have started informal mutual credit arrangements to help each other. This has increased a sense of community among its members. One homemaker mentioned to me that she does not charge her neighbour any interest; she knew that some day she would need some money herself. In another neighbourhood, some community members, in desperate search for money, have become gambling agents, causing enormous amounts of money to leave the community.

Since the monetary system does not factor social work into the economic decision-making process, the search for money is to the detriment of the social well-being of women. It has gone so far as to cause individuals to exploit their fellow community members through gambling schemes. The informal credit schemes, set up by women, are a way to reduce the dependency on the market over which community members have no control.

In this paper we do not judge social and cultural norms in a community. However, the morality of the profit-making business is fairly clear. Dependent on making money, it induces greed and undermines the values of externalities.
What we need to do is to create another form of money which reduces our dependency on the national currency. A money which supports a more equitable allocation of resources, a money which does not determine our social relationships, a money which is used to represent values instead of prices. So, how do we create this *new money*?
In fact, we should be clear on one thing, which is, *we do not need money*! What we do need is the goods and services, for consumption or for working capital or even investment. The most important function of money is as a tool which allows us to procure those goods and services, what economists call the function of medium of exchange.

Interest free money

Money, designed to act as a medium of exchange, should be interest free. As pointed out above, borrowers and creditors are interdependent and a new framework should incorporate this realisation.

Islamic Banking

Islamic Banking is based on religious principles, one of the central tenets of which is that interest payments are a form of usury and are therefore, a sin. In allocating savings to investments, instead of using interest rates, Islamic banks work with the profit-and-loss-sharing principle. If there is a profit, lender and borrower benefit; if the harvest is destroyed, the lender and the borrower both share this loss. Thus Islamic Banking is a monetary system with the clear advantage that the risks (like harvest loss due to a storm) in the real economy are not entirely borne by the borrowers.

There are two more advantages of Islamic Banking[16]. First, resources will be distributed more efficiently as the funds will go to where expected profits will be highest; not to the most creditworthy. Second, the money creation is in line with productivity levels in the real economy and therefore makes the system more stable.

Despite the advantages of risk-sharing over interest-based systems, Islamic Banking is not

widely practised. It faces the difficulty of operating in an interest-based financial environment. In this environment, individuals would be able to cheat the system and not report their full profits to the bank. If the bank discovers this and refuses them further funds, the fund seeker does not risk being put out of business; they can still go back to the interest-based banks.

Furthermore, entrepreneurs with very promising projects might choose interest-based loans that would leave them a larger percentage of profits as compared to risk-sharing. In contrast, those who are less sure about the profitability of their ventures would prefer profit-sharing, as it would, at the least, relieve them of the obligation of paying a fixed return on the funds obtained. This would result in lower profits for Islamic banks than would be possible in a purely profit-sharing environment[17].

Linking the financial economy with the real economy, through interest free lending and sharing risks, encourages the creation of real wealth over purely monetary wealth. Nevertheless, it can be argued that while focusing on sharing profits, the system still does not allow for environmental and social factors to be incorporated in making economic decisions. Thus a small farmer, might not have access to Islamic funds as her expected profits are lower than the farmer in a next door village where soils are of better quality.

The lender-borrower relationship in Islamic banking has a parallel in CSA (Community Supported Agriculture). CSA is a marketing system where producers and consumers *share the risks* of production. As both consumers and producers are aware of their interdependence, just like borrowers and lenders in the Islamic banking system, consumers make advance payments of working capital to the producer and they see their investments repaid in agricultural output throughout the growing season.

Demurrage

Alternative money systems attempt to re-link the money economy to the real economy. Silvio Gesell, a money reformer who formulated his " natural economic order" in 1890, claims that as money is a public good, it should be accessible to anyone in need and must not be hoarded. A fee on money ('demurrage', or a sort of negative interest rate) is levied and is justified by the argument that if money represents goods, it should depreciate in value just as fast as goods do; money should "rust"[18]. Creditors should face the same risks as producers. If money ' rusts', creditors will be forced to make financial resources available to the ones in a position to use it. As a consequence, a demurrage charge increases the rate of circulation. Suddenly the ' time preference of money' has been turned upside down; *money becomes worth less over time and the real economy gains in importance*. In a demurrage economy, making money, is not the main priority of the economic actors, and neither is making profits, at least not necessarily in the short term. Money functions as a medium of exchange and as a means to invest, where profits can be reaped at a future date. As such, individuals have greater opportunity, to value social exchanges.

Community Currency Systems

Community Currency Systems (CCS) are mutual credit-creating systems, specifically designed for local communities. Members of the system create their own money, which they use to exchange locally available goods and services with each other. Trade with the outside takes place in national currency.

HOURS-based community currencies employ a piece of paper ('notes' or 'coupons') as the medium of exchange, while LETS (Local Employment and Trading System) use credits and debits in an account ledger, with no physical representation of the currency. The value of these currencies is determined by members of the community. Variously, the value has been tied to the national currency; equated to an hour of labour; or allowed to determine itself through members' exchanges.

It is estimated that worldwide there are over 2000 LETS-type community currency systems, where total number of members varies from as small as 20 to over 2000. Trade in these systems still happens mainly in the services

sector, although many also have small businesses participating. Currently about 100 ' note'-type systems operate in North America. In the HOURS system in Ithaca New York, monthly trade volume is estimated at 6,000 HOURS (60,000 US$) between 1,500-2,000 people[19]. In Third World countries, systems have started in Mexico[20], Argentina, Paraguay and Senegal.

As in the case of Islamic Banking, CCS are interest-free, credit-creating systems. Some systems charge demurrage. Community currency practitioners claim that community currencies fulfill the two most essential functions of money[21]. They provide

- a standard of measure, to compare the value of goods and services, and
- a medium of exchange, to facilitate the exchange of goods and services.

In a CCS, community currency is created when community members exchange goods and services with each other. This money can not be spent outside the community and it will thus circulate within the community, creating more economic activity through the multiplier effect.

The accounts of sellers and buyers increase or decrease by the value of the goods and services traded; no more community currency is created or is needed to realise this trade. In this way, the system relinks the real economy with the financial economy[22].

Apart from creating this stability, CCS also has the advantage of allowing goods and services to be given a value independent of the price set by the outside market. This can include social obligations, as in the case of the household managers in Cicadas (see box 2), or valuing local education in indigenous knowledge, as planned in Yasothon (see box 3). Admittedly, it remains very difficult to fully quantify such activities, but it is easier to value externalities within a community then to try to internalise them using a macro economic model (due apologies to environmental economists, who, instead of reducing the power of money, try to appreciate the value of environmental and social concerns!).

It must be noted that community currency systems are backed by the resources within the community, including the labour of its members and the trust, members have in each other. Luis Lopezllera, an experienced NGO worker and CCS practitioner in Mexico, mentioned that the objective of CCS should be: "to teach people the forgotten values of the social and cultural ingredients of our lives, now predominantly undermined by poisoned money!"[23].

In this respect, we can learn a great deal from indigenous exchange systems, like reciprocal labour systems, which were based in a gift economy. Reciprocity does not mean to borrow money and to go into debt; rather, it means a complex web of social relationships between members of a community (and sometimes outside) to exchange goods and services, based on mutual benefit, responsibility and interdependence. There was no money and no time preference involved. (Note: philosophically we can probably still speak of money whose value is determined by the gift economy.) It should be noted that in a gift economy investments do not easily take place as the connection between savings and investments is not really established. Should a community choose to investment in a local business, the required capital may be mobilised through a profit-sharing arrangement.

Conclusion

The power of money is responsible for income inequality, social degradation and the destruction of the environment. The excessive power of money expresses itself through interest rates, the creation of money by banks as debt and the inability to incorporate externalities and real risks in the economic decision making processes through which resources are allocated.

Interest based money increases in value, transferring all the risks from money makers (creditors) to producers (who are also borrowers). Governments and bankers are responsible for creating enormous amounts of money, as debts. These debts function as claims on the real economy, and hence put pressure on people to repay those claims, in taxes; often

Box 3: Community Currency Systems in Thailand

The financial crisis of 1997 has started discussions in Thailand about the real benefits of the boom of the decade before the crisis and on alternative paths of development which would prevent such a crisis from happening again. NGOs and People's Organisations in Thailand have shown an increasing interest in Community Currency Systems (CCS). The TCCS project has, for the last two years, explored ways to implement a CCS in Thailand.

After having attended a seminar about CCS, some villagers from Yasothon province in the Northeast of Thailand, have decided to learn more about how the system works and to try to set up such a system. A small group of villagers have taken up the task to prepare the implementation and generate enough interest amongst the 495 households, spread over 5 villages, which have been designated as a pilot community. The members of the 5 villages, have strong geographical, economic, social and cultural links. In the future it would be possible to incorporate another 4 villages nearby, if they so wish.

Community workers are working with villagers to prepare the launch of a 'hybrid system' early in 2000. A hybrid system is a combination of a LETS and a 'notes' based system. It works as follows: those who want to become members of the CCS, go to the community bank, where they can open an account. They can withdraw community currency, interest free, from this account. The money will be in the form of a note called 'Bia', named after a sea shell used as currency before the introduction of metal coins. These notes will carry pictures of culturally and socially significant events designed by local school children, symbolising the fact that this money does not carry just a monetary value. By withdrawing 'Bia', money has been created which can then be used with whomever wants to accept it. It should be noted that the 'Bia' can be spent by villagers who are not members of the system (who do not have an account), however, it can not be spent outside the community. It is unlikely that somebody who lives outside the community, would actually accept the 'Bia' unless she is a regular visitor.

The CCS organisers, believe that community members will be able to rely on 'Bia' for their exchange of local goods and services, thereby reducing national currency expenses and dependency on credit. Furthermore, the 'Bia' will circulate within the community, creating more economic activity, as opposed to the national currency which leaves the community very quickly in its search for higher profits. In effect the use of 'Bia' stops the leaking of resources from the community. If villagers choose to increase their use of 'Bia', an incentive will have been created to support local economic activities. This would make investments in, for example, herbal production and indigenous knowledge more likely.

It should be stressed that the CCS organisers do not seek to isolate the pilot villages from the outer world. CCS are a tool to increase bargaining power in trade relations with other markets by first strengthening the local economic base. One might suggest that a CCS could be undermined by free-riders (cheaters), but experience so far has shown that social controls prevent this from happening. Nevertheless to prevent problems in the initial phases the organisers have decided that a credit limit be imposed on the amount members can withdraw from their accounts. By turning this argument on its head, a strong case can be made that the co-operation and trust which the process of establishing a CCS engenders is vital to the accumulation of social capital.

there is no choice but to jeopardise social obligations, such as looking after your children, and sell national resources, such as tropical forests. Trillions of dollars move around global markets every day; most of it (over 98 %) as speculative money in the currency and stock markets, not in the markets where you buy your food. The size of the money economy has no relationship with the real economy or anything of value. Reducing the power of money would allow us to re-assess what we value and base our activities on those values.

Islamic Banking bases its monetary system on sharing risks in the real economy between debtors and creditors. Those profits generated by investors using Islamic funds in the real economy are shared. Thus, the growth of the money economy is linked to the profitability of real activities, rather than a fixed interest rate and ever-increasing debt. However, it is not clear whether such systems are able to

incorporate externalities into the allocation of financial resources or whether the pressure to produce profits remains higher than compared to the ability of the real economy to satisfy those same demands.

The second alternative discussed was demurrage. Not so much a system, demurrage is a theoretical tool to be incorporated into a more equitable monetary system. Charging a fee on money causes money to lose its value over time, forcing users to invest in the real economy rather than in the monetary economy. Those in possession of funds with no inventive idea how to use it will be more likely to invest it with someone who does not have money, but needs it to invest in some kind of economic activity.

Community Currency Systems have the potential to create interest-free mutual credit, based on an understanding of interdependency and mutual responsibility between community members, creditors and debtors, consumers and producers. Apart from creating only as much money as the real economy requires, CCS allow an independent assessment of values. In other words, CCS have the potential to incorporate externalities.

CCS is different from the other alternatives, in that it has the potential to work independently from the pressures of the global market. A community does not have to wait for the money creators to change their course against their self-interest, and reform the monetary market. Communities can start a system right now. Although in essence political, since a CCS may change the position of the actors in the economic landscape, the practise of the system does not necessitate confrontation with policy makers. Remember that it is not the objective of CCS to replace the national currency. Rather an attempt is made to increase self-reliance thereby increasing bargaining power in relations with other actors. As such they are seeds planted, of which the benefits can be used by other communities, monetary reform campaigners and development workers.

Endnotes:

[1] Tony Clarke, "It's the Economy Stupid, Twilight of the Corporation", *The Ecologist*, Vol. 29, No 2, May/June 1999. p. 158.

[2] The Gini co-efficient for Thailand was 0.46 in 1998, see National Economic and Social Development Board (NESDB), "Indicators of well-being and policy analyses". A Newsletter of NESDB. Volume 3, Number 1, January 1999.

[3] The Gini co-efficient for Indonesia, was 0.36 in 1997,see ILO/ UNDP(1998), "Employment Challenges of the Indonesian Economic Crisis". Quoted in International Labour Organisation (ILO) , "Indonesia's Crisis and Recovery: The Myths and Reality", Occasional Discussion Paper Series No.1. ILO Jakarta. (Internet)

[4] Prapas Pintobtang. Quoted in Subhatra Bhumiprabhas, " Farmers Sow, Owners Reap", *Bangkok Post*, Sept 15, 1999. P. C1.

[5] Helena Norberg-Hodge, "Reclaiming Our Foood: Reclaiming Our Future", *The Ecologist*, Vol. 29, No 3, March/April 1999.

[6] Ubon Uwaa, (in personal conversation) , April 1999.

[7] Cynthia H. De Alcantara, "Introduction: Markets in Principle and Practise", *In Real Markets, Social & Political Issues of Food Policy Reform*, ed. Cynthia H. De Alcantara (Frank Cass & Co. Ltd. 1993). pp. 1-16.

[8] The Japanese government issued bonds to finance grandiose infrastructure projects, in order to spur the sluggish economy. As a result the national debt last year exceeded annual GDP. Taxpayers will have to foot the bill for the government bonds. Quoted in Chester Dawson, "Pork-Barrel Express", *Far Eastern Economic Review*. November 11, 1999. Pp. 42-44.

[9] For a more detailed description on the madness of banking practises see Jeff Powell, "The History of Banking", *In Community Currency Systems*, ed. Local Development Institute (LDI), 1998 (in Thai).

[10] In the US, the national debt has continued to increase at a rate of $211 million per day since November 30, 1998! Total debt in the US stands now at over 5 trillion dollars, which is a little more than US $22,000 per person, In Bureau of the Public Debt, (Internet: http://www.publicdebt.treas.gov/opd/opd.htm). The average GDP in the US was less than US $27,000 per person in 1997, In World Development Report 1997. (Internet: http//uts.cc.utexas.edu/-gwk/courses/grg3lq/resources/GDP.html).

[11] Joel Kurtzman, quoted in David C. Korten, *When Corporations Rule the World*, (Kumarian Press, Inc. 1995).

[12] David C. Korten, *When Corporations Rule the World*, (Kumarian Press, Inc. 1995).

[13] For a complete analyses on the roots of the crisis, see Walden Bello, "Addicted to Capital. The ten year high and present-day withdrawal trauma of Southeast Asia's economies", *Focus Papers*. (Focus on the Global South. Bangkok, 1997)

[14] Furthermore businesses are strongly motivated to make profits quickly because money today is worth more than money tomorrow (again the time preference of money).

[15] From conversations with community members and In, Akatiga, "Poor Urban Women as Household Managers- a field study", (March 1999).

[16] Muhammad Nejatullah Siddiqi, "Islamic Banking: Theories and Practise", In ed. Mohammed Ariff, *Islamic Banking: Islam and the economic development of Southeast Asia*, (Institute of Southeast Asian Studies, Singapore. 1988)

[17] For this reason, most Islamic banks and some Islamic groups in the South of Thailand practise lending and leasing, with a pre-determined repayment rate. Instead of calling them interest rates, they are called service charges.

[18] Silvio Gesell, "The Natural Economic Order". (Translated from the German edition by Philip Pye, Neo-verlag, 1929.)

[19] Jeff Powell and Menno Salverda, "A Snapshot of Community Currency Systems in Europe and North America", (Internet: http:\\ccdev.lets.net 1998).

[20] For a description of the Mexican system, see Jeff Powell, "A Fair Exchange", *Bangkok Post*, Sept. 16, 1999.

[21] Bernard Lietaer, "Community Currencies: A New Tool for the 21st Century". (Internet).

[22] An HOURS-based system is strictly speaking not a credit-creating system. The notes are issued by the central administration, which needs to ensure, through market research, that the money supply keeps tread with the real trade happening. Credit can be created through conditional loans.

[23] Through personal conversation. March, 1999.