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IMF-Led Austerity: Implications for Troubled Borrowers

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An Intelligence Assessment

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IMF-Led Austerity: Implications for Troubled Borrowers

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An Intelligence Assessment

This assessment was prepared by Office of Global Issues, with contributions from the DDI regional offices. It was coordinated with the National Intelligence Council. Comments and queries are welcome and may be directed to the Chief, International Finance Branch, OGI,

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IMF-Led Austerity: Implications for Troubled Borrowers

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Key Judgments

Information available as of 25 April 1983 was used in this report.

We believe that many of the rescue packages coordinated by the International Monetary Fund (IMF) for major debtor countries are in trouble. These programs have thus far enabled a number of countries—notably Mexico, Brazil, and Argentina—to avoid default and to obtain breathing room for economic adjustment. However, we are concerned that:

- Economic recovery in Organization for Economic Cooperation and Development (OECD) countries will not be rapid enough to support programed growth in less developed country (LDC) exports.
- Growing social and political instability in the financially troubled countries will lead governments to backslide on domestic austerity measures.
- Banker confidence in the stability of financially troubled LDCs will wane, jeopardizing lending commitments as well as precluding new loans that may become necessary.

We believe these concerns will remain valid for the next two to three years and are particularly doubtful about LDC governments' willingness and ability to stick with austerity in the face of declining living standards.

Several of the major debtors are already having difficulty implementing policies and meeting performance criteria agreed to with the IMF. Specifically, government leaders within key LDC debtors are under strong political pressure to abandon IMF-mandated restrictions on wage increases and reductions in price controls and subsidies. Violent protests against austerity measures have already erupted in Brazil, Argentina, Chile, Peru, Ecuador, and Bolivia; we expect more and possibly better organized antigovernment activity in the next few months. In Mexico, although most interest groups remain quiet, organized labor appears increasingly restless and is calling for an advanced wage hike and rent controls. Intense hostility from major interest groups could threaten serious disorder in Brazil, Mexico, and Argentina.

We do not know how the IMF and commercial banks will respond to countries' failure to meet performance criteria. One possibility is that disbursement of funds will be halted, in which case new large bridging loans will be needed to avoid default until new agreements and targets can be negotiated. We believe, however, that the Fund will allow a fair amount of flexibility in judging adherence to performance criteria and that the banks will follow the Fund's lead in determining whether disbursements should be interrupted. We doubt, however, that bankers will be receptive to any new funding requests that may be involved in the renegotiation of agreements, especially if official creditors are unwilling to share the burden.

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If funds are curtailed, debtors would almost certainly turn to Washington for direct assistance, help in renegotiating bank and IMF loans, and new debt- rescheduling efforts. If such efforts fail, troubled debtors will have to turn inward and intensify their efforts to adjust as best they can to a lack of foreign exchange. Without the ability to finance imports, troubled debtors would have to impose even more austere import restrictions which would slow the recovery of the United States and other industrial nations by reducing export markets. If access to IMF and bank credit is substantially reduced, debtors will have little choice but to move unilaterally to relieve financial strains. Several of the major debtors have already suspended payments on portions of their debt, and public speculation is growing in US and Brazilian financial circles that instead of seeking additional loans the Figueiredo government will soon declare a payments moratorium.

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Table 1
Major IMF Standby and Extended Arrangements, as of March 1983 [a]

Million US $ [b]

Country	Date of Arrangement	Expiration Date	Amount of Agreement	Amount Available, 1983	Other IMF Disbursements, 1983 [c]	Total IMF Financing, 1983	1983 New Medium-Term Bank Loans Tied to IMF Arrangements
Standby arrangements							
Argentina	Jan 1983	Apr 1984	1,650	990	572	1,562	1,500
Chile	Jan 1983	Jan 1985	550	253	325	610	1,400 [d]
Costa Rica	Dec 1982	Dec 1983	101	81	0	81	0
Hungary	Dec 1982	Jan 1984	523	366	0	366	0
Morocco	Apr 1982	Apr 1983	309	93	0	93 [e]	0
Philippines	Feb 1983	Feb 1984	347	347	207	554	0
Romania	Jun 1981	Jun 1984	1,213	404	0	404	0
Sudan	Feb 1983	Feb 1984	187	187	43	230	0
Thailand	Nov 1982	Dec 1983	298	256	0	256	0
Turkey	Jun 1980	Jun 1983	1,375	209	0	209	0
Yugoslavia	Jan 1981	Jan 1984	1,828	609	0	609	600 [d]
Arrangements under the extended fund facility							
Brazil	Feb 1983	Feb 1986	4,663	1,372	779	2,171	4,400
Dominican Republic	Jan 1983	Jan 1986	408	140	51	91	0
India	Nov 1981	Nov 1984	5,500	1,980	0	1,980	0
Ivory Coast	Feb 1981	Feb 1984	533	170	0	170	0
Jamaica	Apr 1981	Apr 1984	525	157	0	157	0
Mexico	Jan 1983	Dec 1985	3,752	1,103	221	1,324	5,000
Pakistan	Dec 1981	Nov 1983	1,011	521	0	521	0
Peru	Jun 1982	Jun 1985	715	275	0	275	900 [d]

[a] Other LDCs with current upper credit arrangements in which loan disbursements are contingent upon meeting targets contained in a mutually agreed upon adjustment program include Barbados, El Salvador, The Gambia, Guinea, Haiti, Honduras, Liberia, Madagascar, Malawi, Mali, Panama, Senegal, Somalia, South Africa, Togo, Uganda, and Uruguay. Bangladesh, Bolivia, Venezuela, Ecuador, Zambia, and Zimbabwe are negotiating arrangements.
[b] SDRs converted at rate of 1 SDR = $1.1.
[c] Includes compensatory financing for export shortfalls and drawings under the first credit tranche that have been disbursed as of 15 March.
[d] Currently under negotiation with banks.
[e] Projected: Morocco is likely to begin negotiations soon and obtain another standby arrangement.

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IMF-Led Austerity: Implications for Troubled Borrowers

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Introduction

The rescue programs coordinated by the IMF have so far averted international financial collapse. More than 40 LDCs and East European countries with a combined medium- and long-term debt of close to $475 billion have, or are negotiating, IMF financing agreements (table 1). These programs have enabled such countries as Mexico, Brazil, and Argentina to forestall default and obtain some breathing room for making needed economic adjustments. Financial disbursements under the IMF programs are made quarterly and are contingent upon meeting quantitative performance criteria, which usually govern international reserves, domestic bank credit, and government budget deficits. In addition, the borrower must agree not to introduce new restrictions on trade and payments or new multiple exchange rate practices and, if possible, also agree to eliminate existing restrictions.

In negotiating agreements with the major debtors beginning in late 1982, the IMF successfully coerced major bank creditors to extend new medium-term loans this year. Again, however, disbursements of these loans are contingent upon compliance with IMF performance criteria. In some instances, such as in Brazil and Yugoslavia, the IMF is also asking that banks maintain minimum levels of short-term credit during the year. For Mexico and Brazil, commercial bank credit associated with the IMF agreements amounts to several times the value of IMF lending commitments. In the case of Mexico, the ratio of commercial bank to IMF lending this year is almost 4 to 1. For Brazil the ratio is 2 to 1. Currently, the banks are committed to lending $12-14 billion to troubled debtors this year, while the IMF is to provide $7 billion.

IMF Targets

The IMF has established demanding domestic and international economic performance criteria in exchange for its financial support. To gauge the economic and political repercussions of trying to meet these criteria and associated targets, we have evaluated IMF programs for 14 high-debt countries. This group includes the largest debtors—Mexico, Brazil, Argentina, and Chile (table 2). Taken together, the 14 have an external medium- and long-term debt of $270 billion, with scheduled debt repayments last year of an estimated $40 billion. We chose the countries because of the size of their debt and the availability of data on their recent economic record. In addition, their programs are representative of those formulated for other members needing balance-of-payments support.[1]

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International Targets

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Most of these troubled borrowers must meet an overall balance-of-payments criterion as measured by the change in net international reserves (table 3). To meet this reserve requirement, the programs specify current account targets as well as projected capital inflows. Taken together, IMF targets for the 14 countries we examined imply that their overall current account deficit this year will be held to $24

[1] The countries are Mexico, Brazil, Argentina, Yugoslavia, Chile, Philippines, Peru, Pakistan, Morocco, Romania, Thailand, Sudan, Ivory Coast, and Costa Rica. Besides constituting over two-fifths of LDC and East European debt, of which US banks hold about 25 percent, these 14 countries account for nearly one-fourth of OECD exports to and one-sixth of OECD imports from LDCs and Eastern Europe; 10 to 15 percent of total US trade; and excluding Yugoslavia and Romania, some 55 percent of non-OPEC LDC national output. Of the 14 countries, Thailand currently appears to be the most creditworthy; we believe it will have no problem servicing its debt this year.

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IMF Lending Programs

IMF loans are intended to help members redress payments deficits and facilitate economic adjustment toward a more sustainable balance-of-payments position without resorting to trade or payments restrictions deemed harmful to national and international prosperity. In cases where a deficit is judged to be temporary and caused by circumstances beyond the member's control, limited borrowing is available subject to few or no conditions. These low-conditionality loans include the reserve tranche (equal to the excess of a member's quota over its currency holdings in the Fund's General Resources Account), compensatory financing for shortfalls in primary commodity exports, and loans for member contributions to approved buffer stocks.

Members with severe payments problems and desiring larger amounts of funds must negotiate an acceptable stabilization program outlining economic targets and policies to be pursued for the restoration of internal and external balance. Generally, standby arrangements involve one-year adjustment programs designed to correct deficits caused by price distortions and excess demand. The basic prescription is upward adjustment of local prices and interest rates, reduced subsidies and bank credit, and devaluation of domestic currency. Extended arrangements usually involve three-year adjustment programs that attempt to deal with protracted price distortions and a deeply entrenched misallocation of resources, which require structural changes in addition to pricing incentives. Extended arrangements often call for major institutional reforms, shifts in investment spending, and performance-oriented tax incentives.

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Specific performance criteria are monitored quarterly and must be met for the member to draw installments of the loan during the program period. Quantitative performance criteria govern macroeconomic variables such as international reserves, the volume of external borrowing, the public-sector deficit, and credit expansion within the economy. Qualitative criteria involve commitments to avoid the introduction or intensification of trade or exchange restrictions. To provide internal consistency and the specific steps a member should take to meet performance criteria, the programs also outline policy understandings concerning exchange rates, fiscal reform, price and interest rate adjustments, incomes policy, and institutional reform and specify related microeconomic targets. Although no explicit sanctions are attached to failure to implement a policy understanding, the Fund usually takes an uncharitable view of any breach of performance criteria in such cases.

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billion, compared with almost $35 billion in 1982. The improvement reflects export volume increases of about 7 percent and export price rises in dollar terms of about 5 percent. An advocate of expanded world trade, the Fund does not require import restrictions. Current account objectives, however, imply that the group will reduce total import costs by about 2 percent this year. This implies a volume change of close to 5 percent, on top of the estimated 17-percent decline registered last year. Interest charges and other service payments in the IMF programs are generally consistent with these trade targets and current international interest rates of 9.5 to 10 percent.

The IMF is calling for the largest current account turnaround to occur in Brazil. Specifically, the Brazilian current account deficit is projected to fall by half, dropping from $14.5 billion in 1982 to $7 billion in 1983. The improvement, according to the IMF, would reflect a $3 billion reduction in imports, a $2 billion gain in exports, and sizable savings in interest and other service accounts. The Mexican program calls for a $4 billion current account deficit, compared to a recently revised figure of $3 billion for 1982. Despite the reductions in oil prices since the targets were set,

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Table 2
Major LDC and East European Debtors, 1982 [a]

Billion US $

	Total External Debt	Medium- and Long-Term Debt	Estimated Short-Term Debt	Estimated Bank Debt [b]	Debt Due and Not Paid [c]	Debt Service Ratio [d] (*percent*)
Brazil	88.0	70.0	18.0	59.0	0	70
Mexico	84.3	59.6	24.7	64.0	12.0	54
Argentina	39.1	29.1	10.0	26.0	7.0	101
South Korea	35.8	23.0	12.8	20.0	0	14
Venezuela	33.0	19.0	14.0	27.0	0	25
Poland	24.0	23.5	0.5	14.0	4.4	80
Indonesia	23.0	20.0	3.0	9.0	0	10
India	22.0	21.0	1.0	1.6		8
Chile	19.3	15.3	4.0	16.0	0	64
Turkey	19.0	16.5	2.5	4.0	0	25
Yugoslavia	18.3	16.5	1.8	8.9	0.5	25
Egypt	18.0	15.5	2.5	5.5	0	23
Algeria	18.0	17.0	1.0	8.0	0	25
Philippines	17.2	13.0	4.2	11.0	0.1	27
Morocco	13.8	11.0	2.8	7.5	0	33
Nigeria	12.0	8.0	4.0	7.0	3.0	16
Taiwan	12.0	8.0	4.0	6.5	0	NA
Peru	11.6	8.6	3.0	6.0	0	44
Thailand	11.4	9.5	1.9	6.0	0	18
Pakistan	11.3	10.3	1.0	0.9	0	27
Romania	10.0	9.0	1.0	4.5	0.4	26
Malaysia	9.5	8.0	1.5	5.5	0	6
Sudan	7.8	7.8	NA	2.2	2.2	60
Hungary	7.8	5.9	1.9	6.5	0	37
Ecuador	6.8	4.3	2.5	4.8	0.2	45
Ivory Coast	6.5	6.5	NA	5.0	0	32
Costa Rica	3.1	2.5	0.6	1.1	1.2	47

[a] Countries shown in italic had IMF adjustment programs as of 31 March 1983.
[b] Owed to Western banks.
[c] Includes short-term debt and interest.
[d] Ratio of medium- and long-term principal repayments and total interest payments to exports of goods and services. Includes IMF repayments.

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The Interest Rate Issue

We believe the IMF program assumptions of an average 1983 interest rate of 10 percent on short-term commercial debt and 13 percent on long-term commercial debt for nonoil LDCs are appropriate. Most economic forecasters are predicting LIBOR rates of 9.5 to 10 percent this year; the higher long-term rate takes into account the high lending spreads for the larger debtors and the substantial front-end fees being charged for reschedulings and new loans. Overall, about 50 percent of nonoil LDC debt has been negotiated at variable rates and would be affected by a decline in interest rates. For the larger debtors the ratio is higher, reaching 70 to 75 percent for Brazil and Mexico according to our calculations. A 1-percentage point decline in LIBOR rates would mean savings of $600 million for Brazil and $700 million for Mexico. Such savings would not be realized immediately, however, since generally there is a three- to six-month lag until the new rates affect actual debt service.

the deficit is projected to hold at this level largely because of declines in imports and interest rates. Both Brazil and Mexico must improve last year's overall balance of payments by more than $7 billion. Table 4 shows the trade, current account, and overall balance-of-payments targets used by the IMF, compared with actual country performance in 1982.

A critical variable in the IMF programs is the amount of funds available to the debtors. In addition to current account deficits, the 14 debtors owe $32.5 billion on medium- and long-term debt this year. In addition Mexico, Argentina, Yugoslavia, Sudan, Romania, and Costa Rica must settle a total of $21.3 billion in arrearages, and Mexico must add $2 billion to reserves by yearend to satisfy IMF performance criteria. Altogether, the IMF programs assume that these 14 LDCs will be able to obtain about $80 billion in financial assistance excluding short-term credit (table 5):

- About two-fifths of these needs apparently will be met by medium- and long-term loans. New commercial bank loans to Brazil, Mexico, Argentina, Yugoslavia, Peru, Thailand, and Morocco appear to account for roughly one-fifth of total financing with the balance to be provided by governments and multilateral institutions other than IMF.
- Rescheduling of medium- and long-term debt obligations in 1983 meets almost 40 percent of financing requirements.
- Net private inflows of direct investment provide close to 4 percent.
- Reserve drawdowns of $2.8 billion and IMF gross disbursements of $8.9 billion fill the remaining 15-percent gap.

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Domestic Targets

The domestic performance criteria and targets contained in the IMF programs are stringent (tables 6 and 7). In almost all cases government operating expenditures are to be slashed through employment freezes and wage cuts as well as through the consolidation and elimination of public-sector agencies. Prices of subsidized goods (including food, fuel, and industrial and agricultural raw materials) and tariffs on public services (including electricity and transportation) are to be substantially increased. Public-sector investment will be curtailed except in Thailand, where a meager 1-percent real increase is allowed, and in Argentina, where a 7-percent real increase over very low levels last year is programed for the petroleum sector and labor-intensive projects with low import content. Public revenues are to be boosted through higher income taxes (Mexico, Brazil, and Thailand), higher luxury and new retail taxes (Mexico, Philippines, Peru, Thailand, and Yugoslavia), import surcharges (Chile, Peru, Thailand, and Philippines), export taxes (Brazil,[2] and Argentina), and the strengthening of tax administration in all countries.

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All countries must meet performance criteria governing limits on credit extension by either the commercial banking system or the central bank. Sublimits have been established on net credit to the public

[2] These taxes are slated to be removed before yearend.

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Table 3
Quantitative Performance Criteria for 1983 Under Selected IMF Adjustment Programs [a]

	Change in Net International Reserves	Foreign Borrowing by Public Sector [b]	Reduction in External Arrears	Net Domestic Assets of Banking System [c]	Net Domestic Assets of Central Bank [c]	Net Credit to Public Sector [c]	Overall Public-Sector Deficit [c]	Total Public-Sector Financing Deficit [c]	Other
	Million US $			*Annual percent change*			*Percent of GDP*		
Mexico	2,000 (−5,500)	5,000	600		18 (99)	133 (348)	−8.5 (−16.5)		
Brazil	0 [d]	6,000 [d]			66			−2.5	Monthly depreciation of cruzeiro vis-a-vis US dollar to match domestic rate of inflation.
Argentina	−500 (−5,500)	2,000 [e]			170			−8.0 (−14.2)	
Chile	−500 (1,650)	2,050 [f]			33 (114)			−1.7 (−4.0)	Unification of foreign exchange system by yearend 1983.
Yugoslavia		1,500 [g]		11.7 (15.5)		0	13% limit on expenditure growth		Must meet a monthly real effective exchange rate target.
Philippines		1,600		16.4 (26.8)		32.2 (96)			
Peru	−100 (100)	NA			NA			−3.8 (−6.6)	
Thailand		1,500		18.2 (21.2)		20.6 (14.2)			
Romania	800 (600)	900 [h]		73 (2.9)					Must meet trade surplus target of $1.6 billion.
Sudan		0 [i]		26 [j]		8.8 [j]			"Flexible" administration of price and profit margins, minimum land and water charges, progress on debt rescheduling.
Costa Rica	0 (−0.9)	100 [k]	No new arrears		4 (85.6)	15.2 (36.3)			

[a] Most of these criteria have quarterly limits against which performance will be evaluated. Criteria are evaluated at the end of March, June, September, and December for most countries. This table depicts only limits expected to be observed over the course of 1983. Last year's data, where available, are given in parentheses.
[b] For Mexico, Brazil, and Argentina, these borrowing limits apply to all maturities. For Romania, loans with maturities of one to five years are limited to $500 million and short-term loans to $400 million. For the remaining countries, the limits apply to loans with maturities of one to 10 or one to 12 years.
[c] Although the program set these limits in terms of domestic currency, we have converted those figures into annual percentage changes and percentage of GDP for easier comparison.
[d] Excludes disbursements of loans to refinance short-term bridge loans obtained in 1982, and any reduction in short-term liabilities of monetary authorities resulting from such loans will not be considered for purposes of the net reserve target.
[e] Excludes $1.1 billion short-term loan and $1.5 billion medium-term bank loan arranged in coordination with IMF funding. Subceilings on maturity structure are imposed to ensure that no more than $500 million will fall due within three years of standby expiration date.
[f] Excludes borrowing by Central Bank, Banco del Estados, and SINAP.
[g] Excludes borrowing by National Bank of Yugoslavia or under National Bank guarantee.
[h] Excludes credits obtained to refinance $370 million in suppliers' debt.
[i] Nonconcessional loans. Does not apply to new loans that may result from refinancing of debt.
[j] Annual change from June 1982–June 1983. These criteria will be evaluated in July.
[k] Excludes loans related to debt rescheduling.

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Table 4
Selected Countries: 1983 IMF External Targets, Compared With 1982 Data

Billion US $

	Exports f.o.b.		Imports f.o.b		Current Account Balance		Overall Balance of Payments	
	1983	1982	1983	1982	1983	1982	1983	1982
Mexico	23.7	21.0	15.2	14.4	−4.2	−2.7	2.0	−5.5
Brazil	22.2	20.2	16.1	19.4	−7.0	−14.5	0	−7.5
Argentina	9.5	8.1	5.6	4.8	−1.0	−2.2	−0.5	−5.5
Chile	4.5	3.8	3.5	3.7	−1.6	−2.5	−0.5	−1.1
Yugoslavia [a]	6.3	5.9	7.9	8.8	−0.5	−1.4	0.2	−1.6
Philippines	5.5	5.0	7.9	7.8	−2.5	−3.4	−0.6	−1.2
Morocco	2.4	2.4	3.7	3.6	−1.5	−1.8	NA	−0.5
Peru	3.5	3.2	3.2	3.5	−0.9	−1.4	−0.1	0.1
Thailand	8.1	7.2	9.6	8.4	−2.0	−1.5	−0.4	−0.4
Pakistan [b]	3.0	2.6	6.6	6.0	−1.3	−1.3	−0.2	−0.3
Romania [a]	6.6	6.2	5.0	4.7	0.8	0.7	0	0.8
Ivory Coast	2.7	2.5	1.8	1.9	−1.1	−1.2	0	−0.3
Costa Rica	1.1	0.9	0.8	0.9	−0.3	−0.4	0	−0.1
Sudan	0.7	0.5	1.8	1.8	−0.7	−1.0	−0.8	0
Total	**99.8**	**89.5**	**88.7**	**89.7**	**−23.8**	**−34.6**	**−0.9**	**−23.1**

[a] Convertible currency.
[b] Fiscal years beginning June of stated year.

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sector. Expansion of private credit is to be curtailed in all countries except Chile and Thailand; and in Argentina any private investment will have to be financed by repatriation of private funds abroad. In Yugoslavia, the IMF is requiring a 30-percent decline in interenterprise trade credits. Restrictions on both private and public bank credit translate into reduced gross domestic investment and higher unemployment. In fact, total investment is projected to decline by 1 to 2 percentage points of gross domestic product (GDP) in most country programs. Peru and Yugoslavia expect a much sharper decline of close to 10 percent over last year. Chile's program originally allowed for a marginal increase spurred by increased private-sector outlays. This, however, appears in jeopardy, given continued financial uncertainty in the aftermath of nationalization of major banks and large outflows of private capital.

Achieving the Targets

To achieve the domestic and international trade and financial targets set in the IMF programs would require that all the parts fit together perfectly. Specifically, it would require:

- Rapid economic recovery in OECD countries to support programed growth in LDC exports.
- Enough social and political stability in the financially troubled countries to implement the domestic austerity programs and stem capital flight.
- Sufficient bank confidence in the economic and political stability of financially troubled countries to permit large new medium-term loans and the maintenance of short-term credit lines.

We do not believe these results can be counted on to materialize.

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Table 5
Foreign Exchange Requirements of Selected Countries, 1983 [a]

	Brazil	Mexico	Argentina	Chile	Yugoslavia	Philippines	Peru
Current account balance	−7.0	−4.2	−1.0	−1.6	−0.5	−2.5	−0.9
Debt repayments							
Longer term maturities	7.1	7.5	6.5	1.7	2.5	1.1	1.2
Shorter term maturities	13.0	16.7	12.0	4.0	1.8	4.2	3.0
Arrears [d]	0	10.0	7.0	0	0.5	NEGL	0
Gross foreign exchange needs	27.1	38.4	26.5	7.3	5.3	7.8	5.1
Financed by:							
Direct investment	1.5	0.8	NEGL	0.5	NEGL	0.2	0.1
Medium- and long-term credit	8.7	9.3	3.7	2.6	2.2	2.8	2.0
Official and suppliers' credits	2.1	3.0	0.6	0.8	1.0	1.1	0.8
IMF	2.2	1.3	1.6	0.6	0.6	0.5	0.3
Commercial bank loans	4.4	5.0	1.5	1.2	0.6	1.2	0.9
Short-term credit	12.9	7.8	6.6	3.7	1.8	4.2	2.9
Bridge operations	2.3	0	1.6	0	0	0	0
Short-term rollovers	9.6	6.8	5.0	3.7	1.8	4.2	2.9
Short-term borrowings	1.0	1.0	NEGL	NEGL	NEGL	NEGL	NEGL
Debt rescheduled	4.0	22.5	15.7	0	1.9	0	0
Change in reserves	0 [e]	2.0 [e]	−0.5 [e]	0.5 [e]	0.6	−0.6	−0.1 [e]
	Pakistan [b]	**Morocco** [c]	**Romania**	**Thailand**	**Sudan**	**Ivory Coast**	**Costa Rica**
Current account balance	−1.3	−1.5	0.8	−2.0	−0.7	−1.1	−0.3
Debt repayments							
Longer term maturities	0.5	0.9	1.3	1.0	−0.5	0.5	0.2
Short term maturities	1.0	2.8	1.0	2.0	NA	NA	NEGL
Arrears [d]	0	NEGL	0.4	0	2.2	NEGL	1.2
Gross foreign exchange needs	2.8	5.2	1.9	5.0	3.4	1.6	1.7
Financed by:							
Direct investment	NEGL	0.1	NA	0.2	NA	NA	NA
Medium- and long-term credit	1.8	2.0	1.0	2.4	0.8	1.2	0.4
Official and suppliers' credits	1.5	1.2	0.2	1.3	0.6	1.0	0.3
IMF	0.3	0.3	0.4	0.3	0.2	0.2	0.1
Commercial bank loans	0	0.5	0.4	0.8	0	0	0
Short-term credit	1.0	2.8	1.0	2.0	NA	NA	0
Bridge operations	0	0	0	0	0	0	0
Short-term rollovers	1.0	2.8	1.0	2.0	NA	NA	0
Short-term borrowings	NEGL	NEGL	NEGL	NEGL	NA	NA	NEGL
Debt rescheduled	0	0	0.8	0	2.7	0	1.4
Change in reserves	0	−0.3	0.8 [e]	−0.4	0	−0.4	0 [e]

[a] Compiled from IMF program documents. Items may not add to totals shown because of rounding.
[b] Fiscal year beginning June 1983.
[c] Financing sources are estimated.
[d] Includes short-term debt arrearages and interest in 1982.
[e] IMF performance criterion.

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Table 6
Selected Countries: 1983 IMF Government Budget Targets, Compared With 1982 Data

	Annual Percent Change				Share of GDP			
	Government Revenues		Government Spending		Public-Sector Deficit		Public-Sector Investment	
	1983	1982	1983	1982	1983	1982	1983	1982
Mexico	98.0	67.0	59.0	73.0	−8.5	−16.5	8.6	10.8
Brazil	82.0 [a]	NA	78.0 [a]	NA	−2.5	−4.9	NA [a]	NA
Argentina	23.7	21.6	18.1	19.7	−8.0	−14.0	9.4	8.5
Chile	7.0	−8.3	3.4	5.2	−1.7	−4.0	5.0	5.5
Yugoslavia	24.0	20.0	25.0	17.0	0	−0.1	NA	NA
Philippines	13.9	6.4	0	9.4	−2.4	−4.2	2.7	3.0
Peru	−8.5	−0.5	−6.7	−13.9	−3.8	−6.6	8.3	70.1
Thailand	25.0	2.0	10.2	17.6	−3.5	−5.3	4.1	4.3
Romania	−5.9	−1.0	−6.4	−5.2	2.4 [b]	2.7 [b]	NA	NA
Ivory Coast	13.2	24.6	11.9	18.7	−6.2	−8.9	13.4	15.5
Costa Rica	60.0	70.0	47.0	55.0	−2.3	−3.3	7.5	7.5

[a] Targeted current revenues and expenditures for 335 largest state enterprises.
[b] Romania traditionally runs a public-sector surplus.

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Table 7
Selected Countries: 1983 IMF Macroeconomic Targets, Compared With 1982 Data

	Annual Percent Change						Gross Domestic Investment Share of GDP	
	Real GDP		Consumer Prices		Wage			
	1983	1982	1983	1982	1983	1982	1983	1982
Mexico	0	−0.2	55	92	26 [a]	78 [a]	22.7	23.6
Brazil	−3	0	78	95	78	105	−3.4 [b]	−2.5 [b]
Argentina	5	−4.3	168	215	106	131	19.2	17.1
Chile	4	−12.8	25	19.6	Less than 25	9.3	15.5	15.4
Yugoslavia [d]	−2.5	0.3	30	31	27.5	28.5	28	29
Philippines	2	2.5	11	10.2	[e]	NA	30	30.5
Peru	0.5	1.0	55	63	NA	NA	−10 [b]	NA
Thailand	6	4.9	6	4.8	0	5	25.6	24.1
Romania [f]	3.8	3.2	7.0	17.8	8.1	8.7	30.4	31.4
Ivory Coast	2.6	10.1	9.3 [c]	12.0 [c]	6 [a]	14.1 [a]	21.8	26.4
Costa Rica	0	−5.9	40	100	Less than 40	NA	18.1	16.2

[a] Public sector.
[b] Annual percent change.
[c] GDP deflator.
[d] Gross social product.
[e] Limited to productivity gains.
[f] GNP.

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External Constraints

OECD Business Cycle. IMF export targets established for the 14 countries imply a relatively rapid pace of economic recovery in the major industrial countries. Our economic models suggest that the IMF export targets seem more consistent with a 1983 industrial country growth rate of 3 to 3.5 percent than the 2- to 2.5-percent rate that most forecasters now anticipate. In any event, we believe that it will take longer than usual for the business upturn in industrial countries to feed back on demand for Third World exports.

We would, therefore, expect a delay of six months to a year in LDC export responses to stronger OECD growth. OECD demand for key LDC agricultural exports, such as sugar, are not sensitive to the business cycle in industrial countries. Beyond this, the excess capacity and the inventory overhang for most raw materials sold by LDCs will tend to dampen the price response. In the case of copper, for example, stocks in non-Communist countries still amount to 1.5 million tons, This equals 15 to 20 percent of annual copper consumption by non-Communist countries. This is not to say that the business cycle advantages will materialize slowly for all debtor countries. If past business cycles are a guide, the LDCs providing consumer-oriented manufactured goods will capitalize earlier on Western recovery. South Korea, Hong Kong, Taiwan, and Singapore—countries in relatively healthy financial positions—would be the chief beneficiaries. Mexico and Brazil will also benefit so long as they have access to supplier credit.

The financially troubled group cannot count on any significant increase in sales to Third World markets. Third World markets for Latin American debtors will be particularly constrained because of their heavy dependence on each other and on other financially troubled LDCs for export sales (see figure). Brazil's previous "growth" markets of Nigeria, Mexico, Chile, Argentina, and Poland, which helped increase export earnings to an average 17 percent annually in 1974-81, are currently restricted because of their own payments problems. Brazil, Mexico, Peru, and Argentina accounted for 16 percent of Chile's sales in 1981. We estimate Chilean and Brazilian exports to nonoil LDCs were down by almost 30 percent last year. Countries such as Pakistan, Sudan, and Yugoslavia, which depend on Arab oil producers for 10 to 25 percent of export sales, will have trouble selling in these markets because of revenue shortfalls brought on by the soft oil market.

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Banker Confidence. Banker confidence, a critical ingredient for the success of the major debtors' IMF programs, is fragile.

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they are increasingly concerned that the rescue packages being arranged by governments, the IMF, and the banks are only bandages. They believe that the financial problems of LDCs cannot be cured by short-term stabilization programs, in large part because the social and political costs of the associated austerity measures are too high. In the absence of new measures by Western governments to increase LDC access to financial resources, they foresee many of these countries returning again and again for reschedulings. They are already convinced that Brazil and Mexico will need more debt relief or new credit before the end of the year. With a number of major banks having a large portion of their assets tied up in nonliquid loans to LDCs and their concern about political instability growing, we do not believe they will be receptive to additional requests for funds. Lack of bankers' confidence could undercut a critical IMF assumption—that short-term debt outstanding at yearend 1982 is successfully rolled over or, in the case of Mexico, partially rescheduled.

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Small- and medium-size US and foreign banks, many of which began to lend abroad for the first time in the late 1970s, have already pulled in their horns. As of midyear 1982, smaller US banks accounted for over one-fifth of the lending to Brazil, Mexico, and Argentina. They have nearly all refocused their lending operations on domestic customers. To the extent that they are still involved in foreign lending, it is only because they have been forced to join restructuring programs or are financing overseas trade for firms in their domestic marketing area.

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European bankers consider the financially troubled Latin American countries a US problem and intend to focus their international lending on

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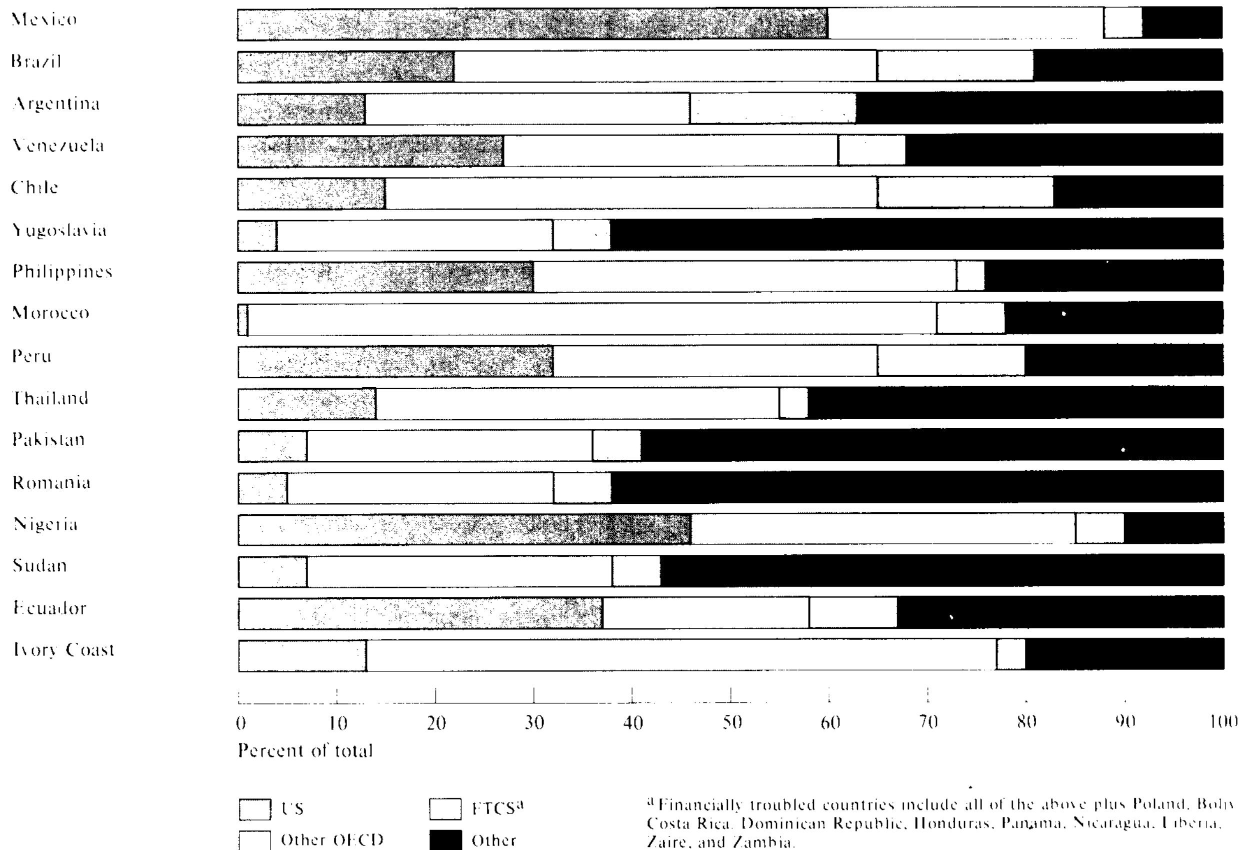
Major LDC Debtors: Direction of Exports, 1981



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their own national export firms and on countries with which they have traditionally close ties. The retreat by foreign and smaller US banks has enormously increased the risks for the major US banks.

The IMF financial programs are vulnerable on another front as well. Specifically, the IMF assumes that large private capital outflows, which badly hurt Mexico, Chile, and Argentina last year, can be held in check by favorable interest and exchange rate policies. If capital flight remains a problem, as it reportedly has in Chile, Brazil, and Mexico, it would seriously disrupt the programs and further undercut Western bankers' confidence in the effectiveness of the present approach. Although exchange rate policies can be helpful in stemming capital flight, we believe that increased risk of political instability in countries such as Brazil and Mexico could give a strong push to these outflows. In Yugoslavia's case, restrictions on withdrawals from private foreign exchange accounts are causing reductions in remittances from workers abroad.

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Domestic Constraints
Implementation of austerity programs has high political and social costs for the ruling governments. While austerity programs usually have a positive effect on a country's external accounts, their short-term impact on the domestic economy is recessionary and inflationary. The IMF programs themselves call for no growth in several of the 14 countries we examined. In fact, we believe that the IMF programs are consistent with real GNP declines of 3 to 5 percent this year for four of the five largest debtors. In most countries real wages will decline, unemployment will rise, and private-sector credit will constrict sharply, if not be eliminated altogether. We believe the risk that politically powerful groups will protest the fall in their living standards is one of the key reasons many LDCs find it difficult to comply with IMF conditions.

In our judgment the major debtors have a less-than-even chance of meeting the tough IMF performance criteria governing bank credit and public-sector deficits:

- Inflationary pressures generated by devaluations and higher prices on subsidized goods will make sharp credit restrictions difficult to control in countries experiencing inflation higher than assumed in their financial packages. Inflation targets are particularly stringent for Mexico, Argentina, and Brazil. In addition, these three will have to rely on domestic credit to a far greater extent than originally anticipated by the IMF because new foreign credits are being used to service interest and short-term debt. We expect new corporate bankruptcies in the Philippines and Mexico, in particular, as a result of tight credit.

- The significant improvement in government revenues expected by the IMF in most programs is not likely to occur this year because of the time lags involved and the pessimistic outlook for economic growth. On the expenditure side, spending by powerful government ministries and public enterprises in Brazil, Mexico, Argentina, and the Philippines will be hard to contain, especially if inflation reduces real-budget allocations. We believe Mexico, for example, is unlikely to fire thousands of employees in order to meet budget limits with unemployment already at 20 to 30 percent. Forced to assist banks, businesses, and farmers with their debts, the Chilean Government is exceeding expenditures as well as credit targets

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Even though governments in the major debtor countries probably will backslide on carrying through austerity measures, we believe the risk of political instability will grow. Widespread anger and frustration with austerity will almost certainly spark periodic strikes, worker demonstrations, and possibly food riots. Protests against austerity measures have already erupted in five countries—Brazil, Mexico, Argentina, Chile, and Peru. Businessmen in Brazil, Mexico, and Chile have generally supported their governments, but they are protesting devaluations and high interest rates and are sending funds abroad. Moreover, the political impact of austerity goes well beyond the 14 countries we examined:

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- Bolivia and Ecuador have experienced more widespread labor disruptions than have occurred elsewhere in South America. Labor leaders in Ecuador staged a three- to four-day general strike in late March to protest the government's devaluation and reported intention to raise prices and interest rates to qualify for IMF assistance.

- In Africa, Zambia's powerful trade union confederation threatened in March to call a nationwide strike if the government refused to discuss demands for the repeal of wage ceilings and the restoration of price controls on essential commodities. The wage restrictions and deregulation of prices were among a series of austerity measures imposed by the government in December and January to meet IMF conditions for a loan.

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The Political Fallout
In *Mexico,* early compromises with organized labor leaders and general acceptance by the business community of the need for austerity should enable the government to remain firmly in control. The rural sector is relatively quiet, and opposition parties remain reluctant to attack government policies directly. However, perceived inequities in public policy or a loss of confidence over the government's management

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of a particular issue could translate into internal security problems. We believe government officials would have little difficulty rationalizing the use of force; de la Madrid appears ready to deal quickly and forcefully with potential disorder to provide an object lesson to dissident elements. He has already warned those planning protests that established procedures must be followed. In the less likely event that the military does not intimidate protesters and crush opposition early, however, the armed forces will encounter serious problems in regaining control should disorders spread.

Mexicans will be more likely to bear the pain if they have confidence that de la Madrid's austerity program will eventually bear fruit. Nevertheless, the chance of sporadic wildcat strikes and antigovernment demonstrations will grow as the sacrifices begin to bite. Sensing a restiveness in their constituency, union leaders are already pushing for an advanced pay hike and rent controls. Victories by dissidents in local union elections this year—particularly among influential unions such as the government-affiliated Confederation of Mexican Workers—would send a clear message to union and national leaders that policy changes were in order.

A series of political blunders by de la Madrid, an unwillingness to take quick action to maintain order, or lack of agreement on what to do, could provoke widespread challenges to the ruling party-government system. Moreover, differences among ruling party leaders over the proper economic strategy could lead to defection of party notables. Labor chief Fidel Velaquez's demise—at his age of 82, a distinct possibility—could throw the labor movement's hierarchy into disarray and deprive the President of crucial union support.

The *Brazilian* Government's austerity policies are drawing widespread domestic criticism and have already triggered the first significant social violence in three years. While we do not expect that effective political resistance will evolve, intense hostility will test the government's ability to cope with political stress. Even before convening, recently elected Congressmen were publicly challenging administration economic policies, including the IMF agreement. In the opening session, opposition leaders intensified their attack, and some government party members threatened to obstruct legislation reducing cost-of-living raises. According to the US Embassy, hundreds of labor leaders packed the galleries to support Congressmen denouncing the proposed changes in wage laws. The Brazilian press has also chastised the government's austerity program. In addition, the Embassy has reported widespread hostility among businessmen to high interest rates and currency devaluation.

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Implementation of the austerity program will be complicated by the fact that for the first time since the 1960s elected officials from the opposition now control the wealthiest and most populous states and the lower house of Congress by a narrow margin. With this greater strength, congressional critics are likely to continue challenging planned austerity measures. Moreover, the popularly elected governors, who will be more sensitive to public opinion than their appointed predecessors, can be expected to lobby against cutbacks in federal spending that benefit their constituencies.

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We expect the government to face more manifestations of social unrest like the violent protests by unemployed workers in Sao Paulo and other cities this month. Wildcat strikes—already frequent—are likely to spread in protest of layoffs of industrial workers and the administration's wage policy. Demonstrations by the middle class could spread to reflect growing political alienation, largely related to discontent with deteriorating economic conditions. Producer protests will likely become more frequent, and some food riots are also possible.

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Argentina's IMF agreement has met stiff popular resistance, and the weak Bignone government has backed away from implementing credit, price, and wage measures as required by the IMF agreement. On 17 March, for example, it went against the IMF agreement by extending price controls and providing interest subsidies to business. Moreover, the government has implemented a costly unemployment compensation program. A variety of reports indicate the ruling junta intends to ask the IMF to renegotiate the

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agreement. To further dissipate dissent, regime officials will also probably replace those responsible for negotiating the IMF agreement.

The regime's tactics have thus far prevented large-scale labor strife. Low-level criticism of its policies is certain to continue, however, and any attempt to reimplement full austerity measures would prompt intense reaction. At a minimum there would be widespread strikes and demonstrations—some of them violent. A worst-case scenario would involve intense pressure on the government from within the military to control the unrest, which could result in escalating violence and continued erosion of the government's authority. Regime leaders, increasingly vulnerable to coup plotting, could be ousted. The military as an institution is divided over implementation of the agreement; hardline nationalists oppose the IMF program, and several have spoken out publicly against appeasing Western banking interests; more moderate elements have demanded that the government take steps to curb inflation and regain control over government spending.

In *Chile*, the poor economic situation is contributing to increased political activism against the Pinochet regime. Demonstrations in late March against Pinochet's economic and political policies drew larger crowds, reflected better organization, and sparked more violence than any opposition activity in recent years. Economic reversals have given the repressed and largely inactive opposition a concrete, exploitable issue. At the same time, we believe they have made the public—including some proregime elements—more receptive to increased political activity. As a result, we expect Pinochet's popular support to decline and hinder his capacity to govern, but we see no threat to his continued rule in the near term. The memory of the chaotic Allende period still grips most Chileans and is thus a strong factor in promoting stability. Moreover, the military continues to back the President, and, as the US Embassy reports, the opposition still lacks any clear concept of how to deal with this phenomenon.

For the *Philippines* the greatest danger, in our judgment, is a private-sector financial crisis, which we believe Manila cannot gauge precisely. Corporate bankruptcies and new requests to the government for financial assistance during the next year could grow beyond Manila's financial management capacity. In our judgment, there is ample reason to fear this prospect, given the poor state of the government budget and the fact that the technocrats are already having difficulty coping with the private sector's limited present difficulties.

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Marcos's political agenda could be decisive in determining the timing and extent of actions Manila will take to avert more serious financial problems. Marcos will almost certainly want to avoid more unemployment, slowing growth, and accelerating inflation in 1984—when he faces the first National Assembly elections since he dismantled martial law two years ago. Amid recurring charges by his political opponents that he has mortgaged the Philippines' future to multinational corporations and foreign bankers, Marcos will also want to avoid a rescheduling of the foreign debt through the next year. Over the longer term, Marcos will have to deal with Asia's highest projected labor force growth—3.7 percent annually in the mid-1980s.

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In *Pakistan* economic conditions would worsen and public dissatisfaction mount if President Zia fails to obtain official donor assistance of $1.3-1.4 billion during fiscal year 1983/84 and is forced to make painful economic adjustments. To stem discontent, President Zia has managed to resist implementation of the more painful IMF measures since the program was initiated in December 1981. Recently, however, he did raise petroleum and other prices to obtain continued IMF support. While there is currently no indication that Zia's disorganized political critics are successfully exploiting economic issues to discredit the President, a sharp decline in living standards could affect the stability of the Zia regime with key groups, such as the bazaar merchants, shifting their support. Living standards will decline if foreign aid and worker remittances from wealthy Arab oil states are cut back and IMF austerity measures are more stringently enforced.

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In *Sudan* public discontent over declining living standards constitutes the most serious threat to President Nimeiri's continued rule. Most Sudanese resent IMF austerity measures, which sharply increased food prices last year. Additional austerity measures under the new IMF program signed in February, including higher land and water charges, could provoke massive demonstrations. There is a further risk that the military will not continue its support for Nimeiri sufficiently to quell widespread protests. Morale, perhaps the key factor in the willingness of the military to support the regime, appears now to be the lowest it has been in recent years.

We believe the greatest source of domestic discontent with the moderate, pro-Western regime of *Morocco's* King Hassan II is the continuing economic deterioration which has accompanied recent financial difficulties. Foreign exchange reserves dipped to only about one week's worth of imports early this year despite imposition of controls on imports and foreign currency transactions. Outside assistance appears to be diminishing. Saudi and other Gulf state financial support dropped by about two-thirds last year, and we believe prospects for an increase this year are slim. Negotiations are scheduled to resume in late April for a new IMF standby loan, but the amount almost certainly will be less than Morocco received in 1982. Food subsidies will continue to be an obstacle to reaching an agreement with the IMF because the government wants to avoid civil strife similar to the food-price riots that broke out in Casablanca in June 1981 following the imposition of IMF-mandated price increases. Organized opposition to the government has been in disarray since the King's crackdown on opposition leaders following the Casablanca riots. Nevertheless, key groups, particularly students, the labor movement, and some religious fundamentalists, are searching for issues on which to challenge Hassan.

Yugoslavia thus far has implemented the IMF-mandated economic program without major political repercussions. But, as the IMF program—price increases, devaluations, interest rate hikes, and tight monetary policy—accelerates a four-year drop in living standards, pressures to ease belt tightening will build. The federal government, already having trouble establishing its authority over regional power centers in the decentralized system, will face tougher opposition as hardships increase. The Communist Party has no serious rival for power, and it still can rely on the military to restore order in a pinch. However, the party leadership itself is weakened by internal differences and distracted by ethnic nationalism, which is once again on the rise. Declining popular morale, eroding confidence in the federal system, and the stringencies of a long-term stabilization struggle will seriously threaten the post-Titoist system of government.

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Performance to Date

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The evidence to date indicates that several of the 14 countries are already running into trouble meeting the criteria agreed to with the IMF:

- The IMF has found Chile to be in noncompliance with its performance criteria for net domestic assets of the Central Bank and net foreign reserves, making Santiago ineligible for its first-quarter tranche of $54 million.

- Embassy reporting indicates that Argentina appears to have come close to meeting its first-quarter performance criteria, although the IMF has yet to respond to Argentina's recently imposed price controls and interest rate subsidies that will almost certainly cause a violation of criteria at a future date. Moreover, the Embassy believes military imports are being underestimated in official trade accounts.

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- Brazil's $840 million trade surplus for the first quarter represents only 14 percent of the IMF's ambitious $6 billion target for the year. Banks' reluctance to extend short-term trade financing, growing speculation in financial circles that the government may soon declare a payments moratorium, and increased capital flight are also adversely affecting Brasilia's ability to meet international reserve targets.

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Meeting the IMF conditions is critical to securing needed funds. Disbursement of close to 30 percent of the combined financing needs of Brazil, Mexico, Argentina, and Yugoslavia is contingent on successful implementation of adjustment programs. A portion of new medium-term bank loans to these countries has been disbursed, but almost $7 billion in quarterly installments is tied to future IMF loan disbursements. In Yugoslavia's case future IMF disbursements are contingent upon completion of a bank-refinancing package and new loans.

Even assuming all IMF and bank disbursements are made on schedule, debt relief anticipated by the IMF is completed, and short-term credit lines are maintained, we believe financing gaps still exist this year for at least three countries:

- Press reports indicate Brazil is seeking an additional $3 billion in short-term financing and may have to reschedule $2.1 billion in amortization due to official creditors this year if cash-flow problems are not eased.

- We estimate that Argentina will also need additional short-term debt relief. As an indication of this, in March Buenos Aires suspended payments of $1.4 billion on private short-term debt maturing under swap arrangements.

- Even with a followup standby agreement expected later this month and $300 million in new IMF funds, Morocco is likely to have difficulty raising the $1.8 billion in funds it needs (table 8).

The remaining countries are operating under extremely tight cash-flow conditions with little if any reserve cushion to smooth seasonal fluctuations in payments positions or to meet shortfalls resulting from erroneous trade projections or unforeseen economic or financial shocks. In the current financial environment, for example, it is possible that the Philippines may be unable to raise the $1.2 billion in new medium-term bank credit the IMF estimates they will need this year. Although Manila raised a similar amount in international financial markets last year,

Failure to obtain this financing will result in reduced import levels and possibly a request for debt rescheduling. The Ivory Coast, which we estimate needs $1.4-1.7 billion in official funds this year, could also request a rescheduling if the French Government refuses to cover financing shortfalls. current French economic conditions probably mean that Paris's financial commitment cannot be open ended.

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Recent requests for short-term bridge loans by Brazil, Peru, and Chile to the US Government demonstrate the continued shortfall in financing needs of these troubled borrowers. Moreover, these official short-term loans are being repaid with scheduled disbursements of IMF and new medium-term bank loans. This practice not only jeopardizes repayment of these Western short-term facilities if IMF and bank funds are curtailed but prevents longer term funds from being channeled into productive investments or imports that could contribute more directly to the longer term adjustment process. This use of longer term funds also violates a crucial IMF assumption that short-term debt is being rolled over. To the extent that IMF and commercial bank loans are being used to pay off official short-term bridging loans without an equal increase in short-term credit during the year, debtors will create even larger financial gaps.

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Additional Demands on the IMF and Banks

In addition to the 14 countries we analyzed, the IMF, governments, and the international financial community will likely have to manage financial packages for one or more OPEC oil exporters. The prolonged weak oil market and recent OPEC price cut have added Venezuela, Nigeria, Ecuador, and possibly Indonesia to the long list of LDCs unable to meet current payments. Ecuador is currently negotiating an IMF arrangement and debt relief with commercial banks. We expect Nigeria, with $3-5 billion in arrears, and Venezuela, with continued reserve drawdowns, to go to the IMF later this year. Indonesia, which we expect

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Table 8
1983 Debt Service and Rescheduling of Financially Troubled LDCs

Billion US $

	Amortization Due on Medium- and Long-Term Debt	Arrears at Yearend 1982 [a]	Amount Rescheduled Under Negotiation [a]	Estimated Amortization	Estimated Interest Payments [b]	Comments
Mexico	7.5	10.0	23.0	1.5	11.0	Rescheduling talks have yet to begin. IMF has set target date of May for completion of rescheduling agreements. Mexico wants to reschedule amortization due on 1983 and 1984 medium-term debt and $15 billion on short-term debt, including arrears, for a total package of $26-27 billion.
Brazil	7.1	0	4.7	3.1	10.0	Brazil has rescheduled $4.7 billion due to private creditors. Recent press reports indicate it may seek rescheduling of official debt maturing this year.
Argentina	6.5	7.0	15.7	0.5	4.4	Government assumed a large share of private-sector debt last December and is seeking to reschedule all debt maturities and arrears due to commercial banks this year. In March Argentina stopped payments on short-term private debt owed to foreign creditors.
Yugoslavia	2.5	0.5	1.9	1.1	1.8	As condition to obtaining 1983 IMF disbursement, Yugoslavia rescheduled principal due this year to banks and government.
Chile	1.7	0	1.7	NEGL	2.3	Talks in progress. Chile seeking rescheduling of $3.5 billion in principal due in 1983 and 1984.
Philippines	1.3	0.1	0	1.3	1.9	Rescheduling possible later this year if Philippines has difficulty raising $1.2-1.5 billion in new commercial bank loans this year.
Peru	1.1	0	3.1	1.2	1.0	In March Peru stopped payments on short-term trade credits and working capital loans to force a partial rescheduling of short-term debt repayments due in 1983 and a refinancing of medium-term loans.
Pakistan	0.5	0	0	0.5	0.6	Likely to ask official creditors for rescheduling if $200-300 million in new bank loans is not raised in second-half 1983.
Morocco	0.9	NEGL	0	0.9	1.0	Rescheduling possible if Morocco fails to raise $1.8 billion from official and private sources this year.
Romania	1.3	0.4	0.8	0.9	1.0	Rescheduled 70 percent of 1983 principal owed to banks.
Sudan	0.5	2.2	2.7	0.1	0.3	Paris Club official creditors have rescheduled $500 million in arrears and principal due in 1983. Sudan currently seeking $1.2 billion in rescheduling from private creditors and $1 billion from Arab governments.

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Table 8
1983 Debt Service and Rescheduling of Financially Troubled LDCs (continued)

Billion US $

	Amortization Due on Medium- and Long-Term Debt	Arrears at Yearend 1982 [a]	Amount Rescheduled Under Negotiation [a]	Estimated Amortization	Estimated Interest Payments [b]	Comments
Ivory Coast	0.5	0	0	0.5	0.7	Ivory Coast depends on French Treasury to meet financing shortfalls. Debt servicing could become a problem for Ivory Coast if French were to cut back large aid flows.
Costa Rica	0.2	0.8	1.5	NEGL	0.2	Costa Rica obtained $400 million in debt relief on interest and principal from Paris Club creditors in January. Currently seeking $1.1 billion in relief from commercial banks.
Ecuador	4.0	0	7.3	NEGL	NA	Seeking rescheduling of public-sector debt 1983 and arrears. Ecuador will need to reschedule $1.7 billion in private-sector debt.
Venezuela	4.0	NEGL	13.0	1.8	4.5	On 22 March, Caracas declared 90-day moratorium of principal payments on public debt seeking to reschedule $13 billion, most of which is short-term obligations. Refinancing of private-sector debt possible later this year.

[a] Includes short-term debt and interest arrears in the cases of Sudan, Costa Rica, and Ecuador.
[b] Total interest due on all debt maturities.

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will run a $9-11 billion current account deficit this year, will be hard pressed to meet debt obligations and has held preliminary talks with IMF officials on potential borrowing arrangements. 25X1

In addition to reduced oil earnings, *Venezuela* has been hurt by soaring capital flight triggered by declining private-sector confidence in President Herrera's economic policies and by reduced commercial bank credit. Capital flight depleted $5 billion in reserves last year, according to Central Bank data, and another $2 billion were used to pay maturing short-term debt that Caracas was unable to refinance in commercial markets. Reduced short-term credit lines and continued reserve drawdowns led Caracas to suspend principal repayments on commercial debt in March and request a rescheduling of all public debt maturing in 1983, about $13 billion. Debt relief negotiations are likely to drag on because of the absence of a realistic economic and financial program for the longer term and bankers' desire for Venezuela to negotiate an IMF agreement first. In our judgment, an IMF agreement—which would entail massive cuts in public spending, reduced consumer price subsidies, smaller wage increases, and devaluation—presents insurmountable political difficulties for the incumbent party in the face of presidential elections to be held this December. We expect IMF negotiations will also be difficult, given the current review team's dissatisfaction with Caracas's economic policies to date and particularly its current exchange control system. An IMF agreement could offer a maximum of $4.5 billion over three years, according to Embassy reporting. 25X1

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We believe Venezuela's worsening economic problems will almost assure a presidential victory—of perhaps landslide proportions—by the opposition Democratic Action Party in December. Economic difficulties are placing unaccustomed stress on the political system and heightening local concerns over the resiliency of the country's democratic institutions. The sectors of society that have benefited most from the oil drive prosperity—the middle class, organized labor, the military, and businessmen—are also Venezuela's most politically powerful groups. The demands that each will be pressing upon the government in a time of austerity are likely to conflict with those of other groups as well as with what the government will see as the national interest. Nevertheless, we believe Venezuelans by and large still overwhelmingly prefer their present system of strong democratic institutions, despite its shortcomings, to alternatives represented by either domestic radical groups or foreign systems.

A precipitous decline in oil prices, which would force sharp cuts in imports and economic growth, could produce political change. The military would be the most likely to seize power, given its anger over widespread corruption, political interference in the allocation of scarce defense dollars, and fear that the left would benefit from the political and economic chaos. The military probably would find considerable support for its action among businessmen and conservative politicians, who would see such an alliance as more profitable than acting on their own.

Ecuador started negotiations with its creditor banks late last year and has tentative agreements to refinance $5.6 billion of public debt contingent upon the outcome of continuing IMF negotiations. President Hurtado recently devalued the sucre 27 percent, one of the measures necessary to break the deadlock in the negotiations. Other sticking points include wage levels, the fiscal deficit, and interest rate increases. Although Hurtado wants to implement the needed austerity measures, popular opposition is constraining his ability to act.

Indonesia encountered difficulty in marketing a $1 billion syndicated loan in March

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Any further weakening in Jakarta's external accounts, or even a failure to show signs of improvement, could intensify bankers' fears and sharply reduce the availability of funds. This, in turn, would force Jakarta to turn to the IMF and deal with additional politically difficult spending cutbacks.

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The sharp deterioration in current account prospects from the OPEC oil price cut has forced the Soeharto government to devalue the rupiah by 28 percent and to reevaluate its development strategy and the need for additional austerity measures.

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Soeharto may yet have to make politically unpalatable decisions to put off some projects in order to avert a financial crisis. In our view he would find IMF conditions a useful scapegoat on the domestic political scene for such moves.

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The Indonesian Government is carefully monitoring the political opposition and potentially disruptive groups such as unemployed youth, students, labor, and Muslims. Although opposition to the regime has been muted, there seems little doubt that disaffection is growing. Indeed, some observers see growing disaffection even among Soeharto's loyalists in the bureaucracy because of the government wage freeze and an increase in corruption to compensate for the loss in real income caused by the freeze. The possibility of anti-Chinese riots sparked by some minor incident is always present, and the current economic situation increases the danger that such riots could quickly develop an anti-Soeharto or antigovernment character.

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We estimate *Nigeria* is likely to face a $4 billion current account deficit even with a planned 30-percent cut in real imports. In March Lagos announced plans to raise a $2 billion loan in order to reduce a backlog of $3 billion in short-term debt. Financial press reports indicate bankers will be reluctant to participate without an IMF agreement in

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place. However, the IMF is politically unpopular in Nigeria and President Shagari is unlikely to agree to IMF conditions prior to the August presidential elections. Once the elections are over, the government probably will seek IMF help, but effective implementation of austerity measures is uncertain given the country's extensive corruption and bureaucratic inefficiency. Lagos will continue to press Saudi Arabia and other wealthy OPEC governments for aid and has also approached Washington.

Acceptance of a strict IMF package could provoke unrest by students, labor, and the growing pool of urban unemployed. Eroding public support for the government coupled with widespread, violent protest could, in our judgment, lead to a military coup. A coup by the predominantly Western-oriented senior or middle-level officer corps probably would not fundamentally alter Nigerian-US relations. The regime might attempt to build domestic support by increasing anti-US rhetoric over Namibia, but economic realities will preclude more serious steps. Although the structure and complexity of the Nigerian military makes an enlisted men's coup less likely than in smaller African countries, a government dominated by populist-oriented lower ranks would prove far more difficult to deal with and could pursue unorthodox and ill-advised economic and foreign policies.

Outlook and Implications

The next six months should offer the test of how well the IMF programs are being carried out and how the Fund and the banks react to the results. Most countries faced their first quarterly evaluations at the end of March, although much of the pertinent data will probably not be available until at least the end of April with disbursements to be made in May. We expect performance criteria to be missed by midyear, although the Fund will probably allow a fair amount of flexibility in judging adherence to performance criteria if it perceives the thrust of government efforts as positive. We do not know how the IMF and the commercial banks will respond if criteria are missed by wide margins. One possibility is that disbursement of Fund and bank money will be halted; in this case new large bridging loans will be needed to avoid default until new agreements and targets can be negotiated. In our judgment, banks will follow the Fund's lead in determining whether disbursements should be interrupted.

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If additional funds are not available, troubled debtors will have to turn inward and intensify their efforts to adjust as best they can to a lack of foreign exchange. In the near term, growth and unemployment would probably deteriorate further and public-sector deficits mushroom as governments try to maintain living standards by avoiding sharp cutbacks in public spending. Without the ability to finance imports, troubled debtors would need to impose even more austere import restrictions, undermining the gradual liberalization of international trade that has been a longer run feature of rescue programs so far. Such moves would slow the recovery of the United States and other industrial nations by reducing export markets.

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Under these conditions, we believe that Washington probably will be caught in the middle. Debtors would almost certainly turn to the United States for direct assistance, help in renegotiating loans with banks and the IMF, and new efforts to reschedule official credits. They will also look to increase exports to the United States. Creditors probably will seek greater official assistance in sharing the burden of meeting debtors' new money requests and will lobby for more expansionary policies in the industrial countries.

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Countries with reduced access to IMF and bank credit will have little choice but to move unilaterally to relieve financial strains. The pattern is already set:

- Chile suspended debt repayments in early January after bankers cut credit.
- In early March Argentina announced a postponement in meeting some short-term debt repayments, while Peru declared an extension of maturing short-term credits.
- Uruguay recently announced a 90-day delay in principal payments as a prelude to formal debt rescheduling.

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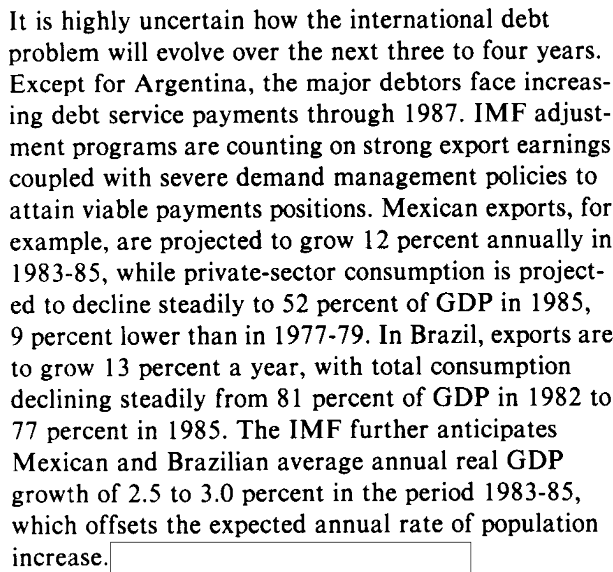
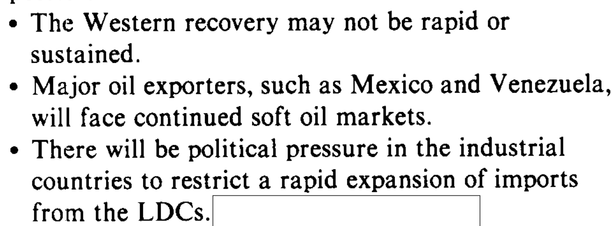
- Brazil is now running commercial arrears because bankers remain reluctant to provide new short-term trade financing.

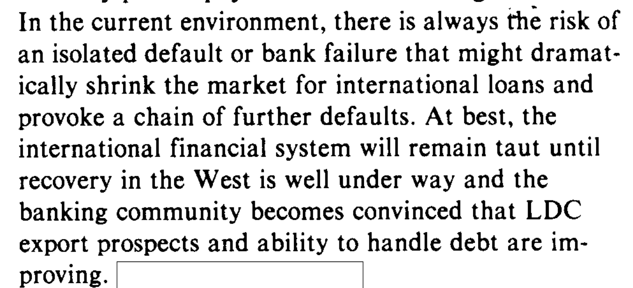


It is highly uncertain how the international debt problem will evolve over the next three to four years. Except for Argentina, the major debtors face increasing debt service payments through 1987. IMF adjustment programs are counting on strong export earnings coupled with severe demand management policies to attain viable payments positions. Mexican exports, for example, are projected to grow 12 percent annually in 1983-85, while private-sector consumption is projected to decline steadily to 52 percent of GDP in 1985, 9 percent lower than in 1977-79. In Brazil, exports are to grow 13 percent a year, with total consumption declining steadily from 81 percent of GDP in 1982 to 77 percent in 1985. The IMF further anticipates Mexican and Brazilian average annual real GDP growth of 2.5 to 3.0 percent in the period 1983-85, which offsets the expected annual rate of population increase.



Such large increases in LDC exports may not be possible for several reasons:
- The Western recovery may not be rapid or sustained.
- Major oil exporters, such as Mexico and Venezuela, will face continued soft oil markets.
- There will be political pressure in the industrial countries to restrict a rapid expansion of imports from the LDCs.

In our opinion, political resistance to austerity in debtor countries will build over time and become better organized. We believe strong political opposition will develop if the adjustment process is perceived as unfair or too harsh. Although at this time, we do not foresee a full-scale revolution or an outright repudiation of debt in the major debtor countries, there are substantial risks:



- In Mexico, a sufficient weakening of the broad political consensus behind the ruling party could threaten serious disorder and a polarization between left and right.
- Without additional credit from Western banks this year, Brazil is likely to declare a moratorium on all debt repayments, including interest.
- In Argentina, there is a prospect that the civilian regime coming to power later this year will demand a drastic renegotiation of IMF and bank agreements.
- There could be repeated debt reschedulings in a number of countries that could, as in Poland, result in only partial payment of interest obligations.

In the current environment, there is always the risk of an isolated default or bank failure that might dramatically shrink the market for international loans and provoke a chain of further defaults. At best, the international financial system will remain taut until recovery in the West is well under way and the banking community becomes convinced that LDC export prospects and ability to handle debt are improving.

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