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THE AFRICAN ECONOMIC CRISIS REVISITED

EXECUTIVE SUMMARY

This paper is the result of two years of work by AFR/DP/PAR. We have been examining the implications of African debt for USG policy and for the effect of this debt on AID's development objectives in Africa. The core of this study is the economic crisis as it affects two very important AID recipients in Africa -- Sudan and Zaire. From examining these two specific country situations we draw a number of conclusions concerning AID and USG policy in Africa.

Servicing its debt continues to be the major impediment to renewed growth in Africa. African countries now owe about $[illegible]0 billion to creditors, an amount equal to 50% of their GDP. For IDA-eligible countries this debt amounts to 75% of GDP, and scheduled debt service equals 40% of export earnings.

It is important to recognize that all African countries do not face the same degree of difficulty in dealing with their debt problem. Drawing on an analogy from the business world, we can divide African economies into five groups: (A) countries which are experiencing reasonable growth; (B) countries which have been improving their economic management and are now ready to resume growth; (C) countries which are candidates for "receivership", i.e., a complete restructuring of their management and a careful plan to reduce expenditures and service debt; (D) countries which are bankrupt, insolvent and therefore incapable of ever paying off their creditors; and (E) countries which are "basket cases," incapable of producing enough to sustain minimal consumption levels out of their own meager resources, and for which economic growth is unlikely. Sudan certainly fits into the bankrupcy category, while Zaire may just make it as a candidate for receivership.

Section II of the paper presents a careful examination of the policy environment, debt structure, balance of payments position and government finance situation in Zaire and Sudan. Sudan needs to make major policy changes before it can even entertain the possibility of growth; Zaire has a reasonable policy environment in place, although there are major institutional and infrastructural weaknesses in the economy.

Section II details the resources needed in Zaire and Sudan, given acceptable policies, if modest growth of 2% per capita is to occur. These resources are summarized below:

AVERAGE ANNUAL RESOURCE NEEDS
(Millions of US$)

	Resource Needs	Planned ODA	Unfilled Gap
SUDAN	2,100	700	1,400
ZAIRE	1,294	331	963

Assuming the numbers above are somewhere close to accurate, what are the policy options available to the donor community, and, in particular, to the USG? Five policy options are examined in this paper: 1) Financing, 2) Cash and Carry, 3) Spiraling Down, 4) Triage and 5) Muddle Through.

Financing: What are the possibilities then of financing growth in Sudan or Zaire through either debt reschedulings or increased ODA? Even with the Baker Plan, there is little prospect for sizeable increases in ODA; therefore if financing is to take place at all it will be through some form of debt rescheduling. After a discussion of various debt rescheduling possibilities, the financing option requires the following resources:

AVERAGE ANNUAL RESOURCE REQUIREMENTS AND AVAILABILITIES FOR GROWTH: THE ZAIRE AND SUDAN CASES, 1986-90

	SUDAN	ZAIRE
Current Gap	1,559	1,202
Additional Resources Needed for Growth	541	92
TOTAL RESOURCE NEEDS	2,100	1,294
Current ODA	700	331
Debt Relief Under Normal Rules	198	161
Additional Relief Under Extraordinary Rules	467	365
Addit'l Relief Under Extra-Extraordinary Rules	149	124
REQUISITE ADDITIONAL ODA	586	313

Thus with very dramatic rescheduling rules (all debt service is suspended except moratorium interest) ODA would need to double in order for the resources necessary for growth to be available. But debt rescheduling does not solve the problem, it only puts off the day of reckoning. The capitalization of interest payments and the suspension of amortization leads to a rapid buildup of debt that needs to be paid off sometime. Fully 25% of Africa's current debt represents previous obligations that were rescheduled. If average interest rates equal 9%, then capitalizing these payments and suspending amortization means that even without new loans, debt will be growing at 9% per year. But we still remain well short of the resources needed to get nominal growth above 9% per year. As a result, debt is growing faster than the capacity to service it. As the Red Queen said to Alice, sort of, "Africa is a place where you have to run faster and faster just to stay in the same place."

FOR ZAIRE AND SUDAN, EVEN WITH BENDING ALL DEBT RESCHEDULING RULES, GROWTH CANNOT TAKE PLACE THROUGH DEBT RESCHEDULING, COUPLED WITH NORMAL ECONOMIC ASSISTANCE. WHAT IS REQUIRED IS NOTHING SHORT OF TOTAL FORGIVENESS, OR AT LEAST A FIVE TO TEN YEAR SUSPENSION OF SERVICE PAYMENTS, AND A DOUBLING OF ASSISTANCE LEVELS.

The Cash and Carry Option: At some point, the costs of debt service becomes greater than the benefits. At that point, either by necessity or design, debtors begin reneging on obligations and arrears begin to accumulate. What are the costs to a country of failing to pay its debt? Failure to keep current with the IMF has a host of consequences. In the first place, Paris and London Club reschedulings cannot take place without an IMF program in place. Second, IBRD policy prohibits the establishment of broad-based structural adjustment programs (sectoral programs seem to be acceptable) in the absence of an IMF program. Third, commercial credit and confidence are likely to dry up in the absence of good standing with the Fund.

Nevertheless, for many countries, there may come a time when debt service payments to certain creditors become impossible to bear. It remains likely that several African countries will find they have more to lose than to gain by keeping current with the IMF, given the substantial negative resource flow such a policy would entail.

This presents a dilemma for the U.S. which we are just now beginning to face in Liberia. Fund ineligibility coupled with the withdrawl of the Bank from a structural adjustment role leaves a policy leverage vacuum. If we are at all interested in stabilization and recovery of an economy like Liberia or Sudan, we will be forced to take a much more upfront role. While it is still possible to call upon Bank and fund technical assistance and policy advice, our non-project assistance becomes the only game in town, a game we are very uncomfortable about playing. Moreover, it is a game for which we increasingly are lacking resources to play. "Cash and Carry" is only a policy option for the U.S. if we are willing to assume the major burden of financing, and conditioning our assistance on, structural adjustment. Moreover, "Cash and Carry" also means an upfront acceptance by the USG that debt service, particularly to the multilateral agencies, is a secondary objective to economic restructuring and resumption of economic growth.

Riding the Downward Spiral: For a number of African economies on the brink of bankrupcy, it is the government rather than the economy itself which is bankrupt. This is clearly the case in Sudan, Somalia and Liberia, and probably true in many other places as well. The bankrupcy of the government becomes a problem for the private sector through government policies, particularly those which direct savings and credit towards the public sector to such an extent that they dampen private sector activity.

In such a situation it might be well to acknowledge government impotence and try to use our influence to limit government interventions in the private economy. We would not have broad stabilization objectives, but rather focus on targets of opportunity, trying to make useful interventions while the economy is imploding. This seems to be the strategy we are currently following in Sudan. There are many difficulties with such an approach, not the least of which is the fact that as the government economy accelerates its descent it tends to bring the private, formal economy down with it. This is a truly minimalist policy, which buys some political time but cannot be expected to have any lasting economic impact.

Triage: As every economist knows, we live in a world of constrained maximization. Resources are scarce and thus we can never produce or consume all we would like. Nowhere is this principle more evident than in Africa. Scarce foreign exchange, scarce investible funds, scarce budgetary resources mean that neither the Africans nor the donors are likely to achieve objectives that are anything in excess of modest. This is a difficult lesson for an Agency that is dedicated to growth and development and a people who believe that any problem can be solved with enough effort and creativity.

The truth is that in Africa development has not occurred. The truth is that both the donors and the African governments are responsible for this failure. The hard truth is that it is impossible for development to occur everywhere in Africa over the next decade. The bedrock truth is that the USG is incapable of achieving its myriad objectives everywhere in Africa -- foreign policy, developmental, humanitarian and economic. The more we seek to achieve many objectives, the more likely we are to fall short of all of them.

The triage option would have us carefully prioritize our objectives in Africa, calculate the cost in terms of financial and political resources, and use those resources to achieve those objectives which can be achieved, and not scatter our resources trying to deal with every problem. For example, it may be that we have only enough foreign assistance resources (including staff) to make a serious effort at structural adjustment in eight or ten countries, countries which have the political and managerial capacity to make structural adjustment work. In the rest of Africa we would not have a growth or stabilization objective, but rather one of showing the flag or "renting" facilities. If we seriously concentrated resources and staff (say 60% of staff and 80% of resources) we might be able to make a difference.

Muddling Through: Of course the most likely option is to refuse to choose, refuse to recognize that we and the Africans and the international financial system are all hurtling down a path to disaster. We will change our actions when the choices facing us are so stark that we are unable to avoid making a choice. It's possible that it is already too late, that none of the choices, none of the options left are feasible, that the relevant economist in Africa is not Adam Smith, but Thomas Malthus, and that there is no way of avoiding the perenial visits of the four horesemen of the apocalypse.

CONCLUSIONS

For the first time in its history as a development agency, AID is facing a development problem which may be insoluble. Without a profound turn around in the international economy, many African countries, including some of those in which the U.S. has a high political interest, are virtually bankrupt. The international economic system has no mechanism for dealing with bankrupcy in an orderly fashion. As a result, these countries will be forced to opt out of the international financial system. Forced to resort to cash and carry, import levels are likely to contract further, and formal economies, particularly the government sectors, will spiral downward or implode.

Other countries, the category C or receivership countries, remain on the brink. They are attempting to undertake the necessary policy adjustments while continuing to service their international debt service obligations. Debt rescheduling together with increased assistance levels have been sufficient to permit stabilization, albeit at the expense of declining consumption levels, particularly in urban areas. However, resources are sufficient only to stabilize these economies, not engender growth. Without growth, debt rescheduling only puts off the day of reckoning, the day when receivership economies become bankrupt.

For a number of other countries (those in category B, Recovering Firms), growth is possible after a difficult adjustment period. Here the existing international financial system is probably adequate, although greater concentration of resources in countries making a reasonable effort to adjust will reduce the political difficulties of policy change and hasten the renewal of growth.

What option should we follow? The logic of this paper leads us to advocate following several options at once, depending on which category of country we are dealing with. The overiding principle which guides these policy prescriptions is the recognition that with limited resources only limited objectives can be met.

For countries in category A, continued, though minimal, levels of development assistance makes sense.

We should choose some subset of countries in categories B and C in which we have a great interest, and concentrate our foreign assistance resources in order to support structural adjustment.

For countries in category D, we should acknowledge their bankrupcy, and not use our resources to pay off debt, unless such payments increase net resources available to the country. In any case, our assistance levels in these countries should be the minimal necessary to support our political objectives. Development assistance, as opposed to ESF, in these countries, except insofar as it goes directly to the private sector, should be eliminated.

For countries in category E our assistance should be directed at achieving political and humanitarian objectives, and should be limited to levels commensurate with these objectives.

Finally, we should acknowledge that a resumption in growth for many African countries depends on the development of an international financial mechanism for dealing with bankrupcy, whether in the form of debt forgiveness or some more imaginative solution.

THE AFRICAN ECONOMIC CRISIS REVISITED

I. INTRODUCTION

In the summer of 1984, AFR/DP/PAR drafted a paper which suggested that there was coming upon Africa an economic crisis of unprecedented magnitude. The paper suggested that there would be insufficient international capital flows to sub-Saharan African countries to reverse the recent trend of economic decline, and that, unless donors restructured the way they did business, African economies would be unable to sustain the policy reforms upon which they have embarked with so much hope. It is important to recognize that while it was largely ill-conceived policies which are responsible for Africa's economic crisis, policy reform, in and of itself, is not sufficient to reverse the decline. Despite recent dramatic improvements in the international economy (the decline in interest rates and oil prices, in particular), events over the last eighteen months bear out the predictions we made at that time.

The average African is now worse off economically than his father was in 1960. Two major African countries have been declared ineligible by the IMF (joining Guyana and Vietnam) and several more are in the wings. Improvements in the quality of life which occurred since independence are now threatened by financial constraints on government delivery of quality health and education services. The most optimistic scenario, one developed by the World Bank and which, in our opinion, understates the expected resource gap, predicts continued decline in per capita income levels for low income Africa until 1990, when a modest turn-around can be expected. It is our opinion that, unless the OECD countries undertake a fundamental restructuring of the way in which African countries are treated in the international financial system, at least one-third of the countries in Africa are doomed to continued stagnation and decline, whatever policy reforms they adopt.

There are five discrete categories of countries in Africa from the point of view of economic potential. As an analogy one might group these countries as one would business enterprises:

A. Sound Firms: Countries with normal ups and downs but with expectations of making profits (i.e. growing economically) over the long term. Examples include BOTSWANA, CAMEROON, and MAURITIUS.

B. Recovering Firms: Countries which have been through a financial crisis, but which have good market prospects, have recently restructured their production lines, and although they may still suffer from short-term liquidity problems (i.e., need debt rescheduling) can be expected to resume profitable operations (i.e., resume growth) in the near term. Examples include ZIMBABWE, MALAWI, and IVORY COAST.

C. <u>Firms in Need of Receivership</u>: Countries whose current stock of debt and debt-servicing requirements make it impossible for them to turn profits (grow), but who could, with management improvements (policy reforms) and help from their creditors (increased resource flows either in the form of higher borrowing levels or much reduced debt service) become profitable in the future. Examples are ZAIRE, ZAMBIA, and NIGERIA.

D. <u>Bankrupt Firms</u>: Countries which are essentially insolvent. Countries whose debt is so onerous that no amount of restructuring will permit growth. Countries which need complete reorganization and bankrupcy proceedings (i.e. debt forgiveness) to become profitable (resume growth). Examples include SUDAN, SOMALIA, and LIBERIA.

E. <u>Firms that Should be Closed</u>: Countries which are not only insolvent, but which would be unprofitable even if debt service were eliminated, in other words, international basket cases. Examples include MOZAMBIQUE and CHAD.

Our present assistance strategies probably remain effective in countries in category A. and category E. Category A countries need continuing development assistance, particularly in areas of technology transfer and training. All assistance to category E countries is fundamentally humanitarian in nature, since for political or environmental reasons development and growth is not currently possible. The interesting problems arise in countries in the middle three categories.

These African countries are in the trouble they are currently in because: (1) they largely mismanaged their economies; (2) they borrowed to maintain consumption levels rather than adjusted to declining revenues and increasing costs; and (3) their market position has been deteriorating. Unfortunately, even dramatic policy reform will not make many countries solvent in the current depressed state of the international economy without a major increase in net resources flowing into these countries.

The current international financial system is not set up to handle any problem more severe that a short-term liquidity crisis, i.e., that represented by countries in category B. There does not seem to be sufficient resources available (in the form of new borrowing or debt relief) to handle countries in Category C, those requiring receivership. There is no institutional framework to deal with countries which are insolvent, let alone those which are basket cases.

The purpose of this paper is to examine more closely the financial situation of Zaire (a Receivership country) and Sudan (a country which is insolvent), and to examine policy options for the international community in dealing with these crisis situations. Section II describes the present problems facing Sudan and Zaire in more detail while section III

II. The Debt Problem in Detail

The data and projections on which this section is based come from two papers drafted by AFR/DP/PAR, "Resource Needs for Debt Service with Growth in Sudan" and "Resource Needs for Debt Service with Growth in Zaire."

II.A. The Policy Framework

The policy performance of both Sudan and Zaire was dismal during the period 1973-1983 and it was this performance that was largely responsible for putting these countries in their current situation. However, Zaire has dramatically reformed its policies, while Sudan, after a few desultory efforts, has been incapable and unwilling to undertake meaningful reform programs.

II.A.1. Sudan's Policy Framework

Sudan's debt problems arose primarily through the Government's persistent mismanagement of the economy. Despite some recent improvement, that policy framework continues to encourage disinvestment, inefficiency and public sector involvement in areas of the economy better left to the private sector. Moreover, recent political events and the fragile structure of the Sudanese polity have meant that needed reforms are likely to lack the necessary political constituency. Major areas needing reforms include:

-- The foreign exchange system, including a substantial devaluation and movement toward a liberalized foreign exchange market;

-- Liberalization of agricultural marketing, particularly in the export sector;

-- The Government budget including elimination of subsidies; and

-- The parastatal sector, with substantial divestiture.

II.A.2. Zaire's Policy Framework

Since 1982 Zaire has engaged in a sweeping economic policy reform program including:

-- An 80% devaluation and the establishment of a floating exchange rate system through the commercial banks;

-- removal of most controls on interest rates;

-- creation of a domestic money market with the issuance of short-term treasury bills;

-- lifting of quantitative restrictions on imports;

-- liberalization of agricultural prices and elimination of agricultural marketing parastatals;

-- dramatic IMF-led reductions in overall government spending;

-- easing or elimination of many administrative bottlenecks to private sector activity;

-- efforts to regularize external debt-service payments and eliminate arrears over time; and

-- opening distribution of petroleum products to private competition along with major reforms in pricing.

As a result of these reforms there has been a rapid improvement in many macroeconomic aggregates and the stabilization program in Zaire can be viewed as a major success. For example:

-- inflation has been halved, from 83% in 1983 to less than 40% in both 1984 and 1985;

-- the current account balance of payments deficit has been substantially reduced from 4.3% of GDP in 1983 to 1.8% of GDP in 1985;

-- the GOZ's budget has been turned around, from a deficit of 6% of GDP in 1983 to a projected surplus of 0.9% in 1985;

-- credit to the private sector has been increased by 10% in 1984 and 14% in 1985, reversing the 22% reduction in 1983; and

-- GDP has begun to grow again, after declining by about 1.0% per year in 1982/83.

There are several policy issues remaining. AID and the World Bank are developing an industrial sector program that is intended to rationalize the incentive structure for private manufacturing. Some policies, particularly those relating to agriculture, have not been fully implemented because of the limited capacity of the Government of Zaire to impose its policies on local officials who have a great deal of de facto autonomy. Much remains to be done to improve government fiscal performance. Nevertheless, Zaire now has in place one of the best policy frameworks in Africa.

II.B. The Current Structure of Debt (end of 1984)

II.B.1. Sudan

The basic facts concerning Sudan's debt are:

-- Sudan's total debt of over seven billion dollars has been growing at a nominal rate of over 25% per year since 1970, and is now equal to 80% of GDP and 900% of export earnings.

-- Public and publicly guaranteed debt makes up 86% of total debt.

-- Arrears of principal and interest now equal $1.4 billion, or 176% of annual export earnings.

-- Current scheduled debt service payments are about one billion dollars, or 120% of export earnings, divided roughly evenly between interest payments and amortization.

-- About 25% of all debt service is owed to multinational institutions and can not be rescheduled under current rules.

-- An additional 44% of debt service over the next five years comes as a result of previously rescheduled debt and also is not subject to rescheduling under normal Paris Club rules.

II.B.2. Zaire

The basic facts concerning the structure of Zaire's debt are:

-- Zaire's total debt of over four billion dollars has been growing at an annual rate of 21% per year since 1970, and is equal to 160% of GDP and 265% of export earnings.

-- Public and publicly guaranteed debt make up 92% of total debt.

-- Arrears of principal and interest have been reduced to $172 million, a mere 3.4% of total debt.

-- Current scheduled debt service payments are about $920 million or about 44% of export earnings, with about 40% going to interest payments and 60% to amortization.

-- About 25% of all debt service is owed to multilateral institutions and cannot be rescheduled under current rules.

-- An additional 50% of debt service over the next five years comes as a result of previously rescheduled debt and also is not subject to rescheduling under normal Paris Club rules.

II.B.3. Summary

The debt structure of the two countries is similar, although clearly Sudan's debt is larger and more difficult to service. More importantly, Zaire has a much greater capacity to service its debt because of its much larger export sector, as will be detailed in Section II.C. below.

II.C. Debt Service and the Balance of Payments

Developing country economies are generally open and require substantial amounts of foreign exchange to purchase imports needed to keep running. Historically, economic growth usually meant borrowing by capital deficit countries in order to make investments to expand capital stock. The failure of past borrowing to increase their ability to produce more has created a situation in which both Sudan and Zaire are facing net capital outflows rather than capital inflows. They are becoming "lenders," not "borrowers."

II.C.1. Sudan's Balance of Payments

A summary balance of payments table for Sudan is presented below.

SUDAN: SUMMARY BALANCE OF PAYMENTS
ANNUAL AVERAGE, 1985/86 - 1989/90
(US $ Millions)

Sources of Foreign Exchange		2,293
Domestic (Exports, Remittances)	1,586	
Foreign Loans and Grants	707	
Uses of Foreign Exchange		3,152
Imports of Goods and Services	2,037	
Debt Service	1,115	
Overall Balance		(859)

This table has been put together based on projections from the IMF, projections which do not take into account recent declines in cotton and oil prices. The data project modest, but possibly optimistic, estimates of rates of increase of exports and donor assistance. They also project modest increases in import levels.

The following elements should be emphasized in looking at Sudan's balance of payments:

-- The average deficit, excluding foreign grants and loans averages $1.55 billion per year. Since expected foreign resource availibilities total only $700 million, balance in the accounts can only be achieved by additional resources, including debt relief, of 120%;

-- If there were no capital flows (both loans and grants and debt service) Sudan's needs for foreign exchange would exceed its foreign exchange availabilities by $451 million (28%);

-- Sudan has received high levels of ODA (over $30 per capita).

-- While Sudan has already reduced the real level of imports per capita by 18% over the past decade, this has been a less serious decline than that experienced by most African countries;

-- Much of Sudan's own foreign exchange resources come from high levels of remittances from Gulf state workers (officially recorded at about $400 million or over 45% of exports of goods and services).

-- Export performance has been dismal (average annual decline of 1.5% over the last decade). Had exports grown at the same rate as population, i.e. 3% per year, export earnings alone would be more than sufficient to meet current import needs and service debt.

It should be noted that unofficial remittances may exceed official remittances by one billion dollars, and that, therefore, Sudan's real balance of payments position may be considerably looser than that suggested by official statistics. With better policy performance, continuing high levels of assistance and the elimination of all debt service, Sudan could be a viable economy from the point of view of its balance of payments, at least in terms of the international economy as it was up until mid-1985. In fact, if Sudan were able to take the necessary policy reforms, high levels of growth could follow.

This situation may no longer pertain as the international economy has turned dramatically against Sudan in the last six months. First, the rapid deterioration of the world cotton market could cost Sudan over $150 million in export earnings in price changes alone. More important, the new structure of international prices could make Sudan's expensive and inefficient irrigated cotton economy a net user of foreign exchange rather than a net generator (this may force an even more dramatic decrease in the value of the Sudanese pound). Second, the decline in oil prices may have a net negative effect on the Sudanese economy. At the current time officially recorded private transfers (largely remittances from Gulf workers) exceed petroleum import costs. While it is impossible to predict accurately, there is a good chance that the recession in the Gulf could cost substantially more in Sudanese remittances than is gained by the decline in oil import costs.

II.C.2. Zaire's Balance of Payments

A summary balance of payments table for Zaire is presented below.

ZAIRE: SUMMARY BALANCE OF PAYMENTS
ANNUAL AVERAGES 1986/87 - 1989/90
(US$ Millions)

Resources		2,772
Exports of Goods and Services	2,433	
Transfers and Loans from Abroad	339	
Uses		3,643
Imports of Goods and Services	2,696	
Debt Service	947	
Overall Balance		(871)

In comparing Zaire's balance of payments to Sudan's a number of facts stand out:

-- Zaire's overall deficit is about equal to Sudan's ($871 million as opposed to $859 million);

-- Zaire's overall deficit as a percentage of export earnings is lower (35.8% as opposed to 54.2%), and debt service is a much smaller proportion of export earnings (38.9% as opposed to 70.3%);

-- Zaire's assistance levels are much lower than Sudan's. In fact, despite the fact that Zaire's deficit is equal to Sudan's deficit, it would take a much larger percentage increase (257% for Zaire as opposed to 122% for Sudan) in foreign assistance or debt relief to close the gap.

-- While Sudan handled its export contraction by borrowing, Zaire was forced to reduce imports. Real import levels in 1983 were only 23% of what they had been in 1973, and per capita imports were a mere 16% of 1973 levels.

II.D. Debt and the Government Budget

Most analysts of the debt problem in Africa concentrate on the balance of payments and the availability of foreign exchange. Since African debt is, by and large, public or publicly guaranteed debt, such a perspective misrepresents the problem. Countries such as Senegal or Niger, which have freely convertible currencies, can not be said to have a balance of payments problem. What they suffer from is a government budget problem.

Even in countries like Sudan, lack of foreign exchange is not making debt service burdensome, rather it is the government's lack of foreign exchange that presents the problem. Where there are markets for foreign exchange, as in Zaire, it is the Government's difficulty in generating sufficient local resources to purchase foreign exchange to pay debt service that is the binding constraint.

II.D.1. Sudan's Fiscal Balance

Sudan's balance of payments is not the only budget which is stretched by debt service problems. Since almost all of the debt is either public or publicly guaranteed, debt service must come from the government's budget. This puts great pressure on the government expenditures, resulting in reduced service delivery, reduced government investment and increased deficits which, in turn, fuel inflation and push the exchange rate even more out of line. If the major reason for imbalance in the foreign exchange account is debt service obligations, then this is even more true for the government budget.

A summary government budget for Sudan is presented below.

SUDAN: SUMMARY GOVERNMENT BUDGET, 1985/86
(Millions of Sudanese Pounds)

Revenues		2,803
Domestic (taxes, profits and fees)	1,576	
Foreign Grants and Loans	1,227	
Expenditures		5,399
Domestic	2,607	
Debt Service	2,792	
Deficit		2,596

The major facts are these:

-- Revenues are 37% of projected expenditures.

-- If scheduled debt service is paid, there is a financing gap equal to 25% of GDP. In terms of the U.S. budget this is equivalent to a deficit of 880 billion dollars.

-- On the other hand, without any debt service, the budget would show a surplus equal to 1.9% of GDP.

-- Debt servicing obligations (including reduction of arrears) equals 58% of total budget expenditures.

Once again it is the presence of an insupportable debt that makes the government budget so impossible to manage. To be sure, there is a substantial need for fiscal reform (elimination of consumer subsidies and payments to parastatals, improved tax collection, etc.). Nevertheless, even with these reforms, it would be impossible for the budget to support debt service at this level.

II.D.2. Zaire's Fiscal Balance

A summary Government budget for Zaire is presented below:

Zaire: Summary Fiscal Performance, 1985
(Millions of Zaires)

Revenues		81,162
Domestic (taxes, profits and fees)	39,750	
Foreign	17,400	
Debt Rescheduling	24,012	
Expenditures		83,812
Domestic	34,750	
Debt Service	25,050	
Debt Rescheduled	24,012	
Deficit		2,650

Once again the comparisons with Sudan are instructive.

The Zaire stabilization program has led to a virtual balanced budget, while Sudan has run an unmanageable deficit;

Scheduled debt service equalled 59% of total expenditures, and it is the provision of generous debt relief that enabled Zaire to keep its budget under control;

Total expenditures declined by 25% in real terms between 1983 and 1985 and real expenditures on wages and goods and services were halved. It's as if President Reagan cut the U.S. federal government in half in two years.

II.E. Growth

Economic growth is dependent on increasing the capital stock, both physical and human, and improving the efficiency with which that capital stock is used. We can measure the growth of the capital stock in terms of the levels and growth of investment. The efficiency of investment is reflected in a measure called the incremental capital output ratio or ICOR. The ICOR indicates the amount of investment needed to generate a given rate of growth. The higher the ICOR the more new capital is required for each increment to growth, or the less efficiently is new capital being used.

It is instructive to compare low income Africa and low income Asia historically in terms of these two measures. This is done in the table below.

A Comparison of Growth Experience
Low-income Asia vs. Low-income Africa

	Low-Income Asia			Low-Income Africa		
	1965-73	1973-83	1965-83	1965-73	1973-83	1965-83
Growth (%)						
GDP Growth	5.7	5.3	5.5	3.7	2.1	2.9
Per Capita GDP	3.1	3.4	3.2	1.1	-0.7	0.2
Investment	6.4	6.1	6.3	6.3	1.9	4.1
Sectoral Shares (%)						
Investment/GDP	21.7	27.1	24.4	15.0	16.0	15.5
Domestic Saving/GDP	19.7	25.9	22.6	13.0	7.0	10.0
Foreign Savings/GDP	2.0	1.2	1.8	2.0	9.0	5.5
ICOR	4.3	4.7	4.5	4.3	7.6	5.5

This table pinpoints the quantitative reasons for Africa's growth problems.

Domestic saving has declined precipitously from already low levels in Africa (due mostly to government dissaving), while increasing in Asia.

Investment levels stayed constant as a percentage of GDP, with donors supplying the majority of the savings.

ICORs for Africa in the later period are much higher than for Asia, largely because poor policies and bad investment choices wasted much of what scarce investible resources there were.

Population growth has increased in Africa, while declining in Asia; as a result it has taken lower levels of overall GDP growth in Asia to achieve per capita income growth levels comparable to those in Africa.

Policy reforms will have two major effects. They will increase the level of domestic savings and they will increase the efficiency of investment. However, the increase in domestic savings is almost certain to be offset by a decline in foreign savings, as aid levels decline and debt service eats even more seriously into foreign resource availabilities. Let us see how these issues play out in Sudan and Zaire.

II.E.1. Growth Prospects in Sudan

The basic growth data on the Sudan economy is presented in the Table below.

Sudan's Growth Experience

	1965-73	1973-83	1980-84	1965-84
Growth (%)				
GDP Growth	0.2	6.3	-1.0	2.8
Per Capita GDP	-2.4	3.1	-4.2	0.0
Investment	0.2	5.6	-3.2	2.7
Sectoral Shares (%)				
Investment/GDP	10.0	15.0	12.0	12.5
Domestic Saving/GDP	9.0	-1.0	2.6	7.0
Foreign Savings/GDP	1.0	16.0	10.0	5.5
ICOR	50.0	2.4	12.2	4.5

Between 1980 and 1984 real per capita GDP in Sudan fell by 16%. Investment levels remain relatively high (15% of GDP), but little of that investment comes from indigenous resources (gross domestic savings averaged 2.6% of GDP between 1980 and 1984). Moreover, efficiency of investment (as measured by the incremental capital-output level) is and has been abysmally low during the 1965-73 and 1980-84 periods. Clearly, growth has been less impeded by resource shortages recently (given current aid levels) than by policy failures which fail to generate domestic savings and use foreign investment unwisely.

However, it should be noted that the current resource picture is based on Sudan's failure to repay debt service commitments. Over the past few years Sudan's debt service obligations of approximately one billion dollars have been equal to its expenditures on investment. Since little of that debt service has actually been paid, it is clear that investment is only taking place at the expense of accumulation of arrears.

For moderate levels of per capita income growth (2% per year), GDP in Sudan would have to grow at 5.2% per year. Making heroic assumptions about policy changes and the efficiency of capital (an ICOR of 3.5) would mean a required investment level of about 18% of GDP. If we make another heroic assumption, i.e., that policy reforms increase the rate of domestic saving from -1% of GDP to a respectable 9% of GDP, then growth will require (in addition to policy reform) foreign savings of 9% of GDP. While historically Sudan had been receiving capital inflows of this magnitude, gross inflows have been declining recently and Sudan has virtually suspended debt service payments, by building up arrears. Another way of defining foreign savings is the excess of imports over exports. So growth in Sudan would require import levels to be 9% higher than export levels. In other words, growth in Sudan, assuming major policy reform, will require current account balance of payments surpluses of about $500 million per year. Thus the requisite resources for growth in Sudan on an annual basis are about three times current levels of assistance. In Section III we will see how much of this could come from debt relief.

II.E.2. Growth Prospects in Zaire

The basic data on Zaire's growth experience are presented in the table below.

Zaire's Growth Experience

	1965-73	1973-83	1982-85	1965-85
Growth (%)				
GDP Growth	3.9	-1.0	1.0	1.3
Per Capita GDP	1.5	-3.5	-1.5	-1.0
Investment	10.2	4.9	...	7.2
Sectoral Shares (%)				
Investment/GDP	28.0	30.0	12.5	30.0
Domestic Saving/GDP	38.0	30.0	22.5	30.0
Foreign Savings/GDP	-10.0	0.0	-10.5	0.0
ICOR	7.2	n.a.	24.0	20.0

Between 1981 and 1985 real per capita GDP in Zaire fell by 6%. Investment levels have dropped precipitously (12.5% of GDP in 1983), largely due to a dramatic decline in net foreign savings. Domestic savings however, have shown consistency. Most important, efficiency of investment (as indicated by the incremental capital-output level) has been and remains abysmally low (as reflected by the high ICOR). Clearly, while growth in the past was less impeded by resource shortages than by policy failures which failed to use investment wisely, this is no longer the case. In fact, while we can expect recent policy changes to dramatically increase the efficiency of capital, debt service (and capital flight) has reduced the level of domestic investible resources beyond that needed for replacement.

For moderate levels of per capita income growth (2% per year), GDP in Zaire would have to grow at 4.6% per year. Making heroic assumptions about policy changes and the efficiency of capital (an ICOR of 3.5) would mean a required investment level of about 16% of GDP. This would require a reduction in capital outflows (foreign dissavings) from 10% of GDP to 6% of GDP.

Another way of defining foreign savings is the excess of imports over exports. Growth in Zaire would require import levels to be 4% higher than export levels. In other words, growth in Zaire, assuming major policy reform, will require current account balance of payments surpluses of about $200 million per year. Thus the requisite resources for growth in Zaire on an annual basis are about four times current levels of assistance. In Section III we will see how much of this could come from debt relief.

III. Growth, Debt, Debt Relief and Foreign Assistance.

Section II detailed the resources needed in Zaire and Sudan if modest growth of 2% per capita is to occur. These resources are summarized below:

AVERAGE ANNUAL RESOURCE NEEDS
(Millions of US$)

	Resource Needs	Planned ODA	Unfilled Gap
SUDAN	2,100	700	1,400
ZAIRE	1,294	331	963

Assuming the numbers above are somewhere close to accurate, what are the policy options available to the donor community, and, in particular, to the USG? There are five policy options which will be examined in this paper: 1) Financing, 2) Cash and Carry, 3) Spiraling Down, 4) Triage and 5) Muddle Through.

III.A. The Financing Option

It is clear that neither Sudan nor Zaire can be expected to grow without substantial inflows of new capital, either through an increase in gross disbursements, or through a reduction in debt service repayments. Were debt payments to be eliminated, the financing gap in Zaire would disappear, while the gap in Sudan would be reduced to manageable proportions. In the absence of debt relief gross capital flows would have to increase by 200% in Sudan and 300% in Zaire. It doesn't take much foresight to recognize that new capital flows of this magnitude are not feasible in the forseeable future. Thus financing the gap would require substantial, if not radical, debt relief.

III.A.1. An Aside on Debt Servicing Rules

The elements of a debt rescheduling can be divided into two broad groups: the base or coverage of the rescheduling and the terms of the rescheduling. The coverage of the rescheduling depends on the portions of the scheduled debt service which is eligible for rescheduling and the portion of this eligible debt service actually rescheduled. Typically, 90-95% of all debt service is considered eligible for rescheduling except:

- -- Debt service to Multilateral Agencies such as the IMF, IBRD, AFDB, Arab Funds;
- -- Service on Rescheduled Debt; and
- -- Interest payments on commercial debt.

The terms of the rescheduling determine the new debt service obligations resulting from the debt relief; thus, their effects are seen in subsequent years. The principal elements which define the terms of the rescheduling are the interest rate charged, the grace period for amortization payments, and the maturity period for amortization payments. Typical rescheduling terms use an interest rate consistent with the rates on the loans being rescheduled, a five year grace period, and a fifteen year maturity period.

III.A.2. Debt Relief Policy Scenarios

The Table below summarizes the characteristics of the three scenarios used in this paper to examine the implications and potential benefits of debt relief. The first two scenarios (Normal and Extraordinary) can be viewed as possible within the current structure and precedents for rescheduling debt. The third scenario (Extra-Extraordinary), however, represents a break with the current system due to the inclusion of multilateral debt service payments.

Summary of Rescheduling Scenarios

Scenario	All Service Eligible for Rescheduling Except	% of Eligible Resched.	---- Rescheduling Terms---- Interest Rate	Grace Period	Maturity Period
Normal	--to Multilaterals --on Previously Rescheduled Debt --Interest on Commercial Debt --on Newly Rescheduled Debt	95%	9%	5	15
Extraordinary	--to Multilaterals --on Newly Rescheduled Debt	100%	9%	5	20
Extra-Extraordinary	--on Newly Rescheduled Debt	100%	9%	5	25

Previously rescheduled debt is debt that was rescheduled prior to 1986. Newly rescheduled debt is debt that was rescheduled during the 1986-90 period (in other words, moratorium interest).

III.A.2.a. Normal Rescheduling Rules

Under normal rescheduling rules, 95% of all debt service can be rescheduled except that to multilaterals, that which was previously rescheduled and interest to commercial banks. The table below summarizes the effect of normal rescheduling on the debt service obligations of Zaire and Sudan.

	Scheduled Debt Service	Debt Relief	Debt Service After Rescheduling
SUDAN			
1985/86	1,240	322	918
1986/87	1,157	261	896
1987/88	1,037	201	836
1988/89	1,011	121	890
1989/90	1,055	87	968
Average	1,100	198	902

	Scheduled Debt Service	Debt Relief	Debt Service After Rescheduling
ZAIRE			
1985/86	865	226	639
1986/87	851	205	646
1987/88	832	171	661
1988/89	842	121	721
1989/90	658	83	575
Average	810	161	649

Clearly normal rescheduling does little to solve the problems faced by either Sudan or Zaire. In 1985/86, normal debt rescheduling provides of the foreign exchange gap in Sudan and 28% of the foreign exchange g in Zaire. Let us look at extraordinary rescheduling which allows the rescheduling of intererest and ammortization of previously rescheduled debt.

III.A.2.b. Extraordinary Rescheduling Rules

Under extraordinary rescheduling rules all debt service except that ow to multilaterals is rescheduled. The table below summarizes the effec of extraordinary rules on debt service obligations.

	Scheduled Debt Service	Debt Relief	Debt Service After Rescheduling
SUDAN			
1985/86	1,240	900	340
1986/87	1,157	749	408
1987/88	1,037	594	443
1988/89	1,011	533	478
1989/90	1,055	548	507
Average	1,100	665	435
ZAIRE			
1985/86	865	726	139
1986/87	851	604	247
1987/88	832	504	328
1988/89	842	394	448
1989/90	658	404	254
Average	810	526	284

Extraordinary debt rescheduling makes the problem in both Sudan and Zaire more manageable. For Sudan, extraordinary rescheduling reduces the unfilled gap over the 1986-90 period to $735 million a year; for Zaire, such rescheduling reduces this gap to $437 million. Though much smaller, both these gaps remain unfillable, and growth remains a chimera.

III.A.2.c. Extra-Extraordinary Debt Rescheduling

While there remain a number of intermediate steps (relating to interest rates and maturities of rescheduled obligations), the next major departure from the current rescheduling rules is to reschedule debt owed to multilateral institutions. If this debt is added to the coverage of rescheduling in the Extraordinary scenario, then countries would be required to pay only moratorium interest. The debt service obligations of Sudan and Zaire under this scenario are presented in the table below.

	Scheduled Debt Service	Debt Relief	Debt Service After Rescheduling
SUDAN			
1985/86	1,240	1,155	85
1986/87	1,157	967	190
1987/88	1,037	697	340
1988/89	1,011	647	364
1989/90	1,055	606	449
Average	1,100	814	286
ZAIRE			
1985/86	865	865	0
1986/87	851	768	83
1987/88	832	670	162
1988/89	842	602	240
1989/90	658	343	315
Average	810	650	160

Debt relief of this magnitude (about 85% of all debt servicing obligations) closes the gap significantly, but still leaves resource shortages of imposing magnitudes ($586 million in Sudan and $313 million in Zaire). In other words, even with extra-extraordinary debt relief, foreign grants and loans to Sudan would have to increase by 84% and to Zaire by 95% to reach the levels needed for growth.

What are the possibilities then of financing growth in Sudan or Zaire through either debt reschedulings or increased ODA? The resource situation is summarized in the following table:

RESOURCE REQUIREMENTS AND AVAILABILITIES FOR GROWTH:
THE ZAIRE AND SUDAN CASES, 1986-90

	SUDAN	ZAIRE
Current Gap	1,559	1,202
Additional Resources Needed for Growth	541	92
TOTAL RESOURCE NEEDS	2,100	1,294
Current ODA	700	331
Debt Relief Under Normal Rules	198	161
Additional Relief Under Extraordinary Rules	467	365
Addit'l Relief Under Extra-Extraordinary Rules	149	124
REQUISITE ADDITIONAL RESOURCES	586	313

But debt rescheduling does not solve the problem, it only puts off the day of reckoning. The capitalization of interest payments and the suspension of amortization leads to a rapid buildup of debt that needs to be paid off sometime. Fully 25% of Africa's current debt represents previous obligations that were rescheduled. If average interest rates equal 9%, then capitalizing these payments and suspending ammortization means that even without new loans, debt will be growing at 9% per year. But we still remain well short of the resources needed to get nominal growth above 9% per year (4% inflation plus 3% population growth plus 2% growth in GDP per capita). As a result debt is growing faster than the capacity to service it. As the Red Queen said to Alice, sort of, "Africa is a place where you have to run faster and faster just to stay in the same place."

FOR ZAIRE AND SUDAN, EVEN WITH BENDING ALL DEBT RESCHEDULING RULES, GROWTH CANNOT TAKE PLACE THROUGH DEBT RESCHEDULING, COUPLED WITH NORMAL ECONOMIC ASSISTANCE. WHAT IS REQUIRED IS NOTHING SHORT OF TOTAL FORGIVENESS, OR AT LEAST A FIVE TO TEN YEAR SUSPENSION OF SERVICE PAYMENTS, PLUS A DOUBLING OF FOREIGN ASSISTANCE LEVELS.

III.B. The U.S. as IMF -- The Cash and Carry Option

At some point, the costs of debt service becomes greater than the benefits. At that point, either by necessity or design, debtors begin reneging on obligations and arrears begin to accumulate. By the end of 1984, of the total African debt of $80 billion, $11 billion was in arrears. For IDA-eligible African countries arrears of long-term debt already equals $3.2 billion, or 57% of normal debt service expected in 1986/87. Several countries, most notably Sudan and Liberia, have fallen so far behind in many of their debt service payments, particularly those to the IMF, that there is little hope that they could ever become current. Others are moving along the same track.

What are the costs to a country of failing to pay its debt? Failure to keep current with the IMF has a host of consequences. In the first place, Paris and London Club reschedulings cannot take place without an IMF program in place. Second, IBRD policy prohibits the establishment of broad-based structural adjustment programs (sectoral programs seem to be acceptable) in the absence of an IMF program. Third, commercial credit and confidence are likely to dry up in the absence of good standing with the Fund.

Of course a country could keep up its service payments to the Fund and allow other creditors to languish. In general, such a policy may have two effects: (1) it will eliminate resource flows from the creditor who is not being paid and (2) it may have an overall negative effect on lender confidence.

Nevertheless, for many countries, there may come a time when debt service payments to certain creditors become impossible to bear. A rational debt management policy would maximize net resource flows, thus budgeting service payments to those creditors who are prepared to lend more than they are currently owed. In most cases, an efficient debt-management policy would make necessary Brooke payments. <u>However, it remains likely that several African countries will find they have more to lose than to gain by keeping current with the IMF, given the substantial negative resource flow such a policy would entail.</u>

This presents a dilemna for the U.S. which we are just now beginning to face in Liberia. Fund ineligibility coupled with the withdrawl of the Bank from a structural adjustment role leaves a policy leverage vacuum. If we are at all interested in stabilization and recovery of an economy like Liberia or Sudan, we will be forced to take a much more upfront role. While it is still possible to call upon Bank and fund technical assistance and policy advice, our non-project assistance becomes the only game in town, a game we are very uncomfortable about playing. Moreover, it is a game for which we increasingly are lacking resources to play. "Cash and Carry" is only a policy option for the US if we are willing to assume the major burden of financing of, and conditioning our assistance on, structural adjustment. Moreover, "Cash and Carry" also means an upfront acceptance by the USG that debt service, particularly to the multilateral agencies, is a secondary objective to economic restructuring and resumption of economic growth.

III.C. <u>Riding the Downward Spiral</u>

For a number of African economies on the brink of bankrupcy, it is the government rather than the economy itself which is bankrupt. This is clearly the case in Sudan, Somalia and Liberia, and probably true in many other places as well. The bankrupcy of the government becomes a problem for the private sector through government policies, particularly those which direct savings and credit towards the public sector to such an extent that they dampen private sector activity.

In such a situation it might be well to acknowledge government impotence and try to use our influence to limit government interventions in the private economy. We would not have broad stabilization objectives, but rather focus on targets of opportunity, trying to make useful interventions while the economy is imploding. This seems to be the strategy we are currently following in Sudan. Our resources could be used to increase credit availability in the private economy as well as to ensure the provision of limited, necessary government services.

Such an approach is not likely to achieve much success. In the first place, as the government economy accelerates its descent it tends to bring the private, formal economy down with it. While bankrupt governments are prepared to reduce activities which they are unable to finance, they will also tend to try to increase their siphoning off of resources from the private sector. Since the tax system by this time is usually inoperative, governments embark on a number of ad hoc measures to increase their access to private resources, all of which tend to distort incentives. The most popular of these measures is printing money and inflating the economy. Other measures include increasing controls on markets so as to use marketing channels as a vehicle of taxation.

In any case, bankrupt governments tend to pursue policies that lead to an increasingly rapid downward spiral. Recently, several African countries, Guinea and Ghana in particular, have emerged out of years of increasingly ineffective policy regimes, and dramatically restructured their economies. However both Guinea and Ghana had been travelling down the spiral for such a long time that their creditworthiness had eroded, and when they emerged from the bottom end of the spiral they were not burdened with an unsustainable debt. Moreover, their escape from the spiral only occurred after their formal economies had virtually ceased to exist, and all economic activity took place in informal, illegal markets. Zaire and Zambia on the other hand were able to finance their misguided policies with enclave mineral earnings, which also enabled them to borrow heavily. Their economic restructuring is much more difficult because they were able to borrow while still on the spiral, and thus not only have to restructure their economies, but also service a substantial debt. Moreover, having not yet reached rock bottom, their adjustment must take place through reform not through collapse, thus making the reform medicine more bitter to take.

III.D. Triage

As every economist knows, we live in a world of constrained maximization. Resources are scarce and thus we can never produce or consume all we would like. Nowhere is this principle more evident than in Africa. Scarce foreign exchange, scarce investible funds, scarce budgetary resources mean that neither the Africans nor the donors are likely to achieve objectives that are anything in excess of modest. This is a difficult lesson for an Agency that is dedicated to growth and development and a people who believe that any problem can be solved with enough effort and creativity.

The truth is that in Africa, with a few notable exceptions, development has not occurred. The truth is that both the donors and the African governments are responsible for this failure. The hard truth is that it is impossible for development to occur everywhere in Africa over the next decade. The bedrock truth is that the USG is incapable of achieving its myriad objectives everywhere in Africa -- foreign policy, developmental, humanitarian and economic. The more we seek to achieve many objectives, the more likely we are to fall short of all of them.

Sudan is an unfortunate case in point. Given the inability of the Government of Sudan to either reconcile its different factions politically or create an environment for economic growth, Sudan has been spiraling downward into political and economic instability. We are no longer able to impede this decline. We are unable to help Sudan pay off its creditors, particularly the IMF. And because we are unable to help, we are in danger of seeing our political relationship with Sudan deteriorate significantly.

The triage option would have us carefully prioritize our objectives in Africa, calculate the cost in terms of financial and political resources, and use those resources to achieve those objectives which can be achieved, and not scatter our resources trying to deal with every problem. For example, it may be that we have only enough foreign assistance resources (including staff) to make a serious effort at structural adjustment in eight or ten countries, countries which have the political and managerial capacity to make structural adjustment work (for example, three or four from Category B, and three or four from category C). In the rest of Africa we would not have a growth or stabilization objective, but rather one of showing the flag or "renting" facilities. If we seriously concentrated resources and staff (say 60% of staff and 80% of resources) we might be able to make a difference. In a way, Graham-Rudman-Hollings may be an opportunity disguised as a problem.

For example, suppose we were to concentrate our resources in eight countries where economic reform is possible. Suppose, for purposes of illustration we chose to concentrate in Niger (C), Senegal (C), Mali (C), Guinea (B), Kenya (B), Zambia (C), Malawi (B) and Uganda (B). We would quadruple our funding in these countries (from $183 million including

PL480 Title I to $690 million) and double our direct hire staff (from 114 to 215). These eight countries have debt service obligations of $2 billion annually and foreign assistance disbursements of roughly the same level. If our assistance were to be flexible and fast-disbursing we could increase ODA to these eight countries by 25%, merely by shifting our own resources, thus making a real difference in the economic prospects of these countries, and at least holding out the possibility of achieving our political, economic and humanitarian objectives in countries containing 80 million of Africa's people.

III.E. Muddling Through

Of course the most likely option is to refuse to choose, refuse to recognize that we and the Africans and the international financial system are all hurtling down a path to disaster. We will change our actions when the choices facing us are so stark that we are unable to avoid making a choice. It's possible that it is already too late, that none of the choices, none of the options left are feasible, that the relevant economist in Africa is not Adam Smith, but Thomas Malthus, and that there is no way of avoiding the perenial visits of the four horsemen of the apocalypse.

IV. A Concluding Word

For the first time in its history as a development agency, AID is facing a development problem which may be insoluble. Without a profound turn around in the international economy, many African countries, including some of those in which the U.S. has a high political interest, are virtually bankrupt. The international economic system has no mechanism for dealing with bankrupcy in an orderly fashion. As a result, these countries will be forced to opt out of the international financial system. Forced to resort to cash and carry, import levels are likely to contract further, and formal economies, particularly the government sectors, will spiral downward or implode.

Other countries, the category C or receivership countries, remain on the brink. They are attempting to undertake the necessary policy adjustments while continuing to service their international debt service obligations. Debt rescheduling together with increased assistance levels have been sufficient to permit stabilization, albeit at the expense of declining consumption levels, particularly in urban areas. However, resources are sufficient only to stabilize these economies, not engender growth. Without growth, debt rescheduling only puts off the day of reckoning, the day when receivership economies become bankrupt.

For a number of other countries (those in category B, Recovering Firms), growth is possible after a difficult adjustment period. Here the existing international financial system is probably adequate, although greater concentration of resources in countries making a reasonable effort to adjust will reduce the political difficulties of policy change and hasten the renewal of growth.

What option should we follow? The logic of this paper leads us to advocate following several options at once, depending on which categoryof country we are dealing with. <u>The overiding principle which guides these policy prescriptions is the recognition that with limited resources only limited objectives can be met.</u>

For countries in category A, continued, though minimal, levels of development assistance makes sense.

We should choose some subset of countries in categories B and C in which we have a great interest, and concentrate our foreign assistance resources in order to support structural adjustment.

For countries in category D, we should acknowledge their bankrupcy, and not use our resources to pay off debt, unless such payments increase net resources available to the country. In any case, our assistance levels in these countries should be the minimal necessary to support our political objectives. Development assistance, as opposed to ESF, in these countries, except insofar as it goes directly to the private sector, should be eliminated.

For countries in category E our assistance should be directed at achieving political and humanitarian objectives, and should be limited to levels commensurate with these objectives.

Finally, we should acknowledge that a resumption in growth for many African countries depends on the development of an international financial mechanism for dealing with bankrupcy, whether in the form of debt forgiveness or some more imaginative solution.

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