Overseas Debt as a Constraint on Alternative Policies for New Zealand.

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December 1991

1) Introduction

It is widely perceived that the freedom of action of any New Zealand Government in its economic management is constrained by the requirement that policies must be acceptable to the country's overseas creditors - or more specifically, to international financiers and credit-rating agencies. This perception deserves examination at several levels.

1) First we need to ask whether it is in fact true that the overseas debt represents a constraint on policy freedom, and if so, what exactly is the nature and mechanism of this constraint.

2) Second, we need to ask what is the payoff in policy autonomy from (a) further belt-tightening, or (b) a change to a strong expenditure-switching policy (that is, deliberate promotion of the economy's traded-goods producers)?

3) Third, regardless of whether a clear-cut constraint exists or not, we need some idea of how international financiers form their judgements about which policies they regard as "acceptable" or desirable. In particular,

> (a) is it reasonable to suppose that international financiers have the same world view, and policy intuitions, as the New Zealand Treasury and Minister of Finance; or might they be willing to see an alternative set of policies introduced with the clear intention of restoring economic health and thus safeguarding their money?
>
> (b) might we not suppose that the international climate of opinion must have been shifted significantly by the experience of the Third World debt crisis of the past ten years, leading international operators to recognise the limitations of narrowly orthodox models of stabilisation for small open economies faced with large external imbalances?
>
> (c) is it not usual for international financiers to concern themselves with the sustainability of a debtor country's real exchange rate, and to criticise policy stances which yield unsustainable (overvalued) exchange rates?

The material which follows is not, alas, a finished paper, but merely the initial exploratory stages of a planned project on the debt sustainability issue in New Zealand.

2) The Quantitative Record.

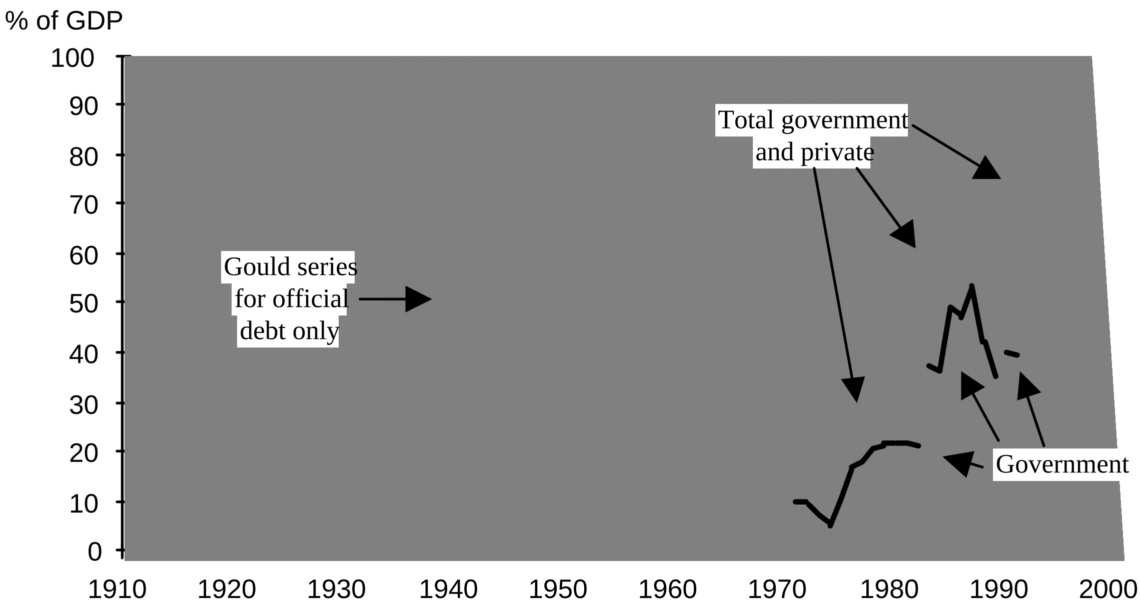
The numerical record comprises stocks, flows, and ratios. The most widely-used number is the outstanding stock of gross debt - that is, the total financial liabilities of the New Zealand economy, *with no adjustment for offsetting assets* . This total also excludes the additional liability represented by the stock of foreign direct investment, because such equity investment confers no entitlement to receive any return, and hence to impose any resource burden on the economy, except insofar as the enterprises in which equity is held turn out profitable.

Servicing charges on external debt, in contrast, constitute a fixed overhead charge on the economy's flow of foreign exchange earnings.

The long-term trend of external gross debt is shown in Figure 1. For the period 1910 to 1970 the figures are those of Gould (1983) for official external debt. From 1971 onwards separate series are shown for total gross debt and the the government gross debt. The breaks in the series correspond to the introduction of new, more thorough surveys by the Department of Statistics, and trends should not be read across these breaks. It will be noted that in both 1983-84 and 1989-90 the effect of the new surveys was sharply to increase the reported ratio of gross debt to GDP. Even after these revisions, the level of government debt (including government's market activities) remained less than half the pre-World War II average as a percentage of GDP. Total debt, both government and private, remains below the propotion of GDP represented by official debt alone in the 1910-1930 period.

Figure 1

New Zealand's Gross Overseas Debt as a Percent o f GDP, 1910-1992



Sources: Gould (1983), Webber (1988), Webber (1990); Colgate and Stroombergen (unpublished) for projections to March 1992.

The common practice of dividing gross debt by GDP makes allowance, in a crude way, for any economic growth resulting from external borrowing; obviously, changes in the ratio of Debt to GDP will be due to the trends of both numerator and denominator, so that a rapidly-growing economy with a constant debt will exhibit a falling ratio, whereas a stagnant economy with rising debt will exhibit a rising one. The increase in the Debt/GDP ratio over the past two decades is therefore a product of the economy's poor growth performance as well as the resort to overseas borrowing. In addition, changes in the nominal exchange rate will impact, in the first instance at least, more on the numerator than on the denominator, since only part of GDP is exported.

The numbers graphed in Figure 1 correspond to the tables and charts in Webber (1988) and Webber (1990) which have become the standard source for commentators on the debt. However, Webber's figures for private-sector debt prior to 1983 are very incomplete, and this combined with the improving coverage of the Department of Statistics surveys from 1983 on gives an artificially-inflated impression of the rate at which overseas debt actually increased between the mid-1970s and the mid-1980s. One might wonder whether the zeal of the Department of Statistics in uncovering and including new items of gross outstanding debt has led not only to an overstatement of the rate of increase of the external debt since 1980, but also a possible overstatement of New Zealand's indebtedness in comparison with other countries in the IMF statistics.

A number of issues of measurement give cause for worry. Webber (1988 p.22) concluded his survey of the available figures with the very relevant warning that

> The ... measures developed in this paper are as accurate as present statistics allow. Recent announced steps by the Department of Statistics to improve the collection of data on overseas debt and capital transactions are overdue and should, in time, provide a more reliable picture. It should be noted, however, that the present measures of debt are likely to understate actual private borrowing and that improved statistics may generate an impression of a worsening trend.

This last possibility - that a considerable part of an apparent worsening in the debt ratio may be a statistical artifact resulting from the growing efficiency of the statistical system in "uncovering" already-existing debt - is already manifest in Webber's analysis of the causes of the rise in his debt figures. Following Dixon and Parmenter (1987) he builds up a picture of the stock of outstanding net debt implied by the balance-of-payments current acount and the effect of exchange-rate changes on the volume of overseas debt recorded in NZ dollars. The result of this exercise is then compared (Webber 1988 pp.10-11) with the recorded stock of net debt from the official series, and it turns out that for the period 1971 to 1982 the cumulated flows ran ahead of officially-recorded debt, whereas from 1983 this was reversed and the official figure rose ahead of the cumulated flows. The years 1983 and 1984 stand out as the period during which the official stock estimate of net debt leaped from 32.5% of GDP (1982) to 48% (1984) while the cumulated-flow estimate rose only from 32% to 39%. Webber's charts show the "residual" between cumulated flows and estimated stocks switching from positive to negative at this stage.

Because of the widespread tendency in popular discussion of the debt to give credence to stock point estimates rather than to totals derived from cumulated flows, this discrepancy is a cause of concern, since 1983-84 was the period when the Department of Statistics introduced its new surveys of overseas debt with the clear intention of obtaining better coverage than that of the pre-1983 data. The new figures were initially released in February 1985 (Department of Statistics 1985a) and appeared as Appendix I in the March 1985 *Monthly Abstract of Statistics* , with only a brief note stating that (*Monthly Abstract of Statistics* March 1985 p.121)

> Although the extended Overseas Balance of Payments Survey has given much more data about overseas private borrowing than hitherto has been available, much detail cannot be published because of the stringent confidentiality provisions of the Statistics Act.

No attempt was made to publish debt stock estimates for 1983 and 1984 on the old methodology, and as a result it is impossible to know how much of the reported rise in external debt between 1982 and 1984 should be attributed simply to the improvement in reporting. The figures from the new survey, as subsequently revised, appear in the INFOS OSDQ series for March 1983, 1984 and 1985.

In June 1986 the survey became quarterly but remained on essentially the same methodological base up to the June 1989 quarter, under the name Quarterly Survey of Long-Term Overseas Debt. This was then replaced in the September 1989 quarter by the Quarterly Total Overseas Debt Survey which attempted to measure short-term as well as long-term debt, and which included inter-bank deposits (a type of liability excluded from the previous surveys) which accounted for $3.9billion of the $46.6 billion debt estimate for September 1989. The Department noted (1990a p.4) that the data for March 1986 to June 1989 was probably less reliable than that for 1983-1985 because of the abolition of exchange control and floating of the New Zealand dollar, with an associated proliferation of new types of debt instruments, and that the new survey would be expected to capture these. Again no attempt was made to overlap the old methodology with the new.

The resulting break in the series coincides with a sharp upward leap in the total outstanding debt shown in Colgate (1991) and Webber (1990 p.4 Table 2) between March 1989 and March 1990, in contrast to the Department of Statistics' warning (1990a p.4) that "after removing the impact of inter-bank deposits, New Zealand's total overseas debt actually fell by $NZ0.8 billion between December 1988 and September 1989".

Thanks to recent work by Pat Colgate and Jos Stroombergen, we now have available a set of gross debt figures which are an improvement on those in Webber (1988) with respect to the trends in major components of the New Zealand debt. It is not clear to me, however, that the problems posed by breaks in the official series have yet been fully dealt with. The Colgate/Stroombergen figures are set out in Table 1 and graphed in Figure 2 and Figure 3.

Table 1
New Zealand's Overseas Debt 1978-1991

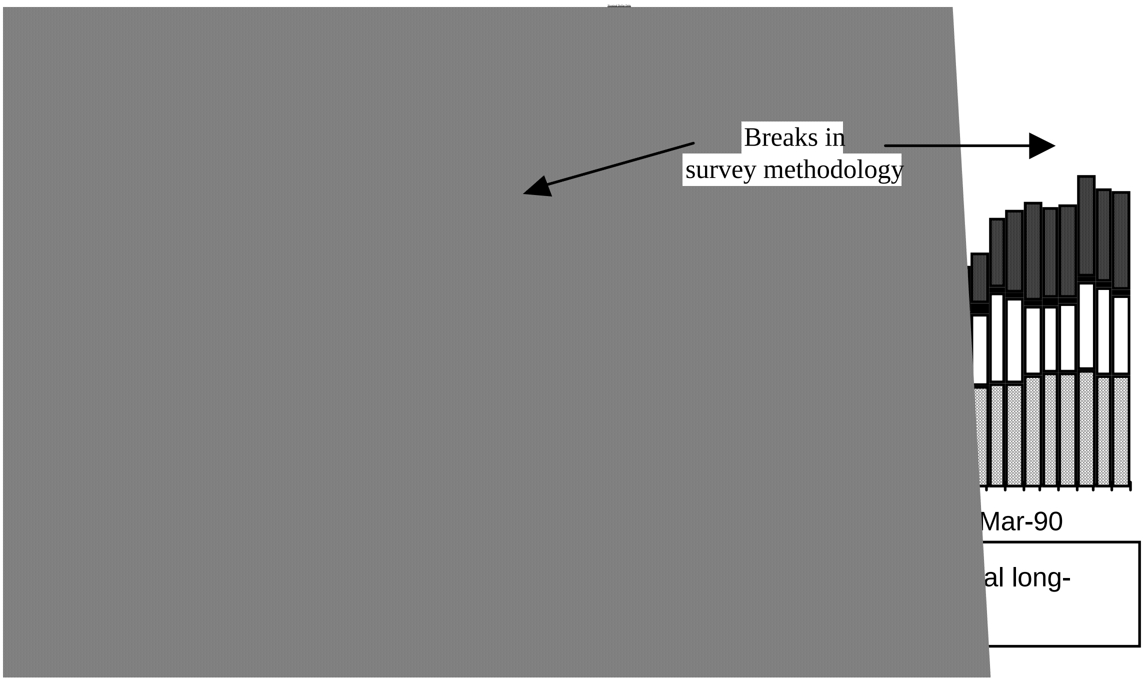
(a) Millions of Dollars

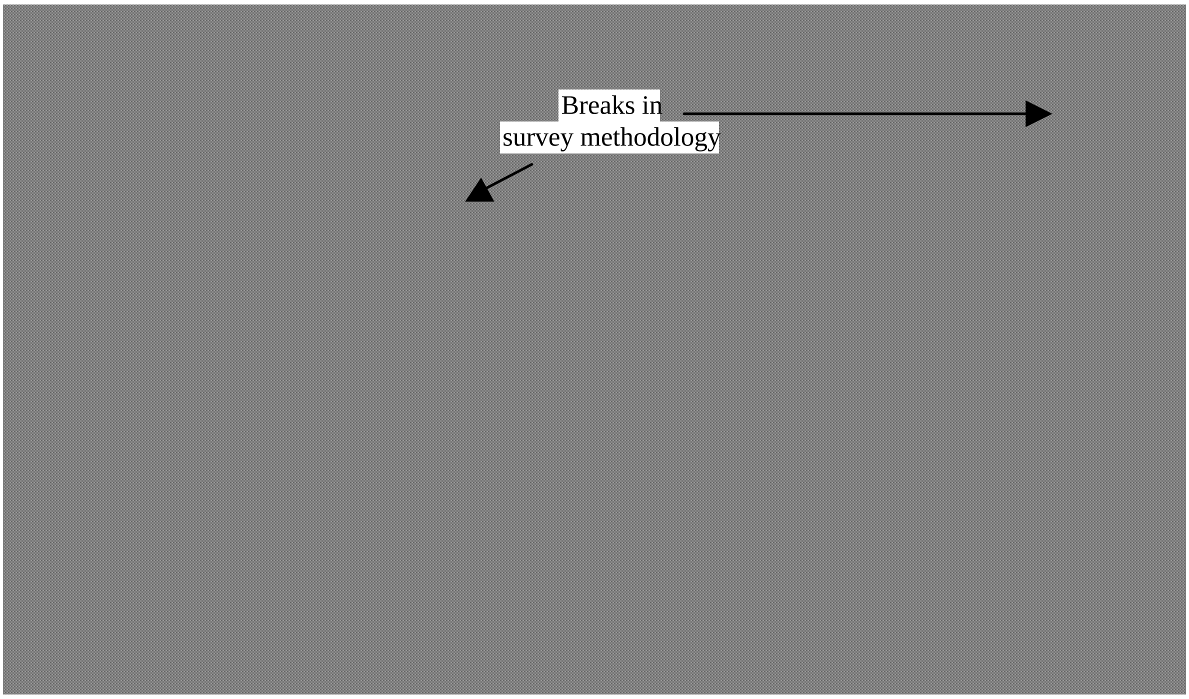
Total	Official short overall term	Official long term	Total official	Market short term	Market long term	Market total	Total short term	Total long term	debt
Mar-78	0	3,256	3,256	352	2,519	2,871	352	5,775	6,127
Mar-79	0	3,676	3,676	334	2,312	2,646	334	5,988	6,322
Mar-80	0	4,297	4,297	357	2,521	2,878	357	6,818	7,175
Mar-81	215	4,594	4,809	367	2,658	3,025	582	7,252	7,834
Mar-82	0	6,776	6,776	448	3,468	3,896	448	10,224	10,672
Mar-83	74	9,178	9,252	525	5,548	6,073	599	14,726	15,325
Mar-84	52	9,337	9,389	899	7,023	7,922	951	16,360	17,311
Mar-85	44	13,916	13,960	2,972	10,698	13,670	3,016	24,614	27,630
Mar-86	292	15,595	15,887	3,535	10,829	14,364	3,827	26,424	30,251
Mar-87	1,191	21,822	23,013	3,729	14,415	18,144	4,920	36,237	41,157
Mar-88	781	19,269	20,050	4,862	14,008	18,870	5,643	33,277	38,920
Mar-89	297	16,777	17,074	7,678	13,124	20,802	7,975	29,901	37,876
Jun-89	1,929	17,068	18,997	8,613	12,486	21,099	10,542	29,554	40,096
Sep-89	1,102	17,571	18,673	11,899	15,518	27,417	13,001	33,089	46,090
Dec-89	954	17,900	18,854	14,335	14,356	28,691	15,289	32,256	47,545
Mar-90	1,041	19,062	20,103	16,697	11,970	28,667	17,738	31,032	48,770
Jun-90	1,291	19,658	20,949	15,552	11,340	26,892	16,843	30,998	47,841
Sep-90	951	19,657	20,608	16,141	11,521	27,662	17,092	31,178	48,270
Dec-90	953	20,153	21,106	16,983	14,998	31,981	17,936	35,151	53,087
Mar-91	872	19,326	20,198	15,958	14,691	30,649	16,830	34,017	50,847
Jun-91	1,042	19,080	20,122	16,705	13,586	30,291	17,747	32,666	50,413

(b) Percent of GDP

Total	Official short overall term	Official long term	Total Official	Market short term	Market long term	Market total	Total short term	Total long term	debt
Mar-78	0.0	21.9	21.9	2.4	16.9	19.3	2.4	38.8	41.2
Mar-79	0.0	21.8	21.8	2.0	13.7	15.7	2.0	35.5	37.5
Mar-80	0.0	21.8	21.8	1.8	12.8	14.6	1.8	34.6	36.4
Mar-81	0.9	20.0	21.0	1.6	11.6	13.2	2.5	31.6	34.1
Mar-82	0.0	24.4	24.4	1.6	12.4	14.0	1.6	34.8	38.5
Mar-83	0.2	29.5	29.8	1.7	17.8	19.5	1.9	47.4	49.3
Mar-84	0.2	27.1	27.3	2.6	20.4	23.0	2.8	47.6	50.3
Mar-85	0.1	35.9	36.0	7.7	27.6	35.3	7.8	63.5	71.3
Mar-86	0.7	35.0	35.6	7.9	24.3	32.2	8.6	59.2	67.8
Mar-87	2.2	40.5	42.7	6.9	26.8	33.7	9.1	67.3	76.4

Mar-88	1.3	32.2	33.5	8.1	23.4	31.6	9.4	55.7	65.1
Mar-89	0.5	25.9	26.4	11.9	20.3	32.1	12.3	46.2	58.5
Jun-89	2.9	25.9	28.8	13.1	18.9	32.0	16.0	44.8	60.8
Sep-89	1.6	26.1	27.8	17.7	23.1	40.8	19.3	49.2	68.6
Dec-89	1.4	26.1	27.5	20.9	21.0	41.9	22.3	47.1	69.4
Mar-90	1.5	27.3	28.8	23.9	17.2	41.1	25.4	44.5	69.9
Jun-90	1.8	28.0	29.8	22.1	16.1	38.3	24.0	44.1	68.1
Sep-90	1.3	27.8	29.1	22.8	16.3	39.1	24.1	44.0	68.2
Dec-90	1.3	28.3	29.6	23.8	21.1	44.9	25.2	49.3	74.5
Mar-91	1.2	27.0	28.2	22.3	20.5	42.8	23.5	47.5	71.0
Jun-91	1.4	26.5	27.9	23.2	18.8	42.0	24.6	45.3	69.9





As Wells points out, (1991 p.7) over 90% of the outstanding debt of Latin American and African countries appears to be either government debt or government-guaranteed.

Market sector long-term indebtedness has similarly stabilised and fallen back

<u>4) The Credit Rating Agencies.</u>

The question of how overseas observers approach the analysis of a country's debt position, and the factors taken into account in a credit-rating exercise, may be tackled by looking at a recent statement by a major credit-rating agency, Standard and Poor's. Discussing sovereign (that is, government) borrowers, the agency starts with a clear statement (Standard and Poor's, 1991b, p.1):

> A sovereign debt rating reflects a govenment's ability and willingness to repay publicly issued debt in a timely manner, and is based on the country's overall credit worthiness. Ratings indicate future debt servicing capacity and, therefore, S&P's rating methodology is forward looking.

Standard & Poors distinguish between "political risk" (willingness to pay) and "economic risk" (ability to pay).

Government is attributed higher credit standing than any other debtor in the nation because of the greater power of government pre-emptively to lay claim to all resources under national control. As S&P put it (1991b p.1),

> In the case of external obligations, the sovereign government has first claim on the country's foreign exchange reserves, and controls the ability of any person in that country to obtain and send funds abroad to repay foreign obligations.

Political risk is judged on the basis of the factors that may limit the ability of policymakers to "implement effectively needed economic policies when confronted with potential payments problems". Orderly succession, stability, flexibility, degree of democracy, centralisation, and "characteristics of major political parties and coalitions" are combined with social indicators such as living standards, literacy, trade union militancy, ethnic and other divisions, and also with international-relations matters such as alliances, adherence to multilateral trading agreements, and potential military threats.

Economic risk is judged on the basis of five factors, four of which involve the real growth performance of the economy in some sense. The five are external financial position, balance-of-payments flexibility, economic structure and growth, management of the economy, and economic prospects. S&P's country report on New Zealand (1991a) does not mince words in identifying the economy's problems from the point of view of a rating agency:

> New Zealand's small export base, consisting of mainly low value-added agricultural and forestry products, and weak external payments position make the country quite vulnerable to adverse international developments and limit policy flexibility.... The economic and social costs of restructuring and disinflation have been high, and further adjustments will be required to reinforce the productivity gains expected in the medium term... Unemployment ... is rising sharply and is unlikely to fall soon. Domestic adjustment has been hampered by the protectionist agricultural policies of some of New Zealand's main trading partners, which limit export growth and depress the terms of trade. Imports have risen due to a loss of competitiveness, tariff reductions, and investment spending related to restructuring. As a result, the current account deficit has grown sharply since 1989 and is expected to reach nearly 7% of GDP in fiscal 1991. (p.59)
>
> The chronic weakness of the balance of payments is the central challenge facing the New Zealand economy. After narrowing appreciably between fiscal 1986 and fiscal 1989, the current account deficit has risen sharply again, reaching NZ$4.2 billion, or 6.0% of GDP, in fiscal 1990. An even higher deficit, on the order of NZ$5.0 billion or 6.9% of GDP, appears likely in fiscal 1991....(p.61)
>
> In the near term, a substantial reduction in imports will be necessary to narrow the current account deficit appreciably. Given the level of the New Zealand dollar exchange rate and the country's rising propensity to import, a further compression of domestic demand would be required to achieve this. However, over the medium term, a sustained improvement in the balance of payments will also depend on the economy's capacity to diversify its narrow export base. (p.62).

The report noted the Reserve Bank's use of monetary policy to prop up the nominal exchange rate, and commented that (1991a p.61)

> The real effective exchange rate, combined with the country's burgeoning current account deficit, suggests that the New Zealand dollar could be overvalued. However, the strategy of the authorities is to allow any real effective depreciation to occur gradually so as not to upset their 0-2% inflation target.

It is the consequences of this situation for medium-term growth prospects that seems to have underlain Standard & Poors' 1991 downgrading of New Zealand's credit rating. Their report shows no special concern about the fiscal deficit position; but the weakness of the external sector, and the consequent constraint on sustainable growth prospects, is a recurrent theme. The agency provides no clear statement on its view of long-term growth prospects, but it is clear in its pessimism about the immediate future. Recent policy measures such as spending cuts and labour-market restructuring

> should enhance New Zealand's economic and financial flexibility by restoring fiscal balance, strengthening overseas competitiveness and reducing the current account deficit, but the timing and extent of future benefits are uncertain.(p.59)

> With last year's investment boom now subsiding, real GDP is likely to show modest increases of under 1% annually in fiscal 1991 and 1992. Fixed capital spending by state enterprises appears to have reached a plateau, while private sector investment is expected to be static due to declining profits, high interest ratess, and excess capacity. Public expenditure rose by an estimated 2% in the current fiscal year, but government spending will have a negative impact on total demand in fiscal 1992 given the size of the cutbacks planned by the National government. Private consumption will also be under pressure during the period, reflecting rising unemployment, modest wages growth, and lower state social benefits. The expected recovery of... net export volumes will likely be offset in large degree by further decline in the terms of trade. (p.62)

The external agency's focus on the underlying productive strength of the economy, rather than the financial and budget indicators, is manifest in the terms of the qualifiers attached by S&P to its discussion of the apparent improvement in the external official debt position. On the external debt, the agency states

> [B]oth gross and net external debt levels, in New Zealand dollar terms, appear to have either stabilized or fallen slightly from the peaks of fiscal 1987. Heavy foreign equity inflows associated with the privatization of New Zealand Telecom and other asset sales largely financed the current account deficit during this period. Nevertheless, New Zealand's external debt is still very high in comparison to other developed countries, and it will soon be on a rising trend again if large current account deficits persist. Moreover, the maturity structure of the debt is unfavourable, with a heavy reliance on short-term debt, particularly by the private sector. Of the total, NZ$27.3 billion, or 57%, is in the form of medium- and long-term obligations. The remaining NZ$21 billion, or 43%, is in short-term debt, although a significant component represents obligations of some private sector companies in financial difficulties that are expected to be restructured. (p.63)

The Standard and Poor's focus on the strength of the external sector as the ultimate determinant of ability to sustain the external debt is not a new theme. Since the mid-1980s the agency has given stronger and more consistent emphasis to the balance of payments current account than have New Zealand Governments. This might provide some evidence of a relatively "structuralist" orientation among at least part of the international financial community compared to the sometimes extremist neoclassical view of key advisers to the New Zealand Government.

The basic thinking behind Rogernomics, and more recently behind Ruth Richardson's approach to macroeconomic management, has, from a structuralist point of view, overemphasized flexible price adjustment and underestimated the structural nature of New Zealand's long-term economic difficulties. This has been manifest in two particular tendencies in official thinking. First was an apparent belief that eliminating the government's fiscal deficit would automatically bring the balance-of-payments current account into line, whether by reducing "excess demand" pressure in the domestic economy, or by enabling interest rates to fall and thus reducing capital inflow. Second was an apparent assumption that the real exchange rate and the associated distinction between tradeable and non-tradeable production were not of great importance, on the basis that (a) the boundary between the two types of production was expected to blur and shift as New Zealand diversified into rising exports of services (especially, it seems to have been hoped, financial services); and (b) the response of tradeables producers to domestic demand contraction was expected to be an increase in net exports regardless of relative competitiveness, rather than layoff, closedowns and bankruptcies.

One lesson of the seven years since the 1984 devaluation has been that the basic structure of an economy depends more on relative competitiveness and the level and composition of real investment expenditure, than on the fiscal and monetary settings and the level of regulation. The long-term external balance situation rests primarily upon production structure (that is, on the economy's capacity directly to convert domestic real resources into net foreign exchange). The ability of an economy to sustain debt thus ultimately hinges upon the extent to which it confronts a foreign exchange constraint.

Standard and Poor's displayed a clear awareness of this throughout the Rogernomics era in New Zealand. Standard and Poor's adjusted New Zealand's sovereign rating as follows:

Date	Action	Reasons given
May 1983:	reduced from AAA to AA+	"the public sector's large and increasing external debt burden, deterioration of the current accou
December 1986:	reduced from AA+ to AA	"continued external imbalances and rising external debt burden... the balance of payments position deteriorated significantly in recent years ... structural factors and international conditions may retard ... improvement." (Chambers 1987 p.21).
1986:	rating outlook listed as "negative"	one of a group of "resource-based economies [which] remain under pressure, reflecting the countries' inherent vulnerability to fluctuations in world commodity markets, large current acccount imbalances, and growing foreign debt burdens.... current account deficits have their counterparts in insufficient private savings, as government finances are in ... near balance..." (Bates 1989 p.5).
March 1991:	reduced from AA to AA-	"large current account deficit, heavy foreign debt burden, and the likelihood of protracted external adjustment". (Standard and Poor's, 1991a, p.59).

The other major rating agency, Moody's Investor Service, took less notice of the external balance position and gave more emphasis to the supposed virtues of domestic policies of deregulation and demand restraint. Along with the steady Aa3 rating, the commentary text in Moody's *Credit Opinions* changed remarkably little from the mid-1980s to the present. Periodic more detailed New Zealand issues of *Moody's Sovereign Credit Report* (September 12 1986, April 1988, April 1989 and June 1991) focus heavily on the domestic reform programme and its repeatedly anticipated benefit in the long or medium term. In general, the tone of the Moody's commentaries seems much more in tune with the public line of the New Zealand Government, and there is a good deal of praise for the free-market orientation of policy.

5) Some Concluding Comments

I conclude with some general propositions for discussion.

1) New Zealand is not insolvent nor at immediate risk of becoming so. The country does however face a rising cost of credit because the indicators generally used to appraise country risk show a fairly high level of gross indebtednesss relative to other developed economies, and the short maturity profile of New Zealand's outstanding debt has contributed to overseas speculation that some rescheduling may be required. In fact any general rescheduling is highly unlikely, although some individual private-sector borrowers are grappling with their own particular financial crises.

2) The real external constraint on policy posed by the foreign debt continues to be, as in the past, the one identified clearly by the Planning Council in 1983, namely that it is not prudent to continue indefinitely to operate the national economy along a path which entails a rising level of external debt. External balance needs therefore to be an explicit objective of economic management, and some appropriate instrument needs to be allocated to its achievement. Floating the exchange rate and deregulating the domestic economy have not freed New Zealand from its long-standing foreign exchange constraint, nor altered the basic nature of that constraint.

3) The standard theory of country risk, reinforced by recent analysis from Standard and Poor's, suggest that the combination of slow growth of GDP and continuing large current-account deficits in the balance of payments imply future worsening of external debt ratios. Domestic demand deflation does not offer a sustainable solution to this problem. Insofar as the New Zealand Government comes under overseas pressure to change its policies, it is most probable that such pressure will be in favour of a devaluation of the New Zealand dollar and the adoption of other policies which would be more supportive than the present stance towards expenditure-switching in favour of tradeables production.

4) Overseas bankers and investors are less starry-eyed about the virtues of free-market policies than is sometimes suggested. Investors have a distaste for any government regulation which reduces their profits, but no automatic distaste for interventionist policies which underwrite their security and rate of return. The general investor preference for sovereign debt over private-sector financial instruments rests upon (a) the recognised fact that within the nation, government retains always the ultimate power to pre-empt resources from other parties in order to meet its own obligations, and (b) the hard-nosed view that it is appropriate for government to use this power when necessary to ensure that debt servicing is paid.

5) It is therefore the perceived quality of economic management, rather than the particular ideological orientation of government, that has most effect upon the cost of obtaining new credit internationally. The 1991 reduction in New Zealand's credit rating, following a period of several years during which the debt ratios had been kept flat or falling, reflected declining overseas confidence in the quality of government advice and decision-making, in view of the continuing failure of neoliberal policies to trigger export-led growth. Overseas investors operate with shorter time-horizons than Ruth Richardson and Treasury, and would clearly prefer pie on the plate now rather than in the sky next decade. Many ordinary New Zealanders share this prejudice.

6) Public knowledge and analysis of the debt situation has been seriously undermined by the inadequacy of New Zealand's official statistics on the country's balance-sheet position. The series which attracts most attention from media, politicians and casual commentators is the gross debt. Estimates of this have been subject to abrupt and destabilising (upward) revisions every time the Department of Statistics changes its survey methodology (in addition to the upward pressure on the numbers resulting from nominal exchange-rate changes). The persistent failure of the Department to provide overlapping debt-stock series prepared under old and new methodologies makes it impossible to be certain about the actual medium-term trend of gross debt and has contributed to over-reaction by politicians as changed statistical definitions caused the prevailing "news" about debt ratios to worsen in 1985 and 1990. It seems possible that the enthusiasm with which the coverage of the overseas gross-debt surveys was improved in the late 1980s may have been motivated partly by Government's desire to frighten off public opponents of its economic policies by reference to a looming debt crisis.

7) As information about the asset side of the New Zealand balance sheet improves, the statistical picture has tended to become less alarming. This is because it is becoming clear that the stock of overseas assets held by the New Zealand private sector has grown very rapidly at the same time as outstanding financial liabilities have risen. In particular the very rapid growth of short-term indebtedness in the past five years seems to have been shadowed by an accompanying rise in assets, albeit less liquid ones. New Zealand has thus shared the world-wide trend for rising gross external debt to reflect "capital flight" as well as foreign trade gaps. This means that the perception of the country's balance-sheet position may brighten in the near future when "official" estimates of the true net-worth position become available.

8) The dynamics of debt accumulation and servicing have been the subject of a large economics literature which generally shows that the relationship between the interest rate on debt and the growth rates of GDP and net exports are the real fundamentals. If present patterns of high interest and low growth persist, there is a real risk of New Zealand's external debt becoming extremely costly to service, in the sense that the squeeze on domestic consumption could be greatly increased as resources are diverted under the pressure to raise foreign exchange availability. The existing debt is sustainable in the sense that it can be serviced, but could become potentially "unsustainable" in political and social terms unless real economic growth is rapidly re-started.

10) Haggard and Kaufman (1989 p.273) conclude their survey of indebted-developing-country stabilization and structural adjustment problems as follows:

> In fact there is probably more room for political maneuver and persuasion than is frequently recognised. The reform process is not merely a technical, policy-making exercise, but demands the building of political coalitions of support....[G]roups will be more likely to acquiesce to short-term costs if they are consulted and sense that their position in the political system is secure. In a number of policy areas, compensation to potential losers may be less costly than an effort to force through policies that are likely to fail politically... In the end,... there is no substitute for a nuanced understanding of the political and social setting into which economic programmes are to be introduced.

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