

Gebauer, Horst H.

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# Public Debt Relief for Developing Countries

by Horst H. Gebauer, Bonn \*

**The problem of the growing indebtedness of developing countries is playing an increasingly important role at international conferences. It was also the central subject of the ninth special session of the UNCTAD Board whose third part ended on March 11, 1978. The resulting resolution, though not generally solving the debt problem, provides substantial progress for the poorer developing countries.**

The developing countries have to invest substantial sums in the infrastructure, industry, agriculture and vocational training in order to speed the development process in their own countries and thereby to narrow the gap separating them from the industrialized countries. They are raising about 90 % of the investment sums each year from domestic savings and export earnings. Some 10 % only are financed by inflows from abroad. In 1976 these totalled \$ 38 bn of which \$ 17 bn were public development aid by donor countries and multilateral organizations and \$ 21 bn private inflows (direct investments, private export credits and portfolio investments). The indebtedness of the developing countries has accumulated as a result of the private credits and of public development aid insofar as it took the form of credits: no more than \$ 3.02 bn out of \$ 17 bn in 1976. Over recent years the debts of the developing countries have risen by leaps and bounds. In 1967 they amounted to \$ 48 bn (incl. commitments). By 1970 they had risen to \$ 73 bn, by 1975 to \$ 173 bn, and by 1976 to \$ 207 bn.

The debt burden is distributed unevenly between the various groups of countries. The least developed countries (LLDC) have 12 % of the population in developing countries but account for no more than 4 % of their debts; the most seriously affected countries (MSAC) have more than half their population and 20 % of the total debt. The rate of indebtedness is higher in rich developing countries: the countries with medium incomes (per-capita incomes of \$ 266 to 520 a year) account for 11 % of the debts and 11 % of the population, the countries with higher incomes (\$ 521 to 1,075 per head and year) for 9 % of the population and 26 % of the debts, and those with the highest incomes (over \$ 1,075) also for 9 % of the population and 26 % of the indebtedness. Poor developing countries other than the LLDC and MSAC owe the rest. It is an interesting feature of this analysis that the rich countries have the relatively highest indebtedness. They have made more headway in the process of development and have therefore a greater need for external sources

of finance while the poorer countries are in part not creditworthy and therefore unable to mobilize an appropriate volume of private finance or receive the development aid from the donors mostly in the form of grants so that their debts cannot rise to such a high level.

High external indebtedness is not in itself a negative aspect as regards the economic standing of a country. Imports of the capital goods needed for development necessarily involve a high foreign currency expenditure which must be covered by foreign credits in order to maintain the equilibrium of the balance of payments. A country's indebtedness thus in a way mirrors its development process. It also reflects the creation of international liquidity for the financing of the world trade.

The industrialized countries do not think that there exists a general debt problem. The developing countries on the other hand point to the heavy burden of their indebtedness for their balances of payments and argue that the heavy debt burden is preventing them from investing their foreign currency earnings from exports in their own countries because they are drained off by debt servicing payments. The situation is bound to become problematic when the disbursements for the servicing of debts (amortisation and interest) grow so large — as has actually happened in a number of countries — that the debtor countries are barely able to service their debts with their earnings from exports. Reflecting the growing international indebtedness of the developing countries, the disbursements for the servicing of external debts have risen from \$ 6.2 bn (in 1967) to \$ 32.0 bn (in 1976).

The debt servicing quotient (the ratio of debt servicing disbursements to export earnings) gives an idea of the burden which debts can impose on the national economy of a country. The debt situation is in general deemed to be critical when the quotient rises above 20 % because at this level too low a proportion of the export earnings will be

\* Federal Ministry for Economic Cooperation.

left for the financing of requisite investments. The debt servicing quotient is in actual fact quite high in a number of countries, e.g. 24 % in Algeria, 46 % in Brazil, 49 % in Egypt, 34 % in Guinea, 37 % in the Sudan.

### Demands of the Developing Countries

Opinions differ about the causes of the big increase of the Third World indebtedness. The developing countries have brought the charge against the industrialized countries that they have triggered a massive rise of the prices of goods which the developing countries have to import by causing an inflation in their own countries while the industrialized countries point to the quadrupled oil prices as the explanation. Overall the debt situation has grown so grave in a number of countries that the developing countries have launched massive demands for concessions by the industrialized countries which are their principal creditors. According to the developing countries these concessions by the industrialized countries should include:

- ☐ Relief of the public debts of the LLDC, island and land-locked developing countries,
- ☐ Relief or conversion to IDA terms of the public debts of the most seriously affected countries (MSAC),
- ☐ Creation of a new financing facility to redeem the private debts of the developing countries,
- ☐ Agreement on debt reorganisation guidelines (so-called common norms) which set an automatic restructuring process in motion when required.

The industrialized countries deny that there exists a general debt problem of developing countries but admit the existence of difficulties in quite a number of countries. To solve the problem, debt restructuring guidelines (called features) have been formulated as an EC-USA proposal which amounts largely to a consolidation of the previously practised procedure. The features offer, in addition to that, for poorer countries which depend largely on aid, remedial measures to deal with situations of a longer term nature. The features are rejected by the developing countries as entirely inadequate, and it will probably be impossible to combine the proposals of the developing countries and the USA-EC features in jointly drafted guidelines because the two concepts are basically too far apart. The only conciliatory move left in addition to the offer, of the guidelines as they stand would be the offer of public debt relief for some groups of poorer developing countries.

By way of compromise the industrialized countries conceded to the developing countries during the CIEC an action programme involving US\$ 1 bn

for the poorer developing countries. A number of donor countries provided their contributions to this by waiving claims to the repayment of outstanding debts. Sweden annulled debt service obligations for 1977/78 to 1981/82, Switzerland commuted sfr. 179 mn of development aid credits to poorer developing countries into grants, and Austria announced a similar operation but reserved the right of examining the individual cases involved.

In anticipation of the UNCTAD ministers' conference and the Fifth United Nations Conference on Trade and Development in Manila next year there have evidently been further developments which throw the previously rigid front of the industrialized countries into confusion. Sweden has already proclaimed a debt remission for LLDC and MSAC. Japan, Great Britain and the Netherlands have apparently similar moves in mind. In the USA a new Foreign Aid Act has been placed before the Senate and House of Representatives as a legacy of Senator Humphrey's; it contains a clause which allows the President to remit the debts of poorer developing countries.

### No Generalized Debt Relief

Generalized debt relief is still rejected by the industrialized countries although there are certain signs that their attitude is softening. They are still agreed that multilateral debt restructuring procedures should only be opened on application in individual instances when a developing country is no longer able to service its debts. The industrialized countries object to a generalized debt remission for whole groups of countries on the ground that:

- ☐ The debt situation varies from country to country, so that individual consideration must be given to the solution of specific problems,
- ☐ A general debt remission impairs the credit standing of the debtors,

**Table 1**  
**Debt and Debt Service by Income Groups**  
(in \$ billion)

	1967	1974	1975	1976
Disbursed Debt				
LLDCs	2	5	7	10
Poorer LDCs	11	24	28	31
Non-oil LDCs	42	113	144	172
Total LDCs	48	137	173	207
Debt Service				
LLDCs	0.1	0.5	0.5	0.6
Poorer LDCs	0.8	1.7	2.1	2.3
Non-oil LDCs	5.8	15.8	20.8	25.6
Total LDCs	6.2	19.8	26.0	32.0

Source: CAD/OCDE and UNCTAD TD/B/685/Add. 1 S. 13.

☐ Debt remission for some groups of countries can lead to an erosion of debtor morale and induce the majority of developing countries to call for similar measures,

☐ Debt remission for poorer developing countries is unlikely to solve their development problems — provision of additional resources and mobilization of the countries' means to help themselves are more urgent,

☐ Debt remission can only relate to public debts (private exporters and banks would otherwise have to receive compensation from their governments); these, however, account for only a relatively small part of the total indebtedness, especially in some of the more advanced developing countries.

### Hypothetical Budget Effects

The liability from German public development aid credits to LLDC (only disbursed) amounted at the end of 1977 to DM 1,838 mn (disbursed and non-disbursed public development aid credits more than DM 4 bn) to which must be added the further liabilities arising from outstanding interest payments which total DM 373 mn for the whole term of the credits. The total liabilities of the LLDC to the Federal Republic of Germany thus amount to DM 2,211 mn. As these liabilities will however fall due only in the distant future, their cash value, i.e. the present value of the future debt, is considerably lower: The cash value of the debt itself (i.e. the sum total of payments due to amortize the debt) is DM 610 mn (also calculated for the end of 1977), the cash value of interest payments is DM 178 mn, and the cash value of the total liabilities is thus DM 788 mn. The total liabilities of the LLDC from public and publicly guaranteed credits (incl. export credits and bank liabilities) amount to DM 3,215 mn (position as per March 1, 1977), so that about 66 p.c. of the debt servicing payments of LLDC to the Federal Republic of Germany would be remitted.

If the Federal Republic were to forgo the debt servicing payments (for interest on and amortization of financial cooperation credits) by the LLDC in 1978, it would suffer a revenue shortfall of DM 22 mn for interest and DM 57 mn for amortization. The total shortfall for 1978 would thus work out at DM 79 mn. The interest and amortization payments due in 1979 and 1980 total DM 79 mn and DM 58 mn respectively.

If the MSAC were to be included in the scheme as well as the LLDC, the Federal Republic would have to expect quite substantial interest and amortization shortfalls. The liability from financial cooperation credits granted to LLDC and MSAC amounted at the end of 1977 to DM 7,052 mn, which was made up of the LLDC's liability of

DM 1,838 mn and a liability of DM 5,214 mn on the part of those MSAC which have not been included in the LLDC figure. If the Federal Republic forgoes the interest and amortization payments falling due from the LLDC and the MSAC, it stands to lose payments of DM 8,871 mn with a cash value of DM 4,282 mn (made up of DM 1,819 mn of interest with a cash value of DM 1,068 mn and DM 7,052 mn for amortization, cash value DM 3,214 mn). The cost of a remission of the debts of the LLDC and MSAC group to the annual budget of the Federal Republic would be substantial. It would amount to DM 534 mn (interest and amortization of public credits to the MSAC and LLDC) in 1978, to DM 535 mn in 1979, and to DM 506 mn in 1980.

### Results of the Ninth Special UNCTAD Session

The described debt situation of the developing countries was the central subject of the ninth special session of the UNCTAD Board whose third part ended on March 11, 1978. A resolution was passed which does not solve the debt problem generally, but leads to substantial progress for the poorer developing countries. The resolution stipulates for two sets of measures:

☐ *Ex-post terms correction.* The decisive passage reads: "Developed donor countries will seek to adopt measures for such an adjustment of terms of past bilateral ODA, or other equivalent measures, as a means of improving the net ODA flows in order to enhance the development efforts of those developing countries (poorer developing countries) in the light of internationally agreed objectives and conclusions on aid".

☐ *Features.* The conference accepted the basic concept of debt restructuring measures, namely: request of the debtor country concerned and case-by-case principle, multilateral procedure under participation of international organizations, consideration of the development situation of the debtor country, consideration of the interests of debtors and creditors. These principles shall be the basis of the work of a group of government experts to be appointed by the Secretary General of UNCTAD whose task it will be to work out, on the basis of the existing concepts (the industrialized countries' features and the developing countries' common norms), guidelines for future measures regarding debt restructuring problems.

The western industrialized countries regarded the two sets of measures as an indivisible whole. Therefore they were prepared to agree to the concept of adjustment of terms only after the developing countries had accepted certain minimum principles for the treatment of cases of debt restructuring.