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Intereconomics

*Suggested Citation:* Meier-Preschany, Manfred (1980) : Is it up to the industrialised countries to finance the developing countries' deficits?, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 15, Iss. 6, pp. 290-292, <https://doi.org/10.1007/BF02924652>

This Version is available at:

<https://hdl.handle.net/10419/139711>

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# Is it up to the Industrialised Countries to Finance the Developing Countries' Deficits?

by Manfred Meier-Preschany, Frankfurt\*

**Over the past decade the non-oil developing countries' external debt has shown a more than threefold increase, a trend that may be expected to continue in the foreseeable future. In response to the recipient countries' changing needs, private lending, their principal source of credit, will have to take different forms involving the creation of new multilateral facilities designed to place a bigger pool of long-term funds at the developing countries' disposal.**

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Once, we are told, the New World came to the rescue of the Old; now, as part of a continuing exercise which has come to be known as the North-South dialogue, it is the First World, though itself reeling under the blows administered by successive oil price explosions, which is expected to come to the rescue of the Third. In this much bigger than any previous rescue operation of a similar kind, the Marshall Plan included, none have a bigger part to play than the industrialised countries' bankers, who not only find themselves walking a political tight-rope where they had previously feared to tread, but have also had to devise entirely new methods and yardsticks from those they had formerly employed in conducting their business. Though in it for more than the glory, theirs is not an easy task.

## Mixed Bag of Countries

Developing countries making up the Third World can be defined and categorised in a number of different ways, of which gradations of per capita gross domestic products (GDP) as a measure of their existing standard of living are perhaps the easiest to apply. Nevertheless, seeing that the mixed bag of 126 developing countries classified as such by the World Bank on the basis of this measure (a 1976 per capita GDP not exceeding US \$ 2,500) comprises, on the one hand, Afghanistan, Burundi, India, Mexico and Turkey and, on the other, the likes of Argentina and Brazil, which by virtue of their trade have already advanced

well beyond satisfaction of the most elementary needs, this criterion which does little or no justice to a country's economic potential clearly leaves something to be desired. Apart from the less developed countries (LDCs) and the "poorest of the poor", there are also the newly industrialised countries like Taiwan and South Korea, not to mention the oil-rich.

An important turning point was, however, marked by the 1979 UNCTAD Conference in Manila, where the frontiers of the developing world began to be re-drawn, birds of the same feather gathered together, and a greater sense of economic realism made itself felt all round.

By the end of 1979, according to an OECD estimate, the foreign debt of the non-oil developing countries will amount to around US \$ 274 bn and cost something like US \$ 40 bn annually to service – a more than threefold increase in both cases on ten years earlier. Of the debt servicing cost, 60 % consists of repayment of existing debt – though in recent years, with debt increasing at an average annual rate of 20 %, this has been more than offset by new borrowing – and 40 % of interest charges. Between 1975 and 1978 Euromarket loans to the non-oil developing countries totalled about US \$ 60 bn – US \$ 27 bn of which in 1978 alone, or twice as much as the year before – while the almost US \$ 12 bn of January-May 1979 represents 40 % of Euro-market lending as a whole.

Nor is the increase in the non-oil developing countries' foreign indebtedness likely to diminish in the foreseeable future. On the contrary, their aggregate current account deficit this year, following the latest oil

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price explosion, is expected to widen from US \$ 31 bn in 1978, and only US \$ 11 bn in 1973, to around US \$ 45 bn.

The principal debtor among this group of countries is Brazil, with a total (private as well as public sector) foreign debt estimated at US \$ 43 bn, followed by Mexico and Spain. Those three countries accounted for over one-third and together with seven others for nearly two-thirds of the debt servicing expenditures borne by all the developing countries in 1977.

The banks, in turn, are the biggest creditors. With an estimated US \$ 125 bn they account for half the total. Rather more than a third of the loans outstanding stems from governments and government agencies, the remainder of 14 % or so from supranational organisations like the World Bank and the International Monetary Fund.

Moreover, indications are that banks in future will be saddled with more than half of the developing countries' increasing external financing burden and recent estimates even point to something like three-quarters. As those countries' foreign debts grow further, so will, other things remaining equal, the proportion of their current earnings from exported goods and services which is required to service and repay them. In 1977 that proportion already amounted to some 25 % on average. For a number of countries it has by now even topped the 50 % mark, although for a lucky few it has been tending to decline.

Any attempt to lighten the load must face the fact that the problem is by no means the same for all countries. While the poorest developing countries' indebtedness has been incurred for the most part by public authorities, it is private borrowers who, by contrast, figure most prominently among the more advanced ones. Moreover, nearly 70 % of all Euromarket loans to non-oil developing countries in the past four years have been extended to Brazil, Mexico, South Korea, the Philippines and Argentina, countries with a high rate of economic growth, a relatively high level of industrialisation and a sufficiently diversified export trade to enable them to take changes in world economic conditions more comfortably in their stride than others.

Demands from many quarters that the 29 LDCs' public sector borrowings throughout should be funded, and that in addition 16 of those countries should in future be given a larger amount of foreign financial assistance by way of grants, have so far, quite rightly, not been pressed to the hilt. Apart from weakening the resolve of the countries thus favoured to live within

their means and to honour their international commitments, they could also, by discouraging private lenders, queer the pitch for all the rest. Given the complexity of the problem, creditor countries should strive for agreement on a flexible code of practice rather than hard and fast solutions, while conceding a moratorium as before only where there are compelling grounds for doing so.

### **Assessment of Creditworthiness**

Even granted that for developing countries debt is, to some extent, unavoidable and helpful to world economic growth, that current account deficits are, in their present stage of development, essential to those countries' growth and must therefore be financed, and that the now leading industrialised nations had been one-time borrowers themselves, the fact nevertheless remains that for countries, no less than for individuals, there are limits to the debts they can run. Even though those limits may vary for different countries – and with regard to the same country for different banks – they are all subject to basically the same criteria.

Banks, in assessing a would-be borrower's creditworthiness, distinguish between political, financial and transfer risks. While political risks relate to imponderables like wars, revolutions and expropriations, and transfer risks to the point of a debtor country becoming unable to service and repay its existing debt because of a shortage of foreign exchange, financial country risks can be evaluated by and large with the aid of statistics, forecasts, gold and foreign currency reserves and the like, and thus present relatively little difficulty.

Equally, though, any bank, whether engaged in domestic or international lending, must seek to limit its risk. It is with regard to the political and social rather than the financial country risk components, however meticulously analysed, that prediction and monitoring leave something to be desired.

In assessing the non-oil developing countries' growing need for financial assistance, however, it is not the level of their current account deficits and debt burdens which gives cause for concern so much as the factors that have led up to it. Instead of representing a rapidly rising import volume, which might merely reflect a corresponding expansion in underlying economic activity, today's nominal import growth constitutes above all price rises for oil and imported manufactures. Moreover, if the objectives laid down in the Lima Declaration of March 1975 still apply – according to which the developing countries' 7 % share of world

industrial production is to be raised to 25 % by the year 2000 —, these imply until the end of 1985 a conservatively estimated annual financing requirement in the region of US\$ 20 bn, or twice as much as is being spent on those countries' industrialisation at present.

### Need for Flexible Financing Facilities

All this demands not only massive but also flexible financing facilities in response to the recipient countries' changing needs. Private lending, though it will doubtless continue to be needed as much as ever, will have to take different forms, involving not so much improved access to the Eurobond market as the creation of new multilateral facilities designed to place a bigger pool of long-term funds at the developing countries' disposal. Again, the various (Asian, African, Interamerican) development banks should play an active part in project-scanning and the formulation of targets and development strategies, while proceeding increasingly to raise funds on national and international capital markets in order to enlarge their range of activities.

Meanwhile, since developing countries in an early stage of their development had few or no internationally creditworthy borrowers to speak of, other banks extending loans to them would quite often, and quite properly, depart from tradition by financing individual projects, embedded into a network of diverse (manufacturing, construction, consulting control) agreements with reputable contracting parties, rather than those concerned with operating them in due course. In this way they did their best to ensure that the plants and installations financed would, when completed, be able to pay their way, and that the earnings derived from them would be sufficient to amortise the loan within the period for which it had been extended.

Only at a later stage, when the developing countries themselves or some of their nationals have become creditworthy, will these be able to raise untied (i. e. no longer project-related) loans on their own account. Advancement to that stage is naturally in the interest of banks and borrowers alike. Banks are therefore anxious to do business with public bodies or private companies whose creditworthiness qualifies them for a large-sized loan, the proceeds of which it is then left to the borrower to allocate within the country among different credit seekers at his discretion. And as it did not take public sector borrowers long to discover that this wholesale method of fund raising is more cost-efficient, this also helps to explain why bankers of the

industrialised world, in lending to developing countries, are dealing with such borrowers on an increasing scale.

A special problem in this connection arises with regard to the uses to which loans are put. It is hard to ensure that governments anxious to cut a figure in the world steer clear of vested interests by confining themselves to projects beneficial to their country as a whole. This is, of course, a difficult question for outsiders, let alone for governments entitled to their own opinion, to resolve. As shown not only by the example of Iran, however, a lender ought to assess each project not merely as to whether it makes sense to him, but also as to whether it is politically and socially compatible with the developing country and its people. He must, whether he likes it or not, take account of political emotions without taking sides.

At the same time, we would do well not to see the North-South dialogue purely in financial terms. Reduction of increasing imbalances between the industrial and the developing worlds is basically a question of the world's future economic order within a greater international division of labour. But it also means that debtor countries, if they are to repay their debts on schedule, must be able to expand their export earnings accordingly. The introduction of voluntary or unilateral import restrictions, minimum import prices, higher tariffs and other trade barriers makes it more difficult for developing countries to help themselves. Forswearing protectionism is, from this point of view, no less important than financial assistance.

Supranational institutions like the World Bank and its affiliated organisations — which themselves had borrowed around the world the best part of US\$ 16 bn mostly for on-lending to developing countries up to the end of 1978 — have an important intermediary role to play as well. Inconvenient to the beneficiaries though its terms may seem at times, the World Bank owes it both to itself and its creditors to concentrate its development assistance on projects or programmes that are at once economically viable and open to scrutiny. To do so is also in the enlightened interest of the developing countries themselves.

Last but not least, developing countries for their part must, by going out of their way to create a favourable investment climate, see to it that private foreign investors are given a fair chance — a score on which the protestations of many still leave a lot to be desired. Where so much is at stake, yet theory and practice so flagrantly diverge from each other, actions clearly must speak louder than words.