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## DEBT CRISIS

# The Debt Burden of Developing Countries

by Herbert Wilkens, Berlin\*

**According to OECD data<sup>1</sup>, the external debts of developing countries totalled \$ 625 billion at the end of 1982. As this does not include certain forms of credit, their indebtedness can be estimated at more than \$ 700 billion, of which \$ 500 billion consists just of bank loans. The resultant burden of interest and redemption payments has become so great that many more developing countries will be forced to seek rescheduling in the future. The debt burdens of developing countries and the vulnerability of the world financial system must be reduced for development policy reasons and also to ensure that the economies of the industrialised countries are not harmed. The following study suggests how this may be done.**

**T**he debt position of the Third World is far more precarious than the picture reflected in the problems of those few developing countries that have attracted widespread attention as the largest debtors. In recent years the debt burden ratios for practically all developing countries have deteriorated dramatically and the number of rescheduling operations has rocketed (see Table 1).

This has significance not only for the internal development of Third World countries but also for the operational ability of the international financial system. Whereas for the economies of the developing countries it is the overall burden of all (private and official) external liabilities that is decisive, for the world financial system it is primarily the relations between the banks and the developing countries that are important. Even a relatively modest volume of debt can pose great problems for the economy of a small developing country, a commonplace fact that is often overlooked in the present debate. Table 3 shows that the countries with a particularly heavy burden of debt in relation to their national product are indeed the smaller ones. By contrast, the workings of the world's financial markets are affected at present only by the situation with regard to a few countries with very high indebtedness towards the banks.

The internal and external causes of the widespread debt crises form a web of interwoven factors, some of which are mutually reinforcing. Chief among these are:<sup>2</sup>

□ a hard core of loans taken up after the first oil price increase and which at that time helped to overcome the crisis of adjustment relatively easily and quickly,<sup>3</sup>

□ the further rise in the cost of energy imports as a result of the second oil price explosion,

□ the worldwide recession and the consequent adverse trends in export volumes and prices, especially for the raw materials that are crucial for many developing countries,

□ the sharp rise in the debt burden as a result of unfavourable borrowing conditions, in particular high interest costs,

□ the curtailment of development aid,

□ the inadequate adjustment of most developing countries to changes in the world economic climate, and especially to changes in price relationships,

□ bad debt management.

Balance of payments deficits on current account, which had grown rapidly as a result of the worldwide recession and the increase in the price of oil, had to be covered mainly by borrowing on commercial terms. This was facilitated by the existence of an international liquidity surplus, which induced the banks to accept ever greater risks in their pursuit of investment opportunities ("recycling pressure"). It must be said that for a long time the banks were encouraged from all sides to play a part in recycling the oil producers' current account surpluses and in promoting the export trade of their home country. Had the industrialised and developing

<sup>1</sup> OECD: External Debt of Developing Countries – 1982 Survey, Paris 1982.

<sup>2</sup> See in this regard H. Wilkens: Aktuelle Lage in den Entwicklungsländern – Hilfe dringend nötig, in: Wochenbericht des DIW, No. 49/1982, pp. 605-611.

<sup>3</sup> Cf. S. Schultz: Zur Verschuldungslage der Dritten Welt. Stand, Entwicklungstendenzen und Lösungsperspektiven, in: Vierteljahresshefte zur Wirtschaftsforschung des DIW, No. 1/1981, pp. 75 ff.

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countries been able to exploit the potential for GNP growth, lending by the banks would subsequently have proved a success and as a rule the borrowing countries would have been able to meet their payment commitments.

The debt service payments (interest and capital) that are due on the accumulated external borrowing are creating grave problems of adjustment for a great many countries in view of the worldwide stagnation in demand, the still high interest rates and the lack of new financial resources in the quantities hitherto available. Since the middle of 1982 bank lending to developing countries has contracted dramatically; for many of them, and in particular for those at an intermediate level of

development, it is even significantly lower than in the preceding year. Hence the way is barred for the developing countries to borrow their way out and they must attempt to establish a new balance of payments equilibrium by pursuing restrictive import and budgetary policies.

The effects of this policy of adjustment are already being felt in many countries. In 1982 the current account deficit of the non-oil developing countries is reckoned to have been a third less than in the previous year (\$ 65 billion compared with \$ 96 billion) and a further reduction to about \$ 50 billion is expected in 1983, a "success" that has been achieved at the cost of declining rates of economic growth everywhere. In the group of middle-income and poorer oil-importing countries<sup>4</sup> the per capita national product will contract even more sharply in 1983 than in the two preceding years.

With the prevailing universal weakness of demand, the developing countries' efforts to adjust are unlikely on their own to raise or restore their creditworthiness. On the contrary, there is the danger that the subordination of economic policy to short-term balance of payments requirements will lead to a downward spiral. Import restrictions do initially release foreign exchange for servicing the country's foreign debts, but in many instances they also harm export production, thus jeopardising both the standard of living of the bulk of the population and the enterprises in the developing countries: many firms that have borrowed fairly heavily abroad are driven into bankruptcy by changes in interest and exchange rates.

On the other hand, justified hope can be felt in the flexibility of countries that have already achieved initial success in modernising their economies and integrating into the world economy. This applies not only to the small circle of newly industrialised countries but also to a larger number of countries at the intermediate level of development. Many of them will quickly be able to escape from their present constrained situation as soon as an upturn in world trade begins. However, such an upturn cannot be expected to occur in the immediate future and will be induced only to a minor extent by the efforts of the developing countries themselves.

In late 1982 an acute crisis in the world financial system was averted. Problems had arisen as a result of

Table 1

**Multilateral Rescheduling Operations**

Debts towards Official and Private Creditors

Year	Number of cases	Volume in \$ million
1975	2	478
1976	2	480
1977	3	382
1978	2	2,312
1979	4	4,920
1980	6	4,459
1981	14	10,786
1982	about 22	about 40,000

Source: Euromoney, August 1982, p. 21; figures for 1982 supplemented by an estimate of the Deutsches Institut für Wirtschaftsforschung (DIW), including a few cases in which rescheduling has begun but contractual agreement has not yet been reached.

Table 2

**Overall Indebtedness of Selected Non-European Developing Countries**

Estimates for end-1982

Country	Amount outstanding (in \$ billion)	Share of overall total (in %)	Debts per head of population (in \$)	Debt service/ exports ratio (in %)
Brazil	90	12	700	117
Mexico	80	11	1090	126
Argentina	45	6	1510	153
Korea (Rep.)	35	5	920	49
Venezuela	30	4	1900	101
Israel	25	4	6750	126
Indonesia	20	3	140	20
India	20	3	30	18
Algeria	20	3	1010	40
Egypt	20	3	420	46
Total	380	52	320	.
All developing countries	730	100	.	.

Sources: Time, 10. 1. 83, p. 5; OECD; IMF; estimates and calculations by the DIW.

<sup>4</sup> Countries that are net importers of petroleum and do not count as newly industrialised countries; they achieve only a middle or low level of per capita income. The LLDCs also belong to this group. The NICs are Argentina, Brazil, Chile, Hong Kong, Israel, Mexico, Singapore, South Korea, Taiwan, Uruguay and the European developing countries excluding Turkey.

the simultaneous default of major debtors of western banks (especially Mexico, Brazil, Argentina and Chile) and a deterioration – at least in the eyes of many bankers – in the situation of a few other large-scale borrowers (primarily Venezuela, Yugoslavia and the Philippines). In mid-1982 the seven countries named accounted for no less than \$205 billion of the total of about \$500 billion that the banks had lent to developing countries (see Table 4). A simultaneous breakdown of negotiations for rescheduling the debts of several of these countries could have caused the failure of a few major banks and thus led to the collapse of the worldwide financial system.

The essential requirements for overcoming acute debt crises are the following:

- Close cooperation among the banks, the debtor countries and the creditor countries (via the central banks and multilateral institutions). This has stood the test in a number of simultaneous and extremely difficult negotiations.
- An adequate supply of finance to multilateral institutions, especially the International Monetary Fund

(IMF). There now appears to be unanimity among donor countries on an increase in IMF quotas and on other means of generating resources.

- Readiness on the part of debtor countries to adjust, i.e. to restrain the pace of their development and limit consumption so that their external borrowing requirement can be calculated more carefully and no longer exceeds their probable assured net receipts (export earnings, capital imports and transfers). This is also consistent with their own interests, as the international machinery of finance and trade would impose drastic sanctions in the event of the unilateral renunciation of debt service commitments.

- Readiness on the part of creditor banks and creditor governments to tide debtors over temporary liquidity shortages. State agencies have also had to accept risks in this connection.

At the end of 1982 the system proved so flexible that the crisis could be weathered. This is an encouraging sign for future emergencies, but the pragmatic solutions devised in 1982 are not sufficient to ensure longer-term stability.

The experience of the sixties and seventies demonstrated that rapid growth in the world economy and in world trade is the best prescription for avoiding debt crises. Consequently, the pace of growth must be raised again, particularly as there are more than enough development tasks throughout the world. The Federal Republic of Germany and other industrialised countries as well are now in a position that permits a joint, co-ordinated initiative to be taken and, moreover, makes such action necessary for domestic economic reasons.<sup>5</sup> The room for manoeuvre has been increased in particular by the slowdown in inflation and the improvement in their balance of payments on current account. With the resumption of economic growth the tendency towards protectionism in the industrialised countries would wane and a lasting worldwide upturn in trade could be expected. Export opportunities would also open again for most developing countries.

Alongside measures on the global scale, effective remedies must be applied to countries' debt problems individually. Steps could be taken in good time to prevent debt problems from arising or from drawing to a head if early warning systems were improved.<sup>6</sup> One

**Table 3**

**The Debts of Highly Indebted Developing Countries<sup>1</sup> in 1980**

Country	Amount outstanding (in \$ million)	Debts/GNP ratio (in %)	Debts per head of population (in %)
Mauretania	750	143	460
North Yemen	1000	122	520
Guyana	650	114	790
Congo	1150	104	760
Nicaragua	1900	99	720
Togo	950	93	380
Gambia	150	86	210
Somalia	750	85	190
Bolivia	2600	81	470
Morocco	7800	78	390
Guinea	1200	74	220
Zambia	2300	71	400
Maldives	50	69	180
Zaire	4350	69	150
Egypt	15050	65	380
Jamaica	1400	63	650
Afghanistan	1100	63	70
Honduras	1300	62	350
Gabon	1500	62	2270
Malawi	800	58	140

<sup>1</sup> Excluding borrowing for military purposes; countries are listed in descending order according to the debts/GNP ratio; rounded to nearest \$50 million.

Sources: OECD; BIS; World Bank; IMF; official statistics; press announcements; calculations and estimates by the DIW.

<sup>5</sup> See: Grundlinien der Wirtschaftsentwicklung 1983, in: Wochenbericht des DIW, No. 1-2/1983, p. 22.

<sup>6</sup> See for instance H. J. Petersen: Zur Früherkennung kritischer Verschuldungslagen von Entwicklungsländern, in: Vierteljahreshefte zur Wirtschaftsforschung des DIW, No. 3/1977, p. 180 ff.

improvement indicated by experience is the need for periodic revision of the threshold values of debt burden indicators beyond which a development is considered as critical.

Improved worldwide information on the indebtedness of developing countries and its critical limits cannot, however, absolve the developing countries of primary responsibility for a more effective debt management. By adopting the wrong approach towards creditors, they have in some cases helped deepen crises that were brewing. This opens up an important field for bank advisory services and technical assistance. The banks' newly established information centre in Washington for documenting and assessing country indebtedness can also play a part in this regard.

Even if recovery began soon in the industrialised countries, the accumulated problems would still be so great that there would be no peace on this front in the next few years. Further rescheduling is a probability. On the creditor side the burdens must be spread

appropriately among all the parties involved, that is to say the banks, central banks and the creditor governments.

At the end of 1982 the *IMF* and the *central banks* urged the banks not to withdraw their investments from the major cases undergoing rescheduling and later to contribute to the rescue operation in proportion to their commitments. The feelings of reluctance and impotence that initially came over the banks, particularly the smaller ones, must give way to a new definition of their long-term interests. Only by entering into partnership in the task of development in the Third World, which also entails a willingness to take risks, can the banks enjoy long-term involvement in this form of business, which is also profitable for them. Admittedly, the *IMF* must be careful in applying pressure to banks because of the danger of forfeiting its role as a catalyst in new lending.

The *banks* must continue to diversify their risks and should not neglect the developing countries as a group.

**Table 4**  
**The Debt of Selected Developing Countries towards Western Banks**  
as at mid-1982

Country <sup>1</sup>	Net in- debtedness <sup>2</sup>	Gross indebtedness		Proportion of short- term debts	Debt ratios <sup>4</sup>			Burden of indebted- ness <sup>5</sup> gross
		total	due at short term <sup>3</sup>		total		at short term gross	
					net	gross		
	(in \$ bn.)	(in \$ bn.)	(in \$ bn.)	(in %)	(in %)	(in %)	(in %)	(in %)
Mexico	51.78	64.40	32.21	50	172	214	107	45
Brazil	50.43	55.30	18.66	34	187	206	69	23
Argentina	19.91	25.31	13.11	52	170	216	112	38
Korea (Rep.)	16.63	19.99	11.40	57	60	73	41	34
Venezuela	10.23	27.25	16.27	60	42	111	66	50
Chile	7.94	11.76	4.88	41	128	190	79	49
Yugoslavia	7.93	9.97	2.64	26	51	64	17	17
Philippines	7.46	11.37	6.89	61	87	132	80	33
Portugal	6.87	8.88	3.24	36	107	139	51	38
Spain	6.33	23.71	9.45	40	19	70	28	12
Nigeria	5.17	6.71	2.18	32	28	36	12	8
Algeria	5.15	7.73	1.53	20	41	61	12	21
Greece	4.08	9.72	3.30	34	44	106	36	23
Ecuador	3.68	4.67	2.49	53	123	156	83	46
Thailand	2.98	4.80	2.74	57	34	55	31	15
Morocco	2.97	3.71	1.01	27	96	120	32	21
Peru	2.93	5.22	3.36	64	69	124	80	32
Ivory Coast	2.45	3.16	0.78	25	85	109	27	32
Turkey	2.29	3.96	1.11	28	37	64	18	6
Colombia	1.32	5.47	2.45	45	27	114	51	17
Indonesia	1.28	8.16	3.16	39	5	34	13	13
Cuba	1.14	1.29	0.66	51	23	26	13	11
Malaysia	1.00	5.31	1.77	33	8	41	14	24
Total	221.94	327.82	145.27	44	72	107	47	24
All developing countries	191.44	506.34	239.22	47	.	.	.	20

<sup>1</sup> Countries with claims or liabilities exceeding US \$ 0.5 billion, listed in descending order of net indebtedness greater than \$ 1 billion. <sup>2</sup> Gross indebtedness less claims. <sup>3</sup> Due in one year or less. <sup>4</sup> Debts in relation to exports of goods and services in 1981. <sup>5</sup> Gross indebtedness in relation to gross national product.

Sources: BIS; IMF; International Financial Statistics; World Bank Atlas; calculations by the DIW.

If they are forced to increase their commitment in countries that are rescheduling and do so by drawing on funds that were or would have been invested in other developing countries, they will merely be plugging gaps at one end by ripping new holes elsewhere and neither the developing countries nor the banks themselves will be better off overall. If the banks want to be able to count on support from the state, the central bank or the IMF, as appropriate, they must also be prepared to supply the supervisory authorities with fuller information on their business activities.

The necessity for the *central banks* to take charge should the world financial system and, with it, the world trade system be threatened derives from their general functions. They lived up to this responsibility when they recently agreed to a substantial increase in the General Arrangements to Borrow and to their extension to the developing countries.<sup>7</sup> Even before then they had been quick to make bridging loans available until the IMF standby arrangements came into effect. However, such assistance should not become standard machinery, as it would simply be an invitation to borrower countries and creditors to adopt imprudent policies. Hence consideration is now being given to making such loans subject to strict conditions as well. One way of achieving this might be for the IMF to manage such resources on a trustee basis for the Bank for International Settlements (BIS). No fund would have to be endowed with a fixed amount of capital; the amount of resources absolutely essential in each individual case would be provided as a final safety net. The risk of default would be reduced by the control that could then be exercised over the use of the funds and would be borne ultimately by the central banks, leaving the standing of the IMF unimpaired.

Central-bank bridging facilities are intended as short-term assistance; the IMF must also help finance medium-term adjustment. For this purpose its own resources must be replenished as a matter of urgency. The increase in quotas of roughly 50 %, for which agreement was recently reached, will not become effective until 1984 and is unlikely to be adequate for long. Preparations must soon be put in hand for the further increase in quotas that is necessary over the longer term. In addition, it would be helpful if the IMF could meet any further requirement that emerges by raising funds in the capital market.

The conditions attaching to IMF standby credits should be revised again. Naturally, the Fund cannot

dispense with setting conditions and monitoring their observance if the facility is to bring about adjustment and if the standing of the IMF is to be maintained. On the other hand, it would be in the interests of neither lending nor borrowing members of the Fund if excessively stringent conditions led to overkill. Hence, greater account should be taken of development policy requirements. Short-term austerity programmes, which are often extremely burdensome in political terms and impede social reform, should be avoided in the interests of longer-term stability. A relaxation of the conditions would seem particularly appropriate in cases where structural current account deficits cannot be eliminated quickly even with great effort by the country itself.

In the present situation, when many countries are under closer IMF scrutiny at the same time, the IMF must be particularly careful to avoid triggering a spate of competitive devaluations by the countries concerned. To this extent, the various IMF reconstruction programmes might impede one another.

The *governments of creditor states* will have to make greater resources available in the years to come. This will involve both measures to stabilise export earnings and the assumption of risks in the event of short-term liquidity problems. It is almost inevitable that the more advanced countries that have built up a particularly heavy burden of debt will benefit substantially for a certain time. In the meanwhile, longer-term assistance in making the necessary structural adjustment is of greater significance from the point of view of development policy. In this area governments could also help ensure the necessary flow of private credit to developing countries by providing conditional loan loss guarantees for long-term loans.<sup>8</sup>

Over the medium term there is no sensible alternative to continued borrowing by developing countries and increased development assistance, for a reduction in the burden of debt would require substantial export surpluses on the part of debtor countries and corresponding current account deficits on the part of creditor countries. However, neither a swing into deficit on the current accounts of the industrialised countries nor an outflow of resources from the developing countries are politically desirable and practicable. As a general remission of debts must be ruled out on development policy grounds and because of the volume involved, the only course open is to extend the present debts for a longer term and cautiously to increase the total by means of new lending.

<sup>7</sup> Until now these resources were available only to help the larger industrialised countries overcome short-term balance of payments disequilibria.

<sup>8</sup> Cf. S. Schultz, *op. cit.*, p. 81.