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Piritta Sorsa*

The External Debt Situation of the Least Developed Countries

While the external debt of the least developed countries (LLDCs) is no threat to the international financial system, its adverse impact on the development efforts of many of these countries is severe. The following article examines their debt and economic situation and reviews major elements of the current international debt strategy with regard to their adequacy in bringing the LLDCs back to sustainable debt burdens and growth.

The share of the Least Developed Countries (LLDCs) in the total debt of the developing countries is very small and their debt problems diverse. Their debt is no threat to the international financial system nor to the status of their creditors. However, at the country level their relative debt burden is heavier than that of many other developing countries and its impact is more severe because of their lower level and potential of development. The diversity of the debt burdens among the LLDCs reflects their heterogeneity in economic level and size and policies applied. The LLDCs include several debt-distressed countries in Africa but also small and large countries across the globe which do service their external debt without reschedulings. All LLDCs owe the bulk of their debt to official creditors, which makes initiatives like the Brady Plan meaningless for them and puts the focus on relief measures for official debt.

In the LLDCs excessive external debt is also part of their general problems of underdevelopment and of the vicious circle of low incomes. Debt burdens reduce growth and investments and can undermine their whole development effort if they are not reduced in a sustainable way. But debt relief will not be efficient unless it is linked to solving the problems that caused the debt burden in the first place. In the LLDCs this is all the more difficult as the general causes of the debt crisis – poor economic management, unfavourable external environment and loose lending practices of many international lending institutions – are exacerbated by the basic problems of underdevelopment.

The total debt of the LLDCs (about US\$ 70 billion in 1988) is a small share – about 6% – of total developing country debt.¹ This is slightly higher than these countries' share in the GDP (3%) of the developing countries.²

The debt and economic situation of the LLDCs has deteriorated during the 1980s. Firstly between 1982 and 1988 the stock of their debt has nearly doubled (from US\$ 37 to 69 billion³) whereas both exports and GDP have stagnated or declined in most countries.⁴ As a result in 1988 they met less than half of their debt service obligations (debt service was 16% of exports and estimated obligations about 37% of exports).⁵ Second, the high debt burden has contributed to low investment levels and declines in imports and consumption, which in turn may have slowed down growth. Third, the general trend hides a large diversity of country situations. Although the bulk of the LLDCs have serious problems in servicing their debt, there are twelve LLDCs of the 38 for which data is available that are not having major difficulties with their debt burden (Afghanistan, Bangladesh, Botswana, Burkina Faso, Haiti, Laos, Lesotho, Maldives, Nepal, Rwanda, Western Samoa, Yemen (Arab. Republic)).⁶

¹ Cf. OECD: Financing and External Debt of Developing Countries, 1988 and 1989 Survey, Paris.

² Cf. World Bank Development Report, Oxford University Press, 1990.

³ Cf. OECD, op. cit.

⁴ Cf. World Bank: World Development Report, op. cit.

⁵ Cf. World Bank: World Debt Tables 1989-1990, Washington 1989.

⁶ Classification of countries to problem and non-problem debtors is not straightforward. Whether the debt is a burden depends on many economic and structural factors. Furthermore, the data used refer to 1988 and as the debt situation of many countries changes rapidly some "marginal" countries can easily have switched from non-problem to problem status and vice-versa. The classification method used is described in Table 1.

* World Bank, Geneva Office, Geneva, Switzerland. The article was written while the author was working at the OECD. The views in the article are those of the author and do not reflect those of the World Bank or its affiliates or of the OECD.

INDEBTEDNESS

Table 1
Some Debt Burden Indicators (1988 Data)

Countries	Long-term Debt Service to Exports ¹ (in %)		Debt Service to Exports ² (in %)		Long-term Debt/GNP ¹ (in %)	Total Debt to Exports ² (in %)	Official Rescheduling since 1980
	Actual Paid	Projected	Total	Interest			
A. LLDCs³	14	33	24	11	74	450	
Non-problem Debtors ⁴	10	14	15	6	57	275	
Afghanistan	n.a.	n.a.	10	7	n.a.	416	
Bangladesh	13	15	20	9	55	435	
Botswana	4	4	5	2	41	37	
Burkina Faso	8	13	11	6	43	200	
Haiti	7	9	18	7	37	278	
Laos	11	15	16	3	172	944	
Lesotho	5	6	5	2	39	69	
Maldives	7	6	8	2	77	53	
Nepal	8	11	8	5	38	265	
Rwanda	9	13	13	7	28	349	
Western Samoa	5	5	10	2	71	97	
Yemen (Arab.)	16	31	28	8	52	253	
Problem Debtors ⁴	18	52	34	17	83	627	
Benin	6	29	12	8	59	254	1
Burundi	25	32	31	14	77	584	
Cape Verde	23	34	29	14	38	425	1
Central African Rep.	6	18	16	8	62	340	4
Chad	3	5	5	3	37	170	SPA
Comoros	1	39	4	4	93	715	
Djibouti	13	14	35	14	183	n.a.	
Equatorial Guinea	23	40	23	13	140	542	1
Ethiopia	30	39	31	10	54	381	
Gambia	9	13	18	7	179	248	1
Guinea	22	41	29	7	102	371	2
Guinea-Bissau	26	101	48	35	294	1574	2
Malawi	18	19	31	13	98	390	3
Mali	13	12	24	9	108	569	1
Mauritania	22	36	29	10	220	391	4
Mozambique	14	243	64	41	418	1197	2
Myanmar	22	55	52	35	39	1219	
Niger	33	45	45	23	76	463	6
São Tomé & Princ.	18	96	21	14	95	913	
Sierra Leone	7	31	25	16	64	588	4
Somalia	3	81	44	27	204	1503	
Sudan	8	105	41	35	110	1211	3
Tanzania	12	64	24	15	157	626	3
Togo	19	13	32	14	94	267	7
Uganda	16	62	53	10	40	630	4
Yemen (Dem.)	22	30	29	9	212	420	
B. Other LICs³	21	46	31	17	104	348	
Non-problem Debtors ⁴	20	20	26	10	60	211	
Sri Lanka	18	20	27	12	76	300	
Swaziland	6	6	8	3	43	52	
Zimbabwe	28	24	30	10	43	166	
Problem Debtors ⁴	21	51	32	18	111	370	
Bolivia	32	65	54	32	128	745	3
Ghana	20	23	52	13	65	332	SPA
Guyana	7	30	12	9	489	407	1
Jamaica	20	22	34	13	153	210	4
Kenya	24	34	36	16	71	311	
Liberia	3	30	13	8	1464	334	4
Madagascar	36	92	59	29	206	839	6
Morocco	20	38	28	16	106	306	4
Nigeria	26	78	31	24	103	408	2
Senegal	24	37	41	19	79	405	8
Zaire	7	55	28	14	141	372	6
Zambia	14	39	17	10	171	481	3
Cut-off Levels for Problem Debtors ⁴		30	30	20	50	275	

¹ World Bank data. Exports refer to total merchandise and service exports. Both this and GNP data are from the World Bank. For Afghanistan exports are estimated by UNCTAD. ² OECD data. ³ This sample uses the OECD definitions of low income countries (LICs) and the UN definition of LLDCs. Excluded are LLDCs with no debt data (Angola, Bhutan, Kampuchea, Kiribati, Solomon Islands, Tuvalu, Vanuatu, Vietnam) and other large LICs (China, Egypt, India, Indonesia, Pakistan, Philippines) that are very large economies therefore not easily compared with the LLDCs. ⁴ Problem debtors are those that either have rescheduled debt, are beneficiaries of the Special Program for Africa (SPA), or are above the commonly used cut-off rates in at least 3 of the five debt indicators above.

Fourth, as most debt reduction has concentrated on ODA,⁷ which is a small share of the total in the LLDCs, its impact is marginal. Major creditors are multilateral and non-OECD ones. This debt has not been subject to major reduction measures.

Compared to other smaller low income countries or to other developing countries the debt situation of the LLDCs is less severe. First, the concessionality of debt of the LLDCs has increased during the 1980s as private flows have been drastically reduced and ODA and multilateral funds increased – concessionality increased from 59 to 64% between 1982 and 1988.⁸ Second, net resource flows (including grants) to the LLDCs have remained relatively constant in real terms in the 1980's fluctuating around US\$ 15 billion in 1987 prices.⁹ Those to all developing countries have dropped from US\$ 169 billion in 1980 to 96 billion in 1988 (1987 prices). Third, most debt burden indicators are lower for the LLDCs than for other low income countries. For example, scheduled debt service of the LLDCs in 1988 was 37% of exports whereas that of the other low income countries was 49%.¹⁰

Structure of Debt

The structure of a country's debt¹¹ is of importance as it determines the range of available solutions in reducing its debt burden, as well as its impact on annual debt service. Multilateral debt (concessional or non-concessional) by convention has not been rescheduled or cancelled. Some bilateral OECD ODA (concessional) debt has been forgiven or rescheduled, and bilateral non-concessional debt owed to OECD creditors has been rescheduled in the Paris Club with varying conditions. Bilateral debt to non-OECD creditors (concessional or non-concessional to Council for Mutual Economic Aid (CMEA), to countries belonging to the Organization of Petroleum Exporters (OPEC) or to other developing countries) has in some cases been rescheduled with terms similar to the Paris Club. Commercial debt (non-concessional) can be either rescheduled in the London Club or reduced by various market based transactions in the secondary market.

All LLDCs are mainly official borrowers – 96% of total debt. Private commercial debt is a very small share of the total (4%), according to OECD statistics¹² to which all data below refer. Major creditors are multilateral (including IMF) (39%) and non-OECD bilateral lenders (25%). The share

of OECD ODA was 20% and that of export credits 10%. (Its terms are close to those of commercial debt.)

The other small Low Income Countries (LICs) have much higher shares of "hard-term" debt: export credits were 27% and commercial debt 19%. This can reflect different borrowing strategies or better credit ratings. For example, Bangladesh (LLDC) has always opted for a high share of ODA finance and Nigeria (LIC) is a major commercial/Paris Club debtor. However, the problem debtors in both groups have much larger shares of "hard-term" debt than the non-problem ones.

The individual country debt profiles vary substantially. In multilateral debt, while the bulk of it is at concessional terms in the LLDCs, there are a number of countries that have high shares of non-concessional multilateral debt and relatively high shares of debt owed to the IMF. For example, the IMF accounted for over 15% of the total in Sierra Leone and Uganda (LLDCs) as well as in Zambia, Ghana and Liberia (other LICs). The share of non-OECD bilateral debt ranges from 83% in Afghanistan and 77% in Laos to 2% in Togo and Malawi. Maldives, Ethiopia, Guinea, Mali, Mauritania, São Tomé and the Yemens owed over 35% of their debt to non-OECD creditors. The share of OECD ODA is small – it varied from 2% in Nigeria or 1% in Lesotho to 62% in Myanmar or 38% in Bangladesh. Export credits varied from 1% in Bangladesh to 41% in Nigeria and Zaire. Private commercial debt was highest (20%) in Niger, followed by Kenya and Benin (12%), and Sudan and Zimbabwe (10%).

The structure of debt service reflects the terms of the stock of debt as well as the potential for rescheduling. The true structure of debt service is disguised by the fact that the data available¹³ refers to actual amounts paid. The interest and maturity structure of the countries' debt is closely related to the debt profiles. Average interest rates on OECD ODA are around 1.9% compared to 7-10% for non-concessional bilateral or commercial debt. IDA credits, for example, carry less than 1% interest-like cost. Maturities can vary from 3-5 years for commercial debt to 25 or 50 years for ODA debt.

In the LLDCs the bulk of service payments went to multilateral agencies (35%) – 14% of the total to the IMF alone. The share of the IMF is also very high in many non-problem (over 50% in Haiti and Western Samoa and about

⁷ ODA = Official development assistance. It includes funds with at least 25% grant element.

⁸ Cf. OECD, op. cit.

⁹ Ibid.

¹⁰ Cf. World Bank: World Debt Tables, op. cit.

¹¹ The study uses the OECD classification of different types of debt. Of the available sources this corresponds better to the different types of relief measures available, of which especially Paris Club debt is important.

¹² OECD, op. cit.

¹³ Ibid.

28% in Bangladesh) and problem debtors as well (57% in Uganda). Next in importance were export credits (20%) and non-OECD debt (15%). ODA and private debt both received about 10% of the total in 1988. Thus despite the low shares of export credits and commercial debt in total stocks they weigh heavily in paid debt service.

Burden of Debt

There is no satisfactory way of measuring the burden of debt on a country. The capacity to tolerate debt depends on factors like the level of development, the potential for growth, the structure of the economy or the state of the external economic environment. A certain relative amount of debt can be a burden for a poor country but pass unnoticed in a developed or growing economy: Sweden and Zimbabwe are not quite equal pairs, for example.

Most conventional measures of debt burdens relate either the stock of the debt or the flow of resources needed to service it to some macroeconomic variables. Countries are then considered as problem debtors if they pass some agreed threshold in an indicator. The cut-off points are often derived arbitrarily: reference is made with experience in countries over time either to service or to the capacity to tolerate debt without serious impact to growth. Statistical deficiencies (in macro and debt data), especially in the low income countries, also reduce the reliability of any measure.

Despite the deficiencies some of the most common burden indicators are presented below for the LLDCs. It is to be noted, however, that relative debt burdens, especially when measured with the flow indicators, tend to weigh heavier in the LLDCs than in the more advanced developing countries due to basic problems of underdevelopment. Furthermore, many commonly used stock-related debt indicators are less relevant in these countries, because of the high concessionality of their debt.

According to most indicators debt burdens are, in general, higher in the other LICs than in the LLDCs. For example, *accrued* (long-term) *debt service to exports* (ratios over 20-30% in World Bank studies have been considered a sign of debt problems¹⁴), was higher in the other LICs (46%) than in the LLDCs (33%). Despite the measurement problems and exclusion of recent reschedulings this indicator (especially if compared to

actual service paid) gives a good indication of a country's difficulties. These rates are alarmingly high in both groups. Apart from a high debt burden they also reflect the generally poor export performance of the low income countries. The higher share for other LICs is influenced by the concessionality of the LLDCs' debt (or biased by Nigeria). This indicator clearly distinguishes the non-problem LLDC debtors (14%) from the problem ones (52%). Several problem debtor LLDCs (Guinea-Bissau, Mozambique, Sudan) had scheduled service of over 100% of exports. All non-problem LLDCs (except Yemen, Arab.) and eight problem debtor LLDCs had ratios below 30%.

Obligations versus actual service payments (long-term debt) is another flow indicator of a country's debt problems. For most countries actual payments have remained between 14% (LLDC average) and 21% (other LIC average) of exports.¹⁵ Many countries service close to fully their multilateral obligations (although arrears are increasing), but are selectively falling behind with commercial and bilateral obligations.

A third flow indicator is *total debt service paid*¹⁶ as of exports. This includes both IMF and short-term payments and thereby reflects the total flow of resources transferred to creditors. On average the non-problem LLDCs had ratios between 10 and 20%. The problem debtor LLDCs show very high ratios: only four countries of the 26 were below 20% (Benin, Chad, Comoros, Gambia) and several transferred more than half of their export revenues to foreign debtors (Myanmar, Mozambique, Uganda).

A fourth flow indicator is *total interest payment to exports*. Despite high shares of concessional debt several problem LLDCs managed to have ratios over 20% (Guinea-Bissau, Mozambique, Myanmar, Niger, Somalia, Sudan). The other LICs had on average a higher ratio (17%) than the LLDCs (11%). Above the critical 20% were Bolivia, Madagascar, and Nigeria.

Data was also calculated for the *debt/GNP ratio* (OECD data). This was 108% in the other LICs compared to about 77% in the LLDCs. Within the sub-groups problem debtors had clearly the highest ratios, 115% in other LICs and 83% in the LLDCs, well above the commonly used critical 50%. However, for highly concessional debt this seems a rather low cut-off point. Ratios below 50% were found only in five non-problem LLDCs (Burkina Faso, Lesotho, Haiti, Nepal and Rwanda) and in at least four problem debtors (Benin, Cape Verde, Chad, Uganda). Ratios exceeding 200% were found in five LLDCs (Guinea-Bissau, Mauritania, Mozambique, Somalia and Yemen, Dem.)

Another stock indicator, *debt to exports ratio*,¹⁷ was substantially higher in the LLDCs (513%) than in the other

¹⁴ Cf. World Bank: World Debt Tables, op. cit.

¹⁵ Ibid.

¹⁶ Cf. OECD, op. cit.

¹⁷ Ibid.

LICs (367%), but varied substantially among the countries in the sample. Five countries (Myanmar, Guinea-Bissau, Mozambique, Somalia and Sudan) had ratios over 1000%. On the other hand, eleven LLDCs had ratios below the threshold level (Benin, Botswana, Burkina Faso, Chad, Gambia, Lesotho, Maldives, Nepal, Togo, Western Samoa, Yemen, Arab.) These ratios are strikingly high in the Asian LLDCs, which however do not have serious debt service difficulties. For example, it was 1025% in Laos and 797% in Bangladesh. This reflects the fact that they are relatively closed economies and have high shares of concessional debt in the total.

Performance

Performance evaluation of the LLDCs is made difficult by lack of data for several countries.¹⁸ Some key indicators are described below.

The non-problem debtors in the LLDCs and in the other LICs distinguish themselves by generally positive *GDP growth* rates between 1980 and 1987. In the problem debtors several highly indebted countries have experienced negative growth. The rates vary from -2.6% in Mozambique to + 3.4% per annum in Mali. Progress in per capita growth in both groups has been more dismal due to high population growth rates.

Exports declined in seven of the fifteen LLDC problem debtors for which data is available. The non-problem debtors in both groups again performed better; only Sri Lanka and Yemen (Arab.) had negative growth in their exports. As many of these countries are commodity exporters, low world prices and the subsequent deterioration in their terms of trade have contributed to this. Negative export growth is especially striking in the other LICs' problem debtors where only two (Morocco, Senegal) of the eleven countries had positive growth of exports.

Many countries reduced *investment* during 1980-87. As *imports* were cut with lack of foreign exchange and declined GDP, both consumption and investment was reduced. The only problem debtor that increased its investment ratio was Burundi, which also had positive export and GDP growth rates and a relatively low debt burden. Investment levels increased also in problem debtors like Ghana, Uganda, Central African Republic and Ethiopia. In these countries this is more likely due to a fundamental change in political climate. In Uganda, the Central African Republic, and Ghana there was a drastic change of political regime and subsequent influx of donor money to rebuild the economies. The most impressive cuts in imports occurred in the other LICs group, where the debt burden is also highest.

The data suggest that the non-problem debtors performed better than the problem ones in both groups: growth of GDP and exports were mostly positive and investment levels higher. The problem debtors in both groups include many countries, where export, import and GDP growth have all been negative in the early 1980s. This would suggest that debt burdens do affect economic performance.

Nevertheless, the links between debt burden and performance are complex. Performance is also influenced by many other factors. The reasons for the generally disappointing performance in the poorer countries are manifold and it is difficult to point out any single factor. The burden of debt, an unfavourable external environment and bad economic policies apart from underdeveloped economic structures are among the key factors. As many problem debtors are major exporters of commodities, their price collapse has greatly influenced performance and is likely to continue to do so in the future. Higher real interest rates have less impact on the low income countries as they have a small share of commercial debt. Furthermore, growth has been influenced by the drastic reduction in private (and in some cases official) financial flows which has put a liquidity constraint on some economies. Finally, the impact of unstable political environments and the legacy of past poor economic policies have reduced the growth potential and caused capital flight.

A common perception is that in several debt distressed developing countries the burdens of debt and debt service have become such that they are having a negative impact on growth as resources are drained from investment and consumption. The causality may also run the other way: poor growth performance and reduced resource flows reduce the ability to service the debt, which increases its relative burden. But as in many countries debt service obligations account for 50-100% of exports and actual payments up to 50% of exports, these burdens, especially in the LLDCs, seem unsustainable. This is shown in actual service payments being far below obligations, increasing arrears, frequent reschedulings and low values for the countries' debt in the secondary market.

Economic Rationale for Debt Relief

At the core of the economic arguments in favour of debt relief or reduction is the strengthening of the adjustment process by channelling resources freed from servicing the debt into productive investment. If the debt is not being serviced, debt reduction would help sustain adjustment programmes and improve the investment climate.

¹⁸ All performance data are taken from World Bank: World Development Report, op. cit.

However, to be economically justified debt relief should satisfy basic efficiency criteria (the best use of the scarce resources), or be additional to current aid budgets. The efficiency of debt reduction is enhanced if a country clearly has a debt overhang problem,¹⁹ as the productivity of additional investments without debt reduction can be questionable.

There are many other costs and benefits that should be taken into account when assessing the desirability of various debt reduction techniques or new lending. Frequent reschedulings are costly in manpower and increase the uncertainty regarding available resources. Debt reduction may also be part of comprehensive deals, which may bring additional benefits to the debtor that are not accounted for by free-standing debt reduction operations. Furthermore, many countries are currently experiencing serious problems in the absorptive capacity of aid, which may increase the efficiency of the debt reduction option.

Debt reduction also has some important drawbacks. It may reward inefficient past policies, delay adjustment or encourage flight capital, take resources away from other countries, and establish bad precedents. It can imply acknowledging an income transfer to high income groups in the recipient countries, who in many cases have benefited from the loans but managed to avoid paying the taxes needed in servicing them. In countries that may be able to restore creditworthiness in the near future, debt reduction can have additional costs in hindering future access to credit, or limiting the choice to a few lenders.

In many of the poor LLDC debtors the potential drawbacks of debt reduction are outweighed by the reality. First, they are unlikely to become creditworthy borrowers in international financial markets in any near future. Second, many current money flows (SALs or ESAFs) flow out of the country in debt service payments leaving fewer resources for investment. Furthermore, unless the obligations are substantially reduced, reschedulings or marginal reductions would only lead to using the thereby released resources for the currently unpaid part of debt service instead of investments. Third, a large part of the debt is not serviced and is likely to remain so, and its rescheduling is only consuming scarce management time. Fourth, their exports and GDP would have to grow at unrealistically high rates in order to return to a sustainable

debt service. For example, in Tanzania (exports are mostly commodities) debt service obligations account for close to 90% of exports while its capacity to pay is certainly less. Its exports would have to quadruple in a sustainable way to meet the obligations. No investment or adjustment policies in a structurally weak country will be enough to achieve this in the near future. Therefore, it may be necessary to admit that a large part of these debts will not be paid back and that they are written off the books of the creditors.

Current Debt Relief Initiatives

Much has already been done by the official creditors to ease the debt situation of the debt-distressed developing countries:

- ☐ Many bilateral donors have cancelled ODA debts in the least developed countries or adjusted their terms.
- ☐ The Paris Club has rescheduled non-concessional debt at a variety of terms, including some concessionality to some lower income countries.
- ☐ Substantial disbursement of additional finance by official creditors (development banks, IMF, bilateral donors) is mobilized to support the adjustment effort of many debt-distressed countries.
- ☐ The burden of IBRD debt in some low-income borrowers is being reduced by granting supplemental IDA credits equivalent to a substantial share of the principal.
- ☐ Some bilateral donors are settling the arrears of problem debtors to the World Bank and the IMF (currently concerning about 13 countries) as a precondition to most assistance or adjustment loans.
- ☐ Most official creditors have given support to the Brady Plan aiming at reducing the commercial debt of the problem debtors. The World Bank and IMF have set aside funds to support market-based debt reduction. Several bilateral donors have provided money for buy-backs, encouraged banks to reduce exposure in the developing countries, increased loan loss provisions for LDC loans and given tax or accounting incentives for the banks to participate in debt reduction deals.

The impact of the relief measures is not easy to assess. It is related to country specific circumstances and to the evolution of other factors having a bearing on debt servicing capacity. Most measures have also been undertaken very recently and it may take time before they have an impact on performance.

As most current debt reduction measures have been applied to either bilateral debt or commercial debt their importance to the LLDCs is diminished. This is because

¹⁹ The definition and potential existence of a debt overhang has been subject to much debate in recent literature. The existence of a debt burden does not necessarily imply that a country has a debt overhang. It has been defined to exist if increases in nominal debt reduce the market value of a country's debt, or when the burden of debt and its service act as a clear disincentive to investment and growth. Whether the debt burden is the prime cause of low investment levels is subject to debate and research, and is heavily dependent on country specific circumstances.

most of their debt is owed to multilateral or non-OECD bilateral creditors, which either do not currently accept restructuring or write-offs (multilateral) or have no coherent debt relief strategy (non-OECD). However, the importance of multilateral creditors is prevalent in fresh money flows and adjustment programmes, which often are a precondition to other relief or initiation of policy corrections.

The debt and economic data presented above suggest, however, that the worst performers have been those countries that have not been able to take part in the major rescheduling or debt relief operations. Countries like Sudan, Mozambique, Guinea-Bissau and Somalia have had or still have arrears to the International Financial Institutions (IFIs), which has prevented them from participating in Paris Club reschedulings or receiving quick-disbursing loans from the IFIs. Lack of resources and relief can thereby have aggravated the vicious circle of poor economic management.

At the country level a number of scattered examples shows that the impact in several cases of many current debt reduction measures is a drop in the bucket. However, the current relief measures combined with the new money packages suggest that the relief measures would have at least prevented a worsening of the situation even if they have not solved the debt problem or relaunched sustainable growth. The following is a brief overview of the actions and their likely impact on reducing the debt burdens.

Forgiveness of OECD ODA debt: The OECD bilateral ODA debt of the LLDCs has benefited from outright

forgiveness, adjustment of the terms of the loans, and rescheduling at concessional terms for 25 years with 14 year grace within the Paris Club.

The impact of the cancellations of OECD ODA debt on reducing actual debt burdens is limited. First, in terms of either present value or improved short-term liquidity the value of reducing ODA debt is low because of its long maturities and low interest rates. Second, much of this debt has not been serviced in practice. Third, the share of OECD bilateral ODA either in total debt or debt service is small in most countries. Bilateral ODA from OECD countries in the LLDCs in 1988 accounted for about 19% of total long-term debt and about 9% of total paid debt service.

Paris Club reschedulings: The Paris Club reschedules officially guaranteed non-concessional bilateral debt (export credits, supplier credits, bank credits) and recently also bilateral ODA. Debt service falling due during the agreed consolidation period and possible arrears are rescheduled. The conventional terms vary, but have been around 7-9% interest, 10-11 year maturity and 3-5 year grace period. As the consolidation period in most cases is only about one year many problem debtors require very frequent reschedulings. For example, Niger has rescheduled her debt already 6 times during the 1980s.

Since 1988 the Paris Club has included some concessionality in rescheduling the debt of the poorest countries, which are committed to carrying out adjustment programmes. This was the first step towards acknowledging the need to actually write off debts in debt-distressed developing countries. The so-called Toronto

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agreement provides for three options: (A) partial write-off (one third of obligations), (B) longer terms with market interest rates (25 year maturity, 14 year grace), (C) lower interest rates (one half or 3.5%). At least 17 African countries (including LLDCs) and Bolivia have benefited from these options.

Despite the better terms the Toronto options provide only temporary relief and do little to reduce the actual debt burden. In present value terms (discount and market rates assumed at 7%) options A and C are close to ODA (about 30% lower than conventional Paris Club terms) but option B has an about 30% higher present value than conventional Paris Club terms. A would provide the lowest and shortest debt-service profile, which should increase creditworthiness but give little relief in the near term. B would require large overall debt-service payments and give relief for a longer period. C would give most relief up-front.

The real impact of the options on a country's debt burden will depend on its economic circumstances (need for liquidity and likelihood of returning to higher growth and exports), the share of Paris Club debt in total debt and its overall terms. In the LLDCs it is a small share of the total. The impact is also undermined, first, by the fact that concessional reschedulings concern only a limited number of debt-distressed countries. Second, in most countries these yearly reschedulings cover only a small part of total non-concessional bilateral debt. Third, some donors have reduced the relief provided from their general aid budgets.

Non-OECD Debt: Relief actions by bilateral non-OECD creditors have been mixed and little is known of their detailed conditions. However, this is an important share of the LLDCs' total debt. The CMEA countries and China have given relatively generous rescheduling terms to the poor debtors. OPEC in principle does not reschedule debt, but has tacitly accepted accumulation of arrears in many countries. Debt to other developing countries is to a large extent rescheduled at Paris Club terms.

Multilateral Debt: The burden of multilateral debt is substantial in many LLDCs. Several countries pay over 50% of their debt service to multilateral agencies (including the IMF). Many countries are also in arrears to the World Bank or the IMF, which increases the cost of finance for other developing countries.

Multilateral debt has traditionally not been reduced or rescheduled. Debt cancellation is made difficult by fears that it would damage the credit rating of the IFIs, which would raise the cost of credit for all developing countries. Debt relief by IFIs has been mainly in terms of fresh money.

The World Bank has established a Facility to help service concessional debt in some low income countries and a Fund to finance buy-backs of commercial debt in the IDA only countries. Some regional development banks are planning their own debt relief schemes. More solutions may be needed.

Commercial or Private Debt: The private debt of many problem creditors has been traded at large discounts in the so-called secondary market. The participation of LLDC debt in this growing market has been sparse. Prices should reflect the market's expectations of the debt being serviced, but can be extremely volatile due to relatively low liquidity and diversity of the products offered. Over the past years there has been a clear downward trend in prices, although the recent deals within the Brady Plan have raised some prices.

The secondary market for the debt of small official debtors like the LLDCs is small and thin. However, in recent years an increasing amount of transactions has been going on in low income countries and more are being planned. There are also signs (recent Morocco deal) that the Paris Club debt might also be made eligible for buy-backs. Among the LLDCs Mozambique, Sudan, Tanzania, Niger, Sierra Leone and Malawi have had some transactions. Discounts have varied from 98% in Sudan to 43% in Malawi. The most common techniques in market based debt conversions have been debt equity swaps, debt for nature swaps, and debt buy-backs. The first two have been used in the LLDCs and the latter in some other low income countries.

Debt reduction via market based transactions can have a potentially large impact on reducing the debt service burden in the official debtor countries. Its present value and short-term liquidity impact are higher than for other types of debt. Although commercial debt is a small share of total debt in the LLDCs, it may represent a large share of service payments due, as interest rates are higher and maturities shorter. In addition, inability to service the debt can pose additional cost on the debtor as this can imply cut-offs in external short-term trade finance, lower the country's creditworthiness in general and defer potential foreign investors. A buy-back would reduce these costs.

The current support among *donors* for the market-based menu options for debt reduction is diverse. A number of bilateral donors have actively supported and provided funds for debt buy-backs especially in the lower income debtors. For example, Belgium participated in the first Bolivian buy-back and is now creating a fund from interest due on bilateral debt to be used to buy back more commercial debt and is considering similar deals for Zaire and Guatemala. The Netherlands and USAID have been

active supporters of debt for nature swaps. Some others have given cautious statements in favour of the Brady Plan or the use of bilateral funds for commercial debt reduction. Some countries are reviewing their tax and accounting rules for debt reduction. The multilateral donors have earmarked quick-disbursing funds for debt reduction purposes on a case-by-case basis.

The attitude of *banks* has been mixed. Some are willing to sell loans at a discount, but require either tax incentives or release from new money packages as incentives. Some are strictly opposed to debt reduction or new money packages. As reduction by others can raise the market values of the remaining debt (depending whether the funds provided are cash or a new debt instrument) the non-selling banks may gain by the actions of others (both official and private debt reduction). For example, in the Bolivia case the price of its debt has been higher since the first buy-back. The banks have been more interested in the debt problems of the larger LICs, which constitute the bulk of their portfolios and more of a threat to their performance.

Is the Current Strategy Sufficient?

The present initiatives on official debt would suggest that the official creditors have not fully acknowledged the existence of a debt overhang in the LLDCs or other official debtor countries – most action has been concentrated on providing new money. As most debt is owed to multilateral and non-OECD creditors, where relief action has been limited, the impact of other bilateral debt reduction measures is small. The dimensions of the debt burden in a number of LLDCs suggest that the current measures are unlikely to be enough to return these countries to a sustainable debt service or growth path.

The reasons for the shortfall are numerous. First, despite relief the remaining burden of debt is such that it absorbs a large share of export earnings or other resource flows reducing resources for imports and investment. Second, adjustment programmes are unlikely to accomplish rapid results in debt-burdened, structurally weak countries, where basic investments on infrastructure alone are lacking or in neglect. Third, most current relief measures postpone debt service obligations by a number of years and thus do not reduce the fundamental burden, which keeps creditworthiness low and can prevent resumption of lending or private investment. Fourth, in most cases relief measures have been applied in a piecemeal manner to different types of debt to deal with problems as they come and thereby have a marginal impact in returning the country to a sustainable debt service.

It is also clear that debt relief is inefficient in the long run unless the causes of the crisis are addressed in a permanent way, i.e. the debt strategy is linked to solving the problems that caused the debt difficulties in the first place. Each country has its individual problems but some common denominators are obvious. The factors that contributed to the surging of debt service problems have been both internal (economic management, overall development of the country) and external (international economy, lending policies of the creditors). First, many of the LLDCs have suffered from poor economic management which has entailed large waste not only of the monies borrowed but also of the overall resources of the country. Second, various elements of the international economy in the 1980s have been unfavourable to many LLDCs. For example, low prices for commodities have hit many of these countries whose main exports are commodities. Third, international lenders are likely to have underestimated the risk of lending to many developing countries in their quest to invest the petrodollars in the 1970s or promote their own exports. Credit was easily available. Projects were often poorly or insufficiently appraised.

The international debt strategy has acknowledged the first issue in linking relief to conditionality of undertaking adjustment programmes. Elements of the external environment which are of importance to LLDCs (overall growth, commodity prices) are difficult to influence directly in connection with the debt strategy. The lending policies of creditors have become more prudent: this is evident in reduced commercial lending to many developing countries. The current state of the debt strategy suggests, however, that creditors should take a greater share of the burden by agreeing to more debt reduction. The market economy principles lectured to the borrower countries by the donor community should also be accepted more by their own banks and institutions.

The current debt situation of the LLDCs calls for further measures. Unless the debt burden is addressed in a more substantial way there is a danger that the whole development effort will be undermined as the debt burden impedes growth and investments and absorbs the bulk of fresh resources. It consumes time and attention of both donors and recipients in yearly rescheduling exercises, which would better be directed to economic management of the countries. More attention is needed especially to the treatment of Paris Club debt (longer rescheduling periods, more concessionality and write-offs) and non-OECD bilateral debt, but also of multilateral and private debt. On the other hand, the interests of the non-problem debtors should not be neglected.