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The Role of the State in Foreign Borrowing by Developing Countries

by Susanne Schattner and Klaus Stanzel, Hamburg*

The debt crisis that has been rumbling for many years repeatedly necessitates fresh rescheduling negotiations. These debt rescheduling conferences bring together two fundamentally different parties: on the one side are the emissaries from the big international banks and on the other the government representatives from the debtor country in question.

The collaboration between the state as debtor and commercial banks as creditors throws up a series of questions:

☐ To what extent have the governments of developing countries actually incurred debt, particularly from private sources?

☐ What considerations induced the banks to lend so much to the state?

☐ Why did the state borrow increased amounts in the seventies?

☐ Were these funds used efficiently?

The State's Influence over Borrowing

The scant attention that has been paid to the debtor structure hitherto may be due partly to the unsatisfactory nature of the data available. Relatively reliable information on creditors can be obtained from internationally comparable statistics; these show that at the end of 1982 private creditors held 63.4 % of the developing countries' total debt (see Table 1). By contrast, it is much more difficult to gain an overall impression of the debtor structure and the state's influence on the allocation of foreign loans.

There are three levels of state influence on borrowing that should be distinguished:

☐ foreign loans raised directly by the state or the central bank (state borrowing);

☐ foreign loans taken up by private or state enterprises but with guarantees issued by the government of the developing country (state-guaranteed borrowing);

☐ loans raised in industrial countries by commercial banks or large companies without obtaining guarantees from state institutions in the developing countries (private unguaranteed borrowing).

International statistics unfortunately do not give separate figures for the first two forms of borrowing, distinguishing only between state and state-guaranteed debt on the one hand and private unguaranteed liabilities on the other. However, it can generally be assumed that in the first two cases the state exerts significant influence over the utilisation of the funds, either in employing the capital itself or in using the granting of guarantees to channel loans into sectors and projects that accord with its economic and social priorities. By contrast, the state can exercise no direct influence over the use of private unguaranteed debt, although it can affect the scale and type of borrowing through its control of capital transactions.

The proportion of foreign borrowing in which the state could directly influence the utilisation of the funds in its capacity as guarantor or borrower rose from 76.6 % in 1973 to 80.8 % in 1982. Over the same period public and publicly-guaranteed debt increased fivefold. The strong influence of the state on credit deployment in 1973 can be explained by the fact that repayable development aid and governmental and multilateral development loans are traditionally granted to the state. In the years that followed, however, it was increasingly the private commercial banks that lent funds. Whereas in 1973 only 38 % of public and publicly-guaranteed borrowing came from private sources, in 1982 the figure was 55 % (see Table 1). It is surprising that the influence of the state did not diminish but intensified further, despite the change in the composition of lenders.

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Table 1
Source Structure of Disbursed Foreign Debt of Developing Countries
(at end year)

Sources of Credit	1973 in US $ bn	1973 in %	1975 in US $ bn	1975 in %	1982 in US $ bn	1982 in %
Public and publicly-guaranteed debt	83.7	76.6	125.6	77.8	418.4	80.8
public lenders	51.7	47.3	71.6	44.3	189.4	36.6
private lenders	32.0	29.3	54.0	33.4	229.0	44.2
Private unguaranteed debt	25.5	23.4	35.9	22.2	99.4	19.2
Total	109.2	100.0	161.5	100.0	517.8	100.0

Source: Debt and the Developing World, Current Trends and Prospects, An Abridged Version of World Debt Tables, 1983-84 edition, in: World Bank press release of 6th February 1984.

It was no accident, however, that in the process of recycling petrodollars the banks gave preference to sovereign borrowers or at least required that the state guarantee the loans. Presumably they rated governments as more reliable debtors or guarantors, as they assumed that the state cannot go bankrupt, unlike private enterprises. Whereas they took the country risk for granted and initially considered it to be very slight, they tried in this way to reduce at least the commercial risk. They might also have been swayed by the thought that in the event of balance of payments difficulties the state, as regulatory authority, would give priority to the repayment of its own loans, whereas the redemption of privately raised credit might be jeopardised by exchange controls. Moreover, if the borrower were a public body, the government of the creditor country would probably be more ready to assist than in the case of a loan between two private parties. However, the behaviour of the banks was such that public-sector bodies in developing countries found it much easier to obtain foreign finance. Superficially, this was in the interests of both parties.

Different State Borrowing Ratios

Although the developing countries' public or publicly-guaranteed debt formed a large proportion of their total borrowing, the actual ratios differed from one country to another. Disparities in the state share of debt may be due to differences in the size of the state sector in relation to the economy as a whole or to different policies with regard to guarantees for private sector loans, both factors which reflect different ideological stances.

The size of the state share[1] also depends on the country's level of development, however, for at the beginning of a process of development the state must give fairly strong stimuli through its economic activities and lenders will be less willing to commit funds without a state guarantee. In order to counter the danger of ascribing differences in individual indicators to the size of the state share whereas they ultimately depend on the level of development, the states chosen for the following comparisons are middle-income countries classified by the World Bank as falling, within that group, in the lower income category.[2]

The 31 countries in the sample had foreign debts totalling US $ 146.2 billion at the end of 1982.[3] Governments borrowed or guaranteed 89.1 %[4] of the funds (US $ 130.2 billion). By comparison with the average for all developing countries, the proportion lent by official agencies in industrial countries was still very high in 1982, at 60.4 % (see Table 2). Nevertheless, here too the importance of private lenders had also increased during the seventies, as the growth in private credit averaged 25.9 % a year between 1973 and 1982, as against a rate of growth of 18.5 % a year in lending by public institutions. To this extent, developments in the lending structure fully reflected the overall trend.

In 1980 the proportion of private borrowing from abroad averaged 12.5 %[5] in the selected countries, compared with an average of 20 % for all developing countries. There were marked differences within the sample; whereas some countries recorded no private borrowing (Yemen Arab Republic, Nicaragua, Syria and Zimbabwe), in Guatemala it accounted for almost one-

[1] Meaning in each instance public and publicly-guaranteed borrowing as a proportion of total borrowing.

[2] Cf. World Bank, World Development Report 1982, Washington D.C.

[3] Calculated on the basis of OECD data; cf. OECD: Geographical Distribution of Financial Flows to Developing Countries, Paris 1984.

[4] On a country basis, the state's share of total borrowing was calculated as the ratio of state and state-guaranteed loans (from World Bank statistics) to total borrowing for the country in question (from OECD statistics). Cf. OECD, ibid.; and World Bank: World Debt Tables, 1983-84 edition.

[5] 1980 was chosen as a normal year for the country classification, as the inflow of capital to developing countries declined from 1981 onwards.

Table 2
Source Structure of Selected Foreign Debt of Lower Middle-income Countries
(at end year)

Sources of Credit	1973 in US $ bn	1973 in %	1982 in US $ bn	1982 in %
Public and publicly-guaranteed debt	23.6	100.0	130.2	100.0
public lenders	17.1	72.5	78.7	60.4
private lenders	6.5	27.5	51.5	39.6

Source: Calculated from World Bank, World Debt Tables, 1983-84 edition, Washington D.C., 1984.

third of all borrowing (31.7 %). Given the wide distribution, it was possible to divide the sample into a group of countries with a high proportion of private borrowing (group I) and a group with a low private share (group II).[6] In group I the proportion averaged 20 %, the same as the average for all developing countries, whereas in group II it was substantially lower, at only 6 %. It may therefore be supposed that this group comprises those countries that attribute a particularly important development role to the state sector.

State Activities and Borrowing

A comparison of the frequency of various economic indicators in different quartiles[7] shows that countries in the two groups differ from one another not only in the structure of borrowers but also in the scale of total borrowing. Countries in group II, in which it was primarily the state that took up credit or made borrowing possible at all by granting guarantees, had significantly higher debts than group I countries in 1982. Whereas the average[8] debt for the entire sample amounted to 29.3 % of gross national product, most of the countries in group II had larger liabilities – indeed, almost one in three had a debt ratio of more than 41.5 % of GNP (see Table 3). The fact that the ratio of private unguaranteed debt to GNP was higher in group I shows that the high overall debt in group II is solely attributable to large-scale public and publicly-guaranteed borrowing. Hence, group II comprises the countries in which official bodies drew heavily on the abundant supply of credit in the seventies.

Public and publicly-guaranteed credit is not necessarily used to cover deficits in the government's budget; the funds are just as likely to be on-lent to state-owned or private enterprises. The state can therefore act as a centralised borrowing agency.[9] If the state influences a large proportion of borrowing and if foreign debt reaches a relatively high level, it can be assumed that state enterprises, whose borrowing is difficult to identify statistically, and the Exchequer both benefit directly from the substantial funds involved. Furthermore, in some countries losses incurred by state-owned enterprises are financed out of the central government budget.

In the seventies the developing countries with little natural resources were particularly hard hit by two external shocks that caused budget deficits irrespective of cyclical trends. Oil price rises in 1973-74 and 1978-79 increased existing expenditure items and led to additional spending, while at the same time the emerging slowdown in growth had a negative effect on revenue.

Without external finance, governments would quickly have been forced to adjust their budgets. Access to foreign capital enabled them to maintain the previous rate of expenditure growth without increasing taxation. In principle, they could have sustained both current and capital expenditure, though they should have given priority to investment to encourage the restructuring of the economy, for investment needs had increased because manufacturing plant had been made economically obsolete by a deterioration in the terms of trade. However, there were many factors working against the necessary adjustment of budget expenditure. Cuts in current expenditure – mainly wages and salaries, but also subsidies of all kinds – generally meet stiff resistance from the sections of the population affected and are therefore politically difficult to implement.

The governments of countries with abundant raw materials were faced with similar problems.[10] The raw

[6] Group I: Colombia, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Indonesia, Jordan, Kenya, Lesotho, Nigeria, Paraguay, the Philippines, Thailand, Tunisia (private proportion of borrowing greater than 12.5 %)
Group II: Bolivia, Cameroon, Costa Rica, Egypt, Jamaica, Liberia, Morocco, Nicaragua, Papua New Guinea, Peru, Senegal, Syria, Turkey, Yemen Arab Republic, Zambia, Zimbabwe (private proportion of borrowing equal to or less than 12.5 %).

[7] A comparison of the arithmetic means of individual indicators has not been carried out here, as the number of observations in the two country groups is relatively small. In a small random sample, extreme indicator values have a strong impact on the arithmetic mean, which then ceases to give the value characteristic of the country group in question. A comparison between the country groups on the basis of the arithmetic mean produces distorted results.

[8] Here and in subsequent references the average is rendered by the median.

[9] With regard to the functions of state borrowing, see Rainer Erbe: Die öffentliche Auslandsverschuldung von Entwicklungsländern, in: Armin Gutowski, Bruno Molitor (eds.): Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik, Vol. 28, Tübingen 1983, pp. 253 f.

[10] Cf. Susanne Schattner: Mineral Economies – Indebtedness Without Growth, in: INTERECONOMICS, No. 5, 1982.

Table 3

Type and Volume of External Inflows of Resources to Countries with High and Low Proportions of Private Foreign Borrowing

Indicators	Number of observations — Countries where proportion of private borrowing is high	Number of observations — Countries where proportion of private borrowing is low	Range (Quartile points)	Number of observations (as % of total observations in the relevant group) — Countries where proportion of private borrowing is high (Group I)	Number of observations (as % of total observations in the relevant group) — Countries where proportion of private borrowing is low (Group II)
Private unguaranteed			≤ 1.4	6.7	43.8
foreign borrowing/GNP[1]	15	16	$> 1.4 \wedge \leq 3.1$	26.7	31.3
			$> 3.1 \wedge \leq 5.5$	33.3	18.8
			> 5.5	33.3	6.3
Public and publicly-guaranteed			≤ 15.3	46.7	6.3
borrowing/GNP[1]	15	16	$> 15.3 \wedge \leq 25.5$	33.3	18.8
			$> 25.5 \wedge \leq 36.9$	13.3	37.5
			> 36.9	6.7	37.5
Total borrowing/GNP[1]			≤ 20.0	46.7	6.3
	15	16	$> 20.0 \wedge \leq 29.3$	26.7	25.0
			$> 29.3 \wedge \leq 41.5$	13.3	37.5
			> 41.5	13.3	31.3
Inflow of external			≤ 3.57	26.7	25.0
resources/GDP[2]	15	16	$> 3.57 \wedge \leq 5.38$	26.7	25.0
			$> 5.38 \wedge \leq 8.90$	33.3	18.8
			> 8.90	13.3	31.3
Direct investment/			≤ 13.45	15.4	36.4
inflow of external resources[2]	13	11	$> 13.45 \wedge \leq 23.10$	23.1	27.3
			$> 23.10 \wedge \leq 38.55$	23.1	27.3
			> 38.55	38.5	9.1

[1] In 1980.
[2] In the period 1970-80.
Sources: Calculated from IMF: International Financial Statistics Yearbook, Washington D.C., Vol. 36, 1983; IMF: Balance of Payments Statistics, Washington D.C., Vol. 28, 1977 & Vol. 34, Part 2, 1983; World Bank: World Debt Tables, 1982-83 edition, Washington D.C., 1983; OECD: Geographical Distribution of Financial Flows to Developing Countries 1978/81, Paris 1982.

materials boom of the mid-seventies and the consequent expectation of a continued strong rise in budgetary revenues had caused many of them to plan for an expansion in expenditure that could no longer be covered by actual receipts. The hope of a resumption of the steep rise in raw material prices probably played a role in the decision whether to quickly restore the budget to health or to resort to increased foreign borrowing. That this hope was not fulfilled, at least for the non-oil exporting countries, is shown by the fact that the deterioration in their terms of trade that began at the end of the raw materials boom has proved to be permanent so far and in fact grew much worse at the beginning of the eighties.

It now became evident that the countries of the two groups reacted very differently to the world economic challenges. In group I the low budget deficits of the seventies (in most countries[11] they did not exceed the average of 2.3 % of GDP) show that rapid and successful budgetary adjustment was carried out in these countries. This is also clear from the fact that these countries' deficits were not generally higher than in the sixties and is demonstrated by the higher state saving in this group. Their governments had comparatively greater current receipts to invest. Whereas just under one-third of the countries in group II had a state savings ratio of more than 2.4 % of GDP, in group I the proportion was just under two-thirds (see Table 4).

By contrast, the high and rising budget deficits in group II (countries with a high proportion of state borrowing) are an indication that a number of governments took advantage of the available external financing opportunities to maintain expenditure at the

[11] Jordan is an exception, with high deficits of 8.5 % of GDP.

existing level and did not do enough to open up additional domestic sources of revenue. In fully 80 % of cases the budget deficit was higher than the all-country average. In seven out of eight countries it was more than 0.5 percentage points higher than in the sixties and in half of them it increased by as much as 3.1 points.[12] The low figures for state saving support the supposition that governments borrowed from external sources not only for investment purposes but also to sustain the growth in current expenditure embodied in their budgets. The necessary shift in the balance between current and capital spending was therefore insufficient or failed to materialise.

As the governments of these countries clung to the previous rate of expenditure growth in spite of the slower expansion in GDP, the relative size of the state sector[13] increased from what it had been in the sixties. This also indicates that the high budget deficits were not caused solely by factors on the receipts side. However, the differences in the size of the state sector cannot be explained only in terms of the more rapid growth in expenditure in group II during the seventies. In the preceding decade the public sector had already played a prominent role in this group of countries; with the help of foreign borrowing, it was further strengthened at the expense of the private sector.

State Borrowing and the Structure of the Resources Inflow

The relatively low and unchanged ratios of state expenditure to GDP in group I and the smaller government borrowing in the capital markets indicate that the climate was more favourable for entrepreneurial activity. Together with the state's relatively modest borrowing abroad, this probably made it easier for private businesses to enter into higher foreign liabilities than countries in group II.[14] On the other hand, private credit demand in group II may have been crowded out

[12] Particularly conspicuous are the high and rising deficits in countries with abundant raw materials.

[13] Central government expenditure as a proportion of gross domestic product.

Table 4

State Activity in Countries with High and Low Proportions of Private Borrowing from Abroad

Indicators	Total number of observations — Countries where proportion of private borrowing is high	Total number of observations — Countries where proportion of private borrowing is low	Range (Quartile points)	Number of observations (as % of total observations in the relevant group) — Countries where proportion of private borrowing is high (Group I)	Number of observations (as % of total observations in the relevant group) — Countries where proportion of private borrowing is low (Group II)
			≤ 13.29	42.9	0
Ratio of state expenditure to GDP[1]	14	11	$> 13.29 \wedge \leq 17.35$	28.6	27.3
			$> 17.35 \wedge \leq 24.19$	14.3	36.4
			> 24.19	14.3	36.4
			≤ 1.55	27.3	14.3
Change in ratio of state expenditure to GDP[2]	11	7	$> 1.55 \wedge \leq 3.74$	36.4	14.3
			$> 3.74 \wedge \leq 5.90$	27.3	28.6
			> 5.90	9.1	42.9
			≤ 0.52	28.6	18.2
Budget deficit/GDP[1]	14	11	$> 0.52 \wedge \leq 2.33$	50.0	0
			$> 2.33 \wedge \leq 3.82$	14.3	36.4
			> 3.82	7.1	45.5
			≤ -1.12	25.0	25.0
Change in budget deficit/GDP[2]	12	8	$> -1.12 \wedge \leq 0.49$	41.7	0
			$> 0.49 \wedge \leq 3.11$	25.0	2.5
			> 3.11	8.3	50.0
			≤ 0.50	7.1	43.8
State saving/GDP[1]	15	16	$> 0.50 \wedge \leq 2.40$	28.6	25.0
			$> 2.40 \wedge \leq 4.65$	28.6	18.8
			> 4.65	35.7	12.5

[1] Average for 1970-80.
[2] In relation to average for 1964-69.
Sources: Calculated from IMF: International Financial Statistics Yearbook, Washington D.C., Vol. 36, 1983; and IMF: Government Finance Statistics Yearbook, Washington D.C., Vol 7, 1983.

by the high level of public-sector credit demand and lenders' preference for sovereign borrowers.

However, the main indication of a better investment climate in group I is the higher proportion of direct investment in the total inflow of resources. In more than 60 % of cases it exceeded the average of 23.1 % and in almost 40 % of cases direct investment accounted for more than 38.5 % of the total capital inflow (see Table 3).

The substantial inflow of direct investment also enabled the countries of group I to achieve almost as large an inflow of external resources as those in group II, despite much lower foreign borrowing (see Table 3).[15] Hence they adopted a fundamentally different approach to harnessing foreign capital in order to accelerate their development process. One of the advantages is that the cost of imported capital does not fall on the balance of payments in the form of contractual interest payments; furthermore, the foreign investor bears the risk of a bad investment.

Endangered Efficiency with State Borrowing

In principle, the more prevalent state activity in group II should not be assessed negatively, nor will it necessarily have been accompanied by a serious loss of efficiency. The state can play a crucial role as a catalyst in the development process. Its task consists in removing bottlenecks that impede development, either through investment in infrastructure that provides the foundation for a flourishing private sector or through expenditure on education and health, the essential elements in improving the quality of the potential labour force.

If the state does justice to its role as catalyst, the economy's borrowing capacity can also be sustained more easily. This depends on whether it succeeds in earning an adequate return on the funds it borrows. For an economy this means that borrowing must lead to income growth able to cover at least the interest payments; if that is not the case, it will have a social cost.[16] If an economy achieves growth, competing domestic and foreign claims for a share of domestic

[14] The lower government borrowing may have been accompanied by restraint in granting guarantees.

[15] However, the group II countries more frequently recorded inflows in the fourth quartile (more than 8.9 % of GDP, cf. Table 3).

[16] Cf. Armin Gutowski: Foreign Indebtedness and Economic Growth. Is there a Limit to Foreign Financing? in: Armin Gutowski, Aldo A. Arnaudo, Hans-Eckart Scharrer (eds.): Financing Problems of Developing Countries, Proceedings of a Conference held by the International Economic Association in Buenos Aires, London and Basingstoke, (to be published shortly); Armin Gutowski, Manfred Holthus: Limits to International Indebtedness, in: Donald J. Fair (ed.): International Lending in a Fragile World Economy, The Hague 1983.

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DIE WETTBEWERBSPOSITION DER DEUTSCHEN WIRTSCHAFT

– Wechselkurs und internationale Wettbewerbsfähigkeit –
(THE COMPETITIVE POSITION OF THE GERMAN ECONOMY
– Exchange Rates and International Competitiveness –)

The real exchange rate, the conventional indicator used to measure changes in international competitiveness caused by the exchange rate, can lead to misjudgements if examined in isolation. The aim of this study is therefore to develop and test indicators which, either individually or taken together, show to what extent changes in exchange rates influence competitiveness on the one hand and, on the other, how far these changes are themselves simply a reflection of trade flows and, thus, of the competitive factors which lie behind them.

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output can be satisfied more easily; in other words, countries whose domestic product is expanding strongly will not find debt servicing burdensome.

However, the management of state enterprises in developing countries can prove much more inefficient than its private-sector counterpart. Many public investment projects financed during the lending boom are also beset by efficiency problems:

☐ The large capital-intensive projects preferred by state planners are often out of keeping with the country's absorptive capacity and the factor relationships determined by the resources available. These soon prove to be unproductive prestige projects.

☐ State-owned enterprises often operate more according to political criteria than according to principles of profitability. Hence they are often used to conceal unemployment and not infrequently they also suffer from management problems.

☐ Finally, state-owned enterprises often do not have to face as strong competition as private companies and are less endangered by bankruptcies if the state affords them financial support.

If state enterprises are less efficient and state investment largely unproductive, this has repercussions on the efficiency of the entire economy and hence on the country's ability to service its foreign debt.

Table 5

Indicators of Success in Countries with High and Low Proportions of Private Borrowing from Abroad

Indicators	Number of observations — Countries where proportion of private borrowing is high	low	Range (Quartile points)	Number of observations (as % of total observations in the relevant group) — Countries where proportion of private borrowing is high (Group I)	low (Group II)
			≤ 2.88	0	43.8
Rate of growth in GDP[1]	14	16	> 2.88 ∧≤ 5.85	21.4	31.3
			> 5.85 ∧≤ 7.43	42.9	12.5
			> 7.43	35.7	12.5
			≤ −3.55	7.7	41.7
Change in rate of growth in GDP[2]	13	12	> −3.55 ∧≤ −0.30	30.8	25.0
			> −0.30 ∧≤ 2.85	30.8	16.7
			> 2.85	30.8	16.7
			≤ 16.32	0	43.8
Marginal productivity of capital[1]	14	16	> 16.32 ∧≤ 26.90	21.4	31.3
			> 26.90 ∧≤ 33.35	42.9	12.5
			> 33.35	35.7	12.5
			≤ 20.40	20.0	31.3
Investment ratio[1]	15	16	> 20.40 ∧≤ 22.34	26.7	25.0
			> 22.34 ∧≤ 23.95	26.7	25.0
			> 23.95	26.7	18.8
			≤ 2.93	20.0	28.6
Change in investment ratio[2]	15	14	> 2.93 ∧≤ 5.66	20.0	35.7
			> 5.66 ∧≤ 7.56	40.0	7.1
			> 7.56	20.0	28.6
			≤ 12.6	20.0	31.3
Savings ratio[1]	15	16	> 12.6 ∧≤ 15 4	20.0	31.3
			> 15.4 ∧≤ 19.7	26.7	25.0
			> 19.7	33.3	12.5
			≤ −0.79	20.0	26.7
Change in savings ratio[2]	15	15	> −0.79 ∧≤ 2.55	26.7	26.7
			> 2.55 ∧≤ 4.13	26.7	26.7
			> 4.13	26.7	20.0

[1] Average for 1970-80.
[2] In relation to average for 1964-69.
Source: Calculated from IMF: International Financial Statistics Yearbook, Washington D.C., Vol. 36, 1983.

The two groups of countries do indeed differ in terms of the pace of expansion (see Table 5). The average real rate of growth of gross domestic product for all countries in the sample came to just under 5.9 % in the seventies. Whereas just under 80 % of the group I countries recorded above-average growth rates, those for three out of four countries in group II were below average, and in seven countries even below 2.9 %. These countries also frequently had to accept growth losses in comparison to the sixties; in two out of three cases the reductions amounted to more than 0.3 percentage points. By contrast, growth rates continued to rise in six out of ten countries in group I in the seventies and only one country (Nigeria) recorded a substantial reduction in its rate of growth (4 percentage points). The difference between the two country groups as far as development is concerned is therefore apparent in both the level and the changes in growth rates in the seventies.

Nonetheless, individual countries in group II did succeed in stimulating growth. For example, the growth rates of 9.2 % and 10 % recorded by the Yemen Arab Republic[17] and Syria in the seventies were the highest of all. In Syria and Egypt the rates of growth were also much faster than in the sixties, accelerating by almost 6.7 and just under 5.6 percentage points respectively.

High rates of growth can be achieved if substantial sums are invested and if the investments are highly productive. From the point of view of investment activity, there are only slight differences between the two groups of countries (the investment ratios for group I fell more frequently in the fourth quartile and those for group II in the first), but the contrast is clear with regard to the efficiency of capital employed (see Table 5).

The two groups differ more markedly in terms of the increase in investment by comparison with the sixties than in the level of investment. In 60 % of group I countries investment ratios showed above-average increases. The domestic component of investment, in other words domestic saving, was also higher than the average in 60 % of cases in the seventies, with the savings ratio exceeding 19 % of GDP in one in three countries. Furthermore, the savings ratios in countries in this group compared to the sixties tended to decline less frequently (see Table 5).

Falling savings ratios[18] at a time of rising inflows of resources indicate that some of the borrowed funds are being used for consumption rather than investment. Such problems of transformation were evident in one in three countries in group II.[19] The poor growth performance of group II can therefore also be explained partly by the fact that actual investment often fell short of the potential permitted by the given inflow of resources.

The cause of the more frequent transformation problems in group II probably lies in government borrowing to finance current expenditure, as described above. The fact that they also frequently occurred in group I does, however, indicate that other factors were also involved. In the seventies they were often caused by price distortions.[20]

Conclusions

The expansion in the supply of credit in the seventies gave developing countries the opportunity to make the necessary adjustment to changed circumstances. The preference lenders displayed for sovereign borrowers was exploited mainly by countries in which the state sector already played an important role in economic life. The increase in budget deficits and in the relative size of the public sector in these countries indicates that state agencies used part of the foreign capital to extend their field of operation further at the expense of the private sector. It is equally clear that state institutions in these countries were less likely to act as a centralised borrowing agency than to use the borrowed funds directly. The fact that public investment accounted for a larger share of total investment had an adverse effect on the efficiency of the capital employed in these countries, however. As some of the borrowed funds were used to maintain current expenditure, so that a restructuring of the budget in favour of capital expenditure did not come about, the income that could be earned from the foreign capital was also modest.

Capital efficiency was markedly higher in those countries where the authorities did not borrow on such a

[17] The high rates of growth and capital productivity in the Yemen Arab Republic can be explained by two special factors. First, the high capital productivity in the seventies was a result of the period of reconstruction after the civil war between 1962 and 1970. Secondly, large sections of the population received rapidly growing incomes owing to the remittances from Yemeni guest workers employed mainly in neighbouring oil-exporting countries. This created domestic markets for farmers and merchants and provided funds for private investment, particularly in house-building and transport. Cf. World Bank: Yemen Arab Republic, Development of a Traditional Economy, Washington D.C., January 1979, pp. 8 ff.

[18] Group I: Guatemala -9.5; Kenya -2.5; Honduras -3 5.
Group II: Peru -3.3; Zambia -8 4; Liberia -16.7; Jamaica -1 7; Nicaragua -0.5 (percentage points in each case).

[19] Transformation problems can be identified only approximately, however, by comparing two periods. A more far-reaching time series analysis might test the observed link between the inflow of external resources and domestic saving.

[20] Cf. Manfred Holthus, Klaus Stanzel: Die Bonität von Entwicklungsländern, in: Udo-Ernst Simonis (ed.): Externe Verschuldung – interne Anpassung. Entwicklungslander in der Finanzkrise, Schriften des Vereins fur Socialpolitik, Vol. 144 (New Series), Berlin 1984.

Table 6
Multilateral Rescheduling Negotiations, 1976-83
(Amounts rescheduled, in millions of US dollars)

Countries with a high private proportion of borrowing	1976	1977	1978	1979	1980	1981	1982	1983
Dominican Rep.								c660
Ecuador								p200 c2150
Honduras								c122
Nigeria								c1830
Countries with a low private proportion of borrowing								
Bolivia					c29	c444		c536
Costa Rica								p107 c1259
Jamaica				c126		c103		c166
Liberia					p30	p25	c27	p25
Morocco								p1200
Nicaragua					c582	c190	c55	
Peru	c387		p478	c821				p450 c2320
Zambia								p320
Senegal						p77	p84	p81 c92
Turkey			a1223	a873 c2640	a2600	c3100		

p = Paris Club agreement
c = Commercial banks' agreement
a = Negotiations with aid consortia

Sources: World Bank: World Debt Tables, 1983-84 edition, Washington D.C., 1984, p. XVIII; World Bank: World Development Report 1983, Washington D.C., 1983, p. 23.

large scale and where the public sector played a smaller role. Governments in these countries adjusted their budgets fairly swiftly and knew how to attract an almost equally large inflow of external resources by encouraging direct investment; this had the added advantage of entailing fewer contractual liabilities.

It is therefore not surprising that the 14 countries in the sample that negotiated a multilateral rescheduling of their debt between 1976 and 1983 (see Table 6) comprised only 4 countries where the proportion of private external debt was high in 1980 but 10 countries where loans were taken up or guaranteed primarily by official agencies. Although certain exceptions illustrate that a high private component of borrowing is neither a necessary nor a sufficient condition for successful borrowing, the analysis nevertheless shows that for most governments it did not pay to borrow in order to avoid making the necessary budget adjustments.

From the banks' point of view, the assumed guarantee that loans to sovereign borrowers would be repaid ultimately proved an illusion. By the late seventies and early eighties many of the debtor countries were no longer able to set aside sufficient foreign exchange to service their loans. There was clearly nothing of substance to back the purely institutional guarantee. The crucial factor for a country's borrowing capacity is ultimately not that the debtor cannot go bankrupt in purely formal terms; more important is whether a sufficient income can be.earned from the loans. This is clearly more likely to be the case if foreign loans are used by the private sector. Moreover, the rescheduling schemes of recent years have shown that when the necessary return is lacking the state is not always able to keep up loan service payments simply by tightening the nation's belts. The need for a long-overdue adjustment of public-sector budgets can now be met only at the cost of serious social and political conflict. Hence in view of the debt problems it may even happen that a change of government will bring politicians to power who wash their hands of the borrowing by their predecessors. The banks' reaction to such problems tends to be to insist even more strongly on state guarantees in developing countries. However, this calculation has already been found wanting in the past.