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INTERNATIONAL DEBT OF DEVELOPING COUNTRIES – ANY STEP TOWARDS SOLUTION?

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The Meaning of a Solution

By now, the economic history of the world debt problem is fairly well understood. The roles of the recycling of the petrol surplus, lending activities of money center banks, the run-up in world interest rates, the deterioration of primary commodity markets, the rise of protectionism and other events or phenomena had much to do with the origins of the problem and the attempts to manage it. The amount of capital flight (from the developing countries) and the world's current account discrepancy are troublesome questions that have not been answered in a quantitative sense. That part of the problem is not fully understood. Clearly, then, there are problems to be faced, and this presentation surveys some steps that have been recommended to deal with them on a global and multilateral basis.

Dealing with these problems after they have been defined, however, calls for clarification of objectives. There are many actors involved and the objectives must be mutually agreed upon; otherwise, there can only be confrontation. The lenders, if left entirely to their own wishes, would look for prompt pay-as-you-go servicing and repayment of principal on the maturity dates. This is their objective for any normal private loan, but they are not dealing with normal private loans and that makes the problem distinctive. In 1982, it became apparent that the loans could not be serviced and repaid in the normal course of events. This was recognized at an earlier date for individual cases like those of Poland, Zaire and others, but in 1982,

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it was evident that many countries having unusually large debts, amounting to hundreds of billions of dollars, were all at once unable to service and repay in the usual way.

From the point of view of the countries in which the main creditors are located, they want to see their own financial institutions functioning smoothly. They want to avoid a financial crisis and, at the same time, they want to maintain commercial relations with debtor nations. By and large, it is a case of the developed industrial countries vis-à-vis the developing countries, and the latter are important export destinations and import origins for the former. The 1985 figures for the United States alone show the large amounts involved in trade with developing countries. They measure up in importance with other geographical-economic areas.

The first response of indebted developing countries was to ask for rescheduling terms in order to get some time to make adjustments and then to agree with externally-imposed conditions of austerity, often under IMF surveillance. It may have appeared that this approach was working, with Mexico as a prime example, but progress was short-lived. Some debtors rejected the austerity line from the start, but, by now, it is generally accepted that a growth objective must be included as part of any total solution. Growth among developing countries is actually in the self-interest of the industrial countries because they are generally involved in important trade relations with the Third World just as the figures in Table 1 depict the situation for the United States.

A solution, therefore, should have different components that reconcile the positions of the banks, the creditor nations, the debtor nations, and the multinational agencies.

1. There should be rescheduling such that debtors can meet service obligations.
2. Maturities should be paid on revised schedule or should be rolled over.
3. Debtors should be allowed to follow a growth path and receive fresh credits as needed for this objective.

Settlement of the debts as originally negotiated is out of the question. There must be some concession on the part of the creditors. These concessions will have to extend beyond any that may be associated with the rescheduling that has already taken place. Nega-

Table 1
U.S. EXPORTS / IMPORTS BY AREA, 1985
($ millions)

US exports to:	Western Europe	Canada, Japan, Australia, New Zealand, South Africa	Eastern Europe	Developing Countries
	56,015	82,991	3,258	71,968
US imports from:	77,454	142,427	1,847	117,135

Source: *Survey of Current Business,* U.S. Department of Commerce, June 1986.

tive and near-zero growth rates are, at the same time, politically unacceptable for the debtors.

Given these objectives, it is worthwhile exploring various policies that have been suggested for dealing with the debt problem. It can be asked whether or not particular policies are likely to achieve the stated objectives.

The World Economic Outlook and Debt Indicators

There has been an expectation of prolongation of the recovery from the world recession of 1980-82 and also of a reinvigoration of the process because of the significant adjustments that have taken place with respect to

1. the U.S. dollar – declining from its unusual high values since February 1985.
2. interest rates – declining with the depreciation of the U.S. dollar.
3. inflation – brought under control in many countries, especially in line with the decline in oil prices.

It was felt that these three adjustments would lead to an extra half or full point of world GDP growth and also an expansion of world trade. It may happen, but so far the response has been modest or negligible. Since steps upward in oil prices seemed to generate world recessionary movements, it was argued that the decline in oil prices would induce a reverse movement in economic activity. The

decline has been helpful in many cases, but it has also set back the producer-exporters to such an extent that the world economy has not yet realized the full benefits. In particular, debtor countries like Mexico, Venezuela, Indonesia, and Nigeria are put in more precarious positions that have far-reaching ramifications for the world as a whole.

When the first major adjustments were being made, following Mexico's inability to service their debt in 1982, private bankers felt that rescheduling with austerity on the part of the debtors would lead to a solution of the debt problem as long as world growth continued at about 3 percent annually. World and OECD growth rates have been that strong, with some periods stronger than others, yet this kind of recovery has not been vigorous enough to obviate the need for a total reconsideration of the debt problem. The kind of growth presently projected, without any special new initiatives, is approximately at the 3 percent rate, with variations, of course, from country to country. It will be necessary to search for new policies to deal specifically with debt issues and also with the promotion of better all-round growth in world trade activity.

Useful indicators of the debt situation are the service burden ratios and the debt-export ratio.

Projections of the total debt service burdens, figured as ratios to exports, are shown in Table 2 for a number of significant debtors.

In some countries with large debt (approximately $50 billion) as in South Korea, extremely strong growth enables them to keep the service ratio in restraint. It is not a significant obstacle to the economy's overall expansion, especially not through export promotion. Argentina, Brazil and Mexico, the largest debtors in Latin America, have very high ratios and only Brazil indicates some hope for reducing it. Some centrally-planned economies (Poland, Romania, and Yugoslavia) have been introduced in the listing, for comparative purposes. They are all able to show improvement in the projected service ratio, but only through the imposition of austerity, especially in Romania. That option can be imposed in a command economy but not in most of the aspiring countries of the Third World.

Another way of looking at the burden of the debt is through the level and movement of the debt/export ratio. This is often cited as a banker's rule-of-thumb criterion for creditworthiness. In the developing world as a whole, for capital importing countries, it has worsened since 1982. In Latin America, there were signs of improve-

Table 2
SELECTED PROJECTIONS OF DEBT SERVICE RATIOS
(Percent)

	1984	1985	1986	1987	1988	1989	1990	1991
Argentina	.85	.88	1.37	1.17	1.18	1.29	1.22	.98
Brazil	.71	.80	.86	.93	.89	.84	.74	.59
Chile	.89	1.23	1.22	1.10	1.43	1.48	1.29	.99
Mexico	.65	.73	.90	.95	.85	.90	.83	.83
Venezuela	.46	.49	.96	.73	.63	.55	.51	.36
Indonesia	.19	.25	.27	.28	.28	.30	.30	.28
South Korea	.17	.20	.19	.18	.18	.18	.16	.15
Philippines	.18	.36	.42	.31	.42	.40	.35	.32
Thailand	.21	.22	.28	.24	.23	.23	.21	.18
Algeria	.49	.48	.66	.66	.63	.60	.48	.44
Egypt	.31	.37	.41	.41	.31	.35	.26	.27
Nigeria	.31	.37	.56	.42	.36	.32	.23	.25
Poland	1.04	1.06	1.00	.62	.56	.51	.42	.37
Romania	.30	.26	.21	.25	.17	.10	.06	.03
Yugoslavia	.72	.69	.59	.61	.56	.52	.44	.38

Source: WEFA, Forecast of July, 1986.

ment in 1984, but in 1985, the ratio again deteriorated. Debt stands at approximately double the exports among 93 capital-importing countries and triple the exports for Latin America.

The principal criterion for stability is that the interest rate should be less than the rate of growth of nominal exports, both denominated in the same currency units. This criterion is a stability criterion and is only indicative because a (nonfactor) current account surplus could act as a supplementary stabilizing term even if the interest rate were not less than the growth rate of exports. These relationships can be deduced from the identity

$$\left(\frac{D}{X}\right)_t = \left(\frac{1+i}{1+r}\right)\left(\frac{D}{X}\right)_{t-1} + \left(\frac{NX}{X}\right)_t$$

D/X = debt-export ratio (exports of goods and nonfactor services)

i = interest rate (LIBOR or U.S. Prime)
r = growth rate of exports

NX/X = nonfactor net exports-export ratio

Table 3
PROJECTIONS OF INTEREST AND EXPORT –GROWTH RATES
(Percent)

	1984	1985	1986	1987	1988	1989	1990	1991
LIBOR	10.9	8.4	7.1	7.7	7.3	9.0	8.0	8.0
US Prime	12.0	9.9	8.4	8.8	9.3	n.a.	n.a.	n.a.
LDC exports (mdse)	8.5	–4.1	–6.2	7.6	13.8	9.5	10.9	10.8

Source: WEFA, Forecast of July, 1986

The current balances are estimated to be negative, and if interest payments were to be deducted, they would be close to zero; therefore, we should not look to help from the final term on the right-hand-side of the above identity. The LIBOR or Prime rates should have a risk premium of about 1.5 percent added. Except for 1988, and possibly in the next decade when the export growth rate is projected to be high or the risk-augmented rate compares unfavorably with the growth rate of exports. The situation looks particularly bad for this year, when LDC exports are expected to decline. Oil export earnings look bleak and the Pacific Basin exporters are the only major grouping expected to show a significant gain. It is possible that interest rates could be much lower after 1986; they are presently falling a great deal. This could be of substantial benefit for the debtor countries.

From this way of looking at the problem, possible routes for improvement of the debt problem can be laid out -- in terms of bringing down or stabilizing the debt-export ratio. The improvement routes are:

(a) Bring down interest rates much further -- by another 200 basis points or more;

(b) Revive export earnings of developing countries -- either through larger volume (with better world growth) or through price rises in primary markets;
(c) Improve the current account positions of developing countries -- preferably through export expansion (as in (b)) or through import restraint, which is not to be recommended.

Combinations under (a) (b) and (c) are certainly acceptable.

Specific Policy Proposals

Macroeconomic policy to get interest rates, export growth, and current account balance coordinated across developed and developing countries can help to establish conditions in which debt-export ratios become stabilized or improved, on average, but the total problem requires more direct policies that get at the debt issues immediately. Waiting for the macroeconomic environment to fall into place has not yet proved to be adequate or satisfying because the debt problem and its unpleasant ramifications persist.

A number of direct policy suggestions have been made in several quarters; a survey of some will be presented in this section.

The United States and other advanced industrial economies have become net debtors internationally, but they do not have the same crisis situations that are found in the developing countries. Holders of the U.S. debt are pleased to accept dollars or any other freely convertible currency as interest or principal payment (servicing). At worst, more dollars could be printed to pay servicing to holders of U.S. debt. People have *confidence* in the U.S. economy, although this confidence would weaken if there were excessive printing. The same cannot be said of most debtor countries in the Third World. People would not be satisfied to accept local currency in payment. Such forms of payment may lose exchange value rapidly or be blocked for conversion into other currencies. If developing countries could service their debt, in whole or in part, in local currency, they would not feel so constrained. Professor Urquidi has suggested that foreign holders of Mexican debt accept pesos in payment for interest, at least for a significant portion of the total payment that has been assessed. This approach is interesting and has some potentiality but cannot be used for a total settlement because pesos may become unwanted and depreciate very much in value.

Another easy or soft way to treat interest is to capitalize it. In effect, rescheduling and other renegotiations among banks, debtor nations, and international agencies have resulted in the making of new credits by the banks to pay interest. The loans are kept in the performing category and improve the appearance of bank balance sheets, while the size of outstanding debt rises. A similar result would be obtained by simply adding unpaid interest to the principal of the outstanding loans. This is only a partial solution because it does not provide capital funding for growth.

Bankers and other persons concerned with the debt problem have noted that debts grew in developing countries because loan capital was readily available and equity capital was not particularly sought after. Equity funds were restricted by many developing countries. There is an obvious trade-off. Equity funding gives more control or power to foreign capitalists, but it eases the service burden in slow phases of the business cycle. Dividends are discretionary, while interest payments are not.

Attitudes towards equity funding are changing and currently some developing countries are actively seeking foreign funds through this route – direct investment, joint ventures, mutual funds, special non-voting shares and other devices. At present equity financing is supplementary and not predominant, but it is a route that deserves encouragement.

In the case of economic relationships between the United States and Mexico, there are some bargaining deals that have been suggested, but not fully explored. It has been suggested, for example, that the United States open the border more liberally in return for more direct investment approvals by Mexican authorities. On a project-by-project basis this kind of exchange can provide relief to the situation. Mexico could probably grow more strongly and quickly if fresh U.S. investment were encouraged. This, too, is not a solution but it is an interesting step to think about.

The United States, quite rightfully, has great interest and concern for Mexican economic welfare. In order to provide some crisis funds to Mexico, crude oil imports have been purchased from Mexico to the United States for the purpose of filling the strategic reserve. A significant move towards medium-term stockpile goal can be done and, at the same time, provide liquid funds to Mexico. This was done on previous occasions after the emergence of the Mexican debt problem in 1982. The world oil price is now favorable for such pur-

chases. This form of capital relief for Mexico cannot be duplicated throughout the developing country world of high debtors, but it does help, and that is important at the present time.

The Baker initiative created headlines and much economic interest when it was first announced at the Seoul meetings of the International Monetary Fund/World Bank. It is well-meaning but it is ideological, focusing attention on capital funding for private enterprise activity in developing countries. Some countries are attuned more closely to socialist economic principles and others to capitalist, free-market ideals. It is more important to get capital in place and actively produce output in the debtor nations than to satisfy an ideological bent. Many public projects can do best for some developing countries. Some practical good may come from the Baker proposal, but it is not yet translated into an acceptable and working system of debt relief through growth and capital transfer.

If a main contributor to the gradual buildup of the debt problem was the matter of recycling the petrol surplus, much can be learned from this experience as we confront a similar recycling problem. The German and Japanese surpluses are not as large as the biggest OPEC surpluses, but they are large enough to warrant concern over the working of the process. On a number of occasions, Japanese economists have raised the idea of a capital transfer to the developing countries to assist improvement of their growth path. The contributions from Germany and Japan could be generous, but they are not large enough to transform the world economy. If they took the lead in this respect and enticed participation by most of the partner countries in OECD, there could be a significant turnaround in the world economy – one large enough to realize increments to growth on a scale that would override the debt problem.

Project LINK has simulated coordinated capital transfers among OECD countries to developing countries that would bring industrial countries to the well-known target figure of transferring 0.7 percent of their GDP to such a cause. This is feasible but substantially larger than the figures that have been mentioned by Japanese economists. In some sense, they are looking for mega projects in developing countries and not a buildup of capital, in general. Mega projects can be extremely helpful but they are not solutions to the problem. It is a question of using the Japanese initiative to launch, on a broader scale, the kinds of programs that are used in the LINK simulations. Annual world sums of some $25-30 billion (this allows for inflation

since the original calculations were made), if properly utilized in developing countries, could add up to one full point of growth, which is no mean event for the present world economy.

Growth orientation in developing countries is feared by some economists, even in the present world environment because, as ever, they are worried about inflation. Econometricians at SERFINA have simulated models of Brazil, Argentina, Uruguay and Peru to test their growth policy. They would have real wage rates restored to their higher values of about three years ago and avoid (or attenuate) responsive price increases by introducing an incomes policy. Unlike conventional incomes policies in which fiscal rewards (or fiscal penalties) are introduced as a trade-off against price increases, they use monetary (credit) concessions. Their scheme does not deal specifically with the debt problem, but does try to keep growth alive and provides an interim program for keeping up economic activity while more fundamental solutions are being sought for the debt problem. Shock treatment of price controls is being tried in Argentina, Brazil and Israel. Initially, there appears to be some degree of success in dealing with runaway inflation, but in some cases, the staying power of direct controls is already being called into question. The SERFINA proposals are worthy candidates for the inventory of ameliorative policies.

All the policy measures (interest paid in local currency, capitalization of interest, advance oil purchases for inventory, equity funding, recycling of surpluses, the Baker initiatives, price controls, and incomes policies) discussed in this section are useful, but none is overwhelmingly attractive as a total solution -- not even combinations of policies.

If it is recognized that there is no automatic growing out of the debt problem and if all the clever/worthy proposals cannot do the job, where does the debt problem stand? There is yet another approach, one that the authorities and creditors are trying to avoid. That approach is to convene a world debt conference, attended by lenders, borrowers, governments on both sides and international bodies. At this conference, there would be an assessment of responsibilities among all the participants, and the developing countries should have scaled-back debts that can be fully serviced under the growth conditions that are projected. Such growth projections should allow for any special growth policies that may be introduced.

This is not unlike an extension of the considerations that are

brought to bear on bankruptcy proceedings in the private sector of the U.S. economy. When private companies fail (or go into "chapter 11" proceedings), they are restructured in such a way that the emerging entity can be expected to grow and survive in the rough competition of American business. There are many instances of successful company operations after having gone into "chapter 11."

The possible restructuring of sovereign nations is more restrictive than that of private enterprises. That is why a world debt conference is needed in order to work out the details on a fair-shares basis. Both creditor and debtor parties will realize losses from this procedure, but there should not be an easy way for all to benefit simultaneously.