

THE DEBT CRISIS

Since 1973 net oil-importing developing countries have made strenuous efforts to adjust to the deterioration in the external environment brought about by two severe world recessions and a dramatic and continuing deterioration in their terms of trade.

The current economic crisis, which began in 1979, has involved most developing countries in significant losses in their terms of trade and greatly reduced the short-term pros-

pects for a rapid expansion in export volumes.

Many developing countries were left with no option but to alter their economic policies by placing greater emphasis on measures to reduce demand rather than on efforts to increase supply. The result has been a marked reduction in GDP growth during the three-year period 1980-1982 as compared with the period 1975-1980. Indeed, in 1981 the growth performance of oil-importing developing countries was the worst in the post-war period.

The principal means of financing deficits of developing countries since 1980 have been through private medium and long term capital flows, as shown in the table below.

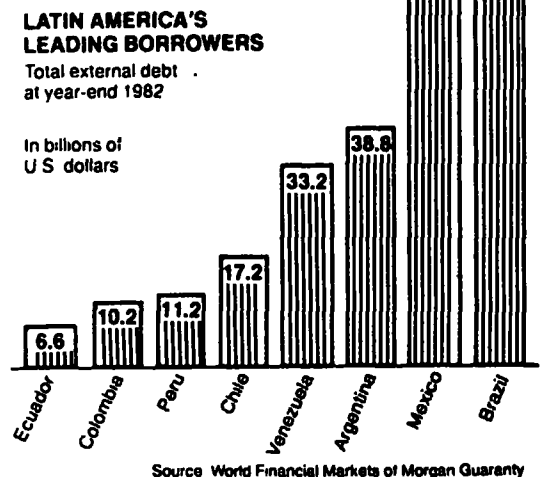
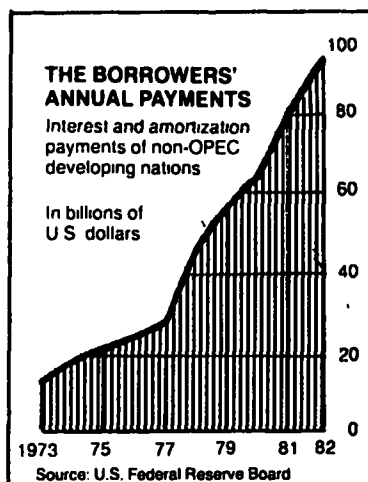
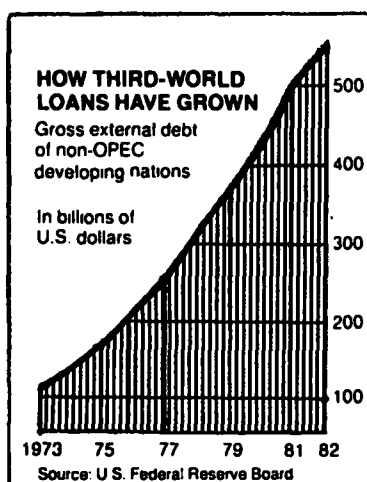
With no significant changes occurring in the global economic situation the debt problems facing the Third World countries have not eased. There is a view, however, that there need not be a problem of solvency, since the big borrowers among the developing countries have enough resources to eventually repay what they have borrowed. But in some of these countries, particularly in Latin America there were signs that the situation was causing increasing poverty and growing social unrest. In Chile, Argentina, Peru, Bolivia, Brazil and Mexico the signs of political agitation against those in authority were emerging strongly. A recent Newsweek comment summing up the Latin American debt crisis as follows, emphasised the lack of options facing these countries: "Locked in a debtors' prison of onerous austerity measures and debilitating repayment schedules, many governments insist that the region will need billions of dollars of additional loans and aid. But there may simply not be enough money to go around. Already deeply exposed the international banking community has sharply curtailed lending to almost all Latin countries, from \$ 31 billion in 1981 to just \$ 11 billion last year. And yet without foreign capital, Latin America may be unable to avoid a continental drift into economic and political chaos". (The Newsweek chart reproduced here also emphasises the enormity of the debtors' problems).

Developing Countries with Current Account Deficits: Net Capital Flows Source of Financing of Deficit

(Billions of US dollars)

	1980	1981	1982	1983
<i>Current-account deficit</i>	76.5	91.9	90.3	94.6
<i>Increase in official reserves</i>	-5.4	-7.9	-1.1	2.6
<i>Total net capital flows</i>	71.1	84.0	89.2	97.2
Official bilateral flows on concessional terms	15.7	17.3	19.0	21.0
Grants	11.0	11.2	12.0	13.3
Medium and long-term bilateral loans on concessional terms	4.7	6.1	6.5	7.0
Other medium and long-term official bilateral loans	3.7	4.1	4.5	5.0
Multilateral institutions	9.1	9.9	10.5	11.1
Private medium and long-term flows	33.2	47.0	50.5	53.9
Direct investment	7.4	8.0	9.0	10.0
Export credits	8.7	14.0	15.5	13.0
Bilateral portfolio investment	3.2	3.5	3.8	4.0
Other international bank lending	13.9	21.5	22.2	22.9
IMF lending (net)	1.0	4.6	5.0	5.0
Short-term capital, unrecorded flows and errors and omissions	8.4	1.1	0.3	1.2
<i>Memo Item'</i>				
<i>Total interest c/and profit remittances</i>	31.9	39.6	43.2	50.1
<i>Net transfer</i>	42.1	46.7	46.7	45.8

THE WORLD'S BIG DEBTORS



Pointing to the growth performance of a selected number of countries, they argue that sound management policies of fiscal and monetary operations, and increasing mobilization of domestic resources for development purposes, should provide the answer to the economic dilemma of developing nations. It is possible that there were a few exceptions but the majority have experienced severe hardships with some countries experiencing sharp declines in real per capita incomes.

A growing number of developing nations resorted to substantial cutbacks in their public expenditure programmes in order to maintain credit-worthiness or to comply with the conditions of the IMF for its continued support for mobilization of international resources. Despite such cutbacks, budget deficits are annually growing and, in some cases by geometrical progression. A favourable policy stand, by the industrial nations, towards the low income non-oil developing nations is very crucial at this point to halt the downturn of their economic performance. This is the main thrust of most of the developing nations with a deterioration of living standards of large sections of their populations becoming more pronounced. Meanwhile, the hopes of reaching a growth rate of 7 per cent, incorporated in the International Development Strategy for the Third United Nations Development Decade, is fast disappearing.

Proposals of relief measures to assist developing nations have been in the forefront of international forums, dominated by developing nations such as UNCTAD and the Group 77, for a number of years. The emphasis is primarily on four priority areas:

- (a) A favourable price structure for primary commodities of developing nations entering international markets;
- (b) A non-discriminative tariff policy, which does not discourage the export of processed or semi finished goods from developing nations to international markets;
- (c) Relaxation of restrictive monetary policies to bring down artificial interest rates, and to establish realistic exchange rates for international currencies;

- (d) A doubling of concessional funds available to non-oil developing nations.

There have also been similar concerns by organizations dominated by the industrial nations. The Bank for International Settlement (BIS) has in its latest Annual Report called for close international co-operation, which will be vitally needed for the purpose of achieving several related objectives to resist protectionist pressures, foster greater stability of exchange rates, ameliorate the difficult debt situation facing a number of developing nations and both expand and improve the quality of official development assistance. The effectiveness of this essential co-operation it states, will depend greatly on the policy approach of the larger industrial countries — an approach that should involve the independent pursuit of sound policies in each country. The BIS believes that economic revival could, and should be led by those countries where inflationary pressures have been brought largely under control and whose external positions permit them to enjoy a certain amount of freedom from balance of payments constraints.

The BIS view is that, the greatest obstacle to sustained expansion in the industrial countries, however, is the high level of US interest rates, which not only could inhibit domestic spending but also forces other countries to keep their interest rates at levels that are unnecessarily high in view of domestic conditions, exerts upward pressure on the value of the US dollar, and increases the interest burden of those countries whose external debt is denominated mainly in US dollars. The burden of bringing interest rates down to more realistic levels falls directly on US authorities in charge of fiscal policy.

It needs to be realised that rising interest rates add further burdens to the problems of the debtor countries. It is estimated that a 1 per cent rise in interest rates of Euro dollars would raise their debt service burdens by \$ 2 billion.

Some of the leading seven industrialised nations such as Canada, France and Japan, however, are pursuing a common solution saying "that the atmosphere was favourable for developing and industrialised countries to search for common

solutions to economic problems". But the others resist such moves as they are not yet ready to adopt more liberal policies. The 1983 Summit of the Western Industrial nations concluded without any specific pledged towards a possible solution of the problems confronting the developing nations. The possibilities that the sixth UNCTAD session would produce some meaningful solutions, regarding international trade, commodity prices and financing, was also bleak as the industrial nations were taking a hard stand on these very issues.

Some observers feel that a surprise debt crisis will be required, with dire implications for Western Banks, to push the leading seven industrial nations into action on North-South dialogue. Possibilities of the emergence of such a crisis is however fading, at least at present, as few short term adjustments have already been made. These measures avoided a collapse of the international financial system. But "the present system is a trap", declared A. W. Clausen, President of the World Bank, it is a trap for debtor countries, now pressured towards austerity by the private banks and the international agencies". He emphasised the need for a comprehensive policy involving (a) a satisfactory balance between the private international banking system and public institutions, (b) an accepted and workable mechanism, designed individually depending on the economies of individual countries, to determine how to allocate austerity policies, and (c) more realistic exchange rates which could reflect their true trade relationship instead of differentiated interest rates.

The attempts to find a way out of the crisis often show leaders of these countries finding an excuse for what has gone wrong; and foreign countries invariably are the scapegoats. Thus, France blames US and West Germany for the weakness of its currency; the US blames Japan and Germany for the ills of its automobile and steel industries; and most industrialised nations blame OPEC. They all want reforms but each favours a different form, one that will benefit its currency and its economy irrespective of the effects on the others. It is apparent that the greatest contribution these countries could make to international co-operation and minimising the effects of the global recession are not only to pay heed to the needs of the poorer nations but also to put their own houses in order.