

DEBTS-RELIEF AND INDICATORS

— A World Bank View

DEBT RELIEF

While most developing countries have been able to meet principal and interest payments on their external debt, some have been forced to seek debt relief. The circumstances leading to debt renegotiations have varied, but most had some similar basic features. These included balance-of-payments deterioration and excessively expansionary fiscal and monetary policies over several years which were aggravated by short-term shocks—that is, shortfalls in exports or workers' remittances, sharp worsening of terms of trade and national calamities. Some steps countries took to cope with these difficulties added to their problems. They borrowed at hardened terms. Private credit also sometimes had a destabilizing effect. For example, banks would lend when commodity prices were rising but would cut back when export earnings declined.

Debt relief has been arranged for a few countries through aid consortia; large sums have been involved and different aims pursued. Pakistan's public debt of \$990 million was rescheduled in a series of agreements negotiated in aid consortia meetings from 1972 to 1974, and in 1981. India received \$1.25 billion of debt relief between 1968 and 1976 (along with aid pledges and without interruptions to service payments) from the Aid Consortium, mainly to improve the quality of aid at a time when debt-service payments were constraining India's access to free foreign exchange resources. Turkey received massive debt relief through the OEEC in 1959 along with general economic assistance.

For 13 other developing countries over the past 25 years, debt relief on official or officially guaranteed debt (loans from governments and insured commercial credits) has been arranged through the Paris Club — ad hoc meetings of representatives of the governments of creditor countries. In contrast with consortium meetings, the Paris Club has discussed only debt relief and not overall flows of foreign aid.

During the 1970s, loans from commercial banks have expanded rapidly, and debt relief has increasingly involved commercial banks. The restructuring of commercial banking debts has taken place in parallel with Paris Club agreements for Peru (1978), Sudan (1980), Turkey (1979) and Zaire (1980). In addition, there have been substantial refinancings of debt to commercial banks without Paris Club involvement: Argentina (1976), Jamaica (1979), Nicaragua (1980) and the Philippines (1970). Debt restructuring agreements with commercial

banks since 1973 amount to \$5.1 billion of which Turkey accounts for \$2.1 billion.

Debt relief has been extended generally for periods of 12 to 18 months — on the condition that the debtor adopts a stabilization program (usually one approved of by the IMF or a stand-by agreement) to eliminate balance of payments difficulties. Repayment of rescheduled debts is normally over 7 to 10 years, including 3 to 4 years' grace. Interest charges on rescheduled debts are typically set at the rate for new loans of the type being rescheduled. Debt relief on concessional terms (low interest rates plus long repayment) has been extended only to India (noted above, Indonesia (where the entire outstanding debt was restructured in 1970), Ghana (1974) and Pakistan (1974 and 1981). Generally, debt relief has not been extended on previously rescheduled debt.

The Paris Club arrangements for debt relief provide for an orderly restructuring of external obligations when debtor countries have serious liquidity problems. But there has been continuing disagreement between debtor and creditor countries over the length of the consolidation period and the terms of repayment, reflecting different points of view regarding the purpose of debt relief. Most creditor countries' position is that the objective of debt relief is to help debtor countries recommence meeting their debt-service payments as scheduled and so restore their creditworthiness. Thus, a short consolidation period is considered appropriate so that debt relief can be adjusted to correspond to the country's changing capacity to repay. The debtor countries point out that when debt difficulties are deep-seated, short consolidation periods compel them to seek continuing debt relief and short repayment periods lead to a future bunching of debt-service obligations. They insist that debt renegotiations should take into account their future adjustment problems and about creditworthiness should take a longer-term view.

The best way for the international community to assist countries with large debt and poor export prospects remains unresolved, but increasingly relief as part of a viable package of foreign financing to support an economic program.

Source: "World Development Report 1981".

DEBT INDICATORS

There are two broad categories of debt indicators:

● Those that measure a country's capacity for making payments in foreign exchange. The most widely used of these is the debt-service ratio — interest and principal payments on long-term debt divided by exports of goods and services. Its meaning can seldom be easily interpreted: some

countries have had little difficulty in managing their debt with a ratio of 40 percent or more, while others have had severe problems when debt-service payments were less than 10 percent of exports.

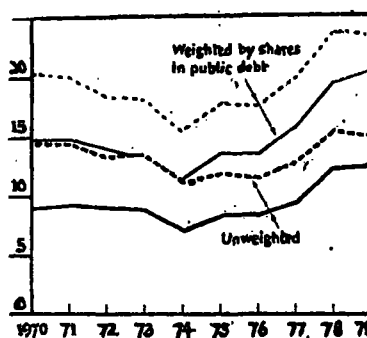
The apparent paradox is explained partly by how easily countries can borrow commercially. As long circumstances, the interest-service roll over principal repayments. In such management of an economy, they will as investors have confidence in the ratio—interest payments divided by exports of goods and services—may be a better indicator of the country's ability to make payments abroad, since it avoids the distorting effects caused by a bunching of repayments, prepayments, or refinancing.

● Those that measure a country's capacity to generate real resources (which can then be used to pay for imports and service debt). The ratio of interest payments to GNP is often used to illustrate the debt-service burden on an economy's productive capacity.

Some indicators—the ratio of external debt to foreign exchange reserves, for example—combine features of both types of measure. But none of them are an adequate substitute for detailed country analysis. In a period (like the 1970s) when debt is substituting for equity capital a country's capital-service ratio—contractual service payments on long-term debt, plus remitted profits on direct investment divided by exports of goods and services—may be the best guide to a country's creditworthiness.

As the table shows, the various measures have not always moved in line with each other, although all indicate a clear deterioration since 1974. Weighted by individual countries' shares in total public debt (so that the effect of countries with growing exports but low indebtedness on the average ratios is minimized) both the debt-service and the capital-service ratios increase more sharply during the 1970s (see figure), reflecting the high and rising debt of those countries that are currently the major borrowers.

Developing countries' debt-service and capital-service ratios, 1970:79



--- Capital-service ratio
— Debt-service ratio