

EXTERNAL DEBT AND ITS SERVICING PROBLEMS
OF THE LESS DEVELOPED COUNTRIES :
A REVIEW OF LITERATURE

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INTRODUCTION

In the '70s and '80s the foreign debt has remained one of the most important problems of the LDCs (Less Developed Countries). Historically, LDCs did face the problem of debt in the last century and the first half of this century but it was not a pervasive one. But after the oil shock of 1973, the problem became more severe. This happened because the rise in the oil prices, poor economic performance of the LDCs resulting into huge current account deficits of the LDCs. Therefore there was a tremendous rise in the foreign borrowing. Oil exporting countries, on the contrary, had surpluses on their current account which were mostly lent to the LDCs. Many LDCs resorted to the private sources for their borrowing. This led to a rise in debt and it's servicing burden. Since, the late 1970s and early 1980s the burden has been growing continuously.

The debt problem has various aspects, such as bank exposure view point, country risk analysis, global debt and debt servicing aspect, debt and international monetary adjustments, etc.. In this dissertation I have concentrated my attention on the global debt and it's servicing aspects.

In Chapter I we will have a brief historical review of foreign debt. And this chapter will also highlight the theoretical explanation for the rising debt requirement of the LDCs in their development programmes. Here the two-gap

model is discussed at greater length.

In Chapter II, we will take a statistical overview of debt and its servicing emphasising maturities, net inflows and transfers. The time period considered is from 1973 to 1982, during which the debt problem assumed serious proportions.

Chapter III reviews the factors influencing debt and its servicing, mainly interest rates, terms of trade, exchange rates and protectionism.

Chapter IV attempts to review the policies adopted by the developing and developed countries, and the international lending institutions. Some further proposals for increasing the volume of lending on concessional terms are also reviewed.

Chapter V gives the summary of the arguments made earlier. It also brings out the conclusions emerging from our discussion.

CHAPTER I

FOREIGN DEBT : SOME THEORETICAL ISSUES

1.1 Historical Perspective

1.1.1 Late 19th and early 20th Century

Historical evidence reveals the fact that the foreign debt played an important role in the process of economic development of various countries, i.e., Canada, the United States, New Zealand, Australia. The size of the foreign debt was quite large in the 19th Century and in the early 20th Century. Estimates of the foreign indebtedness in the 19th century have shown that the United State's total gross indebtedness as a percentage of GNP was 40 per cent in 1830s, 24 per cent in 1869, 20 per cent in 1899, 18 per cent in 1914 and 8.5 per cent in 1929. Net indebtedness as a proportion of GNP is estimated to be 15 per cent in 1899, 10 per cent in 1914 and -7.9 per cent (excess of foreign assets over liabilities) in 1929. In the last decade of 19th century the U.S. was lending abroad and repaying her debt faster than new foreign capital was flowing in. In 1914 foreign obligation of the U.S. amounted to \$ 7.2 billion against her assets equal to \$ 3.5 billion. On the contrary, after world war I, her assets rose to \$ 7.0 billion and liabilities fell down to \$ 4.0 billion. In other words, there was surplus of \$ 3 billion of foreign holdings.

Foreign capital flows, particularly foreign debt, into Canada, Australia and New Zealand reached the peak during the period of the first World War. In 1900 net foreign debt totalled 114 per cent of Canadian GNP. In 1910 this ratio was 111 per cent and by 1920 the proportion of debt to GNP was 88 per cent. In 1960 it came down to 42.7 per cent. These figures clearly indicate Canada's reliance on foreign capital for her economic development. The ratio of external debt to GNP exceeded above 100 per cent for New Zealand and it was close to 100 per cent for Australia in 1900s.

1.1.2 Inter-war Period

After first World War the composition of foreign debt was totally changed. The war transformed America from the world's leading debtor to its principal creditor nation. This transformation took place due to a marked improvement in her international trading position. There was a remarkable fall in agricultural output in Europe which helped to increase the world demand for agricultural food stuffs and raw materials. American industrial exports had also appeared into the world's market, i.e., Automobile exports rose substantially during the same period. All these factors led to strengthening of the financial health of the economy and to the transformation from a debtor to a creditor country.

After first World War there was a need for reconstructing the economies of the nations which participated in the war. As a creditor country it was the U.S. government which had to supply credit to the war affected economies. In 1919 gross capital issued by the U.S. was \$ 771 million and it rose to \$ 1217 million in 1924.

Since 1929 world faced the problem of Great Depression. It was noted that the "income of every government has been decreased, although the debt charges have remained stationary." (Winkler and Stewart, 1932, pp.397) In 1931 estimated debt service costs for principal and interest payments were running at about 1/3rd of the government revenue in Latin America.

This happened because of decline in the prices of the commodities exported by these nations, i.e., prices of coffee fell from 18.5 cents per pound in 1929 to six cents in 1931. Tin prices fell from 45 cents a pound to 20 cents a pound during the same period. A general price index of primary products indicated that prices fell 60 per cent from 1929 to 1931. This resulted into drastic decline in the value of exports of the countries which were specialised in primary products. From 1928-29 to 1932-33 the value of Chile's exports fell by 80 per cent; while Bolivia, Cuba, Peru suffered export declines of about 60 per cent.

This was a period of falling prices. "The burden of debts and accrued interest is much greater in terms of commodities or services than was originally intended and debtors in effect are paying much more than the value they received." (Winkler and Stewart, 1932, pp. 396). The value of world trade fell from \$ 34.3 billion in 1929 to \$ 27.9 billion in 1930, \$ 20 billion in 1931 and \$ 13.5 billion in 1932. Major causes behind the series of default by developing countries, in the early 1930s, were the collapse of world trade, the decline in the prices of their exports and unavailability of foreign currency to meet external debt payments.

1.1.3 Post II World War Period, 1945 to 1982

1.1.3.1 The reconstruction period from 1946 to 1950

In this period major borrowers were the European countries which borrowed mainly for reconstructing their economies. The amount borrowed by the developing countries was very small. Between 1946 and 1950 the West European nations received \$ 16.4 billion in public grants and \$ 14.4 billion in public loans primarily from the U.S. There was rapid increase in the net public indebtedness of the European countries. It rose from \$ 3.6 billion in 1945 to \$ 12.1 billion in 1948. Repayments more or less offset new loans through 1955, when the debt level was \$ 11.7 billion. Since then European net public debt declined

until it was essentially rapid in the early 1960s. Between 1945 and 1950, the net public indebtedness rose upto \$ 4.2 billion.

1.1.3.2 The Growth and Development Period from 1950 to 1974

During this period there was a remarkable growth in the world trade and world income. Public capital flowed in large amount into developing countries. Most of the capital came from the United States and Western European countries. From 1953 to 1973 the developing countries received \$ 75 billion in public grants and \$ 8.1 billion in the form of net public loans from the developed countries. World trade increased from \$ 75.7 billion in 1953 to \$ 524.2 billion in 1973. Rate of growth of many under-developed countries was greater than that of the U.S.. Factors such as a stable international political order, the liberalization of trade and an expansion of markets helped to augment the size of the world trade.

In the 'sixties and early 'seventies the amount of external public debt outstandings of the developing countries rose, in absolute terms, yet the proportion of each region's debt to the total debt outstanding was more or less the same. There was no declining trend in net flows and net transfer. In fact in 1974, proportion of net transfers and net inflows to gross disbursement increased as compared to last four years. This shows that the debt

and debt servicing was not a serious pervasive problem.

Table 1.1 : External resources and debt service payments on external public debt for 86 developing countries, 1967-74 (\$ million)

Year	Gross disbursement	Debt service payments	Net flows	As per cent of gross disbursement	Net transfers	As per cent of gross disbursement
1967	10,775.1	3,901.5	7,947.2	73.6	6,873.6	63.6
1968	11,339.2	4,589.7	8,019.2	70.9	6,749.5	60.0
1969	12,087.1	5,151.1	8,441.5	69.8	6,636	57.3
1970	13,677.3	6,166	9,372.9	68.4	7,511.2	54.8
1971	15,092.7	6,931.6	10,311.2	68.3	8,161.1	54.0
1972	18,869.2	8,524.2	12,879.6	68.3	10,345	54.7
1973	24,186.6	11,370.5	16,195.2	66.9	12,778.1	52.8
1974	30,215.3	13,556.5	21,173.9	70.1	16,658.9	55.1

Source : World Bank Annual Report, 1976, Washington, Table 8, pp. 108.

1.1.3.3 Oil Crisis and Its Aftermath (from 1974 to 1984)

In 1974, a steep rise in oil prices caused huge current account deficits for the oil importing LDCs. This was coupled with bad agricultural output in the underdeveloped countries. A severe draught hit large part of Africa and Asia. Agricultural production fell but consumption needs remained the same as they were in the past. This resulted into steep rise in prices in the world

economy. The prices of basic food stuffs increased by 100 per cent between 1970 and 1974. The price of fertilizer, quite representative agricultural input, increased by 170 per cent in the same period. Oil prices increased since October 1973. Within a span of four months, from October 1973 to February 1974, the oil price rose by almost 300 per cent. Being most essential commodity the demand for oil is quite inelastic. By forming a cartel, Organization of Petroleum Exporting Countries (OPEC) increased both the prices of oil products and the revenues from exports of oil products by monopoly pricing.

The rise in oil prices caused redistribution of income in the world economies. The world, from this view point, was divided into two groups. One group consisted of oil-importing countries while the other that of the oil exporting (OPEC) countries. There was deficit in the current account of the ^{countries of the} former group while the latter group of countries had huge surpluses in the current account. Some industrialised countries underwent a change from a surplus country group to a deficit country group in the period 1973 and 1974. Deficit of the non-oil developing countries rose by 208 per cent during the same period. At the same time surplus of oil exporting countries rose by 814 per cent. Table 1.2 clearly shows these changes.

The OPEC countries had various alternatives to utilise the huge surplus. First alternative was to increase imports

Table 1.2 : Current account balances (in \$ billion)

	1973	1974	1975	1976	1977
1) Industrialised countries	18	-14	18	-3	-6
2) Oil exporting countries	7	64	35	40	31
3) Non-oil developing countries	-12	-37	-47	-32	-28
	1978	1979	1980	1981	1982
1) Industrialised countries	30	-10	-45	-4	11
2) Oil exporting countries	3	70	115	71	25
3) Non-oil developing countries	-39	-59	-86	-99	-97

Source : IMF, world economic outlook, 1982, p. 165.

from oil importing countries which would have offset this surplus. But in the short run import absorption capacity of these countries was relatively small. Between 1970 and 1974 earnings from oil rose from \$ 30 billion to \$ 120 billion. Out of that amount \$ 50 billion was being spent and remaining amount had to be utilised for other purposes. Second alternative before them was to invest the surplus funds in financial assets, dollar or gold. Third was to invest that amount in real assets either worldwide or

in one country. This third type of investment helped developing countries to decrease the amount of current account deficit in their countries.

Oil-importing countries, especially non-oil developing countries, had large amount of deficits in their current account, they had to cure this deficit. For curing this deficit they had two alternatives, either to decrease import of oil by substituting domestic oil or other substitute for it, or maintain the same level of imports by borrowing from the oil exporting countries. Obviously in the short run it was almost impossible for non-oil developing countries either to find a substitute for oil or increase domestic oil production. Hence external borrowing was the only alternative left before them.

In the 'eighties the debt problem aggravated due to different factors than the oil price rise of the 'seventies. In fact oil prices went down in this period. During this period debt and debt service of the developing countries increased due to rise in the real interest rates (nominal interest rate minus inflation rate), consistent appreciation of the U.S. dollar, increasing protectionism, especially of non-tariff barriers, in the industrial countries.

1.2

Theoretical Background

When the process of development begins in an underdeveloped economy, the country has very ambitious

plans. She decides to have investment in capital goods industry which would give rise to further industrialisation and higher growth rate of output in the economy. But being an underdeveloped economy she possesses only primary products minerals etc.. She does not have the capital goods which are required for industrialization. Moreover, she lacks funds; which are to be raised from domestic savings. Such funds can be utilised for purchasing capital goods from abroad. Sometimes she has enough domestic savings to purchase capital goods from abroad but she does not have hard or convertible currency in which payments are to be made for imports. Therefore the country should have available to it, in the beginning of the process of development, foreign debt which would supplement her domestic savings. Simultaneously it would also raise her foreign exchange earnings from exports. That is how investment in capital goods industries become possible which otherwise would have been difficult. Problems of savings and foreign exchange are elaborated in the two approaches. First is the two gap approach and the other is the three phase approach.

1.2.1 Two Gap Approach

There are three major models in this area developed by McKinnon (1964), Chenery and Strout (1966) and Joshi (1970). The above models yield the same results using different tools of analysis. The first two models are based on the Harrod Domar model. The third one uses the

tools of analysis of pure international trade theory. We shall begin with first two models.

In Mckinnon's (1964) model there are two kinds of capital goods, viz., domestic and foreign, which are required in fixed proportion to produce goods.

$$Y = \min [akd, bkf] \quad \dots \quad (1)$$

k_d and k_f are the available domestic and foreign capital goods respectively,

Y is the national income which is inclusive of consumption and capital goods of the country,

a and b are coefficients of k_d and k_f respectively with respect to Y ,

If we assume that there is no unutilised capital in the economy, we have,

$$Y = akd + bkf \quad \dots \quad (2)$$

The total saving is given

$$S = sY \quad \dots \quad (3)$$

The maximum amount of exports are given,

$$E = eY \quad \dots \quad (4)$$

The total investment I is the addition to the capital stock of the country that generates every year and that is

$$I = \Delta k = \Delta k_d + \Delta k_f$$

recollecting the assumption of no - unutilised capital,

we get

$$I = I_f + I_d = \frac{b}{V} I \quad \dots (5)$$

where $V = \frac{ab}{(a+b)}$, is the output capital ratio.

F is the amount of foreign capital, which is received either in the form of aid or loan, takes place during the year. The maximum amount of capital that can be acquired in the year is $(e + f)Y$, where $f = F/Y$. Hence, given (5), the maximum value of I is given by $(\frac{b}{V})(e+f)Y$. Therefore this is the maximum amount of investment possible given the foreign capital constraint.

From (3), it follows that $(1-s)Y$ of the national income is consumed. Total investment cannot be greater than $sY+fY$. Therefore investment is less than $(s+f)Y$ and this is a saving constraint. If we put two constraint together -

$$I = \min [(s+f)Y, \frac{b}{V}(e+f)Y] \quad \dots (6)$$

The growth rate of the economy, g , equals $\frac{\Delta Y}{Y}$, ΔY stands for change in income during the year. From (2) and (5) -

$$g = (V / Y) I$$

Substituting I from (6) we get,

$$g = \min [v(s+f), b(e+f)] \quad \dots (7)$$

$$g = b(e+f) \quad \text{if } b(e+f) < v(s+f) \quad \dots (8)$$

This will be the foreign exchange constraint and

$$g = v(s+f) \text{ if } b(e+f) > v(s+f) \quad \dots (9)$$

will be the savings constraint.

The above explanation can be shown in the diagrammatic form. In Diagram 1, let line AB be the partition space between two zones. To the left of AB the foreign capital constraint will exist and on the right of the line AB the savings constraint will be binding. AB is the locus of all e and f which also satisfies $v(s+f) = b(e+f)$.

I_1 and I_2 are iso-growth curves, which have a 45° slope to the left to AB and are horizontal to the right of AB. It signifies that if the savings constraint is effective, increased export do not lead to raise the growth rate.

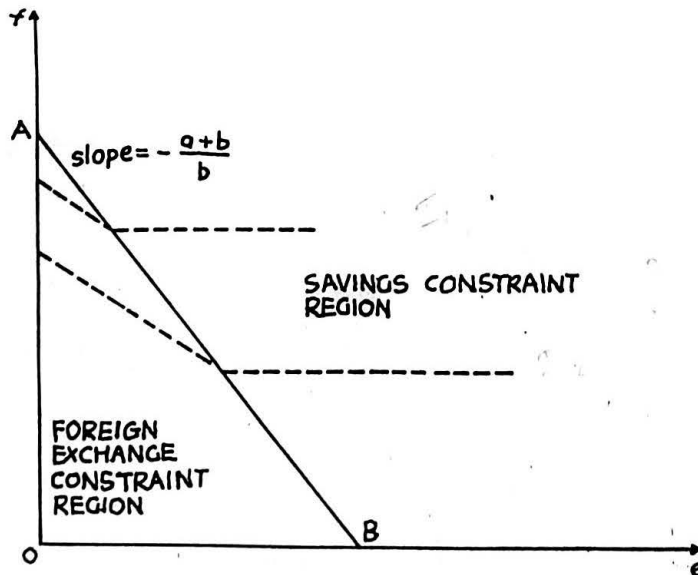


Fig. 1.1

An increase in F always raises the growth rate, even though its effectiveness is greater to the left of AB . However, if foreign capital comes mainly as loan rather than aid, in the future, the economy has to repay it along with its service charges.

Chenery and Strout (1966) also used the Harrod-Domar framework in their approach. It is known as three phase approach but unlike Mckinnon, they have segregated foreign exchange and saving constraints into three phases of economic development.

Target growth rate assumes fixed ICOR (Incremental capital-output ratio), propensities to save and import are fixed. There is also a maximum feasible rate of increase in exports.

Phase I - In the very beginning bottleneck on growth is the absorptive capacity. Rise in investment will lead to rise in managerial and labour efficiency, which takes time. When these improvements take place effective use of foreign aid begins. At the end of this phase the level of investment becomes sufficient to reach the target rate of growth.

Phase II - When Phase I ends investment rate raises domestic saving rate. The savings gap becomes larger than foreign exchange gap. Therefore the function of foreign aid remains to meet the savings gap. If a marginal savings rate rises above the average rate then it reduces the

savings gap. Therefore gradually the savings gap becomes less than the foreign exchange gap.

Phase III - When this phase starts the foreign exchange constraint becomes operative. Therefore, the function of foreign aid is to meet the foreign exchange gap. Both policies, expenditure switching, i.e., import substitution and expenditure reducing, i.e., curtailing imports, are difficult to follow because of the production structure. Whether a country will become self-sufficient or not, that will depend on rate of growth of exports and marginal import coefficients.

Both approaches have severe drawbacks:

(1) Both approaches assume that GNP grows in proportion to the capital stock. ICOR greatly varies by countries, by sectors within a country and it also changes over a period of time.

(2) Over a period of time propensity to save, marginal propensity to import, rate of growth of exports will change. The objective of the development policy should move towards changing these parameters in a favourable direction. As Reynolds puts it, "The question - given a certain amount of aid, what changes in parameter values can the country itself make and what will be the resulting growth rate? would be more relevant." (Reynolds, 1977 - pp. 201).

(3) Political instability, inflation or devaluation will change the importance of the parameters. Therefore the results of the models with earlier values will change in considerable proportion.

Vijay Joshi's (1970) model briefly stated is the two good static model which is common in the pure international trade theory. In the figure 1.2 the economy produces two goods; consumption goods, x and investment good, Y . Given the structure of demand and international costs an economy has comparative advantage in x , therefore x is exportable and Y is importable commodity with given factors of production at a particular point in time. The absorption possibilities of the open economy are traced out by the curve QQ' . This is the availability envelope. It tells us the maximum quantities of x and y which the economy can obtain by making efficient use of both production and trade.

The utility function which is to be maximised is specified, say, by the planning commission. Both consumption and investment goods are included into the planner's utility function, which is to be maximised. There is a limit upto which the consumption can be reduced and that is known as minimum consumption limit.

In Figure 1.2 QQ' is the availabilities envelope with a flat stretch RQ' . Suppose planner's preferences are

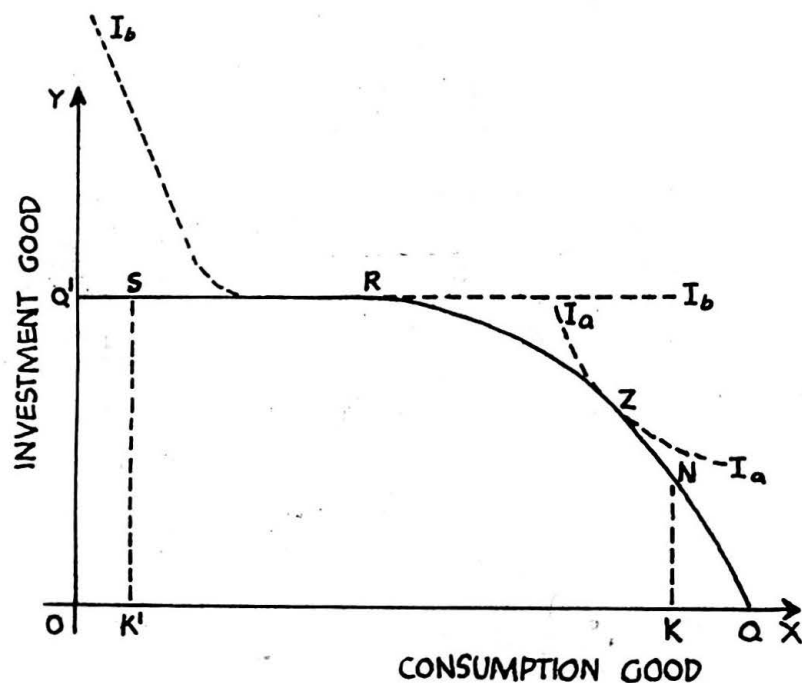


Fig. 1.2

expressed by a family of indifference curves of which $I_a I_a$ is an example. The optimum level is z in this case. If OK is the minimum consumption limit there is a saving constraint at N . At N an increase in saving would lead to a higher planner's indifference curve and higher welfare. Now consider a foreign exchange constraint at R ; with minimum consumption limit being OK' . If the planners are optimising then this implies that planner's indifference curves are shaped in $I_b I_b$, which shows that marginal consumption is valueless at point R .

But if the marginal utility of consumption to planners is always positive then the economy will never get into foreign exchange constraint. If the rate of transformation

falls from positive to zero at a kink then there will be a foreign exchange constraint even if the marginal utility of consumption is positive.

Thus, an increase in investment is constrained solely by 'saving' if, at the margin transformation possibilities still exist but cannot be utilised because domestic consumption has reached its minimum tolerable level. An increase in investment is constrained solely by 'foreign exchange' if, at the margin more savings can be extracted, but the possibilities of transforming consumption into investment domestically and through trade have fallen to zero. If such is the case, a reduction in consumption will not lead to a rise in investment.

In the Harrod-Domar framework, if imports consist of consumption and investment goods, the latter imports will increase output (Y) by output/capital ratio times investment imports. Nevertheless, the former imports will not add anything to the output; those would be consumed by the economy. If the growth rate of investment imports is greater than the rate of borrowing there will be net increase in output via imports. On the other hand if the growth rate of investment imports is less than a country will get into, what is sometimes called, the debt trap. There is one more possibility where the growth rate of investment imports is greater than the rate of borrowing but the proportion of consumption imports is much higher

than that of investment imports. In this case an advantage of output generated by investment imports will be eaten off by the much higher proportion of consumption goods and the country will enter into the debt trap.

1.2.2 Growth and Debt Stages

In the development process due to two gaps the economy's borrowing would go up. When a country will accomplish success in the development process due to its investment in capital-intensive industries, efficient allocation of resources, efficient capacity utilisation, etc., then the economy will be able to achieve growth. This growth would help reduce the burden of debt and simultaneously help reduce the two gaps. Gradually it would reach a point where there would be surplus of savings over investment and exports over imports. But this would not be sufficient to service the debt. Once this surplus becomes large enough to service the debt the economy would be self-reliant. The relation between the resource gap, debt and income in different phases of economic growth is shown below :

<u>Phase</u>	<u>Resource gap</u>	<u>Debt</u>	<u>Income</u>
I	Low	Low	Low
II	High	Low	Low
IIIA	High	High	Low
IIIB	High	High	Middle
IV	Low	High	Middle
V	Eliminated	Low	High

In the Phase I country is in the underdeveloped phase and does not have the development programme. Therefore real resource-gap and debt level would be lower. In Phase II the country begins developing with ambitious development plans that would lead to cause excess of $I+G$ over $S+T$. This resource-gap needs capital inflow which in turn results in increase in debt level. In Phase III resource-gap is still high, debt level is also high but income starts rising. In Phase IV the real resource-gap would be lower. Although capital inflow reduces than the previous size of it, there would be gross capital inflow which would be necessary to service the debt. For accomplishing the objective of self-reliance surplus out of two gaps must be large enough to pay the debt service. Once that is achieved the economy would be no longer depend on foreign debt. When the country passes through these different debt stages it gets transformed from a debtor country to a self-reliant country.

However, the above debt-cum-growth path is not a universal one. If a country gets loans on soft terms, increases exports more rapidly than the rise in imports or a rapid rise in private investment would enable the country to reduce external debt. Due to these factors a country in question may achieve self-reliance more rapidly.

1.2.3 External debt, debt servicing and its Components

External debt : "External debt is defined as debt that has an original or extended maturity of over one year and that is owed to non-residents and that is repayable in foreign currency, goods services." There are different categories of external debt.

(1) Public debt : "It is an external obligation of a public debtor, including the national government, a political subdivision (or an agency either) and automatic public bodies."

(2) Public guaranteed debt : "Which is an external obligation of a private debtor that is granted for repayment by a public entity."

(3) Private non-guaranteed external debt : "It is an external obligation of a private debtor that is not guaranteed for repayment by a public entity."

(Above definitions are taken from World Debt Tables, World Bank, 1983-84, First Supplement).

Debt-servicing is a payment which is to be made to the creditor country in a stipulated period, i.e., a year or so. There are two components of debt servicing, (1) interest, and (2) amortization.

(1) Interest - It is a payment for the outstanding debt payable to the creditor country.

(2) Amortization - It is a gradual reduction of a debt through periodic payments covering a part of principal.

1.2.4.1 Debt Service Ratio

The absolute amount of debt service does not help us much to analyse the problem of the external debt. The amount of debt servicing has to be related to some variable such as GDP, GNP or exports of the country in question. The ratio of debt service to exports is widely used measure for analysing the debt problem. It is so because the foreign debt is to be serviced in the creditor's currency or more generally in the convertible currencies. A country can acquire convertible currency through its exports. A country's capacity to service it's debt depends therefore upon its capacity to export. It is natural therefore to use a measure which relates debt service to exports. The higher this ratio the greater will be pressure on the debtor country. The debt service/export ratio is widely used for several reasons.

Firstly, this ratio is a simple and has easily understandable relation. Secondly, it can be computed on a firm statistical basis - it does not require the use of national accounts with all the guesses involved in their computation. Thirdly, economic analysts who have been aware of the imperfections of the ratio have failed to suggest an alternative.

1.2.4.2 Permissible limits of debt servicing

Can we think of a measure which would enable us to know as to whether a borrowing country is within the limits of borrowing? The absolute amount of debt service would not tell us anything about severity of the problem because it depends on the size of the economy, efficient allocation of resources. "To the best of our knowledge, no one has yet succeeded in developing set of rules which will determine, in a generally acceptable manner, the permissible limit of indebtedness of individuals or of business firms even in the domestic economy. If such rules had been developed, bankruptcy would already have been banished and the job of banking reduced to the operations of punch card machines." (Avramovic, 1964, pp. 5)

But it is very difficult to say upto what point the debt service is sound and when it becomes excessive and dangerous. When one thinks of external debt it would be more complicated because the government of the borrowing country can not print international money in order to pay her debts. Therefore debt servicing capacity from the macro-economic perspective must be considered.

1.2.4.3 Debt servicing capacity

Debt servicing capacity of a country has to be measured in terms of benefits and cost of foreign capital in the process of economic growth. From the benefit side

foreign capital supplements domestic resources of a borrowing country and helps to raise the rate of capital formation. It helps increase capital investment and economic growth. From the cost side debt service is a major item. Debt service is nothing but an amount of the purchasing power which a debtor country has to forgo and which would have otherwise been used for the purpose of consumption or investment.

"Debt servicing capacity depends on the ease with which a country can reconcile competing claims on its resources, on the one hand there is the demand for higher domestic consumption and investment. On the other hand there is the obligation to foreign creditors." (Avramovic, 1964, p. 10)

CHAPTER II

A STATISTICAL OVERVIEW

In the preceding chapter we saw as to why the foreign debt is essential for a developing country. In the present chapter we will see the size of the foreign debt and servicing of the developing countries during the period 1973 to 1982. This decade needs a special attention because it was badly affected by the oil price rise, high protectionism enforced by developed countries, fluctuations in the interest rates, the U.S. dollar appreciation.

Current Account Deficit

In Chapter I, we have given the magnitude of Current account deficit. It is a rough indicator of the need of foreign debt. The magnitude of current deficit of all groups of developing countries has been shown in Table 1.2. Current account deficit rose substantially, particularly of non-oil developing countries, during this period. Current account deficit of non-oil developing countries rose from \$11.3 billion to \$86.1 billion from the period 1973 to 1982. In percentage terms it rose by 661 per cent. The deficit of oil importing countries rose by 569 per cent during the same period. However, deficit figures of 1982 are below the peak deficit figures of 1981, of all groups of countries.

2.1 Debt

Between 1973 and 1982 total debt (outstanding disbursed) of all LDCs rose from \$ 109,263.4 million to \$ 519,360.5 million. This was a 375.3 per cent rise in percentage terms. In 1973, public and publicly guaranteed debt accounted for 76.6 per cent of the total LDC debt. In 1982 it was 80.8 per cent. Figures of foreign debt of LDCs, major borrower and low income Asia and Africa are given in Tables 2.1, 2.2 and 2.3 respectively.

Major borrowing countries¹ received 64.3 per cent of all LDCs public and publicly guaranteed debt. This percentage remained in the range of 60 per cent to 64 per cent in the decade 1973-82. In 1982 it was 60.4 per cent. In 1973, major borrowing countries received 69.8 per cent of all LDC's private non-guaranteed debt. This proportion increased to 77.7 per cent in 1982. Low income Asian and African countries got 24.5 per cent of all LDCs public and publicly guaranteed debt in 1973. In percentage terms it has declining trend over the years. This proportion fell to 14.2 per cent in 1982. This group's proportion of its non-guaranteed private debt to all LDC's non-guaranteed private debt was just 1.4 per cent in 1972 which was reduced to 0.5 per cent in 1982.

¹ This group includes 13 countries : Algeria, Argentina, Brazil, Chile, Egypt; Arab Republic of, India, Indonesia, Israel, Yugoslavia, South Korea, Mexico, Turkey, Venezuela.

Table 2.1 : Total debt of all developing countries

(in U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
1) <u>Total debt outstanding disbursed public/publicly guaranteed debt</u>	109263.4	135785.4	161600.8	195396.2	239595.4	299980.6	353289.9	406819.0	465118.9	519360.5
2) <u>Debt outstanding inc. undisbursed</u>	115481.8	148426.9	180116.9	222742.4	275338.4	346075.0	406156.8	461408.5	510532.0	560874.4
3) <u>Debt outstanding disbursed</u>	83738.8	103718.4	125678.2	154569.8	193222.5	245349.3	290816.1	334998.6	373817.3	419991.2
Official creditors	51738.8	61280.8	71622.1	83415.1	99907.1	120265.9	136074.1	157067.9	171694.1	189730.2
Multilateral	12349.6	15021.9	18531.9	22590.1	28557.0	35439.8	42658.7	51571.0	59913.8	71443.7
IBRD	6661.4	7753.2	9299.2	10939.7	12770.0	14951.2	17940.7	21268.2	25239.9	29792.9
IDA	3623.8	4522.2	5586.2	6883.8	7963.8	8975.3	10332.5	11882.3	13797.8	16292.7
Bilateral	39385.6	46258.9	53090.2	60824.9	71350.1	84826.0	93416.0	105496.8	111780.3	118286.5
Private creditors	32003.7	42437.6	54056.1	71154.7	93315.4	125483.4	154742.0	177930.7	202123.2	230261.1
Suppliers	9954.3	11572.4	12841.7	14252.0	17243.2	21038.5	21096.6	21586.9	20417.5	21421.5
Financial markets	20864.7	29194.7	39860.6	54916.1	74519.3	103110.6	132499.9	155607.2	181128.8	208360.3
4) <u>Private non-guaranteed Debt outstanding disbursed</u>	25524.6	32067.0	35922.6	40827.0	46372.9	54231.3	62473.8	71820.4	91301.6	99369.3

Source : (World debt Tables 1982-83 and 1983-84 (First supplement) pp. 200 & 5)

Table 2.2 : Total debt of major borrowing countries

(in U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
1) <u>Total debt outstanding disbursed public/publicly guaranteed debt</u>	71685.0	89053.1	105604.6	128628.6	156166.5	196265.6	230996.2	261869.7	300089.7	331058.2
2) <u>Debt outstanding inc. undisbursed</u>	70811.3	89403.9	109619.6	135856.5	166471.5	207990.0	240887.7	268894.9	294963.7	322355.8
3) <u>Debt outstanding disbursed</u>	53858.8	66515.6	79997.0	99822.7	122576.9	155068.9	182073.0	205775.9	227709.9	253836.3
Official creditors	31844.6	37259.2	42963.9	48948.4	56741.0	66313.7	72925.3	82208.2	88072.1	96003.0
Multilateral	6871.7	8372.9	10268.5	12368.8	15703.3	18706.2	21853.0	25685.4	29295.2	34709.8
IBRD	3314.6	3948.9	4813.2	5770.9	6863.5	8108.9	9869.9	11721.5	13932.4	16541.2
IDA	2282.2	2797.7	3468.6	4163.7	4603.8	5004.5	5623.4	6340.2	7253.3	8518.1
Bilateral	24972.9	28886.3	32695.4	36579.6	41037.7	47607.2	51072.3	56522.7	58776.9	61293.2
Private creditors	22014.2	29256.3	37033.1	50874.3	65835.9	88755.2	109147.7	123147.7	139637.8	157833.2
Suppliers	6703.1	7773.5	8325.4	9416.7	11101.7	14055.2	13870.0	14505.7	13595.6	14329.9
Financial markets	14751.3	20426.5	27790.5	39720.4	53410.0	73566.7	94291.0	108469.9	125580.0	143124.0
<u>Private non-guaranteed</u>										
4) <u>Debt Outstanding disbursed</u>	17826.2	22537.5	25607.6	28805.9	33589.6	41196.7	48893.2	56093.9	72379.8	77221.9

Source : (World debt tables, World Bank, 1982-83, 1983-84 (First Supplement) pp. 22, 25)

Table 2.3 : Total debt of Low Income Asia and Africa

(In U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
1) <u>Total debt outstanding disbursed</u>	20859.3	24645.4	27765.8	31826.1	36854.1	42178.8	46436.1	52805.1	56415.0	60474.4
<u>Public/publicly guaranteed debt</u>										
2) <u>Debt outstanding inc. undistributed</u>	28070.1	34913.4	38852.5	43519.1	50866.9	59046.0	64726.0	76226.3	80679.0	87356.9
3) <u>Debt outstanding disbursed</u>	20498.6	24305.8	27382.1	31388.2	36250.5	41471.6	45671.9	52265.0	55904.0	59973.3
Official creditors	18307.6	21433.0	24174.8	27733.4	31813.5	35961.7	39598.5	45796.6	48407.4	52107.6
Multilateral	4059.1	4876.0	5823.6	6979.1	8348.5	10221.0	12231.4	15459.4	17807.7	20687.8
IBRD	1134.8	1163.3	1195.6	1269.9	1400.4	1572.7	1716.3	1871.1	2245.3	2497.4
IDA	2834.5	3512.7	4256.7	5211.9	5997.3	6768.3	7892.5	9125.4	10616.5	12645.8
Bilateral	14248.6	16557.0	18351.1	20754.3	23464.9	25740.7	27367.2	30337.2	30599.7	31419.8
Private creditors	2190.9	2872.7	3207.3	3655.0	4437.0	5510.0	6073.5	6409.4	7496.6	7865.7
Suppliers	1430.5	1662.2	1756.8	1836.0	2201.5	2519.5	2548.4	2180.6	2082.8	2053.6
Financial markets	735.4	1189.3	1435.3	1808.0	2226.4	2982.7	3519.8	4225.0	5411.2	5801.4
<u>Private non-guaranteed</u>										
4) <u>Debt Outstanding disbursed</u>	360.7	399.6	383.7	437.9	603.6	707.2	780.2	599.2	511.0	501.1

Source : (World Debt Tables, World Bank, pp. 6, 10)

Major borrowing countries' public and publicly guaranteed debt accounted for 75.1 per cent of their received total debt in 1973; it rose to 76.6 per cent in 1982. Whereas low income Asian and African countries' public and publicly guaranteed debt to their total debt accounted for 98.2 per cent in 1972. It remained between 98 - 99 per cent during this decade. It was 99.1 per cent in 1982.

2.2 Debt Service

Debt service of all LDCs rose from U.S. \$ 14,654.2 million to U.S. \$ 92,588.2 million, between 1973 and 1982. This accounts for 531.8 per cent rise in the debt servicing. Public and publicly guaranteed debt service rose from U.S. \$ 10,198.4 million to U.S. \$ 63,830.1 million during the same period. In percentage terms it had risen by 525.8 per cent. Between the same period, private non-guaranteed debt service increased from U.S. \$ 5,835.2 million to U.S. \$ 28,758.1 million. In other words, it increased by 392.8 per cent. In 1973 ratio of debt service to debt outstanding (disbursed) accounted for 13.4 per cent, which rose to 17.8 per cent in 1982. Figures of debt service of all LDCs, major borrowers and low income Asia and Africa are given in Tables 2.4, 2.5 and 2.6 respectively.

Table 2.4 : Total debt service of all developing countries

	(in U.S. \$ million)									
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total debt service	14654.2	19841.4	22924.3	26059.1	22735.5	47350.3	63387.7	71259.3	82904.0	92588.2
Total Principal repayment	9819.1	13208.5	14696.4	17028.3	21689.4	31927.7	40899.7	40594.0	43888.9	46384.1
Total interest payments	4835.1	6632.9	8227.9	9030.8	11046.1	15422.6	22488.0	30665.3	39015.1	46204.1
<u>Public/Publicly guaranteed Debt Service</u>	10198.4	12204.4	14382.4	16876.4	22833.6	34359.0	46182.0	51602.8	59593.9	63830.1
<u>Principal repayments</u>	7003.7	8027.5	8943.5	10259.7	14254.5	22721.1	29110.7	27985.6	30700.7	30818.1
Official creditors	2381.8	2681.8	3034.5	3251.7	3889.4	4548.9	6210.5	6858.2	7984.2	9117.7
Multilateral	497.3	560.6	616.2	732.4	916.8	1041.0	1264.8	1663.4	2033.8	2567.0
IBRD	367.8	418.2	445.3	505.1	629.2	700.4	827.5	1029.1	1297.7	1705.1
IDA	5.9	9.6	15.3	21.7	25.8	23.5	27.7	31.0	78.1	69.9
Bilateral	1884.5	2121.2	2418.2	2519.3	2972.6	3507.9	4945.7	5194.8	5950.4	6550.7
Private creditors	4621.9	5345.8	5909.1	7008.1	10635.2	18172.2	22900.2	21127.3	22716.6	21700.5
Suppliers	1751.8	2031.2	2500.4	2845.7	3290.2	4064.9	4621.7	4739.1	4872.2	4721.7
Financial markets	2487.6	3153.7	3,104.4	3700.1	6808.6	13853.7	18081.2	16002.6	17754.0	16880.3
<u>Interest payments</u>	3194.7	4176.9	5438.8	6616.7	8309.1	11637.9	17071.3	23671.2	28893.2	33012.0
Official creditors	1527.0	1720.2	2144.8	2585.6	3332.1	4210.1	4939.3	5808.9	6501.9	7503.9
Multilateral	600.1	717.2	852.0	1068.5	1370.0	1904.5	2199.1	2552.5	2775.2	3202.8
IBRD	453.7	538.2	630.7	764.5	932.2	1242.8	1538.5	1753.2	1847.8	2107.3
IDA	27.9	29.2	34.6	45.4	53.3	60.7	70.9	79.0	91.8	108.5
Bilateral	926.9	1003.1	1292.7	1517.1	1962.1	2305.6	2740.1	3256.4	3726.7	4301.1
Private Creditors	1667.7	2456.7	3294.1	4031.0	4977.0	7427.8	12132.0	17808.3	22391.3	25508.1
Suppliers	512.1	521.3	581.6	721.1	742.7	1063.4	1329.5	1420.6	1330.4	1324.8
Financial markets	1064.9	1909.5	2651.9	3201.9	4136.2	6287.9	10703.9	16317.9	21021.7	24149.8
<u>Private non-guaranteed Debt Service</u>	5835.2	7637.0	8542.0	9182.7	10171.9	12991.3	17205.7	19602.5	23310.1	28758.1
Principal repayment	4194.8	5181.0	5752.9	6768.6	7434.9	9206.6	11789.0	12608.4	13188.2	15566.0
Interest payments	1640.4	2456.0	2789.1	2414.1	2737.0	3784.7	5416.7	6994.1	10121.9	13192.1

Source : World debt Tables, World Bank, 1982-83, 1983-84 (First Supplement) pp. 2, 3, 5)

Table 2.5 : Total debt service of major borrowing countries

(in U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total debt service	10343.8	13567.3	15755.7	17579.3	23208.0	32259.1	45973.8	50674.0	57919.2	65195.9
Total principal repayment	7164.2	8958.5	9891.9	11280.4	15549.5	21528.9	30111.1	29033.2	29877.3	31736.00
Total interest payments	3179.6	4608.8	5863.8	6298.9	7658.5	10730.2	15862.7	21640.8	28041.9	33459.9
<u>Public/Publicly guaranteed Debt Service</u>	6489.1	8032.2	9534.7	11316.6	15970.7	23647.0	32765.1	35684.9	40619.2	43074.6
Principal repayments	4417.6	5233.1	5842.6	6764.2	10254.4	15718.6	21119.7	19629.0	20699.3	20243.9
Official creditors	1486.0	1682.2	1831.6	2036.9	2397.6	2673.0	3552.4	3788.9	4222.5	5153.2
Multilateral	259.0	289.3	321.6	389.3	527.1	576.7	666.9	920.9	1042.6	1358.0
IBRD	182.7	206.1	221.8	261.5	361.2	383.0	447.8	573.9	743.4	1003.8
IDA	4.1	5.9	7.8	10.2	11.7	12.2	15.3	18.9	24.7	32.8
Bilateral	1226.8	1392.9	1510.0	1647.6	1870.5	2102.3	2885.4	2868.0	3179.9	3795.3
Private creditors	2931.6	3550.9	4011.0	4727.3	7856.8	13045.6	17567.4	15840.1	16476.8	15090.6
Suppliers	1214.8	1443.0	1803.7	2119.9	2414.1	2784.5	3366.2	3515.2	3723.2	3636.1
Financial markets	1668.5	3059.0	2077.3	2492.5	4944.8	10037.7	14047.2	11954.2	12687.4	11381.2
<u>Interest payments</u>	2071.5	2799.1	3692.1	4552.4	5716.3	7928.3	11645.4	16055.8	19919.9	22830.7
Official creditors	919.9	1051.2	1337.2	1595.1	2087.1	2502.6	2638.4	3095.9	3653.1	4381.2
Multilateral	317.3	384.3	465.6	576.9	765.2	1095.4	1172.9	1350.9	1435.6	4639.0
IBRD	223.2	271.8	328.4	392.1	499.0	684.6	845.1	971.1	1024.5	1174.6
IDA	17.2	18.5	21.7	26.6	31.4	34.7	38.5	43.2	49.1	57.1
Bilateral	602.7	666.9	871.6	1019.2	1321.9	1407.3	1465.4	1745.1	2217.5	2742.2
Private creditors	1151.6	1747.9	2354.9	2957.3	3629.1	5425.7	9007.1	12959.9	16266.8	18449.5
Suppliers	381.6	367.5	395.9	533.4	522.9	749.7	937.3	981.1	964.7	910.7
Financial markets	752.1	1360.3	1903.8	2327.4	3015.3	4608.0	7980.4	11920.1	15275.5	17513.3
<u>Private non-guaranteed Debt Service</u>	3854.7	5535.1	6221.0	6262.7	7237.3	8612.2	13208.7	14989.2	17840.0	22121.3
Principal repayment	2746.6	3725.4	4049.3	4516.2	5295.1	5810.3	8991.4	9404.2	9178.0	11492.1
Interest payments	1108.1	1809.7	2171.7	1746.5	1942.2	2801.9	4217.3	5585.0	8122.0	10629.2

Source : World debt tables, World Bank, 1982-83, 1983-84 (First Supplement) pp. 22-25.

Table 2.6 : Total debt service of low income Asia and Africa

(in U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total debt service	1396.7	1611.7	1827.9	1781.8	1987.5	2328.8	2643.6	3129.6	2964.8	3206.0
Total principal repayment	897.7	1069.6	1219.8	1139.9	1239.4	1383.7	1558.7	1857.1	1781.0	1897.9
Total interest payments	498.9	542.0	608.1	641.9	748.2	945.2	1084.9	1272.5	4183.7	1308.2
<u>Public/Publicly guaranteed Debt Service</u>	1299.3	1489.5	1760.0	1705.2	1903.2	2212.8	2500.1	2989.5	2835.7	3055.6
Principal repayments	822.9	970.8	1174.5	1088.3	1192.2	1314.9	1474.6	1771.1	1694.3	1791.5
Official creditors	529.2	639.1	754.4	734.0	859.9	945.9	1104.5	1264.0	1247.0	1244.7
Multilateral	103.7	116.3	116.9	128.4	145.9	155.3	185.1	218.0	267.0	296.6
IBRD	98.3	102.1	97.2	100.0	113.9	117.2	119.5	129.9	126.8	143.3
IDA	4.4	7.7	11.9	18.0	18.8	17.9	22.0	22.6	59.3	55.2
Bilateral	424.8	522.8	637.7	605.7	714.0	790.7	919.5	1046.1	980.0	948.0
Private creditors	204.7	233.5	321.2	276.9	281.1	324.3	347.3	430.6	449.6	450.7
Suppliers	138.0	150.2	219.2	194.9	177.6	178.5	184.4	182.4	153.3	144.6
Financial markets	102.6	97.4	141.1	99.8	77.9	115.0	127.0	236.2	231.3	351.3
<u>Interest payments</u>	476.3	518.7	585.5	616.9	711.1	898.0	1025.5	1218.4	1141.3	1264.1
Official creditors	385.5	397.7	439.8	500.9	583.2	707.6	823.6	920.3	811.0	843.0
Multilateral	107.3	109.2	115.5	150.3	158.5	208.8	252.6	273.2	289.5	338.7
IBRD	83.6	80.7	81.0	59.9	74.0	99.1	115.3	116.0	118.5	148.6
IDA	21.6	22.7	26.4	34.6	40.2	45.7	53.9	59.8	70.7	83.5
Bilateral	278.2	288.6	324.3	350.6	424.7	498.8	571.0	644.3	521.4	504.4
Private creditors	90.8	120.9	145.6	116.1	127.7	190.4	201.8	298.1	330.4	421.0
Suppliers	49.2	60.7	73.3	58.2	52.3	71.4	74.2	80.7	64.7	61.4
Financial markets	40.4	58.7	71.3	57.3	75.2	119.1	127.5	217.4	265.7	359.6
<u>Private non-guaranteed Debt Service</u>	97.4	122.1	67.9	76.6	84.3	116.0	143.5	140.1	129.1	290.7
Principal repayments	74.8	98.8	45.3	51.6	47.2	68.8	84.1	86.0	86.7	106.3
Interest payments	22.6	23.3	22.6	25.0	37.1	47.2	59.7	54.1	42.4	44.1

Source : World Debt Tables, World Bank, pp. 6, 10, 1982-83, 1983-84 (Supplemented)

Debt service of major borrowing countries increased from U.S. \$ 10,343.8 million to U.S. \$ 65,195.9 million between 1973 and 1982. (530.3 per cent rise). Public and publicly guaranteed debt of these countries rose from U.S. \$ 6,489.1 million to U.S. \$ 43,074.6 million during the same period (563.4 per cent rise). Private non-guaranteed debt rose from U.S. \$ 3,854.7 million to U.S. \$ 22,121.3 million in the same period (473.9 per cent rise). This group's share in all LDCs debt service was 70.6 per cent in 1973 which remained 70.4 per cent in 1982. It's debt service to debt outstanding (disbursed) was 14.4 per cent in 1973 which was 19.7 per cent in 1982.

Debt service of low income Asia and Africa was U.S. \$ 1,396.7 million in 1973 which rose relatively less rapidly than major borrowing countries, to U.S. \$ 3,206.0 million in 1982. (129.5 per cent rise). Public and publicly guaranteed ^{service} debt of this group increased from U.S. \$ 1,299.3 million to U.S. \$ 3,055.6 million in between 1973 and 1982. (135.2 per cent rise). It's share in all LDCs debt service constituted 9.5 per cent in 1973 which went ~~f~~ down to 3.5 per cent in 1982. It's debt service to debt outstanding (disbursed) ratio was 6.7 per cent in 1973 it came down to 5.3 per cent.

(a) Principal repayment (amortization)

As Table 2.7 indicates principal repayments or amortization of all LDCs increased from U.S. \$ 9,819.1

Table 2.7 : Net flows and net transfers

(in U.S. \$ million)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total net flows of all LDCs	15,687.9	23,510.9	29,066.9	32,917.4	39,426.6	48,254.5	53,882.8	55,473.0	69,515.0	53,712.5
Total net transfer of all LDCs	10,852.8	16,878.0	20,838.9	23,886.6	28,380.5	32,831.9	31,394.8	24,861.7	30,499.9	7,508.4
flow Net transfer of major borrowers	11,253.6	15,154.5	18,348.2	22,270.5	24,436.9	31,710.5	34,692.9	31,305.8	44,654.0	27,139.4
Net transfer of major borrowers	8,074.0	10,545.7	12,484.4	15,971.5	16,778.5	20,980.2	18,830.2	9,664.9	16,612.0	6,320.5
Net flows of low income Asia and Africa	1,956.9	3,509.4	4,259.3	3,925.3	3,696.8	4,221.7	4,929.9	7,055.6	5,482.4	5,568.9
Net transfer of low income Asia and Africa	1,458.1	2,942.0	3,654.8	3,283.4	2,952.6	3,904.3	4,562.6	6,534.7	5,044.4	5,156.0

Source : World debt tables, World Bank, 1982-83, 1983-84 (First supplement) pp. 5, 9, 13, 25)

million to U.S. \$ 46,384.1 million in between 1973 to 1982. (372.3 per cent rise). Percentage of public and publicly guaranteed debt's amortization to the total was 71.3 per cent in 1973 which was declined to 66.4 per cent in 1982.

Amortization of major borrowing countries increased from U.S. \$ 7,164.2 million to U.S. \$ 31,736.0 million in between 1973 and 1982. (343 per cent rise). Percentage of public and publicly guaranteed debt's amortization to this group's amortisation rose from 42.7 per cent to 63.8 per cent during the same period.

Amortization payment of low income Asia and Africa increased from U.S. \$ 897.7 million to U.S. \$ 1,897.9 million from 1973 to 1982. (111.4 per cent rise). Public and publicly guaranteed debt's amortization of this group to total amortization accounted for 91.6 per cent in 1973 which was slightly increased to 94.4 per cent in 1982.

(b) Interest payments

Interest payments of all LDCs rose from U.S. \$ 4,835.1 million to U.S. \$ 46,204.1 million from 1973 to 1982. (855 per cent rise). Interest payments owed to public and publicly guaranteed segment was 66.1 per cent in 1973, which reduced to 36.5 per cent in 1982.

Interest payments of major borrowing countries increased from U.S. \$ 3,179.6 million to U.S. \$ 33,459.9

from 1973 to 1982. (952.3 per cent rise). Interest payment owed to public and publicly guaranteed segment 65.1 per cent in 1973, which went up in 1982 to 68.2 per cent.

Low income Asia and Africa's interest payments were U.S. \$ 498.9 million in 1973 which rose to U.S. \$ 1,308.2 million in 1982. (162.2 per cent rise). Interest payments owed to public and publicly guaranteed segment was 95.6 per cent in 1973, it was 96.6 per cent in 1982.

2.3 Net flows and net transfers

In order to understand the volume of net debt borrowed by a country, during the year, the concepts net flow and net transfers are often used.¹ "Net flows (or net lending) are disbursements minus principal repayments. Net transfers are net flows minus interest payments or disbursements minus total debt service payments." (World debt World Bank Tables, 1983-84, First Supplement, p. xii). Figures of all net flows and net transfers are given in Table 2.8.

Net flows of all LDCs were U.S. \$ 15,687.9 million in 1973, in 1982 it was U.S. \$ 53,712.5 million. It's ratio of net flow to disbursements was 58.3 per cent in 1973 which fell to 53.6 per cent in 1982. Net transfers of all LDCs were U.S. \$ 10,852.8 million, in 1982 it was

¹ Disbursements are drawings on outstanding loan commitments during the year specified.

Table 2.8 : Average terms of all creditors (Private and Public creditors)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<u>All L.D.C.s</u>										
Interest (%)	6.6	7.0	6.8	6.8	6.9	7.9	9.4	9.3	11.6	11.0
Maturity (years)	18.6	17.6	16.3	15.0	14.5	14.8	13.9	16.1	14.1	14.4
Grace period (years)	5.6	5.2	5.2	4.5	4.6	4.7	4.6	4.8	4.3	4.3
Grant element (%)	23.4	21.1	21.0	18.8	18.6	14.5	7.0	8.8	3.1	0.5
<u>Major borrowers</u>										
Interest (%)	7.0	7.6	7.2	7.3	7.2	8.6	10.3	10.1	12.6	12.3
Maturity (years)	18.4	16.8	15.8	13.5	13.2	13.9	12.6	15.6	13.4	12.7
Grace period (years)	5.9	5.2	5.2	4.2	4.5	4.6	4.5	4.8	4.1	3.8
Grant element (%)	21.3	16.9	17.5	14.6	15.5	10.0	1.2	4.4	-8.3	-8.1
<u>Low Income Asia and Africa</u>										
Interest (%)	-	3.7	3.9	3.3	3.8	3.3	3.2	3.8	4.0	5.0
Maturity (years)	-	26.4	24.4	27.8	25.8	28.9	30.3	26.6	26.5	27.9
Grace period (years)	-	6.4	6.6	7.1	6.8	7.1	7.3	6.7	6.5	6.7
Grant element (%)	-	47.2	44.8	50.8	46.1	51.6	53.2	47.1	45.4	41.1

Source : World debt tables, World Bank, 1982-83, 1983-84 (First Supplement), pp. 3, 9, 13, 23)

U.S. \$ 7,508.4 million in 1982. It's ratio of net transfers to disbursements was 40.4 per cent in 1973, which fell to 7.5 per cent in 1982.

Net flows of major borrowers were U.S. \$ 11,253.6 million in 1973, which were U.S. \$ 27,139.4 million in 1982. Net transfers were U.S. \$ 27,139.4 million and U.S. \$ -6,320.5 million during the same period. The ratio of net flows to disbursements was 61.1 per cent in 1973, which fell to 46.1 per cent in 1982. The ratio of net transfers to disbursements was 43.8 per cent in 1973 which fell to -10.7 per cent in 1982.

Net flows of low income Asia and Africa were U.S. \$ 1,956.9 million in 1973, which increased to U.S. \$ 5,568.9 in 1982. Net transfers of this group were U.S. \$ 1,458.1 million and U.S. \$ 5,156.0 million during the mentioned periods. Ratio of net flows and net transfers to disbursements were 68.5 per cent and 73.7 per cent in 1973 respectively which were 51.1 per cent and 68.2 per cent respectively in 1982.

2.4 Average terms of all creditors (private + public creditors)

Average terms of all creditors are given in Table 2.9.

(a) Interest (%)

Average interest rate of all LDC debt was 6.6 per cent in 1973 which steeply increased to 11 per cent in 1982. For major borrowers it was 7 per cent and it increased

Table 2.9 : Percentage of concessional and variable interest loans to disbursed credit

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<u>All L.D.C.s</u>										
Concessional loans	45.6	43.0	40.9	37.9	36.2	33.1	30.4	29.7	28.1	26.6
Variable interest loan	11.6	15.7	20.0	22.6	24.6	27.0	31.6	33.2	36.9	37.6
<u>Major borrowers</u>										
Concessional loans	45.4	41.8	39.5	35.3	33.0	29.3	26.4	25.3	23.1	21.3
Variable interest loan	13.5	18.9	23.4	27.0	29.1	32.0	38.0	39.8	44.2	44.1
<u>Low income Asia and Africa</u>										
Concessional loans	70.7	70.3	71.60	71.8	71.1	71.2	70.0	70.3	69.4	70.1
Variable interest loan	-	-	-	-	4.0	3.5	3.4	3.9	4.7	4.5

Source : World debt tables, World Bank, 1982-83, 1983-84 (First Supplement) pp. 3, 9, 13, 23)

to 12.3 per cent between 1973 and 1982. Whereas for low income Asia and Africa it was 3.7 per cent and 5.0 per cent in the above-mentioned periods.

(b) Maturity (years)

Average maturity for all LDCs was 18.6 years in 1973 which came down to 14.4 years in 1982. For major borrowers it was 18.4 years in 1973 which declined to 12.7 years in 1982. For low income Asia and Africa it increased from 26.4 years to 27.9 years.

(c) Grace Period (years)

Average grace period for all LDCs was 5.6 years in 1973 which was shortened to 4.3 years in 1982. For major borrowers it was shortened from 5.9 years to 3.8 years whereas for it lengthened from 6.4 years to 6.7 years between 1973 and 1982.

(d) Grant element (%)

Average grant element was 23.4 per cent in 1973 for all LDCs, which became astonishingly low, -0.5 per cent in 1982. For major borrowers it was 21.3 per cent in 1973, which rapidly came down to -8.1 per cent in 1982. For low income Asia and Africa 47.2 per cent in 1973, which declined to 41.1 per cent in 1982.

In World Debt Tables average interest rates, maturity, Grace period are shown differently for low income Asia and Africa.

2.5 Percentage of concessional and variable interest loans to disbursed credit

(a) Concessional loans

For all LDCs percentage of concessional loans to disbursed loan was 45.6 per cent in 1973 which decreased to 26.6 per cent in 1982. For major borrowers it was 45.6 per cent in 1973 decreased to 21.3 per cent in 1982. For low income Asia and Africa the ratio was 70.7 per cent in 1973 which slightly came down to 70.1 per cent in 1982.

(b) Variable interest loans

In 1973, proportion of variable interest loans to total disbursed loans was 11.6 per cent for all LDCs which increased considerably to 37.6 per cent in 1982. For major borrowers it was 13.5 per cent, it increased to 37.6 per cent in the same period. Figures of low income Asia and Africa's share are not available from 1973 to 1976. In 1977, the ratio was 4.0 per cent which slightly increased to 4.5 per cent in 1982.

2.6 Principal ratios

Principal ratios are given in the Table 2.10.

(a) DOD/XGS (debt outstanding disbursed/
exports of goods and services)

The more the exports the less will be the DOD/XGS ratio. The lesser the ratio the stronger would be a country's BOP position. For, all LDCs the ratio was 84.7 per cent, which was at the peak in 103.8 per cent in 1978, in 1980 it came down to 84.1 per cent. For major borrowers it was 110.6 per cent in 1973, which was at

Table 2.10 : Principal Ratios

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Total LDCs										
DOD/XGS (%)	84.7	63.7	83.5	87.8	91.6	103.8	93.4	84.1	-	-
DOD/GNP (%)	14.3	13.7	15.0	16.4	17.9	19.6	19.1	18.3	19.4	23.5
TDS/XGS (%)	10.3	8.1	9.6	9.6	10.8	14.5	14.8	12.9	-	-
TDS/GNP (%)	1.7	1.6	1.7	1.8	2.1	2.7	3.0	2.8	3.1	3.6
INT/XGS (%)	3.2	2.8	3.6	3.8	3.9	4.9	5.5	5.9	-	-
INT/GNP (%)	0.5	0.6	0.6	0.7	0.8	0.9	1.1	1.3	1.5	1.9
RES/DOD (%)	57.3	64.5	48.0	46.9	44.9	43.0	52.3	50.6	37.0	29.5
RES/MGS (months)	5.2	4.7	3.7	4.2	4.2	4.4	5.0	4.4	-	-
Major borrowers										
DOD/XGS (%)	110.6	89.2	108.8	113.0	116.9	129.0	117.2	100.4	106.7	-
DOD/GNP (%)	14.3	13.5	15.1	16.3	17.9	19.4	18.6	17.7	18.2	22.9
TDS/XGS (%)	13.3	10.8	13.0	12.8	15.2	19.7	21.1	17.4	19.0	-
TDS/GNP (%)	1.7	1.6	1.8	1.8	2.3	3.0	3.4	3.1	3.2	3.9
INT/XGS (%)	4.3	3.8	5.0	5.2	5.5	6.6	7.5	7.8	9.3	-
INT/GNP (%)	0.6	0.6	0.7	0.7	0.8	1.0	1.2	1.4	1.6	2.1
RES/MGS (months) DOD (%)	45.2	45.2	33.4	35.7	35.7	36.0	41.4	28.5	29.8	21.3
RES/MGS (months)	5.3	4.1	3.3	4.1	4.2	4.5	4.8	3.9	3.1	-
Low income Asia and Africa										
DOD/XGS (%)	185.6	179.5	179.9	177.7	272.4	215.8	211.1	233.9	-	-
DOD/GNP (%)	16.1	20.0	21.1	23.0	42.8	21.0	21.1	18.5	21.1	22.7
TDS/XGS (%)	11.9	11.1	11.6	9.5	9.1	11.0	10.4	13.1	-	-
TDS/GNP (%)	1.1	1.2	1.4	1.2	1.1	1.1	1.0	1.1	1.1	1.0
INT/XGS (%)	4.3	3.8	3.9	3.4	3.5	4.6	4.4	5.6	-	-
INT/GNP (%)	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.7	0.4	0.4
RES/DOD (%)	23.6	20.8	15.6	18.6	23.2	24.6	31.1	27.6	19.9	18.3
RES/MGS (months)	3.7	3.1	2.4	3.6	4.6	4.8	5.1	4.2	-	-

Source : (World Debt Tables, World Bank, 1982-83, 1983-84, first supplement, pp. 3, 9, 13, 23)

the peak in 1978; 129 per cent, it further came down to 106.7 per cent in 1981. For low income Asia and Africa it was 185.6 per cent in 1973, which was at the peak 272.4 per cent in 1977, it came down to 233.9 per cent in 1980.

(b) DOD/GNP (Debt outstanding disbursed to Gross National Product)

The lesser the DOD/GNP ratio, the lesser would be the debt outstanding and therefore less vulnerability on BOP side. DOD/GNP ratio was 14.3 per cent, for all LDCs, in 1973, it went up to 23.5 per cent in 1982. The ratio of major borrowing countries was 14.3 per cent in 1973 which rose to 22.9 per cent in 1982. The ratio was 16.1 per cent, for low income Asia and Africa, in 1973. In 1977, which was at the peak during this year, it went up to 42.8 per cent, it further declined to 22.7 per cent in 1982.

(c) TDS/XGS (Total debt service/exports of goods and services)

If debt service payments are small TDS/XGS ratio will be smaller. For all LDCs it was 10.3 per cent in 1973, which was at the peak 14.8 per cent in 1979, it later came down to 12.9 per cent in 1980. The ratio of major borrowers was 13.3 per cent in 1973, which was at the peak 21.1 per cent in 1979, it came down to 19 per cent in 1981. For low income Asia and Africa it was 11.9 per cent which went up to 13.1 per cent in 1980.

(d) TDS/GNP (Total debt service to Gross National Product)

The lesser TDS/GNP ratio the more relaxed position on current account. TDS/GNP ratio was 1.7 per cent, for all LDCs, which went up to 3.6 per cent in 1982. The ratio was 1.7 per cent for major borrowers which augmented to 3.9 per cent in 1982. The ratio of low income Asia and Africa was 1.1 per cent in 1973, which declined slightly to 1.1 per cent in 1982.

(e) INT/XGS (The ratio Interest payments to exports)

INT/XGS ratio was 3.2 per cent, for all LDCs, in 1973 and it went up to 5.9 per cent in 1980. For major borrowers it was 4.3 per cent in 1973, it increased to 7.8 per cent in 1980. For low income Asia and Africa it was 4.3 per cent in 1973, it rose relatively lesser than major borrowers in 1980; it was 5.6 per cent.

(f) INT/GNP (Interest payments/Gross National Product)

If the interest payments are small INT/GNP ratio will be smaller. It was 0.5 per cent in 1973, which uplifted to 1.9 per cent in 1982. For major borrowers it rose from 0.6 per cent to 2.1 per cent during the same period. For low income countries it was 0.4 per cent, which remained the same in 1982. Nevertheless, it was at peak 0.7 per cent in 1980.

(g) RES/DOD (Reserves to debt outstanding disbursed)

The more the reserves, the more the ratio and less strain on the BOP. For all LDCs it was 57.3 per cent in 1973 which went down to 29.5 per cent in 1982. For major borrowers it was 45.2 per cent in 1973 which steeply came down to 21.3 per cent in 1982. For LDCs it was 23.6 per cent in 1973, it went to the peak 31.1 per cent in 1979, it further came down to 18.3^{per cent} in 1982.

(h) RES/MGS (Reserves to imports of goods and services (months))

The lesser the RES/MGS ratio, the shorter the period (in months) in which reserves are adjusted for BOP disequilibrium. RES/MGS ratio was 5.2 per cent in 1973, it increased to 4.4 per cent in 1980. For major borrowers it was 5.3 per cent and it declined to 3.9 per cent in 1980. For low income Asia and Africa it was 3.7 per cent in 1973, it increased to 4.2 per cent in 1980. Nevertheless, this rise is lower than the peak value which was 5.1 per cent in 1979.

2.7 East European Economies : A Statistical Appraisal

East European countries or the CMEA (Council for Mutual Economic Assistance) bloc is also having the debt problems. Until 1960 there was no substantial trade of the East with the West. But since early '70s the trade with the West started improving demand for imports from the

East Europe consisted of attractive Western goods and technology. In order to overcome the import surplus with the West, having no convertible currencies with them, they had to borrow from the Western Banks and institutions. Secondly, except Rumania and Hungary no other CMEA country is member of the IMF and World Bank. Therefore, they had no alternatives other than borrowing from the Western Banks and institutions.

The demand for foreign debt augmented due to two more factors: (1) Increase in oil prices by the U.S.S.R., (2) Increase in food imports.

(1) Increase in oil prices by the U.S.S.R.

Until January 1975 the prices of the U.S.S.R. oil were decided by the average world market prices for the preceding five year period (1966-70). However, the Executive Committee of the CMEA decided to go for the world prices of the commodities of the immediate preceding five years. (1971-75). This strategy led to a rise in the prices of the manufactured goods of the CMEA (excluding the U.S.S.R.) by about a third. On the other hand it raised the prices of raw materials (mainly oil exports of the U.S.S.R.) by about 130 per cent. Therefore this increased the deficit of the East European countries on current account with the U.S.S.R. because these countries are solely dependent for oil on the U.S.S.R.

(2) Increase in food imports

In the early '70s the CMEA countries emphasized the industrial investment at the expense of agricultural sector. They adopted the consumerist approach that demanded steady improvements in material living standards regardless of their objective capacity to pay, i.e., Agricultural imports of Poland from the U.S. rose from U.S. \$ 80 million in 1972 to U.S. \$ 650 million in 1979.

Table 2.11 : East European Indebtedness in the 1970s:
Gross Debt in Billions of U.S. Dollars

Country	1971	1972	1973	1974	1975	1976	1977	1978	1979
Bulgaria	0.7	1.0	1.0	1.7	2.6	3.2	3.7	4.3	4.5
Czechoslovakia	0.5	0.6	0.8	1.0	1.1	1.9	2.6	3.2	4.0
G.D.R.	1.4	1.6	2.1	3.1	5.2	5.9	7.1	8.9	10.1
Hungary	1.1	1.4	1.4	2.1	3.1	4.0	5.7	7.5	7.8
Poland	1.1	1.6	2.8	4.6	8.0	11.5	14.0	17.8	20.5
Romania	2.2	1.2	1.6	2.7	2.9	2.9	3.6	5.2	6.9
East Europe	6.1	7.4	9.7	15.4	23.0	29.5	36.7	46.9	53.7
Yugoslavia	3.2	3.9	4.7	5.4	6.6	7.9	9.5	11.8	15.0
East Europe with Yugoslavia	9.3	11.3	14.4	20.8	29.6	37.4	46.2	68.7	58.7

Source : Marer, P., "Economic Performance and Prospects in Eastern Europe : Analytical Summary and Interpretation of Finding" in U.S. Congress, Joint Economic Committee East European Assessment (Washington D.C.) Government Printing Office, 1981), pp. 2, 57.

Among the East European countries Poland's debt rose very steeply. It was \$ 1.1 billion in 1971 which went up to \$ 20.5 billion. This accounted for 46.9 per cent of total East European debt (excluding Yugoslavia). Second largest debtor of the CMEA bloc is Yugoslavia. The magnitude of her debt rose from U.S. \$ 3.2 to U.S. \$ 15.0 billion between 1971 and 1979.

Table 2.12 : East Europe's Debt Burden in the 1970s.

Country	Debt per capita			Debt/export ratio		
	1971	1975	1979	1971	1975	1979
Bulgaria	85	259	431	1.60	2.41	1.65
Czechoslovakia	11	56	207	0.13	0.35	0.88
G. D. R.	71	211	537	0.89	1.16	2.00
Hungary	82	208	702	1.13	1.30	2.23
Poland	23	217	568	0.52	1.79	3.16
Romania	60	115	306	1.30	0.85	1.26

Country	Debt service/export ratio (%)		
	1970	1975	1979
Bulgaria	35	33	36
Czechoslovakia	8	14	22
G. D. R.	20	25	55
Hungary	20	19	36
Poland	20	30	95
Romania	36	23	25

Source : Marer P., "Economic Performance and Prospects

in Eastern Europe", in U.S. Congress, Joint Economic Committee, East European Economic Assessment (Washington D.C. : Government Printing Office, 1981), Pt. 2, pp. 67-68.

(a) Size of outstanding debt relative to annual hard currency exports (i.e. exports generating hard currency.)

(b) Interest on outstanding debt and principal payments on medium and long term debts relative to hard currency exports (Excludes service revenues and short term debts).

Poland's debt service to exports ratio went up from 20 per cent to 95 per cent between the period 1970 and 1979. Analogously its debt/exports ratio went up from 0.52 per cent to 3.16 per cent between the same period. However, if we see per capita debt Hungary stands first in the year 1979.

These countries lack convertible currency balances which are required for the imports from the West. Secondly, they have to face competition with the LDCs in the markets for their exportables. Thirdly, these countries, too, face the problem of import surplus with the U.S.S.R.

Deficit of the CMEA countries with the U.S.S.R., created large surpluses in the current account of the U.S.S.R. These surpluses were available to the CMEA countries as defacto grants. Those were available in the form of transferable roubles which are purely book keeping units. In the period 1976-80, these defacto Soviet grants reached a level of nearly 8 billion transferable roubles.

CHAPTER III
FACTORS AFFECTING DEBT AND
IT'S SERVICING

In this chapter I shall take a note of factors influencing debt and debt servicing particularly international interest rates, exchange rate fluctuation; mainly dollar terms of trade and protectionist policies of industrial countries.

3.1 International interest rates

Having studied the burden of interest payments we now take the problem of fluctuations in the interest rates on the international market. LIBOR (London Inter Bank Offer Rate) is considered to be the international rate which is interest rate on the Euro-currency market. Now one may pose a question as to why LIBOR is the international interest rate. It is so because all international lending is connected with the LIBOR; basically variable interest rates loan. As the LIBOR goes up or down interest rates on variable interest rate loans will fluctuate pari-passu with it.

As per Table 3.1 in 1973, LIBOR on U.S. \$ deposits was 9.42 per cent for three months, for six months' lending it was 9.4 per cent. It declined in between 1975 and 1978. It again increased from 1979 to 1981, and started declining from 1982. In 1984 it was 10.94 per cent for three months' lending, for six months' lending it was 11.29 per cent.

Table 3.1 : International Interest Rates

	LIBOR on U.S. \$ deposits (Period averages in % per annum)		
	Three months	Six months	One year
1973	9.42	9.40	-
1974	10.90 (28.1)	10.84 (21.7)	-
1975	6.95 (-18.3)	7.75 (13.0)	-
1976	5.75 (-34.5)	6.12 (-31.3)	-
1977	5.96 (-30.0)	6.29 (-29.4)	-
1978	8.73 (2.6)	9.08 (1.9)	-
1979	11.93 (40.2)	11.90 (33.5)	-
1980	14.07 (65.3)	13.91 (56.1)	-
1981	16.84 (97.9)	16.69 (87.3)	-
1982	13.29 (56.2)	13.60 (52.6)	-
1983	9.71 (14.1)	9.92 (11.3)	-
1984	10.94 (28.5)	11.29 (26.7)	-

(IFS, IMF, Yearbook, 1985 pp. 96)

- 1) Figures in brackets indicate percentage change in international interest rates.
- 2) Minus figures in brackets indicate decrease in the LIBOR.

3.1.1 Inflation and international interest rates

Due to inflation interest rates do not reveal the true picture of the interest rates burden. Firstly, if the inflation rate is higher than the international interest rate then real burden of interest rate (nominal interest rate minus inflation) will be negative. It will be beneficial for a borrower whereas a lender will loose to the extent of negative difference between nominal interest rate and inflation. Secondly, the lender will be benefited if the inflation rate is lower than the rate of interest. When the difference between the nominal interest rate and inflation is positive, then the borrower would be the looser. Thirdly, if the nominal interest rate changes with the inflation rate, and are the same in proportion the real burden will be unaltered.

Regarding the third case Kincaid (1981) has raised a very important point. He says that this case would create important short term effects. When real interest will be unchanged the real loan will be amortised faster because interest payments have increased. The rise in amortization would lead to increase debt service payments. Therefore the ratios such as debt service to exports, interest payments to GDP will show the weakening in the debtor's financial position.

For a given maturity higher inflation rates produce progressively greater real debt service obligations in

real terms and corresponding reduction in more distant future. This will be more clear from the example given in Table 3.2.

Interest payments on fixed interest rate loans (which is assumed to be zero) made prior to sudden increase in inflation are unchanged. Thus in every time period the real value of amortization payments is less than originally anticipated. Therefore, the real value of total amortization payments is less than the initial real value of the loan. A variable interest rate loan, assuming that the nominal interest rate fully incorporates actual inflation, would increase interest payment by 10 per cent. Although the total real debt service is higher than under fixed interest rates and then falls below that level. The new amortization schedule given by the total debt service payments reflects a more rapid rate of amortization since the total repayments have not been altered. This more rapid amortization of the real loan also implies that the average period of loan outstanding is shortened.

However, there is a problem in deciding the international inflation rates. Ideally it should be weighted average of price indices of all countries of the world.

It was earlier argued that upto 1979, real interest rates were negative and thereafter they became positive. Therefore, interest rate burden, in a real sense has been higher in recent years.

Table 3.2 : Effect of inflation on a Loan Time Period

	1	2	3	4	5
<u>No inflation</u>					
Loan outstanding at beginning of period	1,000	800	600	400	200
Amortization schedule	200	200	200	200	200
Interest payments	-	-	-	-	-
Debt service (sum = 1000)	200	200	200	200	200
Average period real loan outstanding (3 periods)					
<u>Inflation (10%)</u>					
Fixed interest rate loan	1,000	800	600	400	200
Amortization schedule	200	200	200	200	200
Interest payments	-	-	-	-	-
Debt service	200	200	200	200	200
Real debt service (sum=758.2)	181.8	165.3	150.3	136.6	124.2
Average period real loan is outstanding (3 periods)					
Variable interest rate loan					
Loans outstanding beginning of period	1,000	800	600	400	200
Amortization schedule	200	200	200	200	200
Interest payments due to erosion of outstanding principal	100	80	60	40	20
Debt service	300	280	260	240	220
Real debt service (sum=1000)	272.7	231.4	195.4	163.9	136.6
Average period real loan is outstanding (2.66 periods)					
Price index	1.1	1.21	1.331	1.464	1.611

Source : (Kincaid, 1981, p. 47)

A supplement to the Table :

- 1) Loan is assumed to be 1,000. Maturing is in five period with equal amortization payments. The real interest rate is assumed to be zero.
- 2) Or indexed bond case.
- 3) A five year loan may be considered as five separate loans for different periods, hence the average period is the sum of these loans weighted by the period during which each is outstanding, that is, $(.2)(1) + (.2)(2) + (.2)(3) + (.2)(4) + (.2)(5) = 3$.
- 4) The nominal interest rate equals the constant inflation rate.
- 5) The method in footnote 3 applied to this case would yield $(.2727)(1) + (.2314)(2) + (.1954)(3) + (.1639)(4) + (.1366)(5) = 2.66$.

3.2

Exchange rates

Exchange rate volatility also affect the debt and debt servicing. In the foreign debts of the LDCs U.S. dollar dominated debt has been significantly higher. The following Table (Table 3.3) gives percentage of dollar-denominated debt and debt service to total long term debt. The table excludes short term transactions. It is estimated that some 70 per cent of LDC short-term assets and some 80 per cent of LDC short term variables are denominated in U.S. dollars.

Appreciation of the U.S. dollar reduces the value of debt contracted before the appreciation period but it increases the debt service value which is to be paid after

Table 3.3 : Percentage of dollar-denominated debt and debt service to total long term debt

	(per cent)			
	Total LDCs		LICs	
	Debt	Debt service	Debt	Debt service
1980	51	56	33	35
1981	55	60	37	39
1982	57	61	37	40
1983	56	56	37	41

Source : External debt of developing countries, 1983 Survey, p. 39; OECD, Paris, 1984)

appreciation takes place. Let us take a hypothetical example for clarifying this point.

	<u>Exchange rate</u> US \$ = Rs.	<u>Amount of debt</u> (in US \$)	<u>Amortization</u>	<u>Interest payments</u>	<u>TDS</u>
1980	1 = 8.00	1,000	-	-	-
1981	1 = 9.00	-	500	100	600
1982	1 = 9.00	-	500	210	710

Assumptions - (1) Rate of interest is 10%. (2) Amortization payment is to be paid in the succeeding two years. (3) Before 1980 the country does not have foreign debt and therefore, debt service.

Had India borrowed in 1981, ~~she~~ she would have paid Rs. 100 more for U.S. \$ 1,000. Due to appreciation

India saved Rs. 100. Debt service burden, with new exchange rate, of two years will be Rs. 11,790. Had exchange rate been Rs. 8 per dollar, the debt service would have been Rs. 11,190.

U.S. dollar is appreciating against almost all developing countries' currencies. Table 3.4 shows the magnitude of appreciation against currencies of some developing countries. Since 1973 to 1979, the U.S. dollar appreciated against Indian rupee by 4.9 per cent. But from 1979 to 1984 this proportion was 39.8 per cent. From 1973 to 1979 against Indonesian Rupiah, the U.S. dollar appreciated by 33.4 per cent but from 1979 to 1984 it appreciated by 64.7 per cent. The U.S. dollar appreciated against South Korean Won by 21.7 per cent during the period 1973 to 1979 and from 1979 to 1984 it appreciated by 70.9 per cent. From 1973 to 1979 the U.S. dollar appreciated against Brazilian Cruzeiro by 359.6 per cent. But from 1979 to 1984 it rapidly appreciated by 6757.2 per cent.

3.3

Terms of trade

The rationale behind measuring terms of trade is that how much a country is paying in terms of exports in order to obtain one unit of imports. Incomes from imports and exports are given in IFS (International Financial Statistics, Year Book, 1985). However, quantity of imports

Table 3.4 : Appreciation of the U.S. dollar, against some of the debtor countries' currencies

Year	Rs. per U.S. \$ India	Rupiah per US \$ Indonesia	Won per US \$ S.Korea	Cruzeiro per US \$ Brazil
1973	7.742	415.00	397.50	6.13
1974	8.102	415.00	484.00	6.79
1975	8.376	415.00	484.00	8.13
1976	8.960	415.00	484.00	10.67
1977	8.739	415.00	484.00	14.14
1978	8.193	442.05	484.00	18.07
1979	8.126	623.06	484.00	26.95
1980	7.863	626.99	659.90	52.71
1981	8.659	631.76	700.50	93.12
1982	9.455	661.42	748.80	179.51
1983	10.099	909.26	795.50	577.04
1984	11.363	1,025.94	827.40	1,848.03

(Source : International Financial Statistics Yearbook, 1985, pp. 203, 345, 349, 393)

- (1) Exchange rates are expressed in domestic currency units per US dollar.
- (2) Exchange rates are market exchange rates and they are period averages.

and exports ^{are} ~~not~~ given. But unit value indexes are given for exports and imports. ~~are given.~~ Therefore, I have converted exports and import incomes in the form of indexes. Imports and exports income indexes divided by unit value indexes of imports and exports will give us quantity indexes, for imports and exports respectively. For indexes base year is 1980.

3.3.1 Net barter terms of trade

This type of terms of trade are defined as price of exports divided by price of imports ($\frac{P_x}{P_m}$). Here it is $\frac{\text{Index of } P_x}{\text{Index of } P_m}$. Net barter TOT (terms of trade) of industrial, oil importing and exporting countries are shown in Table 3.5.

Industrial countries' net barter TOT declined by 11.4 per cent upto 1981. In 1982 and 1983 they improved by 2.1 per cent in each year. In 1984 they declined by 0.2 per cent. Due to rise in oil prices the TOT of oil-exporting countries increased by 129.6 per cent in 1974 and ~~it~~ declined thereafter, but again rose by 36.4 per cent in 1980 due to the second oil price rise. The TOT declined by 9.6 per cent in 1983.

Net barter TOT of non-oil developing countries slumped by 56.4 per cent in 1974, due to mainly oil price rise. In 1978 they improved by 8.9 per cent but declined upto 1983 only to rise by 10.7 per cent in 1984.

Table 3.5 : Net barter terms of trade

Year	Industrial countries		Oil exporting countries		Non-oil developing countries	
1973	1.2243	-	0.2822	-	3.5428	-
1974	1.0846	(-11.4)	0.6480	(129.6)	1.5431	(-56.4)
1975	1.1076	(2.1)	0.6169	(-4.8)	1.6209	(5.0)
1976	1.0906	(-1.5)	0.6537	(6.0)	1.5297	(-5.6)
1977	1.0797	(-1.0)	0.6708	(2.6)	1.4905	(-2.6)
1978	1.1074	(2.5)	0.6156	(-8.2)	1.6244	(8.9)
1979	1.0705	(-3.3)	0.7330	(19.0)	1.3642	(-16.0)
1980	1.0000	(-6.6)	1.0000	(36.4)	1.0000	(-26.7)
1981	0.9856	(-1.4)	1.0850	(8.5)	0.9217	(-2.8)
1982	1.0065	(2.1)	1.0998	(1.36)	0.9092	(-1.3)
1983	1.0274	(2.1)	0.9937	(-9.6)	1.0063	(10.7)
1984	1.0258	(-0.2)	-	-	-	-

Notes : (1) Figures in brackets are percentage changes in TOT.

(2) Minus sign indicated in the brackets indicate deterioration in TOT.

3.3.2 Quantity terms of trade

Quantity terms of trade are quantity of exports divided by quantity of imports ($\frac{Q_x}{Q_m}$). Quantity TOT of industrial countries improved by 6.9 per cent in 1974 but fell by 2.7 per cent in 1984. Oil exporting countries quantity TOT declined by 18.9 per cent in 1974. Those improved by 6.7 per cent in 1983. Quantity TOT of the three groups are shown in Table 3.6.

Table 3.6 : Quantity terms of trade

Year	Industrial countries	Oil exporting countries	Non-oil developing countries
1973	0.8682 -	3.1909 -	0.3016 -
1974	0.9284 (6.9)	2.5865 (-18.9)	0.6246 (107.1)
1975	0.9616 (3.6)	1.5711 (-39.2)	0.5445 (-12.8)
1976	0.9391 (-2.3)	1.4566 (-7.3)	0.6537 (20.0)
1977	0.9526 (1.4)	1.1674 (-19.8)	0.6956 (6.4)
1978	0.9599 (0.7)	1.0851 (-8.5)	0.6106 (-12.2)
1979	0.9498 (-1.1)	1.3056 (20.3)	0.9426 (54.4)
1980	1.0000 (5.3)	1.0000 (-23.4)	1.0000 (-6.1)
1981	1.0520 (5.2)	0.7233 (-27.6)	1.1642 (16.4)
1982	1.0393 (-1.2)	0.5084 (-29.7)	1.1307 (-2.8)
1983	1.0211 (-1.7)	0.5424 (6.7)	1.0993 (-2.8)
1984	0.9932 (-2.7)	-	-

Notes : (1) Figures in brackets are percentage changes in TOT.

(2) Minus sign in brackets indicate deterioration in TOT.

Non-oil developing countries quantity TOT improved by 107.1 per cent in 1974, but declined thereafter. In 1983, quantity TOT declined by 2.8 per cent.

3.3.3 Income terms of trade

Income accrued from exports divided by payments given for the imports are income terms of trade.

$\left(\frac{P_x \cdot q_x}{P_m \cdot q_m}\right)$. Here income TOT are export income index divided by import income index. Income TOT of industrial countries declined by 5.25 per cent in 1974, but improved in 1975 and 1981. In 1984 they fell by 2.5 per cent. Income TOT of oil exporting countries improved by 86.1 per cent in 1974; fell in the successive years; except 1979 and 1980. They fell by 18.1 per cent in 1984. Income TOT of three groups are given in Table 3.7.

Income TOT of non-oil developing countries declined by 10.1 per cent in 1974, but improved subsequently, except in 1979 and 1980. In 1984 the TOT improved by 6.3 per cent.

3.4

Protectionism

An increase in protectionistic policies of the industrial countries had detrimental effects, both on the terms of trade and exports of developing countries. If industrial countries increase barriers to exports from developing countries, either that must be adjusted by the higher depreciation of the exchange rate or much higher level of unemployment. Smaller trade therefore implies higher social costs for the adjustment programmes of developing countries.

In the '80s, imposition of non-tariff barriers (NTB) has become rampant. In between 1980 and 1983 the extent of non-tariff barriers of the U.S. almost doubled. During the same period the extent of the NTBs of the European

Table 3.7 : Income terms of trade

Year	Industrial countries		Oil exporting countries		Non-oil developing countries	
1973	1.0629	-	0.9006	-	1.0687	-
1974	1.0070	(-5.25)	1.6762	(86.1)	0.9611	(+10.1)
1975	1.0651	(5.8)	0.9692	(-42.2)	0.8826	(-8.2)
1976	1.0241	(-3.8)	0.9542	(-1.5)	1.0000	(13.3)
1977	1.0284	(-0.4)	0.7831	(-17.9)	1.0370	(3.7)
1978	1.0630	(3.4)	0.6680	(-14.7)	0.9918	(4.3)
1979	1.0180	(-4.2)	0.9569	(43.2)	1.0274	(3.6)
1980	1.0000	(-1.8)	1.0000	(4.5)	1.0000	(-2.6)
1981	1.0424	(4.2)	0.7847	(-21.5)	0.9662	(-3.4)
1982	1.0460	(0.3)	0.5591	(-28.7)	1.0282	(6.4)
1983	1.0491	(0.3)	0.4577	(-18.1)	1.1063	(7.6)
1984	1.0230	(-2.5)	-	-	1.1761	(6.3)

Notes : (1) Figures in brackets are percentage changes in TOT.

(2) Minus sign in brackets indicate deterioration in TOT.

increased by 38 per cent. The extent of rise in NTBs of industrial countries affects the LDCs more than they affect the developed countries. This is because the primary commodities exports of the developing countries to industrial countries are more than that of industrial countries.

Table 3.8 : Share of imports subject to NTBs in industrial country markets (1983)

Market	Industrial countries	All developing countries	Major borrowers
European countries	10.2	21.8	24.9
Japan	9.3	10.5	9.6
U.S.	7.7	12.9	14.5
All industrial countries	10.5	19.8	21.9

Secondary source : World Development Report 1985

In 1983, 29 per cent of developing countries' agricultural exports to industrial countries were affected by NTBs, the ratio was 18 per cent for manufactured exports. The persistent protectionist measures by industrial countries have produced surpluses in the world market.

The volume of steel imported into the U.S. fell by 3.3 per cent a year in 1971-73 when quotas were imposed. In mid-seventies it grew at an annual rate of 8.3 per cent. Korean exports of foot wear to the U.K. increased by 57.5 per cent a year in real terms in 1973-79 but it fell to 19.1 per cent a year 1979-80 after non-tariff barriers were introduced.

Welfare costs and revenue losses on account of imposition of NTBs are quite high. "Welfare cost is an amount of money that exporters would need to receive to be as well off with protectionism against them in industrial countries as they would be without such measures."

Table 3.9 : Estimated effects of trade barriers on sugar exports (millions U.S. \$, 1980)

Exporter	Annual Average	1983
<u>Welfare costs</u>		
Latin America	670.4	1,111.0
Africa	76.4	130.9
Other developing countries	507.3	886.2
Total :	1,254.4	2,128.1
<u>Loss of export revenue</u>		
Latin America	2,224.2	3,391.0
Africa	269.2	421.0
Other developing countries	2,614.9	3,578.1
Total :	5,108.3	7,391.0

Source : World Development Report, World Bank, 1985.

For developing countries' exporters losses on account of barriers imposed on sugar amounted to almost \$ 7.4 billion, at 1980 prices and exchange rates.

3.5 Repurcussions of excessive borrowings

Excessive external borrowing will tighten the terms of the borrowing. As a country goes in for more external borrowing it has to forgo limited aid, concessional finance and accept commercial debt at higher interest rates and lower maturities. Therefore, excessive borrowing raises interest rates and reduces maturity period.

If the debt servicing, resulted from excessive borrowing, is much more than export earnings then there will be net outflow of resources from the debtor to the lender country. The net outflow would further hamper the growth of domestic output.

The debtor country will be influenced by the interests of the lending countries and international institutions. Therefore, their economic freedom and to some extent social and political freedom too, get adversely influenced.

CHAPTER IV

A REVIEW OF SUGGESTED SOLUTIONS

In this chapter an attempt is made to review the policy measures for easing debt and debt servicing problems. Attention is concentrated on the policies adopted by developing countries, developed countries and public lending institutions. Some of the important policy proposals which are put forward recently are also discussed.

4.1 Developing countries

Developing countries in order to increase exports or reduce imports, go in for either export promotion or import substitution respectively. Secondly they can increase the productivity of foreign debt-financed investment through efficient debt management policies.

4.1.1 Import substitution vs. Export Promotion : A Strategy for the LDCs

Import substitution policy is advocated because it increases productivity of an economy without relying on the foreign trade. For import substitution the market is domestic, leaving no alternatives for domestic products, therefore it is more stable. On the other hand in export promotion the market is the world market and hence the country has to face instability in the exports which is characteristic of the world market. Moreover, import substitution saves foreign exchange which would have been

necessary for importing goods.

The advantage of import substitution lies especially in its first stage. First stage import substitution is comparatively an easier task because it involves the production of non-durable consumer goods. For production of these goods unskilled labour is required, the efficiency of output is small, mainly unsophisticated technology is used. Therefore the first stage serves the purpose of import substitution which is to reduce the strain on foreign exchange and produce goods domestically.

When the country passes from the first to the second stage of import substitution (It goes in for producing capital goods) it becomes difficult for her to reap the advantage of import substitution. This happens because for producing capital goods the country in question should have capital and skill-intensive industries. Economies of scale have a large bearing in the capital-intensive industrialization. Domestic market is relatively small in relation to the minimum size of efficient plant. Besides, comparative advantage can not be exploited because the cost of production of output is higher than the cost of importable output on the world market.

Many a times it is argued that import substitution performs the function of protecting infant industries. The infant industry argument maintains that in order to strengthen the domestic industries and to enable them to

compete on the international market in the future, they are to be protected by means of tariffs, quotas, etc.. But the time which is required for them to become efficient in the cost is a questionable thing. Therefore, inefficiency arises out of protectionism and becomes a permanent phenomenon rather than a temporary one. Quotas, licensing also creates problems of corruption.

As higher costs inhibit, due to subsidised import replacement, imports of raw material, etc.. Therefore import intensity of import substitution becomes high. Therefore foreign exchange constraint aggravates. In many cases negative value added is derived from the import substitution. It is so because of the high effective rates of protectionism which impel large excess of value of domestic resources used over the value of foreign exchange saved.

Export Promotion

From the efficiency view point export promotion is a superior alternative to import substitution. It exploits economies of scale. Exports are competitive in the world market therefore the cost advantage is likely to be accomplished. The world market is large enough therefore constraint of the domestic market does not become an obstacle for the produce of minimum size efficient plants. Thus the dynamic gains from trade can be obtained through economies of scale and learning by doing method.

There are two widely used methods for measuring the efficiency of import substitution and export promotion. They are DRC (Domestic Resource Cost) of import substitution and DRC of export promotion (EP) respectively. DRC of import substitution (IS) is saving a unit of foreign exchange.

$$\text{DRC of saving a dollar by IS} = \frac{\text{Value of domestic factors of production used in increasing domestic output of which was previously imported}}{\text{*The net value of foreign exchange saved}}$$

- * Net value - Reduction in value of final goods imports, less increase in foreign exchange payments need to sustain domestic production.

DRC in export promotion is defined as follows -

$$\text{DRC of earning a dollar through exports} = \frac{\text{Value of domestic factors of production utilised}}{\text{Net earnings of foreign exchange (after deducting costs of imported intermediaries)}}$$

It is observed that once the first stage of import substitution is over, the DRC ratio from exporting some of those products is lower than that involved in further import substitution.

Superiority of export promotion over import substitution can be shown through the effective exchange

rate (EER) analysis. The EER on exports is the units of domestic currency that can be obtained for a dollar's worth of exports (taking into account export duties, subsidies and surcharges). The EER on imports is defined as the units of domestic currency that would be paid for a dollar's worth of imports (taking into account tariffs, surcharges, interests on advanced deposits, etc.) In the import substitution strategy the EER m (on imports) is greater than the EER x (on exports) or ($EER\ x / EER\ m < 1$).

Export promotion also suffers from various drawbacks. Export promotion does not always lead to comparative advantage and ripe economies of scale but it suffers from cost disadvantages. It is primarily because of export subsidies, tax incentives, free public utility services, etc.. It may outweigh the cost of protection arising in the process of import substitution. Then import substitution will be a more efficient strategy.

Many a times the government does not rely on either of the strategies but applies both of them simultaneously. The requirement is that, policies should equate the marginal domestic resource cost of saving foreign exchange with the marginal domestic resource cost of earning foreign exchange. When a country operates export promotion via its diversification, import substitution may have a complementary rôle to it. The inputs used in exports

might be replaced by home production instead of imported inputs.

Good progress of NICs (Newly industrialising countries), especially South Korea, Taiwan, Singapore and Hongkong through export promotion makes an impression that it is the best strategy for the LDCs. But in recent times new export pessimism has grown. The proponents of this view say that an experience of the above-mentioned four countries is a unique one. That can not be repeated in the future in case of other LDC exports. This is so because of the slow rate of growth of output and high protection in the industrial countries. Therefore, there is no scope for the LDCs to increase exports in the near future. Further there is also an argument put forward by Cline () that there is a market saturation in the industrial countries. Intra-industry trade is taking place between industrial countries and LDCs.

The argument of export pessimism has been challenged by the following view. As the export potential of the four Asian countries mentioned above prosper their ladder of comparative advantage moves from labour intensive exports to capital intensive exports. Therefore the other LDC exports can take place of their previous labour intensive products and increase their exports. This has been the experience of the four Asian countries when Japan moved up from labour to capital intensive industries.

The four Asian countries captured the previous Japanese exports such as textile.

A proposal for economic integration through intra-LDC trade is advocated particularly when import substitution and export promotion strategies face a disappointing prospects. But this view does not seem to be correct as the need of the LDCs is primarily of capital-intensive goods which can not be satisfied fully by the semi-industrial LDCs. Therefore intra-LDC trade would merely be limited to exchanging inputs such as mineral resources, primary products, while the question of capital goods imports would remain unsolved.

4.1.2 Debt management programmes

Debt management programmes are essential because they involve discipline in using foreign debt and increase the productivity of investment which is being financed through foreign debt. Many countries attempt to keep their debt service to export ratio below 20 per cent which is roughly considered to be the limit. A country like South Korea decides as to how much to borrow for the public sector and how much for the nation as a whole. Philippines attempts to keep her debt service ratio below 20 per cent.

Philippines has a separate department for this purpose. It is called MEDIAD (Management of External Debt and Investment Accounts Department) and it has a monthly reporting system, all borrowers are to report in

detail on their debts. MEDIAD also suggests guidelines on the uses and terms of foreign borrowings. There is CFBP (Consolidated Foreign Borrowing Programme). The CFBP borrows sums from abroad and then onlends the money to banking institutions to finance development projects or to refinance the existing debts.

Some countries have adopted indirect measures to control foreign borrowing by withholding taxes on indirect payments (i.e., Indonesia, Malaysia and Thailand) or obliging the borrowers to keep a certain portion of the loan in the central bank with zero per cent rate of interest (i.e., Brazil and Chile). Some countries imposed limits on interest rates on private foreign debt. This means that a borrower can borrow from the private lender provided the rate of interest charged by the lender is less than the government indicated interest rate limit. Some countries have imposed a restriction through the limit of maturity structure like interest rate limit in the above case.

Having applied such measures a borrower country will have flexibility which will help her to cope up with future debt problems. Such flexibility increases the credit-worthiness of the borrower. For example, Indonesia can borrow at a lower cost than most countries at similar income because in times of difficulty, in the last ten years, her government has continuously shown willingness to cut spending, raise revenue or devalue the currency.

4.2

Rescheduling, refinancing and debt relief

Rescheduling is either an amendment or replacement of the existing debt repayment schedule by extending the date of repayment, reducing the rate of interest or granting a grace period. Rescheduling is undertaken for making the foreign debt burden more manageable but not for reducing the total debt outstanding. More than 60 reschedulings occurred between 1972 and 1982. Most of them have failed to reestablish creditworthiness of the countries concerned with the help of rescheduling.

Under refinancing the debtor is given a new loan or line of credit in order to continue to meet existing service payments. Debt relief is defined as a reduction ex-post in the present value of debt outstanding. Debt relief intends to firstly, help the creditor country to recover, or safeguard its investment. Secondly, to deter the debtor from getting into similar situation in the future. However, it has failed to fulfil the latter objective. These measures are of very short term nature. Thus they do not help the developing countries to ease their debt problems. These measures merely postpone the maturity.

There are also two measures such as repudiation or debt cancellation. Repudiation is a refusal of the borrowing country to repay the debt. In this case the debtor country would have to face serious repercussions in

the international trade and financial sphere. The debt cancellation is a unilateral decision of the creditor country to cancel the debt obligations of the borrowing countries. But both these measures are very rarely used if at all.

4.3 Developed Countries

We have seen in the last chapter that the protectionism has been growing in the industrial countries. It has a detrimental effect on the LDC exports and on the world trade. There should be preferential or soft cornered treatment for primary, semi-manufactured goods exports of LDCs, as it was indicated in the first UNCTAD Conference (United Nations Conference on Trade and Development) in 1964.

Similarly an increase in demand for exports from developed countries will lead to increase in demand for imports from the developing countries. Therefore the liberalisation of foreign trade, particularly from the side of developed countries, will be a mutually advantageous thing.

4.4 Public Lending Institutions

Public lending institutions have a very crucial role to play because of their longer maturities, lower interest rates and ability to handle lending in more efficient manner (due to their established net-work).

4.4.1 IMF

IMF lending is basically made for meeting short term balance of payments (BOP) difficulties. Earlier the major instrument of lending of the Fund was reserve tranche drawings. They are the excess of a member's quota over the Fund's holdings of the member's currency in the General Resource Account. The reserve tranche purchases are made by a country concerned as per her BOP need.

Further there are credit tranche drawings and standby arrangements. Under credit tranche drawings, credit is available in four tranches. Drawings above 25 per cent and 50 per cent are considered to be first and second tranche drawings respectively. For the drawings above 75 per cent and the last quarter are known as third and fourth tranche drawings. Through a standby arrangement a credit tranche purchase can be made. It gives assurance to a member that as long as performance criteria are fulfilled a country can make drawings upto specified amount without further review of its performance. This arrangement was for a year, it has now been extended for three years.

Due to structural difficulties in the BOP, oil price rise, cost and price distortion, in the international market there was a need for more credit and lengthening the time period in which repayment is done. Therefore facilities such as Extended Fund Facility (EFF), Supple-

mentary Financing Facility (SFF), Compensatory Financing Facility (CFF), Buffer Stock Facility were made available by the IMF. The purpose of these facilities was to help the countries which are suffering from structural distortions or temporary shortfall of exports.

Table 4.1 shows maximum limits on drawing under above-mentioned facilities of the IMF.

Table 4.1 : IMF financial facilities : Limits on drawings

Facility	Maximum drawings	Maximum cumulative drawings
Reserve tranche	25	25
First credit tranche	25	50
Higher credit tranche	75	125
Extended facility	140	190 (a)
Supplementary financing facility	140	330 (b)
Compensatory financing facility	125	455
Buffer stock financing facility	50	505

Source : IMF, "How members use Fund's resources....", IMF Survey, 1982, pp. 6-10

Notes - (a) Drawings under the FFF are additional to those available under the reserve and first credit tranches hence the cumulative progress to only 190 per cent of country quota. In effect, the FFF raises the access of a member to the IMF's high conditionality

resources by only 65 per cent of its quota (190 minus 125).

- (b) In special circumstances, additional amounts may be provided by the IMF and these additional drawings are available under the SFF (enlarged access policy). Present IMF guidelines specify the limit of 150 per cent per annum of a country's quota over a 3 year period subject to a 450 per cent limit on the cumulative use of IMF resources. Even these limits it is said, may be exceeded in exceptional circumstances. Furthermore these limits do not include drawings under the compensatory and buffer stock financing facilities or outstanding drawings under the oil facilities of 1974-1976.

In addition to the above facilities the Fund created three more facilities. The special feature of these facilities is that they are not part of the Fund's general resources but are administered by the Fund as a service to the members. There are three facilities under this heading, viz., Oil Facility Subsidy Account, Supplementary Financing and Trust Fund.

Table 4.2 shows the BOP assistance and reserve tranche drawings of the Fund since 1972 to 1982.

IMF Conditionality

Conditionality refers to the policy actions that the IMF may oblige a borrowing country to agree to as a precondition to its borrowing from the IMF. Borrowing under Compensatory and Buffer Stock Financing Facilities can be categorised as low conditionality assistance. But to acquire loan under the facilities such as higher

**Table 4.2 : Balance of Payments Assistance By, and Reserve Tranche
(in millions of SDRs) Drawings on the Fund**

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<u>Fund policies and facilities (drawings)</u>	1,612	733	4,053	4,658	7,010	3,425	3,744	1,843	3,753	7,082	8,784
Reserve tranche	962	391	966	723	991	80	2,536	147	359	310	1,336
Credit tranche (Ordinary) ¹	1,340	228	1,265	641	1,478	2,895	421	648	855	1,662	1,064
Compensatory Financing (export shortfalls)	299	113	107	239	2,308	241	578	572	980	1,231	2,333
Compensatory Financing (Cereal import excesses)	-	-	-	-	-	-	-	-	-	12	295
Buffer Stock Financing	11	-	-	5	-	-	36	38	-	-	144
Extended Fund Facility (Ordinary)	-	-	-	8	90	209	174	132	339	1,041	1,057
Oil facility	-	-	1,716	3,043	2,143	-	-	-	-	-	-
<u>Supplementary Financing</u>	-	-	-	-	-	-	-	306	1,218	2,040	1,711
Credit tranche	-	-	-	-	-	-	-	205	943	1,469	982
Extended Fund Facility	-	-	-	-	-	-	-	101	275	571	728
Enlarged access policy	-	-	-	-	-	-	-	-	-	787	846
Credit tranche	-	-	-	-	-	-	-	-	-	306	491
Extended facility	-	-	-	-	-	-	-	-	-	481	354
<u>Fund administered facilities</u>	-	-	-	-	-	-	-	-	-	-	-
Oil facility subsidy A/c. (grants)	-	-	-	-	-	-	-	546	1,284	441	54
Trust Fund (loans)	-	-	-	-	-	-	-	19	28	50	9
Supp. Financing	-	-	-	-	-	-	-	527	1,256	368	-
Facility Subsidy Account (grants)	-	-	-	-	-	-	-	-	-	23	44

Source : IMF, Bureau of Statistics

¹ Drawings financed from the Fund's ordinary (i.e., non-borrowed resources).

(upper) tranche extended arrangement needs a borrowing country to make structural adjustment for policy action. Such policies are considered to be high conditionality facilities. In recent years there is a shift of the emphasis from low conditionality to high conditionality. In other words LDCs are getting loans on condition of rigorous structural and policy changes in the economy.

4.4.2 World Bank

The major objective of the World Bank loan is to assist LDCs by giving loan on more long term basis and for the development of infrastructure, industry and agriculture. These loans are given on the project basis, after making the cost-benefit analysis of the projects to the LDCs.

There are two affiliates of the World Bank (IBRD). One is IDA (International Development Agency) and the other is IFC (International Finance Corporation).

IDA

In the '50s it was thought that many LICs (Low Income Countries) have no access to set commercial borrowing and having inadequacy of concessional loans there should be an agency which would provide soft loans to these countries. Therefore IDA was established in 1962. IDA has been the 'soft' loan division of the Bank. IDA loans uniformly bear a service charge of only 0.75 per cent for 50 years and have a grace period of 10 years.

In the period 1961-70 U.S. \$ 2,822 million were lent by the IDA, out of which 23 per cent was given for agriculture and development, 41 per cent was given to basic infrastructure and 23 per cent was given to non-project lending. In the period 1977-82 IDA loan amounted to \$ 26,738 million. Agriculture and rural development accounted for 42 per cent, basic infrastructure's share was 29 per cent and non-project lending's proportion fell to 7 per cent. Industry, other infrastructure and human resource development had a small share.

IFC (International Financial Corporation)

The Bank was interested in lending for the private investments in the LDCs. But the Bank required a government guarantee of the respective LDCs, but the LDC governments hesitated to give it. Therefore the IFC was established in 1956. The major objectives of the IFC were to provide capital for private enterprises encouraging the development of local markets and promoting foreign private investment in developing countries. It does not require a government guarantee but functions like any other investment bank. It can participate directly in private ventures, providing upto 25 per cent of the capital. Like any other investment bank, its criteria for lending include the financial soundness of the project. However, it's share is very minor. In 1957, her initial capital was under \$ 100 million. In

the next five years about \$ 20 million a year was the average investment. It rose sharply in 1976, by having net disbursements worth \$ 193 million and \$ 198 in 1977. Nevertheless, it is low as compared to the other sources debt to the LDCs.

In 1980, the Bank introduced SAL (Structural Adjustment Lending) and SAP (Special Action Programme) introduced in 1983. The purpose of the SAL, unlike usual project loan of the Bank, is to help the countries which have severe difficulties and further want to reform their policies. It provides foreign exchange to help meet the transactional costs of restructuring and policy reforms. It is designed for five or more years. By June 1984, twentynine loans totaling \$ 4.5 billion had been made in support of policy reforms in 16 countries.

4.4.3 New vs. Old Institutions

There is a proposal for building an altogether new institution to increase the flow of concessionary finance to the LDCs. The OPEC countries have proposed the formation of a Third World Development Agency. This will be funded by the OPEC countries like the World Bank and IMF, it will not be influenced by the developed countries. However, being a lender group the OPEC countries will have such influence.

The Brandt Commission (1981) recommended a new institution, the World Development Fund. The aim of the institution is to bridge the gap between the long term project financing available from such institutions as the World Bank and the short term adjustment finance available from the IMF. This would have universal membership and would offer an opportunity for developing and developed countries to cooperate on the basis of more equal partnership. The thrust^{of} the new institution will be on the programme lending, basically to increase trade among LDCs, to undertake exploration of minerals, etc.. The World Development Fund ~~should~~ is to be financed by Government contribution rather than from private institutions. Therefore the success of the World Development Fund will depend on the contributions of OPEC and developed countries.

There is one more view which states that instead of opening new public institutions, widening of old institutions is the better way out. Joshi (1982) has stressed this point. He maintains that the existing institutions have built us a stock of relevant expertise. Generally arguments raised against the existing institutions are that they are influenced by developed countries and impose high conditionality. Nevertheless, new institutions will have to be funded by developed countries. But the developed countries will not allow the institution

to impose low conditionality measures. Improvements in the structure of the existing institutions and softening the conditionality will go a long way in meeting the needs of the LDCs.

Then there is what is known as the link proposal for the SDR (Special Drawing Rights). SDR is, at present, used for BOP purposes but not for development finance. The rationale behind the link proposal is to link the issue of SDRs with development assistance. One method would be to distribute a larger share of SDRs to developing countries than their quota share. Second method would be the issue of SDRs to international and regional development banks and institutions. There would be a policy through which SDR should be substituted for international liquidity in the form of reserve currencies, and it should be distributed according to number of inhabitants in various countries.

Yet another proposal aims at reducing interest rates by offering interest subsidy. It would bridge the gap between the market rates charged by the private banks and rates which developing countries afford to pay. This subsidy will be paid out of the funds of the public institutions or by newly created institutions. There is another proposal to reduce interest rate risk and that is indexation of interest rate. This would keep a real interest rate constant around 1 per cent irrespective of nominal interest rate changes.

CHAPTER V

SUMMARY AND CONCLUSIONS

The problems of debt and its service, as we have seen, depend upon how far an underdeveloped country efficiently uses the foreign debt, increases her growth rate and repays her debt and its servicing. As the two-gap theory, debt-cum-growth model argue, is it possible for LDCs to achieve self-sustained growth through debt? Apart from the exception of four South-East Asian countries (i.e., Taiwan, Singapore, South Korea and Hongkong), no other LDC has made a durable progress through debt.

As Bauer and Yamey (1982) put the condition of LDCs in this context - "The concept of Third World and the policy of official aid are inseparable. Without foreign aid there is no Third World. Official aid provides the only bond joining together its diverse and often antagonistic constituents. This has been so ever since practically all of Asia, Africa and Latin America came to be lumped together in the late 1940s, as the underdeveloped world and thereafter known successively as the less developed world, the non-aligned world and now the South. These expressions never made sense except in that they denoted a collectively of aid receivers (Bauer and Yamey, 1982, quoted in Meier, 1984, pp. 293-294, Fourth edition).

Major borrowers have borrowed heavily from commercial sources therefore their debt service is higher. Some of these countries, such as Argentina, Brazil, Mexico are to curb their imports in order to reduce debt burden. Foreign debt has become a serious problem for these economies rather than accomplishing means of self-reliance. Low income countries borrowed mainly from public and publicly guaranteed sources. Therefore their debt service, mainly interest payments, are lower. Their average maturity structure is also longer than that of major borrowing countries. But even then they are far behind the objective of self-reliance because of their weak institutional structure, larger primary exportable and unsatisfactory growth performance.

After studying the difficulties faced by the LDCs due to foreign debt, one should not go to the extent of saying that debt is utmost a problem creating factor for the LDCs. The burden of foreign debt will depend on the borrowing, country's growth performance, her trade dependence, effective use of the policies in the foreign trade sector, i.e., import substitution and export promotion; her ability to adjust with the world market. It also depends on the source from which the country has borrowed, i.e., from international public lending institutions or private lenders. It also depends on debt management programmes for effectively utilising the debt.

Taking into account the problems faced by developing countries and their capacity to improve growth performance, it is clear that LDCs should get loans on concessional terms, i.e., with lower rates of interest and longer maturities.

If we look at the availability of the funds with international financial institutions we will realise that such funds are small in relation to the needs of LDCs. The funds at the disposal of such institutions are meagre and there is little prospect for these funds to expand appreciably. It is therefore necessary to supplement these funds with borrowings from the private lenders and developed countries. Private lending, especially bank lending can be increased through interest subsidy schemes which would be adopted by the international financial institutions.

Developed countries can increase the funds through increasing their contribution to the ODA (Official Development Agency) which is at present targeted to be 1 per cent of their GNPs. Secondly, developed countries will help LDCs through extending the facilities in the international financial institutions, i.e., by adopting the link proposal. Thirdly, developed countries can help developing countries in increasing their trade performance and in turn will reduce the dependence on

foreign debt. Developed countries can do so by reducing the tariff barriers and quantitative restrictions, by giving preferential treatment to LDCs, reducing the element of tied aid, giving import subsidies.

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