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ASIAN DEBT SCENARIOS FOR THE 1990s*

Abstract

This paper reviews the external debt situation for the Asian LDCs; one hypothesis advanced here is that the ultimate origin of these external debts can be seen in the 'modus operandi' of international capital markets. Hence the need arises for intensification of economic cooperation among the debtor countries. Focus here is on the outstanding features of the debt problem and an attempt is also made to identify all these structural components and other variables affecting future scenarios and alternatives open to the LDCs in the 1990s.

Introduction

This paper reviews the external debt situation in the Asian developing countries at the end of 1989. Some of the main alternatives, with which LDCs (Less Developed Countries) will be confronted, are also reviewed. Besides the urgent need to strive for changes in the external environment in which debt negotiations are conducted, it is also important that LDCs restructure their external economic policies. Moreover, it is also postulated in this paper that the ultimate origin of the external debt problem facing LDCs is to be found in the *modus operandi* of the international capital market. Hence the need arises for intensification of economic cooperation among the debtor countries and the launching of a new phase of import substitution along with export promotion.

There are two sources of external debt data for LDCs, the World Bank and the OECD. The OECD reports debts of 155 LDCs and the World Bank for 108 LDCs. Moreover, the OECD captures more of the private non-guaranteed debt and short-term debt than the World Bank.

External debts of LDCs passed the one trillion US $ mark in 1985. OECD data showed that external debts increased from $ 946 billion at the end of 1984 to $ 1054 billion at the end of 1985. This debt was equivalent to 48 per cent of the LDCs' combined annual output of goods and services. Hence, it is obvious that the way in which countries of the region tackle their current difficulties will determine their performance in what remains of the present decade.

Here the main focus is on the outstanding features of the debt problem, along with those aspects that may prove future constraints. Also, an attempt is made to identify

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all these structural components and the variables affecting the future evolution, along with the alternatives open to LDCs.

Origin of the Crisis

Looking back, we find, that world financial markets began to operate and to mature in the 1960s, after three decades of recess. Then, in the 1970s, LDCs in general and Latin America countries in particular were able to secure an increasing share in a rapidly growing market, which created a situation unheard of in the postwar decades.

There has been somewhat different experience among the low-income countries in Asia and Africa. Some low-income countries had worsening debt service ratios, e.g., Burma and Pakistan. But for low-income Asia as a whole the situation is not critical, since most of the debt is in the form of concessional long-term credits such as IDA loans. But on the other hand, low-income African countries saw their total external debt, measured as a proportion of export earnings, increase from about 90 per cent in 1974 — 75 to almost 250 per cent in 1988. Hence, there was a five-fold increase in the total debt over the last decade and a trebling in overall debt service ratios.

According to the IMF over 40 low-income LDCs have a combined debt of $ 88 billion, just over one-eighth of all LDCs debt. About 80 per cent of this is official, owed to governments of industrial countries and multilateral institutions, arising from past official development assistance (ODA) and guaranteed export credits.

Moreover, during the years 1972 — 80 LDCs' bank debt expanded at an average annual rate of 30 per cent, two-thirds of which can be explained by global growth of international financial markets. The remaining one-third was the gradual increase in the participation of LDCs in the World Financial markets.[1]

The experience of this decade was characterised by several features: the growth of international markets, a growing share of LDCs and low 'real' interest rates. The increase in the global dimensions of the market and fuller participation of LDCs involved large annual flows.

Since the early 1980s, however, a 'reverse' resource transfer has been a significant element in the global scene, with 'net' financial flows from the debtor countries running at over $ 24 billion a year according to the IMF and the World Bank. Hence, there is an urgent need now to put the issues of debt and adjustment in the broader context of the direction and scale of resource flows between the developed countries and LDCs. Also, there is an urgent need that a growing ratio of foreign-financed investment to GDP should be accompanied by a growing export/GDP ratio. This statement emphasises that the 'new' investment financed by capital inflows should be export oriented.

The 1980s: Protracted Debt Crisis

Already the Pearson Commission had recommended that aid giving countries should consider debt relief as a legitimate form of aid and that the terms of all aid loans should be softened.[2]

Since 1975 there has been a sharp decline in the economic growth of most LDCs due to rises in the prices of investment goods, imports of oil and fertilizers. The rising 'real' costs of inflation and diminishing returns of investments in various sectors of the world economy during the 1980s made the task of capital formation much more difficult. The problems of LDCs really started with the forced transfer of resources away from them, following two oil price increases, along with a persistent decline in their terms of trade.

Until 1975 — 76 external financing for LDCs was largely provided through non-debt creating flows from official sources and long-term capital investments from private sources. But after the four-fold rise in oil prices private markets made it possible for industrial countries to meet higher oil prices without the strong recession that had been feared for a long time, and to bridge huge current account deficits. In the case of LDCs, however, increasing poverty caused by belt-tightening and net transfers of about US $ 80 billion between 1982 — 84 from Latin America are finally but two sides of the same coin.[3]

The Third World's plight was also underlined by GATT. The combined trade surplus of sixteen heavily indebted countries increased, e.g., in 1985 to about US $ 29 billion. This was achieved with increased export earnings and reduced imports.[4] A similar conclusion was drawn by the World Bank reporting that countries heavily dependent on foreign trade are therefore very vulnerable to sequestration orders and to a cut of trade relations. Thus they are unlikely to choose to jeopardise their future by defaulting.[5]

The net flow of funds from LDCs to the developed countries and debt servicing charges during the 1980s are shown in the table below:

Table: Public and private long-term debt and financial flows
All developing countries (109)
(US $ billions)

	1980	1981	1982	1983	1984	1986	1988
1. Debt disbursed and outstanding	492.6	493.6	551.2	630.2	673.4	730.9	775.0
2. Disbursements (from private creditors)	102.8	122.8	115.8	96.5	88.3	81.7	72.0
3. Debt service charges	74.2	87.6	97.4	90.8	99.0	108.0	101.0
(i) Principal repayments	42.0	46.5	48.8	44.0	46.3	53.5	51.0
(ii) Interest	32.2	41.1	48.6	46.8	52.7	54.5	50.0
4. Net transfers	18.7	22.7	6.4	2.7	-10.7	-26.3	-29.0

Source: IBRD, World Debt Tables: 1988 — 89 Edition.

Trends in Resource Flows

Due to heavy borrowings of non-oil LDCs over several years their aggregate debt rose from $ 288 billion in 1978 to an estimated $ 445 billion or $ 570 billion in 1985, depending on whether one follows the World Bank or the OECD. During the 1970s a major portion of the balance of payments surpluses of developed countries such as Japan were absorbed by LDCs. During the same period the current account (savings) surplus of industrial countries was around 0.07 — 1 per cent of their GNP, but the current account deficit of LDCs together was about 2.0 — 2.5 per cent of their combined GNP.

The share of ODA loans for middle-income countries and South Asian NICs dropped sharply between 1971 and 1985, from 45 to 22 per cent and from 16 to 3 per cent respectively. Since the early 1970s the banking sector emerged as a major source of capital and was a major cause of the debt crisis of LDCs later on. By 1973 the share of ODA in total resource flows to LDCs declined to about one-third. The DAC countries gradually became less important as suppliers of official development assistance.

Resource flows to LDCs touched a new high of $ 107 billion in 1981. The growth in the volume of resource flows during the decade ending 1985 was 85 per cent. This decade also saw a significant change in the composition of aid. The share of ODA in total resource flows declined to about 28 per cent but the share of DAC countries in total ODA was steady around 55 per cent. The OPEC countries also became an important source of ODA, but their lending was reduced from $ 8.5 billion in 1975 to $ 4.5 billion in 1985.

The share of ODA debts in total debt of non-oil LDCs declined from two-fifths in 1971 to less than 25 per cent during 1985. The share of export credits declined from 33 per cent in 1971 to 21 per cent in 1975 also, and remained stable since then. But non-concessional multilateral debt has had a constant 7 per cent share since 1975.

There was a sharp increase in non-concessional flows to $ 82.5 billion in 1985, of which private flows took a major share. While direct investment declined to $ 7.8 billion from its peak of $ 16.5 billion in 1975, the flows from the banking sector were largest at a sum of $ 54 billion, amounting to about half of total resource flows. About $ 19 billion of this sum was for rescheduled short-term debts.

In 1984, total resource flows to LDCs from all sources (grants, debt creating flows and equity as measured by the DAC of OECD) amounted to $ 92 billion (at 1983 exchange rates). This was $ 26 billion below the preceding year and also lower than in any year since 1980. In 1984 a decline in private flows occurred ($ 2.8 billion) and was marginally compensated by growth of official flows of ODA on concessional terms of $ 36 billion and non-concessional official and officially supported flows of $ 28 billion. This total was really under the level of 1980. The decline and stagnation of private lending and investment in the 1980s have not been offset by an increase in official flows.[6]

DAC data do not indicate 'net' transfers which are obtained by deducting outflows caused by debts and investments from the DAC's resource flow figures.

In the case of the LDCs of the ESCAP region — India, Pakistan, Bangladesh, Nepal, Afghanistan, Burma, Sri Lanka, and Indo-China — total debt service payments grew sharply from $ 46 billion in 1978 to $ 100 billion in 1985. Naturally, the debt service burden measured as a share of export earnings differs among groups of LDCs due to different structures of their debts and varying export trends. While interest payments formed a lower proportion of debt service payments for low-income countries due to their ODA debts, total debt service payments have nevertheless

exceeded 25 per cent in several cases due to weak export trends. But for faster growth of middle income countries, exports have accounted for their lower debt service ratio.

One consequence of the rise in debt-service payments has been a decline in 'net' transfers to poor countries since 1980. The total net transfers to low income Africa, which had reached a peak of $ 2.7 billion in 1980 in nominal terms, declined to $ 1.1 billion in 1983. The net transfers to low-income Asia also declined since 1980, though not as sharply as to Africa. In Africa 16 countries showed 'negative' transfers during the period 1971 — 81 and official grants to low-income Africa also declined since 1980.

The continuous upward trend in oil prices in 1978 — 79 complicated the balance of payments deficits of developed countries further. Resource flows to LDCs peaked at $ 107 billion in 1981. With the decline of other sources of finance there has been growing reliance on short-term debts in the case of countries having huge arrears on revolving credits to commercial banks and on import bills from foreign suppliers. One consequence has been that fresh trade credit has dried up for many countries.

This rapid increase of short-term debt was partly caused by borrowers seeking to avoid higher spreads on medium and long-term loans, but also by increasing reluctance of banks to extend other loans to some borrowers. For several sub-Saharan African countries short-term debts and trade arrears reached a quarter of total debt outstanding and in some cases — e.g. Tanzania and Zambia — they equalled annual export earnings.

Another significant development was growing assistance from multilateral development banks, e.g., the World Bank and the Asian Development Bank. The aid provided by multilateral development banks increased from $ 2.4 billion in 1973 to $ 9 billion in 1985.

Some Asian countries (India, Pakistan, Bangladesh) carried out debt renegotiations under the umbrella of aid consortia. Debt relief was linked to new aid in the context of general commitments by donors and has helped to keep South Asia free from debt servicing problems for quite some time.

While the principle that debt relief should be treated as a legitimate form of aid was endorsed by the Report of the Pearson Commission in 1969, later experience showed that the case-by-case approach applied to several poor countries lacked the coordinated framework of an aid consortium. While LDCs insisted on 'generalised' debt relief this demand was widely resisted. A compromise agreement was reached in 1978 (UNCTAD Resolution 165), under which donors agreed to adjust terms of bilateral ODA retroactively as a means of improving net flows. Since this resolution is not binding, the USA have not implemented RTA (Retroactive Terms Adjustment). Other donors applied RTA to various degrees.

Continuing Growth of Debt in the 1980s

The external debt of LDCs continued to increase through 1985 — 89, inspite of the suspension of 'net' bank lending to LDCs in Latin America, Africa and Asia since 1982. The combination of high interest rates and falling export prices, however, made the debt crisis of the 1980s so complicated indeed.

The total resource flows to LDCs (at 1984 exchange rates and prices) continued to decline during the last three years up to 1989, due to a sharp decline in bank lending from $ 49.6 billion in 1981 to $ 13.5 billion in 1989. Bank lending has declined further during 1988 and 1989 and total resource flows to LDCs fell by 15 per cent in real terms.

After declining in 1982 ODA increased to $ 36 billion in 1985. Its share in total resource flows increased to about 46 per cent.

During the period 1975 — 80 an average of 78 per cent of all 'net' resource receipts by LDCs came from DAC member countries, while another 14 per cent came from multilateral agencies financed by DAC member countries. Past trends of resource flows showed ODA as more dependable, although some countries did not bother to implement the UN Development Decade target of 1961, i.e. that the developed countries should provide one per cent of their GNPs as net resource flows to LDCs. The target for their ODA performance was placed at 0.7 per cent of GNP.

So far only Denmark, the Netherlands, Norway, and Sweden achieved the ODA target of 0.7 per cent, while other countries, such as Canada, Finland, France and Italy accepted the ODA target of 0.7 per cent of GNP. But recent data show a trend towards a decline in the share of ODA and an increasing share of non-concessional flows. Bank lending, private export credits and direct investment flows are important non-concessional sources. On average only about one-fifth of ODA and one-twelfth of non-concessional flows were channelled through multilateral agencies during 1980 — 88: over the same period multilateral resources formed about 15 per cent of all resource flows. There has been an increase of one percentage point in the multilateral share in total ODA resources since 1974. This was partly due tu OPEC's contribution to multilateral resources which were at a zero level before 1974. Looking at the distribution of components of resource flows by income groups, about one-third of total resource flows went to NICs (defined as South Korea, Taiwan, Singapore, Hong Kong, Brazil, Chile), another third to middle income LDCs and one-fourth to low-income countries. Non-concessional flows mostly went to NICs (59 per cent) and to the middle-income countries (28 per cent). The low-income countries received only 3 per cent of bank credits and 6 per cent of private investment flows.

While the developing ESCAP countries received 19 per cent of total net resource disbursements to all LDCs in 1980, the Asian LDCs' share in bilateral DAC resources averaged 18 per cent. Moreover, the value of total net resource flows to all LDCs increased by 65 per cent between 1980 — 85; DAC disbursements increased by 76 per cent and multilateral flows by 90 per cent over the same period.

The average rate of growth for the ESCAP region has been strongly influenced by disbursements of multilateral resources to South Asia — i.e. India, Pakistan, Bangladesh, Nepal, Burma, Sri Lanka — since 1980. This trend partly reflects large IMF borrowings by South Asian countries, along with IMF Trust Fund facilities.

Since the early 1980s, several countries in Asia continued to borrow on a significant scale to supplement domestic resources. This group includes: Indonesia (debt of $ 36 billion at the end of 1985), India ($ 35 billion), Egypt (36 billion), Malaysia (20 billion) and Thailand ($ 18 billion).

Moreover, debts of countries with large existing debts ('old' debtors) also continued to grow, though most of them were making massive foreign debt service payments.

The combined debt of six old debtors, Argentina, Brazil, Chile, Mexico, Nigeria and South Korea, rose, e.g., from $ 291 billion in 1982 to $ 337 in 1986 or sixteen per cent. The debt growth resulted from a "de facto" partial capitalization of interest.[7]

During the years 1985 — 89 the rising volume of 'reverse' resource flows from LDCs in general, caused by debt service payments also assumed frightening proportions. In the case of East Asia and the Pacific 'net' transfers amounted to 64 per cent of gross disbursement in 1980, but only to 39 per cent of gross disbursement in 1985.

For the period 1985 — 89, however, the ratio of net transfer to gross disbursements was more favourable to South Asia as compared to East Asia and the Pacific due to a larger element of concessionality in resource flows to South Asia, lower average rates of interest, larger average grace and maturity periods and higher grant elements in total resources.

During the four years 1984 — 88 financial transfers from capital-importing LDCs amounted to $ 48 billion, while their total debt increased by $ 181 billion. This is an absolutely impossible state of affairs for LDCs. Recently the growing resource limitation of multilateral agencies *vis-à-vis* increasing needs of poor countries has been a major concern. The multilateral institutions show a stronger concentration on the low income countries than bilateral donors of concessional resources, because the eligibility for multilateral funds is largely determined by income criteria.

In the ESCAP region South Asia continues to receive a relatively large share of ODA flows. It received 18 per cent of all ODA flows. The ESCAP region's average share was 28 per cent of all ODA flows during 1976 — 80. The share of LDCs in the ESCAP region in annual flows from DAC countries declined. It was 34.5 per cent in 1976, falling to 28 per cent in 1980 and 23 per cent in 1988. Several countries in the region are not classified as low-income countries now and do not qualify for concessional assistance, e.g. IDA soft-term credits. Indonesia recently stopped drawing upon IDA credits, following the earlier example of Thailand.

This tendency to decline of total ODA flows is disturbing for low-income countries of the region. China's entry into the distribution of resources increases the weight of the ESCAP region.

In Asia countries such as Burma, the Philippines, the Republic of Korea, Malaysia and Indonesia had debt/GNP ratios as high as 76, 74, 57, 55 and 42 respectively when India's was merely 19. Debt-service ratios of 55 for Burma or 38 for the Philippines were, e.g., beyond India's 28. What is urgently required is to keep the debt-service ratio within prudent limits, a limit which was crossed in India's case already.

Unfortunately, India's debt-service ratio, which was about 7.7 per cent in the beginning of the 80s, shot up to 11.2 per cent in 1984 and crossed the prudent limit of 25 per cent in 1989. Taking the IMF loan repayment into account the ratio reached 28.5 per cent in 1989. The 30 per cent line was finally crossed during the same year when instalment of $ 1.1 billion of the IMF loan fell due.

The Debt Situation of Asian LDCs

For most LDCs in the region an improvement in international economic conditions, even if sustained, will not resolve the urgent problem of how to clear up the debris left over from the period of international financial crisis, which now may be receding. The latest forecasts suggest that in most of the countries of Africa, South Asia and Latin America, the per capita income will continue to decline or at best stagnate.

Almost all LDCs (low or middle-income) face a growing financing gap over the next decade. Even in China and India, which followed a more self-reliant strategy, additional external capital would help further economic liberalization and higher growth.

According to OECD data external debts of Asian LDCs increased by 15.5 per cent in 1988, which is much more than in 1984 (9.8 per cent) and 1985 (11.7 per cent). The sharp fall of the US dollar against most currencies must be mentioned, which affected external debts outstanding and also debt service payments. While the size of this impact depends on the currency composition of debt outstanding, the share of US dollar debt in total long-term debt of Asian LDCs was 55 per cent and those of yen debt and DM debt were 16 per cent and 5 per cent respectively.

The external public debt outstanding of Asian LDCs increased by 8 per cent in 1985 and 7 per cent in 1988 due to the depreciation of the US currency. There were several changes in the external debt structure of Asian LDCs. The share of short-term debt decreased from 21 per cent in 1980 to 14 per cent in 1988. The NICs, followed by South-East Asian countries, reduced their share of short-term liabilities, but the share of short-term debt in the NICs' total debt still stood at 24 per cent in 1988, compared with 18 per cent for South-East Asia and only 5 per cent for South Asia. The share of IMF credits also increased, mostly due to a significant increase in South Asia's use of IMF credit from 4 per cent in 1985 to 10 per cent in 1988.

China and India really were development successes of the 1980s, unburdened by extensive debt and less adversely affected by the external environment than other LDCs. Their per capita growth rates also accelerated during the period 1980 — 88. India's economic position has, however, dramatically worsened in the more recent past.

In 1986 the UN estimated financing requirements for the large Asian countries — India and China — of the order of $ 10 to 15 billion in 1990 and about $ 20 billion in 1995. Even on the assumption that these countries will absorb one-third of the projected total official bilateral and multilateral lending, their need for private finance is pronounced. It must be asked whether even they will find the changed capital markets of the 1990s helpful?[8]

To assume that the gap will be filled by private finance may be too hazardous, because the potential costs of variable interest rates may prove staggering. Also, we cannot disregard the vulnerability of medium-term financing of development projects with long pay-off periods.

The external debt situation of Asian LDCs, assessed by various external debt indicators, worsened during the period 1985 — 89 as both external debt outstanding and debt-service payments increased significantly. But export earnings and GNP in US dollars declined.

According to OECD data the ratio of debt outstanding to GNP increased from 26 per cent in 1984 to 34 in 1988. The ratio of debt outstanding to exports jumped from 124 per cent to 185 per cent during the same period. According to World Bank data the debt service ratio increased from 11 per cent to 18 per cent and interest-service ratio shot up from 8 per cent to 12 per cent. Still, these ratios are below the average of all LDCs. A declining trend in 'net' transfers since 1986 has been a matter of concern. The net transfers to Asian LDCs from long-term external debt continued to decline from a high of $ 18 billion in 1982 to $ 9 billion in 1983, $ 6.5 billion in 1984 and $ 2.2 billion in 1988. Loan disbursements have increased in nominal terms over the same period, but debt-service payments shot up vigorously, reducing the size of 'net' transfers.

South-East Asia (Indonesia, Malaysia, the Philippines, Singapore) was the most affected group with net transfers declining from $ 3.8 billion in 1981 to 'negative' net transfers in 1988, debt-service actually exceeding debt disbursement by $ 0.5 billion each in Indonesia and Malaysia. The Philippines had negligible net transfers. South-Asian LDCs (except Pakistan), by contrast, continued to have positive net transfers. India's net transfers increased by 50 per cent to over $ 1.5 billion in 1985.

One silver lining in the debt situation of LDCs can be found in the 'average' terms of new loan commitments in the second half of the 1980s. The average interest rate for new commitments to all Asian LDCs fell from 7.9 per cent in 1984 to 7.4 per cent in 1988 and the average grace period increased from 5.9 years to 7.5 years. Some Asian LDCs, which could borrow a significant portion of their debt at concessional terms, could secure a comparatively advantageous position.

The developed countries completely ignored the recommendations of the Brandt Commission for a massive increase in resource transfers to LDCs,[9] and the link between aid transfers and developed country export growth was also dismissed as too simplistic.

Since 1987 — 88 most LDCs have relied heavily on private sources. This is clearly unacceptable, since these LDCs require more access to official financing. Hence there is a need to raise the level of concessional financing during the 1990s.

NOTES

1 See here: Commonwealth Secretariat, *The Debt Crisis and World Economy*, London, 1984.
2 Lester B. Pearson, et.al., *Partners in Development*, Praeger, New York, 1969, p. 164.
3 See here, Oswaldo Sunkel, *Latin America and International Economy*, 1985, p. 17.
4 GATT, *International Trade 1985 — 86*, Geneva.
5 World Bank, *World Development Report*, 1985, p. 92.
6 OECD, DAC *1985 Report*, Paris, Nov. 1985, p. 162.
7 See here, D. Avramovic, "Developing Country debts in the mid 1980s", in Hans Singer, N. Hatti and R. Tandon (eds.), *Resource Transfer and Debt Trap*, 1987, Ashish, New Delhi, p. 856.
8 See here UN, *Development Finance: Meeting a Global Challenge*, New York, 1986.
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