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FOREIGN DEBT: IMPLICATIONS FOR CREDITOR AND DEBTOR COUNTRIES OF WESTERN ASIA*

Note by the Executive Secretary

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* This paper draws on ESCWA document E/ESCWA/DPD/85/12 entitled "External debt: implications for debtor and creditor countries of Western Asia".

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INTRODUCTION

The total foreign debt of developing countries has been accumulating continuously throughout the 1970s and 1980s and recently reached an alarming level. The size of the medium-term and long-term (MLT) external debt carried by all developing countries reporting under the World Bank's Debtor Reporting System (DRS) escalated from $US 75 billion in 1970 to $US 575 billion at the end of 1983. Including non-reporting countries, short-term debts and IMF credits, total liabilities of all developing countries were far higher - about $US 810 billion at the end of the same year (1983).

The huge increase in foreign debt, coupled with the sharp rise in interest rates, have caused a large upsurge in the debt service obligations of debtor economies. For all developing countries reporting under the World Bank's DRS, debt service payments continued to rise reaching an estimated $US 96 billion in 1983 compared to less than $US 20 billion in 1973.

The dramatic accumulation of the external debt and the sharply increasing debt service obligations have put many developing debtor countries in an extremely difficult situation in recent years.

The chain of causation which precipitated the debt crisis had evolved under a complex set of cause and effects. Some of the causes were in operation long before the eruption of the crisis. Among these earlier causes were factors related to the nature of the international monetary system and its inherent inflationary tendency, which increased considerably after the event of ending the gold-convertible dollar in 1971, and the increase in international liquidity, as was represented then by the accumulation of the Eurodollars in the largely unregulated Euromarket. These factors were mainly responsible for creating the substantial waves of inflationary pressure experienced in the early 1970s, and thus, prepared the stage for further causes. These additional factors include:

1. "Stagflation" in the industrial market economy nations led to a decline in aid to and imports from developing countries. Meanwhile, the prices of exports of industrial countries continued to increase due to inflationary pressures, thus resulting in deterioration in the terms of trade for most developing countries;

2. The sharp increase in the price of oil imports, resulting from decisions taken by the Organization of Petroleum Exporting Countries (OPEC) first in 1973-1974 and subsequently in 1979;

3. Active role played by commercial banks in lending huge amounts of Euro-and Petrodollars to developing countries, especially those experiencing large rates of economic growth;

4. The changes in the lending behaviour of commercial banks, which alternated between excessive lending and retrenchment;

5. The sharp changes in the terms of borrowing toward higher (floating) interest rates and shorter maturities.

Among the countries involved in the present crisis of international indebtedness are members of the United Nations Economic and Social Commission for Western Asia (ESCWA). Some of these countries have a capital-surplus and thus can be considered creditor countries, whereas others can be designated as debtor countries.

This report examines the position of the ESCWA member countries in connection with the current international debt crisis. Its main purpose is to identify and assess the implications of foreign debt problems on the external position of both the debtor and creditor countries of the ESCWA region and, ultimately, to consider policy measures contributing to an equitable solution of the issue at the regional and global levels.

It ought to be noted that in relation to the debtor countries, this report is concerned only with their medium and long-term (MLT) debts. Short-term debts, which are of one-year or shorter duration are not included.

A. ESCWA debtor countries

The ESCWA member group of debtor countries, taken collectively, have experienced a rather fast growing external indebtedness, during the 1970s and the early 1980s. The absolute magnitude of these countries total debt has increased quite substantially from about $US 3.2 billion in 1973 to about $US 22.3 billion in 1982.

As a consequence, the total debt service paid annually by these debtor countries has likewise increased more than fourfold, from about $US 0.6 billion in 1973 to more than $US 2.7 billion in 1982. Increase in interest payments was more pronounced in percentage terms (almost 750 per cent) from about $US 72 million in 1973 to $US 614 million in 1982.

The growing debt size, carried by the ESCWA-debtor countries since the early 1970s is indicative of the widening gap between their export earnings and the amount of foreign-exchange resources required to enable them to meet their external obligations. For the majority of these countries, the gap has mostly been due to a large, and often increasing, deficit in their trade balances.

The major factors contributing to this accumulation of foreign debt carried by the ESCWA debtor countries, and by other developing debtor economies, are as follows:

1. The prices of imports of these countries have increased to very high levels as a result of the inflation in the prices of manufactured goods, oil, and food stuffs. This price rise is responsible for most of the expansion of the value of imports, experienced by the debtor countries;

2. The prices of exports of these debtor countries, other than petroleum have declined to a very low level due to a worldwide fall in the prices of primary commodities;

3. The external demand for the exports of these debtor countries has been stagnating, due to the state of recession in the world economy;

4. The hard terms of borrowing from these sources have led to a long-term increase in debt-service payments.

The combined effects of all the above mentioned structural and non-structural (internal and external) factors have eventually resulted in further accumulation of the external debt carried by the ESCWA debtor countries.

The combined pressure of both the imports and debt-services obligations, was partly eased by drawing on these countries, international reserves. This eventually resulted in reduction of these reserves to quite low levels.

To better understand the debt problem facing ESCWA debtor countries a comparison will be made with selected major world debtor countries. The non-ESCWA debtor countries selected for comparison are Brazil, Mexico, South Korea, Turkey and Venezuela.

The major borrower among the ESCWA-debtor countries, is Egypt: it already possessed a high debt level of $US 2,223.6 million in 1973 which accumulated rapidly to $US 15,468 million in 1982.

The second largest debtor among the ESCWA group is Syria, reaching a level of about $US 2.616 (or sixfold that of 1973). Next Jordan's debt grew more than eightfold during the same period reaching $US 1,686 million in 1982. The debt of Yemen grew to become $US 1,574 million in 1983, when it was nine times as large as the level of indebtedness in 1973. Oman, which started with a relatively small debt in 1973, increased it considerably in subsequent years to become $US 1.125 million in 1983. The increase in size of the debt also appears to be high in the case of Democratic Yemen, which reached $US 761 million in 1982, a figure about sixteen times that of 1973. Finally, Lebanon which used to be the smallest borrower among the group, began to rapidly increase its level of indebtedness since 1979 reaching $US 213 million in 1982.

We may turn now to consider the external debt position of these ESCWA debtor countries. Comparison between the two groups, in terms of the absolute magnitude of debt, reveals differences that are vast indeed, except for the case of Egypt.

In 1982, for example, the external debt carried by Brazil alone ($US 47,589 million) was more than twice the total debt of the ESCWA debtor countries taken collectively. However, comparison among absolute magnitudes of external debts does not reflect the real relative positions of different debtor countries.

The ratio of the external debt in relation to exports of goods and services with regard to Egypt, during the 1978-1982 period ranks much higher than any ratio of the other ESCWA debtor countries;it even ranks high among those of the major debtor countries. For example, Egypt's ratio of its debt outstanding and disbursed to exports of goods and services stood at 156.5 per cent in 1981 compared to a figure of 164.8 per cent for Brazil and 138.5 per cent for Mexico, both of which are major debtors. Nevertheless despite the high debt ratio Egypt's debt ratio had declined in 1981 compared to a figure of 183.1 per cent in both 1975 and 1978.

This decrease is indicative of a relative improvement in the external position of Egypt in recent years. This relative improvement is due largely to the sizeable remittances from Egyptian nationals working abroad, mainly in other Arab countries. However, the situation could easily be reversed whenever remittances decline due to recessionary conditions in the Arab Gulf countries.

Next to Egypt comes Democratic Yemen, where the debt increased in relation to export earnings to more than 106 per cent in 1982, marking a considerable expansion in the debt burden of this country in recent years. The debt/export ratios, in the case of Syria appear to be decreasing from about 97 per cent (1978) to lower levels in subsequent years, but are still much higher than in the early 1970s Jordan's ratios appear to be following a decreasing trend from 89 per cent in 1973 to much lower levels in the early 1980s. In the case of Yemen, the debt/export ratio has been increasing rapidly in recent years, reaching more than 90 per cent in 1983. This is due to larger borrowings in recent years, while export earnings (including remittances of Yemenite workers abroad) have been stagnating.

The overall situation, as reflected by the debt/export ratios, indicates that the relative external debt burden carried by most of the ESCWA debtor countries is almost as heavy as that of some major debtors.

However, the burden of servicing the foreign debt (total debt services/exports of goods and services) is much heavier in the case of the selected major debtor countries than in the case of the ESCWA debtor countries, except Egypt. Thus, in 1981, for example, external debt service payments took more than one third of Brazil's export earnings; 27.6 per cent of Mexico's and 15.2 per cent of Turkey's.

Among the ESCWA debtor countries, Egypt's foreign debt-service payments in 1981 had claimed more than one fifth of this country's export earnings. This makes Egypt's foreign debt burden rank the heaviest in relation to the other ESCWA debtor countries, and is even heavier than the burden of some of the world's major debtor countries. However the debt-services ratio, in the case of Syria in 1981 was only 10.6 per cent while that of Jordan was 6.3 per cent; followed by lower ratios for the rest.

One may, therefore, conclude that as far as the debt-service payments are concerned, the burden carried by the ESCWA-debtor countries, except for Egypt, seem relatively lighter than those carried by the selected major-debtor countries.

It should be noted that there is a sharp contrast between the ESCWA group debt structure, and that of the selected major debtor countries. In 1982, for example, 82.5 per cent of ESCWA debtor countries' debt was from official sources, (mainly from Arab creditor countries), while the corresponding figure for the five selected world major debtor countries was only 23 per cent. Loans from official sources normally have longer maturities and lower interest charges than loans from private sources. Moreover, often grant elements and grace periods are included in loans from official sources, thus decreasing the burden of debt.

B. ESCWA creditor countries

The financial position of the ESCWA creditor countries has been closely linked and practically totally determined by the combined effect of the value and volume of their oil exports. Crude oil production in ESCWA creditor countries experienced a significant increase in the 1970s, with some variations from year to year and from one country to another. Total daily production of crude oil in ESCWA creditor countries, increased from about 9.3 million barrels per day in 1970 to about 11.2 million b/d in 1971, and continued increasing to reach its zenith at more than 17.8 million b/d in 1979. Then the early years of the 1980s witnessed a considerable decline in the total daily crude oil production in the ESCWA group.

Foreign exchange earned by ESCWA creditor countries from oil exports also started to increase significantly from 1971 onwards, but until late in 1973 the increase in revenue was mainly due to the expansion in the volume of oil exports. The subsequent large increase in oil revenue came as a result of the first wave of price-raising decisions taken by OPEC in 1973/1974.

The highest value of oil-exports was that of Saudi Arabia, which increased from about $US 2.2 billion in 1970 to a peak of more than $US 113.2 billion in 1981; followed by Iraq's, which increased from $US 784 million in 1970 to a peak of more than $US 26.1 billion in 1980 and by the United Arab Emirates which peaked at more than $US 19.8 billion in 1981.

Following the peak in revenues attained by the ESCWA creditor group of countries, the value of their exported oil declined, as a result of the decrease in the volume of their oil production, as well as that of oil prices.

With respect to the ESCWA creditor countries, the evolution in the value of their oil exports has resulted in large financial surpluses earned by these countries in the form of foreign-exchange resources. The growing magnitude of the surpluses has enabled these countries to assume a greater role in world financial activities, and enlarge their participation in fostering aid programmes to developing countries, besides expanding development programmes at home.

Net aid disbursements by the ESCWA creditor countries increased continuously from about $US 0.3 billion in 1970 to almost $US 7.6 billion in 1978. After a decline in 1979 they rose to more than $US 9.1 billion in 1980, but fell to lower levels subsequently reaching about $US 6.5 billion in 1982. This trend seems to be influenced by development in the value of these countries' oil exports.

As a percentage of gross national official development assistance product (GNP), aid from ESCWA creditor countries averaged 10.4 per cent in 1973, but declined later to 3.4 per cent in 1980. The average Official Developmet Assistance (ODA)/GNP ratio, in the case of the Arab Gulf States, moved from about 13 per cent in 1973 to a little less than 4 per cent in 1981. However, despite the decline, these ratios continue to be much higher in 1981, than those of, for example, the $US (0.2 per cent), the Organization for Economic Co-operation and Development (OECD) average (0.35 per cent) or the Council for Mutual Economic Assistance (CMEA) average (0.14 per cent), in the same year. Nevertheless with further declines in oil revenues of ESCWA creditor countries, their aid contributions may be expected to continue to fall.

ESCWA creditor countries have been extending financial aid to developing countries, with increasing magnitudes since the early 1970s. Most of the aid extended has been in the form of concessional assistance (i.e. with a grant element of 25 per cent and above). Between 1970 and 1982, net disbursements of concessional aid by the five ESCWA donor countries have accumulated to a total of more than $US 61.6 billion. The assistance was extended to a wide range of developing countries in Asia, Africa, Europe and Latin America.

Moreover, ESCWA creditor countries have been extending financial aid to many international institutions that are concerned with economic and social development. Some of the aid extended is concessional and some is non-concessional.

Apart from grants and loans extended to developing countries and institutions, financial surpluses accumulated during the 1970s and early 1980s have also been used to augment these creditor countries' international reserves, and enlarge their accumulated foreign assest holdings.

Data about the exact magnitude of accumulated foreign assets owned by the ESCWA creditor countries are not published but there are estimates in the case of the Arab Gulf States.

It is estimated that by 1981 an amount of nearly $US 125 billion of the Arab Gulf States' foreign assets had been put into the recycling operation handled by private commercial banks.

Needless to say that once these financial resources have been deposited, their uses (recycling) become entirely the responsibility of the banks in which they are deposited.

Of about 100 debtor countries which received official development assistance (ODA) from Arab sources, around 26 have been in debt difficulties. Most of this ODA has been extended by the ESCWA creditor countries.

Among these groups of indebted countries, only a few like Morocco, the Sudan, Pakistan, India and Turkey actually owe a relatively significant debt to the ESCWA creditor countries. The majority of the rest consists of the African and Latin American nations whose individual debt to the ESCWA creditor countries is relatively small.

To date countries in debted to ESCWA creditor countries, like many other borrower economies, have opted for renegotiation and rescheduling rather than defaulting. Default does not seem to be likely, because such an extreme option might entail damaging repercussions to the defaulting debtor country that could be far greater than the volume of the debt itself.

This should not imply, however, that more sound and deeper rooted reforms are not required. On the contrary, the future of the global economy is in dire need for a better based financial system than the present one. Indeed without the reforms that are compatible with development and growth objectives and needs, the present international debt crisis might deteriorate and, then, the risk of wide-range default would become quite possible.

C. Policy measures at the regional level

Given the level of external debt carried by ESCWA countries in recent years, and given the "harsh" international economic circumstances which seem likely to prevail during the rest of the 1980s, it appears fairly appropriate that the debtor countries in the ESCWA region should exercise better management of their external debt. This must come about as part of a general improvement in economic, monetary and fiscal policies. The improvement required in these policy areas should be designed to secure high growth during the coming years. In this endeavour, certain policy criteria should be seriously considered. Thus, these ESCWA debtor countries would be well advised to take the following measures:

1. Apply more effective methods of mobilizing domestic financial resources and enlarge participation of these national banking system in development financing;

2. Ensure maximum efficiency of the allocation and utilization of all domestic resources;

3. Economize on capital, whenever possible, through applying capital saving technologies, especially those which save foreign exchange resources;

4. Refrain from short-term borrowing to finance long-term development;

5. Minimize borrowing from foreign commercial banks as long as their terms of lending remain excessively hard;

6. Borrow only what is 'really' needed (that is only what can be used efficiently);

7. Avoid excessive deficit financing, improve on economic performance and rationalize development planning and allocation of development resources in favour of satisfying basic home needs;

8. Revise trade policy in favour of development and growth;

9. Promote interregional co-operation and economic integration (among Arab economies) and readjust (co-ordinate) development strategies accordingly;

10. Provide sufficiently effective incentives for interregional flows of capital, including private direct investment.

ESCWA creditor countries, on the other hand, should:

1. Continue playing their vital financial role in extending ODA to Least Developed Countries (LDCs), particularly those in the region and other needy nations;

2. Enlarge their role in promoting inter-Arab economic co-operation and integration;

3. Redirect a larger part of their financial assets toward investment in the ESCWA region economies and other Arab countries, especially in promoting "Common Arab Projects".

D. Policy measures at the global level

The general environment of the world economy, which had produced the crisis of external indebtedness, has exerted its adverse effects on the countries of the ESCWA region, both debtors and creditors. No doubt, solutions proposed at the global level for resolving the debt crisis, will have a great impact on debt problems facing the ESCWA region.

The international debt crisis is not just that of liquidity for foreign exchange; it has political dimensions that can no longer be ignored, and thus require a solution dealing with both political and economic aspects. Thus, it is appropriate to briefly review recent efforts initiated by developed countries (creditor) and developing countries (debtor) which represent a new approach for tackling the debt crisis facing developing countries and threatening the international financial system.

During the second half of 1984, two main proposals have emerged: the first has been put-forward by a Commonwealth Group of Experts, and the second has been prepared through the United Nations Development Programme (UNDP) and the United Nations Conference on Trade and Development (UNCTAD) Secretariat. The UNDP/UNCTAD proposal considers the debt problem as being "mainly one of the major borrowers" and deals with it accordingly. The other proposals deal with the debt crisis at large, with attention being drawn to the case of low-income countries which in view of the Commonwealth Group of Experts, requires "special measures" of assistance. Apart from this and a few other minor differences, the proposals and recommendations have practically similar standpoints, explicit or implicit, with respect to the main aspects of the debt crisis and the basic remedies required for improvement of the debt situation. The most important common viewpoints are those which concern the following essential aspects and conditions:

First, the debt crisis is considered not only as a problem of liquidity but also as an issue of equality, in the sense that there should be an equitable distribution of responsibility and costs between debtor countries, creditor country governments and private banks;

Second, the developing debtor countries should be assisted to regain and foster their repayment capacity through economic growth and export expansion. This implies that proper arrangements must be made to the following:

(a) Put an end to the premature outflows of resources from the debtor developing countries (i.e., austerity must be at the expense of investment and growth);

(b) Bring about a positive net transfer of resources which should be directed to produce growth in the developing debtor countries;

Third, creditor countries must assist the debtors (by guarantees or other means) to:

(a) Raise the funds required to pay interest on outstanding debts;

(b) Ensure the flow of new funds to permit higher levels of growth and imports;

(c) Obtain debt relief to shelter them from the extra damage that comes from the currently high rates of interest;

Fourth, given guarantee by the industrial countries, this additional financing would come from a combination of the following:

(a) Commercial bank lending underpinned by a scheme of insurance (by the industrial countries);

(b) Bilateral official lending; and

(c) Multilateral lending through the IMF, the World Bank and the regional development institutions;

Fifth, besides the additional financing, the debt-servicing burden of developing countries should be reduced through rescheduling arrangements, which should be enlarged in scope with a switch toward longer maturities and grace periods (coupled with fixed or capped interest rates as some proposals request);

Sixth, under such conditions, the debtor countries would be enabled to pay the interest and the lending banks would be in a position to bear an equitable share or the burden involved by making realistic write-downs of the debts to sustainable levels;

Seventh, the role of direct foreign investment should be enlarged through measures of encouragement which must be provided by both developing and industrial countries in a mutually acceptable framework;

<u>Eighth</u>, the international financial institutions should play a much more active and enlarged role in resolving the debt problem and in meeting the financing needs of developing economies in a long-term framework.

To carry out such a task, the terms of reference of these institutions should be revised, and their resources should be increased substantially. Thus, the International Monetary Fund (IMF), for example, should be enlarged substantially and the Fund should be transformed into a World Central Bank, or lender of last resort. The Third World should also be better represented on its executive board. Among other required actions, the IMF adjustment programmes should be designed with an emphasis on investment and growth. Similarly, the World Bank and the regional development banks should have greater resources and more flexibility to respond to the need for programme loans - beside other forms of aid badly needed by low-income countries;

<u>Ninth</u>, the industrial countries, on their part, should throw their weight more in the direction of borrowers by seeking a limited, responsible debt relief for countries particularly burdened by debt service at current rates. Also the industrial nations must increase ODA to developing countries at significantly lower interest rates, and roll back protectionist measures against the exports of developing countries.

The rationale behind the proposals is based on the fact that the interests of creditors and debtors countries are intertwined, and the general aim is to help make the international economic environment more favourable to growth in the developing countries and thus create a sounder base for improved debt management. But since the national policies are the crucial factor in economic development, it follows that the developing countries in their turn should improve their domestic policies to secure the following:

(a) Better mobilization of domestic resources;
(b) More efficient use of these resources;
(c) Better management of external debt.

It seems that many developing-borrower countries are in need of more effective methods of debt management, as well as improved fiscal and economic management. The IMF and other international and regional institutions should be prepared to provide such technical assistance whenever called upon to do so.

During 1985 various international fora have stressed that adjustment without growth is unsustainable. In this regard two proposals are worth mentioning:

<u>First</u>, the United States Baker plan presented last October at the joint-session of the IMF and the International Ban for Reconstruction and Development (IBRD) in Seoul. The plan contains the following essential elements:

1. The adoption by principal debtor countries of comprehensive macroeconomic and structural policies supported by international financial institutions, to promote growth and balance of payments adjustment, and to reduce inflation;

2. A continued central role for the IMF, in conjunction with increased and more effective structural adjustment lending by the multilateral development banks, both in support of the adoption by principal debtors of market-oriented policies of growth;

3. Increased lending by the private banks in the amount of $US 20 billion over the next three years in support of comprehensive economic adjustment programmes.

Despite positive aspects in this plan, it is far from fundamentally tackling the debt crisis, since it considers the debt issue mainly as a liquidity crisis.

Second, the United Nations draft resolution (A/C.2/40/L/52) of 20 November 1985 regarding external debt crisis. In the view of the developing countries, including the ESCWA region, it presents an acceptable framework of guidelines to solve the crisis. These guidelines are as follows:

1. Equity and symmetry between developed and developing countries in the distribution of the costs of the economic adjustment process;

2. Lower and stable interest rates, the stretching out of payments, grace and consolidated periods;

3. Improved and stable access to brokers; standstill and rollback of protectionism;

4. Reversing the trend towards disruptive market practices, discrimination and managed trade;

5. Stabilization of commodity markets with fair and remunerative prices;

6. Reversing the net outflow of financial resources from developing to developed countries;

7. Reinitiation of the financial flow of resources for development;

8. Limiting debt services payments to a percentage of export earnings compatible with the development needs and the economic and social requirements of each country;

9. Easing of the conditionality applied, inter alia, by the IMF and avoidance of cross-conditionality;

10. Special treatment, especially for the poorer and least developed countries in the solution of their external debt problems.

It is of utmost importance that developed, or creditor, countries and developing, or debtor, countries reach an agreement on tackling the debt crisis as soon as possible to avoid the collapse of the international monetary and financial system. The United Nations draft resolution may constitute a basis for such an agreement.