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LDC Debt and Exports

Between 1983 and 1986, the major Less-Developed Country (LDC) debtors together generated trade surpluses totalling $128 billion to service their debts. At the same time, however, both investment and output growth have deteriorated in these countries, and indicators of the debt burden, such as ratios of debt to exports and interest payments to exports, have not improved significantly.

One reason for these anomalous and largely discouraging results is that the trade surpluses of LDC debtors are the result of reduced imports rather than growth in export revenues. Such import compression has impaired the ability of these countries to service their debts since many LDC debtors traditionally have imported capital goods to support investment and economic growth. A long-term solution to the debt problem requires LDC debtors to grow and generate increased export revenues to meet their debt obligations.

There is much pessimism on this score. Some observers question whether there are adequate markets for the products of LDCs. They believe that markets in industrial countries are inaccessible or not likely to grow in the future, particularly because of growing protectionist pressures. Thus, these observers hold out little hope for successful investment in many LDC debtor countries, and suggest that the prospects for long-term growth and a solution to the debt problem are grim.

More optimistic observers, on the other hand, point to the rapid growth of the exports of the Asian newly industrializing countries (NICs) as evidence of a large potential market for LDC exports to industrial countries. They argue that a solution to LDCs' debt problems lies in these countries' willingness to adopt measures that diversify their exports and in industrial countries' continued willingness to avoid protectionism. This *Letter* reviews trends in the export growth of LDC debtors and the prospects for enhancing their export revenues.

Trends in export growth

Charts 1 and 2 illustrate the exports to industrial countries of 14 heavily indebted countries listed in the Baker Plan for LDC debtors (Côte d'Ivoire, also listed in the Baker Plan, is excluded due to lack of data) and the four newly-industrializing countries (NICs) in East Asia, respectively. The Baker Plan countries include the major Latin American and African debtor countries, and the Philippines. The four Asian NICs are Hong Kong, Singapore, South Korea, and Taiwan. The growth in export revenue of the heavily indebted countries fell from an 18 percent compound annual growth rate in the 1970s to a 1 percent annual *decline* in the period from 1980 to 1986. In contrast, the growth in Asian NIC exports to industrial countries slowed from a 25 percent compound annual growth rate in the 1970s to a still very rapid 12 percent annual growth rate in the 1980s.

As a result of these divergent growth patterns, the value of the four Asian NICs' exports to industrial countries in 1986 reached $86 billion, a level that was roughly equal to the corresponding exports of the 14 heavily indebted countries. For reference, the value of the exports of the Asian NICs was less than half the value of the exports of the heavily indebted countries in 1980s.

The stagnation in the exports of the heavily indebted LDCs in the 1980s largely is due to these countries' reliance on primary commodities as their main source of export revenue at a time when commodity prices have fallen sharply. (According to International Monetary Fund estimates, real non-oil commodity prices fell 30 percent between 1980 and 1986.) Even among countries that have a well developed domestic manufacturing base, primary commodities still are the major exports. In contrast, the East Asian NICs diversified their exports towards manufactured goods and thus continue to enjoy rapid export growth in the 1980s.

These contrasts are best illustrated by comparing the changes in the composition of U.S. imports, which have been the major source of growth in world trade in the 1980s, with the composition of the exports of an East Asian NIC and a heavily indebted country. In 1985, the share of primary commodities (excluding fuels) in U.S. imports was 12 percent, down from 39 percent 20 years earlier. The share of machinery and transport equipment rose 24 percentage points over the period, to 38 percent. Such manufactured goods, particularly office equipment, account for a major part of U.S. import growth in the 1980s.

The change in South Korea's exports over the period between 1965 and 1985 showed a corresponding shift in composition. Primary commodities fell from 25 percent to 5 percent of total exports, and the share of machinery and transport equipment rose from 3 to 36 percent. Clearly, Korea has diversified towards areas of greatest demand.

In contrast, although Argentina had a much more developed manufacturing base than Korea in 1965, by 1985 primary commodities still constituted 77 percent of Argentina's exports, and machinery and transport equipment had only a 5 percent share. Of course, given its comparative advantage, Argentina, like the U.S., always will be a major exporter of primary commodities. However, Argentina's export performance — and that of other major LDC debtors — would have been far superior if it also had diversified its export base to include those sectors where world demand was growing most rapidly.

Import substitution policies

The inability of major LDC debtors to diversify into manufacturing exports is not accidental; it is the result of trade, tax, and pricing policies that have encouraged domestic production that substitutes for imports in these countries. By protecting domestic firms and limiting external competition, these import substitution policies have prompted the development of domestic manufacturing sectors that are unable to compete in world markets. South Korea and Taiwan also have protected their domestic manufacturing sectors, but they have encouraged producers to face the test of competition in world markets to a much greater extent.

Since the unfavorable export performance of heavily indebted countries in the 1980s largely is the result of economic policies that discouraged the diversification of their export bases, and not the result of stagnant world markets, such LDCs have an opportunity to effect a major improvement in their economic conditions. If they were to adopt policies to encourage the international competitiveness of their manufacturing sectors, they would produce an environment conducive to investment and growth by encouraging capital inflows that would enable them to overcome their present difficulties.

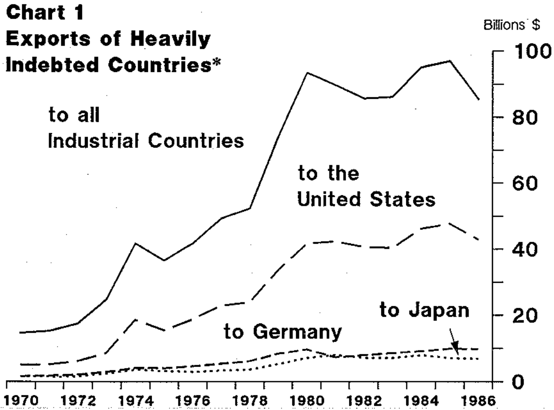
Do markets for LDC exports exist?

One major question is whether the markets of industrial countries are likely to remain open, and whether these markets are sufficiently large to accommodate growing manufacturing exports of LDC debtors. A source of uncertainty is the extent to which the expected reduction in the U.S. trade deficit will lead to a decline in the exports of LDC debtors. There are at least three reasons to believe that in spite of a reduction in the U.S. trade deficit, there is room for LDC debtors to expand their manufacturing exports.

First, it is in the interests of industrial countries to promote economic expansion and export growth in debtor countries. There are economic, as well as political, reasons for encouraging LDC debtors to solve their debt problems. Growth in LDC economies will stimulate demand for the exports of industrial countries to debtor countries. Economic expansion among debtor countries may also contribute to a reduction in the U.S. trade deficit. Part of the reason that the U.S. trade deficit mushroomed in the 1980s is that traditional U.S. export markets in Latin America stagnated during this period.

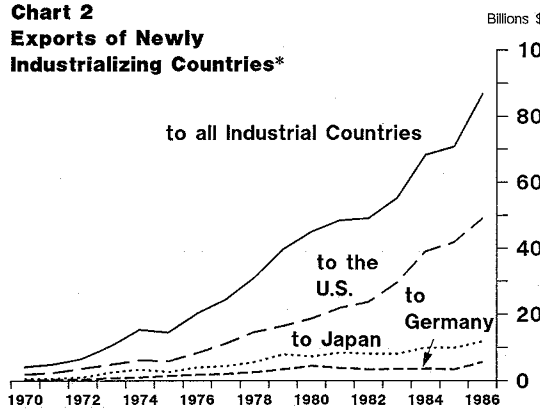
Second, the penetration of LDC debtors in the manufacturing sector of industrial countries currently is not all that large, so there is room for growth in this area. Even after taking the rapid growth in the exports of the NICs into account, the share of developing country exports in the markets for manufactures of industrial countries was only 2.3 percent in 1983. In addition, even among the Asian NICs, the range of manufacturing products exported to industrial countries is fairly limited, suggesting a fairly wide scope for further diversification. Thus, there appears to be plenty of room for an increase in exports, particularly to Japan and West Germany, as these countries thus far have absorbed only a small proportion of LDC exports.

Chart 1
Exports of Heavily Indebted Countries*



* Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, and Yugoslavia.

Chart 2
Exports of Newly Industrializing Countries*



* Hong Kong, Singapore, South Korea, and Taiwan.
Data for 1986 are estimated.

Third, as a result of the appreciation of their currencies in recent years, the export-led growth of Japan and Germany in the 1980s probably is at an end, at least in the near future. LDC debtors that adopt appropriate trade and exchange rate policies may be able to claim some of the shares relinquished by Japan and Germany in world markets. LDC debtors also may be able to increase their shares of world exports if the rapid growth in the exports of the Asian NICs slows down. But even if this rapid growth continues for some time, the Asian NICs are potential markets for the exports of LDC debtor countries, as well as potential competitors.

Emphasis on exports

This analysis suggests that there is significant scope for debtor countries to increase their share in the future growth of world exports. As a result, debtor countries may be well advised to shift away from policies that protect domestic industries from competition with imports towards policies that will make investment in a diversified export sector attractive. Aside from generating additional export revenue, appropriate trade policies in LDCs may encourage capital inflows. For example, the yen appreciation has encouraged Japanese firms to shift production from Japan to LDCs (and to the U.S.) for export to industrial countries. By continuing to attract some of the direct investment capital leaving industrial countries, LDC debtors can enhance their productive capacity and increase their shares in world exports. Capital inflows also would alleviate the short term liquidity problems faced by LDC debtors in meeting their external obligations.

Export-oriented economic policies likely will enhance the repayment capacity of debtor countries, reduce the burden of servicing their debts, and improve the competitiveness of their manufacturing sectors. These considerations are likely to be important components of any long-run solution to the LDC debt problem.

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Opinions expressed in this newsletter do not necessarily reflect the views of the management of the Federal Reserve Bank of San Francisco, or of the Board of Governors of the Federal Reserve System.
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NOTE

The table entitled, "Selected Assets and Liabilities of Large Commercial Banks in the Twelfth Federal Reserve District," will no longer be published in conjunction with the *Weekly Letter*. For those in need of these data, a more timely publication entitled, "Weekly Consolidated Condition Report of Large Commercial Banks and Domestic Subsidiaries" (F.R. 2416x), is available from the Statistical and Data Services Department of this Bank.