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Mounting Debts

Two years ago, following the four-fold increase in the price of oil, most observers wondered whether the current-account deficits of the oil-importing nations could ever be financed. That concern has now faded for the industrial nations, but remains an issue for the non-OPEC developing countries. The combined current-account deficit of this group could rise to a record $35 billion this year, compared with $28 billion in 1974 and $9 billion in 1973. The G-10 industrial countries, by contrast, anticipate a current-account *surplus* of $15 billion in 1975, a turnaround of $27 billion from the $11½-billion deficit in 1974.

The further deterioration in the situation of the non-OPEC developing countries reflects such factors as slower export growth and softening terms of trade, as well as higher oil-import bills. Because of increased credits from large commercial banks and additional financing from OPEC and international institutions, these deficits have been financed with only a modest rundown in foreign-exchange reserves. But there has been fear that some of the developing countries may not be able to continue accumulating debt at such a rapid rate, and that defaults or reschedulings could result.

Debt profile

According to a recent World Bank study, the external debt of the developing countries expanded markedly even prior to the oil crisis. The total volume of this debt rose by 12 percent annually in the late 1960's, by about 16 percent a year in 1970-72, and by 19 percent in 1973. Debt service payments increased at even a faster rate, from a 15 percent average in 1967-71, to 21 percent in 1972 and to 31 percent in 1973.

The rapid growth in nominal terms, however, did not imply an equally rapid increase in debt burden. When deflated by the export-price index for less-developed countries (LDCs), the growth in debt service was 12 percent in 1967-71, 14 percent in 1972, and 6 percent in 1973, reflecting 1973's extraordinarily high commodity prices. Although data are not available, the LDC debt situation has clearly worsened in the last two years as a result of the large trade deficits and softening commodity prices of products they export.

As of 1973, credits from official institutions comprised nearly 70 percent of the $118 billion outstanding debt of the developing countries. The share had remained fairly stable since 1967. But the share of commercial-bank credits outstanding more than doubled to 12 percent in 1973, largely displacing suppliers' credits. Thus, it appears that there was not any significant shift in the composition of LDC-debt financing toward higher-cost sources, contrary to common impressions.

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In the last two years the shift toward bank financing appears to have accelerated. According to Morgan Guaranty estimates, 35 to 40 percent of the external requirements of the non-OPEC LDCs in 1975 were financed by commercial banks, mostly in the form of Eurocurrency credits to a select group of mostly high-income LDCs.

Two views

The trade deficits of the past two years are the result of both structural forces and cyclical forces. From the "structural" viewpoint, they primarily reflect the inability of the developing countries to adjust to the higher price of oil. Their consumption of petroleum has changed relatively little over the past two years, compared with the industrial nations, where reductions averaged 8 percent for all the OECD countries and 13 percent in Western Europe. A reduction in the LDCs oil imports is thought to have a larger (negative) impact on their real output, because of the different structure of their petroleum purchases. Household oil consumption for example, is smaller in the LDCs, where there are fewer automobiles. Also, the price of fertilizer, a key input in the (LDC) Green Revolution countries, has risen considerably in world markets partly due to higher oil prices. Since these countries have little choice in reducing their oil or fertilizer imports, reductions must come from other sources.

From the "cyclical" viewpoint, the developing countries have lagged the industrial countries into recession. Hence, the 1974-75 trade statistics exaggerate the "true" adjustment by the industrial nations and understate the adjustment by the developing countries to the higher price of oil. The $26-billion deterioration in the LDC current account since 1973, for example, is two and one-half times larger than the $10-billion increase in the LDC oil-import bill. Economic recovery in the developed nations in 1976 should stimulate LDC exports, while slower growth in the developing countries should curtail their import demand, causing their deficits to shrink considerably.

Default prospects

Experience with LDC defaults or reschedulings prior to the oil crisis suggests that macro-economic policies ultimately play the pivotal role in affecting a country's debt situation. In a number of countries, large government deficits resulted in inflationary financing that triggered foreign-exchange crises, while in others, emphasis on import-substitution policies generated foreign exchange shortages which led to debt crises. The approach to the debt problems typically included a stabilization program along with trade liberalization and devaluation. Where the programs proved successful, the country was able to avoid future debt problems, and at the same time, to grow rapidly.

An obvious difference today is that the shock is external, rather than internal; also, it affects industrial countries and developing countries alike. Still, countries have been forced to adjust, in a number of ways. Some developing countries have devalued; others have undertaken stabilization programs; still others have revised their target growth rates downward.

On the whole, adjustment should be easier for the higher-income or faster-growing countries. Three countries—Brazil, Mexico, and Korea—account for over a third of the 1974-1975 combined LDC deficits and roughly half of the Euro-currency credits to LDCs. All three have grown rapidly and have diversified export bases, which should permit them to adjust easily.

The countries with the most difficult adjustment problems, on the other hand, are the group of "Most Seriously Affected" countries in Africa and South Asia. India and Pakistan, however, are the only countries in this group with sizeable debt outstanding. They are currently engaged in their seventh and fourth rounds of rescheduling, respectively, but only official credits are involved.

Among the low- to middle-income countries, commercial-bank exposure is significant in Zaire, where bank credits comprise nearly half of the country's outstanding debt. However, commercial-bank exposure in other low- or middle-income countries is quite small, measured either as a share of the country's outstanding debt, or as a share of commercial credits outstanding.

In sum, the LDCs will have to tighten their belts in the years ahead, but the situation is far from hopeless. Should a country incur a debt problem, one can expect creditor nations to assist by rescheduling the country's debt. In the past, arrangements have included ad hoc meetings of major creditors, or consortia chaired by the O.E.C.D., I.M.F., or I.B.R.D., which are responsible for pledging and coordinating regular flows of financial aid. Additional mechanisms, such as the I.M.F. Special Oil Facility, are available today for temporary financing of oil payments problems, and a number of developing countries can count on OPEC assistance. These mechanisms should provide sufficient safeguard against outright default, although a cost is still entailed in rescheduling a country's debt. Because of the limited commercial bank exposure in high risk countries, however, the burden of rescheduling ultimately is likely to fall on the taxpayers in the creditor nations, rather than on the commercial banks.

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