

# *International* INDEBTEDNESS

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*Edited by Manfred Borchert  
and Rolf Schinke*

# International indebtedness

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Manfred Borchert

and

Rolf Schinke

Contributions presented to the Workshop on  
Economics of the Münster Congress on *Latin  
America and Europe in Dialogue*



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# **International indebtedness**

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Under the auspices of *rector magnificus*

Prof. Dr Hans-Uwe Erichsen

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# Münster Congress 1987 – Publications

## General

1. Hans-Uwe Erichsen (editor)  
*Lateinamerika und Europa im Dialog. Menschenrechte – Wirtschaftliche Verflechtung – Menschenbild, Minderheiten, Medien – Politische Beziehungen.* (Latin America and Europe in Dialogue. Human Rights – Economic Linkages – Idea of Human Beings, Minorities, Media – Political Relations), Berlin 1989. *German*

## Other workshops

2. Johann Baptist Metz/Peter Rottlaender (editors)  
*Lateinamerika und Europa – Dialog der Theologen* (Latin America and Europe – Dialogue of the Theologians), Mainz/München 1988. *German*
3. Fernando Inciarte/Berthold Wald (editors)  
*Im Dialog mit Lateinamerika. Menschenrechte und Menschenbild* (In Dialogue with Latin America. Human Rights and the Idea of Human Beings). *German*
4. Rolf Eschenburg (editor)  
*Formas de Cooperación en Europa y Latino America* (Forms of Cooperations' in Europe and Latin America), Münster 1989. *Spanish*
5. Rainer Frey/Gerhard W. Wittkaemper (editors)  
*Lateinamerika – Westeuropa: Annäherung oder Distanzierung* (Latin America – West Europe: Approaching Towards Each Other or Becoming More Distant). Münster 1988. *German*
6. Achim Schrader/Karl-Heinrich Rengstorf (editors)  
*Europäische Juden in Lateinamerika* (European Jews in Latin America), Stuttgart 1988. *German*



# Preface

From 27 September 1987 to 2 October 1987 the University of Münster carried out a Congress on *Latin America and Europe in Dialogue, International Indebtedness* being a part of the Workshop on Economics.

Since the early stages in the preparation of the workshop it was our intention to concentrate the discussion on four closely-related topics: origins, significance, and development of the debt crisis; problems of managing the debt; deficiencies of the world monetary system; and the interrelations between indebtedness and growth. Therefore, we invited researchers from Latin America, Portugal, and the Federal Republic of Germany. The present publication contains the articles prepared for this workshop. Due to urgent duties in Washington Carlos Massad and Alberto Valdés could not present their papers personally. Nevertheless, their articles were included as valuable contributions to this volume.

Without financial help from various sources it would have been impossible to realize this meeting. Therefore we acknowledge gratefully the support given by BASF (Münster), Deutsche Bank (Frankfurt), Deutsche Bundesbank (Frankfurt), Deutsche Forschungsgemeinschaft (Bonn), Deutsche Ibero-Amerika Stiftung (Hamburg), Federal Ministry of Economic Cooperation (Bonn), the Government of the Federal State of North Rhine-Westphalia (Düsseldorf) and WestLB (Düsseldorf).

Dr Ludger Abs and also Dr Michael Angrick rendered great service in the preparation and organization of the workshop on international indebtedness. Ms Barbara Veltman translated all German manuscripts with great care. They, as well as Mr Mathias Erlei, Ms Barbara Schulte, Ms Christiane Vogell and Mr Ewald Wessling, did the proof-reading, and drew up the subject index. Mrs Angelika van Dillen made the manuscript readable with her usual circumspection and efficiency; the final make-up was done by my present secretary Ms Susanne Esselmann. Thanks to them all for their assistance.

Manfred Borchert  
Rolf Schinke  
Münster and Göttingen

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# Introduction

Rolf Schinke

Since late summer of 1982, when Mexico felt unable to service its foreign debt, a rather large number of books and articles have been published on the problems of the highly-indebted countries. This introduction does not intend to give a survey of the literature concerned. Instead, some of the key issues which regularly appeared will be taken up here. The objective is to relate them to the topics of this volume which contains the contributions prepared for a workshop on international indebtedness held in Münster, Germany.

## The present situation

The current debt situation in Latin America can be characterized by the following stylized facts:

- (a) Several major debtor countries succeeded to keep debts from growing, and some of them even experienced a decline in absolute indebtedness. According to estimates by the Economic Commission for Latin America (ECLA)<sup>1</sup> gross external indebtedness of all Latin American countries has declined by more than 2 per cent to 401.4 billion US dollars at the end of 1988.
- (b) This reduction (1988), and overall increases (1983 to 1987) are smaller than debt service payments, resulting in a serious transfer of resources from the debtor to the creditor countries which has accumulated to 178.7 billion US dollars since 1982. In 1988 this transfer was as high as 28.9 billion US dollars.<sup>2</sup> Taking into account the negative change in the export prices<sup>3</sup> since 1980, the drain in 1988 amounts to 39.05 billion US dollars in real terms.
- (c) With the exception of Chile, in 1987 investment measured in percentage of the GDP was still below the pre-crisis level.<sup>4</sup>

Consequently, the rate of growth of the GDP in 1988 has been depressed. As a whole, per capita incomes are below those prevailing at the beginning of the decade. It is generally expected that the same pattern will hold true in 1988, for which data are still unavailable. This points to the existence of a debt trap.<sup>5</sup> Despite policy reforms and high domestic saving rates, per capita incomes remain depressed because investment is constrained as a result of the net outflow of resources to creditor countries.

- (d) While it is therefore correct to regard the 1980s as a lost decade for the debtor countries, the same does not hold true for the creditors. Loans to the debtor countries have stagnated and even declined since mid-1987.<sup>6</sup> The bargaining power of the banks has increased since massive loan loss reserves have been built up.<sup>7</sup> Today, the largest US money centre banks are far less vulnerable than at the beginning of the debt crisis.<sup>8</sup>
- (e) Governments and banks of the creditor countries are furthermore reluctant to solve the debt crisis globally. Case-by-case treatment, with no overall corrections of the nominal value of the debt, is the preferred way of handling the difficulties of the indebted middle-income countries. Only low-income countries – mostly in Africa – and Bolivia received debt relief of a substantial size.<sup>9</sup>
- (f) In solving, or at least managing, the debt problems three rather distinct means have lately received more attention than before:
  - There are signs that governments of some debtor countries might co-operate more closely than they did before.<sup>10</sup>
  - Market-orientated approaches<sup>11</sup> to the solution of the debt problem such as debt equity swaps are increasingly being used in several highly-indebted countries.
  - Despite the acknowledgement that debt relief might create serious disincentives and moral hazard problems, proponents of this instrument are gaining in number even in scientific circles, pointing to the fact that their diagnosis of the debt problem is one of insolvency rather than illiquidity, the latter being the implicit diagnosis of the supporters of reschedulings on a case-by-case treatment.

The picture given by the debt scene so far reveals:

- there is no commonly-shared diagnosis of the debt crisis as being one of illiquidity, insolvency or as being none of both, and,



- policy measures to solve the debt crisis differ widely among the groups involved; growing out of the debt crisis remains as difficult as it has proved to be during the last years.

### **Key factors to the debt crisis**

These divergent views and opinions are in contrast to the rather widespread consensus as to the origins and causes of the debt crisis. Four broad areas can be identified as being the key factors which led to the crisis.

- (a) In the first place reference is made to the oil price increases of the 1970s which immediately led to current account deficits of the oil importing LDCs (less developed countries) and to parallel surpluses of the oil-exporting countries.<sup>12</sup> The latter's preferences for liquid assets in the Euro-currency markets provoked the banks to look for new customers within the group of newly-industrializing countries, thus fulfilling the objective of recycling the petro-dollars, which had been broadly advocated by governments of the industrialised countries, to finance the current account deficits of the LDCs. Adjustment to higher oil prices within LDCs took time, or was partially postponed, both leading to a higher indebtedness. The second oil price shock again led these countries to either finance adjustment or to postpone it, this time, however, at higher price and debt levels. But, different from the first oil price shock, there was no improvement in their terms of trade which, after the first oil price increase, had alleviated the real burden of some oil-importing LDCs in Latin America.
- (b) The decade of the 1970s witnessed a world-wide inflation with rates higher and more persistent than ever since the 1950s.<sup>13</sup> In the industrialized countries there was a growing concern about its negative allocative and distributive consequences. Anti-inflationary measures, documented by the switch in monetary policy in the United States, led to a rise in nominal interest rates and to a reduction in inflationary expectations. Both resulted in unexpectedly high real interest rates. Stabilization policies pursued in several developed countries led to a further reduction of their already slow economic growth. The relative decline in their demand for the exports of the debtor countries led to a deterioration of the export prices of the oil-importing countries and, since 1982, of those of the oil exporters in Latin America. Worse still, there was a decline in