

Carvounis

The Debt Dilemma
of Developing Nations

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*ISSUES
AND CASES*

Chris C. Carvounis



Quorum Books
WESTPORT, CONNECTICUT

Library of Congress Cataloging in Publication Data

Carvounis, Chris C.

The debt dilemma of developing nations.

Bibliography: p.

Includes index.

1. Debts, External—Developing countries. 2. Debts,
External—Developing countries—Case studies. I. Title.
HJ8899.C37 1984 336.3'435'091724 84-1981
ISBN 0-89930-062-6 (lib. bdg.)

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Library of Congress Catalog Card Number: 84-1981
ISBN: 0-89930-062-6

First published in 1984 by Quorum Books

Greenwood Press

A division of Congressional Information Service, Inc.
88 Post Road West, Westport, Connecticut 06881

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

ACKNOWLEDGEMENTS

A generous measure of thanks must be accorded to the researchers and writers whose reportage, conceptualizations and commentaries have provided the substantive basis of this book. They are to be especially commended for their broad and timely response to a crucial topic having universal implications.

I wish to extend my gratitude to my colleagues at St. John's University, especially to Drs. Francis Lees, Maximo Eng, Anthony Angelini and Chaman Lal Jain, for their guidance in this project, and to Professors Terrence Brady, Edward Downe, Valerie Englander, Adrian Fitzsimons, Arlene Furfero, Stephen Kagann, Stanley Lawson, Geoffrey Poitras, John Alexion, Lee L. Lattimer, Ann Bynoe, Frederick D. Schmidt, LeRoy E. Pagano, Joel J. Sokoloff, Angelos Tsaklanganos, Thaddeus Tuleja, Raymond Kudla, and Peter Charanis for their valuable insight. Appreciation is also due to the staff of St. John's Loretto Memorial Library, particularly Francine Russo, Eugene Hunt, Joseph Lipari, William Stone and Rose Leonardi. Most of all I thank my assistant Roger Fields, whose expertise in research and editing proved invaluable in all stages of my work and without whom this volume would never have been realized.

ABBREVIATIONS

ALFA: Grupo Industrial Alfa, a privately held, Mexican conglomerate

BIS: Bank for International Settlements, a multilateral, balance-of-payments adjustment institution

CCC: Commodity Credit Corporation, a trade-credit agency of the United States government

CMEA: Council of Mutual Economic Assistance, an economic support alliance among Warsaw Pact nations, similar in form to the EEC

COC: Comptroller of Currency, a regulatory agency of the United States government

COMECON: Alternative acronym for CMEA

CTLD: Convertible Lira Deposit Scheme, a foreign exchange acquisition program instituted by the Turkish government in the mid-1970s

DAC: Development Assistance Committee, a multilateral body of industrialized nations concerned with global development

DSR: Debt-Service Ratio, a rough index of debt service capacity

EEC: European Economic Community, also known as the Common Market, a mutual economic support alliance among West European nations

FDIC: Federal Deposit Insurance Corporation, an official regulatory and underwriting agency of the United States government

GDP: Gross Domestic Product

GNP: Gross National Product

IBRD: International Bank for Reconstruction and Development, the parent and largest organization within the World Bank Group, a multilateral lending organization

IDA: International Development Association, an organization within the World Bank Group for extending concessional credit to developing countries

IFC: International Finance Corporation, an organization within the World Bank Group similar to the IDA

IMF: International Monetary Fund, the central, multilateral balance of payments institution

JP: Justice Party, a Turkish political party

LDC: Less-Developed Country

LIBOR: London Interbank Offered Rate, the interest rate or cost of funds to prime borrowers in the Eurocredit market

MDB: Multilateral Development Bank, a term covering the IBRD and its regional banks for an organization using funds from a number of nations to support economic development

MNC: Multinational Corporation

NIC: Newly Industrialized Country, an advance LDC

ODA: Official Development Assistance, covers both bilateral and multilateral foreign aid in the form of grants or concessional loans

OECD: Organization for Economic Cooperation and Development, a multilateral economic support and development alliance of the industrialized nations

OPEC: Organization of Petroleum Exporting Countries, an energy cartel dominated by the nations of the Middle East

PEMEX: Petroleos Mexicanos, Mexico's state-owned petroleum production monopoly

PLO: Palestine Liberation Organization, a group representing Palestinian refugees

PRI: Institutional Revolutionary Party, Mexico's largest political party

PT: Worker's Party, a Brazilian political party

RPP: Republican People's Party, a Turkish political party

SAL: Structural Adjustment Loan, a loan extended by both the IBRD and the IMF to help nations adjust to external shocks, e.g., the oil price hikes of the 1970s

SDRs: Special Drawing Rights, a form of "currency" issued by the IMF as a means of redistributing balance of payments surpluses

SEE: State Economic Enterprise, a government-owned enterprise common in the Turkish economy

SIFT: Statement of International Financial Transactions

SNI: Brazil's national security agency

UMS: United Mexican States, official abbreviation for the Mexican government

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The Debt Dilemma of Developing Nations

Chapter 1

INTRODUCTION

Purpose

This book presents both a unified framework for conceptualizing the current external debt dilemma faced by major borrower nations of the developing world, and a set of country case studies geared to this interpretive model. Taken together, the issues and cases set forth in this volume will provide the reader with a multiple perspective on the present developing nation, or less-developed country (LDC), debt crisis and with substantive examples of developing countries having heavy foreign debt-service burdens. The work has its origin in a perceived gap within the body of LDC debt literature as it now exists. Treatments of the Third World debt quandary tend to be of two kinds. On the one hand, there are the scholarly texts and articles devoted to the topic. Frequently written under the aegis of major multilateral institutions, for example, the World Bank, these studies typically feature a broad chronological scope, and while they usually include reference to specific events and trends, their orientation is generally theoretical. On the other hand, there are the professional pieces, such as those which appear in the pages of financial journals and business magazines. These items offer a wealth of detail on the topical aspects of Third World debt, but unless they are followed on an ongoing basis, they tend to be piecemeal and to have no explicit connection to a consistent analytical model. By incorporating elements of both genres, this study seeks a cross-fertilization between theory and practice, affording the reader a more cogent and complete view of the LDC debt problem as a whole.

Scope

It is apparent that a comprehensive explanation of the current LDC debt crisis cannot be contained within a single volume, and so this study's scope of inquiry is squarely focused on the most timely and important areas of the topic.

The developing Third World consists of over one hundred nations with extremely diverse economic, political and social characteristics; most of these countries are net international debtors. The debt and development difficulties of the neediest Low-Income LDCs may be even more pressing in vital, human terms than those of the countries considered in this book, especially in light of what Cyrus Vance has called the "disgraceful" performance of the United States in reducing official aid and loans to these lands over the past five years.¹ My examination is concentrated, however, on developing nations with investable economies. Designated Hi-Income, Non-OPEC LDCs in developmental jargon, these are the nations that have been able to tap commercial credit markets and now find themselves pressed to restructure their official and commercial repayment schedules. Because it is this class of nations that is at the center of my discussion, a major portion of this text will zero in on the most troublesome component of their external debt problems: commercial, floating-interest Euroloans contracted from international banks over the past decade. A Euroloan is, most broadly, a loan granted in a currency, usually \$US, other than that of the lender's nation or the site from which the loan is issued. Narrowly defined, it is a loan from a European lender denominated in \$US. The definition has broadened since inception of the Euromarket. Among the Hi-Income, Non-OPEC LDCs, this mode of lending is the largest element in their accumulated debt stocks, outweighing official bilateral and multilateral obligations. It is also the costliest form of credit extended by suppliers of autonomous capital to LDC borrowers, and the large proportion of such debt due in the near term is presently the greatest onus on the annual debt service of these countries. In short, while this book cannot address the LDC debt crisis in its entirety, it does aim at the heart of the matter by centering on major developing nation debtors who have encountered serious problems in meeting foreign loan servicings.

All of the "issue" portion of this book and the bulk of its case material pertain to the period 1971 to end-1982. To be sure, both an expansion of the Euroloan market and Third World borrowings occurred in the 1960s, but external loan flows to borrowers in developing countries did not reach significant proportions until the 1970s. As important, the entire global financial environment has been irrevocably altered since 1971. Foreign exchange rates now float, international rates vary, the real cost of OPEC oil has quadrupled, commodity exports have gone up and down erratically in volume and price, and all of these innovations have had a profound impact on developing nations in contracting and servicing foreign debt. In 1982-1983, major LDC debtor nations found themselves on the cusp of an equally significant change in the pattern of cross-border capital movements. According to one projection, even with a resumption of bank lending in the mid-1980s to levels approximating those of 1979-1981, there will be a net resource transfer back from developing nation borrowers to commercial lenders, so that "in the five years 1982/1986 banks would receive a net inflow from developing countries averaging \$12 billion a year."² Indeed, for some heavily indebted developing countries, like Mexico and Bra-

zil, this historic switch in the direction of resource transfers is already under way. Clearly, the next few years will be a critical hurdle for major LDC debtors, and now is the time when concerted attention must be paid to their difficulties.

As the aggregate external debt of the developing nations approached \$1 trillion, the year 1983 was one of limbo in international lending to the Third World. The question of whether these major debtor nations of the developing world would reschedule was answered in the affirmative during 1982, so that the "first stage" of the present LDC-debt dilemma has been completed. The second stage, hopefully ending in a successful solution to the problem, or, more pessimistically, ending in a series of debt moratoria or repudiations by the borrower, has not yet been reached. Lenders continue to pare down their loans to heavily indebted LDCs, but the largest among them (the "money-center banks") continue to be pressured by the International Monetary Fund (IMF) and their own governments to extend fresh monies to these countries. Thus, when the Mexican government announced on 8 December, 1983 that it was seeking a \$4 billion "jumbo" loan from commercial creditors, international bankers with high exposure in Mexico blanched at the prospect of IMF arm-twisting in support of this request.

The impact of IMF austerity programs in debt-burdened LDCs has been mixed. The Brazilian austerity package with the IMF included a 70 percent devaluation, but inflation continues at over 100 percent within Brazil. Austerity measures and IMF suasion contributed to a \$6.5 billion syndicated loan from 700 foreign commercial banks approved on 28 January, 1984, most of it to be used in repayment of Brazil's \$90 billion official external debt. Austerity measures, however, have evoked popular discontent in Brazil and elsewhere: Carlos Langoni resigned his position as president of Brazil's central bank in September, 1983, in response to the "socially punitive" effects of the IMF austerity package imposed on Brazil.

Politically, 1983 was a fairly positive year for relations between the industrialized nations and the major debtors of the developing world. Looking specifically at U.S. relations with the five case countries examined here, the ascension of Turgut Ozal as head of the new civilian government in Turkey, based on the electoral victory of his Motherland Party in 1983, is both a political plus for the United States and a positive sign for Turkey's creditors and potential lenders, as is the recent round of conciliatory gestures transmitted between Turkey and Greece over the Cyprus question. Mexico's President, Miguel de la Madrid Hurtado, has encountered political scandal concerning the pocket-lining activities of officials in the Lopez-Portillo Administration, almost all of whom were members of de la Madrid's own PRI party; but the Mexican President has sought closer relations with the Reagan Administration, and this is a welcome sign for Mexico's external creditors. In Brazil, *abertura* continue to progress, this political "opening" helping to offset unpopular austerity measures mandated by the IMF. In Argentina, the return to civilian government and the in-

stallation of moderate Raul Ricardo Alfonsin at its head bodes well in terms of an improvement in the the stability of the Argentine polity. While Alfonsin's debt and development policies stressing continued investment expansion and higher levels of current consumption will not calm the fears of Argentina's international creditors, the consensus is that Alfonsin will soon adopt more orthodox adjustment policies as a means of improving his country's debt-service capacity and securing conditional IMF loans. Although the domestic situation in Poland remains volatile, the Reagan Administration has moved in the direction of a thaw with the Wojciech Jaruzelski regime, rejoining other Western governments in reorganization of Poland's official debt.

In brief, the LDC external debt situation in early 1984 remains essentially the same as it stood in January, 1983, with improvements outweighing downturn by a slim margin. Having entered into official and commercial reschedulings within the framework of IMF adjustment programs, major LDC debtors face a year-by-year round of reschedulings into the late 1980s. Loans reorganized in 1982 and 1983 will continue to be restructured through 1984, 1985, 1986 and 1987 given (1) the need to amortize short-term loans contracted in the 1981–1982 period along with principal payments on medium-term loans extended in the late 1970s; (2) depressed commodity markets and continuing protectionist regimes in OECD nations, an externality that hampers LDC debt repayment capacity despite improvements in both energy costs and international interest rates; and (3) the *ad hoc*, informal, short-horizon characteristics of the rescheduling process for both Paris Club restructurings and bank workouts. The reader should be warned, however, that the potential for a drastic event that would transform the situation overnight, such as a unilateral moratorium on external debt repayment by one or more prominent borrowers, looms large.

Structure

Structurally, this work is divided into two parts which must be considered in conjunction with each other. The first half deals with general issues related to LDC debt. The artificial separation of parties into borrowers, lenders and negotiators is a gross simplification given the overlaps among these groups, (for example, the lenders of the Paris Club negotiating body and the IMF as an international creditor). It does represent the clearest breakdown of the participants in the fundamental sense that the roles of borrower, lender and negotiator are functionally distinct. Chapters 2 through 4 focus upon the position of one of the interested parties. The positions of the borrowers and lenders have been approached as a four-part series of parallel issues: (1) Why engage in international borrowing/lending? (2) From whom to borrow/to whom to lend? (3) Who is responsible for the present predicament in LDC debt service? (4) What is to be done about the situation as it now stands? It becomes plain that while borrowers and lenders face virtually identical issues, they do so from divergent viewpoints, with very different criteria and objectives. Chapter 4 examines the ne-

gotiators: the IMF, the Paris Club and the bank cartels which have served as forums for the reorganization of LDC foreign debts. Here the issues are inherent in the mechanisms of debt restructuring within each stage of the negotiating process and the linkages among these mechanisms.

The case portion of the book (chapters 5–9) examines the accumulation and handling of foreign debt by five major LDC borrowers: Turkey, Mexico, Brazil, Argentina and Poland. With the exception of Poland, each case is subdivided into two parts: a chronology giving background information on the case country, and a commentary section presenting analysis of key debt-related matters. While there are variations in the commentary/analysis segments of the cases, they commonly consider the points of national economic development strategy in handling of economic sectors; the orchestration of internal and external economies; the role of the central government as an investor and regulator; and domestic and foreign political factors pertinent to the country's external debts. In some cases, the commentary will also include an account of lender behavior before and during the nation's rescheduling of foreign commercial borrowings.

The overall structure of the book dictates its sequence of presentation. Chapters 2, 3 and 4 deal respectively with borrowers, lenders and negotiators, the borrowers given the "lead-off" position so that a popular misconception concerning their profligacy can be remedied from the outset. The case countries have been selected because (1) they are major debtors among Third World nations, (2) they have entered into large-scale, multilateral rescheduling exercises, and (3) they are different enough from each other to constitute a reasonable cross-section. In the broadest sense, the cases are arranged along a spectrum of certainty, moving from conditions of comparative certainty in the resolution of present debt problems to conditions that make such resolution dubious. Turkey has been chosen as the first case as it was the first nation to initiate rescheduling in the present era, and its debt restructuring has been all but successfully completed. Mexico and Brazil are examples of countries that have rescheduled official and commercial debts but have not yet reached a stage of resolution in their reorganization equivalent to that of Turkey. Argentina is further down the list, its potential for political upheaval casting doubts on the lasting impact of its latest (1982) restructuring rounds. Finally, Poland is accorded the last position because its official creditors reject any negotiations with the martial law regime now in power.

Method

The theoretical and empirical bases of this book have been derived from three sources: recent scholarly texts and articles; pieces appearing in business and financial journals; and official government and international studies, e.g., monographs and reports from the IMF, the International Bank for Reconstruction and Development (IBRD) and the Organization for Economic Cooperation and Development (OECD). This range of sources is a necessary result of the work's