Managing the Debt Crisis in the 1990s

The resumption of sustained economic growth should take priority

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The goal of the debt strategy is often described as facilitating the return of debtor countries to normal and voluntary access to the international capital markets. Indeed, with this in mind, creditors interpreted the situation, in the immediate aftermath of the 1982 debt crisis, as one of temporary illiquidity. Debt restructuring agreements with both private and official lenders, therefore, essentially focused on adjusting debt service to help countries cope with higher interest rates and worsened terms of trade. Under these circumstances, the debtors that pursued strong adjustment policies had little choice but to restrain imports and raise exports. In the process, they generated trade balance surpluses, which enabled them to meet their debt-servicing obligations.

These adjustments, however, were made at a high price. Investment and output levels have fallen, domestic consumption and wages have been compressed, and governments have frequently financed their budgets through inflationary means. As a result, most of the countries in Latin America and Africa now look back at almost a decade of lost growth. Moreover, even for those countries that managed successfully to tighten their belts, the restoration of normal market access has proved to be frustratingly elusive.

It is now becoming clear that after a debt crisis of the magnitude experienced in the 1980s, a new approach for the 1990s is needed to break this ~~debilitating~~ pattern. With the original goal of the debt strategy still far out of reach, we should revise our goal for the immediate years ahead, concentrating instead on the return of sustained economic growth in the debtor nations. We are still a long way from the end, and many more problems will be encountered en route. But major strides have been made during the last year. A framework for handling commercial debts—the Brady plan—is in place, and the official indebtedness of the poorest countries is being tackled with a variety of initiatives.

Current debt picture

In assessing where we stand as we enter the 1990s, it is useful to take a look at the experiences of those developing countries that have not had to reschedule their debts through multilateral arrangements in the past seven years. This group, which includes 61 out of 111 developing countries, is concentrated in Asia and embraces most of the developing world's people and most of the world's poor. They have enjoyed continued access to voluntary international capital flows from private as well as official sources. Their economies have tended to grow rapidly, with average per capita growth rates of 4 percent since 1980—equal to or surpassing the growth rates of the 1960s and 1970s.

Why did these countries manage to escape the debt crisis, while others operating in the same global economy did not? There are several reasons for the relatively successful performance.

- First, they were generally less affected by the external shocks of the early 1980s. Being typically less heavily indebted, they did not suffer as much from the sharp increase in real interest rates; being less dependent on commodity exports, they were able to better withstand the decline in commodity prices. The lesser dependence on commodity exports of some of the Asian economies—particularly those in East Asia—reflects in part the outward-oriented policies that they pursued. When the global recovery began in 1982, they were able to take advantage of the rapid expansion of manufactured goods exports, raising export earnings sufficiently rapidly to reduce their debt/export ratios and escape the debt crisis.
- Second, they treated the exogenous shocks as permanent and promptly undertook adjustment, thereby avoiding recourse to excessive foreign borrowing. By contrast, those that considered these shocks to be temporary aberrations and postponed adjustment—continuing with normal levels of expenditure financed by external borrowing—now faced severe payment difficulties as the borrowed resources were used mainly for consumption. Clearly, countries must be prepared to react rapidly and sharply to negative shocks.
- Third, they followed relatively cautious macroeconomic policies in the 1970s, thereby avoiding high inflation. Simultaneously, they made productive use of borrowed external funds, eased infrastructural bottlenecks, invested in human resources, expanded productive bases, and did not allow public sector enterprises to run massive deficits.

These attributes of good economic management will remain as necessary in the 1990s as they were in the 1980s if these countries are to maintain their good growth performance. They also point to the policies needed to restore growth and development in the 50 or so developing countries that have been hit hard by the debt crisis.

The severely indebted nations are by no means a homogeneous group. They differ in level of average per capita incomes, severity of debt burdens, quality of adjustment efforts, resource endowments, and economic struc-