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THIRD WORLD DEBT

ILLUSTRATION BY BRUCE FAGAN

History and Analysis

By Linus A. Hoskins

In recent years international hysteria has erupted in regard to the astronomical debt burden of Third World countries. And there have been headlines suggesting that never before have so many countries owned so much to so few. There has also been fear of an eventual collapse in international financial markets, followed by global recession and economic depression.

Basically, four events triggered the debt crisis: (i) in March 1981, Poland notified its creditors that it could not pay $2.5 billion out of its total foreign debt of $27 billion that year; (ii) in August 1982, Mexico indicated that it could not pay the interest on its $80 billion debt; (iii) Brazil quickly followed with the announcement that it too was unable to pay $446 million in interest payment on its $87 billion debt; (iv) Argentina fell behind on interest payments on its $40 million debt.

This article will examine the magnitude, causes, and cost of the Third World debt situation. Also, the article will analyze the reaction by some Third World countries to the debt situation, and the different plans that have been put forward to deal with this intractable problem. In the conclusion, solutions to the debt problem will be put forward.

The plans to be analyzed are the Baker Plan (named after U.S. Treasury Secretary James A. Baker III); the Bradley Plan (named after Sen. Bill Bradley, D-N.J.); the La Falce Plan (named after Rep. John J. La Falce, D-N.Y.); and the Schumer Plan (named after Rep. Charles Schumer, D-N.Y.).

Magnitude of Third World Debt

If one were to take a cursory look at the total external debt of Third World countries, one would find that the figure has now reached an estimated peak of US $1,080 trillion. In general, according to the World Bank, the total outstanding external debt of 109 Third World countries has jumped from $650 billion in 1980 to more than a trillion in 1987.

The 1980-87 figures prove that there has been a phenomenal increase of 67 percent in Third World foreign debt over those years. In more specific terms, Latin America's foreign debt now stands at $400 billion. The figure for Africa is $170 billion; for the members of CARICOM (Caribbean Common Market), $7.5 billion.

On individual country basis, Brazil owes $108 billion, Mexico $106 billion, Argentina $52 billion, Nigeria $23 billion, Chile $20 billion, Peru $15 billion, Zambia $4.5 billion, Jamaica $4.3 billion, Barbados $500 million, Trinidad and Tobago $3 billion, Guyana $1 billion, Tanzania $3.6 billion, and Zimbabwe $2.1 billion. (See table for Third World debt indicators, 1980-1986.)

to shoulder the foreign debt burden. In order to fill this financial and development vacuum, these countries have to borrow—a vicious circle of the debt trap of dependency, underdevelopment and Balkanization.

How then can Third World countries ever generate or achieve self-sustained growth?

The salient fact is, in the Third World, the debt crisis has diverted attention from the real problem — a development crisis. Let us analyze the debt indicators table: In 1980, there was a 20 percent ratio between GNP and foreign debt; by 1986, the figure escalated to 35 percent. This high ratio proves the point made earlier in terms of the gains from domestic productivity (GNP) benefiting foreign interests, i.e., foreign commercial banks and financial institutions such as the International Monetary Fund [IMF] and the World Bank. Over the 1980-86 period, there was a 29.2 percent average ratio of debt to GNP. In fact, Third World countries are paying back about $27 billion annually to commercial banks in the West, while getting about $18 billion from the IMF and the World Bank. This means then that there is a net outflow of $9 billion of capital from poor underdeveloped countries to rich, industrialized countries.

The debt indicator for exports seems too ghastly to contemplate. In this category, the

Third World Debt Indicators (in percent)

Indicator	1980	1981	1982	1983	1984	1985	1986
Ratio of debt to GNP	20.6	22.4	26.3	31.4	33.0	35.8	35.4
Ratio of debt to exports	90.0	98.0	117.6	134.8	121.2	143.7	144.5
Debt service ratio	16.0	17.5	20.6	19.4	19.5	21.4	22.3
Ratio of debt service to GNP	3.7	4.0	4.6	4.5	4.9	5.3	5.5
Ratio of interest service to exports	6.9	8.3	10.4	10.1	10.3	10.8	10.7

Source: World Bank, *World Development Report 1987*, p. 18.

At first glance, what is striking in the table is that when compared to a previous year, only in six instances do the indicators actually decline. But more importantly, the table shows how much of their development effort/output Third World countries have to sacrifice in order to pay a huge foreign debt. In other words, any productivity that takes place does not benefit the people nor the country but foreign interests. The bulk of any foreign earnings/exchange that is generated from exports have to be siphoned off

ratio was 90 percent in 1980, but escalated to 144.5 percent in 1986. With this skewed relationship and increasing protectionism in the industrialized countries, export promotion is a misnomer. The 7-year average for this indicator is a whopping 121.4 percent.

In the debt service ratio category (the sum of payments a country makes on its external debt divided by the exports of goods and services), the percentage fluctuates but still was an astonishing 22.3 percent in 1986. The higher the debt service ratio, the greater the debt burden and the more dependent and underdeveloped a country becomes. This ratio shows how mercilessly Third World countries are being dragged through the economic wringer.

While Third World total external foreign debt increased by 67 percent over the 7-year period, their debt service ratio has increased by about 60 percent. The average for this indicator was 19.5 percent. And when one looks at the ratio of debt service to GNP indicator, there are comparable deleterious trends. The two ratios increase or decrease simultaneously over the years.

The debt serivce to GNP ratio almost doubles over the period with a 4.6 percent average. The last debt indicator, ratio of interest service to exports is frightening. It shows what percentage of export earnings Third World countries have to allocate to defray interest payments on foreign debt. Indeed, this indicator suggests that for the past five years, one-tenth of the export earnings of Third World countries went solely toward paying interest on foreign debt. The average for this indicator stands at 9.6 percent, almost doubling over the period. Although World Bank net new long-term loans to Third World countries declined from $75 billion in 1981 to $30 billion in 1985, the interest paid on these loans increased from $40 billion in 1981 to $50 billion in 1985.

In Latin America, $400 billion foreign-debt represents 60.5 percent of the value of exports of the six major countries. Out of every dollar earned from exports, individual countries must pay up to 40 cents for debt service. If this situation persists, it will inevitably lead to social and political destabilization in the region.

In 1983, for example, the region's foreign debt stood at $336 billion; this represented four and a half times the amount in 1975 and 56 percent of the region's GNP. The interest payment on that debt was 38 percent of all foreign exchange receipts from exports in 1982-83, compared with 13 percent in 1975 and 16.5 percent in 1978. On a country-by-country basis, it has been estimated that in 1985 Brazil's interest payments as a percentage of its export earnings was 44 percent; the figure for Mexico was 37 percent; for Chile 47 percent; for Bolivia 60 percent and for Argentina 55 percent.

The net outflow of money from Latin America in the past five years has averaged $25 billion annually, not counting capital flight. In other words, money is leaving Latin America for the industrialized world at a very crucial time when it is needed for development. This outflow and the drop in living standards have led many economists to describe the region's economic situation as the worst since the 1930s. Even the president of the Inter-American Development Bank (IDB), Antonio Ortiz-Mena, was compelled to warn that "some Third World countries will default on their debts if (Western) commercial banks keep taking back more money in repayments than they put out in new loans."[1]

The net outflow of money from Latin America in the past five years has averaged $25 billion annually, not counting capital flight.

In the case of Africa, the annual cost of servicing $170 billion foreign debt is about $12 billion — enough to eat up one-half of the continent's total export earnings. The total foreign debt of Africa, south of the Sahara, was more than $57 billion at the end of 1984; and the annual debt service was $5.9 billion in 1982-1984. The figure for 1985-87 has been estimated to be $10.7 billion.

In Africa, debt service payments consume about 50 percent of the export earnings in several sub-Saharan countries. For example, Sudan, Mozambique and Madagascar owe more in loan payments to foreign creditors than what they can obtain from exports each year. Nigeria, on the other hand, has to allocate 36 percent of its exports earnings as interest payments on its $23 billion foreign debt. In the case of Zambia, with an estimated $650 million export earnings in 1987, the country was expected to pay debts of about $400 million to the IMF, about $71 million to the World Bank, and nearly all of the balance to Western interests. This again is another development Catch 22. The country then has no other recourse but to borrow money for development projects, despite the fact it has used up its finite factor endowments to produce a huge volume of exports. This productivity has not benefited the country; in fact, the country is worse off. In 1984, Zambia's per capita GNP was $470 but its per capita debt was $429.

Africa's foreign debt grew at an average annual rate of 20.8 percent from 1971 to 1982, while the number of African countries recording negative growth rates reached 27 (out of 50) between 1974 and 1982.

According to the U.N. Economic Commission for Africa, the combination of falling commodity prices and rising debt payments bled Africa of about $30 billion during 1985-86.[2] In fact, commodity prices are one-quarter to one-third what they were in the 1970s when African countries borrowed heavily to finance development projects. Under these circumstances, it seems impossible for any African government to undertake new investments and development projects for growth and to import vital resources needed to maintain current export levels. Or as the U.N. Commission's executive director, Adebayo Adedeji, surmises:

"Africa, poor as it is, continues to be a net exporter of resources, paying more in debt service than the combined total of what it receives in foreign aid and earns from commodity exports. . . ."[3]

Causes of Third World Debt

The Third World "debt crisis is coming more and more to be a trade crisis. The link between trade and debt is crucial."[4] Foreign debt and trade are closely linked because Third World countries cannot build up foreign exchange reserves and pay off their huge debts if protectionism in the rich industrialized countries prevents them from exporting their products. This loss of export earnings is one reason many of these Third World countries have been unable to continue normal payments on their foreign debt and have been forced to seek loan extensions from private commercial banks in the West and emergency aid from the IMF. Compounding this situation is the fact

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that the bulk of the money Third World countries earn from exports flows out to pay debt interest, thus blocking their ability to use trade surpluses to stimulate self-sustained economic growth.

According to the IDB, Latin America's "huge foreign indebtedness is the result of the combined effects of a wide range of circumstances that are endogenous to their economies, relative to their current structure, operations and policies; and of the effect of adverse changes in the world economy on the region's foreign trade and financial relations."[5] In a study, "The External Debt of Latin America," the IDB outlines the specific internal and external causes of the region's foreign debt as follows:

". . . . Domestically, a major portion of the imbalance can be attributed to the policy of expanding final demand in investment, to the lack of appropriate incentives to savings, to deficiencies in the management of exchange policies and to the absence of a stringent policy on the acquisition of foreign debt. External causes include a fourfold increase in oil prices in 1973; the deterioration in many oil importing countries' terms of trade; the 1974-1975 worldwide economic recession and the slow and partial recovery later; protectionist trends in the industrialized countries after 1979; the second rise in oil prices; and the worldwide economic recession which began in 1980.

"These developments were followed by (a) the record rise in nominal and real interest rates in the main financial markets; (b) the readjustment in the industrialized countries; and (c) the imbalances between the foreign exchange rates of major currencies. Thus the decline in activity and world trade was concerted into the most severe general crisis since the thirties. . . ." [6]

And in an analysis of the debt crisis in Africa, development economist Robert S. Browne suggests the following causes for Africa's debt crisis:

". . . . Two prolonged periods of drought, a sevenfold increase in the price of oil, recession and inflation in the industrialized countries resulting in weakened demand for African products, persistent deterioration in the terms of trade, unprecedentedly high interest rates, and a severely overvalued dollar have all helped to place Africa in an economic squeeze which has drastically altered the continent's developmental prospects and indeed threaten the orderly survival of several nations as thriving and coherent political entities. These externally originating catastrophes have been exacerbated by various internal factors such as localized wars, inefficient management, and inappropriate economic policies, including some which have damaged productivity in the all important agricultural sector without producing compensating output in other productive sectors.

"Many governments, when confronted with this series of shocks to their economies, attempted but were unable to reduce expenditures as swiftly as revenues were falling and to cut back on imports in parallel with the shrinkage of their export earnings. Instead they resorted to deficit financing both in their domestic budgets and in their balance of payments, which merely fueled the inflation which had already been created by the rising cost of imports. Strenuous efforts were of course made to cut imports, but since imports constitute a significant input into many of Africa's exports, the cutback in imports soon resulted in serious declines in production for export, thus furthering a self-reenforcing downward spiral. . . ."[7]

Third World countries are caught in a vicious circle because they have to devote so much of their revenues and export earnings to debt servicing.

Cost of Third World Debt

The cost of this mammoth debt on Third World countries is unconscionable. A substantial part of their national revenues must be set aside to repay debts at a time when commodity prices have sharply declined. Since 1980, revenues in Africa and Latin America have declined by 10 to 15 percent, and there has been a deterioration in the nutritional health of children in many countries. Third World governments wanting to reschedule their debts have been forced to accept stiff measures or "adjustment policies" imposed upon them by the IMF. Under the IMF "stabilization program," Third World countries have to agree to:

- abolish or liberalize foreign exchange and import controls;
- devalue currency;
- implement anti-inflationary programs, including (a) control of bank credit, higher interest rates and higher reserve requirements, (b) control of government deficit, curbs in spending, increase in taxes and in the prices charged by public enterprises, and abolish consumer subsidies;
- provide greater hospitality to foreign investment.

Emphasis is placed on enhancing the profit capability of the domestic private sector and foreign investors. Where the majority of the citizens are concerned, however, a cap is placed on the consumption of the essentials of life (food, shelter, health, education, and transportation) so as to free or divert more funds to the domestic business sector. The IMF has argued that ". . . only if large corporations invest and begin exporting from a country, will the country get out of the debt." Such conditionality measures in the IMF "rescue kit," although punitive on the broad masses of the people, do coincide with the interests of banks in the West whose financial assets are tied up in these countries. Some case studies have shown that these conditionality measures, in certain instances, have been imposed to destabilize governments whose domestic and foreign policies have been designated as "anti-American," or Marxist-Leninist, leftist and Communist.[8] Third World governments that have felt the weight of these measures include Grenada, under Maurice Bishop; Nicaragua, under the Sandanistas; Cuba, under Fidel Castro; Zambia, under Kenneth Kaunda; Tanzania, under Julius K. Nyerere; Jamaica, under Michael Manley and Chile, under Salvador Allende.

In 1983, for example, 11 of the 20 largest Third World countries were under IMF conditionality measures. This number has increased significantly since. Some Third World leaders have vociferously protested against these measures. For example, President Kaunda of Zambia has described the IMF debt repayment conditions as grossly "intolerable." Former Tanzanian President Julius Nyerere has blasted the IMF as "an instrument of the capitalist powers . . . bent on suppressing the weak developing countries by taking advantage of their poverty."[9] President Jose Sarney of Brazil has adamantly contended that the IMF program

was "a recipe for recession and an interference in Brazilian domestic policies"[10] and vowed, in January 1987, not to sign an economic performance agreement with the IMF because he feared obvious domestic hardships and repercussions.

In the case of Jamaica, under Manley, government negotiators with the IMF between 1977 and 1979 have publicly described the IMF measures as "punitive," "murderous" and "a prescription for the downfall of the government."[11] Manley's government fell in 1980. In two other cases (Sudan and the Dominican Republic), the IMF programs resulted in riots and severe economic hardship. Even the managing director of the IMF has been forced to confess that "too often . . . it is the poorest segments of the population that have carried the heaviest burden of economic adjustment."[12]

On top of these stiff IMF measures came the collapse in commodity prices, a steep fall in oil prices and a decline in economic performance for Third World countries. These global shocks not only vastly reduced export earnings but also made it more difficult or impossible for Third World nations to pay off their debts on time. For example, between 1981 and 1986 the commodity export earnings of developing countries, measured against the average for 1979-80, declined by $8 billion per year on average despite expanded export volumes. The cumulative losses in their net barter terms of trade and export purchasing power amounted to $93 billion and $13 billion, respectively.

Additionally, the real gross domestic produce (GDP) fell to 4.2 percent in 1986—from 4.8 percent in 1985 and 5.1 percent in 1984. Also, trade slowed considerably in 1986 as export earnings fell sharply and imports declined slightly. The 3.3 percent fall in the U.S. dollar value of exports — to $479.8 billion—marked the second straight year of sharp decline while the 0.1 percent fall in imports — to $501.5 billion — sustained a long downward trend that left nominal import values at 9.4 percent below the 1982 level. The net result has been a worsening situation in the combined trade deficit of developing countries in 1986 — to $21.7 billion. This is more than three times the deficit of 1985 and also is in sharp contrast to the $5.7 billion surplus earned in 1984.[13] The world economic situation has reached such a precarious state with specific devastation for Third World countries that the president of the World Bank, Barber Conable, publicly stated:

". . . . *Stuttering growth, volatile currencies, high real interest rates, heavy debt loads, depressed commodity prices, rising trade barriers and outside (international) payments imbalances have acted in destructive combination not just to slow earlier rates of advance, but actually to erode many previous gains by developing societies. . . .*"[14]

And in its 1986 edition of the *World Economic Survey*, the U.N. Department of International Economic and Social Affairs noted:

". . . *The large imbalances in trade and payments that have in recent years characterized the world economy persisted in 1985 and early 1986. In particular, unprecedented disequilibrium prevailed in the trade and financial relations of major industrial countries, and there was a continued overall net transfer of resources from developing to developed countries, largely related to the international debt crisis. Both of these situations were, in the course of 1985, increasingly perceived as unsustainable, economically as well as politically. . . .*"[15]

Four different plans have been put forward to solve the Third World debt problem.

While the economic costs of the debt burden have been devastating, the social/human costs have also been of similar magnitude. The main human cost is that the struggle to pay interest on the foreign debt has siphoned off resources from social programs that benefit the poor majority. Unemployment has spiralled; poverty escalated; basic human needs/services not delivered; standards of living have dropped; consumer prices (inflation) have shot up (e.g. Bolivia 8,216 percent, Argentina 850 percent, Brazil 234 percent, Mexico 66.5 percent and Jamaica 27.8 percent — as of April 1985). Worst of all, civil violence has erupted in some Latin American countries. As one columnist noted:

". . . . *In many cases, the countries have taken food from the mouths of their citizens in order to sell it abroad . . . (to pay off their debt). . . .*"[16]

In some countries, central government investment has dropped by more than 80 percent in real terms between 1980 and 1985, and the government's efforts to service the foreign debt has aggravated problems that had improved during the 1970s.

Third World countries are caught in a vicious circle because they have to devote so much of their revenues and export earnings to debt servicing. Their ability to invest is severely undercut, along with the possibility for economic growth.

Reaction of the Third World

Just as some Third World countries have vociferously protested against the IMF conditionality measures, they have reacted likewise to their foreign debt situation. On a collective basis, in January 1984, 26 Latin American and Caribbean countries convened in Quito, Ecuador, to deal with the region's $400 billion external debt problem. They unanimously adopted the Declaration of Quito and Plan of Action. They asserted:

". . . . *Responsibility for the external debt problem must be shared by the debtor and the developed countries, the international private banking system and the multilateral finance organizations. . . .*"[17]

". . . *The Latin American and Caribbean countries have already assumed their responsibility by making extraordinary adjustments in their economies and enormous efforts to meet their international obligations, despite the high social, political and economic cost involved. . . .*"[18]

They further agreed:

". . . . *Because of these circumstances and the need to maintain adequate levels of development in Latin America and the Caribbean and to avoid greater crises in the international economic and financial system, it is to the mutual benefit of those concerned that an urgent solution be found to the problem of the region's external debt. . . .*"[19]

In May 1984, the governments of four of the most heavily indebted Latin American

countries met in Mexico to discuss a proposal to extend debt repayments over a 15-year period. The proposal, which was circulated in Argentina, Brazil, Colombia, and Mexico, sought to repay debts over a period of nine years after a six-year grace period. Brazil wanted the period to extend to 10 years with a five-year grace period.

The proposal also sought the following: (i) a repayment schedule similar to a graduated mortgage, with smaller payments at the outset that would gradually increase and interest rates fixed for each country according to the circumstances surrounding each one and its possibility of economic recovery, (ii) debt payments based on the export incomes of the individual countries and set so the payments should not absorb more than is compatible with the maintenance of adequate levels of internal productive activity.

The four governments argued that the rationale behind their proposal was that with current levels of external debt and declining economic activity, Latin American governments are being forced to choose between debt or democracy and that current repayment plans have turned the region into a net exporter of capital.[20]

In June 1984, ministers of 11 Latin American countries met in Cartagena, Colombia, to consider a variety of joint initiatives to ease the foreign debt burden. Among the initiatives discussed were: (i) the establishment of a formal system for proposing reforms in both loan payment terms and the international financial system, (ii) compensation from the industrialized countries whose policies restrict trade or increase the burden of interest payments, and ways to place limits on interest rates or annual debt payments, (iii) the drawing up of new guidelines for the terms of loan payments and to press for financial reform on the industrialized countries[21] (a proposal the Reagan administration has strongly opposed.)

In February 1985, the economic and foreign ministers of the 11 most heavily indebted Latin American countries called for a dialogue between governments of lending and borrowing countries on the issue of external debt within what they called a "political" and "economic" framework. Meeting in Santo Domingo, Dominican Republic, February 7-8, the ministers reiterated their earlier proposals for resolving the debt problem and announced their intention to press for more liberal rescheduling terms for all of the region's debtor countries.

In their final communique, the Cartagena Group called for lower interest rates on loan payments. The ministers also noted that because of the high debt burden and high interest rates, the region was sending abroad far more dollars to foreign interests than it was receiving annually, thus hindering development and growth.[22]

Toward the end of 1985, the Cartagena Group hinted at a confrontation with the multilateral and commercial banks and industrialized nations when the economic and foreign ministers of the 11 most heavily indebted Latin American nations issued a set of "emergency" proposals for negotiations on debt and growth, aimed at gaining concessions from international creditors. Meeting in Montevideo, Uruguay, December 16-17, the ministers stated in a joint declaration that living standards in Latin America have slipped back by a decade between 1980 and 1985, due to the decline in international economic conditions. They argued for a series of emergency measures to counteract the effects of high interest rates and adverse terms of trade, and to finance levels of investment strong enough to support a projected doubling of the region's output.

Developing countries cannot achieve economic growth while continuing to transfer liquid capital resources abroad.

In March 1986, a ministerial-level committee of the Cartagena Group met in Punta del Este, Uruguay, as a follow-up to their December 1985 meeting. During this emergency session, the representatives of the major debtor nations — Brazil, Mexico, Argentina, Venezula and Colombia — stated that there must be "significant changes in existing loan agreements, especially with regard to interest rates" and that "certain countries have reached the point where such changes, which would apportion the adjustment burden more evenly between lenders and borrowers, could no longer be delayed."[23]

The ministers concluded that if lower interest rates cannot be obtained by debtor countries through negotiations with banks, then unilateral action on the part of the debtors is justified and the 11 members of the Cartagena Group would unanimously support such action. The ministerial-level committee did not propose unilateral action as a desirable course of action, but only as a last resort if negotiations with the industrialized countries failed to reduce debt burdens sufficiently. The committee also did not discuss the question of repudiation of all or part of their external debt,[24] as has been proposed by Cuba's Fidel Castro.

In addition, economic and finance ministers of the intergovernmental Group of 24 on International Monetary Affairs, meeting in Buenos Aires, Argentina, March 1986, voiced concern that prevailing debt strategies had failed thus far to produce encouraging results and stressed that the debt-servicing ratio of developing countries would improve only if credit flows were maintained and new initiatives taken.

Also, the ministers called for an international conference to discuss both the debt crisis and the transfer of vital resources to developing countries within the context of reform of the international monetary system. As the president of Argentina, Raul Alfonsin, observed at the meeting:

". . . . the debt crisis does not result primarily from the domestic policies of debtor countries but from the impact of discriminatory and inflationary policies pursued by a majority of industrial countries on the balance of payments position of developing countries. . . ."[25]

And after a consultative meeting in Washington, D.C., April 1986, the intergovernmental Group of 24 issued a final communique in which they reiterated that the failure of the current debt management approach to find a definitive solution to the debt crisis is deeply rooted in an inadequate diagnosis of the problem and, as a consequence, there are inconsistencies between short-term deflationary adjustment policies and the need to obtain a long-term equilibrium.

On an individual country basis, in June 1985, Peru's President Alan Garcia embarked on a plan of "national resistance" in which he declared that his country would use no more than 10 percent of its export earnings to service its $13.5 billion foreign debt. In July 1986, he announced that this

policy would continue for another year and that his government will limit foreign debt payments by private Peruvian companies and will also prohibit foreign investors from repatriating profits for two years.

In July 1986, Brazil's finance minister, Dilson Funaro, told creditors that his country intends to limit its annual payments on its debt to only 2.5 percent of its GNP. The minister argued that Brazil could not achieve the annual 7 percent growth rate of its economy toward which the government was striving if it has to pay foreign creditors 4 percent of its GNP. In February 1987, President Jose Sarney went further. He announced that Brazil would suspend interest payments on its $68 billion in foreign commercial debt, about 23 percent of which is owed to U.S. banks. Brazil has to pay about $800 million in interest payments every month on its staggering $108 billion foreign debt.

In July 1987, Brazil broadened its moratorium on foreign debt by announcing that it had suspended $1 billion in principal payments to the Paris Club, a group of Western creditor nations. The government stated that its action was not meant as an act of aggression against foreign creditors but as a means of defending its dwindling hard-currency reserves.

Further, in June 1987, Brazil asked the IMF to delay payments on its debt. The IMF has *never* before granted such approval. And no member of the IMF has *ever* reneged on loan payments. In fact, debtor governments regard payments of interest and principal owed to the IMF as sacrosanct. Brazil has been paying the IMF about $1.1 million a year in interest and principal. It has yet to unilaterally suspend its payments to the IMF. Brazil's total external debt is $108 billion plus interest, $4.75 billion of which is owed to the IMF.[26]

Bolivia, in 1983, stopped making payments on its debt of $3.3 billion to commercial banks; many banks had already written off the debt as unpayable. Also, in May 1984, this "cash-starved" country announced that it was limiting repayments to international lending agencies (IMF and World Bank) to only 25 percent of the country's export earnings.

In August 1985, Bolivia's President Victor Paz Estenssoro resolved to renegotiate the country's external debt with its creditors "without taking bread from the mouths of the people."[27]

Ecuador, in February 1987, refused to make the required interest payment to its bank lenders. The government stated that "cash flow" difficulties, precipitated by deteriorating oil prices, prevented it from making the payment. And in March the government cancelled all foreign debt payments for the rest of the year and appealed for international aid because of a series of earthquakes that destroyed villages and crippled the country's oil industry. Loss of revenues caused by the quakes forced the government to discontinue making payments on its $9.1 billion foreign debt.

In Mexico, President Miguel de la Madrid declared, in February 1986, that foreign creditors must "share the responsibility" for his country's $106 billion foreign debt crisis and must, as a result, accept a reduction in interest payments. He explained that the chaotic oil market situation has deprived Mexico of $6 billion in anticipated income, reducing federal income by 12.5 percent and the country's total export earnings by almost a third. Mexico depends for two-thirds of its hard-currency earnings on oil exports. In his televised speech, President de la Madrid stated that Mexico's debt-servicing load must be lightened "in accord with the country's ability to pay" and that "requires sacrifice on the part of the international creditors."

Also, he announced that Mexico will be sending proposals for new debt negotiations to foreign creditors because the country wished to retain "the respect of the international community" and hoped to resolve the debt problem "through negotiation, not confrontation."[28]

Mexico's proposals included: elimination of additional new borrowing, conversion of interest calculations from the US base rate to Libor (London inter-bank overseas rate), linkage of interest payments to the world price for oil, and deferral of payments of principal and interest on its old debt. Mexico also proposed to pay half of its foreign debt over 15-25 years.

A high ranking Mexican negotiator has stated that the reaction of the foreign creditors to the proposals was cool; they feared that countenancing Mexico's demand would pave the way for similar demands by Latin America's other debtors.[29]

Cuba's Castro, in April 1986, told foreign creditors that Cuba will suspend debt payments for 90 days starting in May while seeking more favorable repayment terms and $500 million in cash to make up for a projected revenue shortfall. Cuba owes $3.5 billion to creditors in the West. Moreover, in recent months, President Castro has been vigorously urging Third World nations to repudiate the foreign debts they owe to banks and governments. Castro's argument is that Latin America's heavy debt burden stymies the creation of new jobs for the more than 100 million unemployed workers in the region and inhibits financially strapped governments from providing basic human needs to their citizens.

And in July 1987, the Philippines government announced that it would limit payment on its foreign debt to 10 percent of its merchandise trade and commodity export receipts. The government acted because payments on its $28 billion foreign debt consumes more than 45 percent of its merchandise export receipts, and accounts for 40 percent of all government expenditures.

In Africa, in January 1986, Nigerian leader Maj. Gen. Ibrahim Babangida declared that his country would use no more than 30 percent of its export earnings to pay its $23 billion foreign debt. In effect, he told foreign creditors that year either to settle for a little more than half of what they are owed or risk getting nothing. Nigeria's decision, like Mexico's, is based on the sharp drop in oil prices; Nigeria depends on oil for about 94 percent of its export earnings.

Finally, in July 1987, Zambia decided to allocate only 10 percent of its export earnings to pay its foreign debt.

Plans to Solve Third World Debt

Four different plans have been put forward to solve the Third World debt problem. The first is the Baker Plan, put forward by the Reagan administration. This plan was unveiled in October 1985 by Treasury Secretary James A. Baker III during a speech at the World Bank-IMF annual meeting in Seoul. Its essential elements include: (i) adoption by debtor countries of comprehensive macroeconomic and structural policies to promote growth, balance of payments adjustment and lower inflation, (ii) increased lending by the World Bank and other multilateral development banks, amounting to an additional $9 billion in net lending during 1986-88 as well as more effective structural adjustment lending by these institutions in conjunction with a continued central role for the IMF, (iii) an increase in net new lending by private commercial banks over the next three years

to support comprehensive economic adjustment programs.

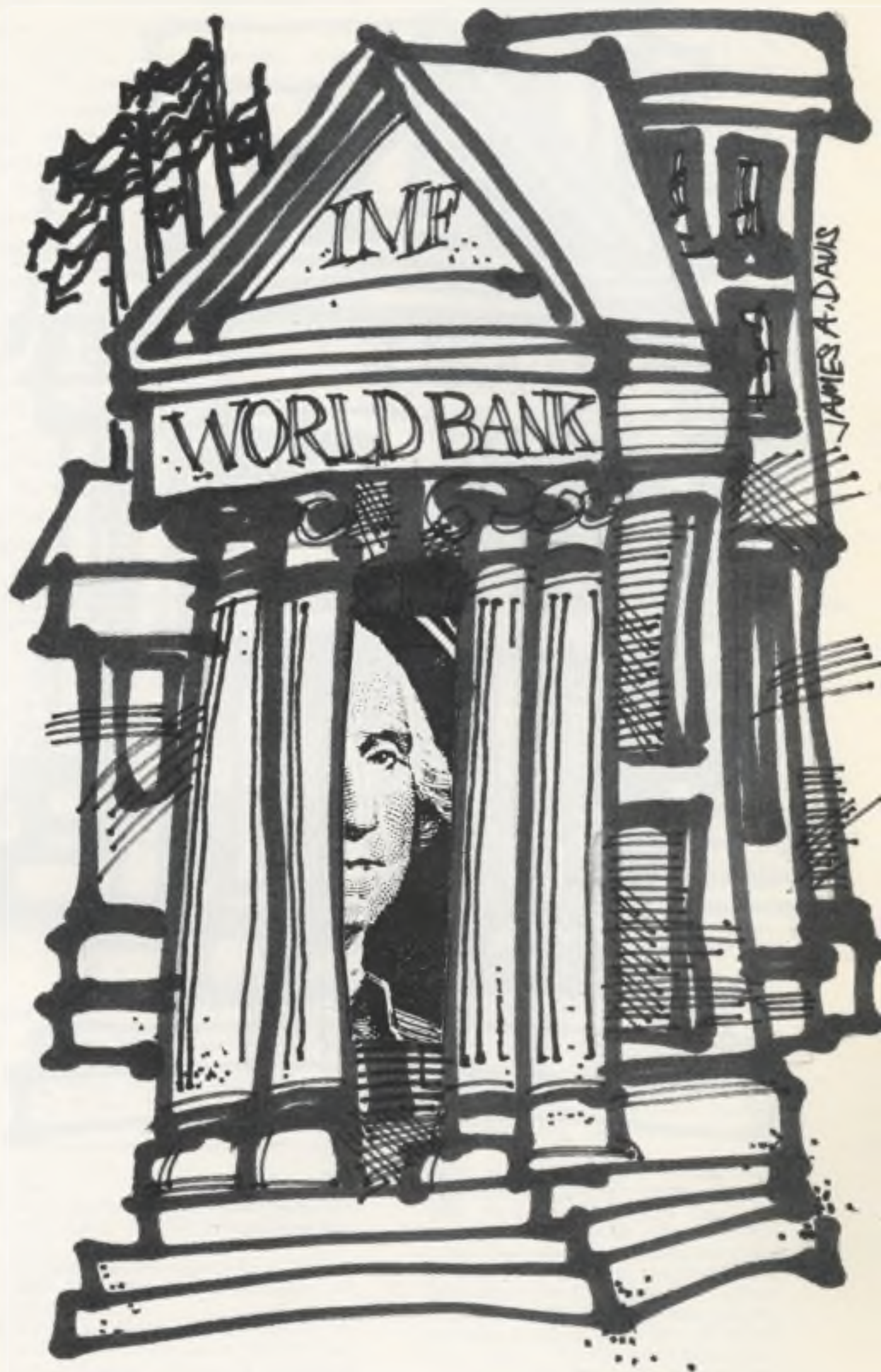
The Baker Plan also identified 15 indebted countries that would require net new lending from commercial banks in the range of $20 billion over the next three years. The plan stresses that countries now receiving adequate financing from banks on a voluntary basis should continue to do so provided they maintain sound economic policies.

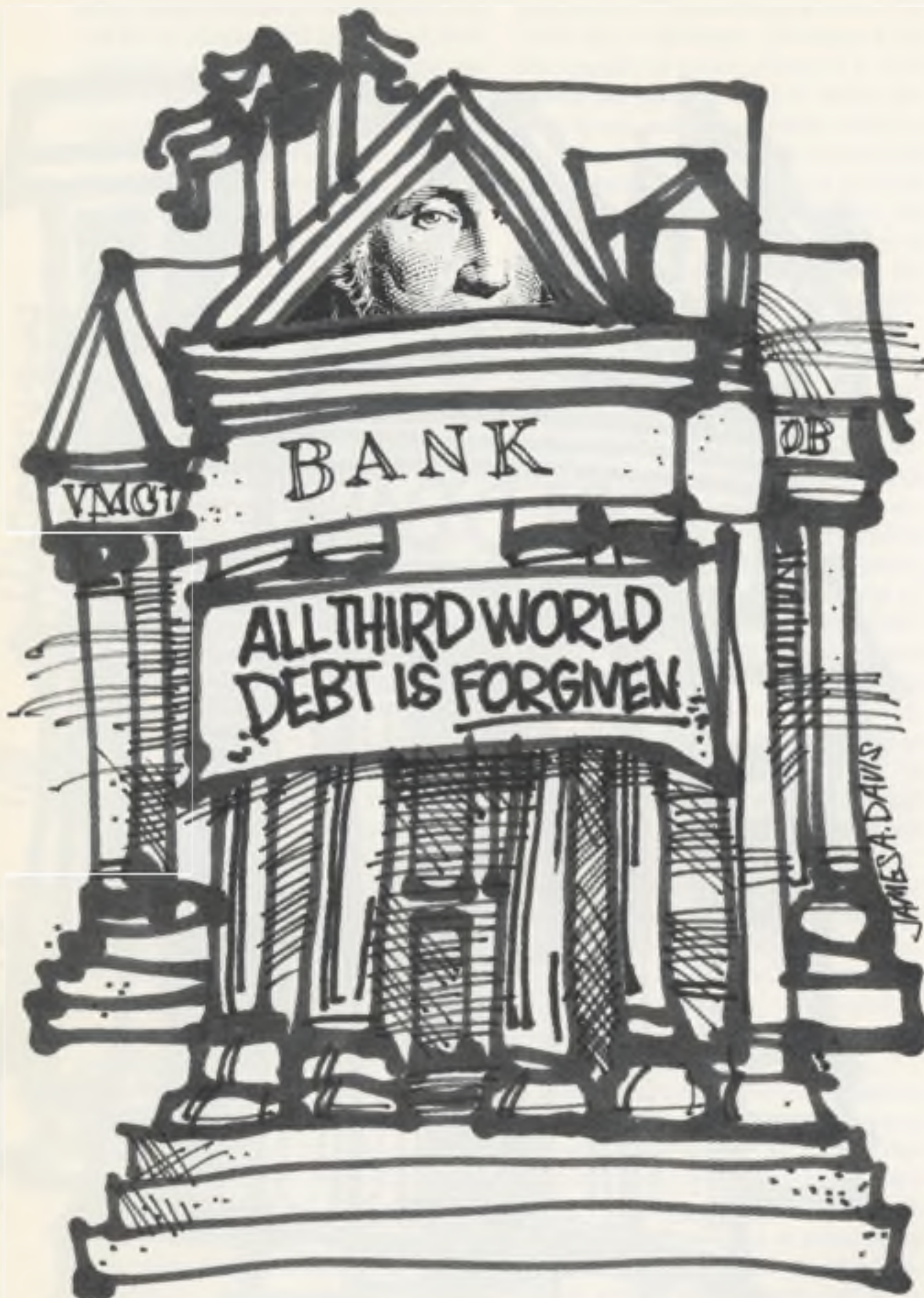
In April 1987, Secretary Baker modified his plan because he felt that the proposed amount of new bank lending in his original plan was "clearly disappointing" in 1986, and that new and creative ways are needed to keep the flow of commercial money moving to the Third Word. The modified plan proposed that banks develop "a menu of alternative new money options" to avoid "periodic financial crises." Baker rejected any "debt relief" or "debt forgiveness" for debtor Third World countries.

The Baker Plan had to be modified because there was widespread concern that it merely added to the existing debt burden of the developing countries, who actually need relief from the cost of servicing their foreign debt instead of new loans. In addition, the commercial banks only lent lip service to the original plan; they were not as forthcoming in lending new money to the heavily indebted Third World countries.

The second is the Bradley Plan, which was unveiled in Zurich in late June 1986. Senator Bill Bradley contends that debt management has stalled development in Third World countries, hurt U.S. industry and trade, lost the U.S. 1.4 million jobs and destroyed jobs elsewhere in the industrialized world. He also links the debt problem with the potential for failure of the democratic process in Latin America.

The main elements of the Bradley Plan are: (i) development banks (as in the Baker Plan) would boost their lending by $3 billion a year over a three-year period, but in contrast to the Baker Plan there would be no new loans required from commercial banks, (ii) an annual trade/debt summit would be called and chaired by the president of the World Bank (using this forum, debtor nations who agree to economic reforms would get 3 percentage points of interest rate relief for a three-year period on all outstanding commercial and other bilateral loans, plus a 3 percent write-down of principal a year over a three-year period), (iii) to qualify for trade relief packages, debtors would make internally generated





(not dictated from the outside) policy changes to generate growth, liberalize trade and capital flow, reverse capital flight, and keep debt management free from scandal.

The third is the La Falce Plan, a debt proposal in a March 1987 congressional bill "to promote a stable international financial system, expand world trade, and alleviate the Third World debt crisis." The centerpiece of Rep. John L. La Falce's legislation is a debt adjustment facility which would be specifically authorized to assist creditor banks in the voluntary disposition of loans to heavily indebted borrowers. Also, the La Falce plan would be empowered to encourage countries with strong capital surpluses to apply these surpluses to investments in heavily indebted countries, purchase bank loans at a discount, and establish mechanisms for passing along the benefit of any such discount to the debtor country. In essence, this would enable commercial banks to voluntarily dispose of loans they no longer wish to hold at a discount and to rebate most of that discount to the debtor country in the form of lower principal.

According to Rep. La Falce, his proposal for a new debt adjustment facility is based on the premise that the burden of existing debt must be reduced before "new private capital flows will or should take place." This, in my view, makes sense. Not reducing the current debt burden before new lending money is received would be tantamount to a debt surtax on debtor Third World countries.[30] This brings up the important question of debt relief or cancellation recommended in the Bradley Plan, but rejected in Baker Plan. World Bank President Barber Conable (a former Republican congressman from New York) has also rejected any form of generalized debt relief for developing nations and stresses that the Baker Plan should be the guiding principle in attempting to cope with the $1 trillion Third World debt problem.[31]

The fourth is the Schumer Plan, which calls for outright debt forgiveness or relief. The main elements of Rep. Charles Schumer's Plan are: (i) traditional new loans, (ii) interest rate relief, (iii) forgiveness of some debt principal and (iv) debt-equity swaps.

In analyzing the four plans, it should be obvious that the Baker Plan would not work because its centerpiece rests on commercial banks making more credit available to heavily indebted countries.

The answer to the debt problem is NOT

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more money but relief/reduction in the debt burden/cost. Only European and U.S. banks stand to benefit from the Baker Plan; there is no impact on the productive forces in the recipient Third World countries.

In short, the Baker Plan is geared toward deepening the dependent-underdevelopment and Balkanization of the heavily indebted Third World countries. Further, it suggests that the "new money" is conditioned on a program of growth-oriented adjustment being in place and approved by the IMF. And the commercial banks will lend only in conjunction with concerted new lending by the World Bank, the International Monetary Fund and the Inter-American Development Bank. By putting these institutions in charge of the implementation of the Baker Plan, the administration is skillfully securing U.S. control over the economic and political policies of debtor nations.

Simply put, the Baker Plan is akin to a credit card customer who owes, for example, $700 and then borrows $700 from a commercial bank to pay the creditors off. After the creditors are paid off, the customer still owes $700 in principal plus interest to the new lender. The customer then has to work hard or overtime to pay the additional costs of the new loan. In the long run, therefore, the customer is worse off.

On the other hand, the Bradley Plan suggests it is time to stop new lending which, in reality, comes right back to the banks as interest payments and increases in principal. This plan calls for fundamental changes, given the current reality that debt is piling up too high in developing countries. The strong points in this plan are loan principal write-offs and interest rate reduction of up to $50 billion.

Also, the Bradley Plan, unlike Baker's, indicates, with fewer loans to repay, Latin America could afford more U.S. exports.

The only sensible plan, therefore, seems to be a combination of the Bradley — La Falce — Schumer Plans, which will focus on the most important elements — debt relief/cancellation and debt-equity swaps.

Solutions to Third World Debt

How can heavily indebted Third World countries solve their debt problem? First, they should take a lesson from the Cartagena Group and resolve NOT to pay on their debt until a reasonable 10-year grace period elapses in order to give them enough time to improve their trade and balance of payments positions. This is based on the premise that only economic growth of the debtor countries will enable them to approach any solution to their debt problems.

Developing countries cannot achieve economic growth while continuing to transfer liquid capital resources abroad. The only way out of their debt crisis is to stop borrowing.

Second, they should ask for debt rescheduling or a moratorium, even though these are just Band-Aid solutions.

Third, in my view, Third World countries should force radical restructuring of the international financial and monetary system within the context of the North-South dialogue. Also, they MUST demand as a collective debtor cartel that international financial institutions and commercial banks CANCEL debts either in whole or in part.

Fourth, they should limit only 10 percent of their export earnings toward foreign debt payment.

Fifth, they should demand better trade policies and less protectionist measures on the part of the industrialized countries.

Sixth, they should reactivate the idea of establishing their own independent development bank — similar to the World Bank-IMF and IDB. This way they have control over development loan measures, thereby extricating themselves from the draconian conditionality measures imposed by international lending institutions. □

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