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Global Debt Situation and USG Response

Issue:

To ensure that the international debt strategy remains realistic and appropriate to the evolving international situation.

U.S. Position:

Our current five point strategy, first enunciated in the fall of 1982 in the wake of the Mexican crisis, has wide international support. It was endorsed by the seven heads of state at Williamsburg in 1983 and reaffirmed at the London and Bonn Summits. It seeks to foster an environment consistent with continued reliance on the private sector for the bulk of financing flows and with sound banking practices and existing public policies.

The approach is of necessity a pragmatic one in which countries are treated on a case-by-case basis. The debt strategy is not based on a formula but on the implementation of a set of conditions, which, if fulfilled over the medium term, can lead to an improvement in the creditworthiness of many of the heavily indebted countries. Success would be defined by those countries developing an improved capacity to meet their interest and debt repayment commitments on time while maintaining imports at levels sufficient to support sound economic growth.

In its original formulation, the five elements of our debt strategy are: (1) economic adjustment by the debtor countries; (2) economic recovery, sustained growth and open markets in the industrialized countries; (3) adequate resources for the IMF; (4) continued commercial bank lending for countries making determined adjustment efforts; and (5) readiness to provide bridge financing, as necessary, from central banks and governments, on a case-by-case basis, in support of adjustment efforts. The Declaration of the London Summit encouraged banks to reschedule principal falling due over multi-years (MYRAs) for countries that have been adjusting well and have favorable prospects and pledged that governments would consider doing the same.

Talking Points

- ° Our current strategy is working; there has been a good beginning since 1982 but the process of restoring the creditworthiness of troubled debtors will take time.
- ° The general situation continues to improve and a number of countries have started to grow again while meeting their debt obligations.
- ° To ensure self-sustained economic growth and the productive use of all resources requires successful policy reforms and structural adjustments for the indebted as well as creditor countries.

- ° Without such changes new credits are likely only to increase debt without increasing the ability to service debt or generate domestic savings.
- ° The U.S. and other creditors have carried their share of responsibilities:
 - sizeable new credits have been provided by governments, private banks and international institutions,
 - reductions in debt service burdens through massive amounts of debt restructuring at more favorable terms have been agreed to,
 - several MYRAs have been negotiated,
 - dollar interest rates have dropped sharply,
 - following U.S. recovery from economic adjustments LDC exports to the U.S. have increased at exceptional rates.
- ° As we indicated in the Interim and Development Committees we are prepared to continue the dialog as long as we talk about concrete measures that can be adopted case-by-case to individual country problems.
- ° President Garcia's limitation on debt service to 10% of Peru's export income is unacceptable in principle and will make negotiations extremely difficult if it turns out to be more than a bargaining device.

Background:

The debt situations of the developing countries are extremely diverse. A few small countries especially in Africa seem to be on the verge of insolvency; many, particularly in Latin America, have persisting liquidity difficulties in meeting their debt obligations of interest and amortization payments on time, while a significant number, mainly in Asia, have managed without serious problems.

Debtor countries responded to the 1982 debt crisis in varying degrees by restricting internal demand, devaluing their currencies and negotiating with creditors to restructure their maturing debt and secure new credits. In 1984, 26 borrowers, possessing about half of the outstanding foreign debt, had either completed or were engaged in restructuring their official and/or commercial debt and as of mid-1985 another 5 countries had restructured their debts. The IMF has played a major role both in reorienting domestic policy and in negotiating with creditors.

The dimensions of the current problem in each of the major developing areas, is shown in the table below. Two-fifths of the debt is concentrated in Latin America where the debt service burden is double the rate in the rest of the world.

The high proportion of private bank credit in their debt results in scheduled interest payments equivalent to 30 percent of their exports of goods and services in 1985 (compared with over 32 percent in 1982). In Africa, where exports are 30 percent below the 1980 level, the debt service ratio has risen abruptly from 13 in 1980 to 32 in 1985 percent.

Indebted Developing Countries, 1985
(percent or \$ billions)

	<u>Total</u>	<u>Americas</u>	<u>Asia</u>	<u>Africa</u> ^{1/}	<u>Europe</u>	<u>Mid-East Non-Oil</u> ^{2/}
Debt Outstanding \$	865	359	229	134	84	59
as % of GDP	35	43	24	36	38	56
Debt service ^{3/} \$141	25%	44%	13%	32%	29%	27%
interest \$ 76	14%	30%	6%	12%	11%	16%
amortization \$ 65	12%	14%	7%	20%	18%	11%
Current account \$	-44	-8	-15	-10	-2	-11
Trade balance \$	+11	+34	-9	+10	-7	-16
Exports of G&S \$	556	127	254	76	66	33

Note: Regions may not add to total because of rounding.

Source: IMF, World Economic Outlook, September, 1985.

^{1/} Includes South Africa.

^{2/} Includes Egypt and Israel.

^{3/} As a percentage of exports of goods and non-factor services.

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