ISSN 2349-7807

International Journal of Recent Research in Commerce Economics and Management (IJRRCEM)
Vol. 2, Issue 2, pp: (110-115), Month: April 2015 - June 2015, Available at: www.paperpublications.org

External Debt - A Comparative Analysis of Various Country Groups

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Abstract: **External capital has been a significant factor affecting the economies of developing countries to a large extent. The experience has shown that during the last four decades, most of the developing countries have not been able to reap the benefits of foreign finance and have become indebted to international financial institutions, commercial banks and developed countries. A large chunk of their resources goes to service their debt. It has been well established that external debt of developing countries increased manifold over the past three decades. There has also been corresponding rise in the debt service payments and other related variables showing pressure of debt on developing world. There have been many factors which exerted their influence on debt from time to time and consequently the problem continued to become more severe. The factor behind the increase in the debt burden have varied but are interrelated.. In view of these certain policy implications need to be paid attention. Present paper concentrates on the rising external debt of various country groups of developing countries and the factors behind the huge magnitude of debt of these country groups.**

Keywords: **developing countries, external debt, World Bank.**

1. INTRODUCTION

External capital has been a significant factor affecting the economies of developing countries to a large extent. As saving and investment rates are, on average, lowest in the developing countries, making it harder to strengthen their productive base, therefore, foreign capital is essential to finance domestic investment (Humphreys and Underwood, 1989; P.10). There is little doubt that developing countries require external capital since typically they cannot generate adequate resources domestically (Bhandari, Haque and Turnovsky, 1989; P.1).

Foreign capital allows a country to invest more than it could from only its national savings. In the early stages of a country's development, when its capital stock is small, returns to investment are generally higher than in industrial countries. This is the basic economic justification for developing countries to obtain capital from abroad (World Bank, 1985; P.45).

Borrowed funds used in efficient and productive manner make a country remain up-to-date in its interest and principal payments and country is termed as a healthy borrower. Therefore, while borrowing from abroad, a country's central aim must be to see that the pattern of growth is such that after some time it will no longer be dependent on the foreign supplementation of domestic resources (Hawkins, 1970; P.59). The influence of large external borrowings on economic growth depends upon the country's ability to invest in projects that generate sufficient real resources and directly or indirectly sufficient foreign exchange to service the large external obligations (Goldsbrough and Zaidi, 1986; P.9). However, the experience has shown that during the last four decades, most of the developing countries have not been able to reap the benefits of foreign finance and have become indebted to international financial institutions, commercial banks and developed countries. A large chunk of their resources goes to service their debt.

It has been well established that external debt of developing countries increased manifold over the past three decades. There has also been corresponding rise in the debt service payments and other related variables showing pressure of debt on developing world. There have been many factors which exerted their influence on debt from time to time and consequently the problem continued to become more severe. The factor behind the increase in the debt burden have varied but are interrelated. A number of studies have summarized both external as well as internal factors responsible for debt problem to accentuate.

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2. OBJECTIVES OF THE STUDY

- To analyse rising debt problem of various country groups of developing countries
- To examine the factors behind rising debt problem of these economies.
- To suggest policy measures to contain the problem of external debt.

To meet these objectives and for a detailed and comprehensive analysis, the paper has been divided into three sections . Section I shows the magnitude and trends in the external debt of various country groups as classified by the World Bank. Section II examines the factors responsible for the growth of debt of developing countries since 1970. Section-III brings out important conclusion of the study.

Data for the study have been collectd from various publications of World Bank mainly Global Development Finance, World Debt Tables etc. for the period 1970-2013 at six points of time viz. 1970, 1980, 1990, 2000, 2010, 2013.

SECTION – I

Trends in the Total External Debt and its Composition:

Total external debt of developing countries consists of long term debt (which has an original or extended maturity of more than one year), the use of IMF credit and the short term debt (the debt having an original maturity of one year or less). Interest on arrears of long term debt and the IMF credit are added to the short-term debt estimates (World Bank,2002). The total external debt or external debt stock indicates total liabilities of a country to non-residents and is considered to be a burden since debt service payments are to be made against the debt. On the other hand, higher proportion of short term debt in total debt is not considered to be good since it can pose serious payment problems in the short run affecting the balance of payment position of a country negatively. Table 1 shows that tremendous increase has been registered in the total external debt of developing countries during 1970-2013. The total amount of debt which was around US$ 72.7 billion in 1970, increased around nineteen times to US$ 1371.4 billion in 1990 and finally reached $ 4109 billion and $ 5506 billion in 2010 and 2013 respectively. Thus the external debt experienced about 76 times increase during 1970-2013. Of the total debt, long term debt (including use of IMF credit) constituted the major component with on an average more than 80 percent share till 2000, the figure being 87.1 percent in 1970 and 84.3 percent in 2003 with little variations in-between. Short term debt increased sharply from 12.9 percent in 1970 to 23.1 percent in 1980, but declined to 15.6 percent in 1990. But again reached to 27.8 percent in 2013.

Table.1 Composition of External Debt of Developing Countries (Billion US $)

Items	1970	1980	1990	2000	2010	2013
Long Term Debt (Including IMF credit)	63.4 (87.1)	420.8 (76.9)	1157.6 (84.4)	2045.7 (85.5)	3060 (75.5)	3975 (72.2)
Short Term Debt	9.3 (12.9)	126.0 (23.1)	213.8 (15.6)	346.8 (14.5)	1041 (24.5)	1531 (27.8)
Total	72.7 (100.0)	546.8 (100.0)	1371.4 (100.0)	2392.5 (100.0)	4109 (100.0)	5506 (100.0)

Note: Figures in parentheses represent percentages of the total.

Source: World Bank, *Global Development Finance: Country and Summary Tables*, Various Issues.

Magnitude of External Debt – Country Groups:

Some changes have been experienced in the debt burden of various country groups over time. A comparative study of the external debt and various components, in case of various country groups is discussed as under:

Total Debt Stock:

The cumulative figures of external debt stock of various country groups, given in Table 2 indicate that each group experienced manifold increase in their absolute amount of debt, however, in relative terms, some changes have been registered. Share of East Asia & Pacific in total external debt of all developing countries doubled from 15.4 percent in

ISSN 2349-7807

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1970 to 30.2 percent in 2013. Europe & Central Asia experienced more than three times increase in their relative debt share from 6.9 percent to 22.2 percent during 1970-2013. There was a gradual decline in the share of Latin America & Caribbean from 44.7 percent in 1970 to 27.1 percent in 2013. Share of Middle East & North Africa also declined from 6.6 percent to 3.4 percent. The share of South Asia

Table.2 Total Debt Stock of Various Country Groups (Billion US $)

Country Group	1970	1980	1990	2000	2010	2013
East Asia & The Pacific	11.2 (15.4)	85.7 (15.7)	269.0 (19.6)	618.0 (25.8)	1136.8 (27.6)	1672.9 (30.3)
Europe & Central Asia	5.0 (6.9)	57.1 (10.4)	217.9 (15.9)	501.8 (21.0)	1061 (25.8)	1234 (22.2)
Latin America & The Caribbean	32.5 (44.7)	242.6 (44.4)	444.2 (32.4)	758.5 (31.7)	1061.9 (25.8)	1495.4 (27.1)
Middle East & North Africa	4.8 (6.6)	64.2 (11.7)	139.0 (10.1)	143.2 (6.0)	168.1 (4.1)	190.5 (3.4)
South Asia	12.3 (16.9)	36.6 (6.7)	124.4 (9.1)	159.8 (6.7)	407.3 (9.9)	545.7 (9.9)
Sub-Saharan Africa	6.9 (9.5)	60.6 (11.1)	176.9 (12.9)	211.2 (8.8)	273.4 (6.6)	367.5 (6.7)
Total	72.7 (100.0)	546.8 (100.0)	1371.4 (100.0)	2392.5 (100.0)	4109 (100.0)	5506 (100.0)

Note: Figures in parentheses represent percentage of total.

Source: World Bank, *Global Development Finance: Country and Summary Tables*, Various Issues.

in external debt reduced from 16.9 percent in 1970 to 9.9 percent in 2013 with some fluctuations in-between. Small variations took place in the share of Sub-Saharan Africa in external debt with share being 9.5 percent in 1970 and 6.7 in 2013.

Table.3 Long Term Debt of Various Country Groups (Billion US $)

Country Group	1970	1980	1990	2000	2010	2013
East Asia & The Pacific	9.1 (14.6)	58.8 (14.4)	218.8 (19.5)	492.2 (24.8)	618.4 (21.2)	790.1 (20.5)
Europe & Central Asia	3.9 (6.2)	44.7 (10.9)	177.0 (15.8)	399.7 (20.2)	784.4 (27.0)	941 (24.4)
Latin America & The Caribbean	27.6 (44.2)	172.8 (42.3)	352.4 (31.4)	646.2 (32.1)	850.6 (29.2)	1250.8 (32.4)
Middle East & North Africa	4.1 (6.6)	54.1 (13.2)	117.5 (10.5)	120.0 (6.1)	121.9 (4.1)	147.1 (3.8)
South Asia	11.7 (18.7)	31.7 (7.8)	107.5 (9.6)	151.9 (7.7)	324.3 (11.1)	433.4 (11.2)
Sub-Saharan Africa	6.1 (9.8)	46.5 (11.4)	149.8 (13.3)	171.4 (8.6)	209.5 (7.2)	291.6 (7.5)
Total	62.5 (100.0)	408.6 (100.0)	1123.0 (100.0)	1981.4 (100.0)	2909 (100.0)	3854 (100.0)

Note: Figures in parentheses represent percentage of total.

Source: World Bank, *Global Development Finance: Country and Summary Tables*, Various Issues.

ISSN 2349-7807

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Long Term External Debt:

Table 3 gives details of long term external debt of various country groups. A broad overview of the table suggests the same pattern of changes in long term debt in absolute terms as was in case of total external debt, since long term debt constitutes the maximum percentage of the total external debt of these groups. However, minor variations were observed in their relative share. Share of East Asia & Pacific increased from 14.6 percent in 1970 to 24.8 percent in 2000 and then declined to 20.5 percent in 2013. Share of Europe & Central Asia increased persistently from just 6.2 percent in 1970 to second highest, after Latin America & Caribbean, at 24.4 percent in 2013. Similarly, share of Latin America & Caribbean although declined from its level in 1970 at 44.2 percent but remained maximum among all the groups at 32.4 percent in 2013. The share of Middle East and North Africa group declined from 6.0 percent in 1970 to 3.8 percent in 2013. South Asia's share in the total long term debt declined from 18.7 percent in 1970 to 11.2 percent in 2013. Not much fluctuations took place in case of the share of sub-Saharan Africa as the share which was 9.8 percent in 1970, became 7.5 percent in 2013.

Short Term Debt:

The figures of short term debt as presented in Table 4 show that in absolute terms, all the country groups experienced much increase in the short term debt alongwith some changes in their relative share in the total short term debt during 1970-2013. East Asia & Pacific registered a persistent increase in its share from 19.3 percent in 1970 to 56.3 percent in 2013. The same pattern was observed in case of Europe & Central Asia with 10.7 percent share in 1970, which increased to 17.1 percent in 2013. A continuous decline took place in the share of Latin America & Caribbean from 51.6 percent in 1970 to 14.4 percent in 2013. Share of Middle East & North Africa declined from 5.4 percent in 1970 to 2.2 percent in 2013. South Asia experienced rise in its share from 4.3 percent in 1970 to 6.4 percent in 2013 with fluctuations in between. Similarly, share of Sub-Saharan Africa in total short term debt varied around 9.0 percent till 2000 but later declined to 3.5 percent in 2013. It is, however, important to note that East Asia & Pacific, Europe & Central Asia, and Latin America & Caribbean collectively accounted for maximum percentage share in the total short term debt of all developing countries which reached around 90 percent in 2013.

Table.4 Short Term Debt of Various Country Groups (Billion US $)

Country Group	1970	1980	1990	2000	2010	2013
East Asia & The Pacific	1.8 (19.3)	24.6 (19.5)	48.1 (22.5)	103.6 (29.9)	497.9 (47.8)	862.5 (56.3)
Europe & Central Asia	1.0 (10.7)	10.3 (8.2)	39.5 (18.5)	80.5 (23.2)	210 (20.2)	262 (17.1)
Latin America & The Caribbean	4.8 (51.6)	68.4 (54.3)	73.4 (34.3)	103.5 (29.5)	187 (18.0)	221 (14.4)
Middle East & North Africa	0.5 (5.4)	9.0 (7.1)	19.7 (9.2)	19.5 (5.6)	37.7 (3.6)	34 (2.2)
South Asia	0.4 (4.3)	2.4 (1.9)	12.3 (5.7)	6.0 (1.7)	62.6 (6.0)	98.3 (6.4)
Sub-Saharan Africa	0.8 (8.6)	11.3 (9.0)	20.8 (9.7)	33.7 (9.7)	44.4 (4.3)	53.9 (3.5)
Total	9.3 (100.0)	126.0 (100.0)	213.8 (100.0)	346.8 (100.0)	1041 (100.0)	1530 (100.0)

Note: Figures in parentheses represent percentage of total.

Source: World Bank, *Global Development Finance: Country and Summary Tables*, Various Issues.

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SECTION – II

The seeds of the debt crisis was sown in 1973-74 when Organisation of Petroleum Exporting Countries (OPEC) quadrupled the price of petroleum. For many less developed countries (LDCs) lacking adequate domestic oil reserves, the decision to substantially raise the petroleum prices in the

world market for a barrel of oil was a severe jolt. Since its inception in 1960, OPEC had earlier never acted as a cartel to fix monopoly price of oil (Hallberg, 1986; P.9). For most less developed countries, it resulted in a dual problem of trade deficit (since import obligations grew beyond export earnings) and high current account deficits in the balance of payments. Since deficit on current account needs financing through surplus on capital account, the high oil import bill forced oil importing poor countries to increase external borrowings.

The deficit on current account was also accentuated by steep increase in the prices of manufactured goods, especially capital goods. The dual trend of increase in prices of petroleum and manufactured goods was not matched by prices of non-oil raw material which represented the bulk of exports from developing countries (Lerosiere, 1979; P.12). A second round of oil price hike by OPEC in 1979-80 further deteriorated the current account balances and as a result, combined current account deficit of non-oil exporting developing countries doubled from $42 billion to $88 billion during 1970-80.

Following the oil shocks, developing countries resorted to private sources of finance,

By 1984, commercial banks' share of total guaranteed medium and long term debt owed by non-oil developing countries to private creditors rose to 86 percent (Hallberg, 1986; P.12). Growing reliance on private sources of credit caused worsening of average terms of developing countries' debt. Rise in real rates of interest increased the cost of debt on fixed as well as floating rates of interest debt. The significant shift toward the international banking community at floating interest rates (which were linked to market rates), increased debt service cost for developing countries (Nowzad, 1982; P.14). Countries like Argentina, Brazil, South Korea and Mexico suffered a lot since they were having high percentage of floating rate debt in their total debt baskets.

An important part was also played by the trade policies of developed countries, which due to the recession and high unemployment rates in their economies in early 1980s, used highly protectionist policies thereby reducing exports from developing countries and hence the export earnings meant to service the debt. In general, combination of high interest rates and recession in 1981-82 damaged the capacity of developing countries to sustain growth and avoid debt servicing difficulties (World Bank, 1985; P.55).

Among other factors, capital flight from developing countries in the late 1970s and early 1980s, was a major factor in the rapid accentuation of the debt service problems in a number of countries including Argentina, Mexico, the Philippines and Venezuela. In a number of countries, borrowing abroad had to finance not only current account deficits but also private capital flight induced by unstable domestic and political conditions.

Large fiscal deficits, too much unproductive expenditure and use of external borrowings for consumption purposes in the past played an equally important role and remained the major domestic reason for growing debt difficulties of many nations. Many oil exporting countries in the wake of large earnings from oil exports resorted to massive spending programmes. Their expenditure, however, became unsustainable as the oil market weakened (Lomax, 1986; P.51).

Section III

The analysis of the past four decades reveals that debt burden of developing countries has increased to a significant extent. Such a huge burden of debt cannot be justified keeping in view the meagre amount of resources of developing counties at their disposal. Most of the debt burden is concentrated in the economies of East Asia & Pacific, Europe & Central Asia and Latin America & Caribbean. The situation is grave also in the sense that share of short term debt in the debt basket of developing countries is persistently increasing as this portion of debt needs to be repaid in relatively shorter period of time and causes balance of payment problems of developing counries. This problem is also more serious in case of East Asia & Pacific, Europe & Central Asia and Latin America & Caribbean.

both external as well as internal factors were responsible for the debt problem to become more serious over time. Oil price hikes, protectionist policies of the industrial countries, rise in interest rates, availability of external finance at relatively cheaper rates, capital flight from the debtor countries due to decrease in investors' confidence were among the major

ISSN 2349-7807

International Journal of Recent Research in Commerce Economics and Management (IJRRCEM)
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external factors where as domestic poor policies, weak macroeconomic adjustments, unproductive and inefficient use of funds, increase in consumption levels, rising fiscal deficits, appreciated exchange rates, inability of the debtor governments to generate domestic tax as well as non tax revenue have been among the internal factors responsible for growth of debt.

In view of these certain policy implications need to be paid attention that the borrowings must be made for a longer period of time so that repayment of debt is made gradually. Moreover these economies must use their borrowed funds for productive purposes so that productive capacity of the economy is increased. Fiscal deficit should be within limits and efforts should be to generate the funds for development from within the economy.

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