

The Twentieth Century International Debt Problem in Historical Perspective

Derek H. Aldcroft

Manchester Metropolitan University

International debts have a long history but until the twentieth century they were never a major problem. It is true that in the great age of international lending in the nineteenth century, there were periodic debt crises and defaults in certain countries and regions, most notably in Latin America. But for the most part debts were serviced satisfactorily, primarily because a large part of the lending found its way into railway stocks, government bonds and utilities in regions with good growth prospects, for example Europe, North and South America, the Dominions and areas under British colonial rule.¹ Much of the lending was put to productive use and the earning power of the major recipients was enhanced considerably thereby. Capital was directed primarily to high-income countries and/or regions of recent settlement, and the chief international capital markets of the nineteenth century (predominantly Britain, France and Germany) were not geared to providing poorer nations with access to western capital.²

The picture is very different in the twentieth century. It began with the massive repudiation of Tsarist debts by the Bolshevik government in Russia, to be followed by the wrangle over inter-allied debts and reparations arising from the war, most of which were never paid. Then there were two massive bursts of commercial lending, one in the 1920s

¹ See M. B. Rose and P. N. Snowden, 'Bond issues as a replacement for bank lending to LDCs: a reconsideration of the lessons of the 19th century for the present day', *World Development*, 16 (1988).

and the other in the 1970s and early 1980s. Both ended in disaster. The first resulted in delinquency and default in the 1930s, while the more recent episode gave rise to a global debt crisis which at one point threatened to engulf the Western financial world. The irony is that the latter debt crisis is very much a re-run of that of the 1920s.

A comparison of the two periods is instructive in itself but there are several relevant questions which are worth considering. Why does so much risky lending take place, and who is to blame for the excesses? Why are debtor countries unable to service their debts properly? Why does capital mobility not produce a state of equilibrium in international factor markets as suggested by a convergence model? And finally, why has the problem of international indebtedness been so much more acute than in the nineteenth century?

Debt Burdens in Perspective

Though most Third World countries have been growing in absolute terms during the present century, they have become relatively poorer compared with their richer counterparts in the West so that today global income is much more unevenly distributed than it was in the nineteenth century.² It is sometimes argued that one of the factors holding these countries back is the overhang of external debt as a result of their postwar borrowing from western creditors.

Until the 1970s the external debt levels of borrowing countries were, in fact, fairly modest. Total reported external debt of all developing countries in 1970 was less than \$70 billion and in 1975, \$167 billion. It then shot up to \$751 billion by 1981 and expanded further in the 1980s, with arrears of interest adding to the burden, to reach \$1,518 billion in 1990 and \$1,662 billion in 1992.³ Geographically

² World Bank, *World Development Report 1985*, (Oxford 1985), p.13.

³ D. H. Aldcroft, 'Rich nations - poor nations: the penalty of lateness', in D. H. Aldcroft and R. Catterall (eds), *Rich Nations - Poor Nations: the Long Run Perspective*, (Cheltenham 1996), p.2.

⁴ See World Bank, *World Debt Tables. 1982-83, 1991-92, 1993-94*, (Washington D.C. 1983, 1992, 1994).

the debt is fairly widely spread by region: in 1992 Latin America accounted for 30 per cent, East Asia and the Pacific 19 per cent, Europe and Central Asia 20 per cent, sub-Saharan Africa 12 per cent, the Middle East and North Africa 11 per cent and South Asia 8 per cent. However, within these large regions a small number of countries dominated, so that some 85 per cent of developing country debt was in the hands of only 33 countries in 1982, though the degree of concentration diminished somewhat in later years.⁵ Moreover, the really serious debt problems of the recent past have been confined to two areas, Latin America and sub-Saharan Africa where debt ratios (debts/exports and debt service/export ratios) have been high for most of the 1980s and early 1990s (Table 1).

	1981	1986	1988
All developing countries	16	23	20
Africa	17	29	29
Asia	10	15	11
Middle East	5	14	13
Western Hemisphere	44	47	42
Sub-Saharan Africa	20	26	23
Four Asian NICs	8	9	5
15 heavily indebted countries	41	45	40

*Interest payments on total debt plus amortisation payments on long-term debt only
Source: M. J. Roarty, 'Protection and the debt crisis', *National Westminster Bank Quarterly Review*, (February 1990), p.35.

Not all countries have been engulfed in debt problems by any means. In fact the majority have avoided getting into serious difficulties and some, notably those in the Pacific Basin region, have turned borrowing to good account, even though they have been very large borrowers in some cases. It is important to note, too, that some of the latter were in no better shape after the war than the majority of African countries. A description of the Republic of Korea in 1960 could easily

⁵ W. R. Cline, *International Debts Reexamined*, (Washington DC. 1995), p. 39.

be that of an African country in the latter half of the twentieth century. Having limited resources and regarded very much as a 'basket case' in the early postwar years, with an income per head as late as 1960 no higher than that of the Sudan or Tanzania, it had accumulated the fourth largest debt in the developing world by the early 1980s, with over 40 per cent of its external liabilities on floating rates of interest. Yet a decade or so later South Korea had become a net creditor and was classed as one of the most successful of the newly industrialising countries, and frequently cited as a model for other low-income debtors to emulate.⁶

It is instructive to look briefly at nineteenth-century experience since by comparison many of today's Third World countries are, in fact, under-gearred. For smaller countries at least, capital inflows in the heyday of foreign investment were much higher as a percentage of total income than they are in contemporary developing countries. For example, capital inflows into Canada in the period 1870-1910 averaged 7.5 per cent of GNP and between 30-50 per cent of annual investment; similar ratios were to be found in Australasia and Scandinavian countries. In Argentina capital inflows ranged between 12-15 per cent of GNP on average and accounted for some 40 per cent of total investment in the first two decades of the twentieth century. By contrast, net capital inflows to all developing countries in the period 1960-73 averaged only 2-3 per cent of GDP, and even after the massive borrowing spree of the next decade they rarely exceeded 6 per cent of GDP and accounted for some 12-20 per cent of gross investment.⁷ Similarly, current debt burdens have been fairly modest by past standards. Before 1914 Canada, South Africa, Latin America, Australia, Russia, Japan and China had debt/export ratios which were two to eight times those of the non-oil developing countries in the 1980s.⁸

⁶ See S. M. Collins and W. A. Park, 'External debt and macroeconomic performance in South Korea', in J. D. Sachs (ed), *Developing Country Debt and the World Economy*, Chicago 1989; S. Corbridge, *Debt and Development*, (Oxford 1993); W. R. Cline, *International Debts Reexamined*, (Washington DC: 1995); J. D. Sachs, 'External debt and macroeconomic performance in Latin America and East Asia', *Brookings Papers on Economic Activity*, 2 (1985).

⁷ World Bank, *World Development Report 1985*, (Oxford 1985), pp.12-13.

⁸ S. Corbridge, *Debt and Development*, (Oxford 1993), pp.101-2.

Nor, with one or two exceptions, have debt/service ratios been especially excessive compared with those of the interwar years, while it is quite possible that debt/service ratios were higher in the nineteenth century.⁹ Data in Tables 1 and 2 indicate that for some countries the debt-servicing burdens of the early 1930s were generally higher than those in recent years, while world economy shocks were if anything more intense on balance in the earlier period.¹⁰

TABLE 2 - Debt Servicing as a Percentage of Export Earnings 1926-1932

Country	1926	1928/29	1931/32
Argentina	10.0	10.4	27.6
Australia	25.0	28.0	47.0
Bolivia	7.3	7.8	50.0
Brazil	13.1	16.7	40.4
Bulgaria	-	12.3	22.0
Canada	16.6	22.2	53.5
Chile	5.5	9.2	102.6
Columbia	2.7	11.9	21.8
Greece	-	32.0	44.0
Hungary	-	17.9	48.0
Peru	2.6	7.4	21.4
Poland	-	11.3	27.0
Romania	-	14.6	36.0
Yugoslavia	-	18.1	36.0

Sources: E. A. Cardoso and R. Dornbusch, 'Brazilian debt crises: past and present', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge Mass. 1989), p.119; Z. Drabek, 'Foreign trade performance and policy', in M. C. Kaser and E. A. Radice (eds), *The Economic History of Eastern Europe, 1919-1975*. Vol. I. *Economic Structure and Performance Between the Wars*, (Oxford 1985), p.425; E. Jorgensen and J. Sachs, 'Default and renegotiation of Latin American bonds in the interwar period', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge, Mass. 1989), p.58; M. Mazower, *Greece and the Interwar Economic Crisis*, (Oxford 1991), pp.112, 202; R. Nötel (1986) 'International credit and finance', in M. C. Kaser and E. A. Radice (eds), *The Economic History of Eastern Europe, 1919-1975*, Vol.II. *Interwar Policy, the War and Reconstruction*, (Oxford 1986), p.223; M. C. Urquhart and K. A. H. Buckley, *Historical Statistics of Canada*, (Cambridge 1965), pp.160-61.

⁹ A. Fishlow, 'Lessons from the past: capital markets during the 19th century and the interwar period', *International Organization*, 39 (1985), p.406.

¹⁰ P. Lindert, 'Response to debt crisis: what is different about the 1980s?', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge 1989), pp.229-31.

The Limits to Convergence

While many heavily indebted nations have failed to break into the virtuous circle, the successful economic transition of several of the postwar debtors, as well as the experience of nineteenth-century borrowers, suggests that international capital flows can provide the means for promoting development more widely in the Third World. Indeed, a neo-classical factor flow model can be invoked to demonstrate that inter-country capital flows may serve as an equilibrating mechanism between rich and poor nations. One such model, the regional convergence model, may be extended to a global setting wherein capital flows from rich to poor nations and labour flows in the reverse direction so that factor returns are equalised under conditions of perfect factor mobility. This is presumably what Beenstock had in mind when he refers to the cycle of indebtedness of poor nations as an equilibrium phenomenon.¹¹ In this context, an increase in the marginal productivity of capital in LDCs (less developed countries) arising say from the beginnings of industrialisation, leads to a temporary disequilibrium in world capital markets, because the marginal productivity of capital in the latter rises relative to that in the developed countries (DCs). Capital will therefore flow from DCs to LDCs so as to restore equilibrium in rates of return. It follows therefore that the LDCs must run current account deficits to match their capital account surpluses which reflect the import of capital from creditor countries. In this scenario the capital account drives the current account not the reverse, and this should be seen, according to Beenstock, as an essential part of the development process rather than an indication that poor nations are borrowing more than is good for them.

On the basis of this optimistic analysis one should have little cause to worry about debtor-nation borrowing since the problem is more one of temporary illiquidity rather than one of insolvency. Unfortunately, the convergence model does involve some rather heroic

¹¹ M. Beenstock, *The World Economy in Transition*, (London 1983), pp.82-5.

assumptions. For one thing it assumes perfectly ordered capital markets and free factor flows in which distortions and misallocations rarely arise. Secondly, it presupposes that borrowers adhere to the 'rules of the game', in that they utilise foreign loans productively to yield a rate of return at least equal to the real interest cost of borrowed money and that they are able to convert the equivalent domestic resources into foreign exchange to service the foreign creditors. A simple solvency rule outlined by Cuddington¹² is that the nominal interest rate on external borrowing (i) is less than the growth rate in the dollar value of exports (g) so that $g-i > 0$. If this condition holds then countries can continue borrowing to service loans without straining the debt/export ratio; if not, then the latter will rise and they will be forced to generate trade surpluses to meet their obligations. But debtors must also ensure that capital imports are channelled into exchange-earning activities (either through import substitution or export promotion, preferably both) rather than into current consumption, so that the debts can be satisfactorily serviced. This will, in turn, depend on appropriate macroeconomic policies. If these conditions are satisfied, then borrowing should not pose a problem; if not, then borrowing nations are likely to run further into debt. Thirdly, the model reckons without the emergence of large destabilising shocks to the global economy, as, for example, a sudden cutback in lending as in the late 1920s, a sharp adverse swing in the terms of trade through a collapse in commodity prices as in the early 1930s, large price distortions in key products as in the case of oil in the 1970s or the emergence of world depression. Finally, it also behoves creditor countries to exercise discretion in their lending policies.

None of these conditions can be satisfied either in the interwar years or more recently. Capital misallocation and misuse has been a common feature of both periods for which creditors and debtors must share the blame. Borrowing was often used to finance consumption or prestige projects rather than employed in productive

¹² J. T. Cuddington, 'The extent and causes of the debt crisis of the 1980s', in I. Husain and I. Diwan (eds), *Dealing With the Debt Crisis*, (Washington D.C. 1989), pp.20-21.

exchange-earning activities. The situation was made worse by dint of the inappropriate macroeconomic policies and political corruption in the borrowing countries, and the irresponsibility of creditor nations in their effort to exploit the maximum return. Hence, few countries were able to gain entry to the virtuous circle whereby borrowing was largely self-financing, as in the case of the Pacific Basin region after the second world war or many of the nineteenth century borrowing countries. More commonly, both in the 1920s and the 1970s onwards, many borrowers, it has been argued, misused capital inflows and ran deeper into debt since renewed borrowings were required simply to service old debts. Consequently debt service costs rose and eventually they exceeded the inflow of new funds. This fragile equilibrium could only be maintained so long as the flow of funds from creditors to debtors was maintained, but it was a situation in which borrowing countries were highly vulnerable to sudden shocks such as the cessation of capital flows, adverse swings in the terms of trade, rising real interest rates and a slowdown in world economic activity. Such a concatenation of events transpired to shatter the precarious equilibrium of the debtor nations both in the 1930s and again in the 1980s

The Role of the Creditors

Creditor nations must share some of the blame for the increasing vulnerability of debtor countries in both periods. Both lending and borrowing could be 'reckless, extravagant and wasteful', as Salter recognised in the early 1930s.¹⁵ Inadequate control over the volume of foreign lending and the use to which it was put, very limited monitoring and appraisal of investments, together with a failure to ensure that debts could be serviced comfortably, constituted the first lapse of responsibility. The second was the sudden curtailment of lending when debtors had incurred heavy obligations, the servicing of which would have proved onerous even at the best of times. To

¹⁵ A. Salter, *Recovery: The Second Effort*, (London 1933), p.101.

take one example from the 1920s, the United States and Great Britain had accumulated in Latin America by the end of the decade a total stock of investment claims equal to four times the combined value of that continent's exports.¹⁴

In retrospect the volume of lending certainly proved excessive in relation to the capacities of the debtor countries during the 1920s. Borrowing countries were allowed or even encouraged to live beyond their means by the unscrupulous activities of some of the investment houses and the banks. The attractions for the lenders were considerable since many countries were avid to secure capital for infrastructure investment, to cover government deficits or to finance an increase in consumption. The returns on offer were far better than those at home. Nominal interest rates varied between 6 and 9 per cent, but the low price of many of the bond issues and other charges often raised the effective yields to 12 per cent or more.¹⁵ Such conditions were conducive to overlending as creditors pressed funds on clients with little regard for their ability to repay. Palyi¹⁶ cites the example of the Bolivian government which, it was claimed, pledged 80 per cent of the country's tax revenues for the service of just one loan, with no questions asked as to how the Bolivian state would manage on the remaining 20 per cent or how it would effect the exchange transfer. While not all foreign lending was a product of ruthless and greedy international bankers inducing impoverished clients to run further into debt, there is evidence that, with the lure of large profits, the creditors could quite easily overlook the pecuniary welfare of the recipient countries. There was little or no control over foreign lending¹⁷ so that competition for business went unchecked and the share-pushing activities of the issue houses meant that borrowers were rarely

¹⁴ E. Jorgensen and J. Sachs, 'Default and renegotiation of Latin American bonds in the interwar period', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge, Mass. 1989), p.53.

¹⁵ Political and Economic Planning, *Economic Development in S.E. Europe*. (London 1945), p.110.

¹⁶ M. Palyi, *The Twilight of Gold 1914-1936: Myths and Realities*, (Chicago 1972), p.207.

¹⁷ See M. J. Hogan, *Informal Entente: The Private Structure of Cooperation in Anglo-American Diplomacy, 1918-1928*, (Columbia 1977).

left in peace.¹⁸ According to Lary¹⁹, enticed by the prospect of commissions much higher than those available on domestic issues and faced with the necessity for a continuous flow of new securities to keep large staffs of bond salesmen employed, American investment bankers had their agents 'sitting on the doorsteps' of prospective borrowers, as one observer put it, offering them money and many times persuading them to borrow more than they actually needed. The American Senate Committee on Banking and Currency in the early 1930s had some equally stringent comments to make about the nefarious behaviour of the investment bankers: the record of the activities of investment bankers in the flotation of foreign securities is one of the most scandalous chapters in the history of American investment banking. The sale of these foreign issues was characterised by practices and abuses which were violations of the most elementary principles of business ethics.²⁰ Even Great Britain, whose long experience in the field of international lending might have ensured more prudent behaviour, can be criticised for the rather lenient attitude to the excesses committed by some of her European and imperial clients.²¹

Uncontrolled lending inevitably led, as it did half a century later, to unwise and wasteful borrowing, and it should have been obvious by the later 1920s that many countries were borrowing more than they could reasonably afford. Moreover, the fact that much of the lending, especially to public authorities, consisted of fixed-interest securities at relatively high rates of interest, was bound to present difficulties once economic conditions deteriorated. Yet creditors gave little thought to the question of repayment or for that matter to the means of servicing the growing burden of debt. In fact they continued to lend to repay without at any time ensuring that the loans would be

¹⁸ See W. Darity and B. Horn, *The Loan Pushers: The Role of Commercial Banks in the International Debt Crisis*, (Cambridge 1988).

¹⁹ H. B. Lary, *The United States in the World Economy*, (Washington D.C. 1943), p.96.

²⁰ Quoted in A. Fishlow, 'Lessons from the past: capital markets during the 19th century and the interwar period', *International Organization*, 39 (1985), p.423.

²¹ Royal Institute of International Affairs, *The Problem of International Investment*, (Oxford 1937), p.165.

employed in such a manner as to generate sufficient exchange earnings. In this way both creditors and debtors became locked into a system whereby the economies of debtor countries became dependent on new borrowing simply to service past debts.²² 'Neither in lending nor in borrowing countries was it generally appreciated that debtors could only pay the service charges on their debts by means of an export surplus of goods and services.'²³

Whether a more effective control over foreign investment with a view to promoting export industries and exchange-generating activities would have eased the situation is debatable, since there is the question as to how far debtor countries could have pushed their products into the increasingly protected markets of the creditors, especially the United States. The tariff barrier argument may be exaggerated but the basic problem still remained, since primary products faced increasingly inelastic demand in major consuming countries, while manufacturing exports ran up against serious cost disadvantages. Falkus²⁴ doubts whether downward tariff adjustment by the major creditor, the United States, would have done much to improve the external situation of the debtors since the fairly self-sufficient nature of the United States resulted in low price-elasticities of demand for imports. Export diversification was another possibility but this was a long-term solution and time was short. In other words, debtors could not have unloaded many more exports onto the American market. To make matters worse, the low import propensities of America were matched by high marginal import propensities in the debtor countries as a consequence of their accelerated development.

That such mistakes could be perpetrated again by creditor nations nearly half a century later may seem surprising at first sight. One explanation is that bankers have limited historical vision and

²² L. Smith, 'Suspension of the gold standard in raw material exporting countries', *American Economic Review*, 24 (1934), p.430; V. P. Timoshenko, *World Agriculture and the Depression*. (Ann Arbor, Michigan 1933), pp.86-7.

²³ Royal Institute of International Affairs, *The Problem of International Investment*, (Oxford 1937), p.289.

²⁴ M. E. Falkus, 'United States economic policy and the "dollar gap" of the 1920s', *Economic History Review*, 24 (1971), pp.600-603.

so do not factor in the lessons of history. Dornbusch and Fischer²⁵ suggest that such behaviour was predicated on the belief that because of the size of the banks governments could not allow them to fail. But perhaps a more powerful motive was the fact that there were high profits to be made on cross-border investment at a time when returns on investment in the western industrial economies were declining.²⁶ And although inherently risky, the profit to be made on sound loans was sufficiently large to offset one or two spectacular failures.

Views differ as to the irresponsibility of the creditors in the more recent period. Certainly not all lending can be tarred with the same brush since a considerable part originated from official sources at concessional rates and this was supposed to be more closely monitored, at least in theory. Rather it is the great wave of bank lending, especially to Latin America, in the 1970s and early 1980s which is often blamed for setting the scene for the debt crisis. Several writers have argued that the debt crisis was a western creation caused by the reckless lending policies of financial institutions.²⁷ Though the evidence is not entirely conclusive there does seem to have been a notable lack of concern on the part of the commercial banks about the quality and riskiness of many of the loans contracted.²⁸ Barbara Stalling in her study of US portfolio investment in Latin America confirms this very point.²⁹ There was a singular degree of vagueness about many of the loans; the banks had neither the capacity nor the

²⁵ R. Dornbusch and S. Fischer, 'Third world debt', *Science*, 234 (1986), p.837.

²⁶ J. D. Sachs, 'Introduction' in J. D. Sachs (ed), *Developing Country Debt and the World Economy*, (Chicago 1989), p.8.

²⁷ O. Mehmet, *Westernizing the Third World*, (London 1995), pp.108-9; W. Darity and B. Horn, *The Loan Pushers: The Role of Commercial Banks in the International Debt Crisis*, (Cambridge 1988), pp.3-4; J. Guttenberg and R. Herring, 'Commercial bank lending to developing countries: from overlending to underlending to structural change', in G. W. Smith and J. T. Cuddington (eds), *International Debt and the Developing Countries*, (Washington D.C. 1985), pp.129-30.

²⁸ B. Fichengreen and R. Portes, 'Dealing with debt: the 1930s and the 1980s', in I. Husain and I. Diwan (eds), *Dealing with the Debt Crisis*, (Washington D.C. 1989), p.70; R. Dornbusch and S. Fischer, 'Third world debt', *Science*, 234 (1986), p.837.

²⁹ B. Stallings, *Banker to the Third World: US Portfolio Investment in Latin America 1900-1986*, (Berkeley 1987), pp.130-1.

interest to vet or monitor them in detail. There were more loans granted for unspecified and general purposes than in the 1920s and a greater lack of information about them since with bank credits, which formed the bulk of the lending, there was no obligation to publish prospectuses as with the bond issues of the earlier period.

However, it should be noted that on average the lending of the 1970s did not strain the debt carrying capacity of the borrowing countries, except some of the African, judging by the stability of the debt indicators (Table 3). The real problem arose with the further massive influx of bank funds at the turn of the decade, when total bank exposure in major debtor countries almost doubled (1979-81), just as the global economic indicators were turning adverse (see below).

Whether much bank lending was judicious or otherwise is still open to debate. Kharas and Levinsohn³⁰ questioned the notion that commercial loans favoured consumption over investment any more than had those from official sources, though they did add that foreign borrowing tended to depress domestic savings rates. Cline³¹ is also favourably disposed, saying that most of borrowing was put to productive use but without being very explicit. The World Bank in the introductory statement to its *World Debt Tables 1982-83* is unusually sanguine about bank lending, challenging the view that it was imprudent and that the proceeds were used wastefully. However, this statement is somewhat at odds with the views expressed elsewhere by the Bank³². Nor does it square with the fact that the banks continued to lend to debtor countries even after their own residents had become disenchanted with domestic policies, and that the borrowing was eventually used to facilitate capital flight on a large scale at the turn of the decade.³³

³⁰ H. J. Kharas and J. Levinsohn, 'LDC savings rates and debt crises', *World Development*, 16 (1988), pp.779-86.

³¹ W. R. Cline, *International Debt: Systematic Risks and Policy Response*, (Washington D.C. 1984), p.17.

³² World Bank, *World Development Report 1985*, (Oxford 1985), pp.51-5.

³³ R. Dornbusch and S. Fischer, 'Third world debt', *Science*, 234 (1986), p.837.

Were the Debtors to Blame?

'There is lots of blame to go round', as Cuddington says,³⁴ and the debtors have also come in for their share. The main allegations can be summarised briefly:

- Debtors overborrowed in relation to their carrying capacity.
- The funds received were used unwisely to finance consumption, budgetary deficits and the like rather than invested in productive activities which generated foreign exchange earnings.
- Macroeconomic policies were inappropriate for good economic management, tending to be restrictive, inward-looking and protective.
- Regime structures were prone to corruption and political favour rather than economic efficiency.

For the 1920s there is ample evidence that debtor countries overborrowed and that some of the proceeds were used unwisely: that is imported capital was used to finance current consumption, retire previous debts, cover fiscal deficits, and finance prestige projects, rather than being focused on foreign-exchange generating activities. This was true both in poor country debtor nations in Latin America and Eastern Europe and in richer countries such as Germany and the British Dominions. In the latter half of the decade most of the countries in Eastern Europe and the Balkans relied heavily on capital imports to plug the gap in their external accounts. Of the total flows of funds into Hungary, Poland, Bulgaria and Yugoslavia between 1924 and 1928, one half went to cover an import of goods and services, while most of the remainder was earmarked for servicing foreign debts. By 1929 capital inflows were barely sufficient to cover interest and dividends on existing debts.³⁵ Only a small proportion of the loans

³⁴ J. T. Cuddington, 'The extent and causes of the debt crisis of the 1980s', in I. Husain and I. Diwan (eds), *Dealing with the Debt Crisis*. (Washington D.C. 1989), p.38.

³⁵ R. Nötel, 'International capital movements and finance in Eastern Europe, 1919-1949', *Vierteljahrschrift für Sozial- und Wirtschaftsgeschichte*, 61 (1974), pp.84-5; R. Nötel, 'Money, banking and industry in interwar Austria and Hungary', *Journal of European Economic History*, 13 (1984), pp.182-3.

was used to increase productive capacity and the import substitution and industrial subsidy policies gave rise to high-cost inefficient industries which depended for their survival on constant protection and official support which led to widespread corruption.³⁶ By the end of the decade the financial position of much of debtor Europe was becoming critical.³⁷

With the exception of Venezuela, where the efficient exploitation of oil resources allowed the country to extricate herself from external debt,³⁸ most Latin American countries had a similar experience. In many cases capital imports were used to retire previous debts, to cover fiscal deficits, prevent default on existing loans, or to finance consumption needs. Where they were employed in investment works these were often show projects of dubious utility. The Bolivian government, for example, relied on American loans to cover domestic deficits, while some of the proceeds were used to retire previous debts in Britain and France.³⁹ A large part of the debt contracted by Argentina was used for unproductive purposes, in that it gave rise to little additional exchange earnings, and the success in obtaining funds from abroad allowed the country to maintain persistent budgetary deficits.⁴⁰ Similarly, much of Columbia's borrowing was dissipated in public works projects of a somewhat dubious nature. Between 1924 and 1928 Columbia borrowed some \$153 million, a large part of which went into constructing an expensive railway between two valleys, the commercial justification for which was very limited.⁴¹

The position was much the same in the British Dominions where

³⁶ S. Pollard, *Peaceful Conquest: The Industrialization of Europe 1760-1970*, (Oxford 1981), p.209.

³⁷ H. S. Ellis, *Exchange Control in Central Europe*. (Cambridge, Mass. 1941), p.74; Political and Economic Planning, *Economic Development in S.E. Europe*, (London 1945), p.110.

³⁸ Royal Institute of International Affairs, *The Problem of International Investment*, (Oxford 1937), p.277; Royal Institute of International Affairs, *The Republics of South America*, (Oxford 1937), p.182.

³⁹ S. E. Harris, *Economic Problems of Latin America*, (New York 1944), p.264.

⁴⁰ See H. E. Peters, *The Foreign Debt of the Argentine Republic*, (Baltimore 1934).

⁴¹ A. Salter, *Recovery: The Second Effort*, (London 1933), p.105.

public authorities were the main borrowers. In the case of Australia, the largest debtor in the world in per capita terms, public external borrowing did little to generate exchange earnings since two thirds went to cover deficits in the balance of payments.⁴² Germany also squandered much of her external borrowing on public and private consumption and, according to Schuker,⁴³ she failed to adjust her macroeconomic stance to her debt situation. Salter⁴⁴ was very dubious as to the wisdom of much of the public borrowing in this period; with the exception of loans recommended by the League of Nations and the Central Banks, the *bulk* of the foreign loans in these years to public authorities in debtor countries would better not have been made. It would be wrong to imply that all foreign lending in this period was utilised unwisely, but generally speaking debtor countries failed to ensure that capital imports paid their way. Debt burdens were increasing steadily in the later 1920s (Table 2) and it is clear that many debtors were becoming overstretched so that they had to rely increasingly on capital imports simply to cover their servicing obligations. But by the end of the decade such imports were no longer sufficient for this purpose. Latin America was then paying abroad on debt account three times its annual current capital inflow. On long-term account the debtors of the US and UK were paying \$686 million in 1928 (in interest, dividends and amortisation payments) more than they received in new loans and investments, and by the following year this burden had nearly doubled.⁴⁵ The crossover point between repayments and receipts probably occurred in late 1928 or early 1929 in the case of American lending and from then onwards the major creditor was draining liquidity from the borrowing regions, that is new lending fell short of servicing costs. In the case of British lending, interest and amortisation costs exceeded new lending throughout the

⁴² R. S. Gilbert, *The Australian Loan Council in Federal Fiscal Adjustments, 1890-1965*, (Canberra 1973), p.104.

⁴³ S. A. Schuker, *American Reparations to Germany 1919-33: Implications for the Third World Debt Crisis*, (Princeton 1988), p.123.

⁴⁴ A. Salter, *Recovery: The Second Effort*, (London 1933), p.106.

⁴⁵ United Nations, *Foreign Capital in Latin America*, (New York 1955), p.15; Royal Institute of International Affairs, *The Problem of International Investment*, (Oxford 1937), p.284.

interwar period.⁴⁶ Little wonder therefore, that when lending and commodity prices collapsed the debtor countries found themselves in dire straits, the final outcome of which was debt delinquency and default.

The more recent episode has remarkable parallels with that of the 1920s though the outcomes were somewhat different. Not all borrowing countries by any means got into debt difficulties in the later period. In fact the majority (100 countries or so) avoided serious problems because, as noted later, they fulfilled the 'rules of the game' for successful debt management.⁴⁷ The main problems were concentrated in a minority of countries, some 30 or more, principally in Latin America and Sub-Saharan Africa, which were alleged to have misused funds and practised bad macroeconomic policies.

Though there are some differences of view on this matter, the weight of evidence tends to go against the persistent debtors. Dornbusch and Fischer⁴⁸ claimed that a large part of American lending was either wasted or unjustified because it financed import binges or was borrowed directly by governments to finance external deficits or public sector spending. Moreover, many debtor countries in both Latin America and elsewhere are alleged to have 'mismanaged their economies beyond belief'.⁴⁹ Sachs⁵⁰ draws out the contrast between Latin American and Asian borrowers in this respect. He says that Latin American countries did not use foreign resources to develop export

⁴⁶ B. Eichengreen and R. Portes, 'Debt and default in the 1930s: causes and consequences', *European Economic Review*, 30 (1986), p.604; H. W. Fleisig, *Long-term Capital Flows and the Great Depression: The Role of the United States, 1927-1933*, (New York 1975), pp.12-13.

⁴⁷ World Bank, *World Development Report 1985*, (Oxford 1985), pp.26-30.

⁴⁸ R. Dornbusch and S. Fischer, 'Third world debt', *Science*, 234 (1986), p.837.

⁴⁹ E. A. Cardoso and R. Dornbusch, 'Brazilian debt crises: past and present', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge Mass. 1989), p.125; J. Greene, 'External debt problem of sub-Saharan Africa', in J. A. Frenkel, M. P. Dooley and P. Wickham (eds), *Analytical Issues in Debt*, (Washington D.C. 1989), pp.53-4; S. Jones, 'Macroeconomic populism and economic failure in Africa since 1960', in D. H. Aldcroft and R. E. Catterall (eds), *Rich Nations - Poor Nations: The Long-run Perspective*, (Cheltenham 1996), pp.89-103.

⁵⁰ J. D. Sachs, 'External debt and macroeconomic performance in Latin America and East Asia', *Brookings Papers on Economic Activity*, 2 (1985).

activities adequate to meet future debt-servicing requirements. Instead they followed import-substitution policies and had overvalued exchange rates, whereas their East Asian counterparts concentrated on export promotion policies and sound economic management.⁵¹ Hence the debt indicator ratios diverged markedly in the two regions and Latin America's overvalued exchange rates eventually precipitated a sensational capital flight which the foreign banks helped to engineer indirectly until the lending shutdown in 1982. In the case of Mexico and Argentina capital flight was equivalent to one half the external debt and for Venezuela it accounted for the whole of it.⁵² Pollard⁵³ reckons that governments and richer citizens in this region 'acted with exceptional irresponsibility'.

Some African countries, under the guise of macroeconomic populism, have also been accused of misusing external funds. Though much of the debt held by these countries was granted on concessional terms by various international agencies and donor governments (only about 21 per cent of external debt was owned by financial institutions in 1987 the bulk of which was concentrated in a few countries), which were supposed to practise better appraisal and monitoring techniques than the commercial banks, the final outcomes do not appear all that different. The World Bank⁵⁴ roundly condemned the deployment of funds, much of which it said had gone to finance large public investments which contributed little to economic growth or foreign exchange earnings. 'Genuine mistakes and misfortunes cannot explain the excessive number of "white elephants". Too many projects have been selected either on the basis of political prestige or on the basis of inadequate regard for their likely economic and financial rate of return.' The problem was not simply one of excessive borrowing but

⁵¹ S. M. Collins and W.-A. Park, 'External debt and macroeconomic performance in South Korea', in J. D. Sachs (ed), *Developing Country Debt and the World Economy*, (Chicago 1989), pp.137-8.

⁵² S. A. Schuker, *American reparations to Germany 1919-33: implications for the third world debt crisis*, (Princeton 1988), p.137.

⁵³ S. Pollard, *The International Economy Since 1945*, (London 1997), p.87.

⁵⁴ World Bank, *Toward Sustained Development in Sub-Saharan Africa*, (Washington D.C. 1984), p.24; World Bank, *World Development Report 1985*, (Oxford 1985), pp.51-54.

seemingly one of a sheer misuse of resources through economic mismanagement, greed and corruption. Schuker⁵⁵ one of the fiercest critics, has severely condemned the activities of governments of many debtor countries who frittered away resources on show projects, on arming against aggressors, on overconsumption, and for the misappropriation of funds by local élites: all around the globe, sovereign debtors frittered away scarce hard-currency resources arming against their neighbours. Numerous third-world potentates, moreover, succeeded in blurring the distinction between public assets and private ones. Marcos of the Philippines, Mobutu Sese Seko of Zaire, and López Portillo of Mexico stood out only by the amount of fungible investment capital that they managed to sequester under their own names. In large parts of Latin America and Africa, speculation became systemic rather than individual. Several Latin American countries slid into a crisis of governability recalling the formative years of nineteenth-century nation building, when *caudillo* élites regularly plundered an impoverished state while deflecting popular discontent through the contrivances of nationalism. Other commentators have echoed Schuker's accusations, though somewhat less stridently. Greene⁵⁶ for example, feels that domestic policies were a major factor in debt accumulation in Sub-Saharan Africa. The combination of over-exuberant development programmes partly financed by external sources and misguided economic policies left many African states with both internal and external transfer problems once the commodity price boom broke. As the terms of trade deteriorated and economic stagnation set in the tax base was eroded thus weakening the governments' ability to raise resources internally to service external public debt, while at the same time exchange earning capacity was reduced thereby aggravating the external transfer of the debt-service costs.⁵⁷

⁵⁵ S. A. Schuker, *American Reparations to Germany 1919-33: Implications for the Third World Debt*, (Princeton 1988), p.136.

⁵⁶ J. Greene, 'External debt problem of sub-Saharan Africa', in J. A. Frenkel, M. P. Dooley and P. Wickham (eds), *Analytical Issues in Debt*, (Washington D.C. 1989), pp.53-4.

⁵⁷ W. M. Corden and M. P. Dooley, 'Issues in debt strategy: an overview', in J. A. Frenkel, M. P. Dooley and P. Wickham (eds), *Analytical Issues in Debt*, (Washington D.C. 1989), p.16.

The World Bank⁵⁸ has also frequently criticised the economic policies of the developing countries which have been detrimental to resource use and debt servicing. Large budget deficits, overvalued exchange rates, protection and subsidies, measures that discouraged domestic savings, negative real interest rates, distortion of the price system through price controls, poor appraisal of investment projects, inefficient tax regimes, excessive interference with market mechanisms and policies that discriminated against agriculture, have led to inflexible and inward-orientated economic systems which have produced poor economic results.⁵⁹ The misguided economic strategies of many developing countries meant that they accumulated large debts without a corresponding improvement in their supply capability, which sapped their economic strength and left them vulnerable to exogenous shocks.

If policy measures had simply been a product of sheer ignorance or even incompetence one could have more sympathy for them. But all too frequently one gets the impression that the macroeconomic stance was a calculated manipulation of the levers of power for the benefit of the ruling élites at the expense of the mass of the population. One classic example is that of Brazil, the world's largest debtor in the 1980s in absolute terms, and with one of the most skewed income and wealth profiles: one half the income of the country accrued to only 10 per cent of households. It has been said of Brazil that 'the whole machinery of state is devoted to government by the haves for the haves'.⁶⁰ The principle beneficiaries of the government's massive public-sector deficits were the middle and upper classes through subsidies and handouts, infrastructure facilities (e. g. education for the wealthy) and the high wages of civil servants. Even more pernicious has been the way élite groups used low-cost foreign loans for business purposes and then shifted their own capital to tax-free

⁵⁸ World Bank, *World Development Report 1985*, (Oxford 1985), p.43; World Bank, *World Development Report 1990*, (Oxford 1990), p.75.

⁵⁹ J. T. Cuddington, 'The extent and causes of the debt crisis of the 1980s', in I. Husain and I. Diwan (eds), *Dealing with the Debt Crisis*. (Washington D.C. 1989), p.35-8; J. Greene, 'External debt problem of sub-Saharan Africa', in J. A. Frenkel, M. P. Dooley and P. Wickham (eds), *Analytical Issues in Debt*, (Washington D.C. 1989), pp.53-4.

⁶⁰ See I. Dawnay, 'Debt relief and the poor', *Financial Times*, 8 February 1988.

havens abroad, which the government facilitated by maintaining exchange convertibility. Capital flight, in fact, became endemic in Latin America in the early 1980s and served to compound the problems of these debtor countries. On average it accounted for nearly 44 per cent of the borrowings of 18 of the chief debtor nations, and in several cases for one half or more.⁶¹

Though there is considerable evidence of waste, inefficiency and bad economic management in many debtor countries, it is important to put the recent experience in proper perspective. In the first place part of the borrowing in the 1970s was to meet the cost of the oil price explosion which hit the LDC oil importers hard. Cline⁶² sees this as the single most important exogenous cause of the subsequent debt burden. Secondly, though borrowing did increase rapidly in the 1970s it did not, in fact, lead to a deterioration in the debt indicators. The debt/export ratios remained remarkably stable in this period; in fact, in the case of the non-oil LDCs they were slightly lower on average in 1980 than they had been in 1973 and only began to rise rapidly thereafter (Table 3). This was because real interest rates remained low and export earnings were buoyant and so the simple solvency rule outlined earlier remained basically intact. Thirdly, though there was a series of adverse events in the early 1980s, the banks clearly exacerbated the crisis with a further massive rise in lending, especially to Latin America where capital flight was a problem, which caused

Table 3 - Debt/Export Ratios (%)

	1973	1980	1981	1982	1983	1984	1985	1986
Non-oil LDCs	115.4	112.9	124.9	143.3	152.8	148.3	162.0	162.2
Western Hemisphere	176.2	178.4	207.9	273.1	290.4	275.2	296.2	331.3

Source: J. D. Sachs, 'Introduction' in J. D. Sachs (ed), *Developing Country Debt and the World Economy*, (Chicago 1989), p.7

⁶¹ S. A. Schuker, *American Reparations to Germany 1919-33: Implications for the Third World Debt*, (Princeton 1988), p.137.

⁶² W. R. Cline, *International Debt: Systematic Risks and Policy Response*, (Washington D.C. 1984), pp.8-11.

⁶³ J. D. Sachs, 'Introduction' in J. D. Sachs (ed), *Developing Country Debt and the World Economy*, (Chicago 1989), pp.6-8.

the debt/export ratios to soar.⁶³ Finally, whatever view is taken of the merits of lending in the 1970s there was no reason at the time to suspect an imminent debt crisis from the reading of the debt indicators and therefore little cause to advocate a cautious borrowing policy 'consistent with foreknowledge of these global shocks'.⁶⁴

The Crisis Years

The argument so far is that through a combination of creditor imprudence and debtor abuse borrowing nations in the 1920s and 1970s were in a vulnerable position to world-wide economy shocks. Dornbusch and Fischer's⁶⁵ summation of the more recent events might equally well apply to the earlier period: imprudent borrowing policies in the debtor countries and imprudent lending by commercial banks had a chance encounter with extraordinarily unfavourable world macroeconomic conditions that exposed the vulnerability of the debtors and creditors. On the first occasion there is no doubt that debtors were overcommitting themselves since the debt indicators were deteriorating steadily before the great depression. They were therefore extremely vulnerable to the global shocks of the period. These included a dramatic fall in commodity prices, of 50 per cent or more, a sharp rise in real interest rates and severe economic depression. Added to which international lending was declining after the middle of 1928 and dried up altogether in the early 1930s. The result was an escalation of debt burdens and an increasing inability to meet service charges as exchange earnings dwindled and capital imports dried up. The initial response of many debtors was to devalue their currencies (which increased their debt burdens), impose trade and exchange controls and then to default on their debts.

The position in the later period is slightly more complex. Though

⁶³ W. R. Cline, *International Debt: Systematic Risks and Policy Response*, (Washington D.C. 1984), p.17.

⁶⁴ R. Dornbusch and S. Fischer, 'Third world debt', *Science*, 234 (1986), p.837.

⁶⁵ A. Maddison, *Latin America, the Caribbean and the OECD.*, (Paris 1986), p.25.

debtors were borrowing heavily in the 1970s there is no clear indication of an imminent crisis since the debt indicators were fairly stable. OPEC surpluses were being recycled by OECD banks to borrowers, especially in Latin America, on the strength of the commodity price boom, and for a time these nations were relatively immune to the western slowdown in economic growth.⁶⁶ But debtors had little margin to spare in the event of serious global shocks though these could not easily have been anticipated at the time. Cuddington⁶⁷ has argued, on the other hand, that borrowing should have been moderated when exchange earnings were strong as a result of the strength of commodity prices in the 1970s, and that had borrowing been better managed debtors would have been less vulnerable to external events. But the real problem, at least for some countries, was the massive burst of borrowing at the turn of decade which caused debt ratios to soar just at the time when worldwide events were turning adverse.

External factors were responsible for much of the increase in indebtedness of developing countries and for much of the 1980s they were paying out more than they received in loans and aid from the western creditors.⁶⁸ The main external shocks of the early 1980s were the adverse movement in the terms of trade for debtors, the sharp rise in real interest rates, international recession and the further rise in oil prices. Overall Lindert⁶⁹ reckons that the world economy shocks of this period were not as severe on average for debtor countries as those of the 1930s, with the real interest rate shock about the same and the terms of trade less severe. Moreover, international trade did not collapse, as in the 1930s, while closure of western industrial markets to debtor countries through protection was less severe than in the earlier period. Nevertheless, the adverse shifts in interest rates and trade terms were severe by most standards. By the early 1980s, as a

⁶⁷ J. T. Cuddington, 'The extent and causes of the debt crisis of the 1980s', in I. Husain and I. Diwan (eds), *Dealing with the Debt Crisis*, (Washington D.C. 1989), p.27.

⁶⁸ V. George, *Wealth, Poverty and Starvation: A World Perspective*, (Hemel Hempstead 1988), p.201.

⁶⁹ P. Lindert, 'Response to debt crisis: what is different about the 1980s?', in B. Eichengreen and P. Lindert (eds), *The International Debt Crisis in Historical Perspective*, (Cambridge 1989), pp.229-31.

result of anti-inflationary measures in the industrial west, real interest rates were very high, more than twice those of the 1960s and nearly six times as large as in the period 1974-9 when developing countries were taking on debt at negative real interest rates. The swing in interest rates was very sharp indeed: between 1979 and 1982 the average real interest rate on developing country floating debt moved from a negative 9.7 per cent to a positive 16.7 per cent.⁷⁰ The additional cost for the Latin American countries alone was roughly \$8 billion a year in the 1980s compared with the average for 1963-80, or close to one per cent of the region's GDP and nearly two per cent at the peak in 1984. The cumulative impact was lower in the case of Africa and South Asia, around a third of that of Latin America.⁷¹ The fall in commodity prices in the 1980s cost both Latin America and Africa some 13-15 per cent of their exports' real import purchasing power relative to the previous decade, with about two-fifths attributable to the impact of lower petroleum prices on oil exporters. In addition, there was the adverse impact of a fall in trade volumes as a consequence of recession in OECD countries.⁷² Much of Sub-Saharan Africa also suffered a stagnation in output in the 1980s with real GDP per capita falling below the level of the early 1970s.⁷³ Finally, the halt to commercial lending in 1982 was a further blow to the hard-pressed debtors.

Though these adverse events helped to trigger a debt crisis in more than 40 countries, with debt indicators more than doubling or trebling, it is clear that this is not the whole story. More countries managed to avoid serious debt problems in the 1980s, even though many of them had borrowed extensively in the 1970s. Moreover, some of the successful Asian economies actually suffered severe declines in their terms of trade through the period 1975-83, whereas several of the problem debtors experienced an improvement.⁷⁴ Nor does

⁷⁰ A. Maddison, *Latin America, the Caribbean and the OECD*, (Paris 1986), p.26.

⁷¹ World Bank, *World Development Report 1990*, (Oxford 1990), p.15.

⁷² World Bank, *World Development Report 1990*, (Oxford 1990), p.13-14.

⁷³ J. Greene, 'External debt problem of sub-Saharan Africa', in J. A. Frenkel, M. P. Dooley and P. Wickham (eds), *Analytical Issues in Debt*, (Washington D.C. 1989), pp. 44.

⁷⁴ J. D. Sachs, 'External debt and macroeconomic performance in Latin America and East Asia', *Brookings Papers on Economic Activity*, 2 (1985), p.525.

relative poverty throw much light on the debt-carrying capacity of individual countries. Low-income countries such as India were able to contain their debt/service ratios within manageable limits of around 15 per cent.⁷⁵ The moral of this tale would seem to be, therefore, that one of the factors for success is the extent to which debtor countries were able to follow the rules of the game in terms of good economic housekeeping and management and were therefore able to fulfil the prerequisites for sound commercial borrowing. By and large successful countries had a prolonged period of growth before entering the external capital market; they had expanded and diversified their traded goods sector, commercial policies were outward-looking and macroeconomic management strategy gave priority to market mechanisms⁷⁶. As Cline⁷⁷ concludes in his recent study of the debt problem; just as many Asian countries with sound policies were able to avoid the debt crisis altogether, and two major countries (Chile and Columbia) within Latin America with good policies (and adequate luck on external variables) managed to survive the regional capital market shutdown without the need to resort to debt forgiveness, so developing countries and countries in economic transition should be able to secure capital from the global markets over the coming decade if their domestic policies are in order.

The Outcomes

The global debt problems of the 1930s and 1980s did not end in catastrophe though the resolution of both episodes was somewhat different. In the former period default and debt moratoria were the order of the day, while several countries reduced their debt overhang by market-based buy-backs. All but one of the South American republics had defaulted by 1933 and many countries in Europe

⁷⁵ W. R. Cline, *International Debts Reexamined*, (Washington D.C. 1995), p.399.

⁷⁶ J. D. Sachs, 'External debt and macroeconomic performance in Latin America and East Asia', *Brookings Papers on Economic Activity*, 2 (2985), p.525; World Bank, *World Development Report 1985*, (Oxford 1985), p.26.

⁷⁷ W. R. Cline, *International Debts Reexamined*, (Washington D.C. 1995), p.487.

suspended servicing of their debts. Debt default, especially for heavy defaulters, has been seen as advantageous for economic recovery in the 1930s,⁷⁸ but one needs to consider carefully the longer term consequences. Recovery was based on import-substitution policies in a highly protectionist climate and it is arguable that this would have happened anyway under the conditions of the time, default or no default. Defaulters became locked into inward-looking economic strategies for half a century or more, long after they had served any useful purpose. Secondly, they were effectively shut out of the international capital market for many years: on average, the heavy defaulters until the 1970s and the lighter defaulters until the late 1950s.⁷⁹

The overall outcome of the debt crisis of the 1980s was more successful. There were few outright defaults, possibly, as Maddison suggests,⁸⁰ because international trade did not collapse in the way it did in the 1930s. In the decade following the Mexican debt crisis of 1982 a series of internationally coordinated policy packages were arranged. The first of these involved emergency relief to hard-hit countries and was supervised under the auspices of the IMF (1982-5). The second initiative was the Baker Plan (1986-8) which fixed targets for bank and official lending and pressed for structural reform in debtor countries. The third, the Brady Plan (1989-94), involved debt reduction agreements and reschedulings.

Overall, the strategy can be regarded as fairly successful even though the amount of outright debt remission was relatively small. It prevented a global financial meltdown and provided debtors with early re-entry to world capital markets. While it caused significant economic dislocation in many debtor countries, it did help to speed up the process of structural reform which eventually bore fruit in some countries in terms of better economic performance and an

⁷⁸ See B. Eichengreen and R. Portes, 'Debt and default in the 1930s: causes and consequences', *European Economic Review*, 30 (1986) and 'Dealing with debt: the 1930s and the 1980s', in I. Husain and I. Diwan (eds), *Dealing with the Debt Crisis*, (Washington D.C. 1989).

⁷⁹ W. R. Cline, *International Debts Reexamined*, (Washington D.C. 1995), pp.153-4.

⁸⁰ A. Maddison, *Latin America, the Caribbean and the OECD*, (Paris 1986), p.227.

improvement in the debt indicators. The majority of African countries are growing again following the stagnation of the 1980s and early 1990s.

In fact the debt indicators showed quite remarkable improvement from their peak in the mid-1980s through to the 1990s.⁸¹ For the 33 largest debtors the net interest payments/exports of goods and services ratio nearly halved, from 20.5 to 10.9 per cent between 1982-93, while for the 17 most heavily indebted countries it declined by some two thirds, from 29.8 to 10.9 per cent. By 1993 only nine of these countries had ratios in excess of 15 per cent, which is conventionally regarded as a sustainable threshold level.⁸² Even in Sub-Saharan Africa some improvement has been recorded and it has recently been argued that the worst of the debt crisis is more or less over.⁸³ Though there are still some very serious cases - the Sudan, Somalia, Zaire, Uganda, Nigeria, Mozambique and Madagascar-for example, where complete write-offs or extensive debt remission will no doubt be essential - for the majority of countries debt burdens are now relatively light so that debt rollovers or reschedulings may be all that is required. By 1992 only 13 of 45 Sub-Saharan Africa countries had debt service ratios in excess of 15 per cent.⁸⁴ However, too much should not be read into these figures. The official debt indicators are notoriously unreliable, while the improvement recorded over the last decade is partly attributable to the effect of debt relief and accumulation of arrears. If scheduled obligations were in force they would look very different.

Thus by the turn of the decade the global debt crisis was almost a thing of the past, at least for the majority of debtors and as far as western countries were concerned. By a coordinated international strategy and cooperation on the part of debtors themselves the crisis had been averted. Debt indicators had improved significantly, many

⁸¹ United Nations, *Report on the Economic and Social Situation in Africa 1997*, (Addis Ababa 1997), p.276.

⁸² W. R. Cline, *International Debts Reexamined*, (Washington D.C. 1995), pp.52-3.

⁸³ T. Hawkins, 'The African problem', *Financial Times World Economy and Finance Supplement*, Part 2, 19 September 1997, p.26.

⁸⁴ W. R. Cline, *International Debts Reexamined*, (Washington D.C. 1995), pp.369-73.

debtors had secured re-access to international capital markets, while economic policy reforms were producing improved economic performance in some countries. But if the stage had been set for more responsible lending and borrowing in the future, there was less optimism among many African countries whose economic burdens loomed as large as ever. Most of the seriously indebted countries are now located in Africa where debt levels are high in per capita terms by international standards and where the capacity to service and/or repay debt is still very limited. Debt relief measures have been too little and too late, with repeated reschedulings simply leading to an accumulation of arrears. Even with the recent improvement in economic performance there is little prospect of many countries being able to meet their obligations in full. Population is growing at twice the world rate (2.8 per cent as against 1.5 per cent per annum) and only very recently has there actually been an increase in per capita output following a decade or more of stagnation or decline. Moreover, the pressure to reduce budgetary deficits under structural reform programmes has led to even more intense competition for the limited resources available in a continent where some two thirds of the population is living at subsistence or below the absolute poverty line.⁸⁵ Thus with low incomes and savings, rapid population growth and limited prospects in world markets, any attempts at indigenous economic transformation could well be aborted, irrespective of the debt situation. The debt overhand however could lead to a disintegration of the present fragile economic and social fabric in many countries. On this interpretation therefore, there is an urgent need for exceptional measures to rescue countries from a permanent debt trap for 'without substantial international assistance, it would be difficult for most African countries to reverse their worsening trend of crushing indebtedness.'⁸⁶

⁸⁵ United Nations, *Economic Report on Africa 1995*, (Addis Ababa 1995), pp.24-7.

⁸⁶ United Nations, *Economic and Social Survey of Africa 1994-1995*, (Addis Ababa 1995), 169; United Nations, *Report on the Economic and Social Situation in Africa 1997*, (Addis Ababa 1997), pp.1-4.

Conclusion

Twentieth century borrowers were much poorer on average than their nineteenth century counterparts; they borrowed heavily at specific times and were then engulfed by exceptionally severe exogenous shocks to the world economy. But even without these shocks there is reason to believe that both in the 1920s and again fifty years later debtor countries were taking on burdens that could not possibly be sustained in the long run. Debts rose to critical levels such that they failed to pass the acid test of generating sufficient revenues to service and repay debts, one reason why capital flows dried up quickly soon after. For the excesses that occurred both creditors and debtors must share the blame, including also the multilateral agencies who failed to appraise and monitor lending adequately. Official lending, like official aid, was all too often hastily conceived, poorly planned and badly supervised.⁸⁷ On the other hand, the fact that many borrowers, even though often very poor, managed to avoid getting into serious difficulties, suggests that it is not impossible for countries to live within their means. Success in this respect is predicated on sound domestic policies, though in many African countries this still remains a very real problem because state capability is noticeably lacking (many countries are under military rule or civil tyranny). For this reason as much depends on the acumen of the lending countries, and especially the official agencies, to ensure that lending is dispensed and used wisely and that it is accompanied by prudent economic strategies. One should also bear in mind that the advanced countries of the West can contribute, in ways other than debt remission and aid, to ease the burden of adjustment of the poorest debtor countries: for example through trade liberalisation so as to allow greater access for LDC exports to western markets, and by more generous terms on which goods are exchanged. A few percentage points improvement in the terms of trade of poor countries would do wonders for their economic viability. Otherwise, 'The dismal alternative is to leave in place a world

⁸⁷ G. Hancock, *Lords of Poverty*, (London 1989), p. 121.

trading system that violates the principles of the market system which they [the industrial countries] profess and under which the OECD economies have prospered.⁸⁸ It is somewhat ironic that in what are supposed to be more humanitarian times, the Third World is probably more exploited today in terms of trade exchange by governments and purchasing agencies of western nations than ever they were in the free-trade era of the nineteenth century.

⁸⁸ I. Goldin, O. Knudsen and D. van der Mensbrugge, *Trade Liberalisation: Global Economic Implications*, (Paris 1993), p.207.