
The Debt Crisis

The origins of the debt problem can be traced to the mid-1970s when the combination of the oil price shocks, high prices for commodities and low real interest rates led many lenders and borrowing countries to contract loan obligations which proved unsustainable when these conditions changed. Excessive debt resulted from overly optimistic assumptions about economic growth, declining terms of trade and inappropriate domestic economic policies. Other factors such as the over-eagerness of banks to recycle petro-dollars, corruption and excessive military expenditure also contributed, often significantly.

By the early 1980s, it was evident that many countries in the developing world were experiencing difficulties in meeting their obligations as real interest rates rose, commodity prices fell and the world entered a recession. Some countries such as South Korea, were successful in responding to these problems. Others did not adjust quickly and the debt crisis erupted in 1982 when Mexico announced it was no longer able to service its foreign debt.

The development process in much of Africa and Latin America over the past 10 years has been undermined by the accumulation of high debt loads and the failure of economies to adjust. **While the root problem is economic, the consequences of the debt burden must be seen in a broader social and political context.** The re-establishment of economic equilibrium, especially in the face of a high debt load, is often a difficult and destabilizing process.

During the 1980s, the size and structure of the debt of developing countries changed significantly. The IMF calculated that the total long-term debt of the developing countries with debt-servicing difficulties was US\$536 billion in 1982 and reached US\$735 billion in 1989.

For debt-distressed middle-income countries, most of the increase in debt was due to new loans extended by multilateral institutions and other official sources. A high and growing proportion of the debt of low-income, debt-distressed countries is also from official sources (multilateral institutions, export credits and aid agencies). **Thus there has been a significant shift in the composition of the debt as the public sector has assumed a greater proportion of the debt (see Table I).** While the commercial banks have been and remain the largest providers of funds for the middle-income countries, governments and multilateral institutions are central to the response to problems of low-income debtors.

The burden of the debt for those with debt-service difficulties has declined in the last eight years especially for middle-income countries (see Table II). **Total debt service as a percentage of exports of goods and services has declined from 37 per cent in 1982 to 26 per cent in 1989, which reflects economic progress in the affected countries and the impact of measures to alleviate the debt burden.** The debt burden, however, remains severe, particularly for low-income countries.