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Causes and scope of world debt

The oil crisis of 1973

2.1 In 1973 the Organisation of Petroleum Exporting Countries (OPEC) restricted the supply of oil, which soon quadrupled in price. This in turn allowed OPEC nations to increase greatly their revenues from the sale of oil. Commercial banks sought to invest this money and made large loans available to developing countries at low, variable interest rates. To illustrate, international bank credits increased from US$135 billion at the end of 1973 to US$936 billion at the end of 1981.[1] Due to the very large amount of money involved, these banks often paid insufficient attention to the viability of the projects on which this money was to be spent.

2.2 A second oil crisis in 1979 had further effects on the world economy. During 1981 the United States Federal Reserve Board pushed interest rates above 21 per cent to defend its dollar, and as a result interest rates around the world rose, making debt servicing for poor countries crippling. As a result of the sudden increase in interest rates, the United States' economy fell into recession, reducing demand for commodities.[2] As they began to default on these loans under the weight of increased repayments, developing countries received advice from the International Monetary Fund (IMF) to shift agricultural production from crops for domestic consumption to crops for export. The resulting glut in the production of these commodities meant that prices plummeted, leaving many developing countries with little revenue and less land available for the production of crops for domestic consumption. This combination of lower

1 McKenzie, G and Thomas, S, 1992, *Financial Instability and the International Debt Problem*, Macmillan Academic and Professional.

2 Joint Standing Committee on Foreign Affairs, Defence and Trade, 1989, *World Debt: An Australian Perspective*, pp. 18-20.

revenues and less domestic consumption led to a rise in poverty in developing countries. These and additional debts have persisted to this day.

Over-reliance on commodity exports

2.3 One of the primary reasons for poverty in developing countries is the narrow base on which their economies rely. Even today, many developing countries have a heavy reliance on only a few major crops and commodities for export, and their economies fluctuate with variations in those prices. Per-capita incomes in such countries have declined in the last 20 years because of population increases, and more recently, falls in commodity prices.

2.4 As Ms Janet Hunt of the Australian Council for Overseas Aid described at the seminar:

> Nearly a quarter of African countries rely on a single commodity for half their export income, and over 20 countries rely on only two or three primary commodities for half their export income. One study of the effect of export instability on economic growth in 34 African countries found that, even after allowing for other variables, export instability had a significant negative effect on economic growth, and that was due to price fluctuations in their primary commodities.[3]

Corruption, poor lending practices and mismanagement

2.5 Beyond the structural and external factors affecting developing countries' indebtedness, there have been numerous internal and domestic causes. Billions of dollars that could have been spent on development projects were used for military or political purposes or simply siphoned off to members of the ruling elite, especially during the Cold War when political considerations could take precedence over economic or developmental issues.[4]

2.6 At the Committee's seminar, Professor Inder indicated how capital and labour would not be put to optimal use if corruption existed in an economy.[5] The World Bank defines corruption as 'the abuse of public office for private gain'.[6] The danger to developing countries from

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3 Hunt, Transcript, p. 12.

4 Remenyi, Transcript, p. 41.

5 Inder, Transcript, p. 34.

6 The World Bank Group, 'Corruption and Development', 19 October 1998, http://www.worldbank.org/html/extdr/offrep/eap/pbsp101998.htm, 18 October 1999.

corruption was spelled out by the President of the World Bank, James Wolfensohn in 1997:

> There is increasing evidence that corruption undermines development. It also hampers the effectiveness with which domestic savings and external aid are used in many developing countries, and this in turn threatens to undermine grassroots support for foreign assistance.[7]

2.7 The payment of bribes or diversion of funds increases the cost of business and reduces the efficacy of development projects. It is therefore a significant distortion of international trade and weakens accountability and the rule of law.

2.8 International law is already evolving to combat the corruption that distorts international trade and reduces the impact of development assistance or loans to developing countries. The negotiation of the *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions* in 1997 is a significant first step towards reducing corruption in both developed and developing countries. By a country signing and ratifying the Convention, it sends a clear signal that corruption will not be tolerated, especially when accompanied by stringent penalties in domestic law.

2.9 However, corruption is a not only a result of misappropriation of funds in the recipient countries, but also a lack of attention to good lending practices in donor countries. Mr Christopher Ariyo of the High Commission for the Federal Republic of Nigeria provided the Committee with the following example:

> The main cause of the current suffocating $US28.8 billion Nigerian debt could be stated as misappropriation of credit for development purposes and corruption involving Nigerian public officials under the past military regimes and in some cases, wittingly and unwittingly, the creditors. In most cases, the conditions for drawing the credit—which ought to have been strictly adhered to by the credit-releasing authorities—would appear not to have been observed.[8]

2.10 Funding of incomplete or unrealistic projects in the developing world has also been a cause of these debt burdens. Many developing countries were not able to repay or service these loans, as the projects they were meant to fund were never completed.

7 The World Bank Group, 'Anti-Corruption Knowledge Resource Centre', http://www.worldbank.org/publicsector/anticorrupt/, 18 October 1999.

8 Ariyo, Transcript, p. 53.

2.11 Spending on domestic consumption, rather than on investment is also a cause of high indebtedness. Countries that borrow heavily to finance consumption will not add to their ability to repay those loans, and will raise the cost of borrowing in the future.

Scope

2.12 In 1997, total developing country debt stood at approximately $US1500 billion, although only a small portion of this debt is unsustainable.

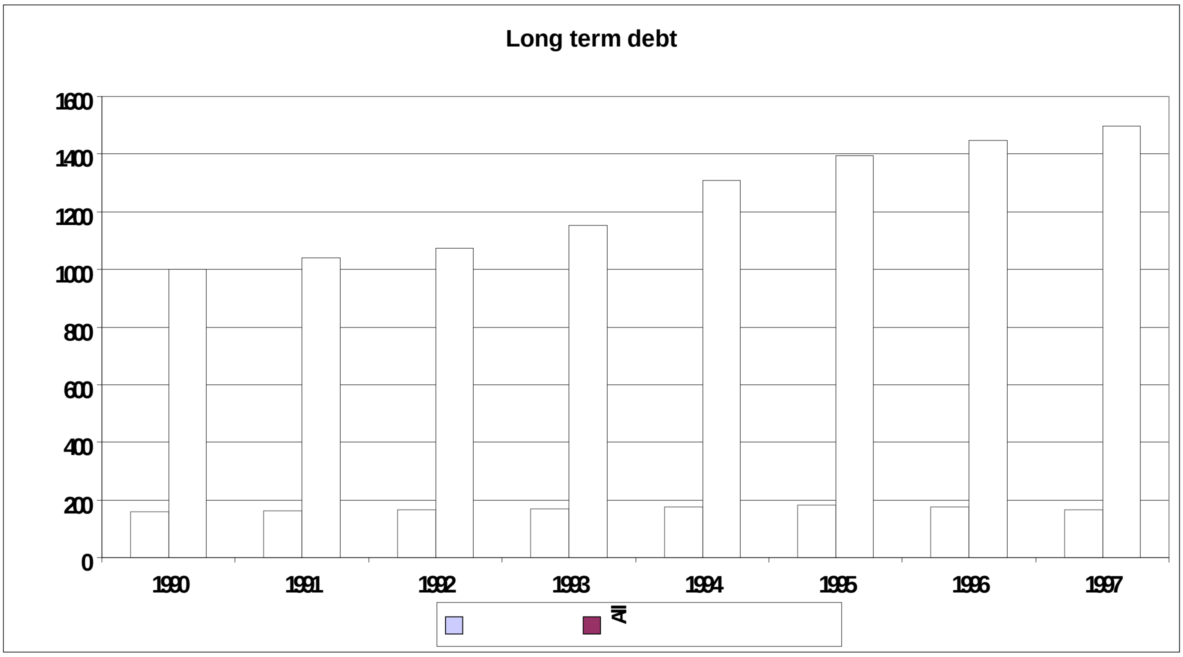

Chart 1: Data courtesy of AusAID

2.13 The main difference between HIPCs and other developing countries is the relative size of their economies. In 1997, the total debt to Gross National Product (GNP) ratio averaged 127 per cent for the HIPCs.[9] For most developing countries, however, the ratio remained much lower at about 30 per cent of GNP.

9 The World Bank Group, 'Key Indebtedness Ratios, 1995-97', 1999, http://www.worldbank.org/hipc/about/debt-table/v2.pdf, 18 October 1999.

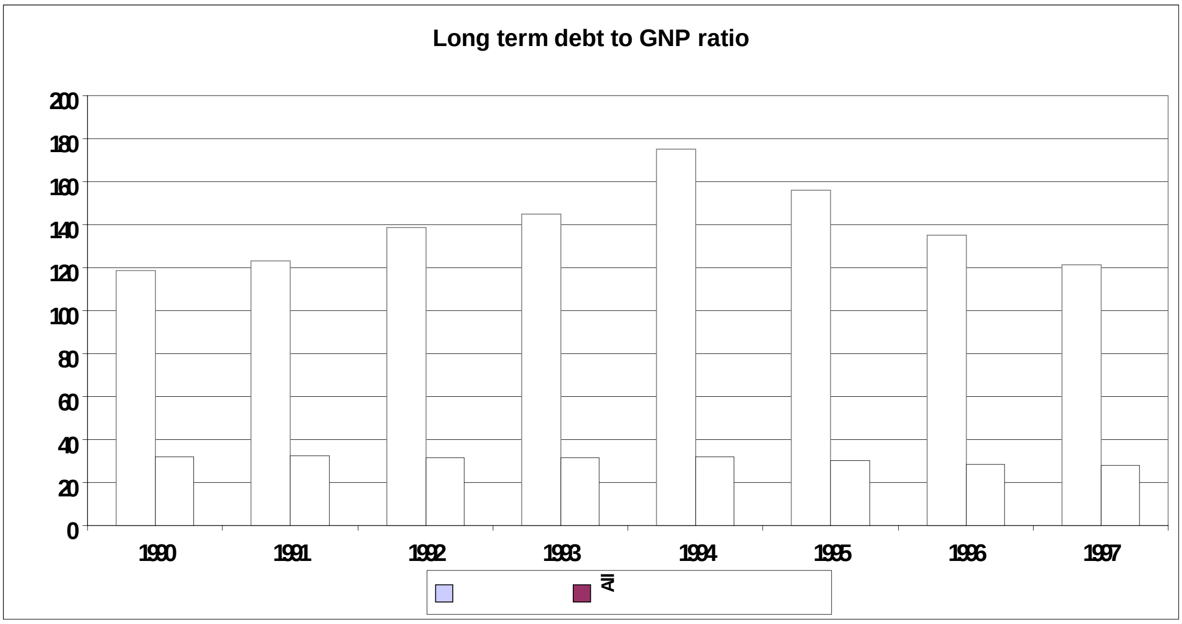

Chart 2: Data courtesy of AusAID

2.14 The long term debts of the HIPCs greatly outweighs the size of their annual exports and thus their ability to generate income to repay these debts.

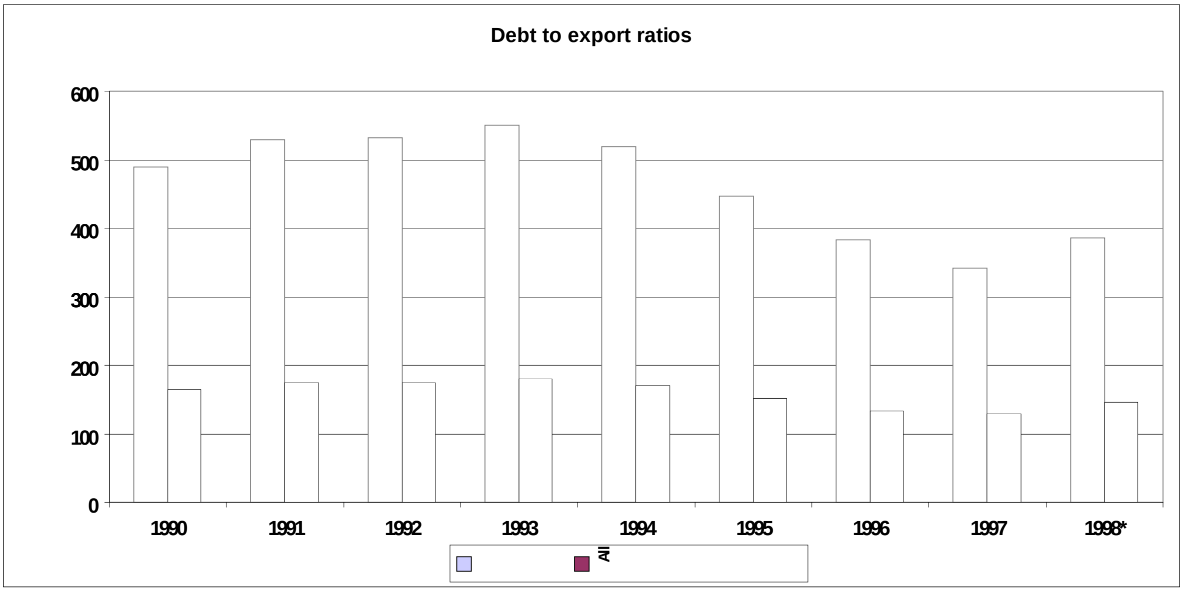

Chart 3: Data courtesy of AusAID

2.15 Servicing this debt each year constrains these countries' ability to fund education, health and other social and economic programs. The amount that HIPCs have to pay to service their debts each year fluctuates, due to the smaller size of their economies, the impact that price shocks have on their narrowly-based export industries and the uncertainties of debt-service rescheduling.

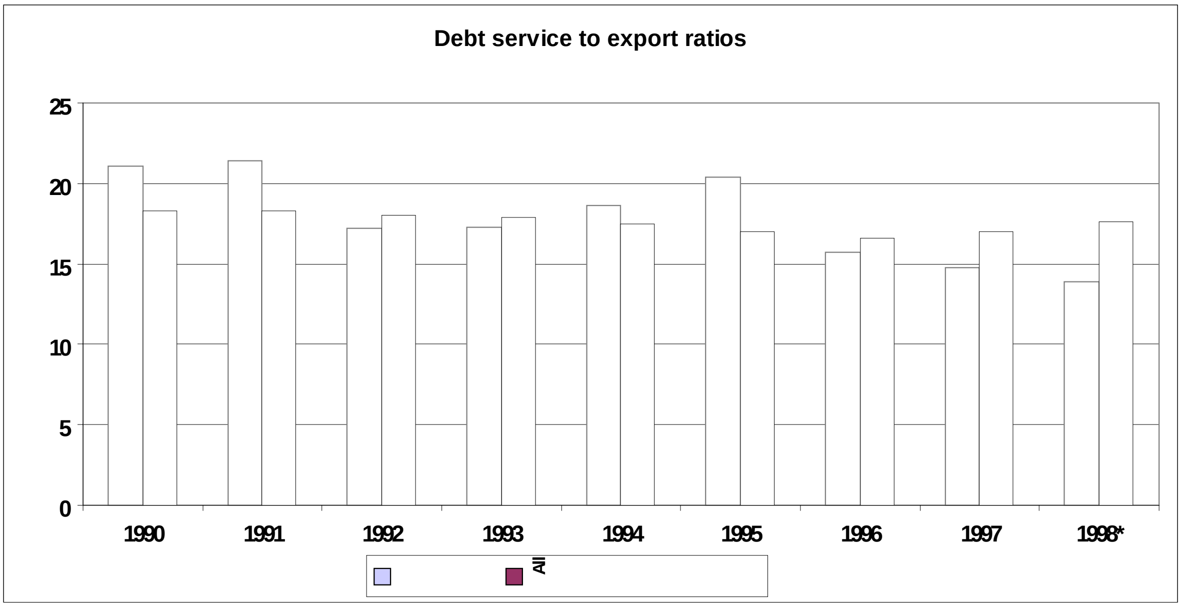

Chart 4: Data courtesy of AusAID

2.16 The relatively large debts of HIPCs are not the only factor operating on the economies of these countries, but they are a factor. Investment in HIPCs is likely to be affected by a decline in the terms of trade or changes in world interest rates. However, as Mr Muir of AusAID suggested at the seminar:

> Unsustainable debt is clearly a constraint on development and poverty alleviation. It discourages investment. It also makes it more difficult for education and health expenditure in the HIPCs.[10]

Global aid

2.17 As the scope of world debt has increased, the amount of development assistance provided by developed to developing countries has been declining for most of the 1990s. Total Organisation for Economic Cooperation and Development (OECD) Development Assistance Committee (DAC) countries' aid fell from 0.33 per cent of their combined GNP in 1992 to an all-time low of 0.22 per cent in 1997. However, in 1998, total official development assistance from DAC members rose by US$3.2 billion (or 8.9 per cent in real terms) to US$51.5 billion. This was 0.23 per cent of their combined GNP.[11] DAC aid figures for 1998 appear in Appendix A.

10 Muir, Transcript, p. 7.

11 Organisation for Economic Co-operation and Development, 'Financial Flows to Developing Countries in 1998: Rise in Aid; Sharp Fall in Private Flows', 10 June 1999, http://www.oecd.org/news_and_events/release/nw99-60a.htm, 18 October 1999.

2.18 The fall in aid is largely a result of fiscal constraints in developed countries, especially since 1993. This trend is a result of the accumulation of large deficits in the 1980s, governments seeking to impose lower levels of taxation, and compliance with the stringent requirements for monetary union in Europe. It is also a result of public scepticism over the effectiveness of aid.[12]

2.19 Despite the decline in relative indicators of aid provided, the World Bank suggests that there is some evidence that aid is being used more effectively, and provided in more satisfactory forms.

2.20 Aid is increasingly provided in grant form, rather than by concessional loans. For example, 47 per cent of assistance was provided in aid form in 1970, which increased to 77 per cent in 1997. Providing assistance in grant form removes the obligation for the developing country to repay a loan, and the possible cost to the creditor nation of default.[13]

2.21 The use of tied aid has also been in decline. Tied aid is aid provided by a developed country that is conditional on purchasing goods and services from the developed country. However, despite the benefits that it may bring to the developed nations' economy, this form of aid is more expensive than non-tied aid. 50 per cent of aid was tied in 1979, while in 1996, only 20 per cent of aid was tied.[14]

2.22 Development assistance is also being directed away from economically productive sectors, instead towards social service, administration and infrastructure projects. This shift is based on the past failure of projects that were intended to be economically productive.[15]

Globalisation and debt

2.23 The process of globalisation that has accelerated since 1989 has meant that a new international economy has been constructed, although these innovations have largely not benefited the poorest countries.[16]

2.24 The massive increases in foreign exchange transactions and Foreign Direct Investment (FDI) have had little positive impact on HIPCs. More than 80 per cent of FDI has gone to 20 countries, much of it concentrated in China.

12 The International Bank for Reconstruction and Development/The World Bank, 1999, *Global Development Finance*, pp. 71-72.

13 *ibid*, p. 72.

14 *ibid*, p. 73.

15 *ibid*, p. 73.

16 Hunt, Transcript, p. 10.

For example, in 1998, the 33 least developed countries in Africa received just US$2.2 billion in FDI inflows.[17] The Asian financial crisis, exacerbated by the ease with which capital can now move, has also impacted on the economies of countries that exported commodities to these markets.

2.25 The new technologies that are transforming the economies of more developed nations are not reaching the HIPCs, and many citizens of these countries still do not even have widespread access to older technologies.[18]

2.26 With such small portions of global trade, the HIPCs are further marginalised in new bodies like the World Trade Organisation (WTO) that determine global trade rules. Typically, the WTO and related processes favour greater trade liberalisation, which may not be to the benefit of developing economies which often use tariff barriers to develop domestic industries, just as developed economies like Australia have done.[19]

2.27 Ms Hunt informed the seminar that:

> My argument is simple: the poorest deeply indebted countries stand, unfortunately, to be further marginalised by globalisation. Debt reduction offers a glimmer of hope for a continent which, as Kofi Annan said recently, "The world seems to be abandoning."[20]

2.28 The picture painted at the Committee's seminar was a bleak one, and by all indications, the disparity in wealth between developed and developing nations would only continue to grow because of an accelerated process of globalisation.

17 United Nations, 1999, *The World Investment Report 1999*.

18 Hunt, Transcript, p. 11.

19 Hunt, Transcript, pp. 11-12.

20 Hunt, Transcript, p. 10.