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International Interdependence and the Debt Problem*

8.1 Introduction

There is little doubt that the current levels and composition of developing countries’ debts present a serious threat to the survival of the international financial system. Not surprisingly, the possibility of a global financial upheaval has inspired a large and rapidly growing literature covering a wide range of issues. Yet it is far from clear that the debate has been very successful in isolating the real origin of the problem. In the debt drama, as in a detective story, the real culprit is not necessarily one of the main suspects, even though the latter may be guilty of many serious offences.

Moreover, disagreement, even confusion, surrounds some of the key concepts used in the debate. For instance, ‘adjustment’ features prominently in the literature. What is not often clear is whether it means the short-term, macroeconomic demand corrections or the long-term, microeconomic structural changes in the volume and patterns of supply. Both processes require international financing, though, of course, of a different kind and duration.

Above all, there is still a tendency to ignore the consequences of international integration and to believe that the corrections, even the adjustments, can be achieved in isolation. Unfortunately, as the inter-war experience shows, the moment that individual countries begin – under external pressure – to apply national solutions to international problems is also the moment that the world economic system begins to disintegrate.

The almost frantic efforts by central and commercial banks, as well as by international institutions, to reschedule the debts have succeeded, so far, in

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averting a major international crisis. Nevertheless, there are growing doubts about the adequacy of all these actions to prevent a repetition of similar crises in the near future.

This raises a number of important questions about the behaviour of each of the major participants in the debt drama. Given the misjudgments and blunders common in a dynamic economy – especially in the early stages of industrialization – have developing countries been guilty of a failure to adjust? Or, have they suffered from adjustment failures brought about by external developments, mostly outside their control?

Next, the borrowing countries’ government and other development programmes in the 1970s are judged now to have been unrealistic and too ambitious. Is this an *ex post* verdict or did they appear in the same light *ex ante*? If the latter is true, why did banks, generally regarded as well-informed and rational, fail to spot this at the time? Even worse, if they were aware of the borrowers’ weaknesses, why did they continue to lend? In other words, has the debt problem arisen as a result of carelessness and failure on the lenders’ part to assess the risks properly? Or have some developments outside the markets’ immediate control completely altered the environment in which banks and other financial institutions operate?

Above all, what has been the role of industrial countries in the debt-creating process? They dominate the world economy in terms of production, trade and technical and managerial expertise. The banks which performed, according to one of the Governors of the Federal Reserve, the “absolutely amazing” feat of transferring quickly vast sums of capital to where it was “needed” (Wallich 1982, p. 247), come predominantly from these countries. Hence, the accusing finger is inevitably pointed at industrial nations, especially the larger ones, whenever the debt problem is attributed to low commodity prices, slow growth of world trade and high interest rates. What has gone wrong there? Has the debt problem been created by the quite unprecedented failure to adjust not in developing but in industrial countries?

The remainder of this chapter will deal briefly with some of these questions. To keep it within a reasonable length, it will be assumed that there is a general familiarity with the history and size of the debt problem (see, however, Table 8.1 for some aggregate data). For similar reasons, the analysis will concentrate on that part of the total debt (excluding export credits) which developing countries owe to private institutions – mainly banks – as this is where the recent difficulties have arisen. As Table 8.1 shows, the share of these debts in the total went up from 20 per cent in 1971 to 46 per cent in 1982. Finally, no systematic attempt will be made to differentiate between individual countries and banks according to the scale and seriousness of their problems, even though it is widely recognized that some developing countries are in a much more precarious position than others.