THE DEBT CRISIS AND ITS IMPLICATIONS FOR THE CARIBBEAN

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There is no doubt that a developing country needs foreign inflows to supplement domestic savings. However, when a large proportion of the inflows take the form of debt, rather than equity, and it is allowed to grow too high relative to GDP, its servicing could quickly stake a claim to future streams of income high enough to turn an otherwise growing economy into a shrinking one, especially if access to new lending becomes limited.

The debt crisis, as the problem has come to be known, emerged in 1982 when Mexico announced that it could not service its US$80 billion external debt without an immediate new loan of US$3 billion. Since then the problem has generated a great deal of discussion and various schemes and financial arrangements have been proposed to deal with it. But how serious is the debt problem in the Caribbean?

1. *The Extent of Debt*

The debt indicators assembled in table 1 gives an indication of the extent of the debt build-up in the Caribbean. For a relatively short period between 1975 and 1987, Barbados' external debt relative to GDP rose more than five-fold. Total public and publicly guaranteed debt increased at an average annual rate of more than 25%. Over the same period, debt service payments as a proportion of exports of goods and services (for public and publicly guaranteed debt) increased from an insignificant figure of less than 3% to nearly 19% in 1987.

The situation is much more serious for Guyana and Jamaica. Guyana's debt/GDP ratio rose from a relatively high level of over 60% in 1975 to more than 150% in 1986 while Jamaica's rose to 145% in 1986 from 31.2% in 1975. The proportion of Guyana's exports of goods and services accounted for by external debt servicing dropped to 10.5% in 1987 after peaking at 23% in 1983. In the case of Jamaica, this ratio rose from 7.4% in 1975 to an estimated 44.1% in 1986. If one considers the fact that the foregoing information excludes private sector debt, then the enormity of the debt problem in the Caribbean becomes apparent.

2. *Causes of Debt Build-up*

The main reasons for contracting external debt have been to

(i) finance major infrastructural projects as was the case for Barbados in the late 1950s and early 1960s;

(ii) finance specific projects to increase exports or save foreign exchange by virtue of being import substitutes;

(iii) refinance maturing loans; and

(iv) support a deteriorating balance of payments position.

However, the rapid build-up in the late 1970s and early 1980s have been largely due to developments in the international economic environment:

(a) The two oil price increases of 1973-74 and 1979-80 and the resulting international recession of the early 1980s severely widened the trade and savings gap of non-oil developing countries as the value of imports rose rapidly while exports faltered, especially primary commodities. These countries relied increasingly on external sources of funds to support their worsening current account positions.

(b) The international commercial banks found themselves awash with a lot of cash deposited by the oil exporting nations. In their desire to re-cycle these funds they over extended credit to some developing countries (mainly Latin America, but also to other developing areas) with little concern on the borrowers ability to generate sufficient external surpluses to repay the debt. The proportion of loans obtained from international commercial banks rose rapidly.

In Jamaica for instance, Bourne (1981) reports that Government indebtedness to foreign commercial banks rose particularly fast from 1973, increasing from 34% of total government foreign debt at end-1973 to a peak of 68% in 1975 before decreasing to 45% in 1978. As short term commercial credits made major gains in the debt profile, the term to maturity structure of the Jamaican government foreign debt was considerably shortened.

3. Sources of Debt Servicing Difficulties

Debtor countries may face debt servicing difficulties for a variety of reasons. Among the main factors are high interest rates, unprofitable use of loans and the inability to generate external surpluses.

High Interest Rates

One of the main sources of debt servicing difficulties has been high interest rates. In the aftermath of the second oil-shock, major countries like the US were more concerned with dampening the inflationary impact of the oil price increases. The policy makers in the US therefore shifted their focus from interest rate targets to monetary targets. Thus targets were set for growth in the various strands of monetary aggregates, M1, M2, etc.

As the growth in money supply was controlled, interest rate started to rise rather sharply. For instance, the US lending rates rose from about 9% in 1978 to 18.9% in 1981. Those countries which had contracted loans under variable interest rates had to pay more to service existing debt and soon found themselves in debt servicing difficulties. Similarly, countries which had their debt rescheduled had to pay higher rates to service their debt.

Unprofitable Use of Loans

Another source of debt servicing difficulties was unprofitable use of the funds borrowed. A large part went to finance consumption, including oil and other consumer goods. Some funds were invested in inefficient and money-losing state-owned enterprises producing products at marginal costs far in excess of competitive world prices.

Bourne (1981) found that although Jamaica Government's foreign borrowing appeared to have contributed to government fixed investment, the yearly additions to investment (additionality) was less than the growth of the debt implied. This suggests that some of the foreign debt proceeds were allocated to government consumption. For some countries, a large part of foreign loans was absorbed by capital flight.

Inability to Generate Sufficient External Surpluses

Economic theory posits that for external debt/GDP ratio to decline over time, domestic savings should increase faster than the sum of investment and interest payments. Alternatively, the country must generate adequate surpluses on its external current account balance. But how successful did Caribbean economies manage to generate sustained surpluses on the external account?

Table 2 summarises the external current account positions of Barbados, Guyana, Jamaica and Trinidad and Tobago. In Barbados, the deficit on the external current account averaged 6.1% of GDP between 1979-83 before dropping to 0.1% between 1983-88. In the ten years from 1979 to 1988, the external current account balance was in surplus in only 1984, 1985 and 1988; and even when the balance was positive, debt service obligations by far outstripped the external surplus. Financing of the deficits was achieved through a mix of foreign capital inflows, running down foreign exchange reserves and through government foreign borrowing, mainly from the international capital markets.

Data for Jamaica suggest that in the period 1979-1988, the external current account was positive only in 1988, averaging -7.8% of GDP. Between 1983-86, the deficit rose to 8.4% of GDP. The mechanics for financing the deficit changed after 1975 when private capital inflows which had hitherto financed the current deficits became inadequate. Between 1979-1988 financing was achieved principally through a combination of running down foreign reserves and foreign borrowing as private capital inflows became negative from about 1978 (Jefferson, 1988, p. 5).

The external current account balance for Guyana was in deficit for the entire period of 1979-88. The ratio of current deficit to GDP for Guyana was consistently high, averaging 25.8% of GDP for the ten year period. For the period 1979-82, the current account deficits were financed through significant inflows of concessionary loans from bilateral and multilateral sources as private capital inflows appeared quite limited (Danns, 1988, p. 90). From 1983-87, the bulk of the financing came from loans from multilateral agencies and the running down of foreign exchange reserves.

Despite substantial export receipts from petroleum sales, the external current account situation in Trinidad and Tobago in the period 1979-88 was no better than for the other countries by any substantial degree (except Guyana). Over the ten year period the current account was in deficit in all the years except 1980 and 1981. The ratio of current account balance to GDP averaged -2.9 % in the five years from 1979 but deteriorated to -5% in the last five years to 1988. The deficits were financed mainly from inflows for foreign direct investment and from long term public sector foreign borrowing.

The above analysis suggests that public sector foreign borrowing played an important part in financing the external current account deficits of all the countries under consideration. It is not surprising that when foreign inflows became less easily available, as happened in Guyana and Jamaica, debt servicing difficulties emerged.

As has been alluded to above external factors contributed to the failure of the regional economies to generate adequate resources on their external current accounts. Of particular interest was the deteriorating terms of trade for the basic commodities which are produced in the region. The price of bauxite fell by nearly 24% (216.34 US$/metric ton to 164.95) between 1981 and 1984 while sugar prices dropped from 28.7 US cents per pound in 1980 to a mere 4.05 US cents per pound in 1985. After reaching a peak of US$33.5 per barrel

in 1982, petroleum prices fell steadily, reaching a low of about US$12 per barrel in 1986.

4. *Problems Associated with Rising Debt Service Obligations*

Foreign exchange resources are needed to service external debt. That necessarily means generating adequate surpluses on the external account. If there are avenues for increased exports the problem is minimised but the surpluses generated must be more than enough to service debt and leave some for normal import requirements. If, as has been the case in many developing countries, avenues for export expansion are limited, either through insufficient domestic investment or limited export markets, a country is likely to run down external reserves to meet debt servicing obligations.

Alternatively, improved current account may imply a cut in imports. But a cut in imports, by limiting inventories of raw materials and spare parts, also limits the output of firms producing for export. Furthermore, the attempt to find resources for debt service has, to a large extent, come at the expense of investment. In most cases investment has been depressed in debtor countries because governments have found it easier to cut investment budgets rather than raise taxes or reduce spending programmes. The problem is compounded when, in their need to finance burgeoning budget deficits, governments compete with the private sector for the available investable resources. In situations where commercial banks' excess funds are limited, this could lead to a corresponding reduction in private sector investment, especially when the competition for credit raises interest rates sufficiently high to crowd out small businesses in the private sector.

With an actively growing labour force, failure to expand capital investment at a rapid rate implies a growing imbalance between actual capacity and a level of capacity that would sustain high levels of employment. The debt service problem then is a source of inflation, too little investment and high unemployment.

5. *Attempts to Deal with the Debt Crisis*

Attempts to find a solution to the debt crisis may be delineated into two parts: strategies for dealing with external debt management per se, and policies that emphasise macroeconomic and microeconomic adjustment intended to remove economic distortions within the domestic economy.

5 (a) *Domestic Macroeconomic and Microeconomic Adjustment Policies*

By domestic macroeconomic adjustment policies we mean measures designed to manage aggregate demand so as to improve medium-term growth prospects of the economy. The centre piece of such stabilization policies are:

(i) a cut in budget deficits;
(ii) exchange rate adjustments (devaluation); and
(iii) setting new credit ceilings to control excessive growth in monetary aggregates.

Policies associated with microeconomic adjustments normally aim to improve the performance of aggregate supply by removing policy-induced distortions in specific markets, in particular the market for

(i) foreign exchange;
(ii) energy;
(iii) public utilities; and
(iv) agricultural produce.

5 (b) Strategies for External Debt Management

Debt management techniques so far available may be classified as short-term, medium-term, medium to long-term and long-term.

In the short-term, countries may find it convenient to borrow to refinance existing loans. Jamaica and, to some extent Barbados have subscribed to this strategy. Next, one may consider loan rescheduling which may take on a medium to long-term duration depending on how long a country succeeds to get its debt rescheduled. Many countries in Africa, Latin America and the Caribbean have had formal rescheduling, often with IMF backing. Then there are measures that aim at basically shifting the external liabilities of developing countries away from debt forwards equity participation. The long-term strategies aim to convert current obligations into long-term ones or emphasize economic growth to generate sustainable resources to meet external debt obligations. Let us briefly discuss some of these strategies.

Debt-Equity Swaps

In a typical debt-equity (DE) swap, the debtor government offers to swap its debt for domestic currency on condition that the currency be used to purchase local equity. The initial transaction normally takes place in the secondary market where the debt is purchased from the asset holder, usually a commercial bank, at a discount, and is then redeemed in local currency at or near the face value of the debt.

The advantage for the debtor country is to have its stock of debt reduced while inducing the flow of new foreign investment. The creditor bank would have a doubtful debt partially restored and the investor receives low cost investment. By acquiring domestic currency of debtor countries much more cheaply than through official exchange markets, investors engaging in debt swaps enjoy a preferential exchange rate.

Despite its potential, wide applicability of the D-E conversion schemes is limited. For instance, it is only applicable to commercial bank debt and is therefore of limited use to debtor countries like Jamaica with more than 78% of its debt owed to official bilateral and multilateral agencies[2].

In the Caribbean only Jamaica has been active in the debt conversion market. At the end of August 1988, applications for around US$220 million had been received by the Bank of Jamaica, the designated authority for debt swaps in the country. Only four small swaps involving US$4 million, mainly for garment plants, had actually taken place, but sixteen projects with some US$85

million had been approved and six worth US$41 million were being processed. Of the amount approved, US$52 million was for three hotels, US$7 million for agricultural projects and US$6 million for projects operating in the free zone. New money in the form of currency and equipment was estimated at US$30 million.

Multilateral Debt Rescheduling

Sometimes countries experiencing severe debt servicing problems have requested creditors to restructure service payments falling due or in arrears. As debt servicing may not necessarily be related to specific loans by individual creditors, requests for debt rescheduling are normally directed to most creditors with significant claims on the country. Thus most debt reschedulings take the multilateral approach, ensuring that all creditors are uniformly treated. In turn, official and commercial bank creditors normally require that a financial programme supported by the conditional use of the IMF's resources be in place at or before the time that the debt renegotiations are concluded. Usually these renegotiations are conducted under the aegis of the Paris Club and in practice the participating creditors have been members of the OECD countries with significant claims against the debtor countries. Multilateral institutions like the IMF or the World Bank do not permit debt owed to them to be rescheduled. The terms for repayment of rescheduled debt are typically arranged along the following lines. First, the negotiators have to agree on a consolidation period when payments to be rescheduled fall due, usually 12 months.

About 80% to 90% of the principal and interest falling due during the consolidation period are formally rescheduled, with maturity of seven to nine years, including a grace period of three to four years. The remainder has to be paid on relatively less generous terms, with part to be paid as down-payment during the consolidation period on the original due dates. In addition, the debtor country pays fees and other charges which usually range from 1% to 1 1/2% of the amount rescheduled.

Jamaica has been the most active in debt restructuring in the Caribbean. According to Jefferson's (1988) study, between 1981 and 1987 Jamaica had an average of 30% of its gross principal and interest falling due to commercial banks and bilateral agencies rescheduled. This translates into about 12.4% of its total annual import requirements and about 7.2% of its public and publicly guaranteed foreign debt. Guyana also rescheduled part of its foreign debt in 1978 (Danns (1988)).

Debt Conversion with Long-term Bonds

A country that adopts this strategy usually offers to buy back a stock of its outstanding foreign debt in exchange for long-term bonds. The transaction can take place at a public auction or in the secondary market. How much of the new bonds the country can float depends on the magnitude of its old debt it aspires to retire and the discount on its debt in the secondary market. Thus, if a country's debt trades at about 50% of its face value in the secondary market, a new bond issue of US$250 million should be enough to retire US$500 million of its outstanding debt.

The key to the success of this strategy lies in what sort of guarantees are offered for repayment of both principal and interest of the new bond issue. In a recent case, Mexico obtained a guarantee for US$10 billion new bond issue by way of a 20-year zero-coupon US Treasury Bonds for which Mexico paid about US$1.8 billion cash. Such a scheme is applicable to developing countries which, like Mexico, have healthy foreign exchange reserves with which to put up a guarantee for repayment. Efforts are currently in train to find ways to help developing countries obtain such guarantees at minimal cost.

Growth-Oriented Debt Strategies

In situations where countries aim to grow out of untenable debt positions, the emphasis has been for such debtor countries to expand the productive base to generate adequate resources with which to service its foreign obligations and to finance desired investment. Continued inflows of external resources is very important for the success of growth-oriented debt policy but the final outcome depends critically on the country's ability to increase the rate of growth of domestic savings and improve the efficiency of capital usage.

6. Concluding Remarks

The paper has attempted to survey the external debt problem, laying special emphasis on the Caribbean situation. The extent of debt, the causes of the build-up, sources of debt servicing difficulties as well as problems associated with increasing debt service obligations have been discussed. In addition, it has outlined some of the policies that have been advocated to deal with the crisis, and has discussed some of the schemes and financial instruments currently available for the management of external debt.

While inappropriate policies have been an important cause of the debt problems, external factors have played a part. The resolution of the problem then should be seen as a cooperative effort between both creditor and debtor countries and should not be left on the shoulders of the debtor countries alone. Already many of these countries have embarked upon stringent structural adjustment measures to cope with the situation. Debt servicing obligations are rapidly depleting the modest savings on the external current account of debtor countries while inflows on the capital account continue to diminish. Such a situation cannot continue for long without throwing the international economic environment into disarray. There is a strong need for positive net inflows of external capital to help alleviate the debt problem.

Footnotes

1. *An earlier version of the paper was presented to participants of an Economic Symposium on the Caribbean Debt Crisis organised by the Caribbean Public Services Association in Georgetown, Guyana in April 1989.*

2. *When Jamaica entered the debt swap market in July 1987, only US$400 million out of an estimated US$3.5 billion of external debt was eligible for conversion.*

TABLE 1

SOME INDICATORS OF EXTERNAL DEBT IN THE CARIBBEAN

	1975	1980	1981	1982	1983	1984	1985	1986	1986
Barbados									
Total Debt* (US$M)	22.4	110.7	176.3	219.0	297.5	332.9	365.8	404.6	444.0
Debt/GDP (%)	5.5	13.0	18.5	22.0	28.2	28.9	30.4	30.6	30.5
Debt/XGS (%)	9.8	18.7	30.9	34.2	42.2	40.1	44.5	51.3	62.2
Debt Service/XGS (%)	2.7	4.0	4.5	7.9	11.0	9.7	13.9	16.7	18.9
Interest Payments/XGS (%)	1.8	0.9	1.1	1.9	2.6	2.3	3.5	4.4	5.4
Guyana									
Total Debt* (US$M)	295.5	561.8	643.3	682.6	698.1	693.3	740.3	772.3	767.9
Debt/GDP (%)	60.3	102.1	126.3	159.5	164.4	184.1	195.2	153.1	
Debt/XGS (%)	79.5	136.9	172.8	252.0	310.0	281.4	282.5	313.2	
Debt Service/XGS (%)	4.5	16.9	21.4	18.0	23.0	15.6	9.5	10.5	
Interest Payments/XGS (%)	2.8	6.5	9.7	9.2	12.6	8.4	5.1	6.7	
Jamaica									
Total Debt* (US$M)	688.0	1866.0	2293.0	2740.0	3267.0	3262.0	3499.0	3524.0	3541.0
Total Debt/GDP (%)	31.2	88.5	108.8	130.8	157.0	137.6	160.7	145.5	
Debt/GDP (%)	61.3	131.4	152.9	196.5	245.3	236.6	276.3	252.4	
Debt/XGS (%)	7.4	24.0	30.3	39.8	43.0	53.4	58.0	61.4	
Debt Service/XGS (%)	7.4	18.5	29.2	29.3	27.9	28.6	39.8	44.1	
Interest Payments/XGS (%)		10.8	12.5	15.9	14.6	13.5	22.5	18.4	
Trinidad and Tobago									
Total Debt* (US$M)	159.4	622.9	670.8	765.5	886.1	914.9	1087.4	1154.1	1074.0
Debt/GDP (%)	6.6	9.8	9.8	9.6	11.7	12.0	15.1	24.6	
Debt/XGS (%)	12.0	18.5	19.2	24.3	34.4	35.4	41.7	79.8	
Debt Service/XGS (%)	2.0	6.4	2.5	2.7	8.8	4.9	7.1	15.8	
Interest Payments/XGS (%)	0.9	1.2	1.9	1.7	4.0	2.1	3.1	6.4	

Note : *Public and Publicly Guaranteed Debt; XGS = Export of Goods and Non-Factor Services.
Source: Boamah (1989, Table 1)

TABLE 2

EXTERNAL CURRENT ACCOUNT BALANCE (1979-88)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988(P)
					BARBADOS[1] (BDS$ MILLION)					
Current Account Balance (CA)	-69.9	-54.3	-250.7	-84.3	-101.3	22.4	81.0	-31.8	-107.0	-4.3
Gross Domestic Product (GDP)	1,348.4	1,730.6	1,904.7	1,990.1	2,112.7	2,302.8	2,409.9	2,646.0	2,913.7	3,097.0
CA/GDP (%)	-5.2	-3.1	-13.2	-4.2	-4.8	0.9	3.4	-1.2	-3.6	-0.1
					GUYANA[2] (GY$ MILLION)					
Current Account Balance (CA)	-211.4	-327.7	-518.9	-426.9	-472.5	-369.4	-410.7	-451.1	-1,032.0	-1,180.7
Gross Domestic Product (GDP)	1,326.0	1,508.0	1,597.0	1,446.0	1,468.0	1,700.0	1,964.0	2,219.0	3,357.0	3,600.0
CA/GDP (%)	-15.9	-21.7	-32.5	-29.5	-32.2	-21.7	-20.9	-20.3	-30.7	-32.8
					JAMAICA[3] (J$ MILLION)					
Current Account Balance (CA)	-245.1	-295.7	-600.0	-727.9	-693.1	-1,332.0	-1,694.3	-219.7	-532.8	398.9
Gross Domestic Product (GDP)	4,274.6	4,750.1	5,267.2	5,841.9	6,897.0	9,381.0	11,263.1	13,328.1	15,717.4	17,446.3
CA/GDP (%)	-5.7	-6.2	-11.4	-12.5	-10.0	-14.1	-15.0	-1.6	-3.4	2.3
					TRINIDAD & TOBAGO[4] (TT$ MILLION)					
Current Account Balance (CA)	-81.4	803.2	898.8	-1,547.8	-2,407.0	-1,254.0	-221.2	-1,590.1	-889.6	-575.7
Gross Domestic Product (GDP)	11,046.0	14,966.0	16,438.0	19,176.0	18,719.0	18,829.0	18,077.0	17,242.0	18,265.0	18,831.0
CA/GDP (%)	-0.7	5.4	5.5	-8.2	-13.0	-6.7	-1.2	-9.2	-4.9	-3.1

Sources:
1. Central Bank of Barbados: Annual Statistical Digest and Balance of Payments of Barbados.
2. IMF: International Financial Statistics (IFS), May 1989 and Guyana Ministry of Finance: Estimates of the Public Sector, 1988-89.
3. IMF: International Finance Statisjcs Yearbook (1988) and October (1989).
4. IMF: IFS, May 1989 and Central Bank of Trinidad and Tobago, Annual Reports, 1987 and 1988.

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