Marxist

XXXIX, 2, April-June, 2023

Another Debt Crisis: Foreign Debt Development in the Less Developed Countries

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It is now well established that one obvious and direct way in which imperialism in its neocolonialist avatar extracts surpluses from poor countries to finance accumulation in the metropolitan centres of capitalism is though trapping them in debt. In the years following the 2008 financial crisis the interest offered at the time of issue on sovereign bonds in 52 emerging market and developing economies (EMDEs) was on average between 2 and 4 percentage points above 10-Year US Treasury bills. Even that premium, attributed to the 'risk' of lending to poor countries, is only at inception. When countries face difficulties in servicing their external debt, as many of them inevitably do, those 'spreads' spike. The number of countries for which the spread was 10 percentage points or more rose to 15 when the COVID pandemic broke and reached a high of 22 in in the summer of 2022.[1] In time, some or many of these countries are forced to default on payments of interest and capital on their debt, signalling an external debt crisis. Numbers from Moody's indicate that the year 2022 recorded the highest number of defaults since 1983, with seven sovereign defaults (Mali, Russia, Sri Lanka, Belarus, El Salvador, Ukraine and Ghana).[2]

Since the pandemic, the world has been experiencing such an external debt crisis in its less developed periphery. A growing number of countries stretching from Sri Lanka in South Asia to Ghana, Zambia and Tunisia in Africa and El Salvador and Argentina in Latin America have either defaulted on debt service payments or are on the verge of default. According to Fitch Ratings,[3] between 2020 and the first quarter of 2023 there were 14 default events across nine different *sovereigns rated by the company* (Argentina, Belarus, Ecuador, Lebanon, Ghana, Sri Lanka, Suriname, Ukraine, and Zambia). This compared with 19 defaults across 13 different countries between 2000 and 2019.

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[1] Mark L.J. Wright , Amy Smaldone (2023), "Are Developing Countries Facing a Possible Debt Crisis?", Federal Reserve Bank of St Louis, September 5, https://www.stlouisfed.org/on-the-economy/2023/sep/are-developing-countries-facing-possible-debt-crisis.

[2] https://www.businessinsider.in/finance/news/highest-sovereign-defaults-in-2022-two-in-2023-moodys/articleshow/99490791.cms. Till July there were two defaults in 2023: Argentina and Mozambique.

[3] https://www.fitchratings.com/research/sovereigns/sovereign-defaults-are-at-record-high-29-03-2023

External debt: A brief history

External debt is, of course, not new. In a world of nation states with differing currencies, short- and long-term external indebtedness of some of them to the others tends to be the norm. But when a country is unable to adequately transform domestic production into foreign currency through trade, its foreign debt becomes a burden too heavy to carry. That is a predicament that chronically characterises less developed countries in an unequal international order. Uneven development under capitalism, results in the dependence of less developed countries on imports, paid for in foreign 'hard' currencies, of food, fuel and manufactures, from the developed or the resource-rich countries. Together with borrowing to finance foreign exchange outflows resulting from the expropriation and transfer abroad of surpluses from the less developed countries by transnational firms and financial institutions, this leads to an unsustainable burden of debt in countries that occupy the underdeveloped or subordinate pole in the international order. Their foreign exchange earnings fall far short of their foreign exchange expenditures, providing the context for debt dependence.

This historical tendency for the accumulation of unsustainable foreign liabilities in the balance of payments of the low- and middle-income countries (LMICs) has been aggravated over the last half century by processes of financialization and financial globalisation originating in the developed industrial nations. Those processes have triggered flows of yield seeking financial capital from the advanced nations to the LMICs. Since the global financial crisis, this flow has turned into a veritable 'push' of capital from the North to the South, because of the infusion of cheap liquidity following the adoption of "easy money" policies as a response to the Great Recession by governments in the developed countries. Interest rates in US, Europe and Japan were slashed to near-zero and bond-buying as a means of 'quantitative easing' infused liquidity into the system by fattening central bank balance sheets. This surfeit of cheap money encouraged yield-hungry financial firms and speculative investors to borrow in hard currency markets and invest in LMIC markets where returns were high. The super-profits implied in this "spread" encouraged the discounting of risk and contributed to enhanced flows of private credit to less developed countries, even the poorest amongst them.

As a result of this supply-side push of capital, over the next decade and a half most low- and middle-income countries were encouraged to take on more loans, particularly from bond investors suddenly interested in more risky debt,

because of the easy access to cheap liquidity. This was looked upon benignly by the International Monetary Fund and even celebrated at the World Economic Forum, as a sign of the greater integration (and possible convergence) of countries that were previously excluded from private capital markets.

If we consider the period since the turn of this century, we find that the total outstanding debt of Emerging Market and Developing Economies as a Group rose from $2.4 trillion in 2001 to $8.9 trillion in 2014. It then came down to $8.4 trillion over the next year, before recording another spike to $11.9 trillion in 2021. It is indeed true that some of the more developed among the EMDEs, especially China, accounted for a significant share of this increase. However, even excluding China, the total external debt of EMDEs rose from $4.8 trillion in 2009 (after the global financial crisis) to $8.9 trillion in 2020. Excluding all five BRICS countries, the corresponding figures were $3.8 trillion and $7.2 trillion. Clearly debt was flowing to poorer and more debt-stressed less developed countries as well.

According to the Fitch report cited earlier: "The median general government debt/GDP ratio of Fitch-rated sovereigns rose steadily from 31% in 2008 to 48% pre-Covid-19 pandemic, facilitated by frontier markets' easier access to the Eurobond market and borrowing from China." Frontier markets are poor countries that were excluded from private debt markets in the past, but now are merely those that are considered riskier than emerging markets and can borrow abroad albeit at much higher rates.

It was while carrying the resulting historically accumulated external debt burden that the less developed countries were hit by the COVID-19 induced crisis and the fall-out of the Ukraine invasion in quick succession. Between end-2019 and end-2020 or during the first COVID year, the external debt of the EMDEs other than the BRICS rose by half a trillion dollars. That was more than double the increase in the previous year.

The immediate impact of the COVID-19 crisis was the loss of export revenues. Revenues from tourism shrank and remittance receipts fell, as the sudden stop in economic activity across the world affected the employment and incomes of migrants. The shutdown of transportation routes hurt exports of goods. Dependent on a few commodities and services for much of their export revenue, debt stressed countries found their export receipts collapsing. While this was partly compensated by a reduction in the level of imports, payments associated with historical debt had to be met. Meanwhile, the pandemic was

triggering volatility in capital flows, with uncertainty pushing investors to revisit their investment strategies in emerging markets, framed at a time when central banks had infused cheap money into markets in response to the crises induced by the financial collapse of 2008 and the pandemic of 2020.

It was when less developed countries were grappling with these challenges that war broke out in Ukraine, cutting off supplies of oil and food from two important exporters. Though increased supplies from alternative sources ensured that there was no major disruption of the supply-demand balance, speculation in global commodity markets dominated by a few conglomerates set off inflation. Prices of many commodities, especially food and fuel, rose sharply, and countries dependent on imports of these commodities experienced a spike in their foreign exchange outflows, even while coping with shortages. The enhanced outflows aggravated balance of payments difficulties.

Finally, as economic activity revived following relaxation of restrictions on movement and travel, it became clear that the uneven distribution of the incidence of the pandemic and asynchronous recurrence of new waves of the infection in different locations tended to delay clearance of clogged global supply chains. With supply not responding adequately to rising demand, the pressure on prices increased. The result was persistent inflation, even prior to the Ukraine invasion. The invasion only aggravated inflationary trends, in the midst of what is a halting recovery in most countries.

Responding to this environment, developed country central banks retreated partially from the unconventional monetary policies they have adopted since the global financial crisis. Interest rates were hiked in quick succession, bond buying was reined in, and there is talk of winding down balance sheets fattened by years of such buying by these central banks to inject liquidity. The result is renewed outflow of financial capital from emerging markets and developing countries, reducing foreign reserves and aggravating balance of payments difficulties in debt stressed countries. With investors seeking out 'safer' dollar-denominated instruments, the dollar also strengthened, raising the domestic currency costs of debt service even further.

It must be noted that the current crisis set in despite past efforts to resolve, through "debt relief", crises resulting from the external vulnerability of the poorest countries. That was what the Heavily Indebted Poor Countries (HIPC) and the Multilateral Debt Relief (MDRI) Initiatives, launched in the mid-1990s and mid-200s respectively, sought to achieve. It is true that these initiatives

were implemented only in the poorest countries, despite the debt overhang in many other LMICs. But they did reduce external debt levels significantly in some of them. However, most of these beneficiaries have seen a return to debt distress pointing to the inadequacy of traditional debt restructuring frameworks.

The roots of indebtedness

In the years following the Second world War, when decolonisation had increased the number of politically independent underdeveloped countries, the principal reason for rising indebtedness was the presence of structural barriers to the diversification of economic activity in these economies. That made them dependent on imports for a host of consumption and investment goods (and intermediates) as income rose, and restricted their exports to primary commodities and early stage manufactures that were at the losing end of the distribution of the surpluses from global trade. However, till at least the 1970s, there were binding limits on the size of those deficits set by the extent of access to the foreign capital needed to finance current account deficits. The level of access was limited for two reasons. First, ***private*** finance flows to these countries were limited, restricted largely to foreign direct investment and not debt, and was determined from the supply side by the interests of the investors concerned. A more regulated global financial system imposed restrictions on investing purely financial capital in developing countries, and in any case those countries were considered too risky. Second, finance from governments, in the form of bilateral credit flows from surplus earning rich nations to the poor countries or of flows through multilateral institutions they controlled, was also determined from the supply side by national economic or strategic interests.

This supply side ceiling on the flow of capital from the Global North to the Global South ended around the 1970s for two reasons. The first was the build-up in liquidity in the international financial system following the oil shocks and the liberalisation and deregulation of finance that followed the late 1960s recession in the developed countries. This drove financial interests and institutions to search for new high-yielding targets to lend to or invest in, leading to the discovery of 'emerging' and, subsequently, frontier markets, setting off a supply-side push of debt and finance from the North to the South. The second was the decision of governments in the less developed countries to open their economic borders to inflows of private foreign financial capital, especially in the form of debt. This led to the cycles of excess debt build-up in

these countries and the emergence of debt stress, which periodically triggered debt crises and/or defaults.

So, debt crises are by no means novel in less-developed regions, especially after economic liberalisation in developed and less-developed countries, which was accompanied by large flows of credit capital from the North to the South that set off a series of calamities starting in Mexico in the early 1980s. These crises were sought to be 'resolved' by special initiatives that varied from the infamous Brady Plan in Latin America in the 1980s to the debt 'relief' to the poorest borrowers offered by the HIPC (Highly Indebted Poor Countries) and Multilateral Debt Relief initiatives launched in the mid 1990s and after. The former was geared to saving the big banks from the US and Europe that had lent excessively large sums to debt-distressed countries but did not repair vulnerability,. The latter set of initiatives too left the underlying problems unresolved.

None of those plans addressed the fundamental constraint faced by these economies, which is the absence of an economic structure that is adequately diversified to reduce import dependence and foreign exchange outflows and enhance, on a sustainable basis, exports that can finance foreign exchange expenditures and limit the accumulation of foreign exchange liabilities. In fact, the neoliberal adjustment strategies imposed by the IMF as an antidote to balance of payments crises only enhanced import dependence and encouraged specialisation in exports that made export revenues vulnerable.

The IMF's role

Even in the current crisis, the most common response to debt stress and/or default is the institution of an IMF programme, with emergency lending from one of the agency's condition-linked financing facilities. In many countries, the IMF became a persistent presence, putting in place multiple emergency-financing packages and wielding powerful influence over policy, but never really recommending measures that either accelerated economic diversification or limited the inflow of foreign capital. Rather the trade and capital account liberalisation measures it favoured, kept markets open for foreign creditors, and only increased external vulnerability and aggravated debt dependence.

But open markets alone are not enough to explain the constant return of global finance to less developed countries experiencing periodic crises. To recall, prior

to the 1970s underdeveloped countries were considered too risky to lend to, and global private finance shunned less developed country debt, except when there was an implicit or explicit guarantee from an advanced country government, as happened in South Korea. But crises are not a deterrent anymore, so long as the periods between crises see a return of confidence that the countries concerned are safe for finance capital to earn quick and high returns, without risk of expropriation.

This is where the IMF's role as a global financial-policing agent comes in. In the new context where the intent is to keep open viable lending opportunities for investment-seeking and yield-thirsty private global finance, the IMF's role seems to be three-fold. The first is to impose policies that it claims will improve the ability of the debtor country to meet its debt service commitments, failing which it can as part of a neoliberal programme release and/or provide access to crucial domestic resources for sale in foreign exchange that can be used to settle excess debt. The second is to provide an assurance that it can extract a sovereign guarantee from both developed and less developed country governments in the form of private debt absorption or debt relief or "debt forgiveness", to ease payments from debtor countries to private creditors. The third is to get multilateral lending institutions, like the World Bank and the Asian Development Bank, backed in turn by sovereign guarantees, to come in with funding when the IMF has 'designed' a resolution plan, so that the IMF's own commitment of resources is minimal.

This is a debt architecture that is in keeping with the evolution of the unequal international order, exploiting and reproducing the inequalities embedded in it. This is not to say that private creditors do not take a haircut or suffer come loss. But it is in the nature of exploitative finance that interest rate premia are set at levels where, well before maturity, capital has been recouped and gains have been garnered. Cumulative losses, if any, are nominal.

The neoliberal response

In most recent cases of debt stress, the IMF has come in late, often after default. Meanwhile, defaulting countries are unable to roll-over or refinance debt falling due, resulting in a collapse in imports and an import squeeze that contracts economic activity and forcing a depreciation of the domestic currency that fuels inflation. Obtaining some emergency external financing becomes imperative even to stabilise economies, making countries desperate for such support. In such 'bail outs', the IMF's financial contribution to the

resolution effort is way short of requirements. Yet staff level approval for support becomes dependent on the government adopting IMF-style adjustment measures that heap new burdens on an already-devastated populations, such as increased user charges for crucial services, reduced subsidies, increased (normally indirect) taxes and, more recently, a commitment to domestic (as opposed to external) debt restructuring. Since these are implemented before issue of the letter of intent on the basis of which IMF support is approved, those policy changes are identified as unavoidable measures adopted by governments given the circumstances.

Following such changes, the debt restructuring process is presented as successfully launched, even though the IMF's financing is grossly inadequate and stretched out over time. This is because, the IMF's support is presented as an unavoidable first step in winning back the confidence of foreign investors and creditors so as to unlock inflows of private capital to stabilise the balance of payments.

The core of these restructuring programmes has three components. The first is to release budgetary resources by curtailing budgetary expenditures (especially on capital and social spending). The IMF identifies a profile of the government's gross financing needs over time—or its overall new borrowing requirement plus debt maturing during a year— and requires the government to make adjustments that generate the resources that can match those needs.

The second is to reduce foreign exchange expenditures on imports by reining in incomes, through imposition of austerity measures that sharply curtail public and private spending. A complementary measure is a devaluation of the currency to improve the balance of trade by making exports cheaper and imports more expensive. The latter measure can be effective only if domestic incomes (of workers and providers of non-traded inputs) do not rise as much as the prices of imports, since that would neutralise any benefits the devaluation may deliver in terms of lower export prices. In practice, the contraction in economic activity that the erosion of real incomes that these measures trigger result in falling government revenues that necessitate larger sovereign borrowing to finance committed expenditures, and a rise in the public debt to GDP ratio.

The third, is the restructuring of debt, which in the new version of adjustment programmes involves restructuring both domestic and external public debt so as to reduce the ratio of the net present value of public debt to GDP to some

initial target value, from where it is expected to adhere to a profile identified by the debt sustainability assessment.

Past experience suggests that these restructuring exercises do not deliver the outcomes laid out in the DSA, resulting in the IMF holding back on later tranches of its promised line of credit. And if the outcome is close to anticipated, it quickly attracts the attention of yield hungry foreign creditors, leading to more inflow of foreign debt, resulting in another cycle of external debt dependence, and in time, another IMF loan. IMF loans basically play serve to "derisk" private credit flows to less developed countries rather than reducing the dependence of the latter on the former. The result is countries getting tied into repeated IMF loans and programmes. Sri Lanka, for example is using a 17th programme-linked loan from the IMF and Pakistan has just obtained a 23rd line of credit.

The composition of debt

Debt restructuring in the context of defaults fail also because of changes in the international credit architecture. Since the 1970s, there have been major changes in the composition of flows of credit to developing countries, including sovereign governments. One change is that flows from governments in the advanced economies that are members of the Paris Club of creditors have been declining, with much of the reduced official flows from these countries being mediated through the multilateral financial institutions. The second is a sharp rise in private capital flows from the advanced capitalist economies to the low- and middle-income countries, in the form of credit from commercial banks and private bondholders. The third is that high growth and large current account surpluses in China have been accompanied by significant bilateral flows from China to the deficit-burdened less developed countries.

Two of these shifts, reflected differentially across debtor countries, have been widely commented upon. One is the increase in the share of private creditors, especially bondholders, in the debt of individual developing countries. Since these creditors tend to hold out when unsustainable debt is being restructured, in order to ensure that any haircut they have to take is low, generating a consensus is extremely difficult. This is a problem in Ghana, where the share of private creditors in external debt stocks rose from 13.4 per cent in 2010, to 29.4 per cent in 2014, 39.8 percent in 2018, and close to half at 49.3 per cent in 2021.[4] Sri Lanka too experienced an increase in private creditor share from 14

[4] Calculated using figures from World Bank's *International Debt Statistics* database.

to 28.9 per cent over this 11-year period. In principle this places the burden of restructuring on bilateral multilateral (such as the World Bank) creditors. But, multilateral development banks, with developed country backing, refuse to take a haircut on the grounds that it would affect their ability to borrow cheap to execute their mandate. In the event, the burden of restructuring is sought to be transferred disproportionately to official bilateral creditors.

The other shift is that, as a result of "aid fatigue" among developed market economy or the "Paris Club" of creditors, both the volume of bilateral flows and concessional credit from these creditors have been shrinking sharply since the last round debt restructuring. In the event, China's relative importance among bilateral creditors has risen significantly, given its growth and the large dollar surpluses it holds. As a consequence China is being called upon to write down a disproportionate amount of debt, in programmes led by the IMF which the the advanced capitalist nations, especially the US and Europe, control.

The 'adjustment' process

Thus, the changes in the flows of capital to finance the deficits in the developing countries have implications for the way in which debt-stressed less developed countries can 'adjust' to their inability to service the burden of external debt they have accumulated. As defaults in debt stressed countries increase in number, it is clear that there are three routes this adjustment can take. One is debt relief offered by the advanced capitalist nations in the form of debt write-offs by the multilateral institutions that have been the principal conduit for official flows to the less developed from the advanced market economies. However, as noted, the advanced economies are refusing to agree to any such measure. The fact that these institutions were participants in the evolution of the international order and complicit in the periodic debt crises that less developed countries have experienced is conveniently ignored.

The second is for China to carry much of the burden of bringing about a reduction in the debt of the less-developed countries, because among bilateral lenders it has emerged an important player. China has been reluctant to agree to any disproportionate contribution in debt restructuring exercises led by the IMF, dominated by the US. In any case, IMF policy recommendations in its previous engagements with most of these countries is partly responsible for their current predicament, where they are dependent on exceptional commodity price increases for stability in the balance of payments. China has

been demanding that institutions like the IMF must nobilise capital from the advance capitalist nations and contribute to reducing debt.

Finally, adjustment can take the form of austerity in the debt stressed countries, which reduces employment and real incomes of the already poor, to curtail imports of essentials in order to reduce deficits. That this is underway is clear from the fact that the current account balance, or the excess of foreign exchange payments over receipts of the emerging markets and developing countries excluding China and the OPEC has fallen from an average of $526.7 billion during 2015-17 to $289.5 billion during 2019-21.

Given the conflicting motivations and objectives underlying these forms of adjustment, there is in practice a wide difference in opinion on (i) how much debt should be written off and how the terms of the rest of the legacy debt be modified as the basis for resolution; (ii) how much additional financing is required to keep development going on a scale that permits servicing of residual past debt and any new debt obtained, and (iii) what should be the development strategy to be implemented using conditionalities associated with the resolution process. Differences between debtors and creditors are inevitable, but given creditor power in international debt negotiations, enforcing creditor driven norms is easy. The difficulty is arriving at consensus among the large number of creditors. In fact, even bringing them to the table to start negotiations proves difficult, with private hold outs refusing to accept any hair cut or revision of debt terms. Some of these tend to be vulture funds that have bought out stressed debt at a huge discount in the hope that that they could redeem the sums in full after prolonged litigation.

The principal issue has become which other creditors should carry the burden of loss in the restructuring. The IMF makes its conditionality-linked, minimal lending contingent on the government of the country concerned arriving at an understanding with its creditors on debt restructuring, according to a plan on debt reduction and rescheduling laid out in a Debt Sustainability Assessment (DSA) by the IMF based on assumptions that are not always transparent. In sum, the IMF puts on the pretence of being able to influence decision making on debt by all creditors: private, multilateral and bilateral. But in practice it has little influence on private creditors, and the position on restructuring of the multilateral institutions is clear. They refuse to participate in providing any debt relief or rescheduling, as that would affect their impeccable 'AAA' credit ratings, which derive from the facts that (i) they are presumed to be backed by their shareholders, which implies a sovereign guarantee from the United States

and its allies; and (ii) borrowers from the multilaterals cannot default by virtue of their treaty-based membership of these organisations. However, experience elsewhere such as the WTO indicates that the US can renege on its commitments. That makes the World Bank, for example, dependent on "freedom from defaults" for its high ratings. Even voluntarily departing from that can affect its "AAA" status, and make borrowing needed to sustain operations and influence across the "Global South". Since that influence too is exercised on behalf of the interests of developed country stakeholders, it receives the backing of the developed for its refusal to negotiate debt relief.

Private creditors, including commercial banks and bondholders do not have any such protection. Their failure to undertake 'due diligence' when lending, because of the their 'thirst for yield', makes it sensible to accept a haircut. But with deep pockets, these creditors are likely to hold out till they can get the best deal, especially if they are vulture capital firms that have bought debt at a huge discount with a plan to settle for a significant profit. That makes early and tenuous 'resolution' of the debt crisis the responsibility of the bilateral creditors, which are the creditors that debtor governments are expected to persuade to carry much of the burden of the resolution. In essence the IMFs role is to control policy in the debtor country and shape a 'bail out' for private creditors at the expense of creditorsgovernments.

The difficulty is that a turn to austerity in a crisis-ridden country tends to raise the debt-to-GDP ratio by contracting GDP, and widen the current account deficit, because it aggravates the structural problems that led to excess external debt dependence in the first place. Sri Lanka is a classic case, where access to $2.9 billion of funding for a country with $57 billion of external debt stocks in 2021 has been made contingent on generating a primary surplus of 2.3 per cent of GDP by 2025, relying on monetary policy as a tool to stabilise prices which has taken the policy interest rate from 5 to 16 per cent in a little over a year, hiking energy prices to "cover costs", and opting for a market determined exchange rate (when that is rate is under severe pressure) in order to "rebuild" foreign reserves. Inflation remains high and the crisis intensifies, however.

The policies recommended by the IMF, with the promise that its intervention would revive capital flows, also foreclose any attempts to limit if not shut out capital flows and restrain the supply side push of capital into developing countries, especially into international sovereign bonds in poorer countries. These capital flows are incentivised not by the austerity that deflates these

economies, but by the prospect of procuring state assets and state-owned natural resources that are privatised at deflated prices to keep even minimal government spending going.

Besides the pro-cyclical nature and the inappropriateness of austerity measures as a strategy for resolution of a debt crisis, the adverse effects these have on the poor and the middle classes triggers social unrest and political instability that make it difficult to implement any debt resolution strategy and worsen the crisis in economies that are already at near standstill. The IMF also tends to be pro-cyclical in its relations with debt-stressed nations when it imposes surcharges on borrowing by heavily indebted countries, which takes interest rates to well above market levels, worsening the debt servicing difficulties these countries are facing.

Overal, therefore, the restructuring, the costs of which are disproportionately borne by bilateral creditors, is likely to fail, returning countries to debt-stressed condition after a brief reprieve. Not surprisingly, the crisis resulting from debt-stress seems to be unresolvable in contemporary capitalism. But this crisis does not take down the whole system because those who bear the burden of this crisis are not the motive force in the system. Nor are countries like India, whose government claimed during its rotating G20 Presidency that it would fashion a resolution of the global debt crisis beneficial to the less developed countries in the South. As expected, no progress has been achieved, and the crisis persists.