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## FACT SHEET

# DEBT IN THE DEVELOPING WORLD – “THIRD WORLD DEBT”

### DEBT – A DEFINITION

#### Money that is owed

#### A liability

#### Being under an obligation to pay money

### HOW DO COUNTRIES BECOME SO INDEBTED?

Debt occurs when countries borrow money. The reasons for borrowing can be varied - to finance public projects, to pay for necessary imports (such as oil), or to service existing debt.

The economic and social costs of debt are high. The burden of repaying money borrowed today often falls on the citizens of generations to come. Governments often reduce public spending for services such as health and education to accommodate debt repayment.

All countries (both developed and developing) have foreign debt. The United States has the largest national debt<sup>1</sup> of any country, and Ireland has the largest debt per capita. Debt in developed countries such as these is considered 'manageable' (even necessary for growth), as their economies generate enough revenue to honour their repayments and their debt is held mainly by their own citizens.

While the debt of developing countries is significantly lower than developed countries, it has far more severe implications. Debtor countries (those that take out the loans) must repay their loans in *hard* currency<sup>2</sup>, this creates problems for countries whose currency is unstable and fluctuates in value. Often the structure and vulnerability of the economies of developing countries, along with the imbalance of world trade means that they are unable to pay their debt. As a consequence, the debts increase as they accrue rapidly rising interest rates. Their debt is generally owned by multi-lateral financial institutions such as the World Bank and IMF and various Western banks.<sup>3</sup>

Developing world debt (often referred to as Third World Debt) comprises only a small amount of total global debt. The combined debt of the 38 HIPC (Highly Indebted Poor Countries) is less than 1% of the total world debt.<sup>4</sup>

In dollar terms, these debts are not large but in relative terms (with regards to the revenue generated by HIPC economies), their debt is crippling and directly hinders development. For example, the country of Senegal has a debt of US\$ 1.6 billion and spends 20% of its GDP on servicing this debt, whilst Uganda's debt service equals 38.4% of its GDP.

### HISTORY

Most of the debt owed today in developing countries was accrued in the 1970s as a result of the international oil crisis. Oil producing nations formed the cartel OPEC (Organisation of Oil Exporting Countries) and became united in a common interest against the exploitation of them by industrialised nations. OPEC was able to end the Western oil corporations' monopoly over crude oil prices and production. During this period Arab producers also decided to initiate an embargo against countries friendly to Israel. This created panic and paranoia in the West and sent oil prices rocketing.

Subsequently, the revenue of OPEC countries increased dramatically. Their money was then invested into Western banks who encouraged developing countries to borrow money for (Western approved) development projects.

1 US debt is currently just under \$8 trillion (refer to footnote No.2) US per capita debt is \$25 821 and the debt increases by \$1.86 billion a day [http://www.brillig.com/debt\\_clock/](http://www.brillig.com/debt_clock/)

2 Hard currency: a currency that is considered to be stable. Eg. US\$, Japanese Yen, Swiss France, Euro

3 See other GlobalEd fact sheets for information on the IMF and World Bank

4 <http://www.globalissues.org/TradeRelated/Debt/Scale.asp>



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Loans were often used for political leverage, furthering the political and economic agendas of the developed countries and had little to do with altruistic development. Loans were granted for a variety of reasons including public works projects, export related incentives, and to support political regimes which in turn supported donor countries' agendas (particularly during the Cold War). Initially the loans were low interest but by the mid 1970s these interest rates had increased significantly. As interest payments rose, the developing countries' found it increasingly difficult to repay their debt. Their export revenues, which were dependent on international markets, fluctuated enormously as over-supply of product saw prices for commodities plummet.

### Why can't debtor countries repay their loans?

Compounding interest rates, exchange rates, and unfair trade practices that give developing countries no voice in the international trade of commodities has meant that the indebted countries of the Developing World have been unable to repay their debt. As debt in the Developing World increased and countries failed to meet their repayments, the response of the rich developed countries was to issue new loans to pay off earlier debt.

This involved the process of restructuring whereby the IMF and World Bank using 'Structural Adjustment Programmes', renewed loans in the 1980s<sup>5</sup>. This period imposed (unsuitable) macro-economic policies on debtor countries, whereby countries were encouraged to increase their export earnings by embarking on large-scale export production associated with cash crops such as coffee, cocoa and cotton. These policies have created severe problems for many developing countries, not least being dependency on a single crop and increased vulnerability to world market fluctuations and natural disasters.

Because countries now owed more than they earned to avoid default and bankruptcy, countries *had* to agree to economic reform and fiscal restrictions in order to have their debt restructured. The problem could not be ignored as the issue of debt repayment is vital to the economic working of a country, because the ability to service debt determines a country's creditworthiness.

### Who are the Heavily Indebted Poor Countries? (HIPC)

There are 38 countries that are categorised as heavily indebted<sup>6</sup>. These countries face an unsustainable debt burden, beyond available debt-relief mechanisms. Collectively they owe approximately \$240 billion. On average, the debt of each country is 4 times their annual export earnings.

#### Africa

Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Congo, Democratic Republic Congo, Cote d'Ivoire, Ethiopia, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Niger, Rwanda, Sierra Leone, Sao Tome & Principe, Senegal, Somalia, Sudan, Tanzania, Togo, Uganda, Zambia

#### Latin America

Bolivia, Honduras, Guyana, Nicaragua

#### Asia

Laos, Myanmar (Burma)

<sup>5</sup> Structural Adjustment Programmes: are free market economic policies promoted by the IMF & World Bank. They are designed to improve a country's ability to repay debt by increasing their export revenue, decreasing imports and cutting back government spending. eg. currency devaluation, trade liberalisation, credit restrictions.

<sup>6</sup> 33 of the HIPC are located in Sub-Saharan Africa



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The IMF and World Bank applied the label of HIPC from 1996 in response to the growing debt crisis. Their programme of assistance is known as the *Heavily Indebted Poor Countries Initiative*. The aim of the HIPC Initiative is not to remove the debt, but for each country to reach a sustainable level of external debt.

Eligibility for the scheme is severely restricted and each country must register a per capita income of \$925 or less. Before any debt relief is provided each country is required to undergo three years of Structural Adjustment. They will then become eligible for refinancing - borrowing additional funds to pay off earlier loans.

Criticism of this programme is widespread and is due largely to the concept that the reforms are aimed at ensuring that the debt can be repaid with little attention being paid to human development, reducing poverty, or improving economic growth. Twenty-two of the countries eligible for the HIPC Initiative spend more on debt servicing than they do on health care.

### **RELEVANT LINKS**

[www.worldbank.org/hipc](http://www.worldbank.org/hipc)

[www.jublieeresearch.org](http://www.jublieeresearch.org)

[www.globalissues.org](http://www.globalissues.org)

[www.afsc.org/africa-debt](http://www.afsc.org/africa-debt)