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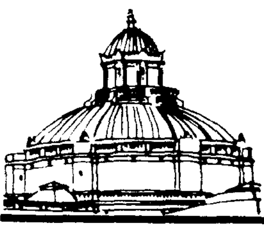
FINANCE AND ADJUSTMENT: THE INTERNATIONAL DEBT CRISIS, 1982-84

by
Patricia Wertman
Analyst in International Trade and Finance
Economics Division



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ABSTRACT

This paper provides an overview of the international debt problem which has significantly disturbed the international economic environment of the 1980s. It describes the characteristics of the less developed country (LDC) debt and discusses the role of major participants in the debt crisis. The study shows how the role of the participants has evolved during the crisis. Lastly, some of the issues arising from the debt crisis are discussed.

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FINANCE AND ADJUSTMENT: THE INTERNATIONAL DEBT CRISIS, 1982-84

I. INTRODUCTION

Following the oil price rises of 1973-1974, the subsequent world-wide recession, and the drop in commodity prices, the debt levels of many developing countries rose rapidly. Further OPEC (Organization of Petroleum Exporting Countries) oil price rises in 1979-1980, a major tightening in U.S. monetary policy starting in October 1979, another worldwide recession accompanied by historical highs in real interest rates, and another decline in commodity prices further increased LDC debt levels. By late 1982, when Brazil and Mexico, the two largest borrowers, nearly defaulted on their external debt, the problem had become a major international crisis. This paper considers several characteristics of the debt problem -- its size, concentration, composition, structure, and pricing, the role of the various participants, and the impact on world trade and financial markets. Finally, there is a brief discussion of policy issues involved.

II. CHARACTERISTICS OF INTERNATIONAL DEBT

A. Size

The Organization for Economic Cooperation and Development (OECD) has estimated that total disbursed medium- and long-term debt of the less developing countries was $606 billion at the end of 1983, having risen dramatically from $86.0 at the end of 1971. 1/ A recent World Bank estimate which includes short-term debt places total Third World debt at $810 billion at the end of 1983. 2/ 3/ Gross hard currency debt of Eastern Europe and the Soviet Union was estimated by the Central Intelligence Agency (CIA) to be $28.7 billion at the end of 1982. 4/

B. Concentration

The international debt is not only huge, but also highly concentrated. Table I, produced from OECD data, emphasizes the sharp concentration of the LDC debt; it is organized by size of debt service. The OECD believes that size of debt service is a more meaningful way to assess debt concentration because a large debt on soft terms generates only a small debt service. The OECD

1/ OECD. External Debt of Developing Countries, 1983 Survey. Table 9, p. 54.

2/ World Bank. World Debt Tables, 1983. 1984 ed., p. xii.

3/ The number of countries included in the OECD Survey and the World Bank Debt Tables also differs. The OECD estimate covers 157 countries; in the World Bank estimate 133.

4/ CIA. Handbook of Economic Statistics, 1983, p. 46 and p. 71.

TABLE 1. Disbursed Long-Term Debt, Debt Service, and Interest Paid, Year End 1980-1982: All LDCs and 20 Largest Borrowers a/ ($ billion)

Borrower	Year-end Disbursed Debt: 1980	1981	1982	of which owed to banks, d/ 1982	Debt Service Paid 1980	1981	1982	Interest Paid 1980	1981	1982
1. Brazil	57.1	64.7	72.6	43.9	13.3	15.3	18.1	6.0	7.6	9.1
2. Mexico c/	43.5	53.5	60.4	38.9	9.6	10.7	11.8	5.0	6.3	6.1
3. Argentina	16.0	23.7	27.1	15.5	2.8	4.4	6.3	1.3	1.8	3.4
4. Venezuela b/	13.8	14.9	16.5	12.9	4.7	5.0	5.2	1.5	2.0	2.2
5. Algeria b/	17.3	16.9	16.8	3.2	4.1	4.2	4.6	1.5	1.7	1.8
6. Korea, Rep.	17.6	20.0	22.0	8.7	3.3	3.9	4.5	1.4	1.8	2.1
7. Iran b/	10.0	6.9	5.0	0.2	2.0	5.3	2.9	0.8	0.9	0.7
8. Yugoslavia	15.1	15.1	14.4	4.1	3.3	3.4	3.6	1.2	1.6	1.5
9. Chile	8.9	11.9	13.4	8.5	2.2	3.0	2.4	0.8	1.1	1.7
10. Indonesia b/	16.6	17.5	20.4	3.8	2.1	2.5	2.8	1.0	1.2	1.3
11. Egypt	13.8	15.2	16.6	0.5	1.5	2.1	2.5	0.3	0.6	0.6
12. Saudi Arabia b/	2.9	2.4	2.7	0.8	2.0	2.2	2.1	0.2	0.2	0.2
13. Nigeria b/	5.2	6.0	7.9	3.5	1.2	1.8	2.0	0.5	0.6	0.9
14. Iraq b/	2.5	3.0	2.2	0.1	1.1	1.8	1.9	0.2	0.2	0.2
15. Peru c/	7.1	7.4	8.4	2.9	1.6	2.0	1.6	0.6	0.7	0.9
16. Philippines	8.7	10.2	11.9	3.9	1.2	1.7	1.8	0.6	0.7	1.0
17. Greece	7.0	8.2	8.8	5.4	1.3	1.7	1.7	0.6	1.0	1.0
18. Turkey	13.9	14.5	15.0	3.6	1.1	1.3	2.1	0.6	0.7	1.2
19. Portugal	6.0	7.1	9.1	5.2	1.2	1.6	1.8	0.5	0.7	0.9
20. India	18.2	18.9	20.7	0.5	1.4	1.4	1.7	0.3	0.4	0.6
Total 20 Countries	301.2	338.1	372.0	165.6	61.2	75.4	81.4	24.8	31.8	37.5
(% of Grand Total LDCs)	(67.7)	(67.5)	(67.4)	(82.6)	(74.3)	(75.7)	(70.5)	(70.5)	(73.6)	(74.6)
Total LDCs	445.0	506.7	551.7	200.0	82.3	99.7	107.5	35.2	50.3	48.1

a/ Borrowers are ranked by average debt-service payments in 1981-82. Next-ranking countries include Israel (not including official military debt), Morocco, Thailand, Taiwan, Ivory Coast.

b/ OPEC Member.

c/ Net oil exporter.

d/ Outstanding international bank loans from DAC countries and international capital markets (other than officially guaranteed export credits).

Source: OECD. External Debt of Developing Countries, 1983 Survey. p. 54, 55, 76, 77, and 83.

found that the 20 largest debtors accounted for 76 percent of the debt service paid by LDCs. 5/ Indeed, Brazil and Mexico together accounted for 25 percent of the debt service. 6/ Thus, international debt is highly concentrated, increasing the risk to holders of the debt and violating generally accepted principles of portfolio diversification.

C. Composition: Public or Private fund sources

As shown in table II, of the total debt disbursed at year-end 1983, 21 percent was official development assistance; 8 percent, non-concessionary multilateral assistance; 23 percent, export credits; and 48 percent, private market credits. During the 1970s there had been a shift from inter-governmental transfers to increased provision of funds by the private markets. This can be attributed to the success with which private markets recycled the OPEC balance-of-payments surplus and to the unwillingness of the OECD governments to provide financing. Since private financing is more costly than government loans, this shift increased the level of debt service.

D. Pricing

Much of the borrowing from private sources has been done by the more advanced developing countries at floating rates, that is, at a spread over the

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5/ OECD. External Debt of Developing Countries: 1983 Survey, p. 42.

6/ Ibid.

TABLE 2. Sources of Long-Term Lending to LDC
(percent of total)

	1971	1975	1980	1983
Official Development Assistance	41%	34%	24%	21%
Non-Concessionary Multilateral Assistance	3	6	7	8
Export Credits	32	25	28	23
Private Markets	24	34	40	48

Source: OECD. External Debt of Developing Countries: 1983 Survey. p. 69.

London Interbank Offered Rate (LIBOR) or the U.S. prime rate. 7/ The use of floating rate debt increases the vulnerability of large borrowers to the impact of rising interest rates which increase debt service costs. Argentina, Brazil, South Korea, and Mexico, as leading borrowers, had the highest floating rate debt, accounting together for 81 percent of the floating rate debt. 8/ In addition to pricing international loans with variable interest rates, loans are also most frequently denominated in U.S. dollars. In periods of an appreciating dollar, this also increases LDC debt service.

7/ The London Interbank Offerred Rate is the rate at which high quality banks in London are prepared to lend to each other in the interbank market. The interest rate on Eurocurrency loans is usually expressed as a "spread" over LIBOR.

8/ OECD. External Debt, p. 67.

E. Term Structure

There has also been a major shift in the term structure of LDC debt: the debt has become increasingly short-term. This is, in itself, an indication that LDC debt is viewed as increasingly risky. As a country's economic situation deteriorates, banks become increasingly unwilling to lend at longer maturities. Large amounts of short-term debt open the borrowing countries up to increasing difficulties in rolling over existing debt. Countries having large short-term debt include Argentina, Brazil, South Korea, and Mexico.

F. Summary

The size, concentration, composition, pricing, and structure all combine to make the international debt issue one of paramount concern. Nothing, however, dramatized the problem more clearly than the late 1982 international financial crisis caused by the near default of the system's two largest borrowers--Mexico and Brazil. Emergency intervention by the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the U.S. Treasury, the Federal Reserve and other central banks, accompanied by the forced lending of the private international banks served to contain the effects of the 1982 crisis. The next section of this paper looks at the institutions, the role they have played in the international debt crisis, and how they may themselves have been changed by the crisis.

III. ACTORS

A. The U.S. Government 9/

The U.S. Government has been a major source of finance for the developing countries. As of September 30, 1983, the U.S. Government had made $52.4 billion in long-term loans to developing countries, including OPEC nations. 10/ These loans were made under a variety of legislation, including the Foreign Assistance Act of 1961, the Agricultural Trade Development and Assistance Act of 1954 (P.L. 83-480), and the Export-Import Bank Act of 1945. Most of these debts are owed by government obligors.

In addition to the debt owed to the U.S. Government by developing countries, $2.2 billion was owed by Eastern Europe and the Soviet Union. 11/ The bulk of these loans are accounted for by Commodity Credit Corporation (CCC) loans to Poland, World War II lend-lease to the Soviet Union, and U.S. Export-Import Bank (Eximbank) loans. Currently, however, in Eastern Europe only Hungary, Romania, and Yugoslavia are eligible for loans from the U.S.

9/ For a fuller treatment of debt owed to the U.S. see Wertman, Patricia A. Foreign Indebtness to the U.S. Government: An Overview. Library of Congress, Congressional Research Service, March 29, 1984, 34 p.

10/ U.S. Treasury. Office of the Assistant Secretary for International Affairs. Status of Active Foreign Credits of the United States Government, September 30, 1983.

11/ Ibid.

The U.S. Government has extended emergency assistance during the debt crisis, notably to Mexico and Brazil. It has done this bilaterally through the Exchange Stabilization Fund and other government agencies and multilaterally through such agencies as the Bank for International Settlements.

The U.S. also participates in debt rescheduling. U.S. Government policy on debt rescheduling is clear and specific. All debt rescheduling is to be done on a case-by-case basis within the context of a creditor club, that is, the formal group of creditors who negotiate with the debtor countries. This club is known as the Paris Club and is part of the Organization for Economic Cooperation and Development (OECD). Rescheduling is on the basis of nondiscrimination among creditor countries. Private unguaranteed credits are to be on terms comparable to government and government-guaranteed credits. The debtor country is to implement an economic program to correct its economic difficulties, usually in cooperation with the International Monetary Fund (IMF). The U.S. will reschedule payments in arrears and falling due not more than one year following the rescheduling negotiations. Finally, debt relief is not to be given as a form of development assistance. 12/

As the debt crisis has accelerated, the number of reschedulings has increased rapidly. Between 1956 and the end of 1982 the Paris Club had held at least 60 debt reschedulings for 20 countries. 13/ In 1983 debts of 15 countries were rescheduled. The impact of rescheduling varied. According to an IMF

12/ U.S. National Advisory Council on International Monetary and Financial Policies. Annual Report for Fiscal Year 1982. July 14, 1983, p. 65-66.

13/ IMF. Debt Rescheduling: What Does It Mean? Finance and Development, September 1983, p. 28.

Survey, 14/ official debt relief amounted to less than 30 percent of total debt service payments due when only current maturities were rescheduled, that is, payments falling due during the consolidation period. When arrears were included debt relief was raised to 100-200 percent of actual debt service in about one fifth of the cases surveyed and more than 200 percent in a further one fourth. Where official indebtedness to official creditors represented a small portion of some countries total debt, relief was correspondingly small.

B. The International Monetary Fund (IMF)

The IMF has played one of the most important roles in the debt crisis. The 146-member international monetary organization was founded in 1945 to foster international financial stability. The Fund provides short- and medium-term loans at below market rates (currently 6.6 percent) to member countries experiencing balance-of-payments difficulties. These loans carry with them economic policy conditions--IMF conditionality--intended to bring about fundamental economic adjustment. The amount of required adjustment and the amount of financing are finely tuned. IMF conditionality is restrictive and may include such targets as the level of government spending, growth of money supply, exchange rates, and the trade balance. Failure to meet these targets can result in delayed disbursement of IMF loans or their renegotiation. Availability of private funds is also affected by compliance with IMF programs.

Conditionality is a unique attribute of IMF loans. For this reason Paris Club creditors and commercial banks insist that troubled borrowers have an IMF accord. IMF conditionality is, however, the center of much debate.

14/ This paragraph follows Brau, E. and R.C. Williams. Recent Multilateral Debt Restructurings with Official and Bank Creditors. Washington, D.C., International Monetary Fund, December 1983, p. 21.

> While the principle of conditionality is, by and large, not contested, there are strong misgivings about the design and application of conditionality. In particular country cases these misgivings related to the specifics of the performance criteria. Frequently, Fund credits are negotiated in the midst of an economic crisis, with reserves plummeting, foreign debts accumulating, accelerating inflation and serious dislocations to domestic production. While this increases the value of access to the Fund, as a lender of last resort, it also gives Stand-by negotiations an unwanted flavour, with the member government feeling it is rushing into actions it would rather avoid and believing that it is in a weak negotiating position vis-a-vis the Fund. The Fund, for its part, sees itself as forced into imposing harsher conditions than would have been necessary had the member requested assistance at an earlier stage. The policy conditions laid down may be resented, both because of the loss of sovereignty implied and because of a belief that the Fund's objectives do not necessarily coincide with those of the national government. The Fund, on the other hand, often sees itself made a scapegoat for unpopular measures made inescapable by poor economic management. 15/

The basic issue is whether the policy conditions are too "tight" or too "loose," that is, whether they involve too much or too little economic discipline. IMF conditionality consists of various austerity measures which usually result in a recession in the recipient country, although economic growth may reappear in the later stages of a program. Particular concern has been expressed that the prolonged austerity which may be required by the current crisis is politically and economically unsustainable. Indeed, the imposition of IMF conditionality has sometimes been the occasion for riots, most recently in the Dominican Republic. At another level the efficacy of IMF programs has been questioned. Recently the IMF listed some of the countries in which its programs had been beneficial: Mexico, India, Pakistan, Kenya, Somalia, Mauritius, Turkey, Hungary, Romania,

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15/ Sutton, Mary. In Killick, Tony, ed. The IMF and Stabilization: Developing Country Experiences. New York, St. Martin's Press (1984). p. 4.

and Yugoslavia. 16/ There is also a debate whether IMF prescriptions, when applied multilaterally, are not cumulatively destructive of the goals which the IMF is trying to achieve. Nevertheless, under current circumstances private funds would be unlikely to be forthcoming without conditional IMF loans, and these private loans comprise the major share of lending to Third World countries. Lastly, it should be noted that the deep involvement of the IMF in the debt crisis represents an important shift in the IMF's role as a provider primarily of short-term funds to industrial nations to being a provider of medium-term funds to developing countries (lending to industrial countries in the future should not be discounted). This shift is a result of major disequilibria in the world economy, as well as economic mismanagement by individual countries. Thus, further instability in the international economy may imply a continued high demand for IMF financing and further quota increases.

Although the IMF does not reschedule debt, it acts as a catalyst in negotiations between borrowers and lenders, fostering cooperation between governments, central banks, the Bank for International Settlements, and the commercial banks. In this role the IMF stepped out aggressively during the Mexican and Brazilian debt problems of late 1982. The IMF not only told the banks to lend but, in order to insure that the countries got the funds necessary to assure success of the adjustment program, told them how much to lend. The IMF which once was concerned that commercial banks not threaten IMF conditionality by lending too much is now concerned that too little will be lent. IMF assessment of how much funds the banks will provide, that is, of a country's capital account prospects and its implications for the current account, are key to the level of IMF funding.

16/ IMF. Fund Managing Director Describes Case Studies, IMF Survey, February 6, 1984, p. 33, 42-47.

Finally, the IMF's ability to provide resources to the LDCs was greatly enhanced by the expansion, in late 1983, of its quotas by 47.4 percent to SDR 90 million (about $98.5 million). The quotas are the IMF's basic lending source. The IMF General Arrangements to Borrow (GAB), which were initially intended to finance balance of payments difficulties encountered by members of the Group of Ten, were also expanded to permit access by all IMF members in the event of a major international financial crisis.

C. The Bank For International Settlements (BIS)

Located in Basel, the Bank for International Settlements (BIS), the central bank for central bankers, played an important role in the 1982-83 debt crisis. The BIS provided short-term bridging loans to five countries: Mexico, Argentina, 17/ Brazil, Hungary, and Yugoslavia. The loans were intended as financing until loans from the IMF could be obtained. Provision of credit for developing countries represents a departure from the normal role of the BIS, and the BIS has curtailed its loans to troubled LDCs. Thus, future involvement by the BIS in international debt problems appears unlikely, although it may depend on the extent of the crisis.

D. The Borrowers

Throughout most of the 1970s the major borrowers had deteriorating balance-of-payments accounts. Payments deficits accompanied by foreign borrowing and a large external debt are normal for a developing country, as it was for the U.S. in its infancy. However, the unprecedented rise in oil prices followed by international recession and declining commodity prices led to dramatic payments

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17/ Argentina never drew on its standby credit.

deterioration and a run-up of LDC debt. As early as 1975 concern was expressed about the debt level. Further oil price rises exacerbated the problem. The run-up of real interest rates following a shift in U.S. monetary policy in October 1979, rising dollar exchange rates, and a shift to short-term and floating rate debt also increased the LDC debt burden. A major recession in the industrial world and rising protectionism made it difficult for developing countries to earn the foreign exchange needed to pay their debts. For many countries, their ability to adjust to these external shocks was frustrated by poor demand management and unrealistic exchange rate policies. Poor debt management meant that many countries simply failed to realize the scope of their debt problem until their debt crisis was upon them.

Domestic economic policies are also a major determinant of the existence and extent of a debt problem. The Latin American countries chose to follow the path of import substitution. That path led to quotas, overvalued exchange rates, and increased foreign borrowing. At the same time exports were handicapped. By comparison, most of Asia successfully chose export-led growth. Exchange rates and other prices were not fixed and the market mechanism usually allocated resources. The results of these policies are summarized by the Economist: 18/

GDP Growth

	1973-80	1981	1982	Average
Latin America	5.8%	-0.1%	-1.5%	1.4%
Asia	5.3%	5.8%	3.7%	4.9%

18/ The Policy Difference. In World Economic Survey, The Economist, September 24, 1983, p. 39.

Clearly, while import substitution policies initially led to faster growth, an export-led growth stategy had higher average growth and was more resistant to economic recession.

Conventionally a debt crisis must be met by some combination of financing and economic adjustment. The greater the availability of finance, the less adjustment is required. The degree of adjustment is also determined by the severity of the economic and financial crisis. Severe debt problems are closely linked to weak economic policies. 19/ Thus, economic adjustment means policy reform. In practice, the focus is on demand management and pricing policies, including exchange rate and interest rate policies. Oversized fiscal deficits must be cut back by cutting government spending and subsidies and by raising taxes. Cuts in public sector borrowing, credit expansion, and money supply are intended to control inflation. Overvalued exchange rates, typically a major cause of debt problems, are corrected by devaluation, with the hope that resources will be directed to the export sector. This mix of deflation, disinflation, and devaluation makes the upper tranche adjustment programs economically painful and politically difficult. For these reasons, for example, Argentina has so far failed to negotiate an IMF program. However, economic adjustment is inevitable and the alternative of adjusting without a program could well be more difficult. Moreover, in the later stage of an IMF program economic growth may emerge.

IMF programs are tailor-made for each country. Programs are the product of negotiations between debtor countries and the IMF and are embodied in a confidential "letter of intent" to the Managing Director of the IMF. At

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19/ IMF, Survey, February 6, 1984, p. 42.

the same time, IMF rules require equal treatment of members, hence, the similarities of the programs. Economic policy change are expressed in "performance targets." These targets are largely fiscal and monetary, occasionally qualitative (such as balance of payments restrictions), but never supply side. Although inflation is frequently a major problem, the inflation rate itself is rarely a target. Performance targets are the access to IMF funds. Countries often find the targets difficult to meet, principal measures of adherence to adjustment programs, thus governing fall out of compliance, then renegotiate or cancel the program.

The success of IMF programs in individual countries appears to be mixed, whether compared to key economic variables of the immediate past or to the performance criteria. 20/ A look at the Third World's two largest debtors illustrates some of the difficulties of measuring success. In return for a $3.9 billion credit Mexico reportedly agreed to one condition in its letter of intent -- the reduction of its budget deficit to 8.5 percent of GNP. (Additional details were apparently contained in an unreleased technical agreement.) Mexico has successfully compiled with its IMF performance targets, yet Mexico remains in the severest economic crisis of its history. The achievement of large trade and current account surplus during the last two years was offset by recession, high unemployment, and high inflation.

In the wake of Mexico's difficulties, Brazil, the Third World's largest debtor, was forced to negotiate a $4.9 billion extended arrangement with

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20/ See discussion and footnotes in Killick and Sutton in Killick, Tony, ed. Adjustment and Financing in the Developing World: The Role of the International Monetary Fund. International Monetary Fund, Washington, D.C., 1982. p. 34-35.

the Fund. Conditions included cutbacks in government subsidies, state companies, and debt. In a test of its will to deal with its economic problems, Brazil failed to cutback wage indexation, a major cause of inflation. As a result Brazil fell out of compliance with its IMF programs. The IMF did not resume lending until after passage of a new wage measure, Decree Law 2065, in November 1983. Despite mofication of the wage indexation law, in the first quarter of 1984 inflation was at an annual rate of 230 percent. Brazil's IMF accord does not contain an inflation target, but other targets imply an inflation rate of about 100 percent. The present rapid inflation has jeopardized Brazil's adherence to targets which are in its program and caused Brazil to be out of compliance with its fifth and latest IMF accord. Meanwhile, Brazil's trade surplus has soared; unemployment in industrial areas is stabilizing; and the government, disagreeing with private economists, is forecasting economic growth for the first time in four years. Thus, economic results following imposition of an IMF program in Brazil also appear to be contradictory.

In addition to the conventional approaches of finance and economic adjustment, a political approach to the debt problem has been suggested recently, namely the formation of a "debtors' cartel" to extract more favorable terms from lenders. This idea has been discussed by the nonaligned nations, but it is in Latin American where the idea has gained the most acceptance. In Latin America, with more than half of the outstanding LDC external debt, the idea of a debtors' cartel was first discussed in Ecuador at a March 1983 meeting of the Inter-American Development Bank. In September 1983 a report produced by the U.N. Commission for Latin America and the Latin American Economic System was discussed at the OAS meeting in Caracas. According to the Wall Street Journal this report recommended institutionalizing

the restructuring of debt, greater refinancing, longer postponement of principal payments, additional new financing, lower fees and interest rates on refinancings, and increased loans from government and multilateral organizations. 21/ In sum, the proposal wanted more money on easier terms. At meetings held in Quito from in January 9-14, 1984, and Cartagena on June 19-20, 1984, these proposals were amplified.

The failure of a debtors cartel to develop has been in part because of the disparate interests of the major borrowers, such as Brazil and Mexico, and the smaller borrowers. As one banker put it "the cocktail theory of a debtors' cartel is not the real world. There are too many different trade patterns among debtors, different political systems and different stages of negotiations with the IMF." 22/ For the moment, at least, the debtors will go the more traditional route of rescheduling, financing, and adjustment. The recent rescue of Argentina by four Latin debtors reinforces this view. The significance of the cartel idea may well be the extent to which it merges with earlier LDC demands for increased long-term aid and a new economic order. Beyond pressing for more funds and softer terms, the option of outright default is only likely to be taken when a country perceives it has less to lose and more to gain from such an action, such as Cuba in 1962. In this debt crisis no countries have so far chosen to default. Cessation of trade, cutoff of loans, attachment of assets, and general economic isolation -- the consequences of default -- are an extremely high price to pay for getting out from under foreign debt, especially when rescheduling is an alternative.

21/ Rout, Lawrence. Bankers Worry Monday's OAS Meeting May Boost Support for Debt Moratorium. Wall Street Journal, September 2, 1983, p. 16.

22/ Brazil to Join Caracas Debt Strategy Talks, Financial Times, August 10, 1983, p. 1, 4.

Recent loan packages negotiated by Mexico, Brazil, and Peru have softened terms. It is problematic, however, whether this is the market's recognition of economic improvement in these countries or a recognition that, over the long pull, debtor countries probably cannot sustain a continuation of previously high borrowing costs.

E. Lenders and Supervisors

At the end of December 1983 the banks reporting to the BIS had assets in the non-OPEC LDCs of $256.2 billion. 23/ Domestic U.S. banks accounted for approximately $127.6 billion of this lending, nearly 80 percent in Latin America. 24/ With such large holdings it is not surprising that the international debt crisis of 1982-1983 has had as dramatic an impact on international lenders and international financial markets as it has had on other actors in the international financial system. Important changes have occurred in the international money and capital markets. Fundamentally, there has been a greater emphasis on quality. This has resulted in some market tiering.

The $1-trillion interbank market consists of short-term deposits banks keep with each other. Banks unable to obtain funds in the interbank market may face a liqudity crisis threatening the entire system. This is not just a hypothetical possibility. When Banco do Brazil, the settlements bank for Brazil, was having difficulty meeting its obligation in mid-December 1982, five New York banks lent it $175 million rather than allow the market to come to a halt. This is important not only because the interbank market

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23/ BIS. International Banking Developments. Fourth Quarter, 1983. April 1984. Table 5.

24/ Federal Reserve Board of Governors. Federal Reserve Bulletin, v. 70, April 1984. p. A57.

was nearly brought to an abrupt stop, but also because an acutely clear message was delivered; loans between banks carried a risk. Banks began to reexamine their interbank lines and the market began to shrink dramatically. Maintainence of interbank lines became a crucial factor in major debt reschedulings, such as Mexico and Brazil. Regional banks, in particular, were reluctant to maintain interbank lines, creating a major problem. Market shrinkage, however, may have left the market smaller and healthier. 25/

Perhaps the financial turmoil of 1982-1983 had its deepest impact on the Eurodollar syndicated loan market. In 1983, the volume of lending in the Eurodollar loan market dropped by one-third to $64.3 billion, the sharpest decline ever recorded by the OECD. This shrinkage largely reflected concern over credit risk, but it also reflected the increasing use of International Banking Facilities (IBFs) in the U.S. and increased use of floating rate notes. Toward the end of 1983 market concern for quality meant that most loans went to OECD countries, and, since more banks were chasing fewer borrowers margins were also shrinking.

New loans to developing countries were almost exclusively "forced lending," that is, banks are being forced to maintain or increase lending in support of IMF adjustment programs. International credit is to a large extent being allocated. Syndicated loans have, in practice, become nearly an open-ended commitment to the borrower. Rescheduling makes it difficult for a bank to withdraw from a loan

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25/ See for example, Atkinson, Caroline and James L. Rowe Jr., Smaller Banks Slash Loans, Complicating Brazil Resue, Washington Post, February 23, 1983, F1, F2; Bennett, Robert A., I.M.F. Plans Plans Pressure on Banks to Help Brazil, New York Times, December 15, 1982, p. D1, D3; and Hall, William, Banks Urged to Keep Open Credit Lines, Financial Times, February 19, 1983, p. 1, 14.

consortium. Moreover, bankers are likely to find their actions constrained in this fashion for years to come. This has made Eurodollar loans to LDCS relatively unattractive.

A secondary market in Eurodollar credit that includes both sub-participation, in which larger banks sell parts of loans to smaller banks, and a discount market in rescheduled sovereign debt also developed in 1983. The market is small (about $2 billion), in comparison to the major international financial markets, but growing. 26/ It introduces on element of flexibility, allowing banks to partially restructure their balance sheets, increasing their liquidity, and enabling them to lend to more highly rated borrowers. It also helps to solve the problem of mismatched maturities and enhances the primary syndicated loan market. It can, however, adversely affect the rescheduling process, as, for example, when Bankers Trust sold some of its Brazilian exposure while simultaneously participating in Brazil's advisory committee. 27/

The regulatory climate has also changed substantially as a result of the debt crisis. On April 7, 1983, the Federal regulatory authorities issued a Joint Memorandum which improved supervision and tightened regulation of the international lending of U.S. banks. The Joint Memorandum included clear guidelines for bank examiners commenting on large international exposure, public disclosure of large concentrations of country debt, amortization of spreads and fees earned in debt rescheduling, and the requirement to maintain reserves for "troubled" international credits. Shortly thereafter Federal

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26/ Montagnon, Peter. Debt Crisis Brings New Creativity to Banking. Financial Times, December 15, 1983. p. 21.

27/ Hector, Gary. The Banks' Latest Game: Loan Swapping. Fortune, December 12, 1983. p. 112.

regulators imposed a requirement on the 17 largest banks to maintain capital equal to 5 percent of their assets by 1984. The requirement merely locked in existing capital levels in most cases.

The Joint Memorandum was issued in a climate of congressional charges of bank irresponsibility in LDC lending and was perhaps intended to preempt more stringent congressional action. Congressional desire for tighter control of international lending by U.S. banks was eventually embodied in title IX of PL 98-181, the "International Lending Supervision Act," which was enacted on November 30, 1983. This law requires Federal authorities to evaluate foreign country exposure and transfer risk and to establish procedures taking these into account in evaluating capital adequacy. Minimum levels of capital adequacy are to be established. Special reserves may also be required when a bank's assets have been impaired by "a protracted inability of public or private borrowers in a foreign country to make payments on their external indebtedness." Fees are to be amortized and disclosure requirements are tightened up.

Increased international cooperation on the issue of bank supervision may also be aiding international financial stability. Following the 1974 collapse of a large German bank, I.D. Herstatt, a committee of major central banks (the Committee on Banking Regulation and Supervisory Practices or the Cooke Committee after Peter Cooke of the Bank of England, its Chairman) was established to examine problems of international banking regulation. This committee, the main organ of international banking cooperation, prepared the first Basel Concordat. The Concordat was endorsed by the governors of the major central banks in December 1975, but was never published. It established lines of authority for the supervision of branches, subsidiaries, and joint ventures

of international banks. Branches were to be primarily the responsibility of parent supervisory authorities; subsidiaries and joint ventures, of host authorities. It stopped short, however, of addressing the central problem of how lender-of-last resort responsibilites are to be shared. In part this is because lender-of-last resort responsibilities must necessarily be left vague so as not to encourage bank imprudence. This is known as the "moral hazard" problem. The limitations of the 1975 Basel Concordat were revealed in August 1982. The bankrupcy of Italy's Banco Ambrosiano threatened a Luxembourg subsidiary, but neither the Italian nor the Luxembourg authorities would take responsibility for the Luxembourg subsidiary, which was allowed to fail. The failure of either authority to take responsibility called into question the validity of the 1975 Basel Concordat. A revised Basel Concordat was issued in May 1983. It clarifies lines of supervisory authority by emphasizing supervision of a bank's business on a consolidated basis by parent country authorities. Although the failure of Banco Ambrosiano was unrelated to the debt crisis, it served to strengthen international cooperation in a critical area at a critical time.

Participation in the debt crisis has not been limited to the commercial banks. Investment banks also play a role. Approximately 10 investment banks are involved in giving advice to developing countries on financial matters, including debt rescheduling. The most important of the investment banks which are giving countries advice is the combined financial service of the Troika, consisting of the firms of Lazard Freres et Cie in Paris, S. G. Warburg & Co. in London, and Lehman Brothers Kuhn Loeb in New York. The Troika signed its first contract in February 1975 with Indonesia, at the onset of Pertiminia's difficulties, thereby initiating a new phase in bankers' role as

advisors to sovereigns. By March 1983, Institutional Investor was estimating the fee income from advising governments was $50-$60 million, fully half of which was accounted for by the Troika. 28/ The investment banks' role as advisors to financially troubled countries has sometimes generated opposition from commercial banks involved in debt negotiations who tend to view the investment bank as polarizing the negotiations. This was particularly the case in the two-year rescheduling of Costa Rican debt, the longest negotiations on record. Nevertheless, clients appear to be willing to continue the relationship, although some have pressed for lower fees. Counseling on debt and reserve management, borrowing and trade strategies appear so far to be a positive contribution to improving the financial expertise of the developing countries.

1. "A Rolling Loan Gathers No Loss" 29/ or the Recognition of Losses

For some time there has been a debate whether the debt crisis is a liqudity crisis or a solvency crisis, i.e. whether the LDCs cannot pay now or cannot pay ever. This debate tends to fog the issue, polarizing it into one of alternatives, thereby possibly obscuring policy options. 30/ One banker bridged this chasm by terming the LDC debt crisis a "long-term liquidity crisis." 31/ Payment is likely to be a matter of time and degree. Nevertheless, the perceived ability to pay determines the relative amounts of finance and adjustment. If

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28/ Koenig, Peter. Country Advice: Tales of the Troika. Institutional Investor, v. 17, March 1983, p. 369.

29/ Pardee, Scott. Prospects for LDC Debt and the Dollar. Federal Reserve Bank of Kansas City. Economic Review, January 1984, p. 6.

30/ See Bell, Geofrey and Graham Ruttidge. How To Account for Problem Loans. The article details a range of models of countries experiencing varying degrees of debt difficulties.

31/ de Vries, Rimmer at the Cato Institute Conference, "World Debt and the Monetary Order." January 20-21, 1984. Proceedings soon to be published.

the crisis is considered to be a matter of liquidity, then more financing is required; if a matter of solvency, more adjustment will be necessary. If these are unsuccessful, then the banks face the necessity of writing off some of their assets. To write-off a loan is to reflect the loss on the bank's balance sheet, resulting, at best, in a decrease in profits.

Banks' LDC assets have deteriorated with a widening gap between the nominal value and the market value (as, indeed, the existence of a discount market indicates). Under some circumstances LDC loans may be written off against the banks' loan loss reserves, a painful experience. Consequently in 1983 U.S. regulators moved to strengthen the financial system by requiring the 17 largest U.S. banks to increase their capital to 5 percent of assets. By the end of 1983 all had complied. (Primary capital includes equity, debt securities convertible into common stock, and reserves for losses.) The banks themselves have also taken measures. Since bank shares were weak, U.S. banks sold $2.5 billion in preferred stock. 32/ Provisions to loan loss reserves by the top 10 banks were up by $2.9 billion or by 13.5 percent in 1983. 33/ Increased loan loss reserves put banks "in a stronger position to absorb future problems, particularly in light of continued uncertainty in various credit markets" as Bank of America President Sam Armacost put it. 34/ On the other hand, nonperforming loans increased by $14.1 billion during 1983. 35/

32/ Lascelles, David. Why the Banks Have Built Up Their Reserves. Financial Times, April 2, 1984, p. 16.

33/ Ibid.

34/ Ibid. Bank of America increased its loan provisions from 0.87 percent to 1.25 percent in the face of constant earnings.

35/ Hall, William. Flat Patches in a Champagne Year. Finanical Times, January 24, 1984, p. 13.

In addition to general reserves, under the terms of the International Lending Supervision Act of 1983 (Title IV of the IMF legislation, P.L. 98-181) special reserves against specific losses may be required. The requirement to establish special reserves amounts to declaring a default and is likely to be used sparingly in order to avoid undermining any efforts that a country might be making to straighten out its arrears.

Putting aside any additions to loan loss reserves--general or special--adversely affects a bank's profits picture. Since a loan loss reserve is often replenished at the time of a write off, the effect is to take the loss out of earnings. As one banker stated: "the courage with which people establish loan loss reserves is inversely proportional to the size of the loan." 36/ Because of their more limited exposure, regional banks are in a better position to recognize losses. This also helps to explain their reluctance to continue in various loan consortia; they simply have less to lose.

The issue just discussed is the recognition of losses, but losses can be avoided or hidden. Financing may be extended to keep a borrower afloat or to assist adjustment. Financing can also be used to avoid losses. A major way to avoid losses is to "front-end load." This procedure permits the rapid drawdown of new loans, usually for the purpose of paying arrears on earlier loans. The major advantage of front-end loading is that it prevents earlier loans from becoming non-performing and it increases bank profits. These advantages are offset by equally substantial disadvantages. The front-end load amounts to an incentive to run up arrears. Quick disbursement makes it easier for the borrower to break commitments or, conversely, it diminishes the leverage

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36/ Hector, Gary. The True Face of Bank Earnings. Fortune, April 16, 1984, p. 84.

of lenders over the borrower. By papering-over losses it impedes the development of long-term solutions to the debt problem. In addition, front-end loading makes the debt crisis worse. Total debt and total debt service are increased and added to existing debt aggregates. Moreover, the so-called "new" financing results in no new productive capacity able to produce export earnings to defray the debt in the future. Thus, the debt problem has become structural; it feeds upon itself. To preserve the present apparent viability of the international system an illusion has been created which may actually increase system vulnerability. Lastly, front-end loading is unlikely to reduce the risk of voluntary default.

2. The Allocation of Costs

Between 1973 and 1982 the non-oil producing LDCs had a cumulative current account deficit of $541.9 billion. 37/ (This number would expand if oil producers with current account deficits were included.) The deficits were largely financed by net external borrowing amounting to $425.6 billion. $179.5 billion or 42.4 percent of net borrowing came from private financial institutions, not including short-term credit. Long-term borrowing from official sources amounted to $132.5 billion or 31.3% of the total net long-term borrowing. Reserves were drawn down by $66.5 billion. Thus, private financial institutions played the dominant role in financing the LDC deficits occurring in the post-1973 era. The relative shares of the sources of LDC finance affects at least the initial distribution of the real costs associated with the deterioration of loans to LDC's. Ultimately, however, these costs

37/ For a yearly breakdown and additional details on the financing of the current account deficits, see IMF. Annual Report 1983, p. 33.

will be allocated either by political decisions of the borrowing and lending countries, arbitrarily or consensually, or by the private international financial markets based on the existing distribution of outstanding financing.

Numerous proposals have been put forward which would have both recognized the losses and allocated them, often to U.S. taxpayers. Most of these proposals called for discounting LDC debt and for a protracted payback. 38/ None of these proposals attracted much political support in the U.S. More modest proposals call for the banks to cap interest, lower "spreads", extend longer or variable maturities, lengthen grace periods, lower fees, and provide greater equity financing. In this case costs of the LDC loans would remain with the banks.

If the debt problem is chronic, the Congress and other major legislative bodies may face decisions regarding the costs of the LDC debt crisis, their allocation, and, perhaps, their socialization.

38/ The two most well-known of the proposals are put foward by Kenen, Peter B. Outline For a Proposal for an Interntional Debt Corporation. Princeton University, May 3, 1983 and Rohatyn, Felix G. A Plan for Stretching Out Global Debt. Business Week, February 28, 1983. p. 15-18.

IV. TRADE, COUNTERTRADE, AND PROTECTIONISM

Exports provide the hard currency earnings which allow developing countries to pay their debt service. They also represent a significant portion of GDP. After a drop in export earnings in 1982, there was a slight increase in export earnings during 1983 (see table 4), attributable to economic recovery. At the same time, a marked decline in imports resulted in an improvement in the trade deficit. Further cuts of LDC imports, however, may be difficult to achieve. In the first place, some LDCs require substantial food imports. Secondly, imports of components for manufactured goods intended for export are also an important part of the trade picture; they can not be cut without jeopardizing future

TABLE 4. International Trade of the Non-Oil Exporting LDCs
(billions of U.S. $)

	1980	1981	1982	1983
Exports				
Dollar Value	321.9	332.57	316.7	322.26
Annual Percentage Change	--	+3.3	-4.8	+1.8
Imports				
Dollar Value	407.97	435.97	390.19	369.41
Annual Percentage Change	--	+6.9	-10.5	-5.3
Trade Balance				
Dollar Value	-86.07	-103.4	-73.49	-47.15
Annual Percentage Change	--	+20.1	+28.9	-35.8

Source: IMF, International Financial Statistics, August 1984.

export earnings. A related point is that the non-oil producing developing countries have faced adverse and worsening terms of trade every year since 1980. Import prices have risen faster than export prices. It simply takes more export sales to purchase the same amount of imports.

The U.S. has played an important role in the LDC trade. Imports from the U.S. amounted to $63.3 billion or 15.9 percent of total non-OPEC LDC imports. The non-OPEC LDC trade deficit with the U.S. was $3.0 billion. If OPEC nations are included, LDC exports to the U.S. would rise by $26.4 billion and imports by $23.2 billion. Calculations from IMF figures also indicate that the U.S. has a proportionately larger share of LDC trade than other industrial countries. 39/

LDC trade is also heavily dependent on the U.S. market. In 1982, $60.3 billion or 19.5 percent of all non-OPEC LDC exports went to the U.S. As shown in table 5, the trade of several major borrowers as is even more dependent than the average LDC on the U.S. market.

TABLE 5. Exports to the U.S. as a Percentage of Total Exports, Selected Countries, 1982

Country	Percent
Mexico	55.0 %
Venezuela	24.1
Peru	32.4
Chile	20.9
Argentina	9.4 (1981)
Philippines	31.8
South Korea	27.5

Source: IMF Directions of Trade Yearbook, 1983.

39/ Calculated from IMF, Directions of Trade, Yearbook, 1983.

LDC trade is frequently concentrated by product, causing market disruption in some industries, such as steel. The need to increase exports because of debt service problems has exacerbated the problem. The recent recovery has apparently not given much respite to some import-beleaguered sectors. Moreover, the GATT estimates that 30 to 40 percent of the non-oil producing LDCs' exports are under some kind of restraint in the markets of the creditor countries. 40/ Protectionism may save jobs in the short-run but it does so at the cost of preventing the LDCs from servicing their debt and increasing their imports from each other and the industrial nations.

While imports from the LDCs may displace U.S. jobs in some industries, exports to the LDCs also expand U.S. job opportunities. Between 1981 and 1983 U.S. exports to the 11 major debtor countries shown in table 5 dropped by $15.2 billion, representing a significant loss of jobs. 41/ Only South Korea consistently increased its imports from the U.S. This may, in part, reflect Korean attempts to deflect U.S. protectionism and deal with U.S. demands for a more open Korean market. In any case, the debt crisis has resulted in a drop in both U.S. exports and jobs in the export sector.

40/ General Agreement on Tariffs and Trade. International Trade 1982/1983. Geneva, 1983, p. 14.

41/ Reportedly, the Commerce Department estimates that 25,000 jobs are generated by each $1 billion of exports. Farnsworth, Clyde H. Third World Debt Means Fewer Jobs for People. New York Times, December 11, 1983, p. E3. This would imply an estimated job loss of 383,000.

TABLE 6. U.S. Exports to Selected Major LDC Borrowers
(billions of dollars)

Country	1979	1980	1981	1982	1983
Mexico	$9.8	$15.1	$17.8	$11.8	$9.1
Venezuela	3.9	4.6	5.4	5.2	2.8
Peru	0.7	1.1	1.5	1.1	0.9
Chile	0.9	1.4	1.5	0.9	0.7
Brazil	3.4	4.3	3.8	3.4	2.6
Argentina	1.9	2.6	2.2	1.3	1.0
Philippines	1.6	2.0	1.8	1.8	1.9
South Korea	4.2	4.7	5.1	5.5	5.9
Nigeria	0.6	1.1	1.5	1.3	0.9
Poland	0.8	0.7	0.7	0.3	0.3
Yugoslavia	0.8	0.8	0.6	0.5	0.6
TOTAL	28.6	38.4	41.9	33.1	26.7
CHANGE (percent)	--	+34.2%	+9.1%	-21.0%	-19.3%

Source: U.S. Department of Commerce, FT 990, various years.

As discussed above, the LDC debt crisis has intensified protectionist pressures in the import-competing industries and unemployment in the export sector. It has, thus, made the management of trade policy more difficult. Lastly, it has the potential to adversely distort resource allocation in the U.S., with an unfavorable impact on the U.S. international competitive position. This would be particularly likely if the debt crisis is prolonged.

Finally, one of the by-products of the LDC debt crisis is the growth in countertrade, or barter, trading in which export sales are paid for in kind. Traditionally, countertrading has most often occurred between Eastern Europe and the industrialized West. With the onset of the debt crisis, however, it has

increasingly involved Third World countries. As a result, countertrade has been growing, with estimates that it now accounts for 20-40 percent of world trade. 42/ Its chief advantage is in enabling an overborrowed country to trade when they might otherwise not be able to trade. This may be particularly important as increasing amounts of new credit go to the repayment of interest. However, countertrade has serious drawbacks. It is costly. Since countertrade often involves goods which are inferior or obsolete, companies involved in such deals usually raise their "prices" to reflect the possibility that goods received in such transactions may not be resaleable. It is also inconvenient for a corporation asked to resell countertraded goods outside their own sector. Lastly, and most seriously of all, it represents a breakdown in the multilateral international trading system into bilateral arrangements which is extremely destructive to the allocative efficiency of the trading system. It is not a substitute for a more open market.

42/ International Trade Reporter. U.S. Export Weekly, v. 19, no. 23, September 13, 1983. p. 868.

V. LESSONS

There are varied lessons to be learned from examining the debt crisis. Some of these lessons are briefly summarized below:

1. Exogenous (external) factors are a major determinant of external debt problems. The price of oil was an important external variable helping to precipitate the international debt problems in the early stages. Later, U.S. domestic economic policies became very important since they resulted in high real interest rates and world-wide recession.

2. Domestic economic factors are also very important. Countries pursuing export-led growth strategies, tend to have less serious problems with external debt than those pursuing import substitution policies.

3. Poor debt management is a major cause of the crisis. Beyond good macroeconomic policies, effective external debt management involves knowing the debt, deciding how much to borrow, and selecting the appropriate available financing. 43/ In most countries experiencing debt-servicing difficulties these conditions for effective debt management are not met. In particular, country after country did not keep sufficient records to determine the extent of their borrowing. The IMF and the investment banks are trying to improve debt management.

4. The debt problem has been met with more than an ad hoc or "muddling-through" response. Elements of the international system have changed. Inter-

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43/ Hope, Nicholas and Thomas Klein. Issues in External Debt Management Finance and Development. September 1983, p. 24.

national banks are locked into "forced lending," but are in better financial condition than a few years ago. The syndicated loan market has all but dried up, but the floating rate note market has expanded. In perhaps one of the most significant changes, the IMF has taken a role of leadership in the rescheduling process. The rescheduling process itself appears to have been institutionalized, with a protocol concerning the order of negotiations having emerged. The U.S. and, reluctantly, the BIS have played a very important role in providing emergency loans.

5. Trade offs must be made between the amount of financing and the amount of economic adjustment. To a large extent this is determined by a country's political capacity to carry forth an austerity program. The stability and success of an IMF program is, thus, the hostage of political constraints. A miscalculation could be dangerous.

6. The timing of an IMF adjustment program may perhaps be important to the success of the program. The Mexicans who used "shock treatment" have had better success than the Brazilians whose approach to the Fund was somewhat slower. The two cases are not entirely comparable, however, and there may be no single "right" timing.

7. There is a chasm between the positions of the money center banks and the regional banks. So far, the banks have largely remained united but this unity may fragment if conditions worsen. Fragmentation would complicate negotiations.

8. Protectionism by the Paris Club creditors deprives LDCs of the ability to pay their debts and to purchase goods imported from the developed world. The developed countries, therefore, pay a substantial price for protectionism as well as the LDCs.

V. CONCLUSION

During 1983 and early 1984 prospects for handling the LDC debt problem improved. The key factor, economic recovery in the developed countries, was sufficiently strong to aid the LDCs. This meant that LDC exports to the industrial nations expanded, helping to bring about improvement in their current account. Commodity prices also improved during 1983. Meanwhile, oil prices, in particular, did not rise dramatically. Diminished revenues hurt the oil-exporting LDCs, but the low oil prices helped the oil-importing LDCs. Inflation was at the lowest level in fifteen years.

Other factors contributed greatly to the improved state of the LDC debt problem in 1983. The international financial system adapted creatively as the crisis unfolded after late 1982. The IMF has played a leadership role, and in the view of many, for better or worse, an IMF program is the sine qua non of a debt rescue. The rescheduling process itself has become institutionalized. Short-term debt and debt service ratios for the borrowers declined. Conditions in the financial markets also seemed to improve making banks better able to withstand the pressures of the LDC debt crisis. Capital reserves and profits were generally up. Some write-offs were made. Balance sheets appear to have been healthier, allowing some growth in "spontaneous" new credit during the last quarter to areas outside Latin America. The floating rate note market expanded providing a source of funds for both borrowers and for the major international banks. A small discount market for LDC debt emerged during 1983.

Improvements in bank regulation should provide the climate for greater international financial stability.

Nevertheless, some of the achievements of 1983 appear to hide future difficulties. Despite an expansion of exports, improvements in the current account balance were also bought at the expense of severe import compression rather than just export expansion. Future export growth and recovery are, therefore, likely to be hampered. In 1983 debt service exceeded net inflows by $11 billion; the developing countries, incongruously, have become net exporters of capital. 44/ Latin America, which has the severest debt problems, has received little new lending. Perhaps most seriously of all, the world debt problem is just being rolled over into the future. As Harold B. Malgram, former U.S. Trade Representative, stated it, "[m]ost of the debt problems have simply been postponed in the hopes that world economic growth, improved trade performance and lower interest rates will make the future a better time to address fundamentals." 45/ The World Bank estimates that 65 percent of all LDC debt will fall due in 1987. 46/ Finally, the debt rescue packages result in both increased total debt and increased debt service.

Successful management of the debt crisis depends to a large extent on the macroeconomic policies of the industrialized countries, especially the United States. Sustained noninflationary growth with lower real interest rates,

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44/ World Bank. World Debt Tables, 1983-1984, p. x.

45/ Farnsworth, Clyde H. IMF Girds to Meet Bids for Aid. New York Times, January 2, 1984, p. 39, 41.

46/ Bureau of National Affairs. Daily Executive Report. February 7, 1984. p. L10.

moderately rising commodity prices, stable oil prices, and a realistically priced dollar would provide a congenial environmnent for easing the crisis. Recent increases in the U.S. prime rate belie such a scenario and have generated increased concern about the ability of the LDCs to handle their debt.

Finally, concern has been expressed by some writers that the debt crisis has moved into a new phase. As Scott Pardee formulated the problem,

> [t]he flash point has shifted from purely financial considerations, which influence the ability to pay, to political considerations, which might affect the willingness to pay. The fear in the markets now is that one or more countries will be forced by events to flatly repudiate their debts. Such an action is likely to be in a political context in which hard work and skillful negotiation by experts in international finance just won't matter. 47/

Since the 1982 onset of the crisis no country has repudiated its debt and pressures against doing so are strong. Nevertheless, we may be moving into a new and more difficult phase of the LDC debt crisis.

47/ Pardee, Prospects for LDC Debt and the Dollar, p. 3.

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