

## INTERNATIONAL FINANCING AND THE THIRD WORLD

Gilles Couture

According to statistics published by the Organization for Economic Cooperation and Development (OECD), in the two periods, 1970 to 1977 and 1977 to 1984, the foreign debt of Third World countries as a group rose from US\$ 72 billion to US\$ 244 billion portfolios in the first period, and to US\$ 810 billion by the end of the second.

Between now and the end of the 1980s, the figures for the foreign debt owed by some of the Third World countries will reach record heights. Banks do not usually reveal the contents of their investment portfolios. Yet a 1983 study, by the Institute of International Economics in Washington, reveals the extent of involvement in commercial and industrial loans of the 13 largest American banks (out of about 14,500 in the U.S.A.) in five countries in Latin America (Argentina, Mexico, Brazil, Venezuela, and Chile.).

Expressed as a percentage of their capital, overall, the CITICORP bank has granted loans to Brazil that amount to 73.5 percent of the value of its shares, a figure that rises to 174 percent for the five countries listed above. Figures for other major American commercial banks show: Bank of America, 158 percent; Chase Manhattan, 154 percent; Morgan Guaranty, 140 percent; Manufacturers Hanover, 262 percent; Chemical, 170 percent; Continental Illinois, 107 percent; Bankers Trust 141 percent; First National Chicago, 134 percent; Security Pacific, 83 percent; Wells Fargo, 126 percent; Crocker National, 196 percent; and First Interstate, 136 percent.

Another important phenomenon is that from 1982 to 1984, nonperforming loans by US commercial banks have increased by more than 20 percent a year.

*Gilles Couture, the author of several works in his speciality, is a consultant in management and informatics in Quebec, Canada.*

## INTERNATIONAL DEBT ISSUES

*International indebtedness has continued to be one of the most pressing problems on the world economic horizon in recent years; and since it began to reach crisis proportions for big borrower nations around 1983, no significant changes have occurred in the global economic situation to help the most indebted of these Third World countries. Throughout the 1970's the oil importing developing countries made strenuous efforts to adjust their deteriorating external environment brought about by recurring global recessions and a continuous deterioration in their terms of trade which resulted in increasing payment deficits for these countries in the 1980s. Short and medium term capital flows came to be the principal means of financing these deficits; the most recent debt-servicing difficulties of these indebted countries being caused by a shortening of the maturity structure of their foreign debt.*

*The level of Official Development Assistance (ODA) was deteriorating and ODA was generally not available for meeting balance of payments problems. It was left to the commercial banks to finance a large extent of the developing countries deficits under their own credit responsibility and these banks saw in this situation an opportunity for profit. It was they who rushed to intermeddle between the savings or bank deposits of the newly surplus OPEC oil exporting countries and the demand for loans by the deficit countries. The big debtor countries made full use of these offers of loans, mainly from the New York banks which were acting as the main money-centre institutions of the world banking system, and the world's banking community entered into what has been described as "an orgy of credit". The year 1982 began with international debt in a very fragile state. The situation worsened in 1983 and by 1984 had reached the crisis stage.*

*The debt problem has caused serious concern among both creditors and debtors. The creditor banks have followed a policy of cautious prodding to recover their funds, while the debtor countries have in most cases attempted re-scheduling of loan payments and in a few cases attempts at holding up payment. But such countries find that without further international financing and liquidity the immediate problems of their economies can be further intensified, as illustrated in the reports of Chile and Argentina in this issue.*

*Of much interest was the stand of the Latin American debtor Peru at the end of July this year, restricting its foreign debt payment to 10 percent of export earnings. Also of interest was the forum of over 1,000 leading personalities from debtor countries organised by the Cuban government, in Havana, in August where President Castro's views on cancelling the debts in the region were acclaimed by some sections. These events are discussed in the paper by Firdius Jhabrala. Other fundamental issues connected with the international debt problem are also discussed in this symposium on international debt, and finance in the following pages.*

percent a year. Nonperforming means capital loans and interest that have not been paid by debtors within 90 days after their due date.

### NEW LOANS

The negotiations between Argentina and its creditors in the spring of 1984 over the country's arrears of interest mark a new stage in the rescheduling of the debts of Third World countries. The US commercial banks in effect agreed to grant a new loan so that a part of the interest due could be paid. This enabled them to avoid having their balance sheets for

the third and fourth quarters of 1984 showing a sharp drop and being obliged to declare that part of their loans were nonperforming. At the same time, four heavily indebted Latin American countries, Mexico, Brazil, Venezuela and Colombia, loaned Argentina another part of the sum due for interest. They are not taking any very serious risk because the U.S.A. undertook to pay them the amount after an agreement had been reached between Argentina and the IMF.

Additionally, on the credit side of the ledger of US commercial

banks, medium-term loans are in the process of becoming long-term loans. So as to delay the due dates on debts owed to them. US commercial banks have issued long-term obligations on behalf of their offshore branches, which are involved in international finance. The consequence is that, in international operations, interbank financing is increasingly regarded as dangerous, since the US commercial banks at the moment show a severe imbalance in their statements that they must correct as quickly as possible.

Moreover, this quest for medium term funds or deposits on the part of the US commercial banks adds to the current pressures on medium-term interest rates on the Eurodollar and Euro-Yen markets. As things are currently going, it is a mistake to believe that in the more or less long run, inflation will diminish the significance of the debts of Third World countries in the makeup of the balance sheets of the US commercial banks.

In such a situation, it is no surprise that the shares of the major US commercial banks did not keep pace with the stock exchange recoveries in New York in August 1982 and 1984. The profitability of US commercial banks is now very generally in doubt. The overwhelming danger of Third World loans is not the only reason for this, since US commercial banks also are faced with bad debts in the petroleum and agricultural sectors.

#### IF MEXICO COLLAPSES

The menace to the international banking system and especially to the US commercial banks, materialized in a dangerous form in August 1982 when Mexico found itself unable to meet its financial obligations. To declare that Mexico has suspended payment would have been tantamount to declaring Chase Manhattan

Bank, City Bank, and several others virtually bankrupt. There is more. For some months past, since the near failure of Continental Illinois, the US Federal Reserve Bank has been acting as a sort of guarantor of loans, thus endowing shakily loans with a cloak of respectability and encouraging banks to grant credit.

Very few of those who attended the 39th General Assembly of the International Monetary Fund (IMF) and the World Bank in September 1984, were not anxious about the course of the balances of the major US commercial banks because their credit balances are suffering severely from US monetary policy.

In the view of the financial experts present at that meeting, the decade of the 1970s was marked by a break in the continuity of international funding for development. International petrodollar credits and the quest of the multinationals in crisis for foreign outlets have led to a considerable increase in bank loans to the Third World and the privatization of the debts of Third World countries.

Since the beginning of the 1980s there has been a falling off in the flow of private money to the Third World, and in 1982 petrodollars almost vanished as interest rates rose, and foreign trade stagnated. With these factors and the rising insolvency of Third World countries, coupled with the swing against them of the terms of trade (a drop in the purchasing power of most mineral, agricultural and forest products) have all acted to slow down private transfers to Third World countries.

Thus from 1970 to 1983, it has been above all the new industrial, petroleum producing countries, essentially the intermediate countries in terms of income, that have received the essential credits from the international banks and, since 1974, have had the stimulus of commercial credits

to cover the gap between deliveries and receipt of payment.

In the poorest countries, quite the reverse, more than 80 percent of loans come from public aid for development and export credits funded or guaranteed through the public sector. Direct and indirect assistance from multilateral aid programs of the members of the Committee for Development Aid (CDA) and the Organization of Economic Cooperation and Development (OECD) to some 36 of the poorest countries has doubled from 1975 to 1981, rising from US\$ 2.8 to 5.5 billion on from 0.07 to 0.08 percent of the GNP of the member countries of the CDA. This is very little compared to the loans granted by the international banks to developing countries, a figure put by the financial experts at more than US\$ 900 billion.

#### A NEW SCENARIO

Moreover, in 1982, so as to offset the drop in international bank loans to Third World countries, the World Bank recorded its priorities and gave up its aim of combating poverty, in that it cut the funds given to its offshoot, the International Development Association (IDA), which specializes in interest free loans to the poorest countries, and began to play the game more profitably for the private banks by participating in syndicate loans, co-financing and the issuing of obligations. The role of the IMF has also changed. In February 1983, so as to restore the credibility of Third World countries with lenders of international funds, the IMF refused to increase the Special Drawing Rights (SDR) of developing countries in financial difficulties, insisting instead upon readjustment plans before granting them further credit.

All bankers agree that the American and Japanese economies are centrally involved in the financial and monetary tensions just described.

**NONPETROLEUM-PRODUCING DEVELOPING COUNTRIES:  
SHORT AND LONG TERM DEBT AND DEBT SERVICE; 74-81**  
(figures in \$US billions: % ratios)

	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
<b>TOTAL DEBT</b>	160.1	190.8	228.0	278.5	336.3	396.9	474.0	555.0	612.4	725.7
Short term debt	22.7	27.3	33.2	42.5	49.7	58.8	85.5	102.2	112.7	130.5
Long term debt	138.1	163.5	194.9	235.9	286.6	338.1	388.5	452.8	499.6	595.2
Ratio of foreign debt to exports of goods and services	104.6	122.4	125.5	126.4	130.2	119.2	112.9	124.9	143.3	155.1
Ratio of foreign debt to GNP	21.8	23.8	25.7	27.4	28.5	27.5	27.6	31.0	34.7	42.1
Payments for debt service	22.1	25.1	27.8	34.7	50.3	65.0	76.2	94.7	107.1	125.2
Ratio of debt service	14.1	16.1	15.3	15.4	19.0	19.0	17.6	20.4	23.9	26.8

One possible resolution involves a progressive equalization of conditions and levels of activity in these two leading, in the long term, to the domination of the world economy by Japan and the U.S.A. However, it is difficult to rule out a less-controlled outcome, involving the collapse of the world economy and a savage fall in the US dollar.

The principle that lies behind such a scenario is a rebalancing of the growth of the U.S.A. and of Japan, which will show up from 1985 on: of steadily declining growth in the U.S.A. as compared to Japan, and a medium rate of growth in Europe.

Despite relatively high rates of growth in the developed countries, such a course of events will do nothing to resolve the problem of the Third World countries. In this scenario it is expected that the US commercial banks between now and 1990, will try to bring the solvency ratios of indebted countries down to their 1979 level.

Following the same scenario, managing international credit in this way would result in an average growth figure for Third World countries ranging from 4 percent in 1985 to 1 percent in 1987. However rates will differ sharply between different regions. From now to the end of the decade black Africa will show negative, or at best, zero growth. The same will be true of the Latin American countries except for Mexico. Mexico, close to the U.S.A. and other countries, which are themselves close to Japan, may be

able to maintain their rates of growth constantly above 2 percent.

A strategy like this has nothing to do with a New Deal for the planet, nor with a Marshall Plan for the Third World. The combination of a Japan-U.S.A. rate of growth averaging 3.5 percent for the next few years, and lower rate of interest will maintain the status quo in the relationship between creditors and debtors. The international debts of the Third World countries will continue to be managed by piecemeal re-scheduling. IMF pressure on countries in financial difficulty will not soften. This will not remove the financial threat to the US banks, but it will restrict it to separate countries and manage them by rationing the quantity of credit.

#### A DESIRABLE AGREEMENT

The conference of Latin American countries at Caratagena in June 1984, and the meeting of the IMF and the World Bank in September 1984 did not reopen the subject of case-by-case negotiation of foreign debt. They did, however, for the first time, point out the need for a framework to serve as the basis of individual negotiations. Two basic principles were laid down: the responsibility for finding a lasting solution was shared by all parties; and, the strain of recovery should be equally shared. A good many of those present treated the problem of the foreign debt of the Third World countries as a political problem.

If, however, there is a major crisis in 1985 or 1986 in one or more of the US commercial banks involving one or more Third World countries and the payment of past due loans or interest, it is likely that the US government will intervene with the IMF, so that the country concerned gets a loan conditional upon its adopting a recovery program and that, in the last analysis, the US government will back the IMF or allow it to make loans to refinance its loans. In this light the significance of the vote by the Congress of the U.S.A. to share in an increase of the US quota for the IMF can be seen. The US government, like the US commercial banks, has no wish to allow a situation to develop in the Third World countries that could lead to suspension of payments.

Thus, the needs for refinancing of the most indebted countries are regularly met. There is, in fact, no limit to the functioning of this mechanism, since there is no institutional brake upon the international monetary system.

The truth is that the debts of the Third World countries have become an important element in the complex and huge pyramid of international credit, which like the multinationals, is developing in a world climate that makes it quite likely that it will escape from national control, and, even more, from regional or international control.