NORTH SOUTH ROUNDTABLE

Santiago Roundtable on World Monetary,
Financial and Human Resource Development Issues

February 27 - 29, 1984

THE INTERNATIONAL DEBT CRISIS: PRACTICAL NEXT STEPS

George J. Vojta

A paper prepared for the North South Roundtable on Money & Finance
Santiago, Chile, February 27-29, 1984

THE INTERNATIONAL DEBT CRISIS: PRACTICAL NEXT STEPS

George J. Vojta

In the six months following the September 1983 meeting of the Commission, a measure was made in managing the international debt crisis.

1. Energy prices remained stable.

2. The economic recovery continued on a non-inflationary course in the developed economies. Although economic activity in the developing economies remained relatively unaffected, the growth trends were in the right direction. As an offset some commodity prices weakened during this period.

3. The most difficult debt restructuring case - Brazil - was accomplished, and a policy program was agreed to by Brazil with the Fund. Except for Venezuela, Nigeria and the Philippines, the major debtors have established stabilization programs with the IMF. Venezuela remains a difficult case, but the perception of the lending community is that Venezuela has the capacity to service its external debt and that the Philippines will come to terms with the Fund. Nigeria's situation remains ambiguous in view of the recent change in government. The new government in Argentina has assumed a constructive posture vis-a-vis the policy commitments made by the military government to the International Monetary Fund although currently there are arrearages in payments.

The principal causes of the debt crisis, high energy prices, the global recession, and the absence of appropriate stabilization programs in individual countries continued on a turnaround trend.

On the negative side, system-wide financial flows remain perverse. The continuing U.S. fiscal deficits, the over-valued dollar, high interest rates and political instability in certain third world countries resulted in a continued strong net capital inflow trend into the United States and other developed economies. According to recent data, net foreign investment in the U.S. for the year ending September 30, 1983 amounted to $49 billion; total foreign holdings in the U.S. amounted to $711.4 billion compared with $834.2 billion of total U.S. holdings abroad. If this trend continues, the U.S. stands to become a net international debtor; which would mean that the total recorded U.S. net foreign investment position built gradually over the post-war period would have been reversed in a three year period - 1983, 1984, 1985. Although the value of the U.S. dollar has declined by roughly 3% in recent months, the basic trend has yet to be reversed.

During this period, calls for fundamental reform in the international financial system abated and the international community de facto committed itself to working within the system to resolve the debt crisis. Undoubtedly this is not by choice, but arises from the absence of a visible alternative.

On specific issues both positive and negative developments can be recorded.

1. The shrinkage of the number of banking institutions willing to continue international lending probably has bottomed out - and thus far the ability to put loan syndicates together has not been significantly impaired, although the recent Mexican new loan facility was difficult to place. On the other hand no progress has been made in introducing any new class of lending institution into the international credit picture. The best that can be said then is that the reduced lending base is holding and at this point keeping up with the demand. Third world borrowers are now in the pipeline for "new money" facilities for 1984 and are negotiating and closing these transactions on better rates and terms, an encouraging sign.

2. In terms of potential secondary market activities involving international loans, it would be accurate to say that many banks are working on this issue diligently. Initiatives range from changing loan documentation to permit placement of loans in the secondary market; active portfolio swap or sale transactions offered in the marketplace, and a great deal of serious study of the question in both the commercial bank and the investment banking fraternities. It is fair to say that a major effort is underway.

3. The Institute of International Finance is functioning with the support of the international financial community and borrowing countries. It is still too early to assess performance, but encouragement can be taken that this potentially vital institution has been launched.

4. There have been no new initiatives taken by multi-lateral or official institutions at the national level with respect to lending or guarantor functions, secondary market activity or uses of market funds to augment resources.

5. One of the most important steps forward during this period was the U.S. congressional approval of higher United States quotas for the Fund and at least approval of the IDA quota, but to be sure at the less than desired level. Importantly, the trade-off on reserve requirements levied on American banks against their international loan portfolio was non-punitive - requiring stipulated write-offs of from 10%-75% against loans outstanding to five particular countries (Zaire, Poland, Sudan, Bolivia, Nicaragua), most of which the banks had taken already. A similar pattern emerged in other major countries.

The regulatory community appears committed to policies which would require the banks to build up "restructuring" or "concentration" reserves over a period of time and doubtless there will be active discussion of this issue during 1984. On the whole this matter is being considered in more balanced fashion.

The important point is that the IMF quotas were voted and the banks permitted to continue lending without incurring punitive regulatory sanctions.

6. Although a formal review of more flexible conditionality standards has yet to occur, there are signs that in bilateral negotiations concerning future performance targets with member countries which are in compliance with stabilization program targets, the Fund is showing flexibility and a willingness to expand targets to permit more latitude for anti-recessionary domestic policies. Additionally, this conference will debate some formal proposals on conditionality and hopefully stimulate a more comprehensive review of the subject.

7. No particular progress has been made on creation of a new institution to promote international debt restructurings or on the universality of membership issue with regard to the Fund/Bank.

A summing up of the last six months on the issues on which practical progress was deemed to be possible, shows that positive movement was achieved on four issues and reversals avoided or a neutral position recorded on the other four. This occurred in the general context of continuing macro-recovery from the recession, stability in energy prices, improving individual country performance, offset by the perversity of the international capital account flows, the persistence of high interest rates and an over-valued dollar.

The focus of attention in the next several months must address three important priorities.

1. At the macro-level, the correction of the perverse capital flow situation stemming from the over-valued dollar and high interest rates which threaten to abort the global recovery. Regrettably the prognosis is not good since the root cause of the problems are the uncorrected U.S. fiscal deficits. In an election year the prospects for significant spending reductions are not great; the greater danger is the erosion of confidence in the U.S. dollar which would arise from market perceptions that U.S. deficits will reach unsustainable levels and lead to a renewal of inflation. A bipartisan political commitment to a deficit reduction program over time would be helpful to maintain market psychology on even terms.

2. The remaining debt restructuring cases and acceptable levels of new money to meet 1984/85 requirements must be negotiated to prevent the emergence of arrearages which would require punitive reserves being taken by the banking system. This will involve persistent effort by the international financial community consistent with the effort expended during the crisis period.

3. The IMF needs to continue its flexible attitude toward compliance targets in support of expansionary policies which do not create excessively inflationary conditions in borrowing countries; an enlightened "conditionality debate" should be conducted.

4. A secondary market function for international loans must continue to be built and hopefully can be brought into being.

* * * * * *