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EDITORIAL

Hochverrat, sagt ein Bonmot der Staatstreichsprofession, sei eine Frage des Datums. Mutatis Mutandis gilt dies auch für die Ursachen der Schuldenkrise in der Dritten Welt. Was gestern für die "Schwellenländer" Lateinamerikas noch als erfolgreiche, weil angeblich dem westlichen Vorbild folgende, Entwicklungspolitik galt, ist heute der Inbegriff wirtschaftspolitischer Verantwortungslosigkeit, wird aber für morgen bereits wieder zum non plus ultra ökonomischer Weisheit erklärt. Die Rede ist von der exportorientierten Wachstumsstrategie und ihrer Finanzierung um jeden Preis. In der zweiten Hälfte der 70er Jahre durfte das empfohlene Entwicklungskonzept als Milchmädchenrechnung gelten: Geld war billig zu haben und der Export florierte, der Schuldendienst ließ sich bequem aus den Ausfuhrerlösen finanzieren. Als die Tide kippte blieben die Schuldnerländer als die Schuldigen auf der Strecke. Anders und doch verwandt die Geschichte der armen Entwicklungsländer. Ihre Entwicklung finanziert sich aus zwei Quellen: aus den Rohstoffexporten und aus der Entwicklungshilfe.

Als die Krise in den Industriestaaten die Nachfrage und damit den Preis für Rohstoffe verdarb und zugleich die Entwicklungshilfe zu stagnieren begann, blieb als Alternative entweder gleich in Entwicklungsruinen zu hausen oder die Lücke mit Kapitalmarktmitteln zu füllen. Letzteres veränderte die Struktur der Außenverschuldung beträchtlich, die des Schuldendienstes aber enorm. Denn es macht einen Unterschied, ob man für Entwicklungskredite der Geberländer Zinsen zu leisten hat oder den dreifachen Zins für Kapitalmarktkredite.

Ein Bild der afrikanischen Arme-Leute-Verschuldung zeichnet der Aufsatz von Herbert Pönisch. Unstreitig haben Mißwirtschaft und Korruption ihren Teil am Fiasko: Mancher geliehene Dollar berührte gar nicht den Boden des Empfängerlandes sondern wurde von den defraudierenden Eliten und Herrschaftsklassen gleich auf ausländische Privatkonten transferiert. Aber die Vorstellung einer geteilten Schuld paßte nicht ins Konzept des internationalen Privatbankensystems, der westlichen Regierungen und des Weltwährungsfonds: Wenn die Entwicklungsländer die Zeche allein zahlen sollten - und das sollten sie - mußten sie auch die alleinigen Schuldigen sein. Daß dabei nicht die Verantwortlichen in der Dritten Welt, sondern die arme Bevölkerungsmehrheit die volle Wucht der Sanierungspläne und Austerityprogramme zu spüren bekam, störte dabei weniger. Schließlich war das schon immer so.

Die Mechanismen des internationalen Finanzkarussels beschreibt der Artikel von Claudia Dziobek. Immerhin brachten die Umschuldungsvereinbarungen mit den wichtigsten Schuldnerländern Beruhigung für das Privatbankensystem. Dementsprechend verkündeten westliche Zentralbanker und Finanzminister, einem modernen Neville Chamberlain gleich, auch ihr "financial peace in our time". Inzwischen beschleicht aber auch professionelle Optimisten eine Ahnung, daß damit die Schuldenbombe noch nicht entschärft sein könnte. Andre Gunder Frank hat schon Mitte vorigen Jahres auf den diesbezüglich verdächtigen Trend der Rezessionszyklen aufmerksam gemacht. Auf die Rezession der Jahre 1973 - 1975 hat die eskalierende Verschuldung der Dritten Welt - durch die kreditstimulierte Importexpansion der Entwicklungsländer - noch dämpfend gewirkt, hat aber die Rezession 1979 - 1982 - durch den Einbruch bei den Entwicklungsländerexporterlösen und der konsequenten Liquiditätskrise angesichts anziehender Zinssätze - bereits verstärkt. Die nächste, durchaus absehbare, Rezession wird das Schuldenproblem zur Insolvenzkrise eskalieren und, angesichts einer Massierung von Fälligkeiten Mitte der Achtzigerjahre, die Zeitbombe zünden. Daß dann aber auch die Industriestaaten mitgerissen werden können, ergibt sich aus dem dichten Geflecht weltwirtschaftlicher Interaktionen, die gemeinhin als Interdependenz bezeichnet werden, und die Jean-Philippe Platteau in seiner Studie beschreibt.

Klaus Derkowitsch

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Claudia Dziobek

The MANAGEMENT OF THE THIRD WORLD DEBT CRISES: FORMATION OF A LENDERS' CARTEL*)

It is by now a well known fact that commercial bank lending to Third World countries runs less smoothly than perhaps expected by private financial institutions. 1982-1984 were three tense years in the banking industry as the international financial community watched major debtor countries enter foreign exchange crises and the number of bank failures rose to levels not seen since the Great Depression of the 1930s. Pessimists forcast the collapse of large private banks and anticipated a repetition of the big Crash. They turned out to be wrong. Not only is the financial order by and large still intact, but, most banks involved in Third World lending do not even appear to have suffered significant losses and their overall profit performance is remarkably stable.

An explanation for this unexpected development is offered here focussing on large U.S. commercial banks and their lending to Argentina, Brazil and Mexico. We will argue that an analysis of private bank lending to the Third World shows that from early on banks were careful to prepare for the event of extended debt crises.(1) Their risk calculations were and continue to be based on two pillars: On the one hand a close net of cooperation among all banks participating in international business was established, ensuring joint and coordinated action in the event of a debt-service crisis. On the other hand they counted on - and institutionalized - the support of international financial institutions.

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* This paper is a revised version of a lecture presented at the Conference on "Structural Adjustment in the World Economy and East-West-South Economic Cooperation," Dubrovnik, February 17-March 2 1985.

This does not presuppose the existence of secret arrangements or conspiracy, because it is sufficient to know that international financial institutions will always act so as to preserve the stability of international financial markets, a goal overriding considerations regarding prospects of economic development or growth in the Third World. Because financial market stability presupposes the stability of its component parts, that is the individual banks, it was clear from the outset that any solution to the debt crisis would protect the banks' interests. We therefore conclude that it was and is the existence of a lenders' cartel that saved the day for the banks.

This general result can be specified further by a discussion of the mechanics of debt crisis management i.e. the rescheduling process in Argentina, Brazil and Mexico. The actual risks assumed by the banks are relatively low and do not justify the prices charged to Third World borrowers. In contrast to domestic lending which serves as a basis for comparison, the risk of default is virtually absent. Hence the increase in spreads over the London Inter Bank Rate (LIBOR) that goes hand in hand with reschedulings might be considered a surplus profit reaped by the banks. Moreover the banks are given access to the free-of-charge services of the international financial institutions. Without IMF-negotiations and stand-by agreements with the debtor countries and the bridge-loans provided by the central banks and the Bank for International Settlements (BIS) significant costs and losses would have to be shouldered by private banks themselves. Although not explicitly discussed in this paper the implication for policy makers and regulatory authorities would include substantial revisions of risk calculations and a more equitable distribution of the actual costs involved in rescheduling arrangements.

The argument will be developed as follows. First, some information is given on major banks' performance during the last few years and the mechanisms they developed to enforce discipline within their own ranks. Second, the debt crises of Mexico, Brazil and Argentina (in chronological order) are discussed to show how rescheduling agreements are reached. The role played by the international financial institutions will be considered in this context.

1. The condition of large U.S. commercial banks

To get an idea of the weight of LDC (Less Developed Countries) loans in the banks' portfolios the largest 12 U.S. commercial banks have an average of 20% of total loans outstanding to LDC borrowers with a high concentration of major debtors in Latin America and Asia. Relative to the banks' capital, which is considered a safety margin, credits outstanding to the two or three largest debtors in many cases are well over 100%. Citicorp for instance had given credits to Brazil equal to 80% of its capital base (Citicorp: 1983) and had 200% of the value of equity capital outstanding to only four LDCs in 1983. In comparison, U.S. bank regulators normally consider a loan to any one borrower equal to 5% of the banks' capital base the upper limit. The banks' exposure to LDCs is large by any standart, and has been high for more than 10 years. In the United States this situation has prompted much debate and been a reason for concern among bank regulatory authorities and in many governments. Countless congressional investigations were undertaken and new institutions created to study possible ways of avoiding a repeat of historic financial panics. Public concern spurned numerous studies concerning this subject and the production of data bases to ensure that deficient information or ignorance of the scope of the problem would not stand in the way of quick action when it should become necessary.

Tabelle 1: Growth Rates in Earnings of 12 U.S. Banks, 1970-1983. Percent Change from Previous Year

	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
International Earnings	+42	+20	+56	+46	+19	+18	+3	+14	+6	+11	+4	+33	-5
Domestic Earnings	+5	+7	+11	-7	-6	-7	+19	+32	+32	-4	+6	-2	+55
Total Eanings	+6	+7	+23	+11	+5	+4	+10	+25	+18	+11	+3	+12	+24

Source: Annual Reports, Forms 10-K (Dziobek 1984)

Bankers in the United States were forced to disclose figures and

statistics on their Third World lending including the disclosure of credits outstanding to individual countries exceeding one percent of their total assets. While evidence was collected to prve that banks were acting unwisely and imprudently, more loans were granted to Third World borrowers throughout the 1970s, particularly to those large borrowers who enjoyed good standing in international credit markets.[2] Moreover, profits from international operations grew steadily. Table I shows that with teh expection of 1983, profits (earnings after security transactions and before taxes) from international business grew at a relatively high rate. Negative growth in 1983 of -5% may be considered a satisfactory result griven the previously high grow rates.

Even then the over-proportional rise in domestic profits compensated the small loss leading to a 24% increase in overall profits. A remarkable result, particularly if we recall that in the summer of 1982 Mexico went through severe financial and economic crises,

Tabelle 2: Terms on Credit to Selected Developing Countries Involved in Rescheduling, 1981-1984 Percentage points except as noted*

Year of Disbursal	Spread over LIBOR	Spread over U.S. prime rate	Maturity (years)	Front-end fees
1981 (base year)	1.04	1.02	8.01	.83
1982 (through July)	1.25	1.24	6.14	1.05
1983	2.17	1.98	7.50	1.28
1984 (through July)	1.75	1.47	9.25	.75

* The data cover rescheduling and new bank loans to Brazil, Chile, Mexico and Peru. Data are unweighted by size of borrowings by individual countries. The 1983-4 credits include new loans and rescheduling of debts that are part of financial "packages".
Source: Federal Reserve Bulletin (December 1984).

1983 saw a repeat of the drama in Brazil followed by Argentina towards the end of the year. While these events brought about considerable hardships for the people in the aforementioned countries, documented by massive strikes and protests, little harm was done to the banks' profits. Quite the contrary, rescheduling agreements which were reached turned out ot be very favorable for the banks' income. Table II shows that during the "crisis years" both spreads over LIBOR and front-end-fees, the price charged once, over and above the interest rate for the service of rescheduling existing debts (including some "fresh loans") rose significantly. The crisis raised the banks' income independently of the general upwards trend of interest rates in the market while at the same time a higher price (in percent, not in absolute terms) was charged for banking services.

In other words, even the management of the crisis itself could be turned into a profitable business. It must be noted that the turn of the events was not entirely due to the banks' negotiation skills and power position vis a vis the debtors. Nor did all participating banks profit equally. The international financial institutions, particulary the IMF and the U.S. Treasury worked actively to induce banks to grant new credits, when they were reluctant to do so. We will return to this point later on. It is also true that not all banks were benefitting equally. In fact many of the smaller banks would have preferred to withdraw from Third World business entirely, even if some of the loans would have had to be written off. Instead they were forced to underwrite their proportional share of additional credits granted to the debtors by the bank committees conducting the negotiations on their behalf, without, however receiving any part of the additional fees. To understand "group dynamics" of the banking industry, a few words must be said about the interbank organization at work behind the scene.

Inter-bank organization behind the scenes of Third World lending

Under normal circumstances, banks advance credits to customers, normally within the region of their operation, after an assessment of the project to be funded has been made. Loans are granted at a magnitude that the bank could conceivably write off as a loss without ruining itself. The contract then is made between two legal parties, the bank and a corporation or individual. In international business new forms of lending arrangements have become established.

Lending to LDCs almost exclusively took the form of syndicated credits. That is, banks did not grant credits on an individual basis. Instead, for each loan one bank acted as a "lead bank" in putting together a credit

which several, sometimes dozens of other banks subscribed to. The lead bank did not necessarily provide the largest share of the credit, nor did it assume all of the risk. It merely acted as an initiator and organizer on behalf of the borrower to raise the funds on the international financial market. Thus, from early on, LDC lending constituted a "joint venture" of commercial banks. This form of lending differs from the conventional individual bank loan in several ways. First, because for each syndicated credit the participating banks change so that all banks became closely interconnected within only a few years. Second, a matter of the perception of risk changes as more big banks add their names to the list of underwriters. Though impossible to prove it appears a reasonable assumption that an independent assessment of the projects to be funded with any given credit was at best made by the lead bank. Thus, while the banks joined forces in raising large-denomination loans for LDC borrowers similar coordination efforts were not made to assess the risks involved; formally each bank took full responsability of its share of the loan.

The event of a default was defined collectively through the introduction of cross-default clauses linking default of one share of a syndicated credit to another and linking the borrower's default on one bank to a general default. The clause makes it impossible for a country to default selectively on some banks and not on others. A default on one portion of the loan constitutes a default of the entire loan for all participant banks. Conversely, for the banks this clause makes "secret agreements" with its customers impossible. If one bank attempted to write down its loans to Argentina for instance in order to clean out its portfolio, this would require all other banks to do the same. Such a mechanism thus constitutes both a danger to other banks and an insurance for all parties involved, a danger, should one country decide for a unilateral debt repudiation, since then hundreds of banks would immediately have to write off their loans as losses. In this case the tightly knit web of loans would unravel instantaneously. Cross-default clauses forbid discriminatory behavior and prohibit LDCs from drawing up a list of banks to receive servicing priority. "Selective default" options are foreclosed. On the other hand a cross-default clause has its advantage in enforcing strict discipline within the ranks of the banks. The banks are thus forced to take collective action in the case of payment difficulties and jointly to negotiate new arrangements with the debtor.

close interrelations of the banks on the lending side was further promoted by the nature of the funding side. In the international business, the bulk of the source of funds used for LDC loans originated from the Euro-currency market.(3) A large international pool of funds, accessable to all international banks involved in the business of LDC loans, is the source of lending. Hence banks became closely connected on the funding side. Any major market disruptions translate immediately into a generalized change of the availability of funds, increasing the potential volatility of available funds.

A further distinctive feature of LDC lending is its enormous size and its relative weight in the international financial markets. The rapid build up of LDC debt would not have been possible had the banks employed traditional lending patterns. This came to be an important factor in the Euro-currency markets. Total private bank credits outstanding to LDCs in 1983 amounted to 20% of the gross figure of all international lending within the Bank for International Settlements reporting area. The shares of U.S. banks alone were 7%, or 12% if we substract interbank credits(BIS 1984: 116). This is not surprising, since when a number of large banks, in control of substantial market shares collectively venture into the LDC business, employing lending techniques that allow them to advance higher-denomination credits than usual they are likely to have a significant impact on the entire financial market. The close interrelation on the funding and on the lending sides, together with the establishment of cross-default clauses are sufficient to ensure that any debt crises necessitated joint action by all banks. The first cases of debt servicing difficulties, Zaire and Peru, in the wake of the international business crisis of 1975, marked the beginning of the formalization of bank joint action in renegotiating LDC debts. In each case one of the banks took the lead in putting together a bank steering committee to conduct the negotiations directly with the government involved (Stallings: 1974; Euromoney: 1975). It was the explicit goal of these initiatives to renegotiate the countries' external debt without writing off any part of outstanding loans. The goal was to be reached by inducing a change of government policy, more specifically to begin an austerity program that would be compatible with continued debt servicing (Friedmann: 1976). It became clear in the process that the banks had to involve themselves directly in the international affairs of their customers, a step that even bankers considered too similar to imperialistic behavior. It was against this background that bankers came to realize that a buffer had to be found to bear responsibility.

The banks had put their own house in order, Citibank in the case of Zaire and Wells Fargo bank in Peru assumed the lead and most other banks followed the agreed-upon conditions of rescheduling. The main point of disagreement among the banks was the direct political involvement which they considered inappropriate, and which shed an unfavorable light on bank activities. The IMF turned out to be the optimal choice available. An international institution that would mediate between the private financial institutions and the borrowers: one that would be given the power to make economic adjustment programs for the borrowers, a prerequisite not only for small support loans, but for continued access to international credit markets. Because of the limited funds available to the IMF itself, its power in the negotiation process would be effective only in conjunction with private bank cooperation. Hence the banks considered the loss of autonomy in renegotiating their LDC loans an acceptable compromise.

Moreover, as an international organization, the IMF has no juridical power over the lenders as does a central bank or a Finance ministry (Treasury). This is an important detail, because if for example, the Federal Reserve Bank, which is also a regulatory authority for banking decided in the process of debt renegotiations that loans outstanding to Bolivia must be considered of "substandard" quality, U.S. banks - and hence all banks would be forced to write these credits off as losses. Finally, the IMF could not refuse its cooperation, because as discussed earlier, the matter was important enough to present a potential threat to the stability of international financial markets, the protection of which constitutes the prime task of the institution.

In conclusion, the banks' favorable profit performance throughout the crises can be attributed to a firm interbank organization. Their goal, to manage the crisis jointly and to avoid losses at any cost, led them to enter an agreement with the IMF. It was thus possible to turn even the LDCs' debt crises into a profitable business. Our thesis that this behavior amounts to the formation of a lenders' cartel will be further substantiated in the following discussion of crisis management in Latin America.

Before discussing the rescheduling agreements, mention must be made of the exception to the rule, namely the near-failure of Continental Illinois Bank, one of the largest ten in the United States and among the top lenders to Third World countries. Even though its fate was not directly related to LDC lending, it is highly relevant to our discussion.

The "problem banks": Continental Illinois

When in mid-1982 Continential Illinois' problem loans surfaced, leading to a run on the bank's deposits, the U.S. banking industry was in the midst of a major crisis. The number of bank failures rose continuously and the failure rate of 1983 reached dimensions not seen since the last years of the Great Depression (Thureau: 1985). The industry's crisis is often discussed in the context of international financial crisis (Thureau: 1985). In this context, the emphasis is laid on a different aspect, namely on the way in which the failure of a large bank is dealt with domestically. Continental Illinois' demise as an independent private bank provides a case study of how losses a bank incurs (because of miscalculations in risk assessments with respect to credits) are distributed. It thereby provides an interesting insight into what the banks stand to lose with their Third World credit portfolio, and hence why they are as adamant as they are in their negotiations with LDC customers.

As in the case of most other banks that failed, the problems of Continental Illinois were due primarily to domestic credits. The near collapse can be related to the purchase of speculative credits from Penn Square Bank. In 1979 and 1980, the years of the energy shortage and soaring gasoline prices in the United States, Penn Square lent more than $2 billion to wild-Catters and companies servicing the oil-drilling industry in Oklahoma, firmly counting on rising oil prices. While interest rates rose in 1981-2 and energy conservation sent oil prices down, the borrowers were unable to keep up with their payments and defaulted on their financial obligations(4). Because Penn Square folded in July 1982, bank share-

holders of Continental Illinois began to withdraw their funds and sell their shares in anticipation of trouble related to the $1 billion in bad loans the bank had bought from Penn Square.

A clear difference between the public's perception of domestic and international credits must be noted. This is due to the fact that domestic insolvent borrowers, (individuals or corporations) can be held liable only up to a specified limit. The limit is defined in bankcruptcy legislation and when it is reached the bank has to begin writing off the loans in question, using its reserves to fill the gap. On the international level, when Third World borrowers enter debt-service difficulties, precedence has been established that no matter how bad the economic conditions, the Third World pays its debt. The countries pay under extreme conditions, thereby saving the banks to go through the trouble of adjusting their portfolios and hence when Mexico and later Brazil found themselves in a deep financial and economic crisis the shareholders did not withdraw their support(5).

To return to the fate of Continental, the Federal Deposit Insurance Corporation (FDIC) intervened to support the bank with funds and its institutional backing, while at the same time trying to work out a long term solution. For almost two years the FDIC attempted to arrange for either a merger with another bank or a take-over, but was unable to find any seriously interested parties. Because the bank proved unable to regain the confidence of its customers and the investors, a more radical solution had to be found. By the end of 1984 the FDIC de facto nationalized the bank, and in December, exercizing its veto power over Continental's board of directors and management, fired ten of the bank's directors who had served since before 1980. The action implied, in the FDIC's judgment, that the collapse of the bank was the result of bad and irresponsible management. The FDIC-appointed team headed by John E. Swearingen and William S. Ogden explained the consequences these "outcasts" had to suffer in their hometown. "Chicago is a small town. They are all members of the Chicago Club 9 a prestigeous business club). These are all the buddies you meet with four or five times a week". (Wall Street Journal, Europe: Dec. 3: 1984) Besides the management, losses were taken by the stockholders who were not able to sell their shares on time-by necessity the majority. While before the crisis 1000 shares of Continental were valued at $25,000 the value fell to $4,500 by 1984. The take-over agreed upon in the stockholder meeting meant that the value could be further reduced to virtually zero, should the new management be unable to raise the necessary funds. Furthermore, the crisis led to a massive reduction of the bank's scale of operations, which meant that many employees were laid off and others went to look for employment opportunities elsewhere. Also state and city incomes from taxes were reduced; thus part of the burden was transmitted directly to the taxpayers. Finally, though not applied in this case, the FDIC only guarantees deposits below $100,000, so that legally the owners of higher denomination deposits (mostly Certificates of Deposits) would also have lost their money.

In summary, Continental made mistakes and paid for them. The losses were distributed among the borrowers, the employees, the management, shareholders and the taxpayers. Control over the bank's operations went to the state. Continental might be considered an extreme case, nonetheless, in principle, this is the way problems are dealt with domestically. Once among the 10 largest financial institutions in the United States, only $1 billion in problem loans triggered this run, an amount that is very well comparable to what most other large U.S. banks have outstanding to only one or two of their LDC customers. The Continental case illustrates what probably goes through the bankers' heads when they sit at the negotiating table with their LDC customers.

In the following section we will discuss the rescheduling process of the three largest Latin American borrowers. We will show how the banks and international financial institutions were able to establish crisis management procedures departing from the rules applied domestically.

2. Rescheduling external debt of Third World borrowers: Mexico, Brazil, Argentina

International debt accumulated rapidly during the 1970s. While during the early 1970s a steady growth could be noted, the sudden rise in real interest rates, transmitted quickly to all external debt outstanding because roughly three fourths of it was contracted at variable interest rates and

forced the countries to borrow more, simply to keep up with the ever rising debt-service costs. At the same time terms of trade became unfavorable for LDC exporters which lowered the countries' foreign exchange revenues.

The rescheduling process described here is representative for most of the LDCs with high external debts to private commercial banks. It is important, however, to draw a clear distinction between Less and Least Developed Countries, including most Subsaharan African countries. The latter contracted very little debt from private financial institutions and even though in many cases the IMF is involved in managing the debt crisis it appears that the outcome is quite different. This difference is often disregarded and many authors simply assume that the external credits raised by LDC borrowers mostly disappeard in a general mass of corruption, combined with capital flight (Körner, Maaß, Siebold, Tetzlaff: 1984). This view disregards that the bulk of bank credits went to the Newly Industrialized Countries (NICs) who in fact used the largest portion of the loans for investments. It is only with the sudden rise in interest rates in the 1980s that increasing shares of the debt could be called "unproductive" (Cline: 1983). Nonetheless, evidence suggests that considerable structural changes occured as a result of foreign borrowing in the NICs.

In 1982, when Mexico entered a phase of foreign borrowing; exchange shortages in 1983, when it was Brazil's turn, and later in 1983 and 1984, when Argentina came under increasing pressure, the public perceived the crisis as triggered by an acute case of insolvency. Individual debtors become insolvent when they lose their jobs and hence the source of income for the debt-service payments to be made. The analogy is false because Third World - or other countries sell commodities on the world market and hence continue to receive an income. Upon closer investigation one finds that no "objective" limit can be identified empirically as marking the beginning of a crisis. While a company's negative net worth, when liabilities exceed the assets can be relied upon as an indicator of insolvency, a country always owns more than it owes. Therefore, a negative current account or rising debt-service to export ratio are not necessarily a sign of "insolvency". Such developments merely indicate that the transfer of debt-service payments may become problematic if, as is the case of virtually all large LDC debtors, the home currency is not regarded an internationally acceptable means for payment and the country lacks other international reserves such as gold. Even then, it is often the case that existing credits are rolled over, or refinanced upon maturity and new credits are granted, at least in part, to service the existing debt. This practice is well established and rational from the point of view of commercial banks, if it is assumed that at some future date, internal payoffs in the borrowing country will exceed the net inflow of new credits. If, for instance, the completion of an investment project is delayed, but both investors and lenders are convinced that the delay is temporary and future expected profits will be above interest rates, fresh money well be justified despite deteriorating economic indicators.

Tabelle 3: Indicators for Debt-Service Capacity: Argentina, Brazil and Mexico

	Interest Payments Coverage[1)]			Debt-to-Export Ratios[2)]		
	1982	1983	1984	1982	1983	1984
Argentina	52	55	67	385	435	405
Brazil	-30	33	81	339	366	331
Mexico	57	156	132	288	317	293

1) percent of interest payments on external debt covered by surplus on trade in goods and services. Negative number indicates deficit on trade in goods and services. 2) average of gross external debt at beginning and end of year as percent of exports of goods and services.
Source: Morgan Guaranty Trust Company Oct.Nov. 1984

The impossibility in defining an exact point at which rescheduling of the external debt must be undertaken does not mean that the date is completely arbitrary. It usually occurs in the context of a general economic downturn where growth slows in all major sectors of the economy, terms of trade deteriorate and external debt begins to accumulate at an increasing rate. The 1981 recession with falling export prices negative GDP growth combined with rising interest rates made drastic restructuring of external debt mandatory for all major LDC debtors. However, the important point is that it comes to an acute foreign exchange crisis only when the lenders refuse to grant further credits or refinancing[(6)]. Hence there is some flexibility, allowing the creditors to influence the timing of reschedulings. For a well-coordinated and organized group of lenders this flexibility made it possible to avoid a cumulation of large reschedulings and manage the upcoming crises so that the large borrowers were dealt with consecutively. Interest payments coverage and debt-to-exports as proxies for the debtors' capacity to service their external debts are shown in Table 2 I for the three major Latin American debtors. Table 3 confirms that the timing of the respective debt crises is not apriori the result of deteriorating debt-service indicators. In 1982, Mexico underwent rescheduling negotiations even though both Brazil's and Argentina's indicators looked much weaker. Brazil had a negative current account and Argentina's interest payments coverage was slightly below that of Mexico. And even though Argentina's interest coverage shows a steady improvement, rescheduling negotiations were started in 1984.

The chronological order of acute foreign exchange crisis can be better explained from the point of view of global crisis management. When Mexico's rescheduling agreement had come to a close, negotiations began with Brazil, and the conclusion of the "Brazilian drama" marked the beginning of Argentina's foreign exchange crisis. The crisis management strategy can be likened to an exercise in disciplining children: Try to control them all at once and the reaction will be one of unified resistance against authority. A far more effective way is to discipline one at a time, while holding up the others as examples to follow. When in late August of 1982 bankers together with the IMF set out to put together the Mexican "rescue operation", Brazil and Argentina were cited as examples of countries "competently" managing their economies and external debts.

Representatives of the Banco do Brazil proudly announced their country's "consciencous and organized" manner in tapping the international financial markets and in managing her external debt, while the Finance Minister was already involved in secret negotiations with the IMF. Barely one year after Mexico's finance crisis, while bankers and the IMF were in the midst of rescheduling Brazil's debt, Mexico was heralded as the success story of IMF-policies and an example of responsible behavior (Euromoney: July 1983; Economist: Aug. 20, 1984). Both Mexico and Brazil are now rehabilitated and in June of 1984 Walter Wriston, chairman of Citicorp and one of the most vocal bankers on the Third World Debt crisis stressed that debt reschedulings were successfully being handled on a "case by case" basis, terming Mexico an "enormous success" and Brazil following "very close behind", (WSJ-Europe 4-w1984) exposing Argentina as the "enfant terrible".

The strategy turned out to be successful for the creditors, as it became clear that the Latin American debtors failed to put together a borrowers' cartel - the bankers' biggest trauma - in Cartagena in 1984. A similar effort was undertaken as early as 1976 by the United Nations Conference on Trade and Development (UNCTAD), when the Group of 77 pressed for joint action of the debtor nations for debt relief. At the time, the largest debtors, including Brazil and Mexico refused to underwrite the demands, since they considered the request for debt-relief detrimental to their international credit rating. Rescheduling was still looked upon as a highly exceptional procedure for dealing with debt-servicing difficulties and one that would be applied only to those smaller debtor countries that were unable to manage their external debt by themselves (Fierdman: 1977). In 1984 the situation was different, and rescheduling had become an undeniable fact of life for all LDC borrowers. Yet, many debtors, particularly those that had "successfully" completed IMF austerity programs and concluded rescheduling agreements with the banks, saw that their interests were better served when they were negotiated on an individual basis. Mexico, for instance had been able to contract new credits with relatively favorable conditions and was therefore not interested in jeopardising her credit rating to enhance the negotiation position of Argentina or other smaller Latin American nations. The Cartagena initiative concluded with not much more than a joint resolution to show on long term measures for a debt-crisis settlement. The banks' insistence on a "case by case" and consecutive debt crisis management eroded the basis for a strong organization of the debtors.

Cooperation between commercial banks and international financial institutions

The crisis management outlined above would not have been possible without the active cooperation of international financial institutions, central banks and at times the finance ministries themselves. Here, the function of the IMF as an institution central to the entire rescheduling procedure and that of the BIS and central banks must be seperated. The latter

intervened sporadically and involved themselves primarily on an ad hoc basis by granting short term bridge loans or by providing other forms of band-aid support. In the summer of 1982, the Bank for International Settlements and the U.S. Federal Reserve made available a loan of close to $2 billion to Mexico to ensure that negotiations with the IMF could continue and the country did not have to call a default on its loans. The credit was to be replaced by a credit from the IMF as soon as a stand-by agreement including austerity measures was agreed upon. Under similar conditions the BIS offered a $1.2 billion loan and the U.S. Treasury Exchange Stabilization fund(7) added another $1.3 billion to tide over the period of negotiations between the IMF and the Brazilian government. Other short term measures included loan guarantees by the U.S. Commodity Credit Corporation and the U.S. Export-Import bank to Mexico and advance payments for oil imports from Mexico(8). All of these constituted "first-aid" but were fully in line with commercial market conditions. When Treasury Secretary Donald Regan, alluding to his previous employment said that the American taxpayer would be given the same kind of service as the stockholder of Merrill Lynch he proved his point by attaching a 20% discount on the price and a 30% interest rate to the prepayment of Mexican oil imports (Kraft: 1984: 16).

Although these measures are instrumental for preventing excessive arrears in debt service payments, and hence write-offs for the banks, the rescheduling arrangements themselves are worked out first between the debtor country and the IMF and then with the commercial banks. It has become customary that as soon as bankers signal their unwillingness to grant further credits, the IMF sends a mission to the debtor in order to prepare the ground for a stand-by program. An IMF-loan is provided conditional upon the letter of intent outlining an austerity-adjustment program. The IMF then gives the green light for rescheduling arrangements of the private credits, after price liberalizations including exchange rate devaluations, a reduction in government expenditures and expansion of internal credits and other austerity measures have been implemented and lead to tangible results. The process is easier described than completed.

The agonies of the adjustment process are sufficiently known. The governments of Mexico, Brazil and Argentina made it clear that externally imposed redirections of their economic policies are not accepted easily. Compromises are made by the debtors in the full understanding that the economic rationality of IMF-austerity is at least questionable. The Mexican President, Madrid Hurtado asked the U.S. Congress, "How can we explain that developing countries are being told to reduce public expenditures while other countries make use of growing deficits as an essential lever of recovery?" (WSJ-Eu 6-25-1984). The answer given by many economists is that not the recovery of LDC economies, but that of the international financial markets, guide IMF policies(8). And while the two are not necessarily incompatible, a compromise is not a choice the IMF is willing to make. "The concept of unilateral adjustment - with one group of countries at best neutral toward, and at worst frustrating, the adjustment process of the other group - is not an acceptable basis for IMF supervision of the international monetary system. There is a pressing need for the IMF to reconsider its position on this basic issue" (Sydney Dell 1983: 44).

In summary, the technical-sounding term of debt rescheduling describes a complicated mechanism whereby banks and the International Financial Institutions attempt to ensure two things: The debtor countries must prove their willingness to assume most of the adjustment costs by agreeing to and implementing far-reaching economic austerity programs. This goal is in full harmony with the interests of commercial banks. The second objective is to ensure continued flows of international credits. Officials of both the IMF and BIS emphasize that "fresh money" must be made available by the banks to end disruptions in the negotiations that often last for several months. We have shown above that the banks are reluctant to raise further credits for developing countries and do so only at increased costs (higher spreads and fees).

Our characterization of the lenders' cooperation is flawed by excessive simplifications. Nonetheless, there can be little doubt that debt crisis management was and is one-sided, favoring the lenders and relieving the banks from having to absorb any part of the costs involved in the adjustment process. This result is disturbing especially to Third World debtors who pay the price by sacrificing important development objectives. However, the results of the lenders' crisis management begin to bear upon the

industrialized countries as the unconditional agreement to pay by the Third World countries translates into reduced imports and expanded exports. Latin America absorbs fewer imported products and at the same time becomes an increasingly important competitor to industries in the creditor countries. Until recently the IMF and commercial banks found it relatively easy to fend off attacks from critics of the left-wing political perspective who accused them of taking advantage of the unequal distribution of political power between the "North" and the "South". The 1980s wave of reschedulings has widened the range of criticism to include the entire political spectrum. Today, financial analysts, investment bankers, exporters of the industrialized countries and representatives of the steel and textile industries, to name only a few, are beginning to voice their opposition to the bankers' postponement strategy(10). Moreover they accuse the IMF of narrowly focussing on international trade flows. The scrutinization of effectiveness, legitimacy and the gap between theory and practice of IMF policies is currently in full swing (Körner et. al. 1984; Killick 1983; Williams 1983). A critical analysis of commercial bank business in the Third World is still in an early phase. This paper is intended as a contribution to providing a better understanding of the latter.

Conclusion and prospects

The organized approach of commercial banks to manage the debt crisis of the 1980s was successful on two accounts: Defaults were avoided as was a major disruption in the international financial markets. Secondly, the banks' portfolios were protected and reports on profits remain relatively favorable. This result was the combined effort of strict inter-bank organization together with cooperation from international financial institutions. Whether this strategy will be successful in the long run, however, cannot be predicted easily. The sometimes hastily assembled rescue operations, while keeping the loans on the books, did not guarantee a solution of the underlying causes of the debt crisis. A strict focus on financial stability brought about a superficial calm and a containment of the Third World debt crisis. However, what is good for the banks is not necessarily desirable from the point of view of other actors in both creditor and debtor countries. Prolonged economic recession in the Third World brought about by the austerity programs will impact upon the countries' future capacity to service external debts. The "economic overkill" (Dell 1983) has further reduced the prospects for Third World recovery. By the standards of the commercial banks and the IMF the debtor countries were relatively "well-behaved" and cooperative in bringing about the adjustment via austerity. To the extent that the presently observed results are considered detrimental to world trade, criticisms will have to be addressed directly to the banks and the IMF as originators of the rescheduling-solution to the debt crisis. Calls for more protectionist measures within the creditor countries stand in direct contradiction to the interests of the banks, as the Third World's ability to export itself out of the debt crisis would be severely curtailed. The banks' crisis management might be considered mere cosmetics, yet in the process of rescheduling the situation changed. In a time of hightened instability in the domestic banking industry, problems on the international front could be neutralized, at least temporarily. This is no minor accomplishment. And perhaps, the next round of Third World debt-servicing difficulties will be fought out in a different arena, among financial and industrial interests within the "North".

Footnotes:

1) A more detailed study of commercial bank lending to Third World countries prior to 1982 is provided in my dissertation (Dziobek 1984).

2) Figures on country credit rating are published on a semiannual basis by Euromoney and Institutional Investor

3) Euro-currency lending is documented by the Bank of England Quarterly Report and by the BIS in its Annual Report.

4) Other large borrowers such as International Harvester, Chrysler Corporation, Braniff Airlines, Wickes Co, Charta Co. and AM International had repauing difficulties their loans or went out of business. Among Continental Illinois' problem loans was a $175 million credit to Nucorp.

5) An exception is Manufacturers Hanover Trust that came under pressure in the wake of Continental's crisis as well. The bank's stock values declined as rumors spread about the poor quality of loans to Brazil's private sector and in fact a considerable write-off became unavoidable. Recently a study was conducted analyzing the impact of the banks' Third

World portfolio on stock prices showing that the stockholders' judgment on the stability of Third World loan portfolios is less optimistic than that of the bankers.

6) In principle a request for rescheduling can be made by the borrowers as well. But because the banks insist in economic adjustment programs supervised by the IMF as a prerequisite for renegotiating outstanding credits, this step is not taken easily. Going to the IMF is perceived as a political demise and was considered an admittance of incompetence particularly by the largest borrowers. Therefore, most LDCs prefer to do what they can to obtain further refinancing credits and look for informal ways (not involving the IMF) of restructuring their external debts. In practice the initiative for formal rescheduling is taken by the banks when they refuse further credits (For case studies see Dziobek 1984).

7) A reserve to provide countries with short-term financial aid to prevent instability in currency markets.

8) A detailed description of the Mexican "rescue" operation can be found in a report published by the Group of Thirty (Kraft: 1984), a study group composed of bankers, financial analysts and politicians. The prepaid oil imports were used to stock up the U.S. strategic oil reserves.

9) A large number of both theoretical and empirical case studies have been made supporting this point. E. Bacha (in Williams 1983); R. Bernal (1980); S. Dell (Williams 1983); Wohlmuth (1983) are only a few examples within a growing literature.

10) see e.g. the Special Report "World Debt in Crisis" published by the Wall Street Journal Europe (June 22, 1984) where commercial and investment bankers as well as politicians and economists are interviewed on the subject.

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DOES AFRICA'S INDEBTEDNESS MATTER ?

As the other contributor on this topic of the Third World debt has pointed out in her essay the Latin American countries certainly rocked the international financial boat when some of the big debtor countries ran into difficulties servicing their debts. As we all know once the boat started rocking the former all powerful creditor banks realized that they were in the weaker position when some big debtors threatened to default on their debts pushing the banks to the brink of bankruptcy. To paraphrase a now well known insight, "when you owe banks $700 million (like some heavily indebted African country) you have the problem; when you owe banks $70.000 million the banks have the problem".

Does this, however, mean that this smaller amount is less of a problem for the particular country concerned ? Viewing the debt problems from the northern hemisphere one gets a distorted view because our main concern is the stability of the international financial system and not for individual countries; to put it another way we are concerned about the stability of the galley-boat but not about the welfare of some of the less privileged people on board doing the hard work.

This contribution will focus on the poorer crewmembers of our financial boat and how they were affected by the rough times of financial crises.

Section 1 will present their different starting positions, their current comparative strength and their role in the international division of labour. Section 2 will look at their financial position with particular emphasis on their ability to generate income to service their debts. Finally, section 3 will try to give an outlook on the policy options open to these countries.