Click here for Full Issue of EIR Volume 8, Number 32, August 18, 1981

Much of Third World already bankrupt

by Renée Sigerson

Twenty-six countries in the developing sector have worked up serious arrears on their debt payments to Western banks and governments, according to the International Monetary Fund (IMF), the global agency which monitors countries' balance of payments positions. In a just-released report from the IMF's Department of Exchange and Trade Relations, the sum of accumulated arrears is estimated at $6.5 billion.

Asked what the IMF meant by arrears, one author of the report stated bluntly, "defaults," adding that the published $6.5 billion figure was a "low estimate." For many countries, the official explained, outstanding bad debt was now larger than earnings on a year's worth of exports.

This is the first time the IMF has publicly admitted that bankruptcy is a serious problem in the international monetary system.

One problem associated with these Third World bankruptcies is that they quickly translate into insolvency for the lending institutions as well. Investigation has revealed, however, that the major New York banks involved in international lending are currently sanguine about the fact that large portions of their back international loans are nonperforming.

How these banks are "adjusting" to the bankruptcy of their clients was described in a private interview this week, made available to *EIR*, with a leading New York commercial banker in the international operations field.

He explained that there were new features to international lending which gave him the confidence that the expansion of international debt can continue unabated. The new features are working both on the side of lending and in the acceptance of deposits, particularly Eurodollar market deposits. The change in the structure of Eurodollar deposits has been forced partly by the shrinkage of the available surplus held by Arab and other oil-producing countries. From 1980 to 1981, the oil producers' surplus is expected to decline $30 billion from its 1980 record of $120 billion. On average, 75 percent of that surplus is placed with international commercial banks.

Our source indicated that on the one hand, the banks have become much more careful about who they lend to. "I wouldn't lend to anybody at Libor [the London Interbank Rate] plus 3/8 percent. Those countries that want to attract funds will have to pay for them. . . . Brazil is getting all the funds it needs, because it is paying two percent" over Libor.

In addition, continuing high interest rates and costly oil payments have forced many industrialized countries to go into the Eurodollar markets to fund their persistent payments deficits. These countries have been welcomed by the banks as prime borrowers, and are simply crowding those developing nations who can't pay their bills out of the market. "Remember," the officer explained, "the countries hit hardest by the oil prices . . . are in Southern Europe. Most European countries will be borrowing" this year.

He added that the pressure of high oil payments was not that great on developing countries "because they are not the great oil consumers." The truth behind this statement is that developing countries have indeed slashed their oil imports—not because they couldn't potentially consume energy, but because austerity programs imposed by the IMF, with pressure from the private banks, have forced them to reduce consumption. The IMF reports that even after reducing consumption, "the great majority" of Third World nations have simply been turned down by the banks for any new loans, relying now on the IMF, which has about $20 billion in resources, as their only means of finance. Since January, the IMF has allocated $11 billion in loans.

As the banks issue new lines of credit to European borrowers, as well as the strongest Third World economies typified by Brazil, the only question is how the banks in question are making up the deficit in deposits resulting from the reduction of oil surplus funds. Addressing this problem, usually referred to as the "recycling" problem, the banker explained that the Eurodollar market now works in such a way that "deposits are activated by demand. It is when lending occurs," he asserted, "that the deposits start coming in." The only question in getting funds is what kind of interest rate the banks are ready to pay. "At an interest rate of 10 percent, I can get $50 million. At 14 percent, $100 million."

Currently, 80 percent of all such deposits, he added, come from wealthy private individuals seeking gains on interest rate differentials. "By 1985, the [oil producers] surplus won't exist. . . the biggest component" of funds coming in "is capital flight from individuals," mostly European, Middle Eastern, and Asian family fortunes amounting to tens of billions of dollars a year.

© 1981 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

Interview

IMF official sees 'defaults, defaults'

The following is an Aug. 2 interview conducted by EIR*'s International Credit columnist, Renée Sigerson, with a high-level official at the International Monetary Fund's Exchange and Trade Relations department. The official comments on his view of outstanding debt in the Third World.*

EIR: Discussions about the problems of "recycling" Third World debt with deposits from the Eurodollar market are mounting. Do you foresee increasing "recycling" problems?

A: In order to understand how the financial system is working, you have to divide the LDCs into various groups.

There are the major borrowers, the market borrowers, with whom we expect no major problems. There are then some LDCs who succeeded in building their reserves over past years, when they could borrow a little. They have some—a small scope—for drawing down these reserves.

Then there is the great majority of LDCs. The majority are coming to the IMF.

EIR: What magnitude of funds can the IMF commit to helping them?

A: The IMF can commit itself—well, it is complicated because this includes standby credits—to, well $10 billion.

The point is that a lot of these countries are coming to us in the hope of gaining access to the banks. The rest are accumulating arrears. They are forcing exporters to lend to them.

We give a figure on estimated arrears in a just-published report, but our numbers in the report are minimum estimates.

EIR: What do you mean by arrears?

A: Defaults.

EIR: What do you think the amount of defaults actually totals up to?

A: Well, it's hard to say, but for some countries, it's 100 percent of export earnings, others 20 percent.

They've been defaulting on trade financing credits. These include commodity financing loans which have government guarantees in the lending countries.

But then there is also Peru, Turkey—and of course, Poland—which have borrowed cash loans from banks. These are not guaranteed.

EIR: Poland is a special case. I thought Peru had been cleaned up.

A: All right, fine, but Nicaragua, Turkey, all defaults.

Turkey is the worst case. Its exports cannot even pay interest on its loans. The magnitude is so great, the IMF quotas are so small, we feel like it's a case of the tail wagging the dog.

What they do is impose import restrictions, they clamp down on buying from abroad.

These countries would like to borrow, but they can't. Take Guinea. It has some arrears on its back debt. We talked to them, because they don't know how to go about changing the situation.

There's a demand among these countries to find ways for getting in better with the banks.

Of course, from the standpoint of economics, there is no recycling problem: a surplus must be relent. But, we're not working in a truly freely competitive situation.

Many banks have overcommitted themselves. There are many cases in which recycling won't work—in the case of smaller countries. There are far more cases of arrears.

Take Gambia: the government nearly fell. They tightened up too much, it provoked social and political problems. Now, the Latin countries—they will improve if the U.S. stays in recession.

You see, there was an overreaction initially. A year or two ago, when the Western financial press ran all these scare stories about a debt collapse, they scared away the Japanese banks from international lending.

Last year, the Japanese government moved to discourage lending abroad. Now they have relaxed somewhat. . . .

EIR: What are our options?

A: If one could expect a continued downturn, slowdown in the industrial countries, the profit motive will force the banks to lend abroad.

If, however, there is an economic recovery in the developed countries, I really don't know what will happen in the Third World.