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Is the Debt Crisis Getting out of Control?

Brazil, with borrowings amounting to US \$ 90 billion the largest international debtor nation, is on the verge of complete financial collapse. Of all people it was the "father" of Brazil's economic miracle, Minister of Planning Delfim Netto, who was obliged to file an official rescheduling application to the Paris Club – an association of the 24 most important western creditor nations – at the end of August. Brazil was no longer able to meet its payment commitments to western governments. Furthermore, it could not meet the deadline for the repayment of the first two tranches of a bridging loan granted by the Bank for International Settlements (BIS) in December 1982. The rescue package put together by banks and the IMF at the end of February 1983 with the intention of averting an acute financial crisis has also unravelled. Neither have the banks brought the lines for money market dealings and inter-bank lendings up to the level agreed upon, nor has Brazil itself abided by the conditions laid down by the IMF. The IMF responded by stopping the disbursement of the already promised stand-by credit of US \$ 5 billion. Although the IMF and the 14 advisor banks reached agreement on a credit package at the end of September, a lasting and acceptable solution to the problems of the country, which now receives oil and other import goods vital to the economy only on a cash-before-delivery basis, is still remote.

Brazil is no isolated case. Well over 40 countries throughout the world have already defaulted on their interest and redemption payments; virtually all south American debtor nations require rescheduling. This means that today the international financial system is at greater risk than it was in the wake of the successful management of the Mexican crisis just under a year ago. There are several reasons for this situation, apart from the fact that the mounting difficulties facing its member countries have stretched the IMF to the limits of its own possibilities.

To begin with, the behaviour of creditor banks has increasingly exacerbated the situation. The overhasty throttling of lendings to the Third World means that the countries affected are confronted by unsolvable short-term adjustment problems. Crises have been triggered off which could have been avoided if a more careful approach had been selected. In rescheduling cases, too, the united front of commercial banks is becoming more and more shaky. In Brazil's case, for example, it is most doubtful whether the more than 800 banks involved will reach agreement on the joint package, negotiated between the IMF and the advisor banks. Many of those institutions which are not so deeply involved hesitate to provide new credits and seem more inclined to write off the loans granted to Brazil. If an "every-man-for-himself" mentality were to prevail in the case of Brazil and other rescheduling operations, there would be a growing medium-term danger of banks collapsing on account of the increasing concentration of poor risks on a decreasing number of institutions. And in view of the considerable ramifications in the international banking system the chances of larger-scale bankruptcies not leading to chain reactions are very slim.

Secondly, many debtor nations are faced by growing political instability. Stagnating or falling real income levels have weakened the position of many governments. What is more, the drying-up of the flow of foreign capital forces many governments to resort to socially painful and thus politically risky measures to put the current account and public finance situation back on its feet. This twofold pressure of endogenous and exogenous factors on the

government restricts the latter's room for manoeuvre. There is an increasing tendency to blame the foreign creditors and the IMF for the economic crisis. Political and economic developments in Brazil between 1959 and 1964 bear out this point. Today the banks and the IMF are once more in danger of losing the most important prerequisite for overcoming the crisis in the long run: reliable negotiating partners in the debtor nations with sufficient room for manoeuvre. Mexico's rescheduling immediately after the presidential elections was the kind of fortunate situation which is unlikely to recur.

In view of their increasing political weakness at home many governments feel obliged, if only for reasons of self-preservation, to pursue a vigorous forward-defence strategy with regard to their creditors. This reveals the third danger to the international financial structure: the formation of a "debtor-OPEC", accompanied by the announcement of unilateral moratoriums by the large debtor nations. Up to now, the countries in questions have refrained from taking such a step, regarding the economic risks as greater than possible benefits. For such a cartel would be cut off from the world market and the member countries would have to be able to supply each other with the most vital imports. Such a situation can be ruled out for the immediate future. The interests of the individual countries are simply too varied: oil-exporting countries such as Mexico, for example, see more advantage to be gained from reestablishing their credit-worthiness than from joining a cartel in which they would assume the role of oil supplier, with uncertain services in return from their partners. In fact, the conference of Latin American debtor nations which took place in Caracas at the beginning of September, was characterised by a remarkable degree of realism on the part of the debtors. Unfortunately this is more than can be said for the attitude of the USA, the only participating creditor country. Its delegates demurred to that passage in the final document of the conference which demanded improved access to the US market for Latin American products.

In view of this generally gloomy situation, the remark by the President of the World Bank, Clausen, that there is at present no such thing as a global debt crisis, individual countries suffering only temporary liquidity bottlenecks, must be seen as a case of calculated optimism. Suggestions to be heard more and more frequently in commercial bank circles on how to overcome the problems of indebtedness provide a different picture. More or less openly the demand is made that western governments and central banks take on the existing risks and burdens. Recourse to the taxpayer or – indirectly via money creation – to the saver, however, can certainly not be justified by reference to "temporary liquidity bottlenecks".

Such suggestions and plans, which in the final analysis only amount to curing symptoms, are both superfluous and damaging. Instead a process of rethinking on the part of the creditors would seem to be urgently required for dealing with international problems of indebtedness. Carefree lending by the banks themselves for many years has contributed towards the current crisis. Meanwhile a glance in the annals of economic history has taught the banks not only that nations, too, can go bankrupt, but also that the latter's chances to survive such financial disasters are much better than those of their private creditors. This realisation threatens to induce them yet again to behave incorrectly and thus aggravate the crisis even more.

Alongside the drastic reduction in lendings and the cutting down of the loan periods, a most questionable factor in the current situation would appear to be the completely outdated rescheduling techniques. Brazil and other debtors need more than just a brief breather: What is needed is a comprehensive rescheduling of the total amount of debt. The repeated and – with certain countries – almost continual negotiations tie down substantial resources on the part of creditors and the governments affected, cause unrest and impede longer-term economic policies without which there can be no political stabilisation and economic recovery in debtor nations. The banks will therefore not be able to avoid a certain amount of new lending and the speedy conversion of their outstanding claims – which are already today de facto locked in – into longer-term borrowings with prolonged redemption-free periods. Provided speedy and level-headed action is taken, the international debt crisis would still seem to be controllable and also solvable in the long run in view of the economic potential of most debtor nations.

Rainer Erbe