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## BANKING

# The International Debt Crisis and the Banks

by Otmar Emminger, Frankfurt\*

**When the international debt crisis broke in 1982 it appeared for a time that the crisis might engulf the international banking system. What part did the banks play in the creation of the problem? What was their role in overcoming the crisis? Dr. Otmar Emminger, former President of the Deutsche Bundesbank, answers these questions and names the consequences the crisis will have on the international banking industry.**

The international banks have played a central role in the international debt problem from the very beginning. From the early seventies to the onset of the acute debt crisis in 1982 they were heavily involved in building the enormous pyramid of international debt – indeed, they were the true driving force over that period. They have also played a central role in crisis management since 1982, by joining the International Monetary Fund, the leading central banks and the governments concerned in an unprecedented example of international co-operation to defuse the worst cases of debt and prepare longer-term solutions.

The origins and development of the debt problem cannot be gone into in detail here. However, attention should be drawn to a number of facts that should serve to correct certain widely-held historical misconceptions and errors. One of these, for example, is the assertion often made by leading representatives of the banking system that the excessive credit expansion in the Third World was more or less forced on the banks by the need for the OPEC countries' massive surpluses to be recycled to deficit countries; they claim that governments and central banks even encouraged or pressurised them to recycle the funds.<sup>1</sup>

In reality, the runaway momentum of international bank lending before 1982 had quite different causes. It is rather interesting that as early as May 1973, several months before the beginning of the first oil price explosion, the annual conference of the American Bankers' Association for Foreign Trade debated the possibility that bank lending to the Third World was excessive and voiced fears about placing too heavy a burden on debtor countries.

Since then, the external debt of the developing countries (excluding OPEC) rose from \$ 130 billion at the end of 1973 to \$ 633 billion at the end of 1982, when

the crisis broke. The annual rate of increase averaged more than 20 %. Bank lending rose even faster, recording an annual growth of 25 % between 1975 and 1980, almost twice the rate of expansion in the banks' domestic business and in the value of world trade over that period. Bank loans rose from 36 % to almost 50 % of these countries' borrowing between 1973 and 1982; in the case of the Latin American debtor countries the proportion was even higher. At the outbreak of the debt crisis in 1982, initiated by Mexico in August of that year, this dynamic expansion in bank lending came to an end, probably for good.

There were many factors behind this explosive expansion in international lending. Since the sixties, the banking system had been engaged in a rumbustious *phase of internationalisation*. The Euro-currency markets expanded at a phenomenal rate and all the major banks hastened to establish branches or subsidiaries in the most important international financial centres. During the seventies the number of institutions engaging in international banking business rose by leaps and bounds year after year. Competition for customers became increasingly keen, owing partly to the sheer pressure to expand and the competition mentality and partly to the prospect of particularly good earnings on this type of business. Studies on the major American banks in the seventies showed that the rate of return on foreign business was substantially higher than that on domestic business, while the loss ratio at that time was low in relation to that on domestic lending. Some of the particularly active large US banks earned well over half of their total profits from foreign business, although such transactions accounted for a considerably smaller proportion of their total business. For the banks, international lending is predominantly "wholesale" business, with relatively low staff costs and

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<sup>1</sup> A view expressed by a leading German banker in a private discussion on the debt problem in 1983.

**Table 1**  
**Bank Lending to Developing Countries (excluding OPEC)<sup>1</sup>**  
(in billions of dollars)

	1973	1978	1979	1980	1981	1982	1983
Banks' foreign loans to all countries (net increase)	32	90	125	160	165	95	85
of which:							
to developing countries (excluding OPEC) <sup>2</sup>	10	25	41	49	51	25	17
Total outstanding bank claims on developing countries (excluding OPEC), at year end <sup>2</sup>	32	155	195	241	286 <sup>a</sup>	306 <sup>a</sup>	319 <sup>a</sup>
Current account deficit of developing countries (OECD definition) <sup>3</sup>	-6	-26	-41	-63	-81	-68	-41

<sup>1</sup> Foreign loans of banks reporting to the BIS.

<sup>2</sup> Source: IMF: International Capital Markets (on the basis of BIS statistics).

<sup>3</sup> Including official transfers to developing countries.

<sup>a</sup> According to the more comprehensive IMF estimate (all banks): 1981: \$ 378 billion; 1982: \$ 414 billion; 1983: \$ 433 billion.

overheads. Moreover, the banks' offshore business is free from minimum reserves and other burdens.

The internationalisation of banking is illustrated vividly by Federal Reserve figures on the US banks. These show that the international claims and investments of US banks (and their foreign branches) rose from about \$ 5 billion to around \$ 140 billion between 1960 and 1983; over the same period their foreign liabilities rose from practically nil to \$ 150 billion.

Conditions in the world economy greatly favoured the expansion in credit up to the beginning of the eighties. It was the time of worldwide chronic inflation, particularly in the dollar area. Until the beginning of the eighties, real interest rates in the dollar area stood at around zero, sometimes well below zero, particularly when measured in terms of the export prices of the large debtor countries. The Federal Republic of Germany was the only major country to have positive real interest rates throughout the seventies. Until the end of the decade, the annual rates of growth in the debt service charges of the larger debtor countries were generally lower than the nominal growth in their exports, which was distorted by inflation. All these factors gave the largely uncontrolled international credit market extraordinary dynamism, with the ever present risk of excesses. Neither the lending banks nor the debtor countries reckoned on the inflationary environment coming to an end, let alone on the subsequent dramatic turnaround to worldwide disinflation with exceedingly high real interest rates and a serious deterioration in the terms of trade of most debtor countries. The lack of foresight on the part of lenders and borrowers can be excused only partly by the fact that well into 1981 some international institutions (such as the World Bank and the OECD) were publicly declaring that the pace of borrowing by developing countries was not intolerable.

The two oil price explosions gave this dynamic growth particular impetus and a particular character. The

dramatic increases in oil prices, first at the end of 1973 and then again in 1979 and 1980, greatly swelled the trade and current account deficits of the oil-importing developing countries. This in turn considerably increased their external financing requirement, at least for a transitional period of several years. William R. Cline<sup>2</sup> has calculated that the cumulative additional burden on non-oil Third World countries as a result of the two oil shocks (by comparison with a rise in oil prices in line with the US wholesale price index) was around \$ 260 billion between 1974 and 1982.<sup>3</sup> The current account deficit of this group of Third World countries therefore rose from \$ 6 billion in 1973 to an initial peak in 1975, but then levelled off temporarily. After the second oil price shock their aggregate current account deficit reached a peak of \$ 81 billion in 1981.<sup>4</sup>

But what role did the banks really play in recycling the OPEC surpluses? It was substantial, but it was far from fully explaining the tremendous expansion in international bank lending. According to the IMF's "World Economic Outlook" for 1984, the net current account surpluses of OPEC Countries totalled almost \$ 400 billion between 1974 and 1982. These surpluses of foreign exchange had to flow back to other countries in one form or another. This return flow or "recycling" was a rather complicated and roundabout process. Only \$ 140 billion, or just over one-third of the total surplus of around \$ 400 billion, flowed into the banks of industrialised countries up to the end of 1982. As some of the OPEC countries also borrowed quite substantial amounts from the international banking system from

<sup>2</sup> William R. Cline: International Debt, Institute for International Economics, Washington D.C., 1984, p. 10.

<sup>3</sup> Neither the effects of the volume adjustment forced on countries by high oil prices nor the additional export openings in OPEC countries have been taken into account.

<sup>4</sup> According to the OECD current account definition. According to the IMF definition, the aggregate current account deficit of this group rose from \$ 11 billion in 1973 to \$ 109 billion in 1981.

time to time, the net inflow to the banking system was actually far less than one-third of the total OPEC surpluses. Substantially larger amounts of the OPEC surpluses flowed back via other channels, such as the purchase of securities denominated in dollars or other currencies, direct investment, contributions to international institutions, direct aid to other developing countries, and so forth.

In fact, the banks granted far more in international loans than they received in petro-dollars. Net bank lending to developing countries (excluding OPEC) alone rose over the same period by around \$ 275 billion, more than twice the (net) inflow of petro-dollars. At the same time, the banks were naturally also making massive loans to other international borrowers. It is also interesting to note that in 1977 and 1978, when the banks received only small amounts of petro-dollars, their lending to Third World countries continued practically undiminished. In short, *the recycling of petro-dollars explains only a fraction of the tremendous expansion in lending by international banks*. Indeed, in the Annual Report of the Deutsche Bundesbank for 1978 (pp. 52 f.) we had already emphasized this phenomenon of "over-recycling" by the banks. International bank lending was fuelled also by many other sources, not just petro-dollars. To some extent, it was probably a self-generating process, in other words credit creation within the Euro-currency markets. At a symposium on international indebtedness in September 1979, at which serious concern was already being voiced about excessive bank lending, Wilfried Guth (the spokesman of the Deutsche Bank) characterised the process aptly as follows: "The apparently inexhaustible supply of liquidity in the Euro-markets leads to temptation. . . Instead of urging deficit countries to knock on the door of the IMF, the banks themselves continue to hand out money."

### **The Central Banks and the IMF**

A little over two years ago, one participant in a discussion on the international debt problem (it was the former Federal Chancellor Helmut Schmidt) claimed that a large share of the blame for the dangerous excesses in bank lending to Third World countries lay with the central banks and the IMF, as they had failed to curb the euphoria of the banks and debtor countries early enough. This assertion does not square with the facts. It is true that immediately after the first oil price explosion at the end of 1973 there was agreement among the major governments (reinforced at a conference of the Group of Ten in Rome in January 1974) that the adjustment of trade and current accounts

to the new level of oil prices would take some time, during which financing facilities would have to be sought for the weaker nations. During this first stage, the recycling of petro-dollars by the banks (which accounted for only part of the oil surpluses) was naturally welcomed. As early as 1976, however, the International Monetary Fund and leading central banks declared that the transitional period of "financing" the increased oil burden had to come to an end and that it was time for energetic action to begin the necessary "adjustment" in the domestic economy and in the balance of payments. The Managing Director of the IMF at that time, Johannes Witteveen, expressed this view at the Fund's Annual Meeting in Manila in September 1976, and received general support. Already then, it was criticized that over-generous unconditional bank lending to debtor countries might deter them from applying in good time to the IMF, with its credits granted on economic policy conditions. Admittedly, the IMF saw that if it was to maintain its supervisory role over the debtor countries in the face of competition from unconditional bank loans it had to hold out the prospect of larger access to its resources, because at that time the IMF quotas of many heavily indebted members were such that only insignificant aid could be given.

As far as the central banks are concerned, they too turned their attention to energetically curbing excessive bank lending from about the autumn of 1976 onwards. In the United States, the Chairman of the Federal Reserve Board at that time, Professor Arthur Burns, emphasised in testimony to a US Senate Committee (the "Church" Committee) that on no account could or should the large banks continue to lend to developing countries on the scale seen hitherto. He also urged the introduction of a special reporting and assessment procedure. The central bank governors of the Group of Ten examined the practical means available for curbing international bank lending at a series of meetings held in 1977 at the Bank for International Settlements in Basle. The American proposal to introduce minimum reserves on international banking business in the Euro-currency and other offshore markets was not adopted, owing to the opposition of two central banks. It was eventually agreed that all the leading central banks should endeavour to bring the pace of international bank lending under control and to improve the transparency of international credit business by consolidating the balance sheets of foreign banking subsidiaries with those of their parent banks and applying common principles for the banks' capital ratios. In accordance with this joint central bank decision, which the Central Bank Council of the Deutsche Bundesbank expressly

endorsed, a letter was written to the German Federal Government in December 1977, stating the Bundesbank's urgent request for amendment of the Banking Law to put the consolidation of balance sheets into effect. As it was clear from the first that the change in the law would take considerable time if it were linked with the reform of other provisions of the Banking Law that was already envisaged, the Bundesbank suggested that the consolidation requirement be introduced as quickly as possible by passing special amending legislation. Many further initiatives were taken in this matter, both verbally and in writing. The outcome is well known: it took until the end of 1984 before consolidation could be introduced as part of a comprehensive reform of the Law. Nevertheless, better transparency in the balance sheets and credit transactions of foreign subsidiary banks had been achieved a few years earlier as a result of a voluntary agreement with the banks. The German banks had to expect that consolidation and a limit on lending by their foreign subsidiaries would be introduced sooner or later; they have probably brought their international lending at least partly into line with these restrictions over the past few years, which stands them in good stead today.

### Overcoming the Debt Crisis of 1982-83

Bank lending to developing countries (excluding OPEC) reached a peak in 1981, when the net increase amounted to \$ 51 billion and covered no less than 63 % of the aggregate current account deficit of this group of countries (calculated in accordance with the OECD definition). The sharp expansion in bank lending in 1980 and 1981 was due partly to the fact that the second oil price explosion in 1979 and 1980 caused a renewed massive increase in the foreign exchange deficit of the oil-importing developing countries and hence in their external financing requirement. However, it also reflected some very unhealthy developments. A number of major debtor countries, mainly in Latin America, failed to adjust their economic, financial and monetary policies quickly enough to the radical change in world economic conditions. Their budget deficits rose inordinately. Part of the funds raised abroad was used, directly or indirectly, to finance these deficits and hence to finance consumption. Exchange rates were kept artificially high; in several important debtor countries this reinforced the capital flight that had been triggered partly by the critical turn of events in the economy as a whole. In the final stage before the crisis broke, excessive budget and balance of payments deficits, inflated consumption and unviable prestige projects as well as the capital flight were thus being financed on a large scale by recourse to foreign bank credit lines, a state of affairs that has rightly

been condemned. The flight of capital from major debtor countries from 1979 onwards is estimated at more than \$ 50 billion by the BIS, but many put it as high as \$ 100 billion. All these factors meant that in particular the *short-term* liabilities to banks had risen alarmingly by mid 1982.

The temporary suspension of payments by Mexico in August 1982 brought the crisis to a head. The subsequent train of events is well known. During the *first phase*, central banks (via the BIS), governments and the IMF had to ward off collapse by arranging short-term bridging loans. In the *second stage*, rescheduling agreements spread over one or two years and coupled with adjustment programmes were concluded under the auspices of the IMF between the creditors and the individual debtor countries on a case by case basis. There is no need to describe the key role of the IMF in greater detail here. However, it is worth noting the successful worldwide co-operation among the creditor banks in negotiating these difficult agreements. In many cases more than 700 banks from a large number of countries had to be persuaded to accept a uniform rescheduling and adjustment programme negotiated by an "advisory committee" consisting of the representatives of around twelve banks and the IMF. A particularly difficult problem for the banks was that in the majority of cases fresh money had to be found to grant the debtor country adequate bridging loans while it reshaped its entire economic and financial policy. For many banks, it was not and still is not easy to lend further sums to debtor countries on whose existing doubtful loans they have often already made provisions or write-offs. In 1984 the banks had to find around \$ 12 billion for such "involuntary" loans under rescheduling agreements. The German banks' share was about 6 %, which itself gives some indication of their relatively small involvement with problem loans. Their total share is certainly below 10 %, far less than the towering share of US banks but also considerably smaller than that of their Japanese and British counterparts.

The debt crisis has now entered its *third stage*: since September 1984 long-term rescheduling agreements with several important debtor countries have either already been negotiated (Mexico, Venezuela) or are nearing conclusion (Brazil, inter alia). On the other hand, there are a few major debtor countries that are still in the thick of an acute liquidity crisis; these include important countries such as Argentina and the Philippines.

1984 was a fundamental turning-point in both the domestic and external economic situation of a number

of important debtor countries. Whereas in 1983 they had been able to improve their current account only by means of an import curb forced upon them by their shortage of foreign exchange – thereby suffering a fall in national product in most cases – in 1984 they were able to expand their exports to such an extent that they could further reduce their current account deficit and at the same time slightly raise their imports and their national product. Some important debtors, such as Mexico and Venezuela, even recorded temporary current account surpluses; in other words they were able not only to meet maturing interest payments entirely from their own export receipts but also to increase their foreign exchange reserves somewhat. The same applies to a few threshold countries in Eastern Europe. Others, such as Brazil, did not record a current account surplus, but they were able to increase their trade surplus by far more than had been envisaged in the recovery programme. In 1984, after several years of crisis, most Latin American debtor countries were again able to record modest economic growth (average economic growth of about 2½ % in real terms in Latin America as a whole, considerably more in some countries such as Brazil). There is at least the prospect that this improvement will continue in 1985. The overall current account deficit of the developing countries (excluding OPEC) was reduced by more than half between 1981 and 1984, falling from a record of \$ 81 billion to \$ 32 billion; in Latin America the reduction was even more pronounced. Viewed in global terms, this new scale of the deficit seems now to be acceptable and financeable; in the normal course of events, the overall current account deficit could even rise back to around \$ 40-50 billion annually without causing serious difficulty. It should also be noted that most developing and newly industrialising countries in Asia and the Pacific came through the world recession relatively well and without suffering a debt crisis; by 1983 they were already recording growth rates in excess of 6 % again, the one exception being the Philippines.

There are two main reasons for the improvement in Latin America, which surprised most experts. The first is the vigour with which some countries have carried out the adjustment programmes agreed with the IMF, and the second the unexpectedly good sales opportunities in the strongly expanding US market. Between 75 and 80 % of the expansion in Latin American countries' exports in 1984 represented increased sales in the United States. Finally, in the last few months of 1984 their debt servicing burden was greatly eased by the fact that US interest rates declined substantially from the middle of 1984 to the beginning of 1985, thus more than

reversing the increase in the first half of 1984, which had posed a serious threat to the debt situation.

This all shows that the easing of the international debt problem is attributable very one-sidedly to the unexpectedly strong economic recovery in the United States and especially to that country's import pull. Judicious economic growth in the industrialised countries under the leadership of the United States, combined with a willingness on the part of creditor countries to keep their markets open to goods from the debtor nations, is undoubtedly the most important requirement for the continued positive evolution of the debt problem. In view of the uncertainty whether these requirements will continue to be met, the situation has been described as one of "relaxation pending further developments". Indeed, if the industrialised countries relapsed into recession or even just stagnation, the success achieved so far would be jeopardised. An IMF model of the world economy shows that the most important prerequisite for a successful medium-term solution to the debt problem is average economic growth of just over 3 % a year for the next five or six years in the industrialised countries. In 1984 the average growth of 4¾ % far exceeded that figure, but thanks only to the above-average performance of the US economy. Hence, the debt problem is still not yet finally solved. But it has been demonstrated that the case-by-case approach, with bank agreements concluded for each debtor country under the aegis of the IMF, stands a realistic chance of success.

### Role of Governments

This assertion is occasionally questioned by certain prominent politicians. For example, Henry Kissinger never tires of pointing out that the international indebtedness is such an enormous political and social problem that it can only be solved at the political level, that is to say through negotiations between governments; and, if necessary, through accommodation on the part of creditors at the taxpayer's expense. In his view, negotiations on such an issue between creditor *banks* and debtor *governments* can never bring lasting success – one would simply be risking the future of the banks. In mid 1984 a former German politician, Helmut Schmidt, also expressed a similar opinion. He too considers that the banks are not in a position to resolve a problem of such magnitude without the help and financial support of governments. When events began to move towards long-term rescheduling agreements between creditor banks and debtor governments in the autumn of 1984, Kissinger prophesied in a speech delivered in

Washington that these long-term agreements would fall apart after a few years and that new negotiations would then have to be held on worse terms.

This is a fundamental issue of prime political importance. However, all experience to date indicates that in major countries, first and foremost the United States, parliament would not be prepared to provide direct or indirect financial aid, in other words public funds, to ease the debt problems of the threshold countries. Negotiations on bank debts between governments would also be difficult, owing to wide divergences in the interests of the main creditor countries and, in particular, in the exposure of their banks. Creditor governments cannot, of course, avoid intervening directly if government claims have to be rescheduled, which usually takes place in the so-called Paris Club. Creditor governments have occasionally also to make additional export credits or export credit guarantees available under certain rescheduling packages. Furthermore, creditor governments are indirectly involved in the present procedure of case-by-case rescheduling linked with adjustment programmes by supporting the often decisive contribution of the IMF.

In any case, at the London Economic Summit in June 1984 it was decided that the pragmatic case-by-case approach should be maintained and that the banks should continue to represent their own interests in rescheduling negotiations and to conduct the negotiations on the settlement of bank claims, with the co-operation or under the leadership of the IMF.

This procedure for overcoming the debt problem represents an extraordinary test of the international banking system's resilience and ability to co-operate. Wilfried Guth, one of the spokesmen of Deutsche Bank, said at the beginning of 1984, "There is one event in the life of every banker that leaves an indelible impression; for this generation of bankers it is the international debt crisis." Even for those who are not directly involved, the international debt crisis and its containment up to now by means of unprecedented international co-operation are an impressive phenomenon.

### **Consequences for the International Banking System**

The debt crisis was a serious setback to the growth in international banking business and will have a number of lasting consequences.

First, a few remarks on the shorter-term problems. The international debt problem is under control at present, and the latest developments in important debtor countries afford the hope that we are generally

moving towards the third stage of tackling the debts, namely longer-term rescheduling. We are now faced not with a worldwide global problem but with critical situations in individual countries, each of which has its own specific problems. However, accidents along the way cannot be ruled out, even for the more advanced debtor countries, particularly if the world economic situation deteriorates. We are therefore still in a situation of risk. The banks should therefore not rely too heavily on the positive outlook for the debt situation; they must also bear in mind the possibility that events will take a less favourable turn. That means that they must continue to take adequate precautions against the risks associated with the debt problem by making debt provisions, write-offs or capital increases. The German and Swiss banks are probably in a better position in this regard than many other banking systems.

A further short-term problem for the banks is the way in which the present acute cases should be treated. It is time to switch from treating acute liquidity crises to arranging longer-term rescheduling wherever possible. This is in the interests of both debtors and creditors. The creditor banks should not hesitate to accept some risks in this respect. One of these stems from the difficulty of monitoring debtor country adherence to sensible economic and financial policies over the long term once the IMF is no longer a direct contracting party. However, this problem would appear to be soluble. Another is the currency risk, which is probably more serious in the case of long-term rescheduling. Such rescheduling should therefore be sufficiently flexible to take account of the different positions and interests of the various creditor groups (currency diversification option).

The international banks are also facing *longer-term problems*. Creditor banks and debtor countries alike will have to learn from past experience. Some of these lessons will be:

- The period of phenomenal expansion in international bank lending, with annual growth rates of between 20 and 25 % as in the seventies, is now gone for good. In future, the net increase in international bank lending to Third World countries may range between 4 and 6 % a year. For one thing, the ability of debtor countries to increase their enormous debt burden still further is limited; for another, the lending banks are faced with the need to establish a healthier ratio between their loan exposure to Third World countries and their own funds (in the USA, for example, experience has shown that own funds can be increased by an average of between 6 and 10 % a year). In fact, the net increase in bank lending to developing countries already seems to be

adjusting to the rate mentioned above, namely between \$ 15 and 20 billion a year.

□ The *debtor countries* will themselves be more cautious about further expanding their already excessive foreign debt, particularly as long as their export prices are under pressure and real interest rates are very high. In fact, a number of countries, including Brazil and Indonesia, have already declared that they hope to be able to do without additional bank credit entirely in the near future and to obtain any needed foreign capital by other means, such as through the World Bank and other multilateral agencies. It is in the interest of the debtor countries to obtain the necessary foreign capital in the form of longer-term fixed-interest loans or, better still, foreign direct investment. The banks could act as intermediaries in this connection, thereby expanding their service activities. This would be fully consistent with the present trend in international banking, which is to switch from direct credit expansion to services and assistance, which are reflected in the balance sheet simply as fees and similar receipts.

□ The *banks* will certainly be more cautious in their lending and more selective with regard to country risks. They will also have to pay much closer attention to the use to which their loans are put in the borrowing country and to concentrate on their true function in the international field – financing foreign trade and providing short-term interim project financing – instead of financing balance of payments and budget deficits.

□ The *banking supervisory authorities* will also have to draw lessons from the debt crisis. One of the tasks facing them is to bring about a better international harmonisation of their rules and of their supervisory activities. Finally, in future they should think not only of crisis management but also of crisis prevention to a greater extent than in the past.

Assessments of the prospects for bank lending to developing countries vary. Some fear that, as a result of their experiences with bad loans, the banks will for some considerable time be more cautious than would be desirable for the restoration of normal conditions. Indeed, in the first two years since the onset of the debt crisis the majority of new bank loans to Latin American countries, for example, have been granted only as “involuntary” loans in connection with rescheduling agreements. At that time, appeals were made to the banks, including from the IMF, to continue lending to developing countries on a reasonable scale. In September 1983 the former Managing Director of the IMF, Johannes Witteveen, proposed<sup>5</sup> that an international guarantee fund for bank loans be established under the auspices of the IMF to ensure an

adequate volume of credit, with limits set for individual debtor countries. However, this was rapidly recognised to be impracticable.

In fact, bank lending to the Third World has slowly resumed, even on a voluntary basis, although it has been confined to those debtor countries that have maintained or regained their creditworthiness. However, many observers, including important central bankers,<sup>6</sup> are already expressing doubts whether the international banks have really drawn sufficient lessons from past mistakes and excesses. They clearly have the impression that as soon as the situation improves slightly the banks will once again begin to urge loans on potential borrowers, given the pressure of competition and the as yet uncontrolled money creation capacity of the Euro-markets. The latter point raises a very fundamental question. In the opinion of the author, however, adversity is a good teacher, and there has been no shortage of adversity facing both the banks and the debtor countries. Finally, in the case of German banks the consolidation of foreign subsidiaries' balance sheets that has finally been introduced provides a means of curbing excesses.

At present, the international banks appear to have found a substitute for the lack of new business in the Third World in increased lending to industrialised countries. American banks and corporations are becoming increasingly prominent as borrowers. This reflects the massive shift in the international payments system: at present, the United States' current account deficit is more than twice as large as the aggregate deficit of the entire Third World. The enormous American deficit and the still relatively high US interest rates constitute a sort of permanent invitation – or temptation? – to the Euro-credit and Euro-bond markets. It is to be hoped that they will not indulge themselves excessively.

Wilfried Guth of the Deutsche Bank clearly recognised the problem when he asked in a speech in January 1985, “How can we keep up with international competitors at a time of ever faster developments in new forms of financing and techniques, without being drawn into new excesses and concentrations of risk?” It is to be hoped that after the sobering experiences of recent years the international banking industry will find its appropriate place in the world financial system, for it has become an indispensable part of that system and of the world economy.

<sup>5</sup> Johannes Witteveen: Per Jacobsson Lecture, Washington, September 1983.

<sup>6</sup> Dr. Helmut Schlesinger, Vice-President of the Deutsche Bundesbank, address delivered in Zurich on 12th June 1984.