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International Debt and You

During the past few months, increasing attention has been devoted to the problem of mounting international debt, particularly that of nonoil-exporting less-developed countries (N-O LDCs). In recent Congressional testimony, Dr. Arthur Burns, Chairman of the Federal Reserve Board of Governors, agreed with Senator Hubert Humphrey that outstanding loans by U. S. banks to N-O LDCs had increased to about $50 billion, an amount that carries worrisome risks. Indeed, two out of the five largest New York banks reportedly are on the Federal Reserve's "watch" list because of risk exposure through N-O LDC loans.

We have read many analyses of the international debt situation. Typically, most of them have dealt with the symptoms, not the underlying problem. Consequently, the suggested "solutions" to the problem would not be solutions at all; instead, they would be temporary expedients postponing the necessary corrections until the problem will have become more severe. Of course, during this delay, the bankers, who have craftily designed and assiduously preached the purported remedy, would reap large profits, while you, the American taxpayer and victim of inflating, would bear the burden of the plan.

As often described, the international debt situation would seem beyond the ability of all but the most erudite readers to understand. Perhaps it is thus by design, for the confusion enables those closely involved in the situation to disguise self-serving plans as solutions. Herein we examine international debt – its cause, its size, its immediate problem, its purported solutions, and its implications.

An Analogy

International debt has skyrocketed since OPEC markedly raised the price of oil late in 1973. The implications of the price increases have been different for different oil-consuming nations, and when attention is focused on these differences in detail, the fundamental aspects often are neglected. An analogy may be useful for clarifying the basic problem.[1]

The analogy we shall use is that of the individual faced with a sudden and marked increase in the cost of fuel for heating his dwelling. (For Americans, little imagination is required to appreciate this situation.) The individual incurring higher fuel bills can adjust in a number of ways or any combination of them to his higher bills. His options include: reducing consumption of fuel or of other goods, reducing his current saving, drawing upon past savings, taking another job to increase earnings, borrowing funds from others, seeking gifts (welfare) from others.

All of these options may not be available; for example, one may not have any past savings to draw upon or may not be able to find another job. Moreover, some of the options would be available for only a limited time; this would be the situation for using past savings (eventually savings would be depleted) and for borrowing (eventually one's credit would be exhausted).

Only two of the options can be viewed as sound adjustments to the new circumstances of different relative prices: working harder to increase earnings in order to maintain the former consumption of other goods and/or reducing consumption of fuel or of other goods. Borrowing or using past savings might enable one to make the necessary adjustments during a longer period than otherwise and thereby to spread over time the adverse consequences of adjustment, but they can not eliminate the need to adjust. Getting a handout might be possible for some individuals, but for all it would be quite impossible.

Sovereign states are facing the same problem as individuals because of higher petroleum costs. In simplest terms, the international debt problem of today is attributable to the failure of many nations to make the harsh adjustments to the higher petroleum prices dictated by OPEC. For 3 years, these nations have had large balance-of-payments deficits that they have financed in whole or in part by borrowings.

Imbalances of Payments and Debt

In a closed system such as the world economy, the total of international payments deficits must equal the total of such surpluses. Even though the international transactions of the world economies must net out to zero, the problem with international payments balances is that for the past few years, OPEC nations and a few industrial nations have accumulated surpluses, while the majority of industrialized nations and N-O LDCs regularly have run payments deficits.

The current-account balances[2] during the 3 years 1974 through 1976 for selected areas are shown in Table 1. Clearly, the OPEC countries have accumulated large international payments surpluses during those years, which indicates that the oil price increase is primarily responsible for the large deficits shown in the lower portion of Table 1. Among the OPEC nations, Saudi Arabia's surpluses totaled about $70 billion during the past 3 years, or about one-half of the total OPEC surplus.

The accumulated deficits of France, Great Britain and Italy are consistent with the distressing economic conditions of those nations. Canada's situation has not

[1]Analogies must be used with caution, because situations similar in many aspects may not be similar in the aspects of significance. In this instance, we think the analogy is valid.

[2]The current account includes private fund transfers but not government fund transfers in addition to the balance on goods and services transactions.

Table 1
TOTAL CURRENT-ACCOUNT BALANCES
BY AREA, 1974-76
(Billions of dollars)

Surplus	
OPEC	$142
U.S., W. Germany, Japan	26
Benelux countries & Switzerland	12
	$180
Deficit	
France, G. B., Italy, Canada	$50
Other industrialized	50
Non-oil LDCs	78
Residual	2
	$180

Source: J. A. Kirbyshire, Chief Adviser, Bank of England.

yet become critical. Among the N-O LDCs, the deficits did not occur equally. An idea of the distribution of the deficits can be gained from the data shown in Table 2.

A major difficulty in working with international debt data is that a mechanism for comprehensively gathering and reporting such data on a timely basis has not been implemented, although we understand that the World Bank is proceeding with plans to do so. For this reason, the debt totals shown in Table 2 should be viewed as estimates.

Noteworthy in the data are the large totals of outstanding debt for a few of the countries, namely Brazil, Mexico, India, South Korea, Peru, Egypt, Argentina and Pakistan. Together these nations accounted for about two-thirds of the total at the end of 1976.

In terms of significance to the banking community in the event of defaults, of course the nations with the larger amounts of debt outstanding are the most important. However, others may be more heavily indebted in relation to their ability to service their debt and therefore are riskier credits. One crude measure of ability to service is the amount of foreign debt outstanding as a percentage of the nation's Gross National Product. By this measure, Chile and Zaire must be viewed as heavily indebted. According to the Morgan Guaranty Trust Company of New York, this percentage was 68 for the former and 50 for the latter at the end of 1976. Both Chile and Zaire, along with Peru and Argentina, have been unable to meet their debt obligations as scheduled and have had the terms of their loans altered. This practice is called debt restructuring.

The sheer magnitude of outstanding international debt, the recent necessity for restructuring it for some nations, and the relentless additions to it have attracted the widespread attention referred to earlier. Some analysts have reacted with alarm. A newspaper recently reported the comment of Guido Brunner, a member of the Common Market's executive commission, that the recent increases in international debt "are especially threatening because we have not yet overcome the effects of the big oil price increase in 1973." The same article described the European view that such debt constitutes a "time bomb," because it cannot continue increasing at current rates.

Other analysts admit that mounting debt is a problem but deny that it currently poses a clear threat of large-scale default. Particularly with reference to the exposure of U.S. banks, they assert that the debtor N-O LDCs are the middle- and higher-income countries within that group, and thus should be able to manage the debt burden as scheduled or with some minor restructuring.

Table 2
OUTSTANDING DEBT
OF SELECTED DEVELOPING COUNTRIES
(Billions of dollars)

Latin America	*1974*	*1975*	*1976*
Argentina	$ 5.0	$ 6.1	$ 6.5
Brazil	17.8	24.4	30.5
Chile	3.6	4.0	4.8
Colombia	3.5	3.8	4.2
Mexico	13.2	19.6	22.7
Peru	3.1	3.9	9.7
Asia			
S. Korea	5.9	8.2	10.3
India	11.6	12.4	14.9
Pakistan	4.6	5.0	6.2
Philippines	2.6	3.2	3.9
Taiwan	2.2	3.8	4.1
Thailand	1.8	1.9	2.4
Africa			
Egypt	3.9	6.4	7.4
Tanzania	0.6	0.8	1.0
Zaire	1.5	1.9	2.1
Zambia	0.7	1.0	1.3
Total of 71 Less-Developed Countries	$106.7	$132.0	$157.1

Source: Data Bank.

Moreover, the point is made that many loans to borrowers in poorer countries (public or private) are guaranteed by government agencies (such as the Export-Import Bank), international organizations, or by multinational companies. David Rockefeller, Chairman of the Chase Manhattan Bank, recently asserted that U.S. banks recognize the need to restrain lending to some LDCs, and he chastised those attracting attention with "... scare stories and apocalyptic warnings."

Although there is disagreement about the seriousness of current international debt problems, a unanimity prevails that the lending and borrowing practices of the past 3 years cannot continue. The question then arises, What is to be done about the probable continuing large imbalances of payments, especially among the N-O LDCs? We now direct our attention to the proposals for handling this problem.

Proposed Solutions to Debt Problems

For the industrialized large debtor nations, such as Great Britain and Italy, the debt problems generally are considered manageable. Attempts in those countries to reduce the payments deficits by somewhat restrictive domestic economic policies have been made. Although we doubt that success, if it comes at all, will be achieved quickly, further attention to their problems probably will await the evidence of the results of current programs. Attention is focused on the N-O LDCs. We shall refer to the choices described in the earlier analogy in presenting the proposed solutions to the debt problem.

The basic problem, you will recall, is the failure of nations to adjust their external transactions to the higher prices for oil. Precisely what adjustments would have to be made for each nation, we have no idea. Only the free play of market forces could determine them. What is clear is that during the past 3 years few nations have adjusted to the new situation; instead, they have borrowed to maintain their former consumption patterns. In the words of Federal Reserve analysts presented in the 1976 Annual Report of the Federal Reserve Bank of New York, "... in

some cases financing may have been so freely available that deficit countries, far from being required to make adjustments, have had little incentive to do so and have postponed measures that, sooner or later, will be necessary."

The funds borrowed from international banks largely were those deposited by the OPEC surplus countries. Now the banks, after reaping large profits from the tens of billions of dollars channeled through them, see the loan losses, and the possibility of much larger losses, on the foreign lending beginning to increase, although for U.S. banks, the loan-loss ratio on foreign loans is smaller than that on domestic loans. Therefore, they face the prospect of having to restrict foreign lending, but that would cut their profits. Their solution?

They support and present analyses concluding that although debtor-nation adjustment is necessary, it must be achieved gradually, through increased export earnings and foreign aid, rather than abruptly through restrictive domestic policies and trade barriers. The latter policies might plunge the world into a depression. During the period of gradual adjustment, the N-O LDCs will continue to have large current-account financing needs. Since banks no longer can assume the risks of lending to them as they have to date, the International Monetary Fund (IMF) and private banks should work together to provide financing. The IMF's role would be to design the requisite economic reforms and impose them on the borrowing nations as a condition to the granting of some IMF credit. (The private banks aver that they are unable to impose such restrictions themselves, but we cannot imagine why not, inasmuch as banks always have the right to deny credit to borrowers who fail to put their financial houses in order.) If the IMF conditional credit were granted, the private banks would feel free to extend more loans to the debtor country in the confidence that appropriate adjustment policies were implemented. Of course, the private banks could continue to report large profits on such loans.

Other Proposals

An alternative proposal to the granting of further credit by the IMF would have the IMF impose economic reforms in return for a guarantee of the debtor-nation's obligations to private banks. Surely this would be attractive to the banks; after all, it would enable them to eliminate or reduce the risk on billions of dollars of loans and to report the appealing profits that accompany them.

Augmenting the earnings of the N-O LDCs and thereby reducing the risk of default or the necessity for restructuring also would be achieved by commodity agreements designed to keep up the prices of commodities comprising a large part of the exports of LDCs. The ongoing United Nations-sponsored meetings between "rich" and "poor" countries, the so-called North-South dialogue, have the discussion of such agreements on the agenda. If such an agreement is reached, the commodities consumer will pay for the oil-importing costs of N-O LDCs and thus will underwrite the large surpluses being accumulated by OPEC states. This situation would be analogous to the individual demanding that an employer pay him a higher salary for his services so that he might continue his former buying habits in spite of a higher cost for heating his dwelling. We need not describe the probable effect on the general level of prices if such demands were met.

Also to be mentioned here is the proposal that the "strong" industrialized nations, namely, the United States, West Germany, and Japan, should further stimulate their economies in order to provide increased demand for the export commodities of deficit nations. Proponents of this view assert that such stimulus also would be consistent with the goal of increasing the rate of economic growth in those nations and, because of remaining unused industrial capacity, would not materially aggravate "inflation." In view of the record of the past decade, that anyone genuinely could make these assertions must be attributed to ulterior motives or to a resolute commitment to avoid necessary adjustments at any cost.

Finally, some analysts have claimed that many of the LDCs are international welfare cases, simply requiring financial grants for development aid for many years to come if major confrontation between the "haves" and "have-nots" is to be avoided. If this is not extortion, it must be the nearest thing to it. Such development aid has been provided in increasing amounts for many years through both bilateral arrangements and international organizations, and with what result? As far as we have been able to judge, such aid has succeeded in distorting the economies of developing countries, in fostering false expectations in the recipient nations, and in driving them into straitjackets of socialist dependency.

Implications

Perhaps no single goal has done more economic harm than that of avoiding the temporary adversity associated with adjustments. Domestically this goal has spawned the deficit-financing scheme of Keynes as a means of avoiding recessions, that is, of postponing the corrections and adjustments necessary for sound expansion. The Bretton Woods system extended this scheme worldwide, for it enabled deficit nations to avoid the restraint that would have been imposed by an international gold standard. The proposals outlined above would rely on a further extension of the IMF, the engine of inflation central to the Bretton Woods system.

What might be the expected results of adopting these proposals? A clue can be found in past results. Keynes' deficit-financing scheme has not eliminated recessions; it has postponed corrections by fostering inflating, and in so doing has worsened the distortions to be corrected. The Bretton Woods system collapsed in 1971, leaving international monetary chaos.

However, the IMF still functions. Originally the IMF was designed to provide short-term financing for deficit member nations in order to enable them to make appropriate domestic adjustments gradually. In practice, it enabled the political leaders of deficit countries to continue irresponsible spending policies for many years, to buy votes to remain in office, and to foster further economic distortions. Moreover, the record clearly indicates that the IMF has been notably ineffective in forcing unwelcomed policy changes on deficit members.

The IMF clearly is to act as a financial aid organization under current proposals for coping with the problem of international debt. In doing so it would further add to international monetary reserves. In spite of floating exchange rates (which supposedly mitigate international imbalances) and a 33-percent increase in IMF lending capacity (to about $45 billion) in January 1976, IMF representatives at a meeting later this month reportedly will consider ways of further augmenting IMF lending capabilities. In the absence of a further increase or changes in IMF practices enabling that organization to "guarantee" loans or to borrow funds, the IMF will not have the means to "assist" with the international debt problem.

Most probably IMF assets again will be enlarged in order to participate in the "temporary" financing of international payments deficits. When the IMF extends loans to member nations, international monetary reserves will increase further and world purchasing media will increase further, whether or not the volume of real transactions require such increases. If the latter do not, inflating will occur, and international economic distortions probably will increase.

The same result would be probable from further "stimulating" the economies of the "strong" industrialized countries, from increasing government grants to LDCs, and from commodity pacts boosting prices.

All of these "solutions" simply delay the necessary adjustments. To believe that the IMF might well be able to impose corrective policies on the deficit countries is sheer folly; that organization has failed to do so during the 30 years of its functioning. Not until market conditions force appropriate changes in policy will the fundamental adjustments be made. When that will be, we cannot even guess. However, when that time comes, it will come unexpectedly, as it did for New York City. In the meantime the bankers will use the opportunity to lend and to profit, while the public will bear the burden of more inflating and ultimately the suffering associated with corrective events.

Readers should not be deceived. Unserviceable international debts can be liquidated only at a fraction of their real values, either by outright default or by repayment in greatly depreciated currency. The "solutions" now proposed would avoid the former but promote the latter. This result would adversely affect everyone, not just the international bankers and their creditors.

STATISTICAL INDICATORS

Among the primary leading indicators of business-cycle changes, the average workweek in manufacturing increased during March. This series remains slightly below its high for this cycle, and its cyclical status remains indeterminate. The index of common stock prices decreased during March, and it now is appraised as probably contracting cyclically. The percentage of primary leaders appraised as expanding cyclically remains 67.

No new data were received for any of the primary roughly coincident indicators, all of which are expanding cyclically.

Among the primary lagging indicators, the ratio of consumer installment debt to personal income decreased during February from an upward-revised January level, but this series probably is expanding cyclically. The composite of short-term interest rates increased during March for the third consecutive month, and this series now is appraised as probably expanding cyclically. Its cyclical status had been indeterminate. This change increased the percentage of primary laggers appraised as expanding cyclically from 83 to 100.

That eight of the twelve primary leading indicators appear to be expanding cyclically warrants the conclusion that general business activity probably will continue to expand during the next few months.

DEMAND

RETAIL SALES

Estimates of retail sales during the most recent week and 4 weeks compare with such sales during the corresponding periods a year earlier as follows:

Period	*Percent change*
Week ended April 2	+11
Four weeks ended April 2	+11

BOOK REVIEW

If Men Were Angels by James L. Buckley, G. P. Putnam's Sons, New York, New York 10016 ($8.95).

At one time or another, and probably with increasing frequency during recent years, most Americans have experienced the frustration of dealing directly with the Government bureaucracy. Rare have been the instances when Government programs have been convincingly successful. Much more often have been the instances when such programs, as though conceived and directed by some fiend, became prime examples of bureaucratic bungling.

As disgraceful and discouraging as the inefficiencies of bureaucracy are, such inefficiencies only vaguely reveal the major danger of Government interference – the assault on individual freedom and liberty. By serving 6 years in the U.S. Senate, Mr. Buckley has viewed the workings of the Government from the inside. In *If Men Were Angels*, he describes the reasons why he greatly fears what politicians have done and are doing to the American people of today and the future in the name of solving social problems.

These words summarize Mr. Buckley's views: "What I fear has happened in the past forty years is that there has been a gradual but unmistakable erosion of the safeguards written into our Constitution. If we are to understand what is happening to us and seek to find the remedy for much of our social and political ills, we must refer to that basic document of our freedom." (p. 69)

Mr. Buckley points out that the Constitution was adopted to limit the role of the Federal Government but that the Government, nevertheless, has increased to its current unacceptably large size. Each step in the direction of more Government has seemed comparatively small and insignificant, but in sum they have created a monstrous Government. If this trend is to be reversed, Americans must choose political representatives who will have Constitutional freedom as their first and foremost priority and solutions to social problems as a lesser priority. To date, not enough have done so.

Readers sensitive to the erosion of liberty will find little new in this book. However, they might recommend it to others who have yet to become concerned about this dangerous trend. That Mr. Buckley writes with the experience of a U.S. Senator may have an impact on some otherwise blind persons.

PRICES

COMMODITIES PRICES

	1976	*1977*	
Index	*Mar. 29*	*Mar. 21*	*Mar. 28*
Spot-market, 22 commodities*	514	570	577
Commodity-futures	629	919	880
Steel-scrap	$95.83	$74.50	$73.83
	Apr. 8	*Mar. 31*	*Apr. 7*
Gold	$128.20	$148.90	$148.70

*For the preceding Tuesday.

Note: The indexes are, respectively, those of the U.S. Bureau of Labor Statistics, Dow-Jones, and *Iron Age*. The spot-market and futures indexes are converted so that their August 1939 daily averages equal 100. The steel-scrap index is a composite price for No. 1 heavy melting scrap. The gold price is the final fixing in London.

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