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November 29, 1983

To: Members of the Executive Board

From: The Secretary

Subject: The Fund, Commercial Banks, and Member Countries - Annotated Bibliography

Executive Directors will find attached an annotated bibliography presented as a supplement to Mr. Mentré's report, "The Fund, Commercial Banks, and Member Countries," which was circulated as EBD/83/200 on August 4, 1983. This document reviews a variety of studies and reports that were used as background material on external debt matters but does not pass judgment on the validity of their content.

Att: (1)

Other Distribution:
Department Heads

November 1983

THE FUND, COMMERCIAL BANKS,

AND MEMBER COUNTRIES

Appendix
Annotated Bibliography

P. MENTRE

The Fund, Commercial Banks and Member Countries

Annotated Bibliography

November 1983

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In the course of the preparation of the report on "The Fund, Commercial Banks, and Member Countries," an extensive use was made of a variety of documents, listed in a bibliography at the end of the report (1).

As a background to the main report, it was felt that it might be useful to produce an analysis of the main documents thus described. This analysis is produced in the attached seven sections which deal with:

I. General Setting

II. Statistical Data and Issues

III. Country Risk Assessment

IV. The Interbank Market

V. Supervision

VI. Rescheduling

VII. External Debt of CMEA Countries

These sections are preceded by an "Introduction: Recent Studies and Proposals," written after the release of the main report. This introduction includes an analysis of two documents issued in September 1983 by the Institute for International Economics and by the Brookings Institution and a brief review of proposals for more fundamental reforms of the existing system.

With a few exceptions, Fund documents are not analyzed in the present document, though they were extensively used in the course of the study, and were cited in the bibliography of the main report (2).

(1) The Fund, Commercial Banks, and Member Countries (EBD/83/200, 8/4/83).

(2) See notably:

Fund Policies and External Debt Servicing Problem (SM/83/45, 3/8/83)

External Debt Servicing Problems--Background Information (SM/83/46, 3/8/83)

Payments Difficulties Involving Debt to Commercial Banks (SM/83/47, 3/8/83)

Data on International Banking and External Debt (SM/83/48, 3/8/83)

External Debt and Debt Service of Developing Countries (SM/83/49, 3/8/83)

Survey of Multilateral Debt Restructurings (SM/83/227, 11/7/83)

Introduction

Recent Studies and Proposals

Two studies of a general nature on external debt problems have recently been issued:

- "International Debt and Stability of the World Economy" by William R. Cline, published by the Institute for International Economics, Washington, September 1983

- "Managing Global Debt" by Richard S. Dale and Richard P. Mattione, the Brookings Institution, Washington, September 1983

These studies are reviewed in the following pages (O-A and O-B), together with recent proposals for fundamental reforms (O-C).

0-A. International Debt and Stability of the World Economy

The report published by the Institute for International Economics analyzes external debt developments under five headings: origins of the problem; system vulnerability and emergency response; debt prospects; debt dynamics; and adequacy of banking institutions.

1. Origins of the problem

A fivefold rise in debt took place between 1973 and 1982.

Table 1. Indicators of External Debt,
Non-Oil Developing Countries, 1973-1982

	1973	1981	1982
External debt (in billions of dollars)			
Total	130	550	610
(Long-term)	(120)	(450)	(500)
Debt/exports (percentage)	115.4	124.9	143.3
Debt service/exports (percentage)	15.9	20.4	23.9
Debt/GDP (percentage)	22.4	31.0	34.7

Source: IMF, World Economic Outlook.

When comparing the nominal export growth rate to a typical interest rate on a loan to a developing country (LIBOR plus 1 percent), as a summary criterion of the ability to service the debt, a "sea change in debt servicing viability in 1981-82 may be seen." Until 1980, the interest rate averaged 10.2 percent, against a growth rate of exports of 21.1 percent; in 1981-82, the interest rate averaged 15.8 percent, while export growth in these countries averaged 1 percent.

The debt servicing difficulties of 1982 are the end result of mutually reinforcing unfavorable developments:

- the impact of exogenous shocks (oil price increases, excess of real interest rate in 1981 and 1982 over 1961-80 average, terms of trade loss in 1981-82, export volume loss caused by world recession 1981-82);

- domestic policy errors: ineffective stabilization policies; overvaluation of the exchange rate; capital flight abroad; distortions in basic development strategies;

- psychological shifts in the credit markets affecting Eastern European and Latin American borrowers.

2. System vulnerability and emergency response

The risks involved for commercial banks in an interruption of debt servicing by major borrowing countries is reflected in bank exposure to non-oil developing countries and Eastern Europe.

Table 5. Exposure of U.S. Banks, Relative to Capital

(Percentages, end-year)

	1977	1981	1982	Amounts outstanding end-1982 (In billions of U.S. dollars)
All banks				
Eastern Europe	16.7	12.9	8.9 1/	6.3
Non-oil LDCs	114.9	148.3	146.1 1/	103.2
Mexico	(27.4)	(34.3)	(34.5)	(24.4)
Brazil	(29.4)	(26.9)	(28.9)	(20.4)
Nine largest banks				
Eastern Europe	25.0	19.5	13.9 1/	4.0
Non-oil LDCs	188.2	220.6	221.2 1/	64.1
Mexico	(32.9)	(44.4)	(44.4)	(12.3)
Brazil	(41.9)	(40.8)	(45.8)	(13.3)

Source: Federal Reserve Board of Governors, country exposure lending survey.

1/ When adding to Eastern Europe and non-oil LDCs, OPEC countries not in capital surplus (Algeria, Ecuador, Indonesia, Nigeria, Venezuela), the total exposure represents 235 percent of capital for all banks and 293 percent for the nine largest banks.

The exposure to five major Latin American borrowers having experienced debt-servicing difficulties in 1982 (Argentina, Brazil, Mexico, Venezuela, Chile) exceeded 150 percent of capital for five of the nine largest U.S. banks.

The collective interest of borrowing countries, commercial banks, central banks, and the IMF in avoiding a debt collapse led to coordinated major rescue operations in 1982-83 (Table 8 in Annex). "By mid-1983, the principal rescue package appeared to be functioning relatively well." "In Brazil, however, the program was proceding less smoothly." But the central policy question concerned not so much the feasibility of immediate financial rescue but "whether over the medium term the debt problems could be managed as tractable liquidity problems."

3. Debt prospects, 1983-86

Projections for the period 1983-86 of the balance of payments and debt for the 19 largest debtor countries (around two thirds of the total external debt of developing and Eastern European countries and around three-fourths of the debt owed to private banks) are presented under alternative assumptions about the rate of economic growth in industrial countries, the international interest rate (LIBOR), the price of oil, and the real exchange rate of the dollar relative to other major currencies.

Table 10 (see Annex), the base case, 1/ shows a significant improvement of the debt situation of oil importing countries over the period. Overall, for 75 percent of outstanding debt, the base case indicates improvement over the next four years, which is consistent with the other studies (Morgan Guaranty and the IMF); however, debt service ratios would remain high for some major borrowers (Argentina, Brazil, Mexico), implying a continuation for them of the process of "involuntary lending" for some years.

Alternative assumptions show:

- a deterioration of the debt situation if OECD growth in 1984-86 is less than 2.5 percent a year;

- a deterioration of debt indicators of oil exporting countries greater than the improvement of debt indicators of oil importing countries under lower assumptions for oil prices;

- a more limited impact of interest rates: "on average, a 1 percentage point change in OECD growth is seven times as powerful as each percentage point change in the interest rate in remedying the debt problem"; and

- a significant impact of the value of the dollar: if the dollar is higher by 10 percent over the period when compared to the base case, one half of the improvement of the ratio of debt to exports is erased.

1/ Industrial country growth in percentages: zero in 1982, 1.5 in 1983, and 3.0 in 1984, 1985, and 1986; oil price in dollars per barrel: 34 in 1982, 29 in 1983, 1984, and 1985, and 34 in 1986; LIBOR in percent per annum: 15 in 1982, 10 in 1983, 9 in 1984, and 8 in 1985 and 1986; depreciation by 10 percent of the dollar in 1984 and stability thereafter.

The ratio of debt to exports of goods and services which stands at 1.87 at end-1982 improves to 1.62 in 1986 in the base case scenario but alternative assumptions lead to other results within a range of 1.41 (best case) to 2.78 (worst case); "clearly, the international debt problem contains major 'downside' risk even though the central analysis here suggests that in the expected base case it is manageable."

4. Debt dynamics

a. Involuntary lending

Involuntary lending is the appropriate answer to present difficulties, since "banks must extend new money in order to shore up the quality of their previous outstanding loans."

"Lenders will provide additional new loans as long as (a) the reduction in the probability of country default thereby achieved, multiplied by previously outstanding loans exceeds (b) the terminal probability of default (after the new loans) as multiplied by the amount of new loans. The amount (a) is the expected (probability-weighted) benefit of new lending, while the amount (b) is its expected cost."

A simple model of involuntary lending suggests that over the range of most relevant situations likely to arise (new lending not exceeding 10 percent of outstanding loans) it will pay the banks to extend additional credits to secure the value of existing exposure. "The process of involuntary lending should be relatively reliable as a source of continued capital flow during the interim period before the country can return to capital markets on the basis of normal creditworthiness and fully voluntary bank lending."

To achieve such a result, there is a need to ensure uniform collective action, including that by regional and smaller banks (the "free-rider" problem, to be overcome by official pressure, the network of influence which large banks have on smaller banks, and the attitude of borrowing countries toward recalcitrant banks).

The analysis implies that a transfer of existing bank claims to an international agency would be counterproductive because it would eliminate the strongest incentive for banks to provide new loans to a debtor country.

b. Rescheduling techniques

While an increase in the interest rate on rescheduled loans "is probably a sensible market response to the situation," there may be "some room for smaller increases of interest rates on rescheduled loans than recently applied." (Mexico experienced an increase of spreads by about 1 percentage point.)

The Mexican and the Brazilian experiences show that it is better to have a more complete and larger rescheduling than to rely on voluntary maintenance of credit lines combined with a smaller amount of rescheduling.

"Private debt should be more formally integrated into the rescheduling process."

c. Default incentives

"The consequence of default could reach far beyond trading the loss of new borrowing in exchange for avoiding interest payments": interruption of short-term credits; cash payments of imports; attachment of foreign assets; and international reprisals.

"The dynamic of credit rating self-preservation is likely to defeat attempts to establish a debtors' cartel" and "the major debtor countries (except perhaps Poland) still remain far from the point where default or radical rescheduling on nonmarket terms would be an attractive option."

5. Adequacy of banking institutions

There is a need for better discipline and organization of bank lending (role of the IMF, role of the new Institute for International Finance).

Supervision of bank lending should be strengthened while avoiding mandatory country limits. The five-point program of regulation 1/ proposed by the Fed, the Comptroller of the Currency, and the FDIC deserves strong support.

Loopholes exist in lender-of-last-resort coverage but "the events of 1982-83 illustrate a willingness of central banks to work together in a crisis, suggesting that, if necessary, they could agree on the division of lender-of-last-resort responsibility for currently ambiguous cases."

6. Policy measures for capital flows

a. A central figure for developing country needs for net capital inflows (non-oil developing countries plus Algeria, Indonesia, and Venezuela) would be on the order of US$75 billion to US$80 billion on average in each of the next few years. This estimate is lower than IMF estimates (World Economic Outlook) and higher than Morgan Guaranty estimates (World Financial Markets).

b. Prospective flows are as follows:

1/ (a) Stricter examination of country exposure, including expectations of high capital-to-loan ratios for banks with greater concentration of country exposure;

(b) more public disclosure of the country exposure;

(c) the definition of new loan classification with requirements for write-off (loss) or provisioning into reserves (reservable);

(d) stretchout of reported income from loan fees; and

(e) increased cooperation with banks' regulators abroad and, possibly, greater sharing of IMF information.

Table 21. Prospective Annual Net Financing, Selected OPEC 1/ and Non-Oil Developing Countries, 1983-86

(In billions of dollars)

	Case A	Case B
Official transfers	14	13
New direct investment	12	10
Official lending		
Concessional	10	10
Nonconcessional		
Multilateral development banks	8	7
IMF	7	2
Official export credits	4	3
Private lending	25	10
Total	80	55

Source: Institute for International Economics.

1/ Noncapital surplus. Cases A and B are based on alternative assumptions for private lending (by commercial banks).

This table underlines the need to implement the IMF quota increase, to accelerate disbursements by multilateral banks, notably the World Bank, through structural adjustment lending, and to maintain an adequate level of bank financing (a US$25 billion figure is equivalent to an annual expansion of exposure by approximately 8 percent).

7. Radical reforms and contingency measures

a. Reform proposals (see Document O-C)

Various schemes have been presented by P. Kenen, Senator Bradley, Messrs. Schumer and Rohatyn, and Norman Bailey. Most of them share the following disadvantages: adverse impact on new bank loans; distressing implications for bank capital; massive requirement of public capital (contingent liabilities in the vicinity of US$350 billion to take over one half of the debt); and unfairness between debtor countries.

b. Contingency planning

Debt problems should continue to be addressed on a case-by-case basis; if conventional reschedulings and rescue packages are insufficient, the package should be repeated with an additional round of support from the key participants; in more extreme cases, banks might have to capitalize some portion of the interest, possibly through the use of zero coupon bond techniques; in even worse cases some arrangements analogous to bankruptcy proceedings could emerge but without setting up a new international machinery.

8. Policy conclusions

- A global recovery is essential and protectionist measures should be resisted.

- Sweeping debt reform should be avoided as counterproductive.

- The resources of the IMF and of the multilateral banks should be increased.

- Private banks should continue new lending at modest rates to countries undergoing adjustment. The IMF should continue its important new role of actively mobilizing bank lending.

Table 8. Financial Rescue Packages for Argentina, Brazil, Mexico, and Yugoslavia, 1983

(In billions of U.S. dollars)

	Argentina	Brazil	Mexico	Yugoslavia
Financial support				
IMF				
Stand-by	1.7	--	--	0.6
Extended Fund facility	--	4.6	3.7	--
Compensatory finance and other	0.5	1.3	0.22	--
World Bank	--	--	--	0.3
Bank for International Settlements	0.5	1.2	0.925	0.5
United States				
Oil payments	--	--	1.0	--
Commodity Credit	--	--	1.0	0.2
Federal Reserve	--	0.4	0.925	--
Treasury	--	1.53	--	--
Private banks, new loans	1.5	4.4	5.0	3.8 1/
Government trade credits	--	--	2.0	1.1
Total	4.25	13.4	14.7	6.5
Debt rescheduling				
Amount	5.5	4.9	19.5	...
Originally due	1982-83	long-term 1983	8/1982 to 12/1984	...
Coverage	public	public	public	...
Pending negotiation	all private 2/	...	15.0 private	...

Sources: House of Commons, Treasury and Civil Service Committee, International Monetary Arrangements International Lending by Banks (London, March 15, 1983), pp. xxviii-xxix; Wall Street Journal, May 9, 1983.

1/ Includes pressure on banks to maintain short-term credit lines.
2/ New loans, US$600 million; US$1.4 billion to repay matured debt; US$1.8 billion stretchout of short-term loans.

Table 10. Projections of Balance of Payments and Debt, Base Case, 1982-1986

(In millions of dollars and ratios)

	1982	1983	1984	1985	1986
Oil importers					
Exports	110,536	125,243	158,805	179,936	199,758
Imports	-125,552	-135,360	-159,308	-174,566	-194,848
Of which: Oil	(-34,499)	(-29,426)	(-29,426)	(-29,426)	(-34,499)
Interest	-29,464	-29,256	-30,058	-29,591	-30,187
Current account	-35,451	-30,890	-20,207	-12,564	-12,626
Debt	299,377	327,595	346,638	355,816	365,535
Net debt/exports	1.94	1.88	1.55	1.40	1.28
Debt service/exports	0.39	0.38	0.32	0.28	0.26
Oil exporters					
Exports	76,300	69,783	74,836	78,072	89,813
Of which: Oil	59,140	50,443	50,445	50,443	59,140
Imports	-64,756	-66,835	-84,013	-92,747	-101,070
Interest	-15,423	-16,520	-16,886	-18,305	-21,284
Current account	-20,989	-19,711	-33,973	-40,933	-40,674
Debt	184,778	201,558	234,702	272,769	310,119
Net debt/exports	1.77	2.04	2.13	2.35	2.36
Debt service/exports	0.34	0.40	0.38	0.40	0.41
Total, 19 countries					
Exports	186,836	195,026	233,642	258,008	289,571
Imports	-190,308	-202,195	-243,321	-267,314	-295,918
Interest	-44,887	-45,775	-46,944	-47,896	-51,471
Current account	-56,440	-50,602	-54,181	-53,498	-53,300
Debt	484,155	529,153	581,340	628,585	675,654
Net debt/exports	1.87	1.94	1.74	1.70	1.62
Debt service/exports	0.37	0.38	0.34	0.32	0.30

Source: Institute for International Economics.

O-B. Managing Global Debt

The report published by the Brookings Institution analyzes external debt developments. It can be summarized under three headings: statistical analysis of international bank lending; debt projections; and policy recommendations.

1. Statistical analysis of international bank lending

Untied bank credits have played an increasingly important role in the provision of external financing.

Table 3. Disbursed Debt of Non-OPEC Developing Countries

(In billions of U.S. dollars)

	1971	1975	1981	1982
Medium- and long-term debt	75	152	445	520
Official development assistance (DAC)	21	30	49	55
Export credits (DAC countries)	20	30	91	105
Of which: From banks	(...)	(...)	(39)	(49)
Capital markets	17	54	192	228
Of which: Bank loans	(10)	(43)	(156)	(182)
Multilateral organizations	10	20	60	70
Other sources (CMEA, OPEC, etc.)	7	18	53	64
Short-term bank debt	...	...	110	134

Source: OECD, External Debt of Developing Countries, 1982 Survey.

The proportion of floating rate net liabilities has increased.

Table 4. External Assets and Liabilities of Non-OPEC Developing Countries

(In billions of U.S. dollars)

	Liabilities 1980	Liabilities 1982	Assets 1980	Assets 1982	Balance 1980	Balance 1982
1. Medium- and long-term debt	322	438	25	40	-297	-398
A. Fixed interest rates	216	272	22	33	-194	-239
B. Floating interest rates	106	166	3	7	-103	-159
2. Short-term debt	93	121	106	114	13	-7
3. Total floating interest rates (1.B. + 2.)	199	287	109	121	-90	-166

Source: OECD, Debt of Developing Countries, 1982 Survey.

The participation of U.S. banks in these developments is as follows for major borrowing countries.

Table 7. U.S. and Non-U.S. Bank Claims on Major Developing Country Borrowers, June 1982

Country	Total Bank Debt	Owed to U.S. Banks	Owed to Non-U.S. Banks	U.S. Share
	In billions of U.S. dollars			In percent
Mexico	64.4	24.3	40.1	37.7
Brazil	55.3	20.7	34.6	37.4
Venezuela	27.2	11.1	16.1	40.8
South Korea	20.0	8.7	11.3	43.5
Argentina	25.3	8.6	16.7	34.0
Chile	11.8	6.3	5.5	53.4
Philippines	11.4	4.8	6.6	42.1

Source: Statement of Paul Volcker to the U.S. Congress, House Committee on Banking, February 2, 1983.

The debt picture has sharply worsened since the second oil shock leading to the 1982 crisis: world recession; highly positive real interest rates; a tendency of banks to respond to uncertainty by shortening the maturity of their new commitments (50 percent of bank loans to Mexico in the first part of 1982 had a maturity of under one year), thus compounding future difficulties; and regional contagion of political difficulties.

2. Debt projections

Under a scenario of adjustment in the developing countries and moderate recovery in the OECD countries, debt projections show a gradual improvement of the present situation.

Table 9. Financing Scenario for Major Developing Country Borrowers

(In percent per year)

	1983	1984	1985	1986-1990 Annual average	1990
OECD real GNP growth	2	3.5	3.5	3.0	
OECD inflation (in dollar terms)	4	8.0	8.0	6.0	
LIBOR	9.25	8.5	9.0	9.0	
Oil price (dollars per barrel)	28.0	29.0	32.0	--	
Change in non-oil commodity price)	2	12	10	1.4	
Current account deficit:					
In billions of U.S. dollars	41	27	28		34
Share of exports (in percent)	(15)	(9)	(8)		(5)
Total debt:					
In billions of U.S. dollars	557	582	619		822
Share of exports (in percent)	(196)	(182)	(166)		(123)

Source: Morgan Guaranty Trust, Global Debt, World Financial Markets (1983).

The situations between individual country borrowers continued to show marked differences.

Table 10. Projections of External Debt of Major Developing Country Borrowers

	1982	1985	1990	1982	1985	1990
	Total In billions of U.S. dollars			Share of exports of goods and services In percent		
21 developing countries	514	619	822	178	166	123
Argentina	39	45	45	388	302	179
Brazil	86	104	122	345	333	219
Chile	17	18	18	285	187	116
Colombia	10	11	14	186	183	132
Mexico	85	95	117	253	199	125
Venezuela	33	37	70	155	190	213
Indonesia	22	33	53	98	135	133
Philippines	21	25	31	233	197	143
South Korea	37	47	50	121	111	64
Turkey	23	26	34	226	184	130

Source: Morgan Guaranty Trust (see Table 9).

The sensitivity of external debt projections to growth in OECD countries is high.

Table 11. External Debt of Major Developing Country Borrowers, Sensitivity to Base Case Assumptions

	1982	1985	1990	1982	1985	1990
	Total			Share of exports		
	In billions of U.S. dollars			In percent		
Base case	514	619	882	178	166	123
Change in OECD Growth rate (-1 percent per year)		632	1,055		174	173
Change in terms of trade (+1 percent per year)		608	660		164	102
Change in oil prices (+20 percent per year)		600	687		154	99
Change in LIBOR (+2 percent)		640	930		170	137

Source: Morgan Guaranty Trust (see Table 9).

The base case leads to a 6 percent annual growth rate of debt until 1990 consistent with net bank credits lower than interest payments to them Even in the base case, the situation of major Latin American borrowers will remain difficult over the next three years (debt export ratios will still exceed 300 percent for Argentina and Brazil in 1985). A sustained world economy recovery will be a crucial element in easing debt difficulties.

3. Policy recommendations

a. The role of the IMF

- A need to increase quotas and to contemplate borrowing on private capital markets.

- A new role in international credit management.

- A better sharing of information.

- A more active role is debt surveillance.

b. <u>The role of regulators</u>

- Limits on country lending: a need to move cautiously.

- Capital-adequacy requirements should be strengthened.

- Reserve provisions: a need to preserve the flexibility of regulatory authorities (present proposal of U.S. regulators: initial provision of 10 percent of bank loans for countries with protracted debt servicing problems, classified as reservable, with additional annual provisions of 15 percent if warranted--see joint memorandum on international lending).

- Disclosure: a need to act with determination (present proposal of U.S. regulators: disclosure of loans to individual countries exceeding 1 percent of total assets, along with information on the type of borrower and the maturity distribution of loans; and total loans outstanding to countries when exposure is between 0.75 percent and 1 percent of total assets).

- Accounting for fees: modest impact on bank earnings of the proposal aiming at dividing fees over the life of the loan when calculating earnings.

- Regulation of the Euromarkets: a specific problem to be considered separately from international debt problems.

c. <u>Change in the terms and source of commercial lending</u>

- Flexible maturity loans (derived from home mortgage practices) difficult to contemplate for lenders but an emphasis to be put on long--term funds (direct investments and bonds).

- Bold new schemes (Exchange Participation Notes, N. Bailey; International Debt Discount Corporation, Peter Kenen; Worldwide Municipal Assistance Corporation, Rohatyn) not favored because they would eliminate all incentive for commercial banks to increase their exposure.

- Marginal loan guarantees (guarantee given by the IMF or some other government-backed body to bank loans mandated under the IMF's own lending program, on the conditions that old loans be rescheduled) could be used to cover an adequate level of new credit flows and cope with contrasting individual situations.

O-C. The Debt Crisis: Recent Proposals 1/

While there is considerable overlapping in the main ideas underlying the various proposals, they can be broadly classified into six main categories.

1. Indexing of the principal

An example of this approach is a proposal by John Williamson. It starts from the proposition that the short maturities of LDC borrowing from banks, together with high nominal interest rates, which effectively shorten the maturities significantly further, mean that the debt service ratios become high, even though the level of debt in real terms is not particularly high by historical standards. The proposal is that an international institution issue bonds of 50-year maturities, denominated in SDRs, with a real interest payment and redemption value which are indexed to some internationally weighted price index. The bonds would be issued on behalf of a group of LDCs, thus spreading the risk. A partial guarantee given by the issuing authority would further reduce risk for lenders. Borrowers' repayment would be related to their share in the issue, modified by any unexpected change in their terms of trade, compared with a "normalized" movement in the terms of trade of the borrowing countries as a group. The proposal aims at insulating the real value of the debts, and also their effective maturities, from unexpected variations in the rate of inflation.

2. Conversion of existing claims

Under the Kenen proposal, 2/ a newly established international corporation would issue guaranteed paper in exchange for part of the LDC debt held by the private banks, which the corporation would take over at a discount of, say, 10 percent of its face value. The paper issued by the corporation would be of relatively long maturity, and would be held by the banks. The corporation would buy up the debts of only those countries which agree on an adjustment program with the Fund. An individual bank would not be allowed to choose the debts it discounts with the proposed corporation; it would need to discount a given proportion of all of its eligible claims on LDCs. The interest rate on the bonds would be below commercial levels, thus providing the mechanism through which the banks absorb their share of the loss. This will affect the banks' income account over time, but not their assets, thereby protecting the banks' solvency.

The Kenen proposal also involves essentially a lengthening of maturities, with the difference that the international corporation deals directly with the creditor banks rather than with the LDC borrowers.

1/ This document has been essentially drafted by Mr. Thakur (European Department).

2/ New York Times, March 6, 1983. See also related proposals by Senator Bradley.

Richard Weinert, an investment banker, proposed in Foreign Policy (Carnegie Endowment for International Peace, Spring 1983) a similar scheme but centered on the World Bank: a swapping of World Bank bonds for LDC debt held by private banks; a share retained by commercial banks which would reschedule it under the new terms granted by the World Bank; an interest rate set annually based on a formula including export volume and terms of trade; and an offsetting payment by the World Bank of any difference between a minimum interest rate and the result of the formula.

3. Sharing of foreign exchange earnings

The scheme suggested by Messrs. Bailey, Luft, and Robinson 1/ calls for the debtor countries to give creditors a claim on a certain percentage of the country's future foreign exchange earnings. In lieu of the scheduled repayment of principal, creditors would receive negotiable Exchange Participation Notes (EPNs), which would entitle them to some agreed percentage of the debtor's gross foreign exchange earnings. The scheme would apply only to part of the debt, especially the part not tied to foreign exchange-earning projects. In order to qualify for the issuance of EPNs, a country would need to agree on a structural adjustment program with the Fund. The central banks of debtor countries would act as collection and paying authorities for the EPNs, perhaps jointly with committees appointed by creditors. The EPNs could be saleable in a secondary market.

4. Stretching out of maturities

The Rohatyn plan and related schemes, as the one presented by Representative Schumer, call for stretching out maturities of short-term loans to 25-30 years at lower interest rates. The schedules of principal repayments would be tailored to the individual country cases to reduce debt service ratio to about 25-30 percent. The Rohatyn plan is based on the model of the Municipal Assistance Corporation (MAC) for New York, which converted the city's short-term debt into long-term debt, with the Fund or another international institution in the role of the MAC. The mechanism of the stretching out would be similar to the Kenen proposal--an exchange of bank debts for long-term low-interest bonds to be issued by an international agency.

5. Marketability of claims

Certain British bankers (including officials of Barclays Bank and Morgan Grenfell) have advocated a discounting device whereby banks could

1/ Messrs. Bailey and Robinson are on the staff of the U.S. National Security Council and Mr. Luft is with the U.S. State Department.

sell off the rescheduled developing country debts to central banks or other agencies to obtain liquidity for use to other lenders, domestic and foreign. 1/

6. Write-off schemes

Some other proposals, less formally presented by their proponents than the above schemes, aim at an explicit writing off of part of the developing country loans. An international conference of creditors and debtors is sometimes mentioned as a venue for the negotiations leading to such a step and an international organization such as the Fund is assigned the role of managing an orderly write-off.

1/ Janet Porter, "Answers to Liquidity Crises," Journal of Commerce, March 13, 1981; Barnaby J. Feder, "The World Banking Crisis: Phase Two," New York Times, March 27, 1983; and talk by Peter Leslie, Senior General Manager, Barclays Bank International at the Financial Times Conference, "The Euromarkets in 1983," on March 8, 1983.

I. General Setting

The documents of the G-30 provide a comprehensive picture of the general setting with a specific reference to possible improvements on: information gathering, the rescheduling process, the functioning of the interbank market, and the problem of the lender of last resort (IA).

Data on international bank lending are provided in IB. The G-30 (IC) stresses the role of new participants in the market. In view of the slowdown in international lending, related notably to the attitude of small banks, the G-30 recommends (document ID) a greater involvement of the Fund, including Fund borrowing on capital markets.

The Development Committee task force on nonconcessional flows (IE) stresses the role of multilateral institutions and cofinancing. Morgan Guaranty (IF) has also devoted several issues of its publication, World Financial Markets, to the debt problem, notably "Global Debt - Assessment and Prescriptions" (February 1983), with debt projections for 1983-86 under alternative scenarios.

I-A. Risks in International Bank Lending (G-30, 1982--Geoffrey Bell, John Heimann, Co-Chairmen)

1. Country risk

Aggregate exposure to the LDCs of the nine largest U.S. banks represents 200 percent of their capital in 1980; foreign assets and liabilities represent 22 percent of total assets and liabilities of OECD banks.

Loss record satisfactory (international net loan losses represent in 1980 0.10 percent of international loans) but new concerns: data deficiencies (military debt, short-term debt, lags in data); use of indicators; role of supervisors.

G-30 observations: insufficient factual information (a need to improve on quality, timeliness and availability); means for centralizing data collection could be explored; the attitudes of supervisors when reviewing risk assessment by banks should be more homogenous.

2. Rescheduling

Since 1956, 53 official reschedulings for 20 countries; standard procedures in Paris meeting (request by debtor countries, existence of arrears, IMF program, attendance by OECD creditors plus observers); standard terms (80 percent of debt; two- to three-year period covered; new maturities up to eight to ten years; according to Chandra Hardy, total net cost for creditors representing 0.5 percent of outstanding debt).

Reschedulings of debt to commercial banks increasing in recent years; a large number of banks normally involved (115 for Nicaragua, 200 for Turkey, 500 for Poland) implying the setting up of steering committees; protracted discussions (six months-four years); somewhat standard terms (interest not covered with the exception of Nicaragua, three-year grace period, seven- to ten year maturity, LIBOR plus 1 3/4 to 2 percentage points).

G-30 observations: A need for a more formalized process through a representative body, to improve the flow of information, to discuss issues relating to debt servicing difficulties, to develop expertise; a need for less rigid patterns derived from bank relations with corporate borrowers.

3. International interbank market

Size of the market (BIS) increasing from US$182 billion in 1975 to US$522 billion in 1981 (two thirds of Eurocurrency deposits).

One thousand banks from 50 countries operating on the market but reliance on interbank funding higher for smaller banks, newcomers, banks withoug U.S. base, consortium banks; most banks will redeposit more than 40 percent of interbank deposits (60 percent for the largest banks).

Assessment of risks based on financial statements, ownership management quality, national support system (supervision, LOLR facilities); tiering limited except in crisis situation (Herstatt crisis with premiums as high as 2 percent) but lending limits.

G-30 observations: risks of re-emergence of steeper tiering and withdrawal of stand-by lines under severe market conditions should add an element of self-descipline, notably for "net takers;" lack of transparency of the market (use of brokers); a need to look at LOLR issues (present ambiguities) and to improve the quality of supervision of a number of banks from outside the major countries.

4. Maturity transformation

Risks in maturity transformation increased by instability of interest rates, hence the use of floating rates and rollover techniques passing the risk to the customer.

Risks of tiering and funding maintained, hence the efforts underway in the Cooke Committee to have a closer look at maturity transformation (already the case for the Bank of Japan and Banque de France).

G-30 observations: in view of the unavailability of statistics additional efforts by supervisors justified.

5. Distressed banks

Three recent examples-Herstatt, 1974 (foreign exchange losses, abrupt close, interruption of international payments); Franklin National Bank, 1974 (cooperation between the Fed, the Bank of England, and European bankers); Banco Inter-Cambio Regional, 1980 (liquidation ordered by the Argentine Central Bank) foreign banks not protected on their US$80 million claims; New York State Banking Department taking possession of the New York branch; run against other Argentine banks with a total loss of reserves of about US$2 billion).

Commercial bankers stress "the need for a clear understanding of LOLR facilities" notably for non-G-10 countries, foreign subsidiaries, multi-national consortiums; central banks adhering to their 1974 statement ("they recognized that it would not be practical to lay down in advance detailed rules and procedures for he provision of temporary liquidity" but they were "satisfied that means are available for that purpose and will be used if and when necessary").

G-30 observations: some ambiguity in the attitude of central banks probably necessary but the concern of commercial banks should be noted.

6. Competition, profitability, and capital

Increasing competition in the market (one third of syndicated loan managers in the first ten positions in 1980 headquartered outside Europe and North America); some feeling of unfair competition from highly leveraged state-owned banks; some impact of different regulatory requirements; profitability based on adequate spreads (true gross return = spread + 0.25 percent); according to banks interviewed, adequate spreads probably in the vicinity of 3/8 percent.

Capital adequacy listed by the BIS April Communiqué as one of the three elements of international banking soundness to which the central bank governors attach "cardinal importance"; national efforts under way in the United Kingdom, Germany, and Switzerland.

G-30 observations: a need for some convergence in capital requirements through increased cooperation between supervisors.

7. Further suggestions for reducing risks in banking

a. Provisions for rescheduled loans

There are arguments for (discipline) and arguments against (refinancing versus rescheduling) provisions for new loans but on balance the group encourages supervisors to go in this direction.

b. A consultative group for international banking

Rescheduling process inadequate; a need for better consultation between banks, regulators, creditor governments, multilateral institutions at a time of increased risks; a bank forum could improve data collection and the rescheduling process; it could constitute a place where the views of borrowers might be conveyed to the international banking community; it could strengthen relations with official agencies, notably for the financing of joint operations.

I-B. The Dimensions of International Bank Lending - (G-30, 1982)

1. Growth of world financing needs

From 1960 to 1980 average yearly growth rate of 3.8 percent for world GNP, 20 percent for world trade which represents now 15 percent of world GNP, and 27 percent for BIS banks' claims.

International bank lending represented in 1980 about 55 percent of recorded international capital flows.

2. Recent growth in international lending by banks:

Size of the Eurocurrency markets in the vicinity of US$1,500 billion in 1980 against US$25 billion in 1964 and US$310 billion in 1973.

Eurocredits granted in 1980 in the vicinity of US$70 billion.

3. Dimensions of international bank lending

Data based on quarterly and semiannual statistics of the BIS with some deficiencies (see (2)).

a. Types of financing

Not available on an aggregated basis.

b. Participants (lenders)

Five hundred and twenty banks from 80 nations have direct presence outside their country (United States, 125; United Kingdom, 25; Japan, 23; Germany, 21; France, 19; Spain and Portugal, 20; Italy, 13; Switzerland, 13; Netherlands, 6; other European, 47; Canada, 8; Brazil, 8; other Latin American, 26; other Asian, 52; Middle East, 43; Africa, 31; Australia and New Zealand, 8); overall 4,400 branches, 440 subsidiaries and 1,200 affiliates (see Page and Soss, "Some Evidence on Trans-National Bank Structures," Office of the Comptroller of the Currency, 1980).

Sixty-five new lenders per year participated in the syndicated loan market (one third from outside Europe or North America).

Loan leaders and managers rankings given in Institutional Investor: top 25 ranked banks (7 from United States, 4 from Canada, 4 from the United Kingdom, 3 from Germany, 3 from France, 3 from Japan, 1 from Belgium) representing 60 percent of lead management of the first 75 banks.

Bank size related to international loan volume for the top 25 banks; below the 25th rank are internationally present banks with an overall relatively limited size (Middle East banks, small European banks, consortium banks) and absent some large domestic banks (cooperative banks, Mitsui Bank, Mitsubishi bank).

c. Borrowers and loan characteristics

(1) BIS data

More than one half of BIS reporting area claims are on members of the area itself (40 percent on three countries: Brazil, Mexico, and Argentina). At the end of 1980 the maturity distribution was as follows: 46 percent below one year, 8 percent between one and two years, 37 percent beyond two years, and 10 percent unallocated.

Unused committments amount to 23 percent of total claims (15 percent for centrally planned economies, 24 percent for non-oil LDCs, including 39 percent for Asia).

(2) Data on U.S. and U.K. banks

Claims of U.S. and U.K banks represented the following proportions of BIS area claims:

Share of BIS Area Claims Held by U.S. and U.K. Banks, 1980

(In percent)

	United States	United Kingdom
Reporting area (gross)	17	7.5
Other industrial	23	20
Centrally planned	9	15
Oil exporting	33	20
Off-shore centers	20	8
Non-oil LDCs	37	14
Latin America	33	12
Middle East	26	10
Asia	51	16
Africa	18	19
Europe	24	17
Total	22	10

Share of U.S. banks especially large in Latin American countries (Chile, 55 percent; Venezuela, 45 percent; Mexico, 38 percent; Argentina, 36 percent; Brazil, 32 percent), in some Asian countries (Taiwan, 86 percent; the Philippines, 67 percent; South Korea, 52 percent) and in Turkey (45 percent); U.K. banks more exposed on East European countries (the share of the U.K. banks in total BIS claims represents 19 percent for the U.S.S.R., 18 percent for East Germany, and 14 percent for Poland against 4 percent, 12 percent, 14 percent, respectively, for U.S. banks).

(3) Data on non-oil LDC debt

Total long-term debt of non-oil LDCs increased by 330 percent from US$97 billion in 1973 to US$425 billion in 1981.

The share of private banks in total long-term debt has increased from 35 percent in 1973 to 49 percent in 1981; correspondingly there was a decline of the share of official creditors from 50 percent to 42 percent and of other private from 13 percent to 9 percent; claims of private banks amount now to about four times the claims of international organizations (13 percent of total claims).

Ratios of non-oil LDC outstanding debt to GDP or to exports showing some improvement; since 1973 debt service payments have increased by 500 percent, faster than the debt itself which increased by 330 percent, due to less concessionary rates, shorter maturities, rising interest rates; accordingly the debt service ratio has increased from 14 percent in 1973 to 18 percent in 1979 and 21 percent in 1981.

At the end of 1979, 12 countries had an outstanding debt larger than US$10 billion (Brazil, 52; Mexico, 33; Algeria, 17; India, 17; Indonesia, 16; Korea, 16; Yugoslavia, 12; Egypt, 12; Turkey, 11; Venezuela, 11; Argentina, 11; Israel, 10) and 9 countries had an annual debt service higher than US$2 billion (Brazil, 11; Mexico, 11; Korea, 3; Argentina, 3; Algeria, 3; Indonesia, 2; Yugoslavia, 2; Venezuela, 2; Iran, 2).

(4) Funding

Interbank transactions represent 40 percent of external liabilities of BIS banks; burgeoning volume of international transactions contributed to the tenfold increase in annual settlement volume through CHIPS since 1970.

Twenty largest banks able to attract a disproportionate volume of deposits, relending them on the interbank market on which one thousand to two thousand participants operate.

The ratios of net positions by maturity class to total assets and liabilities show a maturity mismatch: a ratio of 1.7 for maturities between one and three years and of 5.9 for maturities beyond three years (London banks).

Large tiering normally exceptional but differences between four categories: (i) five prime U.S. banks; (ii) other large U.S. banks, and three or four German, Swiss, U.K., Dutch, and Japanese banks; (iii) other prominent international banks; and (iv) second-tier banks from all other countries (see Giddy, "Risk and Return in the Eurocurrency Interbank Market," August 1981).

(5) Profitability

Average quoted spreads are narrowing (see table) but are supplemented by fees and by large spreads on the unpublicized private market.

	Average Spreads	
	1977 IV	1981 II
	(In per cent)	
All borrowers	1.17	0.74
OECD borrowers	0.84	0.47
COMECON	1.05	0.62
Non-OECD	1.46	0.99
Average maturity	7 years	7 years, 9 months

Banks generally obtaining funds at below LIBOR rates (minus 1/8 percent or minus 1/4 percent less), which represents an added advantage for highly leveraged banks.

As for the 10 leading U.S. banks, international earnings represented in 1980, 47 percent of total earnings (against 52 percent in 1975) and 0.48 percent of international assets (against 0.52 percent in 1975).

The loss experience of U.S. banks on international loans appears favorable compared to domestic loan losses, with the ratio of net loan losses to total loans in 1980 of 0.12 for foreign offices, and of 0.44 for domestic offices.

See also "Is International Banking Such a Good Idea"? by N. Oshors in Institutional Investor, June 1981, which underlines that return on total assets (Rota) is lower on foreign assets than on U.S. assets,

	Overseas	U.S.
Chase Manhattan	0.56	0.82
Continental Illinois	0.56	0.70

and that the foreign assets ratio is further eroded by the ongoing reduction of the spread between overseas earning assets and overseas earning liabilities.

I-C. Trends in Eurocurrency Credit Participations, 1972-80
(Page and Rodgers, G-30, 1982)

a. The World Bank data give the names of the first ten participants in syndicated Euroloans between 1972 and 1980; they can be summarized as follows:

	1973	1974	1975	1976	1977	1978	1979	1980
New participants in the market	75	65	64	56	66	63	64	73
Total number of participants	178	207	235	256	288	327	342	386

Breakdown of Total Number of Participants

(In percent)

	1972	1980
Europe	37	43
United States/Canada	26	16
Asia	16	11 1/
Middle East	1	8
Latin America	7	7
Other consortiums	9	8
Other (Africa, Oceania)	5	5

1/ Restrictions by Japan in 1979.

b. In terms of the number of participations, the figures are as follows:

	1972	1980
Grand total	415	4,913
First ten	412	3,723
First listed participants	230	798
	(In percent)	
Europe	42	45
United States/Canada	30	22
Asia	10	22
Middle East	0	7
Latin America	5	4
Consortium	10	11
Others	5	3

c. Overall, in recent years the number of participations and the number of participants has increased more rapidly than the volume of the market; on average there were about 66 new participants each year, notably with new entrants from LDCs and the Middle East.

I-D. New Financing for Developing Countries
(G. Bell, M. Wilcox, G30 - London, December 1982)

Between 1979 and 1981, commercial bank lending to developing countries reached US$125 billion, representing 60 percent of their cumulative current account deficit; in 1981, commercial bank lending reached US$45 billion against a deficit on current account of US$86 billion.

Net lending in 1982 might be in the vicinity of US$20 billion and a further slowdown is expected in 1983, while the current account deficit should in both years remain in the vicinity of US$75 billion, which means an overall financing gap of about US$20 billion.

The basic element beyond the slowdown of international bank lending is the attitude of small banks; when bank lending was increasing by 20 percent, lead banks were not increasing their capital base at the same rhythm and their share in total bank lending to developing countries was declining (from 31 percent in 1974 to 23 percent in 1981 for the 9 largest U.S. banks); the expansion of the market was fueled by the entry in syndicated credits of newcomers (on average 66 new banks were entering the market each year between 1974 and 1981); in view of present uncertainties and funding difficulties, this source of expansion is now closed.

To fill the financing gap (US$20 billion) there is a need for an expansion of Fund credits, at least to match funds demanded from commercial banks (e.g., Mexico where the Fund is providing only US$4 billion over three years when banks are asked to provide US$5 billion for the first year); some innovative techniques should be developed (exchange of information, parallel phasing, longer maturities ensured by the Fund): in addition to its ordinary resources the Fund should therefore offer new types of assets to central banks and borrow on the commercial money and capital markets, for a total amount of about US$10 billion in 1983.

Developing Countries Financing

(In billions of U.S. dollars)

	1978	1979	1980	1981
Use of funds				
Current account deficit	31	48	75	86
Growth in reserves	16	12	5	2
Sources of funds				
Official lending	17	17	25	26
Bank lending (BIS)	29	39	43	45
Direct investment	7	9	10	14
Residual	-6	-5	-2	3

Source: Federal Reserve Bank of New York, Autumn 1982.

I-E. Task Force on Nonconcessional Flows (Development Committee, 1981)

I. Situation and Prospects for Nonconcessional Flows

1. Changing patterns of financing (see attached table)

2. External indebtedness

A need for sound debt management and appropriate adjustment policies; great care in the use of debt indicators (not a substitute for comprehensive economic surveys).

Private debt rescheduling should be approached constructively by commercial banks with the Fund and multilateral development institutions providing good offices, with a view to reliability and credit-worthiness

3. Current conditions and near-term prospects

Capital requirements, internal country limits, and liquidity problems should not constitute major constraints. International cooperation of bank supervisors is welcome, especially on maturity transformation but any adjustment in supervisory practices should be gradual: harmonization of capital/assets ratios (figures end-1980: United States, 4.1; Canada, 3.2; Japan, 5.3; United Kingdom, 5; Germany, 3.3; France, 2.2; Switzerland, 6.1); consolidation for which an excessively mechanical approach should be avoided.

In the medium term there should be a reduction of the annual rate of increase of commercial bank lending from the rate of 25 percent registered in recent years.

II. Recommendations

A need for an increase in the lending capacity of multilateral development institutions and for higher priority given to cofinancing through market-oriented techniques, including potfolio sales, partially guaranteed loans, and pass-through certificates.

No need to pursue further the idea of an independent partial guarantee framework, in view of the negative reaction of most bankers.

Some merit in organizing, on an annual basis, meetings between representatives and members of the Development Committee and of the international financial community to review further developments.

Changing Patterns of Financing

(In billions of U.S. dollars)

	1970	1973	1975	1978	1980	1970	1973	1975	1978	1980
	Low income countries					Middle income countries				
Current account deficit	3.6	4.9	7.0	5.1	9.1	14.9	6.7	42.8	20.4	48.9
In percent of GNP	1.9	2.4	3.9	2.6	4.5	2.6	1.0	5.5	2.3	2.0
Net capital flows										
ODA	3.4	4.1	6.6	5.1	5.9	3.3	5.3	5.3	6.5	7.9
Private direct investment	0.3	0.2	0.4	0.2	0.2	3.4	5.1	3.8	4.6	4.5
Commercial loans	0.5	0.6	0.8	0.9	0.7	8.9	13.7	21.0	29.4	27.1
Changes in reserves and short-term borrowing	0.5	-1.1	-0.7	-1.1	2.4	-0.8	-11.7	12.7	20.1	9.5

Source: WDR, 1981.

I-F. Morgan Guaranty: World Financial Markets (various issues)

1. The limited role of the IMF (April 1982)

In 1980-81, the net use of IMF resources was US$5.6 billion, to be compared to US$85 billion of net credits extended by commercial banks.

In recent years the Fund has been more and more involved in the poorest countries (at the end of 1981 26 percent of commitments in countries with 1978 GNP per capita lower than US$300 billion and 30 percent for countries in a range of US$300 billion to US$700 billion) while banks have extended their loans to middle-income countries.

Some commonality of interests between banks and the Fund (Turkey, Korea, the Philippines) and a need to improve relations between the Fund and commercial banks: the Fund could provide market participants with more timely economic information and policy analysis and could publish for the principal borrowing countries "the kind of adjustment indicators that the staff would monitor under a Fund supported adjustment program and which normally serve to establish performance criteria."

2. International lending--implications of a slowdown (October 1982)

After a decade of very rapid expansion, international lending is slowing down sharply 1/ due to difficulties of major borrowers, to regulatory constraints, to the contraction of the interbank market and associated funding difficulties for Eurobanks.

The potential effect that a slowdown of bank lending would have on the economic growth of non-OPEC LDCs is examined under two scenarios: Scenario A; a decline from 20 percent to 10 percent a year of the rate of growth of net bank lending; net capital inflows would be lower by about 25 billion when compared with previous trends;the growth rate of non-OPEC LDCs would be 1 1/2 percentage points lower (and 3 percent lower

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1/ The slowdown of international bank lending already emerged during the 1979-81 period, as appears from the following table:

Table 2. BIS Reporting Banks' Claims on Selected Countries

	1979	1980	1981	End-1981	U.S. Banks Percentage Share of End-1981 Total	
	Percentage change			Total*	All	9 largest
Developing countries	25	20	17	331.3	35	23
Non-OPEC	(32)	(24)	(20)	(258.5)	(36)	(23)
OPEC	(9)	(8)	(5)	(72.8)	(32)	(22)
Eastern Europe	20	9	2	71.5	11	7

* In billions of U.S. dollars

for major Latin American borrowers). Scenario B: no increase of net bank lending to non-OPEC LDCs; net capital inflows would be lower by about US$50 billion and the growth rate of non-OPEC reduced by about 3 percentage points.

The associated reduction in OECD growth would be at least 1/2 percentage point (scenario A) and 1 percentage point (scenario B).

A balanced approach should be devised: moderate overall expansion by 5 percent to 10 percent of net new bank lending to developing countries, further adjustment of LDC domestic economies based on appropriate exchange rate policies; adequate IMF resources; proper policy mix in industrial countries, aiming at a sustained recovery.

3. Global debt: assessment and prescriptions (February 1983--see above pages 15-17)

a. Origins and magnitude of the LDCs debt problem

Recycling after the first oil shock proceeded much more smoothly than even the optimists had expected: major LDC borrowers' total external debt to banks and other lenders increased at about a 25 percent annual rate between the end of 1975 and the end of 1979 but their exports grew at a 22 percent annual rate and their total debt to export ratio rose only slightly from 120 percent in 1979 to 133 percent in 1980. Moreover, all of the rise in this ratio reflected borrowings to build up foreign exchange reserves which climbed from US$23 billion at year-end 1975 to over US$75 billion at year-end 1979.

Recycling after the second oil shock was less successful: bank credits continued to increase in 1980 and 1981 at an annual rate of about 20 percent but with a growing proportion of short term credits and a growing concentration on a few major borrowing countries; total debt service ratio (including short-term) of the 21 largest LDC borrowers climbed from 50 percent in 1979 to 75 percent in 1982 (and 125 percent for major Latin American borrowers):

In 1981-82, the extent of world recession terms of trade deterioration, sustained high real interest rates and the consequent impact on the ability of LDCs to service their debt was underestiamted and a few "confidence-shattering" developments such as the Polish troubles, the Falklands conflict, and the Mexican foreign exchange crisis were sufficient to trigger the major slowdown in international lending that precipitated the current global debt situation.

b. Blueprint for reconstruction

The need for a balanced approach to address the present situation is underlined by the results of three alternative scanarios for 21 major LDC borrowers:

Scenario A is based on a major LDC adjustment (real GNP growth of 1.5 percent in 1983, 3 percent in 1986, 5 percent in 1985 and 1986) and a moderate OECD recovery (real GNP growth of 1.5 percent in 1983 and 3 percent in successive years): the current account deficit of LDC borrowing countries would fall to about US$30 billion in 1986 (against US$60 billion in 1982) and their debt service ratio by the mid-1980s could revert to its 1977-79 average.

Scenario B retains the assumption of scenario A concerning the OECD recovery but adds 0.5 percentage points each year to LDC GNP growth. The current account deficit would remain in the vicinity of US$60 billion over the period and the debt service ratio would not return to its 1972-79 level before 1990.

Scenario C retains the same adjustment for LDCs as under Scenario A but associated with a minimal OECD recovery (0.5 percent in 1983, 1.5 percent in 1986, 2 percent in 1985 and 1986); the current account deficit would increase in absolute terms and in relation to exports from 1983 to 1986 and debt export ratios would rise further; today's debt problems would only worsen.

A sustained recovery in OECD countries is thus the basic answer to present debt problems. In addition there is a need for a continuation of the present close cooperation between the IMF commercial banks, increasing their exposure under the three scenarios at a 2 percent annual rate, which means US$70 billion over the three years 1983-85. The gap in the LDC financing requirements could be met by other sources under Scenario A (a residual US$55 billion, out of which US$30 billion for the IMF and the World Bank and other international organizations) while the corresponding gaps under Scenario B (US$100 billion) and Scenario C (US$180 billion) would most probably not be met.

c. Conclusions and recommendations

The debt problems of LDCs appear manageable provided there is a proper blend of adjustment and financing. It will still take three to four years for major LDC borrowers to restore their creditworthiness, regain normal access to financial markets and resume robust economic growth. Sustained IMF and World Bank lending is crucial to smooth the transition until major LDC borrowers regain access to markets.

The international financial system should at the same time be strengthened to make it better able to deal with emergency situations and to reduce the likelihood of their recurrence: broadening of the capacity of the BIS to furnish short-term liquidity, and as a complement to Fund assistance and conditionality; improved yardsticks about debt service capacities and other criteria of country creditworthiness, developed by the IMF and the BIS, and applied by borrowing countries, commercial banks, and central banks.

II. Statistical Data and Issues

The BIS data (IIA) on international bank claims are judged by bankers as essential to their country limits management. They have been criticized, notably by the G-30 (IIB) on both grounds of coverage and timeliness. The BIS points out that delays in publication should not have affected the perception of looming problems.

The BIS data are supplemented by the data supplied in the quarterly bulletin of the Bank of England, notably in its annual review of the international banking markets (IIC).

The OECD adds to statistics on international bank lending, statistics on bond issues and officially sponsored export credits (IID) while data on long-term debt are published annually by the World Bank (Debt Reporting System - IIE).

The Fund data and policies are described in SM/83/48 (3/8/83), "Data on International Banking and External Debt." Document IIF underlines the main outstanding issues.

IIA. International Banking Developments, Second Quarter 1983
(BIS, October 19, 1983)

Quarterly press releases by the BIS remain the main source of information for market participants. The most recent available data describe second quarter 1983 developments. They are summarized as follows by the BIS.

The growth of international banking aggregates is almost coming to a standstill, owing to an absolute contraction of cross border interbank activity within the reporting area: on an exchange rate adjusted basis, the external assets of the reporting banks expanded by only US$6 billion to a total of US$1,689 billion (a cumulative increase of US$22 billion for the first half of the year against US$76 billion recorded in the first half of 1982) (Table 1).

An abrupt halt in external assets growth of banks in the United States and a modest growth in Europe; after acting as net capital exporter in the first quarter (US$11.2 billion), banks in the United States took up a net amount of US$3-4 billion from abroad in the second quarter.

A partly seasonal acceleration in new lending to the outside area (Table 2): net international credit to outside area countries increased by US$6.5 billion during the second quarter against US$0.5 billion during the first quarter. In particular net lending to non-OPEC developing countries accelerated faster US$1.6 to US$4.2 billion but remained well below the US$13 billion total recorded in the second quarter of 1982.

A large inflow of direct nonbank deposits from within the reporting area, notably from U.S. nonbank entities.

Table 1. BIS Reporting Banks: Summary of Changes in External Positions 1979-83

(In billions of U.S. dollars)

	1979	1980	1981	1982	1982 Q1	1982 Q2	1982 Q3	1982 Q4	1983 Q1	1983 Q2	Amounts outstand-ing end-June 1983
A. Total external assets	205.9	241.2	264.9	175.0	43.1	30.6	67.1	34.2	16.3	6.0	1,689.0
1. Of which: vis-à-vis											
2. Outside area	57.1	68.1	65.8	39.6	6.3	20.1	4.1	9.1	0.5	6.3	492.7
3. Reporting area	141.5	166.2	191.6	125.4	34.8	9.9	57.2	23.6	14.8	-3.5	1,141.1
a. Claims on nonbanks 1/	149	30.5	31.0	18.9	3.4	4.4	7.6	3.5	0.7	0.4	177.6
b. Interbank claims	126.6	135.7	160.6	106.5	31.4	5.5	49.6	20.1	14.1	-3.9	963.5
4. Unallocated	7.2	6.9	7.4	10.0	2.0	0.6	5.8	1.5	1.0	3.2	55.2
B. Domestic assets in foreign currency	48.8	82.8	70.6	53.3	33.5	-22.0	40.4	1.4	24.8	-37.8	413.2
1. Of which: vis-à-vis nonbanks 2/	8.9	20.8	19.3	12.7	2.6	4.1	2.98	3.0	3.3	3.4	111.7
C. Estimate of total net international bank lending 3/	125.0	160.0	165.0	95.0	20.0	30.0	25.0	20.0	10.0	15.0	1,035.0
D. Total external liabilities	252.9	242.3	237.6	124.1	44.1	15.3	47.1	17.7	8.8	8.8	1,620.3
Of which: vis-à-vis											
1. Outside area	61.4	52.4	16.6	-12.2	-4.6	-1.6	-1.2	-4.8	-8.1	-4.4	287.7
2. Reporting area	180.4	183.7	205.0	125.0	44.8	14.3	44.2	21.9	20.6	8.6	1,260.2
a. Liabilities to nonbanks 1/	27.3	22.4	49.8	27.9	9.8	14.5	-1.2	4.8	1.4	10.6	220.7
b. Interbank liabilities 4/	153.1	161.3	155.2	97.1	35.0	-0.2	45.4	17.1	19.2	-2.0	1,039.5
3. Unallocated	11.1	6.2	16.1	11.2	3.9	2.6	4.1	0.6	-3.7	4.6	72.4
Of which:											
4. Identified liabilities to official monetary institutions	39.7	19.2	-13.8	-27.7	-6.4	-7.0	-1.1	-13.1	-3.7	-6.2	105.6
E. Domestic liabilities in foreign currency	42.5	58.8	53.7	51.4	30.9	-21.6	41.2	0.7	20.0	-36.9	339.4
1. Of which: vis-à-vis nonbanks 2/	2.8	5.5	5.3	7.1	1.8	1.2	1.9	2.2	-1.2	0.2	48.8

Source: BIS, Monetary and Economic Department.

1/ Including as from end-1982 claims on liabilities to nonbanks in the Bahamas, Cayman Islands, Panama, Hong Kong, and Singapore.

2/ For banks in Europe and Canada only.

3/ Excluding double counting resulting from the redepositing of funds between the reporting banks themselves. Net international bank lending is thus the sum of items A.1., A.2.a, B1, plus parts of items A.2.b. and A.3. It also equals the sum of items D.1., D.2.a., and E.1 plus parts of items D.2.b. and D.3.

4/ Including liabilities resulting from the interbank placement of trustee funds and liabilities to international monetary institutions.

Table 2. Gross and Net Lending by BIS Reporting Banks to Outside-Area Countries, 1979-83

(In billions of U.S. dollars)

	1979		1980		1981		1982		1983
	First half	Second half	First half	Second half	First half	Second half	First half	Second half	First half
Other developed countries									
Gross	2.7	4.8	7.3	8.1	8.5	8.3	9.2	6.7	1.3
Net	-0.6	1.1	6.8	2.9	9.1	3.9	9.5	6.6	2.7
Eastern European									
Gross	2.2	4.9	1.9	4.8	3.0	1.8	-3.1	-1.6	-1.1
Net	2.9	-0.4	4.8	1.1	8.0	-3.3	-0.7	-6.0	-1.7
OPEC									
Gross	1.5	5.7	-0.9	7.9	-1.0	5.2	4.9	3.4	0.8
Net	-3.5	-26.6	-24.8	-10.0	-7.5	8.5	11.5	15.1	16.0
Non-OPEC developing countries									
Gross	14.8	20.5	14.4	24.5	12.3	27.6	15.4	4.7	5.8
Net	8.3	14.7	12.7	22.3	12.8	17.7	12.3	3.5	2.3
Of which: Latin America									
Gross	8.5	12.0	12.7	15.6	10.2	15.5	12.5	1.7	1.2
Net	6.2	12.0	12.7	15.6	10.2	15.5	12.5	1.7	1.2
Total outside area									
Gross	21.2	35.9	22.7	45.3	22.8	42.9	26.4	13.2	6.8
Net	7.1	-11.2	-0.5	16.3	22.4	26.8	32.6	19.2	19.3
Memorandum items:									
Current account of non-OPEC developing countries	-40		-62		-74		-35	-24	-24 1/
Of which: Latin America	-20		-32		-43		-34		-10 1/
Official foreign exchange reserve movements of non-OPEC developing countries	5.2	2.8	-2.4	1.2	-7.0	6.3	-5.9	2.1	4.3
(excluding China)	(4.9)	(2.4)	(-3.7)	(2.4)	(-8.5)	(5.4)	(-8.2)	(-1.9)	(2.2)
Of which: Latin America	1.7	3.1	-3.0	0.7	-5.5	2.0	-4.2	-4.2	0.1

1/ BIS estimates, based on IMF and OECD data.

IIB. BIS Statistics
(The Dimensions of International Bank Lending,
G-30, 1982)

The BIS has collected since 1953 and published since 1974 quarterly total transborder claims of banks in the reporting area (14 industrial countries plus U.S. banks' foreign branches in the Bahamas, The Cayman Islands, Panama, Hong Kong, and Singapore) supplemented semi-annually by a breakdown by maturity and a breakdown by country of undisbursed credit commitments; (the semiannual statistics cover banks from 14 industrial countries plus all banks' foreign branches in: the Bahamas, the Cayman Islands, Panama, Hong Kong, Singapore, Barbados, Bahrain, Bermuda, Lebanon, Liberia, Netherlands, Overseas Territories, United Kingdom, Virgin Islands, and other British West Indies, and Vanuatu).

Deficiencies in the BIS Reporting System:

Domestic currency assets and liabilities incompletely reported; trustee business in foreign currencies not reported by Switzerland; some institutions and some branches in offshore centers excluded; no breakdown by type of borrowers, instruments, guarantees; data reported on a "location basis"; data too aggregated; delays in publication.

N.B.: In its 1982 annual report, the BIS points out that delays in the publication of statistics had no impact on risk perception by markets. Graphs for eight "problem countries," comparing the evolution of assets and liabilities, are reproduced in the report. In all cases, according to the BIS, it was possible to observe the buildup of external debt several years prior to the outbreak of the crisis.

IIC. Statistics on the Eurodollar Market (Bank of England)

In its quarterly bulletins, the Bank of England publishes periodically data on the Euro-dollar market under the following format.

1. Size of the market (in billions of U.S. dollars, end-September 1981)

- Lending by banks in the BIS to non-residents	
- Foreign domestic currency (1)	886
- Domestic currency (2)	369
- Lending by offshore banks to non-residents	387
- Total lending to non-residents (4) = (1) + (2) + (3)	1,642
- Lending by banks in the BIS in foreign currency to residents (5)	360
- Gross size of the Euro-currency market maket (6) - (1) + (3) + (5)	1,633
- Swiss trustee accounts 1/ (7)	88
- Total international bank lending (8) = (4) + (5) + (7) = (2) + (6) + (7)	2,089

2. Net international bank lending and bond issues (in billions of U.S. dollars, first 9 months 1981)

- Outstanding lending by BIS:	
- Gross	1,423
- Net of interbank	875
- New net international bank lending	110
- Euro and foreign bonds, notes	27
- Total (after elimination of double counting)	123

1/ The role of the Swiss banks in operating these accounts is formally that of an agent but, to the extent that they advise clients where the funds should be placed, they can be said virtually to be performing a banking function.

3. <u>U.K. Banks international lending by bank groups</u> (in percent, end-September 1981)

- British banks 23
- U.S. banks 24
- Japanese banks 23
- Other overseas banks 25
- Consortiums 4

4. <u>International bank lending by currency</u> (in percent, 3rd quarter 1981)

	US$	DM	SF	£	Yen	Others
- Foreign currency lending to non-residents	73	14	7	2	2	4
- Foreign currency lending to residents	76	8	6	1	2	7
- Domestic currency lending to non-residents	57	12	8	6	5	12

IID. International Capital Markets
(OECD Committe on Financial Markets, 1982)

The OECD's quarterly and monthly reports on international capital markets (see formats in attachments) complement the BIS statistics with figures on foreign and international bond issues and syndicated Eurocredits.

In addition, the OECD (DAC) publishes annual data on long-term official and private lending to developing countries and is working with the BIS on a project aiming at a reconciliation of export credit figures and bank claims data.

International Capital Markets

(In billions of U.S. dollars, at annual rate)

		1982			1983	
	1982	I	Q3	Q4	Q1	Apr.-May
Euro bonds						
U.S dollar	38.7	44.8	31.4	33.7	39.9	35.4
Deutschemark	3.3	3.3	3.4	2.9	5.4	6.2
Other currencies	4.4	5.0	3.2	4.8	5.7	4.3
Total	46.4	53.1	38.0	41.4	51.0	45.9
Foreign issues						
United States	6.0	3.6	12.8	4.1	5.1	11.4
Switzerland	11.3	12.3	10.6	10.2	17.5	12.7
Japan	3.3	3.8	3.2	2.4	4.5	3.2
Germany	2.1	2.0	1.9	2.5	3.5	2.0
Other countries	2.5	2.3	2.7	2.4	1.9	3.0
Total	25.2	24.0	31.2	21.6	32.5	32.3
External bonds						
Total	71.6	77.1	69.2	63.0	83.5	78.2
Loans	98.9	105.8	96.4	87.4	81.8	70.2
Grand total	170.5	182.9	165.6	150.4	165.3	148.4
OECD countries	112.4	117.3	115.9	98.9	97.4	108.4
OECD-based international organizations	3.5	3.0	3.3	4.6	4.7	4.7
Non-OECD countries						
Comecon	0.7	0.8	1.2	0.1	--	1.3
OPEC	9.4	10.0	5.6	11.9	8.2	2.8
Other developing	35.4	43.3	27.7	27.1	47.4	23.8
International development institutions	7.6	6.6	10.5	6.8	6.5	6.6
Other	1.5	1.9	1.4	1.0	1.1	0.8
Grand total	170.5	182.9	165.6	150.4	165.3	148.4

Source: OECD, International Financial Markets.

IIE. World Debt Tables (World Bank)

The World Bank, under its Debt Reporting System (DRS), has published annually, since 1981, publicly guaranteed debt outstanding and new loans with original maturity higher than a year. The attached table gives a summary of the content of this publication. 1/

Some critics (see The Economist, "Survey of International Banking," March 1982) underline some shortcomings of coverage of this publication (short-term debt, non-guaranteed private debt, military debt, CMEA countries) and raise the problem of timeliness (figures for 1980 published in January 1982 with final details for only half the countries).

1/ The World Bank discontinued in 1982 another statistical series, relating to publicized loans.

World Debt Tables - External Debt of Developing Countries
(The World Bank, 1982-1093 edition, in U.S. dollars)

1. Total debt outstanding disbursed (end 1981) 462

- public or publicly guaranteed 368
- private/nonguaranteed 94

	Debt Outstanding disbursed (end 1981)	Commitments	Disbursements	Principal repayments	Net flows	Interest payments	Net transfers	Total debt service
2. Breakdown of public/publicly guaranteed debt (1981)								
official creditors								
- multilateral	60	19	11	2	9	3	6	5
- bilateral	109	17	17	6	11	4	7	10
private creditors								
- suppliers	19	8	5	5	-	1	-1	6
- financial markets	180	50	47	18	29	21	8	39
Total	368	94	80	31	49	29	20	60

3. Average terms: public debt new commitments (1981)

	Interest (percent)	Maturity (years)	Grace period (years)
official creditors	6.7	22.1	5.6
private creditors	14.7	8.9	3.4
all creditors	11.7	14.0	4.3

4. Principal debt ratios (end 1980)

5. Projected public debt service (1982-1989)

IIF. IMF: Statistics on International Banking and External Indebtedness

Issues related to data on international banking and external debt are dealt with extensively in SM/83/48 (3/8/83), "Data on International Banking and External Debt." Two main issues are outstanding:

a. The development of BIS-type data on international bank claims (the international banking statistics project): a breakdwon of claims between banks and nonbanks, now available; in Phase II cross-checking between debtor countries data and creditor countries data (35 industrial countries and off-shore centers) aiming at a publication of six lines in IFS, 1/ which implies a close cooperation with the BIS and technical assistance to some offshore centers and to debtor countries; in Phase III a currency breakdown and a breakdown by maturity.

b. The integration of the external debt data on each member country provided by various international and regional reporting systems (see attached document), which might culminate in the publication of a supplement to IFS devoted to debt statistics.

1/ Banks claims vis-à-vis foreign banks; banks claims vis-à-vis foreign nonbanks; banks liabilities vis-à-vis foreign banks; banks liabilities vis-à-vis foreign nonbanks; nonbanks foreign assets; nonbanks foreign liabilities.

Catalogue of External Debt Data in Data Fund System
(Appendix VI to SM/83/48, 3/8/83)

A	IFS	(1) Money and banking data: foreign liabilities (2) International liquidity: foreign liabilities (3) Government finance data: government external debt
B	IBS	Deposit banks' foreign claims analyzed by debtor country and cross-classified by sector of debtor (bank and nonbank)
C	BIS	Deposit banks' external claims
D	GFS	(1) Central government total external liabilities (2) State and local governments total external liabilities
E	BOP	Total external liabilities
F	DRS	Total long-term external liabilities
G	National Sources	External liabilities of public and private nonmonetary enterprises.

III. Country Risk Assessment

A growing attention is paid by banks and supervisors to the procedures and methods under which country risks are assessed. The Export-Import Bank of the United States (IIIA) and the G30 (IIIB) have analyzed a sample of existing models and stressed the growing importance of the "structured qualitative systems" (a standardized country evaluation report supplemented by economic statistics).

IIIC analyzes various articles devoted by commercial banks to country risk assessment, with a specific reference to debt models and to the studies showing a correlation between bank lending and various variables, notably rating.

IIIA. Survey of Country Evaluation Systems in Use
(Export-Import Bank of the United States, December 1976)

A survey of 37 U.S. banks, including the 12 largest and 25 other banks selected to give geographic diversity; these banks account for 30 percent of the banking system's total assets and more than 50 percent of its international loans.

1. Overall size of foreign lending

Ratios of foreign loans to total loans range from 1 percent to 74 percent among survey participants with an average of 23 percent.

Nearly two thirds of the participating banks devoting less than a quarter of their total portfolio to foreign exposure.

2. Procedural format

In most cases, country evaluation undertaken at the banks' headquarters (line personnel, 30 percent; staff economists, 22 percent; both 22 percent, in shares of all survey banks); 12 percent of banks are relying on overseas personnel and 14 percent do not have a comprehensive system.

Seventy-five percent of banks in survey update their country evaluations at least annually with more frequent reviews for high exposure countries.

3. System structure

a. No system; evaluation of individual loans only (14 percent of survey sample).

b. Fully qualitative system (11 percent of the survey).

Country evaluation system structured around a qualitative report without standardized format.

c. Structured qualitative system (75 percent of the survey).

A standardized country evaluation report augmented by economic statistics.

d. Check-list system

Scoring of each country's performance with respect to various indicators or variables.

Scores on each indicator aggregated into a summary score for each country using subjectively determined weights (weighted check-list approach).

Weighted check-list approach normally associated with a structured qualitative system.

e. Other quantitative techniques

A weighted check-list using variables and weights selected on the basis of standard econometric and statistical tests of predictive accuracy.

The World Bank is using a "two-gap" model; independent estimates based on econometric techniques of foreign exchange requirements and sources of financing; countries compared on the basis of any gap between the two estimates.

4. Testing and rating of system

Only one survey bank tests the results from its country evaluation system against past experience.

5. Variables included in the evaluation system

Variables relating to the internal economy (GNP, inflation, and money supply growth most commonly used).

Variables relating to the external economy (trade balance, reserves to imports ratio, and debt service ratio most commonly used).

Social and political variables (wholly judgmental, thus increasing the subjectivity of the final score).

6. How the systems are used

Uses of country evaluation systems can be summarized as follows:

Use Made of Results 1/	Number of Survey Banks	Share of All Survey Banks	Share of Total Survey Assets
Set country limits	20	54	34
Set country limits and analyze portfolio	6	16	42
Analyze portfolio	3	8	15
General use	3	8	2
No system	5	14	7

1/ None of the banks in the survey uses the country evaluation results in fixing interest rates or fees.

Indicators Included in Check-List System

Variable	Number of Check-List Banks Using Variable
I. Variables Relating to the Internal Economy	
1. GNP	5
2. GNP per capita	5
3. Real GNP growth	5
4. Inflation rate	4
5. Investment-to-income ratio	3
6. Money supply growth	3
7. Government's net budget position	1
8. Income growth-to-fixed-capital formation ratio	1
II. Variables Relating to the External Economy	
1. Exports and export growth	5
2. Imports and import growth	5
3. International reserves	4
4. International reserves-to-imports ratio	4
5. Trade and current account balances	3
6. Debt service ratio	2
7. IMF borrowings	2
8. Current collection experience of U.S. suppliers	1
9. Debt service	1
10. Principal payment-to-total-external-debt ratio	1
11. Share of gold in reserves	1
12. Share of leading non-oil export in total exports revenues	1
13. Share of trade in GDP	1
14. Share of short-term credit in total credit	1
15. Total external debt	1
III. Social and Political Variables	
1. Political stability	3
2. International banking division's region rating	1
3. Past trend in unemployment	1

IIIB. Commercial Banks' Attitude to Country Risk Assessment (G-30, Risk Study Group - June 1981)

A review of 11 systems described in previous articles (see Appendix of the G-30 report).

Economic indicators emerging from the analysis as being fundamental to country risk assessment are: debt service ratio, balance of payments position, export growth trend, and GNP growth.

Data on exports and GNP available from the IMF and World Bank; debt service ratio more dependent on assumptions on existing debt, future borrowing requirements, and level of interest rates.

Other economic indicators: inflation rate; level of gross capital formation, and government borrowing.

Political indicators: factors indicating the ability of the political system to accommodate change; factors which identify factions within a political system which may seek to cause disruption.

Economic and political factors included in the overall country risk assessment (see main report).

Key factors in future risk assessment: political analysis; ability to refinance existing debt; ability to move toward the level of foreign exchange earnings required to service the debt; and covariance (evaluation of world events in terms of their overall effect on a portfolio of borrower countries).

Commercial Banks' Attitude to Country Risk Assessment (G-30, 1982)

Commercial banks have gradually developed country risk assessment systems, notably for the U.S. banks since 1978 with a "new supervisory approach to foreign lending."

Four types of approach:

a. Unstructured approach

Assessment of risks and rewards on a case-by-case basis without ranking of countries.

b. Check-list approach

Scoring technique: scaling of country with respect to prespecified variables.

c. Qualitative approach

Use of country evaluation reports.

d. Structured/qualitative approach

Standard format (political-economic factors) plus statistical analysis when appropriate.

Economic indicators: debt service ratio, balance of payments position, export growth trends, GDP growth supplemented by less generally used indicators (inflation, capital formation, economic diversity, and money supply), and political indicators assessing the ability to have changes accepted and describing factors at play which might lead to crisis situations.

Most banks using a structured/qualitative approach; "there could be a move toward more sophisticated models based on covariance at least for asset allocation purposes. This will involve a global approach to country risk evaluating world events in terms of their overall effect on a portfolio of borrower countries."

A review of 11 models (see page 59) shows that most systems use debt service ratios (except F.), debt figures (except A., B., and E.), import/reserves ratio (except B., C., E., and G.), domestic financial indicators (except A. and I.), and political factors.

Commercial Banks' Attitude to Country Risk Assessment
Schedule of Factors Used in the Individual Systems Reviews at Appendix II

Measure	Systems Reviewed (see key on next page) A	B	C	D	E	F	G	H	I	J	K
Debt service ratio	X	X	X	X	X		X	X	X	X	X
Imports/reserves ratio	X			X		X		X	X		X
Capital/debt ratio	X			X		X		X		X	
Income per capita	X	X	X	X				X	X	X	X
Income growth rate	X	X	X		X	X	X	X	X		X
Export growth rate	X		X	X	X		X	X	X		X
Export analysis		X	X		X	X	X	X	X	X	X
Imports/exports ratio		X	X	X	X	X	X		X	X	X
Economic diversity		X	X			X			X		X
Exports/GNP		X	X	X						X	X
Level of IMF support/ reserves ratio		X		X	X	X	X	X	X		X
Debt structure		X					X	X	X	X	X
Inflation/monetary/fiscal policy		X	X	X	X	X	X	X			X
Physical resources			X	X		X	X	X	X		X
Debt			X	X			X	X	X	X	X
Import analysis			X	X	X		X	X		X	X
Basic strength		X	X	X			X				X
Ability to change peacefully		X		X		X	X	X			X
Likeliness of internal conflict		X				X	X	X	X		X
Policies of ruling group		X	X			X					X
Philosophy of ruling group		X									X
Ability of government officers		X				X	X	X			X
Flexibility of the political system		X						X			X
External relations		X				X		X	X		X
Minority groups		X	X		X		X		X		X
Religious problems		X			X		X		X		X
Unemployment		X	X				X				X
External ethnic problems		X		X			X		X		X
Government support			X				X				X
Type of system			X				X	X	N/A		X
Opposition groups						X	X		X		X
Wealth disparity			X				X		X		X

In some cases similar measures from two or more systems are grouped together under one heading. For example, "Income per capita" and "Income growth" are taken in terms of either GNP or GDP.

Systems H and J allude to a comprehensive political analysis but factors are shown above only where detailed in the articles.

Key to the Systems Reviews

A. Feder/Ross, World Bank (G. Feder and K. Ross), 1977
B. C. M. Korth, University of South Carolina, ex-First National Bank of Chicago, 1979
C. J. N. Robinson, Chase Manhattan Bank, N.A., 1981
D. K. Janoeri, Union Bank of Switzerland, 1980
E. Amsterdam and Rotterdam Bank, N.V., 1980
F. Business International Country Risk Assessment Service, 1981
G. P. S. Nagy, Bank of Montreal, 1978
H. W. R. Heller, Bank of America, 1980
I. P. Gutman, National Westminster Bank Ltd., 1980
J. American Express Bank, 1980
K. A. Von Actmael, Bankers Trust Co., 1976

IIIC. Country Lending and Exposure Limits
(Country Risk Management Process (Irving Friedman, Seminar on Central Banking - Washington, July 1982)

According to the Association of Reserve City Bankers' Survey (1977), 15 percent of the 119 responding banks had more than 25 percent of their total assets in international activities; only 14 percent (12 banks) did not prepare country exposure reports on a regular basis; two thirds of reporting banks had a breakdown of country limits by type of exposure and by maturity.

According to the Robert Morris Associates' Survey (1980), 90 percent of the 70 banks in the survey were setting country limits; sublimits for the government sector were applied by 40 percent of banks.

Managing International Indebtedness
(Heller, Bank of America - Vienna, 1982)

Evaluation of country risks by Bank of America based on judgmental economic indicators, political judgmental rating, and debt service capability, supplemented by commercial parameters such as the rate of return.

Judgmental economic indicators (rating from A to F) based on questionnaires completed by field officers with a screening process by regional officers and headquarters; the following items are covered: monetary policy, fiscal policy, regulatory policies in the financial sector, attitude toward domestic and foreign investment, economic development program, management capacity of the government, exports and imports diversification, access to international source of credit, and exchange rate policy.

Political judgmental rating based on assessment of governmental control, potential for social unrest, and external factors.

Debt service capacity based on three indexes: short term (external liquidity); medium term (government policies), and long term (structural elements); the model is based on a correlation between data for 1974 and debt service performances from 1975 to 1977 for 80 countries; overall it indicates a deterioration of the short-term index from 1974 to 1976 and a stability since then, a stability of the medium-term index during the period 1973-81, a deterioration of the long-term index; the model has a good predictive capability (advance deterioration in countries which have had rescheduling or arrears); average debt service capacity in U.S. banks' portfolio better on short term than medium and long term, and better than average BIS banks' portfolio.

Country limits, on the basis of these analyses are set for commitments and for outstanding claims; a country exposure central matrix applies sublimits by maturities (less than one year, one to three years, more than three years) and by types of borrowers (government, banks, commercial; see annex).

International Lending, Risk, and Portfolio Quality
(Heller - Montevideo, 1981)

Determinants of bank lending

The best single correlation is between variations of the debt to BIS banks and GDP of the previous year; the best multiple correlation for debt to BIS banks is with GDP, plus reserves (minus gold) plus score element (rating in Institutional Investor):

BIS debt = 0.019 GDP (past year) $R2 = 0.53$

BIS debt = -5,060 + 0.17 GDP + 0.34 RES + 153 SCORE $R2 = 0.59$

For U.S. banks alone the results are the same but explanatory factors are more important and the role of SCORE higher (greater role of country risk assessment?).

Country Risk Analysis and Country Risk Management
(Senkiw, Bank of Montreal - Washington, 1980)

A need for a country risk assessment system (Bank of Montreal rating from A to E) comprehensive, based on professional expertise, well enforced.

The correlation between portfolio and risk analysis is not perfect due to other factors (size of the country, profitability, market thrust); for Bank of Montreal the correlation coefficient is 0.74 (ideally, 1).

Types of lending depending upon the perception of risks with such devices as "short term only" (added flexibility), "only LOC's business," or "only export finance in support of major corporate customers of the bank."

The Impact of Country Risk Assessment on Eurocurrency Interest Rate Spreads
(IMF, May 1980)

A study of statistical correlations of spreads with various indicators shows that the best correlation is with rating (Institutional Investor).

As far as correlations with objective indicators are concerned, the best correlations are with the ratio of reserves to imports and to a lesser degree the ratios of debt service to exports and of total debt to exports.

IV. The Interbank Market

Statistics produced by the BIS and the Bank of England (IVA) underline the importance of the interbank market, which represents 70 percent of transborder claims of commercial banks. They show how, through the interbank market, the main financial centers and the banks of all nationalities, with various attitudes and constraints, are linked together in a worldwide single market.

The report of the BIS study group (IVB), supplemented by national reports (IVC), underlines the essential function played by the market while pointing out potential strains in the system.

Finally, document IVD shows how the international dollar market is linked to the domestic U.S. dollar market and stresses the role of the largest New York clearing banks in the overall operation of the system.

IVA. The Statistics of the Interbank Market

(BIS, The International Interbank Market, July 1983, and Bank of England, Quarterly Bulletin, September 1981)

1. The size of the interbank market (see Table 1)

Interbank claims and liabilities in foreign currency represent approximately 70 to 75 percent of the total positions of the reporting banks (60 to 65 percent for positions with banks inside the reporting area).

The ratio of interbank to total cross-border positions in domestic currency is between 35 to 40 percent for banks in Europe, Canada, and Japan and 75 to 80 percent for banks in the United States.

2. Evolution of the market over time

Overtime stability around 70 percent of the share of the interbank market in the international banking market (see Tables 2 and 3).

Stability around 60 percent of the share of interbank claims in total foreign currency business with residents; foreign currency interbank claims on residents representing about 30 percent of external interbank claims.

Movements of a cyclical and seasonal character around this trend, in relation to the size of the OPEC surplus and window-dressing operations; smaller-than-usual seasonal rise in the second half of 1981 and steeper-than-usual seasonal fall in the first half of 1982.

3. Currency analysis of the market (see Table 4)

The currency composition of foreign currency claims in the interbank market (banks in Europe, Canada, and Japan) is as follows (December 1981):

	In Billions of U.S. Dollars	Deutsche Mark	Swiss Francs	Other
Amount of interbank claims	686	103	62	78
Percentage of total claims	71	66	71	74

The share of the U.S. dollar varies from 80 percent for the London market to 40 percent for the Luxembourg market (average share, 74 percent).

The breakdown of U.S. dollar interbank claims is the following: residents of the same financial center, 28 percent; banks in country issuing currency, 8 percent; other banks in the BIS area, 50 percent; and banks outside the BIS area, 14 percent.

A greater proportion of total interbank claims is held on the issuing country in the case of the deutsche mark (17 percent) and some other currencies (pound sterling, 33 percent; Dutch guilder, 34 percent; Japanese yen, 20 percent; and French franc, 15 percent, against 8 percent for the U.S. dollar and the Swiss franc), in relation to the smaller international role of these currencies.

4. The location of interbank business and linkages between centers

Claims on banks in the inside area are 83 percent of total claims on banks (more for Canada and the United States, less for Germany and Austria).

Fourteen percent of all cross-border interbank claims are on the United Kingdom.

Banks in the United Kingdom have US$45 billion net (assets minus liabilities) claims on other reporting centers; only banks in the Netherlands, Switzerland, and Germany have also net creditor positions on the interbank market.

Banks in Japan have the largest net liability position (to banks in the United Kingdom, the United States, and the off-shore centers).

5. Cross-border interbank positions between own offices

Approximately 46 percent of interbank claims of banks located in the United Kingdom, the United States, Japan, Germany, France, Belgium, and Luxembourg are with "own offices."

Major differences in the ratio of own offices to all interbank positions vis-à-vis various centers (for instance, 90 percent of all interbank transactions with the Caribbean area are intrabank).

6. The nationality of banks operating in the interbank market

Leading roles played on the interbank market by the Japanese banks and the U.S. banks out of which more than 50 percent is due to inter-office positions.

Sixty percent of total interbank claims of an international character are booked by the head office with two major exceptions: Japan (70 percent) and the United States (70 percent for establishments in other G-10 countries and 80 percent if branches in off-shore centers are included).

U.S. banks and Swiss banks are net suppliers to the interbank markets and others, notably Japanese banks and German banks, net takers.

Table 1. Size of the International Interbank Market: Positions vis-à-vis All Banks

(End-December 1981)

	Claims		Liabilities	
	Outstanding interbank claims In billions of U.S. dollars	As a percentage of total claims 1/	Outstanding interbank liabilities In billions of U.S. dollars	As a percentage of total liabilities 1/
Positions of banks in the European reporting area, Canada, and Japan				
1. Foreign currency within border	243	64	257	84
2. Foreign currency cross-border	684	73	677	65
Total foreign currency (1 + 2)	927	70	934	70
3. Domestic currency cross-border	93	54	73	55
Positions of banks in the United States (including IBFs)				
4. Domestic and foreign currency cross-border 2/	176	69	127	72
Positions of all banks				
Total cross-border domestic currency 3/ (3 + 4)	269	63	200	64
Total cross-border (2 + 3 + 4)	953	70	877	65

Source: BIS.

1/ For that particular type of business.

2/ Almost wholly in domestic currency (i.e., U.S. dollars).

3/ Assumes the position of banks in the United States (line 4) are entirely in domestic currency.

Note: Definition of interbank: excludes positions vis-à-vis official monetary authorities. Also excludes trustee funds (estimated) placed in the market by banks in Switzerland and certificates of deposit (CDs) held by banks on behalf of nonbank customers.

Table 2. Size of the International Interbank Market: Positions vis-à-vis Inside-Area Banks 1/ Only

(End-December 1981)

	Claims		Liabilities	
	Outstanding interbank claims	As a percentage of total claims 2/	Outstanding interbank liabilities	As a percentage of total liabilities 1/
	In billions of U.S. dollars		In billions of U.S. dollars	
Positions of banks in the European reporting area, Canada, and Japan				
1. Foreign currency within-border	243	64	257	84
2. Foreign currency cross-border	553	59	559	54
Total foreign currency (1 + 2)	796	60	816	61
3. Domestic currency cross-border	59	34	56	42
Positions of banks in the United States (including IBFs)				
4. Domestic and foreign currency cross-border 2/	137	53	118	66
Positions of all banks				
Total cross-border domestic currency 4/ (3 + 4)	196	46	174	56
Total cross-border (2 + 3 + 4)	749	55	733	54

Source: BIS.

1/ Banks in the European reporting area, Canada, Japan, the United States, Singapore, and the Caribbean.
2/ For that particular type of currency.
3/ Almost wholly in domestic currency (i.e., U.S. dollars).
4/ Assumes the positions of banks in the United States (line 4) are entirely in domestic currency.

Table 3. External Interbank Claims, 1975-81
Domestic and Foreign Currency Claims on All Banks, Reported by
Banks in Europe, Canada, and Japan

End of Period	Outstanding Interbank Claims		Adjusted 1/ Changes in Interbank Claims over Previous Year	
	Amounts	As a percentage	Amounts	As a percentage
	In billions of U.S. dollars	of total outstanding claims	In billions of U.S. dollars	of change in total claims
1975	246	74		
1976	286	73	35	67
1977 2/	342	72	42	67
1978	458	69	84	66
1979	596	70	130	78
1980	705	70	130	69
1981	777 3/	70	100	63

Source: BIS.

1/ Adjusted to exclude exchange rate effects of movements in nondollar currencies against the U.S. dollar.
2/ Major break in series after the period. Figures before and after the break are not strictly comparable. At end-December 1977 outstanding interbank claims for the new series were equal to US$352 billion.
3/ Cf. Table 1: US$684 billion (foreign currency cross-border) plus US$93 billion (domestic currency cross-border).

Table 4. Currency Composition of Interbank Claims and Total Claims

(End-December 1981)

Currency	Interbank Claims as a Percentage of Total Claims	Claims on Banks in Country Issuing Currency as a Percentage of Total Interbank Claims
U.S. dollars	71	8
Deutsche mark	65	17
Swiss francs	71	9
All other currencies	73	26
Of which:		
Pounds sterling	76	43
French francs	72	16
Yen	79	20
Dutch guilders	62	34

Source: BIS.

Note: For definition of interbank, see Table 1. Coverage banks in Europe, Canada, and Japan.

IVB. The International Interbank Market (BIS Study Group, December 1982) 1/

1. Introduction

Up to three quarters of international lending (US$1,500 billion) consists of broadly defined interbank positions (out of which one third to one half may be between own offices).

The bulk of interbank activity is between banks in major international centers, particularly London; markets in the United Kingdom and the United States are net suppliers of funds to other centers.

2. The effect of the market on lending to nonbanks

The interbank market has led to a greater volume of lending to final users through enlarged access of lending banks to foreign currency resources.

A contraction of the interbank market would lead to a smaller volume of lending and a higher price; a rapid contraction of the market could force some banks into positions of critical illiquidity or insolvency and some final borrowers, deprived of funds, might be forced to reschedule or default; either of these effects could have widespread repercussions on the banking system and hence on nonbank lending.

3. Risks in the interbank market

a. There is a gap between the risk some banks perceive in the market and the actual risk they are incurring. The tendency to underestimate risk in the market may extend to banks' attitudes toward interbank liquidity. The role of brokers is helpful but direct dealing can lead to closer relationships and a greater flow of information between participants.

b. There is no evidence that the maturity transformation risk is increased by the expansion of the interbank market.

c. Some banks operate with considerably smaller capital ratios than do others, due to attitudes of supervisory authorities, ownership of the bank, and management policies.

Recent developments have led to a reduction in the volume of interbank activity due to a growing awareness of the risks attached to it.

Alternative means of reducing mismatch risks may develop (interest rate futures markets) but an orderly evolution of the interbank activity is clearly needed.

1/ See BIS Economic Paper No. 8, July 1983: "The International Interbank Market."

4. The robustness of the interbank market

The interbank market is unlikely to amplify even quite severe shocks and disturbances, provided that imprudent exposures have been avoided and, most critically, provided that confidence generally is maintained.

Circumstances can, of course, be envisaged usually involving a significant erosion of confidence, in which banks are unable or, more probably, unwilling to redeploy funds to disturbed segments of the banking system, which might require action by authorities.

5. Policy issues

a. Attitude of the authorities

Banks themselves clearly bear the risk of lending in the interbank market and are responsible for maintaining their own creditworthiness.

But there is a perception by banks, in relation to the G-10 governors' communiqué of 1974 and to the recent attitude of authorities toward the obligation of branches of Mexican banks, that banks facing temporary liquidity difficulties would be supported by the authorities.

It appears advisable to avoid giving signals that could be interpreted as implying special status for the interbank market or for some participants; but in case of emergency, authorities will, of course, be expected to consider actions beyond those appropriate to normal times.

b. Possible policy measures in support of the smooth functioning of the market

Authorities could help to improve the transparency of the market (data more comprehensive, more timely, more aggregated by nationality).

Supervisors should ensure that banks have in operation systems appropriate to a more measured assessment of interbank risk (liquidity, capital requirement, implications of substituting of off-balance sheet future transactions for on-balance sheet interbank lending, coordination of interbank deposit exposure with exposure to banks generated by spot or forward foreign exchange business).

There is a need for banks to ask for more information, to consolidate risks on the parent country, to adopt a greater differentiation through the pricing mechanism.

There is at the same time a need to take due account of the impact which actions of official depositors (G-10 and non-G-10) may have on the market.

c. Possible policy measures to minimize damage caused by disturbances

Various techniques available to authorities in different countries to support their banks should be kept under review to ensure that they could be called into play with due speed if necessary (see Cooke Committee reports).

Cooperation between central banks would be a vital element in dealing with disturbances if they materialized.

d. Conclusion

Self-regulation should be the basis of a smoothly running and prudent market.

The authorities have several means at their disposal to contribute to the smooth running of the market: statistics on the interbank market (coverage, timeliness, accessibility); encouragement of greater differentiation by a strengthening of banks' risk evaluation systems; other supervisory matters in relation to liquidity and capital; behavior of official depositors; and the position and activities of brokers.

There is a transition under way toward a more discriminating market, one which reflects a better adaptation to the inevitable risks. That transition must be effected without itself generating undue disruption.

IVC. The Character of the International Interbank Market
(Bank of England, November 1982)

1. Characteristics of the market

International interbank market closely related to the wholesale domestic currency money markets and the foreign exchange markets (use of swaps).

Normally placements of six months or less with a maximum maturity of one year.

Role of interoffice business and degree of independence of branches varying according to nationalities.

2. Uses and mechanisms of the market

Use of the market to avoid a mismatch between claims and liabilities plus some "jobbing" for arbitrage profits.

Spread between the bid and offered rates around 1/8 to 1/4 percent, equivalent to the normal rate of return on operations in the market.

3. Risks in the market

Most bankers relate risks to the borrowers' location but a growing tendency to use a combination of both location and nationality limits; electronic data processing mentioned for more comprehensive control over countries and specific banks in the market.

Capital requirements against interbank assets vary widely but in most cases are lower than capital requirements against nonbank lending.

Some banks arrange paid stand-by lines of credit, sometimes in response to policies of their domestic supervisors.

Archetypal interbank transaction is a short-term placement of funds by one bank with another, the borrowing bank drawing on a normally unadvised and uncommitted line of credit set up by the lending bank; overdrafts and clearing balances between correspondent banks can play a similar role; limited role of stand-by lines of credit (more for domestic business than international business).

Market most active in London; some degree of isolation between markets (differences in time zones), but strong links through the London market; a mix of customer-related transactions and pure trading.

Interbank borrowing activities of banks specializing in lending to a narrow set of customers (frequently minor European, Eastern bloc, or developing country banks) constitutes a part of the market.

Interbank market used by banks for coping with imbalances between their branches, with various degrees of independence for various branches; a desire to have a 24-hour dealing capacity and hence positions are passed from branch to branch rather than being left open overnight.

Extensive use of deposit brokers (about 50 percent to 80 percent of deals).

Risk assessment: limits for large banks based on a certain proportion to total assets or net worth; limits for smaller banks and subsidiaries based on a variety of factors: country of origin degree of supervision, ownership, role in the domestic banking system and general reputation, capital adequacy, and nature of loan portfolio.

Allocation of interbank credit either according to location or to nationality (normally nationality with some concern for exotic references).

Tiering normally limited to a premium from one eighth to one half but increasing in 1982.

IVD. The Eurodollar Conundrum
(Federal Reserve Bank of New York Quarterly Bulletin, Spring 1982)

A close correlation between domestic dollar interest rates and Eurodollar interest rates with rate differentials reflecting the advantage of nonreserve requirements (increasing with interest rate levels) and a risk premium (residual).

The risk premium increased in 1974, fell to nearly zero from the middle of 1975 (when markets were reinsured by the Basle communiqué of September 1974 and the Concordat of 1975) to mid-1980, and have risen to about 0.25 since then. When adopting the Concordat, the governors "placed the primary burden for superivising the liquidity position of Eurobanks with host authorities. The duty of supervising the solvency of subsidiaries and joint ventures was also placed chiefly, but not exclusively, with the host authorities, while that for branches was held to belong clearly to the home authority of the parent banks."

No logical or statistical correlation between the expansion of the Eurodollar market and the size of the U.S. balance of payments deficits but some correlation with the size of the oil exporters' surplus (a preference for Eurodollar assets with short maturities).

In setting monetary policy and monetary targets, the U.S. monetary authorities have to take into account Eurodollar developments; an alternative would be to put the domestic market and the Eurodollar market on equal footing, either by the elimination of reserves on domestic deposits or through the imposition, internationally, of reserve requirements on Eurodollar deposits (proposed by the United States in 1980 and not accepted by other central banks which mentioned alternatives such as capital/assets ratios).

The Settlements Revolution
(M. Mayer, Institutional Investor, September 1981)

"CHIPS," the clearing house interbank payments system, is an electronic transfer system for worldwide settlement of dollar accounts among banks.

Until October 1, 1981, it settled at 10 a.m. New York time, at the same time as the America-wide debit transfer checking system; starting October 1, the CHIPS system will settle 16 hours earlier, at 6 p.m. the evening of the day the business was done, in order to eliminate a day's worth of credit risk every bank ran when it pledged payments to other banks relying on its colleagues to provide the funds with which those payments were to be made.

There are about 100 participants in CHIPS but the major risks are borne by the 7 largest New York clearing banks and the "move to same-day settlement at CHIPS means that the U.S. dollar market and the Eurodollar market are to be much more integrated than before."

V. Supervision

The G-30 has devoted a special analysis to international regulatory arrangements affecting international bank lending (VA).

The trend toward international cooperation is described by Peter Cooke (VB) and reflected in the BIS document on country risk analysis and country exposure (VC).

The views of supervisors of various creditor countries are analyzed in VD while the new supervisory approach to foreign lending by U.S. banks is described in VE.

VA. Overview of International Regulatory Arrangements (R. Dale, G-30, 1982)

1. Preventive regulations

Market entry (normally capital requirements); capital adequacy with a trend toward consolidation and in Europe the use of ratios of weighted loans against capital (within Switzerland a penalty attached to foreign loans and in the Netherlands a zero weight attached to loans to foreign governments); liquidity adequacy (ratios); permissible business activities; foreign currency exposure (formal limits put in some countries such as Germany and the United Kingdom); concentration of loans (with a maximum ranging from 10 percent of capital in the United States to 100 percent in Italy); country risk exposure (formalized process in the United States and the United Kingdom, others being more qualitative, also disclosure of methods required in Belgium, Germany, and Switzerland); inspection of banks (collaboration between supervisors for foreign branches and subsidiaries, with the United States wanting to inspect foreign branches).

2. Deposit insurance

Official schemes existing in the United States, the United Kingdom, and Canada; France, Germany, and the Netherlands relying on the banking industry; insurance normally not covering foreign branches; treatment of foreign currency deposits, treatment of certificates of deposit, amounts covered by the insurance, variable among countries.

3. Lender of last resort and emergency measures

Functions normally performed by central banks with some exceptions: absence of central banks in Luxembourg and Hong Kong; use in Germany of a special fund jointly established by the authorities and commercial banks; broad powers granted in the United States and Canada to deposit insurance agencies.

4. Support of foreign parent institutions

Letters of comfort required by the United Kingdom and Canada.

VB. Developments in Cooperation Among Banking Supervisory Authorities
(Peter Cooke, New York, March 1981)

September 1974, Basle communiqué on lenders of last resort and setting up of the "Committee on Banking Regulations and Supervisory Practices," chaired by Mr. Blunden until 1977 and by Mr. Cooke since then.

The Committee worked first on the division of responsibilities: the governors approved in December 1975 the Concordat which, with some gray areas, confers responsibilities to the host central bank for liquidity and to the parent central bank for solvability.

Other works of the Committee: consolidation; country risk; early warning systems (an idea now dropped); solvency and liquidity; and information flow.

An attempt to open discussions with non-BIS banking supervisors International Conference of Banking Supervisors (London, July 1979); meeting with central bankers of off-shore centers (Basle, 1980); International Conference on Banking Supervisors (New York, September 1981).

The International Banking Scene: A Supervisory Perspective
(P. Cooke, December 1982)

The present period is a period of reappraisal. How can soundness be reconciled with keeping the system going? By the recognition that "new lending may on occasion be the best way of protecting the quality of the existing lending and ensuring its ultimate soundness, all the more so as the Chairman of the Fed in the United States has made reference, in respect of a country lending associated with a program of adjustment undertaken by a country in connection with IMF assistance." The burden should, however, be shared properly between governments, international agencies, and banks and between banks, with small banks having to accept their responsibilities. Supervision of international bank lending could register progress in the near future in three areas:

(a) the coverage of international supervisory arrangements, through extension to non-G-10 countries; contacts between the different authorities concerned wherever a bank operates across national borders; and consolidation.

(b) the adequacy of the capital base of banks engaged in international lending; and

(c) the best possible access to data about businesses, economies, markets, and risks on which sound, broad-based management judgments depend.

VC. Management of Banks' International Lending: Country Risk Analysis and Country Exposure, Measurement, and Control
(Committee on Banking Regulations and Supervisory Practices, BIS - March 1982)

1. Banks assessment of country risk

A need for all banks to establish an independent country risk assessment system.

Since the key question is whether there will be impediments to the payment of external indebtedness, the size, nature, and maturity pattern of a country's current external indebtedness are particularly significant. The analysts will nonetheless wish to project a path for countries' external debt and to forecast their ability to service and repay, which means looking at the outlook for official reserves and other balance of payments items, terms of trade, exchange rates, inflation, the country's record in servicing and repaying external debt, and other relevant factors.

2. Banks' measurement of country exposure

Systems for measuring country exposure need to be tailored according to the size and complexity of an individual bank's international lending operations; nevertheless some common guidelines are:

a. Allowance for risk reallocation

Dual exposure measurement in order for funds placed with a foreign branch of another bank or for loans covered by guarantees from a resident of a country other than that of the borrower.

b. Consolidation

Consolidation is an essential aid to the management of country exposure, but as well as measuring its exposure on a consolidated basis, the bank will need to be aware of the gross country exposure arising from funding of its individual overseas branches and subsidiaries.

c. Breakdown and analysis of claims by borrowing country

Country exposure consists of all balance sheet assets which represent claims on residents of another country; a breakdown between claims on sovereign borrowers, banks, and others might be desirable; intercountry loans denominated in the local currency to be treated somewhat differently.

A need to monitor all commitments to provide funds (letters of credit, guarantees, some proportion of forward foreign exchange contracts,...); offset of deposits against credit possible but quite limited in practice.

3. The control of country exposure

Any system for control of country exposure should be based on the setting and monitoring of country exposure limits with a separation of the marketing function from the limit-setting function.

Limits should be related to capital and reserves and an excessive concentration of risk should be avoided (relation between a bank country exposure pattern and the overall exposure of international banks as reported by the BIS); sublimits by types of lending or types of borrowers may be useful.

A need for a regular review of country limits in response to changing risks.

Provisions to be made against expected losses, even in cases where a rescheduling agreement has been reached.

4. The role of the banking supervisor

A need to ensure that banks have adequate methods of assessing, measuring, and controlling country exposure: existence of a country risk assessment system; relations between individual country exposures and bank capacity to sustain losses; monitoring of country limits; accuracy in statistics.

VD. Supervision of International Bank Lending

(John Heimann, International Conference of Bank Supervisors, London, July 1979)

In the United States an interagency country exposure committee with a statistical prescreening system and specially prepared country studies; a look at diversification among countries and among borrowers (with an interpretative ruling in 1978 on foreign entities); evaluation of the bank management ability to analyze and monitor country risk (sources of information, analytical tools, independence from market considerations) and to define and control exposure on a country-by-country basis.

The strengthening of international cooperation between supervisors is a positive development but gray areas remain (the Concordat).

Evaluation of Risk in International Lending: A Bank Examiner's Perspective

(Schuler, Office of the Comptroller of the Currency, 1980)

After harmonization of views between examiners, loans placed into one of five categories:

(1) Pass

(2) Especially mentioned: Analysis indicates conditions which could lead to an interruption.

(3) Substandard: Orderly repayment is jeopardized. Ultimate payment in full is expected.

(4) Doubtful: No performance--full repayment appears tenuous.

(5) Loss: No performance and no repayment expected in the near future. The loan is not bankable, requiring its removal from the bank's assets.

In addition, examiners check the application of the 10 percent of bank capital aggregate limit to any individual group (for foreign entities, a state-owned entity is considered as distinct from the government if it has its own repayment capacity).

Bank Management in a Changing Environment

(Muller, The Netherlands Bank, October 1980)

During the period 1974-79, G-10 banks expanded their credit at an annual rate of 12.75 percent for domestic credits, 26.75 percent for international credits, and 14.25 percent for total credits.

Cooperation of supervisors in the EC through the "Contact Group of Supervisory Authorities of the EC Countries" (1972) and the "Advisory

Committee of the Commission for Banking Coordination" (December 1978): consolidation for solvency supervision (directive under study); coordination of prudential regulations ("observation ratios for solvency and liquidity").

Cooperation of supervisors within the BIS area through the Cooke Committee: division of responsibilities by the Concordat (basic principle; liquidity responsibilities based on host country supervision; solvency responsibility based on the supervision by parent authorities); closer look at capital/exposure ratio; maturity mismatch; country risk (supervisors examining the possibility of an integrated and more complete system of information on countries' financial positions).

Bank Supervision on a Consolidated Basis
(Colje, The Netherlands Bank, June 1980)

Principle of consolidation accepted by G-10 governors in 1979 (Zijlstra letter, June 1979) and endorsed by the London Conference of supervisory authorities (July 1979).

A more precise and a more explicit EC directive under study within the EC "groupe de contact" instituted in 1972. 1/

1/ This directive has been since approved and published.

LDC Credit Risk and Bank Regulations--Financing Developing Countries

(Wallich, Federal Reserve System, February 1982 and February 1983)

Scope for improvement in the treatment of weak sovereign loan; greater homogeneity in regulators' practices; greater homogeneity in provisioning; better integration of the treatment of sovereign loans in the tax system; better international coordination.

To ensure moderation in the growth of bank lending to the largest foreign borrowers several options have been mentioned:

(1) specific country limits (but they are likely to be either too rigid or so flexible that they are not workable);

(2) disclosure requirements;

(3) establishment of specific reserves for troubled country loans; and

(4) income-accounting requirements that loan fees be amortized over the life of the loan.

Overreaction to problems in foreign lending should be avoided through adequate international cooperation.

World Banking in 1983

(Duisenberg, The Netherlands Bank, December 1982)

Current account deficits of developing countries should register an improvement in 1983 through the conjunction of lower interest rates and of the constraints imposed by the slowdown in international bank lending.

The Fund should play a central role as a catalyst, and not a substitute, for lending by private creditors. Parallel financing of the banks with the IMF should provide important advantages to all parties concerned. While G-10 governors were right in 1974 when avoiding any details on liquidity support, there is no doubt that the central banks' role of lender of last resort implies that solvent banks incurring liquidity problems due to the temporary illiquidity of international claims can in principle count on the provisions of temporary liquidity support. Insofar as there would be a need for foreign exchange in connection with support operations, the existing cooperating between central banks will ensure that such needs are accommodated smoothly.

Monetary authorities should at the same time attempt to prevent debt crises from emerging in the future, through a clearer view of the size of balance of payments deficits that various country groups can incur and therefore can have financed, and to what extent adjustment should take place. Influencing the flow of credit, through direct or indirect instruments of monetary policy, is a part of domestic central banking and should become a part of a coordinated approach to international banking.

VE. A New Supervisory Approach to Foreign Lending
(Federal Reserve Bank of New York, Quarterly Bulletin, Spring 1978)

An ad hoc committee on foreign lending was appointed in late 1976 to study procedures used by member banks in making foreign loans. From this study, it appeared clear that a restructured supervisory approach should incorporate several features:

(a) uniform measurement of a bank's country exposure;

(b) adequate internal system to monitor country risks; and

(c) uniform criteria for supervision, avoiding, however, credit ratings since action of bank supervisors is not intended to result in the channeling of credit flows.

The main characteristics of the new system applied since end-1977 are as follows:

(1) a semiannual country exposure report breaking down the bank's claims for each country by type of borrower and by maturity; loans are reported on a consolidated basis; a reallocation of risks according to the countries of ultimate risks (guarantees), contingent risks, and activities in local currencies are also shown;

(2) an identification by supervisors of the countries for which an in-depth review is warranted through simple statistical screening techniques (current account deficits, external debt service, international reserve position relative to GDP or exports); countries identified through the screening process would be specifically reviewed;

(3) a comparison of exposure by country, in relation to capital, with the average exposure of all U.S. banks, with specific emphasis on countries identified through the screening process and on portfolio diversification; and

(4) a judgment on the adequacy of the internal systems set up for controlling foreign lending.

VI. Rescheduling

The Overseas Development Council has devoted an extensive study to the outcome of past rescheduling negotiations and to possible improvements in the future (VIA).

The G-30 (VIB) and investment bankers (VIC) also stress the need for a more formalized process.

Two specific issues are analyzed separately: comparative provisions in rescheduling agreements (VID) and accounting treatment of problem sovereign debts (VIE).

VIA. Rescheduling Developing Countries' Debts, 1956-1980: Lessons and Recommendations
(Chandra Hardy, Overseas Development Council, 1981)

From 1956 to 1974, 30 debt negotiations for 11 countries (total debt US$7 billion) and, from 1975 to 1980, 16 negotiations for 9 countries (total debt US$9 billion). 1/

1. Factors contributing to debt problems

Excessive borrowing to finance consumption; economic and social rigidities (role of the public sector); excessive credit creation (rapid increase in banks' claims on the government); excessive debt accumulation (excessive reliance on short-term suppliers' credits, poor debt management, and deterioration of the debt service ratio); weak export growth (frequently a drop in export prices); and limited access to medium- and long-term capital (plus outflow of capital through "errors and omissions").

2. The response of official creditors

Paris Club dealing with public and publicly guaranteed debts; normally rescheduling of 80 percent of principal due over a two- to three-year period; repayments over ten years with a two and a half-year grace period.

The cost of debt relief (difference of discounted present values of the streams of debt service payments before and after rescheduling) has been limited: US$2 billion for the 1956-74 period for a total outstanding debt of US$400 billion; in percentage of outstanding debt, it exceeded 10 percent for only three countries (Turkey, 1978-80: 41 percent; Ghana, 1966-74: 45 percent; and Indonesia, 1966-70: 56 percent), but for some individual creditors, notably France, Germany, the United Kingdom, and the United States, and depending upon the structure of the debt and the influence of subsequent exchange rate movements, this level of 10 percent has been reached more frequently.

3. The response of the commercial creditors

Since 1975, commercial debt problems handled rather rapidly for five countries (Argentina, Chile, Iran, Indonesia, and Gabon) and after protracted negotiations for six countries (Turkey, Zaire, Peru, Nicaragua, Sudan, and Jamaica).

Common patterns. The attitude of banks was part of the problem (injudiciously rapid growth of bank claims succeeded by a precipitous withdrawal); severe conditions attached to the rescheduling (transfers from banks after restructuring negative if interests are included).

1/ See Annex.

4. Debt problems in perspective

Debt problems largely created by factors beyond the control of borrowers: export price fluctuations; instability of interest rates; use of short- and medium-term debt to finance development; and political pressures.

5. Proposals and recommendations for reform

The G-77 recommendations: to drop the distinction between debt relief and development assistance; to have the terms of debt relief suited to the medium-term balance of payments profile and to the borrower's needs; to set up a formal multilateral framework for debt renegotiations.

Outcome of the G-77 recommendations: retroactive terms adjustment for US$6 billion debts of poorest countries (March 1978); agreement in March 1979 on four concepts to guide future rescheduling (request of the debtor country, appropriate multilateral framework, due account of the financial situation and development prospects, and protection of both creditors and debtors); agreement by UNCTAD in September 1980 to present framework, but with a larger role for IBRD/IMF.

A need for IBRD/IMF to implement the UNCTAD agreement: a systematic monitoring of the emergence of debt problems (suggestions in consultation reports on steps to avoid debt servicing difficulties); quick response capability in collecting private and short-term debt data from creditor sources; preparation of a medium-term adjustment program protecting a minimum rate of growth; participation of all creditors in mutually satisfactory solutions (joint meetings of official creditors and banks at the initiative of the IBRD/IMF), terms of debt relief reducing the prospective debt burden.

Debt Negotiations (1956-80)

Argentina	:	May 30, 1956; October 26, 1962; June 26, 1965
Turkey	:	May 12, 1957; May 27, o965; May 20, 1978; June 24, 1979; July 23, 1980
Brazil	:	May 24, 1961; July 1, 1964
Chile	:	February 24, 1965; April 19, 1972; March 25, 1972; May 6, 1972
Ghana	:	December 9, 1966; October 22, 1968; July 11, 1970; March 13, 1974
Indonesia	:	December 20, 1966; October 18, 1967; October 17, 1968; April 24, 1970
India	:	May 5, 1968; December 27, 1972; February 16, 1973; June 14, 1974; June 27, 1975; May 26, 1976
Peru	:	September 27, 1968; November 19, 1969; November 3, 1978
Cambodia	:	June 29, 1972; October 31, 1972
Pakistan (B)	:	May 26, 1972; June 15, 1972; June 28, 1974
Bangladesh (B)	:	June 28, 1974
Zaire	:	June 16, 1976; July 7, 1977; December 11, 1979
Sierra Leone	:	December 15, 1977; January 8, 1980; November 13, 1979; December 15, 1979
Liberia	:	December 19, 1980
Gabon	:	June 20, 1978
Sudan	:	November 13, 1979
Togo	:	June 15, 1979

VIB. The Rescheduling of a Country's Debt: Is a More Formalized Process Necessary? (Richard Huff, G-30, 1982)

Rescheduling starting in 1956 for official creditors and in the 1960s and early 1970s for commercial banks (Argentina, Brazil, and Chile) but in recent years more frequent, involving a greater number of participants, conducted on a greater scale.

Rescheduling process negotiations: beginning one or two years after emergence of arrears or reluctance to rollover; role of the steering committee (agent banks, lead managers, bank with the largest exposure); relations with officials (the "comparable treatment" clause of the Paris Club), multilateral institutions (IMF programs), advisors (Kuhn-Loeb, Warburg, Lazard, for Indonesia, Zaire, Gabon, Turkey, and Sri Lanka; and Morgan Grenfell for Sudan and Oman).

In spite of the comparable treatment clause, official creditors are more generous on below-market interest rates, on the rescheduling of interest, and in resumption of lending; each bank is expected to participate in proportion to existing exposure ("fair treatment doctrine"); short-term trade financing generally not covered which leads to reductions of exposure exacerbating problems.

Alternatives to the present process: institutionalized process under the auspices of the Fund (reluctance from banks); international banking institute; and incorporation of the appropriate clauses in the loan documentation.

VII. The External Debt of CMEA Countries

The Polish crisis and the associated difficulties in several Eastern European countries have induced a series of analyses of developments which led to the present debt situation.

They include a comprehensive study by the Vienna Institute for Comparative Economic Studies (VIIA) which stresses the need to differentiate between countries and a document by "Le Courrier des Pays de l'Est" (VIIB) with specific references to individual sources.

They are supplemented by a document established by an Austrian bank on the Comecon current situation (VIIC) and by two tables on developments in 1982 and 1983 (VIID).

VIIA. An Assessment of European CMEA countries' hard currency debt (G. Fink, Vienna Institute for Comparative Economic Studies, International Conference on Country Risk Assessment, New York, September 24th, 1981

The first attempts to make projections of European CMEA countries' debt started in 1975-1977 but their results showing unmanageable situations were dismissed by bankers deprived of adequate information on the internal equilibrium and too confident in "command economies" (the capacity to force adjustments); in addition these projections were overestimating the debt of the U.S.S.R. and underestimating the debt of Hungary and Romania (impact of the increase in oil prices).

A variety of debt indicators is needed to assess the situation: the debt service ratio singling out Poland (92 percent), the ratio of short-term, debt to exports singling out Hungary, the ratio of liquid assets to imports with particularly low ratios for Romania (7 percent), the ratio of total debt (including debt to the U.S.S.R.) to exports.

The combination of the debt ratios and of the liquidity ratios gives overall the most appropriate ranking:

	West debt ranking	West and U.S.S.R	Debt and liquidity
U.S.S.R	1	1	1
Czechoslovakia	2	2	2
Bulgaria	4	4	3
Romania	3	3	6
G.D.R.	5	5	4
Hungary	6	6	5
Poland	6	7	7

VID. Comparative Provisions in Rescheduling Agreements
(Surrey and Morse, November 1982)

Coverage: Normally all obligations in principal to signatory banks outstanding at a given date; reference to rescheduling terms for suppliers' credits and guaranteed credits; exclusion of interest.

Definition of debtors (government agencies): Normally any agency of the government and any entity in which it has, directly or indirectly, more than 50 percent of the capital stock.

Operative refinancing language: A typical end-result: principal in 48 monthly installments ending on the seventh anniversary of the date of the refinancing agreement. Interest payable monthly at 1 3/4 percent, over the floating LIBOR for U.S. dollar loans.

Conditions precedent: (i) Payment of amounts of past due interest and fees; (ii) certification by the borrowing country of the effectiveness of the financing agreement; and (iii) certification of officers and opinions of counsels.

Mandatory prepayment: Normally required if any other obligation is prepaid.

Events of default: (i) failure to pay pursuant to the refinancing agreement, failure to perform any other obligation under the agreement, untrue representation; repudiation; (ii) cross default or any other foreign exchange indebtedness; (iii) failure to continue to be a member in good standing of the IMF; and (iv) a majority of banks find that circumstances have arisen which will have adverse effects on the condition of the borrower.

Affirmative covenants: Provision of periodic reports on economic development and foreign exchange allocation.

Negative covenants: (i) Not to create any other indebtedness with senior rank; and (ii) not to accept any lien on international monetary assets.

Guarantee: Normally unconditional guarantee by the central bank, including adequate provision of the needed foreign exchange.

Servicing bank duties: (i) Role of the agent limited to administrative functions; and (ii) fees and expenses reimbursed.

VIE. Supervisory Options for Mandating Specific Accounting Treatment of Problem Sovereign Debt
(Comptroller of the Currency, December 1982)

1. International banking and supervisory developments, 1960-81

After Herstatt, Franklin National and the U.K. "fringe" banking crisis, a growing involvement of regulators; joint effort of the Fed, the COC, and the FDIC in the United States (1978); disclosure requirements by the SEC; international cooperation.

2. Options for accounting treatment of problem sovereign credits

a. Retain the present system.

b. Exert moral suasion.

c. Public disclosure.

d. Assign heavier "weights" to problem sovereign countries in systems using solvency and liquidity ratios as basic supervisory tools.

e. Nonaccrual and nonperforming loans (all loans 90 days or more overdue to be placed on an accrual status; all loans placed on an accrual status to be reported as nonperforming loans; public disclosure of nonperforming loans; requirement that any interest payments received on loans in nonaccrual status be first applied against principal or applied to a specific reserve for nonperforming assets).

f. Mandated provisioning to reserves (with four suboptions: implicit provision to general resources, implicit provision to hidden reserve, specific provision to general reserves, provision to specific reserves).

g. Mandatory "charge off" (to mandate a "charge off" of all or part of a problem sovereign credit directly reflected in bank earnings).

These options have to be assessed against some fundamental and somewhat conflicting goals: integrity of the system, promotion of competitive markets, market stability, flexibility, market discipline.

See also: Henry Wallich, International Lending and the Role of Bank Supervisory Cooperation, Washington, September 1981; a need for regulators to formulate ideas about the balance sheet and income statement treatment of rescheduled loans.

VII. The External Debt of CMEA Countries

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A variety of debt indicators is needed to assess the situation: the debt service ratio singling out Poland (92 percent), the ratio of short-term, debt to exports singling out Hungary, the ratio of liquid assets to imports with particularly low ratios for Romania (7 percent), the ratio of total debt (including debt to the U.S.S.R.) to exports.

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Bulgaria	4	4	3
Romania	3	3	6
G.D.R.	5	5	4
Hungary	6	6	5
Poland	6	7	7

For the future 4 sets of projections have been established:

- Scenario 1: Past trade elasticities and OECD growth rate of 3.5 percent.

- Scenario 2: (Base Scenario) Same exports as in (1) but trade balanced in 1985.

- Scenario 3: (Low Growth) Same as Scenario 2 but with an OECD rate of 2 percent.

- Scenario 4: (High Interest Rates) such as (2) but with LIBOR at 15 percent against 10 percent in Scenarios 1, 2, and 3.

The range of these projections is as follows (in billions of U.S. dollars):

	1980	1985	1990
U.S.S.R.	7.5	-1 to +6	-2 to- 35
Czechoslovakia	3.8	9/10	12/20
Bulgaria	4	6/8	4/17
mania	8	14/17	20/31
G.D.R.	10	20/30	10/30
Hungary	8	17/20	23/39
Poland	23	27/42	-4/61

Conclusions for individual countries :

- Three countries without major problems: U.S.S.R., under all assumptions; Czechoslovakia whose debt will continue to grow but to remain moderate; Bulgaria for which a further slowdown on debt accumulation is necessary.

- One country (Poland) facing extreme difficulties (liquidity gap, decreasing export potential, additional financing needed).

- Three intermediate countries: Romania (liquidity gap, fragility of debt position); Hungary (still exposed in view of its liquidity situation); G.D.R. (a danger of rapid increase in indebtedness because of over ambitious growth targets).

VIIB. External Indebtedness of U.S.S.R. and Eastern Countries (A. Tirasplosky, le Courrier des Pays de l'Est, Septembre 1982)

Various estimates of COMECON countries' debt (see attached Table 1) are available, with a central figure of $80 billion as the outstanding debt.

A rapid increase of the debt service ratios (debt service to exports) has taken place during the last ten years, with, however, constrasting situations:

	Debt service ratios		
	1970	1975	1981
Bulgaria	0.30	0.44	0.23
Hungary	0.14	0.20	0.45
Poland	0.19	0.32	1.02
G.D.R.	0.13	0.24	0.44
Romania	0.36	0.21	0.35
Czechoslovakia	0.09	0.11	0.26
U.S.S.R.	0.07	0.13	0.07

Source: Wharton Econometric Forecasting Associates April 27, 1982.

The perception of risks by the market is accordingly contrasted: the risks are judged limited for the Soviet Union and growing from Bulgaria, Czechoslovakia, G.D.R., Hungary and Romania to Poland.

Table 1. Net Indebtedness of CMEA European Countries--Various Estimates
(In billions of U.S. dollars, end of year)

		1970	1975	1980	1981
Bulgaria	a	0.7	2.26	3.00	2.50*
	b	...	2.0	...	...
	c	...	2.0	...	...
	d	0.7	2.1	2.5	2.2
	e	...	...	3.2	2.3
	f	...	...	4.0	...
Hungary	a	0.6	2.19	7.70	8.00*
	b	...	2.3	...	...
	c	...	2.1	...	...
	d	0.6	2.3	6.6	7.2
	e	...	...	7.4	7.8
	f	...	...	8.4	...
Poland	a	0.8	7.38	26.00	28.50*
	b	...	7.1	...	...
	c	...	6.7	...	...
	d	1.1	7.7	22.3	22.6
	e	...	...	22.1	22.4
	f	...	...	23.0	...
G.D.R.	a	1.0	3.55	10.37	12.20*
	b	...	4.2	...	...
	c	...	3.8	...	...
	d	1.4	4.8	11.6	12.8
	e	...	...	9.6	11.3
	f	...	...	10.3	...
Romania	a	1.2	2.45	9.25	11.0
	b	...	2.3	...	11.0
	c	...	2.1	...	...
	d	1.6	3.1	9.4	10.1
	e	...	...	9.1	9.6
	f	...	...	7.9	...
Czechoslovakia	a	0.3	0.83	3.00	3.00*
	b	...	1.2	...	...
	c	...	1.1	...	...
	d	0.6	1.2	3.4	3.4
	e	...	...	3.5	3.6
	f	...	...	3.8	...

Table 1. Net Indebtedness of CMEA European Countries
--Various Estimates (concluded)
(In billions of U.S. dollars, end of year)

		1970	1975	1980	1981
Total 6 countries	a	4.6	18.66	59.32	65.20*
	b	5.1	19.1	...	...
	c	...	17.8	...	...
	d	6.0	21.2	55.8	58.3
	e	...	...	54.9	57.0
	f	...	...	57.4	...
U.S.S.R.	a	1.9	7.45	9.60*	12.10*
	b	1.8	8.4	...	...
	c	...	10.7	...	...
	d	1.0	7.8	8.7	10.2
	e	...	...	13.5	19.5
	f	...	...	7.5	...
Total 7 countries	a	6.5	26.19	68.92*	77.30*
	b	6.9	27.5	...	...
	c	...	28.5	...	...
	d	7.0	29.0	64.5	68.5
	e	...	...	68.4	76.5
	f	...	...	64.9	...
CMEA banks	a	...	2.79	4.93	5.00*
	b	0.6	3.1	...	...
	c	...	...	...	...
	d	0.3	2.2	4.1	3.9
	e	...	...	4.0	4.2
	f	...	...	5.5*	...
Total CMEA Europe	a	...	28.90	73.85	82.30*
	b	7.5	30.7	...	...
	c	...	28.5	...	...
	d	7.3	31.2	68.6	72.4
	e	...	...	72.4	80.7
	f	...	...	70.4	...

* Estimates.

a CIA. Estimating Soviet and East European Hard Currency Debt.
b L.J. Brainard "East Europe Improves its Trade." Euromoney, May 1978.
c Chase Manhattan Bank. East West Markets, September 20 and October 4, 1976, May 15 and 29, 1978.
d Wharton Econometric Forecasting Associates Inc.; Central Planned Economies, current analysis, April 27, 1982.
e United Nations.
f. Wiener Institut für Interational Wirtschaftsvergleiche, July 1, 1980.

VIIC. The Current Economic Situation of the Comecon Countries (Creditanstalt, Economics Department, June 1982)

Economic results in 1981 are below planned targets (see table below)

Changes in growth of the net material product

(Annual percentage change)

	1976-1980		1979	1980	1981		1982	1981-1985
	Plan	Actual	Actual	Actual	Plan	Actual	Plan	Plan
Bulgaria	7.7	6.2	6.6	5.7	5.1	5.0	3.6	3.7
Czechoslovakia	4.9	3.7	3.1	3.0	2.8	0.2	0.5	2.0-2.6
East Germany	5.0	4.1	3.8	4.2	5.0	4.8	4.8	5.0
Hungary	5.4-5.7	3.2	1.9	-0.8	2.2	1.8	1.0-1.5	2.7-3.2
Poland	7.0-7.3	1.6	-2.2	-4.0	...	...	...	...
Romania	11.0	7.1	6.2	2.5	7.0	5.5	5.5	7.1
U.S.S.R.	4.7	4.4	2.1	3.5	3.4	3.0	3.0	3.4

Source: National statistics and reports on the plan, CA - BV estimates.

Leaving aside U.S.S.R, this reflects some specific difficulties, notably in the energy sector, but fundamentally mirrors the unavailability of the external resources required to finance the current account deficits associated with planned growth. 1/

The external balance, and particularly debt service, narrow the economic scope for Comecon countries. Present estimates of Comecon countries debt show that a restrictive stance will continue to be needed in coming years for most Comecon countries.

1/ According to OECD statistics, international medium- and long-term bank loans raised by CMEA countries have developed as follows (in millions of U.S. dollars):

1979	1980	1981	1982	1983 I	1983 II	1983 III
3,719	2,716	1,509	704	-	200	235

VIID. Evolution in 1982-1983

Hard-currency debt of Eastern European Countries

(Billions of U.S. dollars at year-end)

	1977	1978	1979	1980	1981	1982	
Gross amounts							
Bulgaria	3.7	4.3	4.4	3.5	3.1	2.9	
Czechoslovakia	2.6	3.2	4.1	4.9	4.4	4.0	
GDR	7.1	8.9	10.9	13.8	14.9	13.4	
Hungary	5.7	7.5	8.5	9.5	8.7	7.8	
Poland	14.0	17.8	22.7	25.1	25.5	24.8	
Romania	3.6	5.2	7.0	9.6	10.2	9.8	
Total	36.7	46.9	57.6	66.4	66.8	62.7	
Soviet Union	15.6	16.4	18.1	18.6	20.9	20.1	(P)
Total	52.3	63.3	75.7	85.0	87.7	82.8	
Net amounts							
Bulgaria	3.2	3.7	3.7	2.7	2.2	1.9	
Czechoslovakia	2.1	2.5	3.1	3.6	3.5	3.1	
GDR	6.2	7.5	8.9	11.7	12.7	11.4	
Hungary	4.5	6.5	7.3	8.1	7.8	7.1	
Poland	13.5	17.0	21.5	24.5	24.8	23.8	
Romania	3.4	5.0	6.7	9.3	9.8	9.5	
Total	32.9	42.3	51.2	59.9	60.8	56.8	
Soviet Union	11.1	10.4	9.3	0.5	12.5	10.1	(P)
Total	44.0	52.7	60.5	69.4	73.3	66.9	

Sources: Estimates based on the following US publications: "Estimating Soviet and East European Hard Currency Debt," June 1980, and "1983 Handbook of Economic Statistics" as supplemented by BIS data.

P = preliminary

Assets-Liabilities ratios of Eastern European Countries vis-à-vis Western Commercial Banks

	End-1977	End-1978	End-1979	End-1980	End-1981	End-1982	End-June 1983
Bulgaria	0.19	0.15	0.23	0,30	0.38	0.48	0.55
Czechoslovakia	0.30	0.32	0.35	0.36	0.34	0.27	0.35
G.D.R.	0.18	0.19	0.25	0.22	0.21	0.22	0.30
Hungary	0.21	0.14	0.16	0.19	0.12	0.11	0.12
Poland	0.04	0.07	0.07	0.04	0.05	0.07	0.09
Romania	0.14	0.09	0.08	0.05	0.06	0.07	0.06
Soviet Union	0.38	0.46	0.67	0.64	0.53	0.71	0.66
Total	0.22	0.22	0.28	0.26	0.25	0.28	0.30

Source: BIS, quarterly reports.