

Commercial Bank Lending to the Developing Countries

The enormous expansion of commercial bank lending to the developing countries during the last several years has generated a great deal of discussion and concern.¹ In 1976, some \$20 billion of bank credits was extended to these countries, about three times as much as in 1973. By the end of 1976, the total outstanding debt of the LDCs to both private and public lenders reached about \$180 billion, compared with roughly \$75 billion in 1972. This rapid buildup of debt has understandably raised questions about the pace of lending and the ability of the developing countries to service their debts.

Most of the discussion of the LDC debts has overlooked an important development: the strong growth performance of the developing countries as a group over the last fifteen years. The real domestic product of the LDCs grew by nearly 6 percent annually during the thirteen years before the quadrupling of OPEC oil prices in 1973-74 and by a somewhat lower but still very respectable rate of nearly 5 percent during the last three years, despite this being a period marked by widespread economic dislocation and recession. These rates exceeded the average growth of both the industrialized countries and the centrally planned economies by a significant margin. The achievement has also been impressive by historical standards, considering that real output in the developing countries increased by only 2 percent annually during the first half of the century.

This rapid growth was to a great extent made possible by large inflows of external finance. Such funds

supplemented these countries' domestic savings and thereby allowed them to import substantially more than they exported. The inflows from abroad generally averaged about 20 percent of the LDCs' gross domestic investment and 4 percent of their gross domestic production. In the early 1960's, the inflows comprised mainly official assistance, private direct investment, and trade credits. But in the late 1960's and early 1970's an increasing proportion of such flows consisted of commercial bank loans.

This change in the source of LDC financing went largely unnoticed until 1974 following the quadrupling of OPEC oil prices and the subsequent slowdown in the industrial countries. Because of the huge increase in their import costs and the adverse developments in their exports, the developing countries required still larger capital inflows to finance their planned levels of imports and to maintain the momentum of their development programs. Official assistance was inadequate to meet this greatly increased need, and thus the higher income LDCs turned for funds to the large commercial banks. Consequently, most of them were able to maintain high, although reduced, growth right through the world recession and the period of adjustment to the higher oil prices.

Commercial bank lending to the LDCs also benefited the industrial countries in certain respects. It provided their private financial sectors with a relatively new source of growth and earnings, and it also helped maintain foreign demand for their exports during the recession. Nevertheless, the rapid growth of bank lending introduced a new element of uncertainty and instability into the international and domestic financial situation. On the one hand, a very sharp curtailment of bank lending could make it difficult for some countries to make payments on their external obligations; on

¹ In this article, the designations "developing countries" and "LDCs" (i.e., less developed countries) are used interchangeably. The coverage here excludes countries in Southern Europe as well as the oil-producing countries that are members of OPEC (Organization of Petroleum Exporting Countries).

the other hand, a widespread interruption of interest and amortization payments could cause liquidity problems for some of the world's largest commercial banks.

Fears of defaults are exaggerated

The severe recession of 1974-75 served as a reminder of the years before World War II, when many foreign governments defaulted on their external debts during the 1920's and when several domestic bank closures produced a domino effect on the United States banking system in the early 1930's. The danger of default now is much less than it was in the 1920's, since today the debt is held by fewer lenders and international cooperation is stronger. In that earlier period, individual investors held much of the external debt in the form of bonds and there was no ongoing relationship between the borrower and the lender. In such a situation, it was very difficult to restructure or reschedule a country's debt when payment problems arose. Nowadays, large commercial banks do most of the private lending, and they maintain a continuing interest in and relationship with the borrowing country.

Furthermore, when repayment problems arise now, the borrower can seek help through various international organizations. There is also much greater recognition of the need to maintain lending to the debtor countries and to allow their exports reasonable access to markets in the industrial countries. During the 1930's, many industrial countries stopped lending to the LDCs and also erected barriers against the LDCs' exports, thus making it practically impossible for them to service their debts.

Although current fears of widespread defaults appear exaggerated, legitimate reasons for concern do exist. Commercial bank lending to developing countries has grown at a very rapid rate. Furthermore, the loans are highly concentrated on both the borrowing and the lending sides. Mexico and Brazil, for example, account for one half of United States bank claims on the nonoil LDCs, and most of the lending to the developing countries is done by a small number of large banks. This concentration of lending to the stronger economies and by the larger banks may be desirable from the viewpoint of repayment capacity, lending experience, and country expertise, but not necessarily in terms of portfolio diversification and risk dispersion.

Bank lending before the oil price increase

The large commercial banks have been active in the developing countries for many decades, but their lending activities remained rather modest until the late 1960's. Previously, they kept mainly to their traditional role of financing foreign trade, which by its very nature

was considered to be short term, self-liquidating, and relatively secure. The banks engaged in some project financing, particularly if it involved home-based multinational corporations. In many developing countries, however, the large national development projects were financed by government-sponsored development banks, and much of the external financing was done through the World Bank and foreign assistance programs. In the mid-1960's, however, several major changes occurred in the world economy that greatly expanded the commercial banks' traditional role of financing short-term trade and provided them with the new role of financing development projects and payments imbalances. These changes included the worldwide expansion of multinational corporations, the growth of the Euro-currency markets, the shifts in official aid programs, and the sharp acceleration of world trade.

The late 1960's and early 1970's was a period of rapid expansion for the multinational corporations in the LDCs. It was natural for them to turn to the large international banks to finance their foreign operations, which frequently included medium-term financing for physical facilities as well as short-term trade financing. Moreover, in many LDCs it was common for the government to restrict the multinationals' access to domestic financial markets and to force them to borrow funds from abroad. The government thereby tried to increase the net inflow of foreign capital with minimal cost or risk to itself. The multinationals were attracted mainly to developing countries that had either large natural resources to develop, cheap and efficient labor to employ, or potentially large domestic markets to exploit.

In the 1950's and early 1960's, the multinationals focused heavily on Western Europe and those LDCs with large mineral resources, but in the late 1960's they turned increasingly to those higher income and fast-growing countries in Latin America and East Asia that had strong growth potential and also were receptive to foreign capital. Foreign investment in Latin America had been high for a long time, but it was stepped up briskly in the late 1960's, particularly in Brazil. Furthermore, an increasing amount of this foreign investment in Latin America went to manufacturing rather than mining. At that time attention also shifted to East Asia, where Korea, Taiwan, Hong Kong, and Singapore emerged as attractive centers for the manufacturing and exporting of labor-intensive goods—particularly textiles, leather goods, and more recently electronic equipment.

The late 1960's and early 1970's also witnessed the rapid growth of the Euro-currency markets, making it possible for the multinationals to obtain dollar financing in spite of the capital controls that the United

States had imposed on outflows of funds. Up until January 1974, when these controls were finally removed, most foreign lending by United States banks was done through foreign branches.

Branches spread from the original center—London—to the Bahamas, Panama, Hong Kong, and Singapore. These regional centers helped satisfy the demand for financing in their areas by facilitating the flow of funds from the industrial countries to the Latin American and East Asian countries. During this time, European and Japanese banks joined the American banks in expanding their lending activities in the developing countries.

Many higher income LDCs were compelled to seek greater private financing from abroad in the late 1960's, a period when the industrial countries and international agencies were making revisions in their

official aid programs. The United States not only continued to keep assistance at a modest level (which meant little, if any, increase in real terms) but, in addition, concentrated it in the lower income countries. Although other industrial countries increased their foreign aid, most of them also concentrated it in the poorer countries.

The World Bank continued to lend money to all its creditworthy LDC members but raised its interest charges to reflect the cost of the funds it borrowed from the private financial markets. Therefore, the advantage of borrowing from the World Bank instead of from the Euro-currency markets diminished for many developing countries, particularly since the World Bank restricted its loans to projects that it had approved. Furthermore, the more creditworthy LDCs found that they could obtain large amounts of Euro-currency credits at relatively small premiums above the prevailing minimum lending rate.

At the same time, the higher income countries were charting increasingly independent development strategies and adjustment policies, partly to free themselves from what they felt to be constraints set by the international lending agencies. As far as the International Monetary Fund (IMF) was concerned, some countries preferred to borrow from commercial banks rather than to meet the even stricter conditions on economic performance that the IMF mandates as a country's borrowing from it increases. Some of the higher income LDCs also found it possible and convenient to use the proceeds of balance-of-payments loans to finance their ordinary government expenditures.

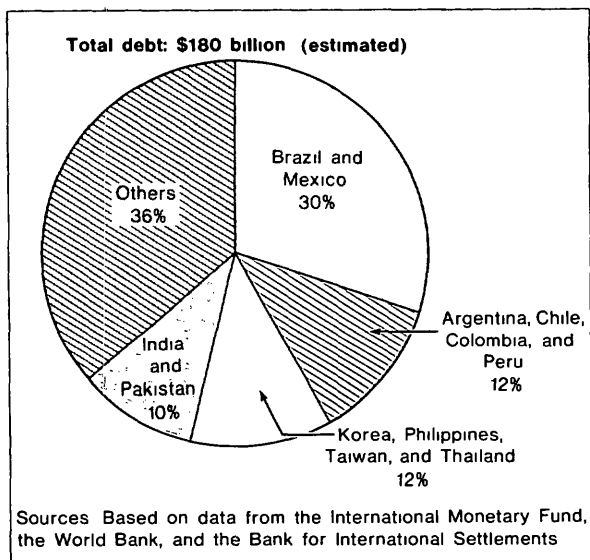
Commercial bank lending to the LDCs was boosted further by the acceleration of world trade—particularly during the commodity price boom that began in 1972 and lasted until 1974. Between 1965 and 1974 the non-oil LDCs quadrupled their merchandise exports in nominal terms, from \$25 billion to nearly \$100 billion per year. In contrast, during the previous decade, they increased their export proceeds by less than one half. The 1965-74 surge in the LDCs' exports was part of a worldwide expansion of trade, for, in those same years, the industrial countries also quadrupled their annual export earnings. The increase, of course, reflected partly the accelerating inflation during the late 1960's and early 1970's, but also the growing economic strength of Europe and Japan which resulted in much greater demand for the traditional exports of the LDCs.

It was also at about this time that a number of Latin American and East Asian countries began to emerge as major exporters of manufactured products. Then, in 1973 and 1974, the major copper-exporting countries—Chile, Peru, Zaire, and Zambia—all enjoyed

Chart 1

Distribution of External Debt of Nonoil Developing Countries

Year-end 1976



The LDC indebtedness is concentrated mostly in a small number of higher income countries. Over one half of the total is held by ten countries in Latin America and Asia; nearly a third is held by Brazil and Mexico alone. Much of the debt of these higher income countries is owed to commercial banks. The debt of India, Pakistan, and "others" is owed mainly to foreign governments and international organizations.

temporary booms. And Argentina, Brazil, Mexico, the Philippines, and Thailand experienced a surge in demand for their agricultural and mineral products. These developments greatly increased their capital needs and, since direct investment was inadequate, there was greater recourse to borrowing in the Euro-currency markets.

The oil price increase and the recession

A new and greater impetus to commercial bank borrowing by the LDCs came with the 1973-74 oil price rise and the subsequent recession in the industrial countries. The abrupt oil price increase raised the oil import costs of the LDCs by nearly \$10 billion. These higher oil costs accounted for about one half of the \$20 billion jump in the average annual deficit of the LDCs between 1971-73 and 1974-76; the worldwide inflation and the recession in the industrial countries accounted for most of the other half. During 1974, the year when import prices of the LDCs rose the most rapidly, their nonoil imports expanded by 50 percent in dollar terms but very little in real terms. In 1975, during the depth of the recession, their earnings from merchandise exports actually dropped. As a result, the current account deficit of the LDCs as a group widened from \$10 billion in 1973 to \$30 billion in 1974 and \$38 billion in 1975.

Many LDCs delayed putting into force strong adjustment measures to reduce their deficits until late 1975 and early 1976. Quite a few had over-expanded during the previous period of boom and found it politically or economically difficult to adjust their living standards or growth targets. Some probably also underestimated the depth and duration of the recession and hoped to ride it out by borrowing heavily from abroad while awaiting a revival of their export markets.

A number of developing countries continued to borrow large amounts from commercial banks in 1976 despite the adjustments they made in economic policies and the improvements they realized in their export performance. Some countries took advantage of the continuing easy money market conditions in the industrial countries to rebuild their official reserves to a safer level. During 1974 and 1975 they had added very little to reserves, but in 1976 they increased them by over \$10 billion. While much of the 1976 expansion in reserves resulted directly from foreign borrowing, some countries also gained reserves by running current account surpluses.

Overall, during the three years following the oil price increase, the nonoil LDCs as a group obtained an estimated \$60 billion in commercial bank credits or about one half of their gross external finan-

cial requirements (*i.e.*, their amortization payments and other capital outflows as well as their current account deficits). Of this amount, publicly announced borrowings from the Euro-currency markets alone totaled nearly \$30 billion, a sharp rise from the previous three years when total new Euro-currency credits were less than \$10 billion.²

The debt in perspective

These and other borrowings caused the nonoil LDCs to more than double their total external debt from some \$75 billion in 1972 to an estimated \$180 billion last year. To a large extent, the rapid growth reflects the high inflation that prevailed during this period. Between 1972 and 1976 the LDCs' import and export prices both doubled in dollar terms, so that the real debt of the LDCs as a group—*i.e.*, nominal debt deflated by the changes in the dollar prices of either their aggregate exports or imports—increased by only a fifth over the period 1972-76.

The LDCs' debt also appears less excessive when looked at in light of the size of their export earnings or their domestic production. Between 1972 and 1976 the developing countries increased their aggregate exports by two and a half times, about the same rate as their outstanding debt in nominal terms. Similarly, their real GNP in constant dollars rose by a fifth during this four-year period, *i.e.*, at about the same rate as their real debt.

Another measure of debt burden, the widely used public debt service ratio, also indicates that the aggregate burden may not have grown excessively since the early 1970's. The percentage of export earnings that is used to make annual interest and amortization payments on long-term public debt now stands at about 12 percent, only slightly higher than it was five years ago. This ratio, however, understates the total debt-servicing burden since it does not take into account interest and amortization on short-term debt and on long-term private debt that is not publicly guaranteed. (No precise debt-servicing figures are available on nonpublicly guaranteed debt, which comprises about one third of the LDCs' total debt. Much of it is owed to commercial banks and is likely to mature within the next several years.)

² Some of the higher income LDCs may be overall debtors, but they also hold assets in the form of loans and credits to other countries. Brazil and Korea, for example, have established their own export-import banks to provide export credits—particularly to smaller and poorer countries with limited access to private credit. In some cases they have acted as financial intermediaries, borrowing at short term from the Euro-currency markets and lending at long term to other countries. These export credits are not yet significant in the aggregate, but they may become so as the higher income LDCs expand exports and compete more directly with the countries that are already industrialized.

Outstanding External Debt of the Nonoil Developing Countries

Year-end 1976, estimated

Debt	Billions of dollars
By source	
International institutions*	27
Governments	48
Commercial banks	80
Other private sources	25
Total debt	180
By type	
Long-term public†	120
Long-term private	20-25
Short-term public and private	35-40
Total debt	180

* Includes approximately \$7 billion outstanding to the International Monetary Fund

† Public debt or private debt which has an original or extended maturity of over one year and which is publicly guaranteed by the government of the borrowing country

Sources Based on data from the International Monetary Fund, the World Bank, and the Bank for International Settlements.

By the end of 1976, total long- and short-term disbursed debt of the nonoil LDCs is estimated to have been about \$180 billion. Nearly half was owed to commercial banks in the industrial countries, and most of the other half was owed to foreign governments and international institutions. By far the largest part of the debt consisted of private and public long-term obligations (maturities of more than one year), while the rest consisted of up to \$40 billion of short-term debt—mainly liabilities to commercial banks. American banks accounted for over half of all the commercial bank lending, Canadian, European and Japanese banks accounted for most of the remainder.

The debt burden of these countries in the aggregate thus appears not to have risen nearly as rapidly as their nominal debt, but the situation varies widely from country to country. For example, the debt service ratio on long-term public debt for the higher income LDCs is about twice as high as for all the LDCs. At the same time, the developing countries differ greatly in their debt-servicing capacity, depending on a large number of domestic and external factors. These include not only the size of export earnings, but also the level of domestic savings, the dependence on imported goods, and the outlook for export and income growth. Political

and social conditions and institutional factors are also important.

Perhaps the key factor is the quality of economic and financial management. Especially important is the adoption of sound budgetary, monetary, and exchange policies, the maintenance of efficient price and tax systems, and the proper structuring of debt maturities and repayment schedules. All of this implies a realistic evaluation of a country's export potential and import needs, as well as the tailoring of a country's investment projects, development strategies, and social welfare programs to its debt-servicing ability.

The managerial aspects are not easily measured, but clues are available from a wide range of economic indicators. Among them are the size of the fiscal deficit relative to domestic income, the growth of the monetary aggregates, the relation of the current account deficit to export earnings, and the projected ratio of debt-service payments to export earnings.

Any rigid or uniform application of risk evaluation or debt indicators to all countries is likely to give misleading results. Even among countries with similar debt burden ratios there is a wide range in their capacity to contract and to service debt as well as in their ability to adapt their institutions to changing economic conditions. The higher income Latin American countries historically have been able to sustain high debt levels relative to their export earnings. Countries in South America also seem to have had a relatively high tolerance for, and adaptability to, domestic inflation; in contrast, the more prosperous East Asian countries put much greater emphasis on domestic price stability. Yet both groups of countries have performed well in terms of domestic growth and export expansion.

Disparities in growth

As commercial bank lending to the developing countries expanded, it became very concentrated among the higher income countries in Latin America and East Asia. Most of them had achieved exceptionally strong rates of income and export growth during the late 1960's and early 1970's, and they were apparently able to achieve even more rapid growth as a result of their ready access to private credit. These higher income LDCs had been expanding significantly faster than the lower income countries in earlier years, and this divergence increased dramatically after the advent of large-scale private lending to them.

Real growth in the higher income LDCs accelerated from a 6 percent annual rate in the early 1960's to over 7 percent in the early 1970's. In the lower income countries, it slowed considerably, from 4 percent to less than 2 percent, during the same period. The dif-

ference between these two groups of countries is even more striking when the two aspects of their economies most directly dependent on private external financing—manufacturing and imports—are compared. Between 1965 and 1973, industrial production and real imports increased by nearly 9 percent per year in the higher income LDCs; in contrast, they grew by less than 4 percent in the lower income countries.

Even these figures insufficiently highlight the performance of the largest debtors. Of the one hundred or more LDCs in the world, ten countries accounted for the bulk of the commercial bank claims on developing countries at the end of 1976: Mexico and Brazil for about a half of the total, and eight other higher income countries in Latin America and East Asia (Argentina, Chile, Colombia, Peru, Korea, the Philippines, Taiwan, and Thailand) for much of the other half. The relatively strong economic position of these countries is illustrated by the fact that they have only a quarter of the LDCs' population but over one half of their combined gross national product.

On the whole, it was this small group of ten or so high-performing countries that benefited from the explosion of commercial bank lending to the LDCs in the past decade, and not the many poor and populous countries in Africa and the rest of Asia. The lower income countries continued to rely mainly on the traditional sources of external finance—official loans or outright grants—to underwrite their deficits. In general, these poorer countries have had to remain content with the moderate real growth of official assistance during the past six years.

An improved economic outlook

In recent months the economic outlook of the LDCs has improved greatly. As a group they cut their current account deficit from \$38 billion in 1975 to an estimated \$25 billion last year, and at the same time they resumed higher economic growth. Nevertheless, they are still confronted with serious problems and they are by no means assured of the external financing they need.

The lower deficits last year resulted largely from a resurgence of the LDCs' export earnings that accompanied the economic recovery of the industrial countries and the upward trend in commodity prices. Most importantly, the improved economic positions of the developing countries also reflect the impact of adjustment policies that were undertaken by most of the major borrowers. The countries differed greatly in the timing, stringency, and nature of their stabilization programs, and this naturally has resulted in varying rates of progress toward strengthening their external positions. By the end of 1976, however, most had

either reduced their external deficits considerably or had adopted programs to do so.

The East Asian countries were among the first to put adjustment programs into effect. Most of them had experienced severe deteriorations in their current account positions in 1974 and 1975 as a result of a marked increase in their import costs and a slowdown in their export earnings. Most also suffered rates of very high inflation in the first half of 1974, but by early 1975 nearly all had sharply slowed inflation through tight monetary and fiscal policies.

Taiwan chose to adjust quickly to the rise in oil prices by trimming its nonoil imports and reducing its external deficit. As a result, it suffered a very steep, although temporary, slowdown in real growth—from a nearly 12 percent annual rate in the early 1970's to very little growth during 1974 and 1975. South Korea, on the other hand, decided to adjust more slowly. In 1975 it borrowed heavily from abroad to finance imports and to maintain income growth, thereby enabling it to wait for a revival of the export markets to correct the external imbalance. Consequently, Korea's economy continued to move forward with a nearly 10 percent real rate of growth right through the period of oil price adjustment and economic recession. Last year both Korea and Taiwan witnessed a rapid expansion of their export sectors; each realized a 50 percent increase over 1975 in export receipts. As a result, Korea's current account deficit was slashed from \$2 billion in 1975 to nearly zero last year, and Taiwan's economy resumed double-digit growth.

The Philippines benefited from the sugar export boom in 1974 but suffered large deficits after prices fell abruptly the following year. For a while, the country tried to maintain its high imports by borrowing from foreign commercial banks, but in 1976 it instituted a stabilization program in agreement with the IMF. By the end of last year, it too began to achieve substantial progress in its external account. Meanwhile, it continued to expand at a 5 percent rate, nearly the same as in the previous two years.

The Latin American countries generally waited much longer than those in East Asia to implement comprehensive adjustment programs. Some of them held off until they were threatened with economic disorder. Argentina, Chile and Peru made policy adjustments during the course of 1976, after having had difficulty in rolling over maturing bank credits. In the end, all three countries improved their external positions considerably. Argentina reversed its current account balance from a \$1½ billion deficit in 1975 to a \$½ billion surplus last year, Chile moved into small surplus, and Peru cut its current account deficit in half.

Brazil and Mexico, the two major borrowers from

United States and other foreign banks, seemed to be doing reasonably well early in 1976, although both of them were still running large current account deficits. Brazil's economy continued to grow at a real average annual rate of 8 percent during the last three years, a performance substantially lower than the 10-12 percent rate of previous years although still high by any standard. Rapid growth was maintained despite the oil price increase and economic recession abroad, but at the cost of accelerating domestic inflation, large current account deficits, and more foreign debt. Mexico also maintained fairly strong domestic growth during most of this period, but it too had to borrow heavily from abroad.

By the end of 1976, however, both countries took action to close their deficits. During the last half of 1976, Mexico experienced a crisis: confidence in the peso deteriorated and heavy outflows of capital occurred. As a result, the Mexican authorities floated the peso late last August, and for a time it was at a dollar rate equal to only about 50 percent of its previous value. Then, in December, Mexico enacted a comprehensive stabilization program in agreement with the IMF as a condition for receiving financial support from the Fund. Brazil had tightened economic policy somewhat in 1975, but it had eased up when its domestic growth was threatened. In the latter half of 1976, with the current account deficit continuing at the high level of the previous two years, the Brazilian authorities again took measures to slow domestic inflation and reduce the external deficit.

Strengthening the international system

The experience of the last several years indicates that the high-growth developing countries generally possess a substantial amount of economic resilience. Though most were hard hit by the economic recession in the industrial countries and were seriously affected by the higher oil prices, many of them were able to maintain remarkably strong income growth by borrowing heavily from abroad. Despite these achievements they remain quite vulnerable to external shocks and to adverse developments in the industrial countries.

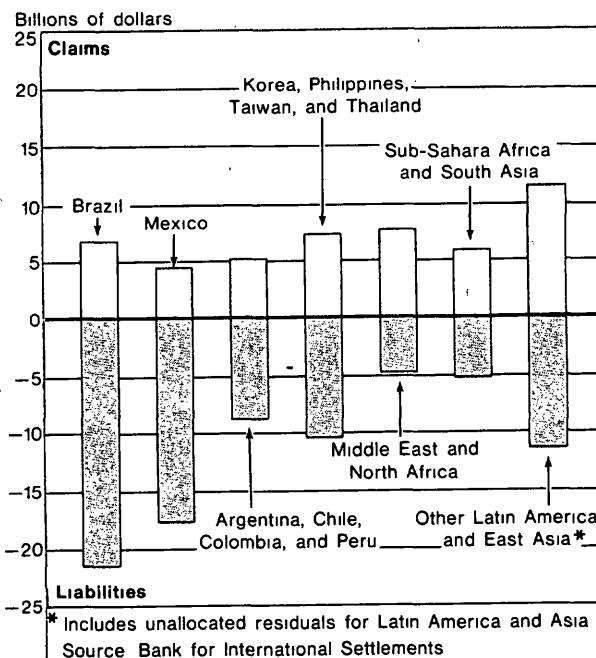
There are new risks inherent in the deeper financial involvements between the industrialized countries and the rapidly growing LDCs, as well as in the economic vulnerability of one side to adverse developments on the other side. The large borrowing countries that have geared their development plans and economic policies to continuously high export growth and large capital imports would be particularly hard hit if their export earnings or their ability to borrow were drastically cut.

The need for large-scale lending by commercial banks to developing countries is likely to continue.

There are at least three reasons for this. First, the developing countries' need for external development capital is expected to continue for an indefinite period. Second, the LDCs will from time to time require temporary financing to carry them through periods of economic recession or downswings in commodity prices. Third, the OPEC surpluses are likely to last for some time. A substantial part of these surpluses will probably continue to flow into the industrial countries' banking systems and from there, in one way or another, to the developing countries.

Commercial bank lending, however, cannot be expected to reduce the need for a continuing or even

Chart 2
Nonoil Developing Countries: Claims on, and Liabilities to, Foreign Banks.
 Year-end 1976



The LDCs, aside from their large liabilities, also have large claims on banks in the industrial countries. The combined bank liabilities of the ten higher income countries in Latin America and East Asia, as reported by the Bank for International Settlements, exceed their overall assets at foreign banks by about \$30 billion. In contrast, the lower income countries in Asia and Africa generally have more assets at foreign banks than they have liabilities.

increased flow of official funds. In any case, new official approaches would seem to be required to strengthen the international financial system in ways that would protect both lending and borrowing countries against unexpected disruptions of financial flows.

Within the industrialized countries, central banks act as lenders of last resort to the private banks when the danger of a major loan default threatens the liquidity and the stability of the banking system. If the IMF's ability to act as an international lender of last resort for member countries were enhanced, it could then more readily protect the international financial system if a debtor country were faced with involuntary default as the result of a sudden drying-up of foreign credit. While no such situations appear to be on the immediate horizon, knowledge that the Fund could act promptly and effectively in such cases would greatly reduce apprehension about the potential dangers in the present system.

More resources for the IMF?

If the Fund is to take on an enlarged role of lender of last resort to the world, it needs to be assured of adequate resources to deal with any massive financial disruption. At the same time, the present rules place strict quotas on the amount the Fund can lend to member countries. It is generally acknowledged that the quotas are in many cases out of line with the potential needs of individual economies. In particular, a number of major LDC borrowers are now eligible to draw from the IMF—even over two or three years—amounts equivalent to only a fraction of their current annual deficits and their refinancing requirements. The so called "Witteveen proposal" to enlarge the Fund's lending capacity that is now being considered by the industrial and oil-producing countries would be a significant step toward meeting the needs of the world's financial system.

The unusual developments of the last several years have increased the involvement of commercial banks in lending to individual countries for overall balance-of-payments support. The purpose of balance-of-payments lending is to bridge a country's financing gap for several years while it reduces its current account

deficit to a sustainable level. A country that requires such financing also needs to assure lenders that it will adjust both its domestic and external economic policies in order to narrow its deficit.

Experience has shown that, in this kind of situation, the IMF, as an international institution, can properly provide outside advice and establish lending conditions. The Fund helps to design and oversee the policy programs necessary to accomplish a deficit country's adjustment. Of late, the Fund's role in this process has been strengthened because of the increasing trend toward "parallel financing"—an arrangement in which some private loans are made contingent upon the borrowing country's meeting credit conditions laid down by the IMF.

Certain problems, however, can arise when integrating private and official actions. Parallel financing, if carried to an extreme, could become a credit allocation system, in which private lenders would be encouraged to stay with an "approved list" of countries. This might well conflict with the efficient operation of the market system. Parallel financing could also lead the banks to relax their own credit judgments, *i.e.*, it could cause them to believe that an implied approval of a country's policies by an official institution such as the IMF somehow ensures them against losses on loans made to that country.

Beyond this, greater attention also needs to be given to the external financing of the lower income countries that have little access to private credit. The scope for expanding the flow of official assistance to these countries, both directly from aid-giving nations and through the international lending agencies, would seem to be substantially greater now that the higher income LDCs can increasingly finance their development programs through private channels. It is to be hoped that a larger flow of official assistance to the very poor countries may help make it possible for them to start moving toward faster economic growth and thus eventually to gain access to private capital markets. A recent commitment made by the industrial countries at the London economic summit to increase their aid is a modest beginning toward this end.

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