Bank Lending to Developing Countries

Problems and Prospects

The current account deficits of developing countries are narrowing.[1] This is true for all countries combined, for important subgroups of countries, and for most important individual countries as well. Unfortunately, some of this decline is being forced by financial constraints, and not all of this forced decline is proceeding smoothly The problems of Argentina, Bolivia, Costa Rica, Mexico, Poland, Romania, Sudan, and Zaire, among others, are well publicized. Often overlooked, however, is the progress being made by most developing countries in reducing their deficits in a period of worldwide economic difficulty. While some individual countries will continue to face difficult adjustment problems even as global economic activity picks up, large numbers of other developing countries already are taking measures that will greatly strengthen their ability to compete in world markets in the 1980s. There is some risk at present that the adverse publicity given to the debt-servicing problems of a few countries may spill over onto other reasonably creditworthy borrowers. Thus, reduced credit availability could force unnecessarily sharp adjustments by these countries. The result would be to prolong the world recession and generally to intensify payments problems for developing countries and for their creditors.

This article reviews the progress of developing countries in adjusting to the present world environment. It concentrates on those countries that have chosen to develop their economies by borrowing from private banks as well as on the behavior of banks, particularly in past instances of payments interruptions. The main findings are:

- Most LDCs have sharply slowed their own import growth to adapt to higher oil prices, higher interest rates, and weak world demand for their exports. These world conditions are now beginning to turn favorable for most countries.
- Developing country external deficits are falling and, relative to their exports, are already about in line with past trends.
- But LDCs have suffered a recession about as steep as that in industrial countries.
- And most developing countries are much less liquid than they were three years ago Their debt is larger, more is on market terms and short maturity, and their international reserve cover is down.

[1] The term developing countries, or LDCs for short, is used broadly to include all countries except those classified as "industrial" or "oil-exporting" countries by the International Monetary Fund Oil-exporting countries are principally the members of the Organization of Petroleum Exporting Countries (OPEC) The analytic and regional subgroups also follow IMF classifications Data on bank lending exclude those countries defined as "offshore financial centers" in Bank for International Settlements (BIS) and Federal Reserve statistical releases Poland and Taiwan, which are not IMF members, are considered developing countries when reviewing bank behavior

Table 1

Developing Countries' Current Account*

In billions of dollars

Components	1978	1979	1980	1981	Projection 1982	Projection 1983
Exports	195	250	317	327	340	380
(Oil exports)	(7)	(13)	(23)	(27)	(29)	(30)
Imports	−228	−298	−388	−402	−405	−430
(Oil imports)	(−26)	(−39)	(−63)	(−67)	(−67)	(−70)
Trade balance	**−33**	**−48**	**−71**	**−75**	**−65**	**−50**
Service receipts	55	69	83	94	100	105
(Interest receipts)	(9)	(12)	(15)	(19)	(17)	(17)
Service payments	−75	−99	−120	−140	−150	−160
(Interest payments)	(−22)	(−32)	(−44)	(−64)	(−66)	(−66)
Net private transfers	14	19	21	22	25	30
Balance on services and private transfers	**−6**	**−11**	**−16**	**−24**	**−25**	**−25**
Net official transfers	**8**	**11**	**12**	**13**	**14**	**15**
Current account balance	**−31**	**−48**	**−75**	**−86**	**−76**	**−60**

Because of rounding, figures may not add to totals

* Excludes members of the Organization of Petroleum Exporting Countries but includes southern and eastern European countries classified as "developing" by the International Monetary Fund

Sources: International Monetary Fund, *World Economic Outlook* on historic data Federal Reserve Bank of New York projections and estimates of oil trade, official transfers, and interest payments and receipts

- Lending by banks, the major source of funds for developing countries, already appeared to be slowing early this year. The interrupted payments by two of the largest LDC borrowers will slow overall lending further.

- In the past, total bank credit to a country generally declined once payments interruptions began. Usually, these payments delays have persisted for several years and overall bank lending to the country concerned has not recovered until normally scheduled payments were again being met.

- The extent and duration of the slowdown in bank lending to LDCs will depend in part on the willingness of countries to meet market terms when restructuring their debt and on their decisiveness in addressing the particular economic problems they face.

The current account—performance and prospects

The combined current account deficit for all developing countries not members of OPEC appears to be narrowing from about $85 billion in 1981 to around $75 billion this year (Table 1). A further narrowing is projected for 1983. This narrowing is most pronounced for those developing countries that export manufactured goods.[2] As a group, these countries account for over half the bank lending to developing countries. Most other LDCs that are important for international banks export oil. These countries, which account for another third of bank credits, are only beginning to reduce their deficits this year.[3] Most of the adverse external factors

[2] Countries classified as "major exporters of manufactures" by the IMF In their order of borrowing from banks in industrial countries, they are Brazil, Singapore, Hong Kong, Argentina, Korea, South Africa, Yugoslavia, Greece, Portugal, and Israel

[3] Countries classified as net oil exporters by the IMF are Mexico, Bahrain, Peru, Ecuador, Egypt, Malaysia, Tunisia, Bolivia, Trinidad and Tobago, Syria, Gabon, and the Congo

that gave rise to the bulge in 1979-81 deficits are now turning around, and most developing countries already have sharply slowed their imports to adjust to the unfavorable external environment.

External conditions are improving

The softer world oil market is helping oil-importing LDCs. Spot market prices, at which most developing countries import oil, have fallen about 20 percent since late 1980. Although prices remain nearly 2½ times their 1978 average levels and the volume of LDC oil imports has grown since then, the total cost of oil imports to LDCs has leveled off at around $70 billion a year. To be sure, there is always a risk of disruptions that could suddenly tighten conditions in the oil market. But, in the absence of a shock, prospects are very good that oil payments by oil-importing LDCs will not rise substantially over the next year or so.[4]

By contrast, the decline in spot prices has seriously hurt the dozen non-OPEC developing countries that export oil. Most of the OPEC members, which have experienced the volatility of world oil markets in the past, have built large reserve asset positions against such swings. But some of the newly emerging LDC oil exporters, and a few of the OPEC members, were caught generally unprepared for weakening oil prices.

A mild recovery in the industrial world is anticipated next year. This should boost LDC export receipts. This year the volume of exports from the developing world is growing only about 3 percent, less than half the trend rate over the past fifteen years Despite this slowdown, most developing countries are still increasing their penetration of world markets, given that overall world trade may show no growth at all this year. This relatively strong performance reflects exports to OPEC, growing trade among LDCs, and the stronger performance by a few exporters of manufactured goods, especially countries in Asia—Korea, Hong Kong, Singapore, and Taiwan. While recovery in the industrial world is likely to be slow in getting under way, a number of developing countries are well placed to take advantage of any increased demand. Export volume growth of about 5 percent for LDCs appears possible for 1983, even if industrial economies only grow about 2½ percent in real terms.

Moreover, as industrial activity picks up, primary commodities prices should also begin to recover somewhat. The prices received by developing countries for their commodities exports have fallen more than 20 percent since late 1980 and have reached the lowest level in more than twenty-five years relative to the prices of manufactured imports. The recovery in industrial countries is likely to be mild, and it appears that there will be an abundant supply of most commodities in world markets. But continued easing of interest rates on average will reduce the cost of carrying commodities inventories, so that an average increase of 5 percent or more in prices for commodities exports next year appears possible. Most of this increase is likely to be concentrated in primary metals—copper, for example—where the interest rate and industrial demand will have the largest effect.

The easing of world interest rates now under way will help developing countries directly by reducing the interest burden of their debt. Total interest payments of developing countries rose from around $20 billion in 1978 to over $65 billion in 1982, as the effective interest rate these countries paid nearly doubled and their debt grew more than 80 percent.[5] A greater share of the debt came from banks, and the six-month dollar London interbank offer rate (LIBOR), on which much of this debt is based, rose from 9.1 percent on average in 1978 to 16 5 percent last year. The return LDCs earned on international reserves and other foreign assets also rose about $10 billion over this period to offset partially their increased interest payments. But, on either a gross or a net basis, interest payments present a substantial drain on developing countries. Interest payments for the group as a whole rose from under 10 percent of their exports of goods and services in 1978 to over 15 percent last year.

The more than 3 percentage point decline in LIBOR from last year's average to 13 percent by end-September will ensure a substantial drop in borrowing costs for 1982 as a whole, even though the spreads over LIBOR facing most developing countries are widening to reflect lenders' increased perceptions of risk.

There are, of course, wide variations between the average interest rates paid by LDCs and dollar LIBOR rates. Some debt is denominated in other currencies, some is based on U.S. prime rates, and some is based on international agreements between governments. Moreover, the effect of lower rates will not be seen in LDC interest payments immediately, but only as their debt matures and is renewed or as rollover dates are reached. Nevertheless, interest rates are clearly down from last year's peaks and, given reductions of underlying inflation for most countries whose

[4] For a discussion of the world oil outlook, see Edward J Frydl and William A Dellalfar, "The Shifting Balance in the World Oil Market", this *Quarterly Review* (Autumn 1982), pages 41-47

[5] These estimates are much larger than those made by the IMF (*World Economic Outlook*, 1982, page 58) because the interest on short-term debt is included

currencies are important in denominating LDC debt, rates are likely to continue to be lower on an annual average basis. Thus, most developing countries should see a decline in the effective rates they pay. Their continued new borrowing will about offset the lower rates, so that an absolute decline in total interest payments is not expected. Relative to export revenues, the size of these payments, however, will certainly decline for all countries combined as well as for most individual countries.

The sensitivity of interest payments to changing rates varies widely among different groups of developing countries. The major exporters of manufactures and some oil-exporting LDCs were particularly vulnerable to the rise in interest rates and should benefit most as rates come down. Over two thirds of their longer term debt is from private sources, compared with less than one half for all non-OPEC developing countries. Most low-income countries and a few net oil exporters, such as Egypt, have relied primarily on official source borrowing at fixed rates and were less directly affected by rising market interest rates.

Developing country imports have slowed

While the external factors are only now turning favorable, most LDCs have themselves been making a serious effort to adjust to the world economy over the past two years. Imports grew only 3½ percent in volume for the group as a whole in 1980 and 1981 and appear to have stopped growing entirely this year, in contrast to a more than 6 percent growth trend from 1968 to 1978. The constrained real import growth has kept developing country trade deficits in check, even as their terms of trade deteriorated nearly 10 percent between 1979 and 1982. With even a modest improvement in the terms of trade, the lower import volume should produce a more than $10 billion improvement in the combined trade balance. Continued import restraint should lead to an even greater improvement next year as their terms of trade turn more favorable.

This slowing of imports has come at considerable cost to the developing countries. Real per-capita economic growth for all non-OPEC developing countries together has come to a virtual standstill in 1982, and little overall improvement can be expected next year. Comparing growth on a per-capita basis provides a sense of the cost that the world recession brings to these countries whose populations and work forces are still expanding rapidly. In these terms, the recession has been at least as severe in developing countries as in the industrial world (Chart 1). The extent of the slowdown is even more striking when compared with trends over the previous decade. The sharp fall in growth below rates to which people had become accustomed gives a sense of the frustrated expectations that the recession has brought

The recession is especially pronounced in those countries that are exporters of manufactured goods (Chart 2). They began to contract, by and large, early in the cycle, and some recovery is already apparent in 1982 for this group Further recovery is projected for 1983, but growth is likely to remain well below the trend and negative in per-capita terms.

The oil-exporting developing countries who are not members of OPEC did not feel the full effects of the world recession until the oil market began to soften last

Table 2

Developing Countries' Current Account Deficits

As a percentage of exports of goods and services

Country groups*	Average 1967-78	Peak 1975	1979	1980	1981	1982
All developing countries	**−17**	**−29**	**−15**	**−19**	**−21**	**−17**
Exporters of manufactures	−12	−25	−15	−17	−16	−12
Oil exporters	−16	−33	−12	−12	−23	−21
Others	−19	−23	−17	−22	−24	−21

* Country groups are classified by the IMF Major exporters of manufactures are Argentina, Brazil, Greece, Hong Kong, Israel, Korea, Portugal, Singapore, South Africa, and Yugoslavia Net oil exporters are Bahrain, Bolivia, the Congo, Ecuador, Egypt, Gabon, Malaysia, Mexico, Peru, Syria, Trinidad and Tobago, and Tunisia

Sources International Monetary Fund, *World Economic Outlook* on historical data Federal Reserve Bank of New York projections and estimates of oil trade, official transfers, and interest payments and receipts

Chart 1

Real Output Growth per Capita

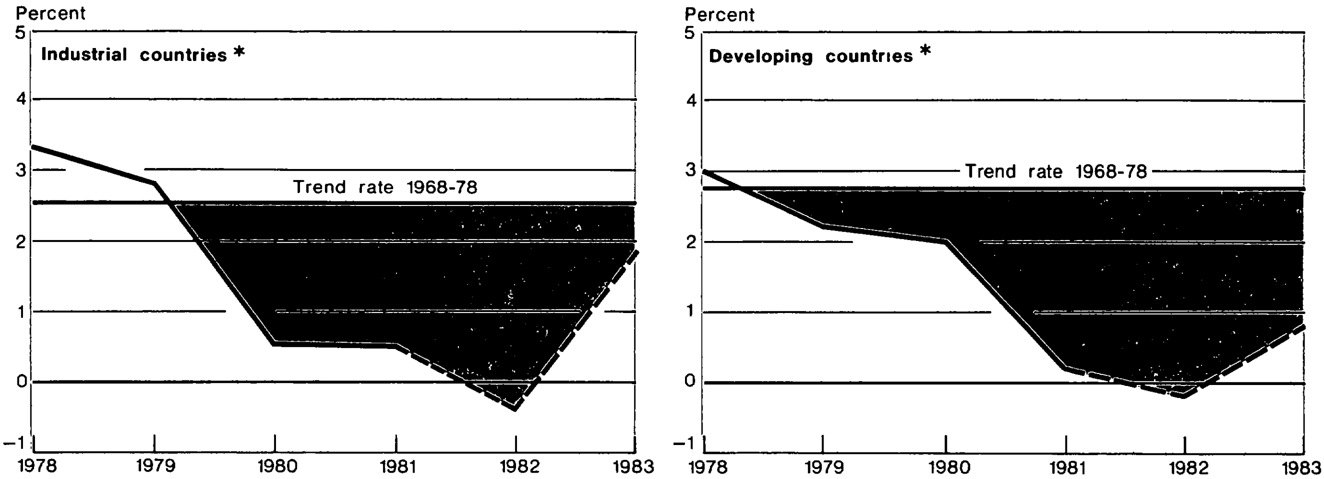
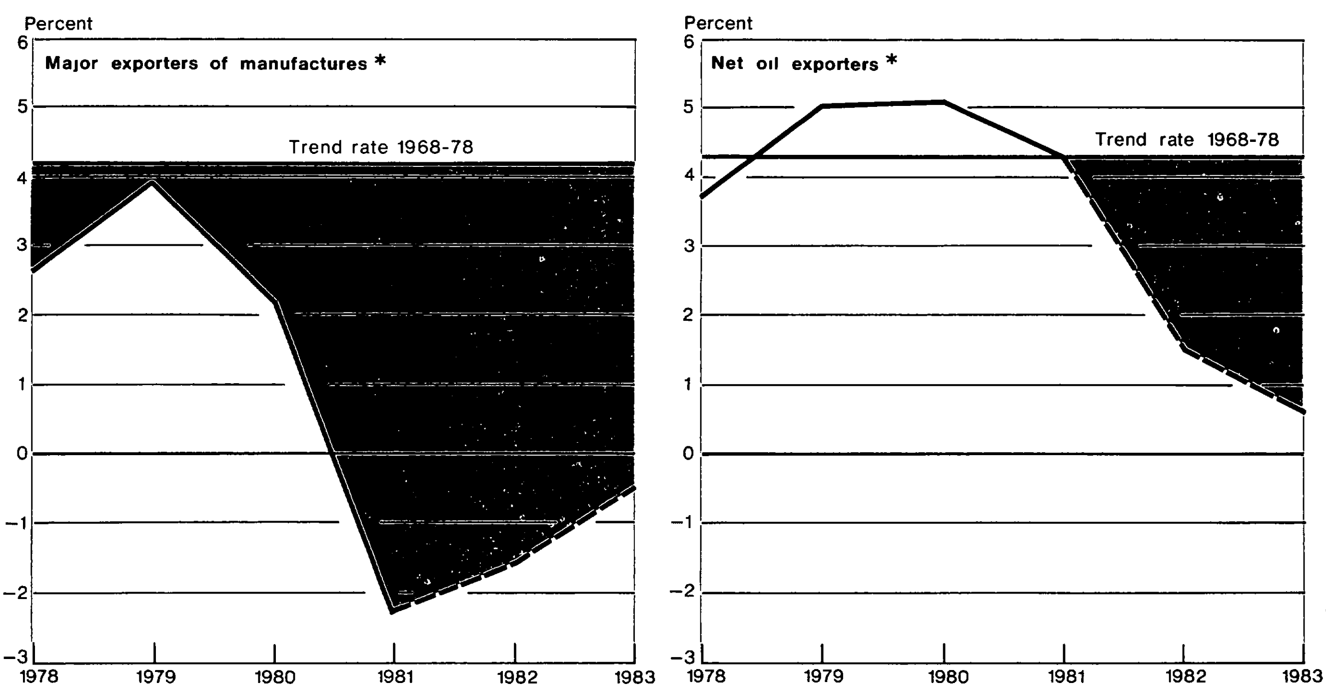


Chart 2

Real Output Growth per Capita in Groups of Developing Countries



*Groups of countries are as classified by the International Monetary Fund

Sources International Monetary Fund, World Economic Outlook (1982), World Bank, World Development Report (1981); Federal Reserve Bank of New York staff projections for 1982 and 1983 year (Chart 2). Their domestic recessions are just beginning, and their real economies are likely to be still more depressed next year.

Deficits are in line with past trends

The decline in economic growth has kept the external deficits in check. The combined developing country current account deficit this year should be about back to its average level of the past dozen years relative to exports of goods and services (Table 2). Comparing the deficit to exports as both grow over time removes the effects of inflation and scales the size of the deficit to the growth of trade.

For 1981, the combined deficit came to 21 percent of exports, much below the 29 percent peak in 1975 during the last major recession in industrial countries. For many developing countries, the current account deficits never reached their 1975 peaks during the more recent cycle and their adjustment already has been considerable. Further reductions by individual countries and in the combined total are expected next year. Projections suggest that next year's combined deficit will be well below its 17 percent average of the dozen years prior to 1979, relative to combined exports.

The aggregation of all the more than 100 individual developing countries hides important differences between countries, regions, and categories of countries. The major exporters of manufactured goods—Brazil, Korea, Greece, and Yugoslavia among them—have clearly brought their current account deficits, expressed as a proportion of exports, back into line with earlier trends. Several Asian countries, Taiwan and Korea, for instance, in fact had significantly higher deficits relative to their exports prior to 1970 than at their peaks in the 1979-81 period. By slowing their imports quickly when world conditions began changing, these countries have adapted to the higher oil price, higher interest rate, and slower growth world environment even more readily than most industrial countries.

The oil exporters, on the other hand, have not managed their economies as prudently as they might. Mexico accounts for more than half the weight in this subgroup, but several other oil exporters—Peru, Egypt, and Ecuador, for instance—also face large deficits and more stringent adjustments this year and next. Earlier, their imports grew even more rapidly than oil receipts and have not fallen as quickly. But these countries exported little or no oil during the previous price run-up so that their deficits in 1981 and 1982 are still well below the earlier peaks, when scaled by exports.

Deficits in the remaining developing countries have not come down as quickly in the 1979-82 recession as they did in 1974-75. These countries mainly export primary commodities, so that their terms of trade have worsened much more over the last three years than the average for developing countries. They are only this year getting their real deficits back down close to the peaks reached in 1974-75. Colombia, Chile, and the Philippines are major borrowers from commercial banks in this group.

The financing problem

While the deficits for developing countries as a group and for many individual countries are decidedly falling into line with past trends, developing countries are faced with continuing financial strains. They have more debt outstanding. A larger proportion is coming due in the short term. And reserves are already relatively low. Consequently, most of these countries are much less liquid than they were three years ago

Banks provided most finance

From 1979 to 1981 commercial banks loaned more than $125 billion to developing countries (Table 3). This amounted to about 60 percent of the cumulative current account deficit of LDCs during the period. Official lending directly by governments of industrial and OPEC countries and indirectly through the World Bank, IMF, and similar institutions has been critical for individual countries and for smoothing the adjustment process. But it has amounted to less than $70 billion in the past three years, under one third of the cumulative deficit and just over half the rate of bank lending. Direct investment, totaling $33 billion, has also been a significant source of finance, particularly for several of the manufactured goods exporters. In addition, suppliers credit, bonds, and other private sources have provided funds.

The total identified sources of finance exceeded the cumulative current account deficit. Part of the difference is accounted for by private capital outflows. In a few countries capital flight—reflecting lack of confidence by the country's own residents—has obviously been significant, although its magnitude generally goes unrecorded. Another part of the difference took the form of increased international reserves. In aggregate, reserves grew more than $19 billion over the period but the growth rate slowed each year and, for a number of countries, reserves fell. There is little room for some countries to draw down international reserves further. A substantial decline in bank finance, therefore, could force larger cuts in imports and reductions of gross national product, particularly for those countries most dependent on the banks.

More debt is short term

The combined external debt of developing countries will have grown from $340 billion at the end of 1978 to

Table 3

Developing Country Finance

In billions of dollars

Uses and sources	1978	1979	1980	1981
Uses of funds				
Current account deficit	31	48	75	86
Growth of official reserves	16	12	5	2
Sources of funds				
Official lending*	17	17	25	26
Bank lending†	29	39	43	45
Direct investment	7	9	10	14
Residual‡	−6	−5	2	3

* Includes long-term bilateral government credits, loans by multilateral development banks, and IMF or other reserve-related official credits

† Growth of outstanding claims of banks in selected industrial countries, as reported through the BIS, adjusted for currency valuation changes.

‡ Net of capital outflows other than official reserve flows, suppliers credit and bond inflows, and errors and omissions in current account data.

Sources International Monetary Fund, *World Economic Outlook*, Bank for International Settlements, *International Banking Developments*; Federal Reserve Bank of New York staff estimates

Table 4

Developing Countries' External Debt Summary

In billions of dollars

Type of debt	1978	1979	1980	1981	Projection 1982
Total debt	**340**	**400**	**480**	**570**	**640**
Long-term debt	**276**	**324**	**375**	**437**	**480**
Public and guaranteed debt	224	266	307	352	390
Of which from					
(Official sources)	(117)	(133)	(156)	(176)	
(Financial institutions)	(75)	(101)	(117)	(139)	
(Other sources)	(32)	(32)	(34)	(37)	
Nonguaranteed debt	52	59	69	85	90
Short-term debt	**60**	**80**	**100**	**130**	**160**
Memorandum items					
BIS-reported bank claims	151	193	244	277	
(Less than one-year residual maturity)	(63)	(79)	(108)	(133)	

Because of rounding, figures may not add to totals

Sources. International Monetary Fund, *World Economic Outlook*; World Bank, debtor reporting system, Bank for International Settlements, *Maturity Distribution of International Bank Lending*, Federal Reserve Bank of New York staff estimates for short-term debt and projections for 1982.

about $640 billion by the end of this year (Table 4). These estimates include short-term and private-sector debt which have become increasingly important, both as a source of finance and as a potential problem when incomplete or delayed external adjustment is suspected by lenders. The interest on the increase in debt alone amounts to nearly $30 billion this year, so that increasing shares of exports are required to pay for the services of funds borrowed earlier. And these funds may not always have been productively invested, particularly if the borrowing was used to sustain consumption rather than to invest for future output.

In addition to its larger absolute size, an increasing share of the debt was undertaken on market-related terms, from banks, and at short maturity. The share borrowed from banks rose from 44 percent in 1978 to 49 percent at the end of last year. The disruptive potential of short-term debt is significantly greater than debt due in five or ten years And the share of short-term debt in the LDC total has risen from 18 percent in 1978 to about 23 percent in 1981. The problem of short-term debt is of special concern because individual lenders often assume that they can withdraw quickly should problems emerge. In fact, when attitudes about countries change rapidly, the attempt by any lenders to withdraw adds to the problem. Borrowers and lenders both frequently underestimate the size of their potential problems because information on short-term and private-sector debt is usually inadequate, even for the authorities in the borrowing country. There is a tendency to focus on data that include only long-term interest and amortization schedules, which may lead to inadequate policy adjustments in crisis situations.

Finally, the liquidity position of developing countries has been eroded by falling levels of international reserves. For the group as a whole, international reserves cover less than 17 percent of 1982 imports, down a full 10 percentage points from 27 percent in 1978.

Most countries are more vulnerable

The general erosion of liquidity in developing countries can be seen on a quick "vulnerability" indicator (Table 5). This indicator combines the effects of rising imports (including interest payments), increasing short-maturity bank debt, and falling reserves. All are scaled by export receipts. Larger values indicate less liquidity and more sensitivity to unexpected shocks. The indicator is not intended to measure the probability of interruptions in payments. A country's economic management and ability to make necessary adjustments when shocks occur are critical and cannot be captured in a simple indicator. Moreover, the indicator does not measure the likelihood of unforeseen shocks that would impair the payments positions of these diverse countries Rather, the vulnerability indicator provides a rough summary measure of the reduced freedom most developing countries now have to delay their response to changing circumstances

The relatively strong current account positions of industrializing countries in Asia are reflected in the low vulnerability indicator for the region. But even here liquidity positions have eroded In Latin America, where commodities (including oil) play a larger role, the real current account adjustment is less complete and the delay in adjustment by oil-exporting countries has led to a more serious erosion in liquidity. But, even in Latin America, countries such as Colombia have been able to minimize their vulnerability to shocks by building reserve positions and limiting short-term borrowing. In nonindustrial Europe, current account deficits have been reduced and the liquidity position has remained fairly constant. The averages here are helped considerably by Turkey's improved liquidity position as a result of debt rescheduling. The relatively low index for Romania shows that countries can be adversely affected by a sudden erosion of market confidence, even though their liquidity positions are no worse than average. In Poland the vulnerability indicator is still growing rapidly as arrearages on interest and principle are added to debt due within a year.

Prospects for bank lending

The major determinants of current accounts—oil and commodities prices, interest rates, industrial country demand, developing country imports—seem to point toward a narrowing deficit this year and next. Even so, unless sufficient finance is available, further cuts in the deficit may be forced. Tight budget policies in industrial countries and falling OPEC surpluses mean that official financing will not grow rapidly. The IMF has sufficient funds for the present and discussions are in progress to enlarge its resources, but many countries remain reluctant to accept IMF conditions. In any case, IMF lending has never accounted for more than a small proportion of the overall deficit. Similarly, direct investment and other financing sources are likely to rise only modestly. Thus, although there is not a strict correspondence between bank lending and the size of the deficits, sharply reduced bank lending could further constrain current account deficits this year and next

Slower overall lending in 1982

Net new bank lending to all LDCs rose $45 billion, or nearly 20 percent, last year. Based on evidence available through early October, the overall growth could slow to 8-12 percent or around $25-35 billion this year. This rate of bank financing would be barely adequate

Table 5

Developing Countries' Vulnerability Indicator*

Regions and countries	1978	1979	1980	1981	1982
All developing countries	**115**	**121**	**124**	**132**	**135**
Asia	**102**	**109**	**115**	**117**	**125**
Korea	108	132	142	145	140
Taiwan	89	104	111	103	90
Thailand	117	134	133	138	135
Latin America	**133**	**131**	**141**	**157**	**160**
Argentina	73	92	121	166	200
Colombia	77	70	83	94	90
Mexico	188	170	166	196	200
Europe	**150**	**152**	**149**	**152**	**150**
Romania	132	142	156	137	125
Turkey	238	258	263	179	150
Poland	193	188	191	205	225

* The vulnerability indicator consists of imports of goods and services plus bank claims maturing within one year less international reserves, weighted by exports of goods and services. The indicator is given for regions as defined by the IMF and for selected countries within a region

Sources International Monetary Fund, *World Economic Outlook* and *International Financial Statistics*, Bank for International Settlements, *Maturity Distribution of International Bank Lending*, Federal Reserve Bank of New York staff estimates for Poland and projections for 1982

to finance even the smaller current account deficit of $75 billion we have projected, although with little cushion for unforeseen events. There remains considerable uncertainty, however, about the level of financing over the remainder of this year and in 1983. Given the increased vulnerability of most developing countries to financing strains, a fall in lending to much below $30 billion could force further sharp cuts in imports for many countries. Firm and responsive actions by those countries with payments problems would improve their own access to credit. Moreover, prompt actions would help reduce the strains on other borrowing countries

A slowdown in bank lending was already apparent in data reported through the BIS for the first quarter of 1982 For all reporting banks, claims on developing countries rose $5 billion in the first quarter of this year (after adjusting for the valuation effects of dollar appreciation). While lending typically tends to be slow early in the year, this $5 billion increase was half that in the same period of 1981 and substantially below the $7 billion first-quarter average of the past three years. For U.S. banks alone, lending to all developing countries slowed sharply in the first half of this year. U.S. bank claims on LDCs rose less than $5 billion in the first half, down from their nearly $9 billion in the same period last year.

Events in Argentina and Mexico very likely reduced overall bank lending to developing countries even further after the first quarter of this year. These two countries alone accounted for $3 billion, or 60 percent, of the $5 billion increase in net new lending to all developing countries reported by banks in the first quarter. For U.S. banks alone, where data are now available through June, Mexico accounted for more than half the increase in claims on all LDCs over the first six months, while U.S. bank claims on Argentina began to fall in the second quarter. By itself, the inability of these two countries to raise substantial additional funds from banks once payments interruptions threatened would reduce the overall rate of lending. Moreover, the payments problems of these two countries have heightened lenders' perceptions of the risks in all countries, particularly the political uncertainties. One result of these developments will be higher risk premia in international lending rates, especially for countries that are similarly situated—economically, politically, and perhaps even geographically—as those in difficulty. Thus, it is unlikely that the developing countries as a group will find it attractive or perhaps even possible to borrow as much as they have in the past.

The behavior of the syndicated international loan market supports this view of a generalized slowdown in lending to developing countries and increased perception of risk, even before Mexico's problems overshadowed the interruptions in Argentina's debt-service payments.[6] The total value of reported syndicated loans to LDCs was down 7 percent in January through September over its 1981 level. The fall would have been steeper without a sharp rise in Mexican syndications in the first half of the year. The July-through-September rate of syndications to all LDCs was more than 25 percent below the similar period in 1981. Spreads on syndicated loans have also increased over the first nine months of 1982, indicating reluctance on the part of lenders. Countries could be substituting other types of bank credit for syndicated credits, but the behavior of the syndicated loan market is consistent with the projected slowdown for lending in general over the year, even before the recent events in Argentina and Mexico.

Past payments interruptions reduced lending

Past behavior of banks toward countries that do not promptly meet their contractual commitments suggests that the lower rate of lending to countries with payments difficulties could persist for some time. Comparison with past experience must remain somewhat tentative, since comprehensive information on bank lending was not available before 1977, and banks do not behave uniformly toward all problem countries. Even so, some patterns seem clear.

In general, banks reduce their outstanding claims on a country significantly when payments interruptions appear. The reduction is most pronounced for claims that are not covered by guarantees by a third party, such as a government agency in the country of the lending bank. U.S. banks, for which data can be adjusted for these external guarantees, typically reduce their adjusted claims 10 to 20 percent within a year or two after significant payments problems surface. Among the selected countries with well-publicized payments problems (Table 6),[7] this tendency is most clear in Costa Rica and Poland, where U.S. bank claims fell 14 percent and 18 percent, respectively, in 1981. In these countries, as in Turkey, Bolivia, and other countries, banks slowed their lending a year or more before the problems surfaced. Mexico and Argentina may prove to be important exceptions. Bank lending to both of these countries appears to have been exceptionally strong right up to the point where payments were interrupted.

Interruptions have tended to persist

Once problems in a borrowing country become sufficiently serious for widespread payments delays to occur, they are likely to persist for some years. Out of nineteen countries the IMF reported to have had payments arrears in 1978, fifteen were still in arrears at the end of 1981. For those countries that reschedule their private debt, the first rescheduling usually is completed at least one or two years after payments interruptions surface. For example, Costa Rica stopped payments on bank debt in August 1981 and still has not completed a rescheduling. Poland stopped payments in March of last year and took nearly twelve months to comply with the first year's rescheduling agreement.

Multiple reschedulings are frequent, as the experiences of Turkey, Jamaica, Nicaragua, and Bolivia indicate. Multiple reschedulings may occur when the country is not able to keep to the terms of the original rescheduling. Each rescheduling may deal only with certain classes of debt or with debt coming due over a short period. In any case, an agreement to reschedule cannot be taken as a sign that the country's problems are near a resolution.

After problems appear, the banks provide very little new money and often withdraw funds until there is evidence that the economic and financial situation has substantially improved. Out of the five publicized countries listed on Table 6 that interrupted their payments to banks in the late 1970s, four had a net decline in bank claims in the three years following generalized payments interruptions. Peru is the only one of these countries that has raised net new funds from U.S. banks since 1978, and this lending did not begin to grow until late 1980, more than three years after payments interruptions began. Peru is also the only one of these countries that managed to turn around its economic deterioration fairly quickly and revert to its original payments schedule.

Restructuring has been slow and costly

The large number of banks with outstanding loans in countries now delaying payments and the large amounts of loans involved may complicate the process of refinancing or rescheduling their debt. There are clearly more banks involved in international lending now than in the mid-1970s. While this diversity is useful in providing new sources of finance and spreading the risks, it also means that debt restructuring must be coordinated among a large and diverse group of creditors.

From 1977 to 1981, the nine largest U.S. banks reduced their share of total bank lending to all devel-

[6] Syndicated Eurocurrency loans, which are publicized and provide the most-up-to-date information on lending, constitute only part of bank lending to developing countries Moreover, many of these loans replace maturing credits, so that these data provide only a very rough idea of the rate of net new bank lending

[7] Tables 6 and 7 refer to countries that are known to have interrupted payments to banks since 1977 when comprehensive data became available and for which dates of interruptions and reschedulings can be reasonably determined

Table 6

Changes in Adjusted U.S. Bank Claims on Selected Countries*

In percent

Countries	1978	1979	1980	1981
All developing countries	**12**	**20**	**27**	**23**
Countries with payments problems appearing in 1981-82				
Costa Rica	−2	39	8	−14
Poland	−2	16	3	−18
Romania	34	16	−10	−3
Argentina	8	81	51	17
Mexico	−5	9	40	39
Countries with payments problems appearing in 1977-80				
Turkey	4	−10†	4	−3†
Nicaragua	1	−27	11†	−5†
Bolivia	34	−6	−18†	−7†
Peru	−13†	−13	23	13
Jamaica	−5†	−1	−9	2†

* Outstanding claims are adjusted for guarantees by residents of other countries

† Year in which a private bank debt rescheduling agreement was signed with commercial bank creditors

Source U S Federal Financial Institutions Examination Council, *Country Exposure Lending Survey*

Table 7

Nine Largest U.S. Banks' Share of U.S. Bank Claims and Commitments*

In percent

Countries	1977	1978	1979	1980	1981
All developing countries	**66**	**67**	**67**	**66**	**64**
Turkey	67	60	68†	65	66†
Nicaragua	61	60	56	62†	64†
Bolivia	74	72	69	68†	69†
Peru	60	58†	66	62	57
Jamaica	87	91†	86	87	82†

* Outstanding claims and commitments to advance funds, adjusted for guarantees by residents of other countries

† Year in which a private bank debt rescheduling agreement was signed with commercial bank creditors

Source U S Federal Financial Institutions Examination Council, *Country Exposure Lending Survey*

oping countries from 31 to 23 percent. These banks were early participants in the market, so that a declining share would have been expected as more banks entered. Moreover, major banks in the United States apparently resisted the decline in spreads over LIBOR that prevailed in the late 1970s on loans to developing countries. In some LDCs, their exposures were already large relative to their capital base so that they allowed new entrants to take on a large part of the additional loans. In any case, international lending to developing countries is now a good deal larger and more widely distributed among banks than in the mid-1970s.

Once an agreement to reschedule has been reached, the major banks' involvement tends to stay constant or increase (Table 7). This can be seen in the largest U.S. banks' behavior toward Turkey, Bolivia, Peru, and Jamaica. The large banks' share of total U.S. bank lending tends to rise in the years during which private bank reschedulings have occurred and to remain above average for several years. Even though overall lending to these countries slowed or declined, these major banks effectively took over part of the interests of smaller banks. Their larger stake and longer term interests in continuing relations with a potentially viable borrower may explain this behavior. Smaller banks tend to participate in loan syndications and to finance the foreign business of domestic customers. Their concern with the borrowing country is more related to current yield than long-term prospects.

Rescheduled loans have not been particularly attractive on the basis of current yield whatever the longer term outlook for the country. The more widespread exposure of countries now undergoing payments interruptions and the large size of the major banks' existing exposure may preclude rapid resolution of the problems. Clearly the more attractive the terms of restructured or rescheduled debt, the more willing will be the participation of all banks and a reasonably early resumption of lending will be more likely. For a bank, the contracted schedule of payments is violated by a payments interruption. The bank loses the opportunity to invest its portfolio in the most advantageous ways, even though in all likelihood debt servicing will eventually resume. The time and resources needed to negotiate a rescheduling agreement are also considerable For the country, the short-term gain of lowering its debt-service payments may be outweighed by the heavy loss in income over the extended period when bank lending falls and the domestic economy is forced to contract.

Conclusions

We find that most developing countries have made serious efforts to adapt to the world recession and that, in the aggregate, current account deficits are improving. But most LDCs have seen their liquidity position deteriorate substantially over the past four years as a result of higher world interest rates, their rising external debt, and greater reliance on short-term borrowing. The payments interruptions this year by two of the most important borrowers from commercial banks will certainly slow the growth of overall bank lending to developing countries. In the past, banks have withdrawn funds from those countries that have disrupted payments Even sharply reduced lending to two countries that accounted for more than 40 percent of the net bank lending in the recent past would in itself slow the overall growth. Moreover, the sudden payments interruptions by countries that were previously well regarded have heightened the perception of risk on loans to other countries.

Our current account projections of a $75 billion combined LDC deficit in 1982 and $60 billion in 1983 assume bank lending will grow $25-35 billion each year, down anywhere from 15 to 40 percent below the average over the past three years The midpoint of this range in bank lending, with some pickup in official flows and a greater drawdown of assets by developing countries, would finance the projected deficits. The upper end of the range of bank lending would allow some rebuilding of foreign exchange reserves and improve their liquidity position But lending scaled back to the lower end of this range could increase the risk of payments disruptions by otherwise sound countries The current account projections do not anticipate a generalized withdrawal of banks from most developing countries Despite the similarity of problems that these countries have faced, LDCs differ greatly in their abilities and willingness to face up to their problems. Most lenders recognize these distinctions, but the projected outcome is not certain New initiatives from the borrowing countries, from their commercial bank creditors, and from the international economic community at large may be needed to prevent more widespread payments interruptions to ease the present liquidity strains and to assure orderly adjustment.

William J. Gasser and David L Roberts