

THE WORLD BANK APPROACH TO DEBT

Despite the debt crisis, the World Bank has never had to reschedule a loan. Here's its view on how bankers should tackle international lending in the future. By Eugene Rotberg

Economic interdependence has become a cliché, yet there is plenty of data to show that the concept still carries a lot of weight. Take the US. In the 1970s, four out of five new jobs in manufacturing were export-related; one out of every three acres of agricultural land was devoted to products for export; 40% of all manufactured exports from 1977 to 1982 were to developing countries; 20% of GNP was export-related.

US exports to Mexico alone dropped by \$10 billion from September 1982 to September 1983; each \$1 billion drop in US exports cost 24,000 jobs. The US trade deficit this year will be \$70 billion.

Now take the developing countries. In the mid-1970s, Jamaica, Guinea, Surinam and Guyana exported 70% of the world's bauxite; Chile, Zambia and Zaïre 40% of the world's copper; Malaysia, Bolivia, Indonesia and Thailand 70% of the world's tin. Eighty per cent of the world's rubber came from Malaysia, Indonesia and Thailand. Twenty-five per cent of its sugar came from Brazil, the Philippines, the Dominican Republic and India. That is what it is fair to call economic interdependence.

What is the conclusion? None of these countries will have a substantial recovery in their economic growth without substantial growth in the industrialized countries, and particularly the Organization for Economic Cooperation and Development (OECD) countries. None will recover the capacity to service their debt unless protectionist measures are reduced, and unless the measures operating now are substantially cut back.

Without their markets, the markets of developing countries, it is highly likely that many industrialized countries cannot have sustained economic growth.

Most bankers have read an enormous amount about the extent, quality, quantity and nature of the debt crisis. Some facts have recently been developed which give that crisis a frame of reference. From 1973 to 1982 the external debt of the developing

countries rose by about \$480 billion. What has not been discussed until very recently is the make up of that external debt: not so much who lent the funds, not so much to whom it was lent, but rather what it was lent for.

Of the \$480 billion of debt, \$260 billion paid for oil at prices higher than the wholesale price index; that is to say, the increase in the price of oil paid by developing countries in excess of that price which would have been dictated by the wholesale price index, is \$260 billion.

F Of the \$480 billion increase in external debt from 1973 to 1982, \$400 billion was attributed to factors outside the control of LDCs **J**

The increase in the interest rate paid by developing countries for the debt they accumulated in the last 10 years, in excess of the interest rate which would have existed in the previous 10 years (the excess real rate of interest) was \$70 billion.

There was a further deterioration in the terms of trade of the developing countries, caused by a drop in commodity prices. The prices of many basic commodities reached the lowest in 30 years, which resulted alone in a drop of \$40 billion earned for exports of developing countries, which had to be financed. A further \$20 billion was borrowed to compensate for the enormous fall-off in the imports of the industrialized countries.

Of the \$480 billion by which external debt was increased, \$400 billion was attributed to factors totally outside the control of the developing countries: factors which were exogenous to their activities, their policies and their growth. These factors were oil, interest rates, terms of trade, fall in OECD growth.

Most of the bankers who have lent the \$480 billion realize that it is highly unlikely,

in the foreseeable future, that any reasonable portion of that debt will be paid down over the next decade or two. That is, it is not reasonable to expect the principal debt to be reduced. These countries will not be exporting capital in the foreseeable future; they will not be shrinking their growth to the point that they can repay debt.

The issue is, for most developing countries, whether or not they will be able to service the debt. That can only happen if there is growth in OECD countries, and a drop in the protectionist measures besetting industrialized countries.

So, what choices do banks have? Again, most bankers have read and seen a great deal about this subject. One solution is to pretend that the banks cause the problem. Bankers can pretend that any resource transfer from the World Bank, the IMF or governments is a bail-out of banks. They can pretend that the developing countries are not of interest to the OECD countries, that they are different from them, that their economic interests are not the same, and that what happens in those countries is of little interest to the developed world. They can say that it is simply pouring good money after bad. But the economic links belie that observation.

Or, as some are doing, banks can say *mea culpa*, take losses, and try to walk away from the outstanding indebtedness. All these things are possible. Or, the commercial banking system, the financial markets, can take another choice. They can look at the world not the way they would perhaps wish it to be, but the way it is. They can say, no, the funds will not be repaid; yes, the principal will be outstanding in the foreseeable future; and we hope that the interest payments, the servicing of the debt, will continue.

In the foreseeable future, perhaps in the next year or two, the commercial banks are likely to offer the latter course, and receive the support of the financial markets, and indeed the governments in which they operate. There will probably be a proliferation of instruments and vehicles in the commercial banking system and many syndicated credits, or bank loans, will be transformed into new instruments. Discount bonds and deep discount bonds will be used as a vehicle for lowering the immediate debt servicing problem of developing countries.

From time to time there will probably be either dual currency bonds or currency shifts. Many of the loans to developing countries permit a shift of the currency of obligation from one currency to another, and given that most of the syndicated credits were written in dollars, it would not be surprising if they were re-written in other currencies — Deutschmarks, yen and Swiss francs — obviously at a low nominal rate, which will relieve some of the debt servicing burden, at least in nominal terms.

I suspect that there will be a restructuring of much of the LDC debt from short term

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debt to long-term, to instruments which are not at all dissimilar from floating rate notes. There could be an FRN going out as long as 10 to 15 years, similar to a typical home mortgage, with or without some of the principal repaid during the life of the loan. This would relieve the principal payments, and avoid having crises every year or two. As a practical matter, the withering of the common stocks and the increased costs of commercial banks to fund themselves, particularly in their last year, will cause commercial banks to say "Enough, the loan is not due for 10 years; we will extend the principal to that time and expect that interest rates will be made and the debt will be serviced."

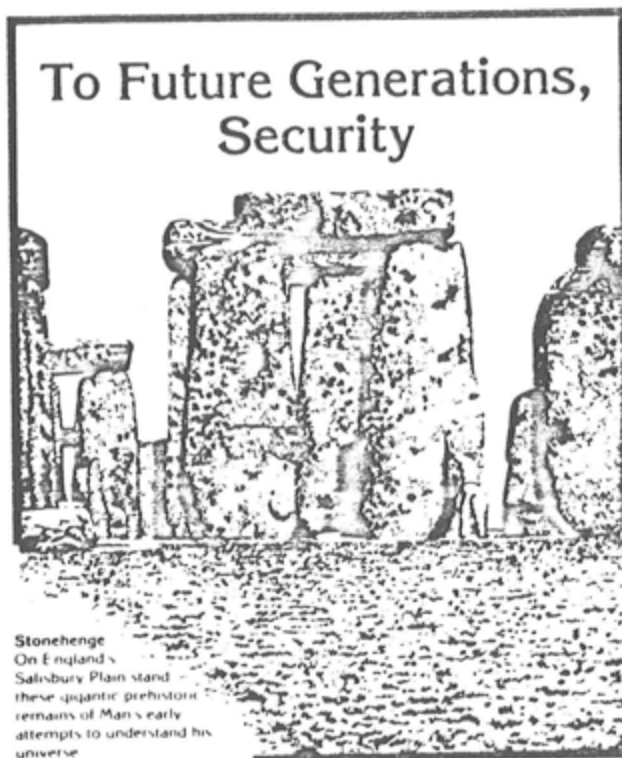
Commercial banks could spend more time supporting measures to remove protectionist barriers

Commercial banks could spend much more time supporting measures in parliaments, in congresses and in legislatures to remove, or at least restrict protectionist barriers which prevent developing countries from exporting goods and earning the dollars which must be used to service the debt — that is, to pay the interest.

There will probably be an increased amount of commercial bank activity, co-lending with institutions such as the World Bank. The Bank lends enormous amounts of money, for the most part on massive projects which take one or two years to appraise. The days of large jumbo credits to LDCs not linked to economic projects, but rather transfer payment blank cheques, are past. Instead there will be increased project lending.

In the last 12 months, the World Bank received \$5 billion of interest and principal payment on its outstanding loans. It rescheduled no loans. It had no non-accruing loans. It took no reserves against bad losses based on actuarial experience. It has never suffered a loss on a loan, it does not reschedule and it has no non-accruing loans. There were no defaults. Of the \$5 billion due on September 30 1983, there was on that date \$10 million overdue by more than 60 days. On October 26 1983, that amount was reduced to \$1.1 million of one borrower.

That experience is a convincing argument that for most of the major future financial flows, it will be the better part of wisdom, and probably the better part of good financial sense, for commercial banks to link themselves to institutions which have long periods of appraisal, long periods of supervision and of monitoring projects.



Stonehenge
On England's
Salisbury Plain stand
these gigantic prehistoric
remains of Man's early
attempts to understand his
universe

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