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Review

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Transnational banks, external debt and Peru

Results of a recent study*

*Robert Devlin***

The causes of the economic crisis experienced by Peru in recent years are primarily of domestic origin. At the same time, however, the author considers that those of external origin should not be underestimated, including those connected with the role played by the private commercial banks, which is the subject of this article.

In the first section of the article, the author explores the economic situation of Peru since the mid-1960s, the behaviour of the suppliers of external finance, the nature of bank lending, and above all the patterns of behaviour characteristic of the various private banks. He then goes on, in the second section, to make an appraisal of the effects of commercial bank lending on the economic development of Peru, distinguishing between its positive and negative aspects.

In the final section of the article, the author presents his conclusions and recommendations. In his view, consideration of the case of Peru gives grounds for the formulation of some more general proposals, either because other developing countries are displaying the same symptoms or because private banks are guided by relatively uniform criteria in similar situations. Hence, he suggests that while private bank loans may be a useful financial tool, they must be analysed with care because of the obvious limitations which they display with respect to the needs of development, the fundamental reason for these limitations being that commercial banks are not development institutions but profit-making enterprises which usually prefer types of investments and terms frequently incompatible with national economic and social goals.

*This is a revised version of a paper on the same subject presented at the CEESTEM/ILET seminar on Financial Capital held in Mexico in February 1980.

**Staff member of the CEPAL Washington Office.

Introduction

The decade of the 1970s witnessed the emergence of private commercial banks as important actors in the external finance of the Third World. Commercial lending to the non-oil-exporting developing countries has displayed astonishing growth from 1970, rising from the equivalent of less than one-fifth of current account finance to more than one-third by the second half of the decade. In the case of Latin America, private banks became the major source of finance, accounting for over 50% of the current account finance of the region's non-oil exporters; in the latter half of the 1960s the banks share of total finance was only 12%.

Notwithstanding the important role of banks in the economic life of developing countries in general, and Latin America in particular, there is an incredible dearth of specific information on the processes of lending by the banks and borrowing by the developing countries. Recent improvements in data collection have mostly involved very aggregate figures that tell little about how banks have lent and what their impact has been on the process of economic development; moreover, data collection and publication is more reflective of the needs of regulatory authorities in the center (who are doing the collecting) than the requirements of the developing countries.

The lack of insight into the process could conceivably be resolved if individual commercial banks made their loan portfolios more transparent. However, banks traditionally operate on the principal of confidentiality, making the detailed study of the experience of individual LDC borrowers the only reasonable alternative for breaching the gap in data and analysis.

In order to gain a better understanding of the role and impact of commercial bank lending in developing countries, CEPAL decided to employ the latter strategy, initiating the project in Peru. The precise focus of the project was on the public sector medium and long-term borrowing for 1965-1976, a period in which the country underwent two complete borrowing cycles. Data collection involved information on the amounts and costs of all loan flows, aggregated according to their various official and private sources, and comprehensive quantitative and qualitative data on a loan-by-loan basis

for all commercial bank transactions that were not related to national defence activities. Using the data on commercial bank loans, profiles were created on individual commercial institutions for the purpose of analysing their behaviour. Data were also reaggregated to provide a more complete view of the nature of bank lending and its impact on the economic development of Peru. The data were further complemented by more qualitative research on the chaotic events of 1977-1979, a period in which the country had lost its creditworthiness and experienced open conflict with its private bankers and the IMF.

The results of the research have recently been published in a book (in Spanish) by CEPAL.¹ The purpose of this article is to summarize some of the major findings of the project. By its nature a summary tends to compress complex issues and detailed analysis into simplified proportions that can sometimes be mis-

leading, so that a reader with more than a casual interest in the matter would be wise to consult the original work, with its accompanying documentation and caveats. However, even here it is worthwhile pointing out that since the project deals specifically with the transnational commercial banks it tends to magnify the role of the banks in Peru's economic difficulties. This focus is further intensified in the present summary article. The author would like to make clear that in his own view many, if not most, of Peru's problems in the 1970s stemmed from poor economic management. What is of interest here, however, is the behaviour of banks in this environment and, as will be seen below, one of the major findings of the study is that the banks' activities tended to seriously exacerbate these deficiencies, thus raising questions about their dominant role in the external finance of Latin America.

I

Effects of bank lending on Peru

1. *Background on the borrower*

During the period under study Peru had two governments with different economic philosophies. From 1965 to 1968 there was the civilian Belaúnde Government, which promoted industrialization and moderate social reform while, however, respecting Peru's traditionally liberal economy based on the export of primary commodities and an inflow of foreign investment. Thus, the government sector, while expanding rapidly with respect to its small size in the 1950s, remained basically supportive of the private sector. The introduction of a 'revolutionary' military government headed by General Juan Velasco Alvarado in late 1968 brought economic policies that showed a much more intensive nationalistic and developmental tone. The philosophy underlying the basic

model was described as something that would bridge the gap between capitalism and socialism. The State became the dominant entrepreneur in productive activities; foreign investment that was not compatible with national autonomy was dismissed from the country; and comprehensive socio-economic reforms were undertaken to enhance the well-being of the population.

Despite the different orientations in economic policy, the factors behind the relatively high demand for foreign resources displayed by both governments were similar. At the risk of oversimplifying some of the basic elements underlying requirements for finance can be defined as follows:

(a) In both cases the public sector was expanding rapidly with respect to previous rates of growth. This was particularly true for the military government, which took control of wide segments of productive economic activity. However, the domestic tax base severely lagged behind the expansion of activity,

¹See R. Devlin, *Los bancos transnacionales y el financiamiento externo de América Latina: la experiencia del Perú: 1965-1976*, Santiago, Chile, CEPAL, 1980.

creating large fiscal deficits that for numerous reasons exceeded the capacity of domestic capital markets to finance them.²

(b) There was a long-term supply constraint on exports, coupled with ever-growing pressures to import.³ The export constraint reflected a combination of laxity, bad luck and long gestation periods and/or delays (sometimes due to TNCs' global procurement strategies) on investments in the export sector. The demand for imports stemmed from rapid growth of investment (especially public), expanding consumption, overvalued exchange rates, dismal levels of domestic food production, and speculation by the private sector.

(c) The public sector was relatively inexperienced *vis-à-vis* the ever-growing responsibilities placed on it. This meant that foreign contractors, imports and finance easily penetrated national investment schemes and there was little effective discipline and/or control with regard to the contracting of debts, thus creating debt service problems which generated their own demand for foreign exchange.

It should be added that the post-1968 government was affected by several unique factors that inflated its demand for resources. One was the comprehensive subsidies paid on basic consumer items, many of which were imported. Another was the virtual disappearance for ecological reasons of the anchovy, a major export item. And perhaps most importantly, there was anticipated (and ultimately exaggerated) reliance on receipts from exports of newly found petroleum in the Peruvian jungle. One suspects that the authorities either consciously or unconsciously mortgaged future petroleum receipts for present-day consumption and investment. Unfortunately, however, actual production fell far short of expectations.

Many of the above factors of demand for foreign finance stemmed from structural weaknesses in the economy that went unrepaired for

prolonged periods. For each government these problems culminated in economic crisis. The Belaúnde Government had its crisis in 1967-1968 and this culminated in the military take-over of the latter year. The Velasco régime entered into crisis in mid-1975, bringing with it new leadership in the form of General Francisco Morales Bermúdez. The military government's crisis was especially severe and prolonged, and signs of improvement did not appear until 1979.

2. Behaviour of the suppliers of foreign finance

Despite the similarities in the factors of demand for foreign resources, the response from the supply side was substantially different for each government, the only common factor being the blockades contrived by one or more official sources of finance.

In the mid-1960s the Belaúnde Government faced varying credit freezes from United States AID, then a major source of concessionary finance for Latin America, because of an investment dispute with a United States-based transnational enterprise, the International Petroleum Corporation, a subsidiary of Standard Oil of New Jersey (now Exxon). This fact, coupled with the taxing analytical and political requirements of multilateral finance, caused the Government to become highly dependent on private suppliers' credits, which were readily available from firms eager to sell their wares. As a result the Government's external debt was already 'commercialized' as early as 1965 (see table 1 and figure 1). As for commercial banks, they played a secondary role in finance, but were important at the margin because of the emergency budgetary loans that they provided to the Government during the 1967-1968 period. The commercial banks may also have been indirectly present in Peru's external finance to the extent that they discounted and assumed promissory notes held by foreign suppliers.

The military régime which was installed in late 1968 encountered a financial blockade on account of its programme of nationalizing foreign firms with compensation that was less

²Between 1969 and 1975 central government expenditures (excluding amortization) as a percentage of GDP rose from 17% to 21%, but income remained constant over the same period at roughly 16% of the product. The deficit as a percentage of the product thus rose from 2% to nearly 8%.

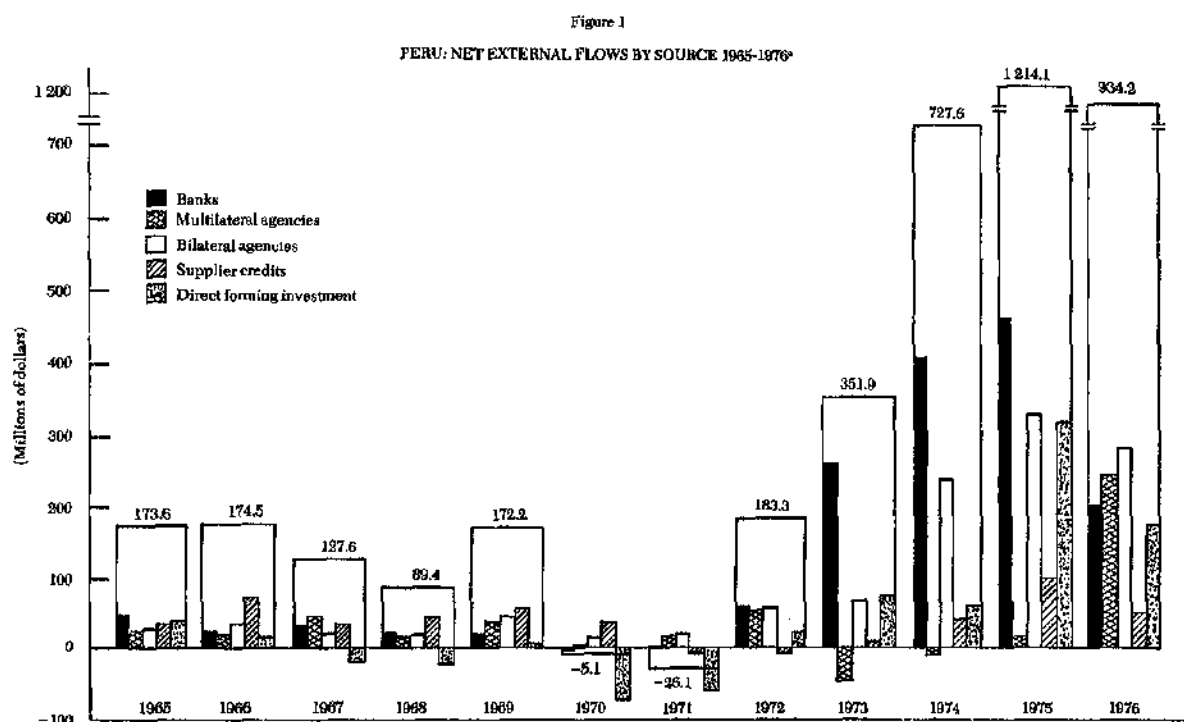
³Over the period 1965-1975 exports as a percentage of the product fell from 18% to 12%, while imports rose from 20% of the product to over 22%.

Table 1
**PERU AND LATIN AMERICA: DISTRIBUTION OF EXTERNAL PUBLIC
 DEBT ACCORDING TO SOURCES OF FINANCE,
 1965-1966 AND 1975-1976***
 (Per cent)

	Private				Official		Total
	Bonds	Suppliers	Banks	Others	Multilateral	Bilateral	
1965-1966							
Peru	5	40	8	3	23	21	100
Latin America	8	20	9	3	23	37	100
1975-1976							
Peru	-	11	45	3	11	30	100
Latin America	4	9	39	5	21	22	100

Source: Inter-American Development Bank, *External Public Debt of the Latin American Countries*, Washington, D.C., 1978.

*Disbursed and undisbursed debt with maturity of more than one year.



Source: CEPAL, on the basis of official data.

*With the exception of direct foreign investment, all flows relate to the public sector and include national defence transactions.

than adequate in the view of the companies and their home governments. United States firms (and the United States Government) were most actively involved in the disputes, reflecting this country's very high profile in the Peruvian economy. Important sources of bilateral finance were cut off and the United States Government used its leverage to slow down credit flows from multilateral agencies. Peru's commercial bankers were also very reserved, lending only for purposes of refinance, and then only for fear of non-payment. Given the difficult economic environment in 1968-1969 it is hard to determine conclusively whether the bankers' attitude was due to objective economic circumstances or participation in the blockade. But there is evidence to suggest that at least some banks held back finance as a retaliatory measure for the nationalization of foreign enterprises and the takeover of the local operations of certain transnational banks.

In 1972 Peru once again began to have access to foreign credit. The renewed access stemmed from several factors. First, Peru's deep determination to overcome the blockade enabled it to successfully reactivate the economy and initiate reforms even in the face of a hostile external environment, thereby making the punitive measures increasingly counterproductive. Second, oil had recently been discovered in the Amazon region, making Peru potentially an important strategic element in the oil procurement strategy of the United States. Third, Peru had begun to diversify its external economic relations to incorporate partners (Japan, Europe and the Soviet Union) with a neutral or favourable view of its economic policies. Fourth, and most importantly, the structural changes in world banking which took place in the late fifties and the sixties eventually induced commercial lending institutions in the early seventies to abandon their traditionally conservative attitude on finance for developing countries in favour of an aggressive strategy involving rapid expansion of lending to these borrowers. Peru eventually got caught up in the process, which intensified with the advent of OPEC surpluses, and commercial banks became increasingly eager to extend no-questions-asked finance to the Government (see again figure 1). Thus, the seemingly un-

limited desire on the part of the banks to expand their assets in LDCs, coupled with the Government's inflated demand for foreign finance, created conditions whereby Peru accumulated enough commercial bank debt to rank it among the top non-oil-exporting developing country clients of the banks.

The banks remained eager lenders to Peru until late 1975, when a new cautious attitude was adopted. On the one hand, banks in general had become more reserved lenders due to a series of major bank failures (connected with bad management of foreign exchange) in mid-1974 and criticism from home governments to the effect that banks had over-lent to LDCs. On the other hand, the structural weaknesses underlying Peru's demand for external finance had been intensifying, as had the burden of its debt.⁴ Moreover, anticipated receipts from petroleum had not lived up to original expectations. By 1976, then, bankers were only very reluctantly financing Peru's balance of payments under onerous terms and conditions, and indeed, as will be explained shortly, relations with the bankers subsequently became even more tense and ultimately creditors forced the Government to have recourse to the IMF. The ensuing harsh stabilization programmes generated heavy social costs for a country already characterized by severe poverty.

3. *The nature of bank lending: 1965-1970*

In the period 1965-1970 a handful of large, internationally experienced United States banks virtually controlled the Government's access to foreign commercial bank credit. Peru's most important bank at this time probably was Manufacturers Hanover Trust, both because of the volume of credit it extended and the fact that it arranged several relatively large, multi-institutional loans for the Belaúnde administration. The other major lenders were Bankers Trust, Bank of America, Chase Manhattan, Citibank and Continental Illinois. Altogether, there were only 27 lending banks in this period (see tables 2, 3 and 4).

⁴The cost of servicing the medium and long-term public debt had risen from 16% of the value of exports in 1969 to roughly 30% by 1975.

Table 2

PERU: MAJOR COMMERCIAL BANK LENDERS GROUPED ACCORDING TO THE AMOUNT AUTHORIZED, 1965-1970 AND 1971-1976^a

1965-1970			1971-1976		
Lending banks and amounts authorized in millions of dollars ^b	Country headquarters of bank	International ranking of bank ^c	Lending banks and amounts authorized in millions of dollars ^b	Country headquarters of bank	International ranking of bank ^c
<i>Major lenders</i>					
1. ≥ 45 and < 55			1. ≥ 123 and < 150		
Bankers Trust	United States	11	Citicorp	United States	2
Citicorp	United States	2			
Manufacturers Hanover	United States	5			
2. ≥ 35 and < 45			2. ≥ 95 and < 123		
Chase Manhattan	United States	3	Manufacturers Hanover ^d	United States	16
			Wells Fargo	United States	69
Continental Illinois	United States	22			
3. ≥ 25 and < 35			3. ≥ 68 and < 95		
Bank of America	United States	1	Bank of America	United States	1
			Chase Manhattan	United States	4
<i>Intermediate lenders</i>					
4. ≥ 15 and < 25			4. ≥ 41 and < 68		
Bank of Nova Scotia	Canada	47	Bank of Nova Scotia	Canada	53
			Bankers Trust	United States	32
			Continental Illinois	United States	30
			Morgan Guaranty	United States	19
			Crocker National Bank	United States	79
			Dresner Bank	Germany	14
			Banco do Brasil ^e	Brazil	12
			Royal Bank of Canada	Canada	22
5. ≥ 6 and < 15			5. ≥ 16 and < 41		
Charter New York corporation	United States	39	Banca Commerciale Italiana	Italy	24
Crocker National Bank	United States	48	Bank of Tokyo	Japan	28
First National Bank Boston	United States	59	Lloyds Bank	United Kingdom	31
Franklin National Bank	United States	78			
National Detroit Corporation	United States	57	Franklin National Bank	United States	...
			Union Bank of Switzerland	Switzerland	41
			National and Commercial Banking ^f	United Kingdom	102
			Bancal Tristate Corporation	United States	199
			Banca Nazionale de Lavoro	Italy	20
			Long Term Credit Bank of Japan	Japan	44
			Credit Lyonnais ^f	France	7
			Banque Française du Comm. Extérieur ^f	France	174

1965-1970			1971-1976		
Lending banks and amounts authorized in millions of dollars ^b	Country headquarters of bank	International ranking of bank ^c	Lending banks and amounts authorized in millions of dollars ^b	Country headquarters of bank	International ranking of bank ^c
			Canadian Imperial Bank of Commerce	Canada	29
			Fuji Bank	Japan	13
			Amro Bank ^f	Holland	48
			First Pennsylvania Corp.	United States	106
			Deutsche Bank	Germany	6
			Bank of Montreal	Canada	45
			Chemical Bank	United States	23
			First Chicago Corp.	United States	35
			Security Pacific Corp.	United States	54
			Commerzbank A.G.	Germany	26
			American Express Int.	United States	223
			Toronto Dominican Bank	Canada	66
		<i>Minor lenders</i>			
6. <6			6. < 16		
There are 15 banks in this group			There are 131 banks in this group		

Source: CEPAL, on the basis of official data.

^aFor credits with and without an export credit guarantee.

^bThe range of authorizations in each group are different for the two periods due to the much greater value of loans in 1971-1976. However, the scaling of the values for each group has been done in such a way that 1971-1976 is roughly proportional to 1965-1970.

^cRanked on a scale from 1-300 in world banking. Size is based on assets; 1965-1970 uses asset size for 1969 as published in *The Banker*, June 1970, p. 596; 1971-1976 uses size for 1975 as published in *The Banker*, June 1976, p. 645.

^dIf credits with export credit guarantees are excluded, would fall into group 3.

^eIf credits with export credit guarantees are excluded, would fall into group 5.

^fIf credits with export credit guarantees are excluded, would fall into group 6.

Table 3

PERU: DISTRIBUTION OF TOTAL AUTHORIZATIONS AMONG MAJOR, INTERMEDIATE AND MINOR LENDERS, 1965-1970 AND 1971-1976^a
(Per cent)

	Major lenders	Intermediate lenders	Minor lenders	Total
1965-1970	71.7	17.4	10.9	100
1971-1976	23.0	46.8	30.2	100

Source: CEPAL, on the basis of official data.

^aLending groups correspond to those of table 2.

Table 4

PERU: COMMERCIAL BANK AUTHORIZATIONS ACCORDING TO COUNTRY OF ORIGIN,
1965-1970 AND 1971-1976^a

Country of banks	Percentage of total loans authorized	Number of institutions ^b	Average size ^c	Number of credit transactions
<i>1965-1970</i>				
United States	86.1	14	5	49
Japan	0.1	1	26	1
Canada	7.8	3	42	5
United Kingdom	1.5	2	74	5
Germany	1.1	1	14	1
France	-	-	-	-
Italy	1.0	1	25	3
Switzerland	-	-	-	-
Other	-	-	-	-
Consortium	1.0	2	301 ^e	2
Unknown ^d	1.2	3	...	5
<i>Total</i>	<i>100.0</i>	<i>27</i>	<i>5</i>	<i>71</i>
<i>1971-1976</i>				
United States	45.3	42	17	196
Japan	11.6	26	41	160
Canada	10.2	6	46	61
United Kingdom	6.5	11	54	41
Germany	6.4	11	18	27
France	4.3	8	43	39
Italy	2.1	8	30	24
Switzerland	2.5	7	54	15
Other	7.5	24	53	58
Consortium	3.5	23	301 ^e	43
Unknown ^d	0.2	1	...	3
<i>Total</i>	<i>100.0</i>	<i>167</i>	<i>27</i>	<i>672</i>

Source: CEPAL, on the basis of official data.

^aIncludes all credits, i.e., with and without guarantees of an export credit agency.

^bSubsidiaries have been consolidated into parent.

^cRanked according to asset size on the basis of *The Banker's* top 300 in world banking. The period 1965-1970 uses asset data for 1969 and 1971-1976 uses asset data for 1975. The country average was calculated by weighting the asset size of each bank in dollars by the amount authorized in each period. The resulting average asset size was then assigned a rank according to where it came in the top 300 of *The Banker*. A rank of 301 is used to indicate an average asset size too small to be ranked in the top 300. Banks whose origins are unknown, of course, received no ranking and do not figure in the overall averages. Since the number of unknown, bore only insignificant weight, the absence of these banks in the ranking exercise had little effect on results.

^dBanks whose national origin could not be identified.

Ninety-five per cent of the value of the loans authorized in 1965-1970 came from the headquarters of the banks, both because the absolute volume of lending was small enough not to require special funding from abroad, and because loans to LDCs were uncommon enough to merit the attention of the very top executives of the banks. Reflecting the source

of the loans, slightly more than 80% of the authorizations had interest costs that were based on a floating domestic prime rate and carried an average spread of 1.72%⁵ (often the variability of the floating rate was alleviated by

⁵The prime rate for all practical purposes was the United States prime rate quoted in New York.

floor and ceiling base rates). Maturities rarely exceeded 5 years, which was normal for international credit at this time. Flat front-end fees on loans also were rare.

Most commercial bank loans (80%) extended in the period were formally designated for purposes of refinance (see table 5). The banks refinanced commercial goods suppliers who were reluctant or unable to lengthen their loan commitments and also official agencies which, for political reasons, were withholding credit to the Government. In view of Peru's inability to service its debt, the banks also constantly refinanced their own credit, especially in the crisis of 1967-1968 and then again under fear of default by the military government in 1969-1970. It must be pointed out, however, that while banks refinanced loans in the difficult economic environment of 1967-1970, their credits were characterized by very short overall maturities (5 years), brief grace periods (sometimes less than a year), and rather high interest margins (1.75% or more).

Table 5

PERU: BREAKDOWN OF COMMERCIAL BANK CREDITS BY TYPE, 1965-1970 AND 1971-1976^a
(Per cent)

Type of loan	1965-1970	1971-1976
Import of capital goods	-	2.0
Import of other goods	-	2.0
Refinance	79.9	48.6
Free disposition	15.3	27.8
Projects	4.8	14.7
Nationalizations	-	6.1
Other	-	0.7
<i>Total</i>	<i>100.0</i>	<i>100.0</i>

Source: CEPAL, on the basis of official data.

^aOnly for credits without guarantees of export credit agencies.

Lastly, bank lending in the period was almost always very conditional. Commercial security arrangements such as escrow accounts were very common in transactions with quasi-autonomous government agencies, and furthermore, with the appearance of economic stress after 1966, refinance credits carried political-economic conditionality. When the Gov-

ernment was under IMF scrutiny in 1967-1969, credits were tied to IMF standby accords and carried debt restrictions very similar to those applied by the IMF itself. When the Government managed to avoid the IMF, as was the case in late 1969 and in 1970, banks reluctantly agreed to refinance their loans, but they also applied unusual forms of conditionality designed by them. The conditionality basically involved precise debt service restrictions which gave the Government little room for contracting new debt in the first half of the seventies. This in turn placed severe constraints on the possibility of financing an ambitious development programme.

4. *The lending nature of commercial bank lending: 1971-1976*

In 1971 commercial banks were still restrictive lenders to Peru. However, in the following year a process began which brought a massive change in relations with the world banking community. Not only was there a phenomenal rise in the volume of lending (see again figure 1), but also a tremendous diversification of sources. The total number of private commercial creditors rose from just 27 in the sixties to 167 in the seventies.⁶ Major lenders at the institutional level were still Citibank, Wells Fargo, Manufacturers Hanover, Bank of America and Chase Manhattan, all of which (with the exception of Wells Fargo) came from the same club of major international lenders of the sixties (see table 2). However, unlike the previous period, when a few major lenders accounted for almost all the lending in absolute terms, in 1971-1976 they accounted for a minority of credit flows. A large mass of newcomers to international lending (of which Wells Fargo was one), although mostly only of intermediate or minor importance as individual lenders, as a whole accounted for the vast majority of credit extended to the Government (see again table 3).

Not only were there many new institutions lending to Peru, but there was much greater dispersion in terms of the geographic origin and size of the institutions. As just mentioned,

⁶It should be mentioned that subsidiaries have been consolidated into the parent.

in the sixties an overwhelming part of all commercial credit came from just six large, internationally experienced United States banks. While United States institutions were still the dominant source of finance in the seventies, however, lending was shared among 42 individual lenders. Moreover, important lending came from Japan and Europe as well. Most of the newcomers in the seventies were of varying degrees of size and often had little international lending experience (see again table 4).

The very significant dispersion in the sources of finance could suggest a greater degree of independence for the borrower, and indeed there is no doubt that there was more plurality than in the sixties. However, in the seventies nearly 80% of all credit was extended in the form of syndicated loans, which were organized and administered by a lead bank, and just 5 lead banks—Citibank, Wells Fargo, Manufacturers Hanover, Bank of Tokyo and Dresdner Bank—accounted for roughly three-quarters of the credit mobilized in syndication during this period.⁷ Thus, with the new mechanism for international lending—the syndicated loan—came a new form of power. While many new banks lent to Peru, a handful of institutions again had a considerable degree of control over the access to foreign credit. Moreover, the situation for Peru was merely a more severe form of a similar concentration at the level of international syndication.⁸

Given the very large volume of credit extended to Peru, most commercial banks had to seek offshore finance (this was particularly true for United States banks, which faced home country capital controls). Thus, while headquarters still remained the main source of loans (47% of all credit), London, the Bahamas, Luxembourg and other offshore centres became important points of funding and booking of loans. Another reason for sourcing loans abroad, especially in the case of tax heavens

like the Bahamas, was to enhance income from foreign transactions.

As regards the currencies in which loans were denominated, in the seventies (as in the sixties) United States dollars were by far the most common currency for loans, accounting for 89% and 98%, respectively, of all transactions. However, in the more recent period there was some use of other currencies such as the yen and D-mark.

The costs and conditions of credit reflected the importance of offshore funding; 94% of the value of all loans were based on the floating London Interbank Offer Rate (LIBOR). Accelerating world inflation caused the disappearance of the floor and/or ceiling base interest rate arrangements that had accompanied many floating rate loans of the sixties.

When Peru first gained access to considerable amounts of commercial bank loans in 1972, the terms of credit were very severe. Margins over the LIBOR were well in excess of 2% and maturities did not extend beyond 5 years (see figure 2). In contrast, established developing country borrowers like Brazil and Mexico were taking full advantage of the bankers' eagerness to lend and were negotiating margins of something near 1.5% over LIBOR and maturities of up to 10 years. Peru's more costly terms reflected bankers' continued uncertainty about the policies of the reform government, the state of the economy and, perhaps to a lesser extent, the authorities' inexperience in negotiating with commercial bankers.

However, as international lending terms became increasingly favourable for LDCs in general (a borrowers' market), and as the banks became ever more interested in Peru, the terms of credit underwent a massive transformation. By 1974 Peru was able to negotiate margins only slightly above 1%, and maturities reached up to 10 years. These conditions were only slightly less favourable than those offered to prime developing country borrowers like Brazil and Mexico.

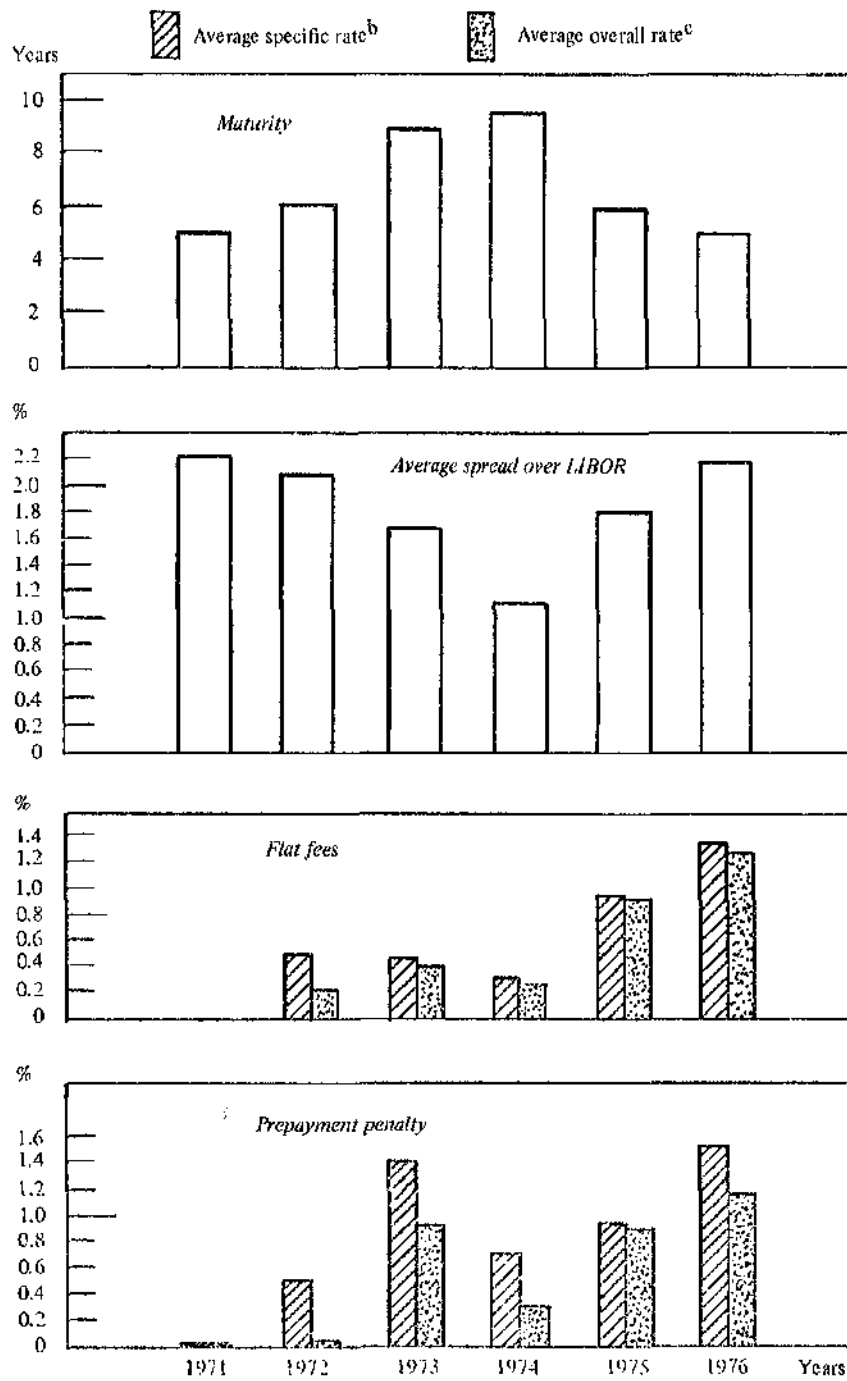
In 1975, reflecting a turn to generally tight international borrowing conditions (a lenders' market), the terms of credit hardened for Peru about as much as they did for most LDC borrowers. In 1976, however, when bankers were openly concerned about the Peruvian economic

⁷Where there was more than one lead bank for a syndicate, the principal lead bank was taken to be the institution which also assumed the role of agent. The principal lead bank usually takes the role of agent because of the increased income it can gain through commissions.

⁸Only about 50 banks worldwide act as leaders in syndication, and within this group the top ten have at times mobilized more than 50% of the credit.

Figure 2

PERU: AVERAGE MATURITIES, SPREADS, FLAT FEES AND PREPAYMENT PENALTIES ON COMMERCIAL BANK LOANS, 1971-1976^a



Source: CEPAL, on the basis of official data

^aExcludes credits with guaranties of export credit agencies.

^bAverage for loans bearing such a fee or penalty.

^cAverage then applied to all commercial bank loans for the period in question.

situation, the country's average terms underwent serious deterioration *vis-à-vis* other borrowers, and by the end of the year borrowing conditions had come full circle and recalled the costly levels of 1971/1972 (see again figure 2).

As far as fees and penalties are concerned, in the 1970s, they became a very common part of commercial bank loans. Nearly nine-tenths of the value of lending in the period carried flat front-end fees of one kind or another, at an average cost of 0.77% of the face value of the loans. Also, nearly two-thirds of the loans carried prepayment penalties, at an average cost of over 1.18% (flat) on the amount to be prepaid (see figure 2).

The generalized application of fees in the 1970s could be attributed to the emergence of syndicated loans as the major mechanism for the extension of credit. Banks were attracted to syndication because each individual institution could commit a relatively small amount of funds and thereby minimize risk. Moreover, fees were often a major inducement for lead banks to initiate syndication of a loan and were also an important inducement to participants. Reflecting the need to attract banks at the margin, syndicated credits generally had higher interest rates and fees than single bank loans and they carried much higher prepayment penalties (see figure 3). Notwithstanding these features, syndicated credits appear to have been more favourable to the borrower than single bank loans because of both longer maturities and the much greater amount of resources that could be raised on any one transaction.

Types of loans. In 1971-1976 refinance operations continued to be the most important form of credit transaction carried out by the commercial banks, accounting for some 49% of the value of all authorizations. Banks refinanced not only their own debt, but also that of other private and official sources. This reflects a government policy of almost continued refinance of its external obligations. In 1971-1972 refinance was motivated by the burden of debt service payments. But in 1973-1974 the Government refinanced its debt basically to take advantage of the more favourable lending terms offered by the banks in this period. In 1975-1976 refinance again was motivated by

debt service problems, and in the latter year Peru arranged a historic US\$ 400 million refinance loan with its major private creditors. The operation was notable not only because of the size of the transaction, but also because the banks agreed to help Peru avoid an IMF stabilization programme.

While refinance credits were the main type of credit, the new style of world banking in the early 1970s was reflected in a significant diversification of lending activities (see table 5). Nearly 28% of the credit was of free disposition, i.e., the banks provided the funds with no strings attached whatsoever. There was also a significant amount of project lending. An interesting point too, is that the banks provided considerable amounts of credit to help the Government compensate foreign firms that were nationalized in the reform programme.

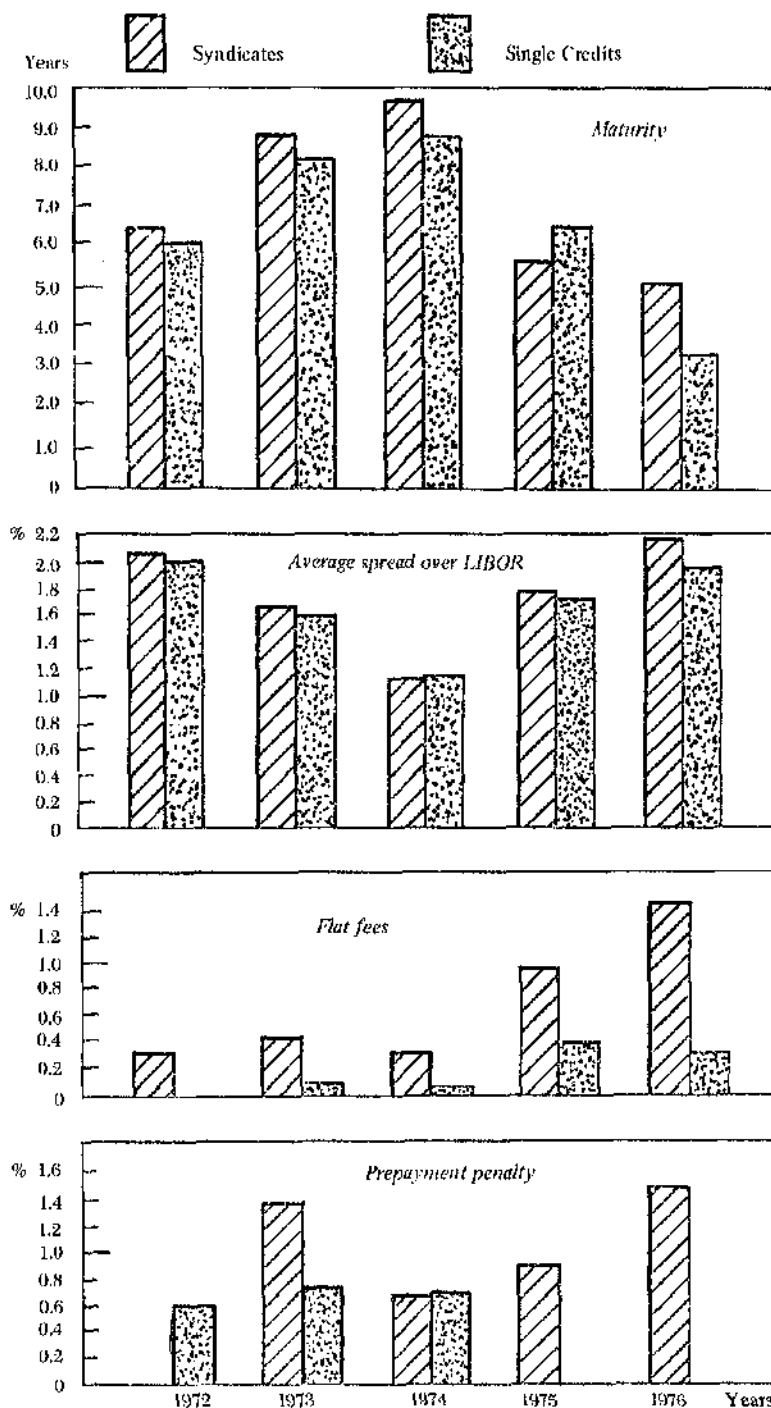
Most of the loans of free disposition were extended in 1973. This reflects the fact that the banks were very eager to lend to Peru at a time when major projects were still in a planning stage, while Peru was also eager to establish itself as a major client. The objectives of the two parties were best achieved through the extension of credit that was not tied to any specific activities.

Unlike the 1960s, the banks' project lending was of some significance in 1971-1976. The economic areas where bank project loans were most heavily concentrated were petroleum-related activities and manufacturing, in that order. It is estimated that over a quarter of the resources were granted for local costs. In most individual projects bank loans complemented other sources of finance like suppliers' credits and bilateral loans; in other words, they were one layer in a multilayered financial package. Significantly, however, commercial banks were very important in the successful financing of some projects of high national priority like the trans-Andean oil pipeline and the Cerro Verde I copper mine.

The nationalization credits, representing some 6% of all credit authorized, were extended as a form of solidarity between banks and home country investors. They were valuable to the Government inasmuch as the loans permitted the authorities to settle prolonged disputes with foreign investors and their home

Figure 3

PERU: COMPARISON BETWEEN AVERAGE TERMS ON SYNDICATED CREDITS AND LOANS ADVANCED BY A SINGLE BANK, 1972-1976^a



Source: CEPAL, on the basis of official data.

^aAll credits.

governments. United States and Swiss banks and investors were the key actors in this type of credit. One historic credit arranged by Morgan Guaranty in 1974 was part of a package agreement with the United States Government to end an investment dispute (and sanctions) that arose in late 1968 over the nationalization of United States-based enterprises.

As for the terms of the credit, the different types of loans carried costs which were broadly similar to each other. The clear exception to this was nationalization credit, which carried notably more favourable terms as regards interest rates, maturities, fees and prepayment penalties (see table 6). The more favourable conditions reflect the special nature of the credit as a form of bank investor solidarity.

Banks in the period 1972-1975—in contrast to the 1960s—were virtually unconditional lenders to the Government. The earlier, heavily conditioned loans of the sixties were prepaid by new (and cheaper) unconditioned credits. Banks showed little interest in securing loans with anything more than a general government guarantee, and it seemed that what was financed, how it was financed, and the ultimate purpose of the finance mattered little to them.

The permissive environment of 1972-1975 changed radically in 1976. As noted before, banks were generally more cautious lenders because of factors external to Peru. However, the country's economic difficulties generated special concern among its private creditors, and loans once again were very closely scrutinized. When Peru requested a large refinance credit from the banks in 1976 the immediate reaction was to condition any new credit on an IMF standby agreement, as had been done with developing countries in the 1960s. But the Government insisted that it could not submit to the traditionally harsh IMF policies, and after intense negotiations, and with strong reluctance on the part of some banks, commercial creditors agreed to extend refinance loans to the government. For this purpose the banks joined together into regional groups—United States, Canadian, Japanese, European, etc.—in order to organize large syndicated credits worth nearly US\$ 400 million, all carrying practically identical terms and conditions

(2.25% over LIBOR; 5-year maturities with 2-year grace period and flat fees of 1.5%).

In the negotiations on refinancing of the debt, banks displayed an open willingness to protect the interests of TNCs. At least implicitly the loans were conditioned by the requirement that the Government settle investment disputes with two foreign firms. This conditionality was a radical departure from the behaviour of the early seventies, when banks lent to the Government even in the face of prolonged disputes with many firms. On at least one other occasion after 1976 the banks attempted to make finance conditional on the treatment given to a TNC (see below).

When the banks agreed to refinance the Government's commercial debt in the absence of the IMF, they did so fully aware of the fact that their credit completely dwarfed all other sources, including the IMF. Banks clearly had the leverage to influence government policy, and this fact was exploited, as is manifest in their agreement to monitor a government-designed stabilization programme that was introduced by the authorities as an inducement to have the banks refinance the debt without the IMF. The banks split the loan into two tranches, with disbursement of the second one contingent upon the success of the stabilization programme.

The agreement of the banks to extend credit without the IMF was not new: as we have already seen, in 1969-1971 commercial banks had provided heavily conditioned finance on their own. What was new was that bankers took it upon themselves to monitor the whole economy, not just a few parameters like external debt.

While some large banks technically had the ability to monitor the economy, and as a group banks enjoyed considerable leverage over government policy, the foray into IMF territory failed. Outside criticism of their venture was strong, and arose from concern about having private profit-making institutions monitoring the affairs of a sovereign government. The possibilities for conflicts of interest obviously loomed large. Also, the Peruvians were unable to muster the political cohesion to make the hard economic decisions that bankers

Table 6
PERU: TERMS ON CREDITS GROUPED ACCORDING TO TYPE, 1965-1970 AND 1971-1976^{a,b}

Category of loans	Interest rate			Total maturity (years)	Flat fees and prepayment penalties	
	Percentage of credit in each category with:				Percentage of credit in each category with:	
	(i) Fixed rate	(ii) LIBOR spread	(iii) Prime spread		Flat fee	Prepayment penalty
	Actual rates				Actual rates	
<i>1965-1970</i>						
1. Import of capital goods	-	-	-	-	-	-
2. Import of other goods	-	-	-	-	-	-
3. Refinance	13.0	4.2	82.9	5.07	1.0	14.9
4. Free disposition	7.96	1.74	1.72	4.78	1.00	0.32
	5.5	-	94.5		100.0	100.0
5. Projects	8.75	-	1.69	5.64	-	0.44
	100.0	-	-		100.0	100.0
6. Nationalizations	7.45	-	-	-	-	-
	-	-	-		-	-
7. Other	-	-	-	-	-	-
<i>1971-1976</i>						
1. Import of capital goods	9.0	53.1	37.9	6.34	35.3	21.9
2. Import of other goods	10.43	1.61	1.15	2.00	0.65	1.28
	100.0	-	-		-	-
3. Refinance	9.00	-	-	6.98	-	-
	-	96.1	1.6		83.0	69.6
4. Free disposition	-	1.81	1.55	7.15	1.00	1.23
	3.9	95.2	1.0		93.3	70.1
5. Projects	8.12	1.79	0.75	6.87	0.61	1.39
	-	93.1	6.9		92.0	61.6
6. Nationalizations	-	1.71	1.78	8.38	0.67	0.52
	-	100.0	-		100.0	100.0
7. Other	-	1.31	-	4.63	0.22	-
	-	12.2	87.8		100.0	100.0
	-	0.59	1.25		-	-

Source: CEPAL, on the basis of official data.

^aCredits without guarantees of export credit agencies.

^bAverage weighted by amounts authorized.

^c2.3% of the refinance credits had rates other than those cited in the table.

wanted so that foreign exchange could be squeezed from the economy for payment of debt.

With the stabilization plan failing, and criticism about their role in the economy mounting, commercial banks withdrew their support from the Government, forcing the authorities to run back and forth between their private creditors and the IMF in search of a solution to their problems.

The post-1976 period. The path to resolution of the problems was highly conflictive and very costly to the economy. Introduction of new austerity measures in mid-1977 met with strong public resistance and brought about the rapid fall of a recently installed economic minister. In late 1977 a new economic team, under pressure from the banks, reached an agreement with the IMF implying adjustments which many felt were totally unrealizable. As a result of this agreement, the commercial banks agreed to negotiate new refinance credits. However, as expected, the IMF targets were not met—notwithstanding a reported attempt to 'cook' the financial books—and in early 1978 both the IMF and the banks withdrew their support. Faced with embarrassment over the IMF fiasco, continuous strikes and demonstrations over austerity measures, and scarcity of foreign exchange, there was another change of economic teams in May 1978. With the introduction of more austerity measures, street riots broke out in Lima. However, the authorities did manage to negotiate a more reasonable accord with the IMF and towards the end of the year enough confidence was generated to renegotiate debt payments falling due in 1979 and 1980.⁹ By the end of 1979 the financial picture showed signs of marked improvement: export earnings boomed because of a recovery of copper prices, new volume from Cuajone and oil exports (with high world prices) from the Amazon; imports slackened because of austerity measures; and outflows of capital had

been reduced by postponement of debt service. Indeed, during 1979 the external sector improved to such a degree that the Government decided to reject part of the debt relief provided in 1978, and by 1980 Peru appeared to be on the verge of initiating another credit cycle with the banks.

5. *The differential behaviour of the banks*

Research also provided reasonable support for the hypothesis that banks behave differently and are not a homogeneous group, which in turn suggest that they merit more discriminating analysis than has heretofore been the case.

In 1965-1970 lending to the Government was dominated by a few large internationally experienced United States banks. The posture of the banks was generally conservative, as exposure, terms, and conditions of credit were restricted. However, in the early seventies there appeared many new lenders eager to expand their international portfolios. Both because of the crowded nature of markets in the industrialized countries, and the relatively lower rates of return to be found there, these banks focussed on developing countries as a way of satisfying their ambitions for earnings growth, displaying an aggressive and liberal attitude with regard to amounts extended, terms offered, types of loans and prevailing conditions of credit. Peru's traditional creditors of the sixties maintained a more conservative posture in this environment. Some, interested in maintaining their market position, followed the trends generated by the newcomers, but other traditional lenders assumed a more rigid posture and resisted them.

The aggressive lenders of the early seventies were characterized by a willingness to extend large amounts of unprotected credit without conditions. They were also likely to be more willing to extend free disposition and refinance loans than their more conservative counterparts, and were inclined to finance activities in non-commercial areas such as social infrastructure. Until 1975 the aggressive lenders continuously undercut the prevailing market terms for loans to Peru, thereby helping

⁹During the negotiations one major bank was accused of 'blackmail' as it reportedly attempted to tie the success of the debt negotiations to the Government's handling of a dispute over management of the foreign exchange earning of Cuajone, a project for which the said bank was a major lender. The ensuing bad publicity made the bank abandon this strategy, however.

to steadily reduce interest margins and lengthen maturities.

By 1975, however, the world's commercial banking community had turned relatively conservative in its posture *vis-à-vis* the Third World. Most of the aggressive lenders of the early seventies retrenched and/or became conservative due to fear about the stability of international finance and the massive debt accumulation of LDC borrowers. Market trends once again came under the influence of the big, experienced international banks which had controlled credit flows in the sixties. Nevertheless, within the confines of a generally more conservative lending environment, some international banks behaved in ways which were more flexible than other institutions.

The study attempted to classify banks according to their behaviour with regard to Peru, although this could be done only in a limited and tentative way due to the fact that few banks individually undertook extensive lending to the Government. Moreover, while some banks showed clear signs of an aggressive approach and others were definitely conservative in their actions, there were others which acted in ways that were sometimes conservative and sometimes aggressive, depending upon the time and circumstances.

6. *Classifying the behaviour of the banks*

From the standpoint of national origin, generally aggressive behaviour was found in Japanese banks, United States (regional) banks and Italian banks and consortia, while generally conservative behaviour was found in British, Swiss and French banks. German institutions also on balance may be considered to have been conservative. Other national groups showed more mixed behaviour, being conservative or aggressive depending on the particular focus of action.

When the banks were viewed from the standpoint of size, generally no clear-cut behavioural patterns were revealed. It is interesting to note, however, that aggressive behaviour was often witnessed in the smallest banks, partly because consortia members fell into this latter category.

Moving to the level of individual institutions, one of the most aggressive lenders was

seen to be Wells Fargo, which came from a zero start to become a major creditor of the Government. Dresdner Bank, American Express International, Bank of Tokyo, Banca Commerciale Italiana, Bancal Tristate Corp. and Crocker National Bank were among the institutions that displayed generally aggressive behaviour. Openly conservative positions were found in Chemical Bank, Bankers Trust, Morgan Guaranty, Continental Illinois, Charter New York Corp., First Chicago, First National Bank of Boston and the National Detroit Corp. Some European banks alike Schrodgers, National and Commercial Banking, Crédit Lyonnais, Banque Français du Commerce Extérieur, Banque de l'Indochine et de Suez, Amro Bank Algemene, Bank Nederland and Banque Worms, to mention just a few, also showed generally conservative behaviour towards Peru. Other banks like Citicorp, Bank of America, Lloyds Bank, Chase Manhattan, Manufacturers Hanover and Bank of Nova Scotia showed varying degrees of aggressiveness and conservatism depending upon the circumstances.

With regard to the relative commitments of the banks (authorizations to Peru as a percentage of total assets),¹⁰ it was found that the public sector was generally a very minor element in the overall portfolio of the banks. However, within this context, in the 1970s consortium banks assumed by far the highest relative commitments (see table 7). Among regular banks, Wells Fargo, followed by American Express International and Bancal Tristate Corp., carried the highest relative commitments in Peru. In general, Peru's 'major' lenders of the sixties showed very similar relative commitments throughout the 12 years covered by the study. Exceptions were Bankers Trust, Continental Illinois, and to a lesser extent Manufacturers Hanover, which reduced their relative commitments in the period 1971-1976. Intermediate lenders of the 1960s such as First National Bank of Boston, Charter New York Corporation and National Detroit Corporation also seem to have reduced their commitments to Peru in the seventies.

¹⁰The reader should be reminded that the measurement excludes short-term debt.

Table 7

PERU: RELATIVE COMMITMENTS OF COMMERCIAL BANKS-TOTAL AUTHORIZATIONS
AS A PERCENTAGE OF TOTAL ASSETS, 1965-1970 AND 1971-1976^a
(100 = 0.499% of total assets)

1965-1970		1971-1976	
Level of commitments and names of banks ^b	International rank of bank ^c	Level of commitments and names of banks ^b	International rank of bank ^c
<i>High</i>		<i>High</i>	
100-80.0		>668.9	
Bankers Trust	11	Libra Bank	301 ^c
Continental Illinois	22	Euro American Bank	301 ^c
Manufacturers Hanover	5	668.9-510	
		Atlantic International Bank	301 ^c
<i>Intermediate</i>		Asian and Euro American Bank	301 ^c
79.9-60.0		509.9-343	
Bank of Nova Scotia	47	Banque Européene de Tokyo	301 ^c
Franklin National Bank	78	Associated Japanese Bank	301 ^c
59.9-40.0		342.9-175	
Schroders Ltd.	187	Iran Overseas Investment Bank	301
Charter New York Corp.	39	Western American Bank	301 ^c
Citicorp	2	Nippon European Bank	301 ^c
First National Bank of Boston	59	Japan International Bank	301 ^c
39.9-20.0		Banque de la Société Financière	
		Européene	301 ^c
Chase Manhattan	3	Wells Fargo	69
Bank of America	1	174.9-100	
National Detroit Corp.	57	Italian International Bank	301 ^c
Crocker National Bank	48	Bancal Tristate Corp.	199
Toronto Dominion Bank	54	United International Bank	301 ^c
		Inter-Union Bank	301 ^c
<i>Low</i>			
<20		London and Continental Banks Ltd.	301 ^c
Royal Bank of Canada	12	International Mexican Bank	301 ^c
Banca Commerciale Italiana	25	European Brazilian Bank	301 ^c
Morgan Guaranty Trust	6	American Express Int. Banking	233
Westdeutsche Landesbank Girozentrale	14	<i>Intermediate</i>	
Philadelphia National Bank	94	99.9-60	
Lloyds Bank	33	Bank of Nova Scotia	53
Western Bancorporation	8	Banque Commerciale pour l'Europe	
Bank of Tokyo	26	du Nord	195
		International Commercial Bank	301 ^c
		Crocker National Bank	79
		Fidelcor	203
		Philadelphia National Bank	144
		Toronto Dominion Bank	66
		Grindlays Bank	154
		Manufacturers Hanover	16
		First Pennsylvania Corp.	106
		C.I.T. Financial Corporation	210
		Banque Canadienne Nationale	130
		Banque Continentale du Luxemburg	301 ^c
		59.9-40	
		Banque Européenne de Crédit	301 ^c
		Bankers Trust	32
		Orion Bank	301 ^c
		Continental Illinois Bank	30
		Franklin National Bank	...
		Citicorp	2
		Royal Bank of Canada	22

1965-1970		1971-1976	
Levels of commitments and names of banks ^b	International rank of bank ^c	Level of commitments and names of banks ^b	International rank of bank ^c
		<i>Low</i>	
		39.9-20	
		Bank of Montreal	45
		Anthony Gibbs	301
		Industrial National Corp.	260
		U.B.A.F.	301 ^c
		Dresdner Bank	14
		Trade Development Bank	219
		Chase Manhattan	4
		Lloyds Bank	31
		First Chicago Corporation	35
		Bank of Tokyo	28
		Morgan Guaranty Trust	19
		Bank of America	1
		Shamut Corporation	248
		Nomura Securities	d
		Cleveland Trust Co.	151
		Midland and International Bank	301 ^c
		Banco de Santander	112
		Long Term Credit Bank	44
		Central Corp.	258
		Marine Midland Bank	77
		Banque Française du Commerce Extérieur	174
		Chemical Bank	23
		Banque Worms	286
		Schroders Ltd.	301
		Security Pacific Corp.	54
		Deutsche Bank	6
		Western Bancorporation	39
		Fuji Bank	13
		Swiss Volksbank	143
		20	
		Remainder of the banks in the study ^e	

Source: CEPAL, on the basis of official data.

^aIncludes only authorizations without a guarantee from an export credit agency.

^bAuthorizations calculated as a percentage of bank assets. The asset size for the period 1965-1970 is based on 1969 data presented in *The Banker*, June 1970; asset size for 1971-1976 is based on 1975 data presented in *The Banker*, June 1976. Where a bank did not rank in the top 300 of world banking, asset size was determined from 1975 balance sheet data of *The Banker* Research Unit's *Who Owns Whom in World Banking*, 1976. Other sources used to determine asset size were the *Japan Company Handbook* and *The Times 1000*. Banks for which no asset data could be secured were excluded from the exercise (see footnote e).

^cThe ranks are based on the list of the top 300 in world banking prepared by *The Banker*. The ranks for 1965-1970 are based on 1969 asset size presented in *The Banker*, June 1970; the ranks for 1971-1976 are based on asset size in 1975 as presented in *The Banker*, June 1976. Banks that did not figure in the top 300 are ranked as 301. The letter "c" in parenthesis designates a consortium bank.

^dNot ranked in *The Banker*.

^eThe following banks were excluded from the exercise: Banque de L'Union Européenne; Banque Internationale du Luxembourg; Balfour Williamson; Commerce Union Bank; La Salle National Bank; Rothschild Intercontinental Bank; Union Planters Bank; Banco Mexicano; Morgan Guaranty and Partners; Dow Banking Corporation; Algemene Bank Nederland; Comco International Bank; LTCB Asia Ltd.; Banque Arabe et Internationale d'Investissement; Trade Invest Bank and Trust Company; Banco Atlántico; Banco Nacional de Panamá; Banco de Bogotá; First National Bank of St. Louis; Bank Lev; Privatbank and Verwaltungsgesellschaft; Bank für Gemeinwirtschaft; Industrial Multinational Investment Ltd.; and Liberal Bank.

Some banks which had maintained or increased their relative commitments in the seventies can nevertheless still be classified as having had a restrictive attitude on exposure in Peru. Morgan Guaranty appeared cautious and kept a low profile until it decided in 1974 to take the symbolic role of heading the large syndicated credit to the Government that was part of a settlement of an investment dispute with the United States. Chemical Bank had an openly restrictive attitude on the Government and did not really initiate lending to the public sector until it participated on the above-mentioned syndicate with Morgan Guaranty. First Chicago also appears to have held back its exposure in Peru, entering the market only after the settlement of investment disputes with the United States.

Empirical tests for the period 1972-1976 suggested that as a rule banks discriminated risk through loan volume and not through the price of credit. While relative loan commitments among institutions showed great variation over time, there was practically no significant divergence by individual banks (and groups of banks) from the general market's interest margins and maturities for Peru. Thus it appears that over time individual banks generally could not resist market trends, nor reflect differential risk considerations in interest rates and maturities.¹¹

Some limited exceptions were found to the above. Empirical tests gave reason to suspect that commercial institutions whose size (by assets) ranked them in the range of 47-91 on a world scale (1975) consistently pursued a pricing policy on the high side of the market trends. Also Bankers Trust appears to have had a deliberately cautious policy and provided maturities that were significantly shorter than the market average, while Dai-Ichi Kangyo Bank appeared to extend significantly longer than average maturities. In addition, a miscellaneous category of banks that included institutions from countries generally outside the mainstream of international finance also showed a tendency to offer maturities signifi-

cantly longer than the market average. Lastly, the Banque Commerciale pour l'Europe du Nord consistently charged significantly higher than average margins on its loans, although this may have been offset by significantly longer than average maturities.

While over time few banks were able to formulate prices that diverged significantly from general market forces, some institutions clearly created inflection points in trends. The key bank in this regard was Wells Fargo. In 1972-1974 it repeatedly headed syndicates—heavily supported by Japanese institutions—that undercut prevailing market trends. This was quickly copied by other banks, thereby markedly lowering the average cost of Peru's credit.¹² To a lesser extent Dresdner Bank played a similar role. Banks which often supported the new trends were Bank of Tokyo and Crocker National Bank.

As part of traditional risk consideration commercial banks have preferred to finance income-generating projects and have been less enthusiastic about refinance, balance-of-payments support and loans of free disposition. Thus, sectoral preference has been for income-generating primary production activities. However, in the seventies most aggressive lenders abandoned this tradition and revealed little preference for specific sectors or types of loans. The big, experienced international banks also showed little preference in this regard.

Aggregating banks into country groups revealed certain preferences with regard to traditional and non-traditional behaviour. Traditional, conservative preferences relating to sectors and types of loans were found in British, German and Swiss banks, and to a lesser extent in French and Canadian institutions, whereas bolder, non-traditional behaviour was found in Japanese, Italian and America banks, as well as consortia. A miscellaneous group of banks from countries generally out-

¹¹The data suggest that fees played a greater role in risk discrimination, but the limitations on the survey prevented any conclusive tests in this area.

¹²Wells Fargo is a good example of a case where personal rapport between bank and government authorities can influence lending behaviour: it is well known that a high-level official of Wells Fargo's international lending operations was a Peruvian national who had worked as an executive in that country's Central Bank during the Belaúnde administration.

side the mainstream of international finance also acted outside traditional preference patterns. On the other hand there was no clear-cut functional relationship between revealed preferences for sectors/types of loans and the size of the banking institutions. However, it is interesting to note that many intermediate-sized banks revealed preferences for traditional behaviour, while small banks did not.

As regards preferences for external protection, the banks most inclined to use guarantees of home country export credit agencies appeared to be the French and British institutions. A group of banks from countries outside the mainstream of international finance also had a high proportion of its lending to Peru covered by such guarantees. Banks which appeared to lend to Peru with little or no insurance from home country governments were the United States, Japanese, German, Italian, Canadian and Swiss institutions.¹³ At the level of individual institutions, banks with a high proclivity to protect their loans with home country guarantees were the National and Commercial Banking Group, *Crédit Lyonnais*, *Banque Française du Commerce Extérieur*, *Banque de l'Indochine et de Suez*, *Amro Bank Algemene*, *Bank Nederland*, *Banque Worms*, and *Banco do Brasil*, to mention just a few.

When banks were grouped according to size, there was some evidence that the frequency of use of home country guarantees increased as the size of the bank decreased.

As for the behaviour of lead banks in syndicated loans, it was found that the aggressive newcomers —e.g., *Wells Fargo*— employed strategies that were different from those of the big, internationally established banks. First, the former gained mandates for syndication through offers to undercut prevailing market terms. Second, they established working relationships with a wide variety of newcomers that were willing to price cut as well. Working relationships reflected them-

selves in relatively large clusters of banks that repeatedly participated in syndicates led by the newcomer. Internationally established banks like *Citicorp* had less recourse to price cutting and maintained only a limited number of working relationships, which interestingly enough, often involved other big, internationally established banks.

There was some evidence that banks which carried on local operations in Peru via branches or subsidiaries (see table 8) occasionally altered the pattern of their foreign currency lending to the Government out of concern for protecting local business interests. However, there were no conclusive patterns established in this regard, making one suspect that most 'protective' lending was done by the local operation itself and in local currency.

In the restrictive environment of international markets after mid-1974 and the open economic crisis in Peru in late 1975, the Government encountered a generally reserved banking community. However, some banks took a more flexible position in negotiations than others. Many aggressive newcomers of the early 1970s with significant exposure in Peru —e.g., *Crocker National* and *Bancal Tristate*— simply retrenched and even did not participate in general refinance accords arranged by the banks in 1976. Other banks maintained their interface with the Government, but took the position of hardline adversaries with regard to the authorities' efforts to avoid the IMF and reduce the social and political costs of adjustment. Among the banks in this second group were *Morgan Guaranty*, *Bankers Trust* and *Continental Illinois*. *Chase Manhattan* would also fall in this group, especially because it continuously conditioned its co-operation on the way the authorities treated the *Southern Peru Copper Corp.* Another group of banks took a softer and relatively more flexible position (within a commercial context) in negotiations with the governments. *Dresdner Bank* and *Bank of Nova Scotia* stand out in this regard. One could also place *Crédit Lyonnais* and *Manufacturers Hanover* in the group of 'soft-line' banks. Despite a noticeable hardening of *Citibank's* position in 1977, it too may be considered to have had a rather flexible attitude in negotiations during the economic crisis.

¹³These findings should be viewed with care, since the borrower is not always aware of the presence of external guarantors on his commercial credit. It should also be noted that the United States Export-Import Bank kept its doors closed to Peru through much of the early 1970s, thereby precluding guarantees for United States banks.

If behaviour in the post-1975 crisis is analysed on the basis of national origin, it is seen that the most flexible lenders *vis-à-vis* the Peruvian position were the European banks. The hard-line adversaries were mostly United

States institutions, which incidentally, had by far the greatest exposure in Peru. The Japanese did not appear to take a strong position, but rather followed bargaining trends which were usually dominated by the United States banks.

Table 8

PERU: BANKS WITH BRANCHES, SUBSIDIARIES OR AFFILIATES IN PERU AND THEIR IMPORTANCE AS LENDERS TO THE GOVERNMENT, 1965-1970 AND 1971-1976

Name	Date of establishment	Importance as a lender to Peru ^a		Relative commitment to Peru ^b		Importance as lead bank ^c	
		1965-1970	1971-1976	1965-1970	1971-1976	As agent and/or manager	As agent only
<i>Branches</i>							
Citicorp	1920	Major	Major	Intermediate	Intermediate	Major	Major
Lloyds Bank	1936	Minor	Intermediate	Low	Low	Intermediate	Minor
Bank of Tokyo	1965	Minor	Intermediate	Low	Low	Intermediate	Intermediate
Bank of America	1966	Major	Major	Intermediate	Low	Intermediate	—
<i>Subsidiaries or affiliates</i>							
Banca Commerciale Italiana ^d	...	Minor	Intermediate	Low	Low	Minor	Minor
Crédit Lyonnais ^e	...	—	Intermediate	—	Low	Minor	Minor
<i>Banks with firms in Peru until 1970</i>							
Chase Manhattan ^f	1964-1965	Major	Major	Low	Low	Intermediate	Minor
Chemical Bank ^g	1966-1967	—	Intermediate	—	Low	Intermediate	—
Royal Bank of Canada ^h	1920's	Minor	Intermediate	Low	Intermediate	Intermediate	—

Source: CEPAL, on the basis of official data.

^a Based on gross authorizations in each period.

^b Based on gross authorizations scaled to size.

^c Based on data on syndicated credits.

^d Major foreign owner of Banco de Crédito. Before banking reform laws this institution, through its affiliate Sudameris, owned 62% of the local bank's stock. This was reduced to less than 20% under the banking reform laws.

^e Had a large holding in the Banco de Lima. As a result of the banking reform laws its share was reduced to less than 20%.

^f Bought 51% of Banco Continental. Was nationalized in 1970 by the Government under the banking reform laws.

^g Was a major shareholder in Banco Internacional. Bought out by the Government in 1970 under the banking reform laws.

^h Closed its branch in the latter half of the 1960's.

II

Impact of commercial bank lending on the economic development of Peru

Up to now analysis has focussed on very specific aspects of the impact of bank lending on Peru. This section will attempt a more global evaluation of the effects of commercial banks on the Peruvian economy. Since it is virtually impossible to empirically isolate the impact of commercial bank loans from other financial, real and political aspects of the economy, any general evaluation of this sort must have a more than usual degree of normative content. Thus, a similar examination undertaken by an individual with another perspective could generate very different findings. No absolute truths are posited here; the reader must ultimately judge the following arguments on their merits and draw his own conclusions.

The positive aspects. In the period 1965-1968 banks were not a major source of finance for the government. However, at the margin they provided important resources that bridged the gap in fiscal and foreign exchange resources during 1966-1968. Subsequently, beginning in 1972, the banks provided important external savings (see again figure 1) and played a crucial role in the development of the country, both in absolute and relative terms. Moreover, it is clear that the appearance of new commercial lenders in 1972 provided Peru with a way of breaking the grip of the financial blockade instituted by hegemonic powers in the centre and possibly also supported by Peru's traditional commercial lenders, who in 1969-1971 extended loans in a very restricted fashion, i.e., only for refinance and then on very onerous terms and subject to conditions restricting future indebtedness. Moreover, not only did the volume of bank credit increase dramatically as from 1972, but competition for Peru's business also created an environment where lending was virtually unconditional and no questions were asked about the use of credit. Even in the more restricted environment of the post-1974 period, banks displayed flexibility by agreeing in 1976 to Peru's request

for refinance of its debt without the interference of an IMF standby agreement.

Another potentially positive aspect of bank loans involves the external sector. With the virtual stagnation of export growth in the seventies, commercial bank loans were the single key element supporting the rapidly growing capacity to import foreign goods and services during the period (see table 9). This growth in import capacity was accompanied by unprecedented expansion of domestic consumption and, at the same time, investment. The cushion provided by imports permitted domestic demand to expand by margins in excess of the domestic product that were large with respect to previous trends in Peru and with respect to current trends in Latin America (see table 10). Accompanying this growth in domestic demand there was significant reduction in unemployment and growth in real wages.

Commercial banks also made a large contribution to public finances in 1972-1975. Over this period government deficits were very large, as was recourse to external finance, the latter dominated of course by commercial banks (see table 11). More specifically, by continuously refinancing the government's external debt, commercial banks freed resources for investment and consumption and a large mass of free disposition credits enabled the Government to build up reserves, or employ them as it wished. And while banks were not overwhelmingly involved in project finance, they supported ventures of high national priority which were not easily financed, such as the trans-Andean oil pipeline and the Cerro Verde copper mine (as well as the Cuajone project in the private sector). Moreover, banks regularly covered the local costs of projects. Finally, considerable finance was also extended to cover compensation for nationalized foreign firms, thereby helping to defuse potentially explosive investment disputes.

Table 9

PERU: EVOLUTION OF CAPACITY TO IMPORT, 1960-1976
(Millions of 1970 dollars; annual averages)

Year	Financial flows (net) ^a							Capacity to import (1+2)
	Purchasing power of exports ^b	Total (6+7)	Foreign flows				Other ^f	
			Direct foreign investment ^c	Loans ^d	Other ^e	Total (3+4+5)		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
1960-1964	754	-38	-66	49	-	-17	-21	716
1965-1970	1 023	-15	-104	77	17	-10	-5	1 008
1971-1976	1 083	210	19	368	20	407	-197	1 293

Source: CEPAL, on the basis of official data.

^aDeflated by import price indexes.

^bExports adjusted for the effects of the terms of trade. Includes non-requested transfers.

^cNet direct foreign investment less profit remittances.

^dGross non-compensatory short, medium and long-term loans, less amortization and interest payments.

^eNet of donations, SDRs, and amortization of compensatory loans.

^fNet movement of assets of residents, and errors and omissions.

Table 10

PERU: GROWTH OF DOMESTIC DEMAND AND PRODUCT IN COMPARISON WITH LATIN AMERICA, 1972-1975^a

(Average annual rates of growth)

	Peru	Latin America
Consumption	6.9	5.5
Investment	13.9	12.0
Domestic demand	8.1	7.0
Gross domestic product	5.6	6.5

Source: CEPAL, on the basis of official data.

^aBased on market prices in 1970 U.S. dollars.

The negative aspects. When viewed from another angle, however, many aspects of the banks' involvement in the economy can be viewed as being less fortunate.

One of the major preoccupations about bank involvement in the Peruvian economy is that their finance may have lulled public authorities into a false sense of security. In 1969-1971, the Government used deep resolve

and discipline to overcome a full-scale external economic blockade and despite a hostile environment the authorities managed to achieve more than respectable rates of growth, reductions in unemployment, increases in real wages, etc., all while significantly reforming relations with foreign and domestic private capital (the after-effects of the 1967-1968 crisis were only a small element in this performance:

Table 11

PERU: CENTRAL GOVERNMENT FISCAL DEFICIT AND ITS FINANCE, 1966-1968; 1969-1971; 1972-1975; AND 1976

	Average			1976
	1966-1968	1969-1971	1972-1975	
Fiscal deficit (billions of soles) ^a	4.8	3.9	17.4	48.4
Deficit as percentage of expenditure ^a	16.3	9.3	21.4	30.3
Finance of the deficit (net)				
Percentage externally financed	47.2	18.0	51.8	32.2
Percentage internally financed	52.8	82.0	48.2	67.8
<i>Total finance percentage</i>	<i>100</i>	<i>100</i>	<i>100</i>	<i>100</i>

Source: CEPAL, on the basis of official data.

^aExcludes amortization of the public debt.

see table 12). However, beginning in 1972—which corresponds to the period when banks entered the economy *en masse*—the economic discipline of the régime began to weaken. With a *carte blanche* from commercial lenders Peru found it could import without adequate concern for exports; invest without adequate concern for import content or an adequate mix of gestation periods; consume food without effective programmes for local production; and spend despite a stagnant or declining local tax effort (see table 13). In this permissive environment, the economy's dependence on external finance and banks became paramount. Thus, a programme originally designed to eliminate dependence on foreign capital ir-

nically evolved, instead, in such a way as to trade foreign firms for foreign banks. The new type of interface with foreign capital was complicated, and the economy clearly became as vulnerable as ever to outside influences.

Had the banks continued to display unlimited willingness to bankroll Peru's economy without interfering in any way the issue of vulnerability would not be relevant. There was, however, a general retrenchment in world banking in 1975; and as bankers became more reluctant to finance and the terms of loans became more onerous, the veil of finance became more transparent, showing behind it an economy which was structurally very weak. In 1976 the bankers panicked and attempted to

Table 12

PERU: EVOLUTION OF EXPENDITURES AND GROSS DOMESTIC PRODUCT, 1966-1971
(Index based on 1970 soles with 1966 = 100)

	1966	1967	1968	1969	1970	1971
Private consumption	100	102.5	103.5	109.9	120.6	125.5
Public consumption	100	105.5	111.3	114.1	123.7	131.7
Fixed investment	100	92.5	78.7	80.9	90.1	99.2
Domestic demand	100	101.8	97.6	102.7	112.4	120.5
Exports	100	101.5	112.8	108.1	112.9	103.1
Imports	100	102.5	89.3	87.5	92.3	92.5
Gross domestic product	100	101.6	102.3	106.8	116.5	122.5

Source: CEPAL, on the basis of official data.

Table 13
 PERU: TRADE AND FISCAL TRENDS
 (Percentage of GDP)

	1960 1964	1967	1970	1971	1972	1973	1974	1975	1976
Export coefficient	23.1	20.4	19.7	17.2	17.5	14.1	12.7	11.5	11.7
Import coefficient	16.1	20.0	15.7	14.9	14.4	16.3	20.2	21.8	17.7
Fiscal revenue	14.2 ^a	15.1	16.1	15.7	15.5	14.9	15.3	15.8	14.5
Fiscal expenditure	... ^a	20.2	19.9	21.8	22.2	23.2	22.1	23.7	22.9

Source: CEPAL, on the basis of official data.

^a1962-1964.

force Peru into an IMF stabilization programme, but subsequently, seeing Peru's resistance and recognizing their own leverage, the banks experimented with explicit balance-of-payments support on their own. Moreover, no longer did they refrain from interfering: not only were banks formally monitoring the economic policy of the Government, but they also began to protect the interests of their TNC clients. Thus banks once again became interventionist.

While the commercial banks thus started to intervene in the economy, they nevertheless provided Peru with unquestioned finance in the seventies, notwithstanding economic policies that promoted ever more inflated reliance on foreign resources. If the banks were aware of underlying trends—as they should have been—then they too must have been placing their faith, as did the Peruvians, in the long-term payouts on investments in petroleum, mining, etc. If they were not aware of trends, then their lending behaviour must be deemed to have been reckless. In either case, however, their tacit support of government policies in the first half of the seventies would lead one to have expected, ideally, that the banks would have borne the consequences of their decisions and have helped Peru overcome the difficulties without grave social costs. As it was, as soon as it became apparent that the momentum of past policies—which the banks unquestionably supported—could not be broken easily, and that the mixture of politics and economics was not ripe for the harsh adjustment needed to

squeeze foreign exchange out of the economy for servicing the debt, the bankers lost their confidence and held back finance until Peru submitted to the even tougher requirements of the IMF.

Banks thus proved to be an ephemeral source of finance for an LDC unable to make quick and hard decisions about economic adjustments. Things might have been different of course, if from the very start Peru had displayed restraint and carefully screened the overtures of commercial lenders for credit. But even if this had been the case commercial finance would still have proved inadequate from the standpoint of providing appropriate maturities for development needs. In the period 1971-1976, Peru's commercial maturities averaged just 7 years, suitable for only the most commercial of ventures. Social infrastructure, of course, can sometimes take up to a generation to pay off, and therefore needs much longer maturities than commercial banks could offer. Even in the commercial sphere 7-year maturities may be too short, because many projects involve infant industries that can have payouts that are much more extended than identical activities in the industrialized countries. This is quite apart from prolongation of payouts due to mistakes or the unforeseen events—such as falls in export prices—that are very common occurrences in LDCs.

This latter issue is important and has implications beyond the Peruvian case: clearly, the lack of symmetry between the long-run requirements of development and the short to

medium-term nature of commercial bank finance places serious obstacles in the way of broad-based socio-economic development. There are a variety of ways in which policy-makers can confront the problem. But in order to illustrate the gravity of the matter for a country that is heavily indebted to commercial banks, one can simplify and reduce policy options to basically two: (i) to focus development strategies on activities with high short-term private commercial rates of return and wait for social development to 'trickle down' to the population; or (ii) to seek balanced socio-economic development today and hope that the banks refinance their short maturities.

The first option might prove attractive to conservative financial managers, but unfortunately experience has shown that 'trickle down' strategies are often worse than useless, acting merely as an excuse for unnecessary postponement of social reform and reasonably balanced income distribution. Likewise, they have been associated with régimes that exclude large segments of society from political participation.

It has already been seen that banks do indeed sometimes refinance (albeit perhaps reluctantly), making option two technically feasible. However, refinance is a terribly awkward way to accommodate the long gestation period of development, since a borrower becomes very vulnerable to the volatile lending terms in commercial markets. If refinance is sought in a borrowers' market, such as 1972-1974, the results can be attractive, with new credits car-

rying low margins and longer maturities. However, if refinance takes place in a lenders' market, as in 1975-1976, the results can be counterproductive to development. Not only may access to credit be difficult, but interest margins will be distressingly high and maturities uncommonly short. This causes bulges in debt service payments, complicates debt management and generates more requirements for refinance. In this type of environment debt service can prove to be more burdensome, making bankers concerned about the country and thereby further aggravating borrowing conditions. As government authorities become preoccupied about the bankers' view of their country's creditworthiness, economic policy can drift away from broad-based socio-economic development strategies into a more narrow approach stressing ventures with high short-term private rates of return and an excessively liquid external payments sector.

If the need to refinance occurs under conditions of open economic duress, as in the case of Peru in 1976, the results can be disastrous to development. Banks, seeking to squeeze out foreign exchange for debt service, become interventionist either in a direct manner, by imposing through the placement of requirements on government policy, or indirectly by forcing the authorities to submit to IMF scrutiny. Moreover, any relief provided by the banks is very short-term in nature, made available on onerous terms and accompanied by considerable social costs and setbacks to the process of development.

III

Some conclusions and recommendations

The purpose of this section is to draw some conclusions about commercial bank lending on the basis of the study of the Peruvian experience. Firm conclusions are, of course, difficult to formulate because of the uncertainties of generalizing from a one-country case and because retrospective analysis of the type performed here can be eclipsed by the fast changing events in world banking. Nonethe-

less, in the absence of more precise analysis of the experience of other borrowers, there are at least two reasons to suspect that general lessons and tentative policy conclusions are indeed to be drawn from this in-depth study.

Firstly, a significant number of the symptoms of the Peruvian case are seemingly apparent in a number of other developing countries (e.g., Jamaica, Bolivia, Zaïre, maybe Ni-

caragua) that have borrowed from banks; furthermore, as debt piles up in the Third World, and should more domestic political régimes evolve towards democratic processes, the aforementioned list could very well expand, even perhaps incorporating some of the so-called successful developing country borrowers. Secondly, while banks undoubtedly have learned from past errors and will attempt to adjust lending accordingly, much of their behaviour is induced by their private-commercial institutional makeup and therefore there is little reason to expect radical alteration of their attitudes in the medium term. Thus, subject to this preliminary warning the following paragraphs will posit some general conclusions and recommendations.

The research raises serious questions about the dominant role of commercial banks in the external finance of developing countries. Their appearance in the 1970s certainly provided LDCs with a new and useful financial instrument, but this new instrument appears to demand caution due to its limitations *vis-à-vis* the requirements of development. It has been found that the maturities that banks have offered on their loans, even under the best of circumstances, have been very short relative to the long gestation period of many activities related to broad-based socio-economic development. Nor has refinance been shown to be an adequate way to overcome the short maturity spectrum. In the case of Peru, banks have also displayed highly erratic lending patterns both in terms of the amount of credit available and its costs and conditions. When banks were in an expansive mood in the early 1970s they aggressively extended no-questions-asked finance to the Government. Facing seemingly unlimited external finance, an inexperienced public sector thought that it could make a dash for development while avoiding timely (and politically disagreeable) adjustments in economic policy; indeed, the bankers' loans masked underlying structural and policy weaknesses in the economy to such a degree that many banks themselves apparently did not anticipate the ensuing problems. Only when financial imbalances became grossly exaggerated did the bankers react. Then, when the authorities attempted to adjust the economy, the banks limited their

loans to the refinance of prior debt on extremely harsh terms, a response which served as a mere stopgap measure rather than real relief from debt service. Moreover, it has been shown that the banks intervened in the domestic affairs of Peru and exerted pressure to protect the interests of their TNC clients at the moments of the borrower's greatest vulnerability. As soon as it became apparent that the adjustment process could not be effected rapidly because of internal resistance to the social and political costs required to squeeze out foreign exchange for debt service, the bankers panicked and refused to extend any credit unless Peru deflated its economy according to the IMF prescription. Thus, commercial banks provided evidence that they are not equipped to cope with the economic dislocation and uncertainties that often arise in developing countries, particularly in periods of economic crisis.¹⁴ Indeed, employing a popular joke of the period of financial crisis in the 1930s, bank loans to Peru have appeared as "an umbrella which a man is allowed to borrow as long as the weather is fine but which he has to return the moment it starts raining".¹⁵

The underlying problem appears to be that commercial banks are not development institutions and their private commercial time and risk preferences make it difficult, if not impossible, for them to fully accommodate the broader socio-economic goals of development, which are long-term in nature and based on social rates of return.

There are several factors which seem to seriously restrict the behaviour of commercial banks. First, they are profit-oriented institutions which operate on the basis of private rates of return. They may internalize social rates of

¹⁴In theory the economic crisis could have been quickly overcome (or of course avoided altogether) through timely economic policy measures. However, in the real world economic criteria are often overridden by more immediate social and political considerations. In poor countries—especially those with a significant degree of political participation—these latter forces can be very strong. Thus, while economic discipline is to be encouraged, recurrent and prolonged economic crises are an unfortunate reality which we must all confront.

¹⁵Taken from Ragnar Nurkse, *Problems of Capital Formation in Under-Developed Countries*, Oxford, England, Basil Blackwell, 1953, p. 135.

return in their lending only to the extent that the latter enhances the former, and in any case the gestation period for such a feedback process tends to be rather long.

Second, the great majority of bankers' resources come from call or short-term time deposits,¹⁶ and this places limits on the degree to which banks can prudently mismatch maturities, i.e., lend long on short funds. Thus, the nature of the resource base gives these institutions only a short to medium-term time horizon with regard to lending.

Third, as bankers will readily admit, they have a special concern for minimizing risk. This is partly a matter of tradition, but also reflects the reality that banks operate with other people's money and must ensure the safety of deposits if access to resources is to be maintained. This leads to a conservative view of life where 'caution and prudence' are usually the watchwords for lending operations. When viewing prospective loans to developing countries, bankers are naturally primarily interested in the prospects for repayment. It is not surprising, then, that short-term liquidity indicators (as opposed to development indicators) dominate creditworthiness criteria; good management is synonymous with assurance of liquidity to service debts, even if this means deflation of the local economy to free foreign exchange.

If banks depart from the conservative mould dictated by institutional constraints—as in the brief period of the early 1970s—the institutional contradictions and the criticism from regulatory authorities build up, forcing them to rediscover so-called prudent banking practices. In these circumstances lending conditions contract and borrowing countries face a very difficult external environment, often causing setbacks to development which they can ill afford; banks, in contrast, appear to lose nothing as their short rollover credits ensure repayment and profits.

The Peruvian experience suggests that commercial bank finance has many characteris-

tics which are out of keeping with the requirements of development. While ideally suited as intermediaries of short-term fund for trade and working capital (a function banks have had for centuries), there is evidence that they find it difficult to satisfy the requirements of long-term development finance and that their time and risk preferences make them a rather unreliable source of finance for structural balance-of-payments problems. It would seem, then, that commercial banks are not an adequate substitute for long-term official finance and access to private bond markets. Indeed, in the case of developing countries such as Peru where public policy suffered from the inexperience of those responsible for shaping it and/or severe domestic pressures for economic growth cum social reform, banks clearly acted as an extremely poor substitute. Peru has suffered the consequences and undoubtedly other countries will too. One would think that the international community should be seeking alternatives to the present system of bank-dominated external finance, which has evolved in an *ad hoc* fashion and which appears to function in a manner that leaves unfulfilled many of the basic requirements of development finance.

Unfortunately, while there is evidence to suggest that commercial banks—for reasons which are not completely their own—are excessively enmeshed in the overall finance of developing countries, there is an unfortunate intellectual and political inertia in the industrialized countries as regards revitalizing alternative sources of finance, especially when programmes aimed at this may involve greater contributions to multilateral agencies, which would appear to be in many circumstances a very suitable source of development finance. Thus, in the harsh world of political reality it must be assumed that barring a collapse of world finance, commercial banks will continue for the immediate future to be the major source of development finance for upper-income developing countries such as those of Latin America. How then can we make the best of an unsatisfactory international financial system for development?

The immediate goal should be to hone down the sharper edges of bank lending beha-

¹⁶For example, in 1976, 61% of Citicorp's total deposits had an average maturity of only 90 days. See Chandra Hardy, "Commercial Bank Lending to Developing Countries: Supply Constraints", *World Development*, Vol. II, No. 2, February 1979, p. 192.

viour. The scope for change is limited by the fact that many problems are intrinsic to the institution of private commercial banking itself. Also, change is handicapped by the fact that there are hundreds of banks operating internationally, with no supervision over their liquidity or behaviour. Nevertheless, it would seem that some action may be taken to alleviate the situation without violating the boundaries of prudent banking.

As a general rule commercial banks could take greater care to operate in areas where they are institutionally most comfortable in the long run and therefore reduce the possibilities of radical alteration of behaviour that is disruptive to market stability and the development of developing country borrowers.

In this spirit, banks could consider concentrating their lending in traditional areas of competence, i.e., short-term working capital or medium-term commercial investment finance. Moreover, banks could avoid lending to commercial ventures merely on the basis of a government guarantee; rather, it might be advisable to coldly evaluate ventures on commercial (and not political) grounds with a view to assessing the real repayment prospects of the venture itself. In other words, banks should cease to treat governments as if they had some type of fail-safe repayment mechanism; lending of commercial ventures should conform to some standards of commercial viability.

Following the above prescription, commercial banks could avoid direct balance-of-payments finance when problems are clearly associated with socio-economic structure as opposed to short-term illiquidity. Experience has shown that banks are incapable of absorbing the political-economic shocks that, as noted earlier, are frequently an unfortunate reality accompanying the adjustment process in developing countries; they are also not suited to be involved in public macroeconomic policy making. So why enter terrain that ultimately may require a quick and disruptive retreat? Of course, it would be feasible for banks to avoid direct balance-of-payments support only if countries came to feel more comfortable with the IMF and if more financial resources could be disbursed from multilateral development agencies. Thus it would be desirable for the

IMF once and for all to moderate its conditionality and adopt a pluralistic and longer-term methodology for tackling the adjustment problem; also, much more medium-term programme lending from the World Bank and IDB would be needed if banks are to avoid direct balance-of-payments finance.

Commercial banks, of course, will frequently be asked to refinance their loans, which is the same thing as indirect balance-of-payments support. Refinance should be considered a natural way of relieving repayment difficulties, and borrowers undergoing adjustment should not be burdened with punitive terms such as much higher than average interest margins and fees, and shorter than average maturities. It must be remembered that the real capacity of almost all borrowers to meet their debt service commitments hinges on the refinance and rollover process; since most developing countries run heavy deficits on current transactions debt is almost always repaid with new debt. Thus, to weigh a weakened borrower down with high interest margins and short maturities may actually induce new problems and increase the risk of non-payment rather than reduce it. In the case where a developing country faces internal structural difficulties and bunched maturities, banks could show less reluctance to enter into rescheduling agreements. A medium-term rescheduling of principal could be viewed as a routine way to provide relief for economic development and reduce risks of non-payment. If interest payments are kept current, as they should be, banks would encounter extra book-keeping work, but not necessarily losses of income.¹⁷

Commercial banks could also take a broader view of the prepayment/refinance strategies of developing country borrowers, and keep to a minimum the penalties and other restrictions related to such activities. This is not to imply that prepayment or refinance is a 'right' of the borrower. Such strategies are undoubtedly troublesome to a bank; for not only does it lose a

¹⁷Since risk premiums have been charged on loans, one could even envisage concessional interest rates (i.e., losses) when rescheduling debts of especially hard pressed (quasi-bankrupt) borrowers.

profitable loan, but it also receives unwanted liquidity, unless the bank itself participates in the new credit, and moreover banks cannot call for *ex post* adjustment of the terms of an old loan when market conditions shift in their favour. Nevertheless, this is a situation in which what appears to be rational action on the part of an individual bank could be detrimental to all concerned in the aggregate. This is because a developing country borrower which can trade in old loans for more favourable terms can thus alleviate the effects of the constantly changing terms on credit markets and will therefore be a better overall credit risk and will generally have increased capacity to assume new debt from the banks.

There are three other specific areas where banks could alter their behaviour:

(i) One is that banks might seek more long-term funds, so as to reduce their dependency on short-term deposits and thus be able to prudently lengthen maturities. Some banks such as Citicorp have already attempted to do this, but hopefully the strategy will become more intensive and generalized in the world banking community.¹⁸

(ii) Banks might reconsider the need to act as world policemen for TNCs. When TNCs invest in a country (and banks help them) all parties take calculated risks based on the returns on capital. Thus, lending to a developing country government must be viewed as a separate business transaction and should not be linked to the fortunes of a locally-based TNC. In the early 1970s banks showed that there does not have to be a connexion between a government's treatment of foreign investment and successful business relations between them and a government. So why renew the ancient practice of fronting for TNCs?

(iii) Banks could avoid offending the sensibilities of developing country borrowers through demands to waive sovereign immunity and local jurisdiction over loan agreements. As an alternative to the traditional practice, one

could envisage greater employment of international arbitration as a way to satisfy a bank's requirements for security and a government's desire to avoid an alien country's legal system.

Another major area of change would be to bring commercial lending out into the open. Lenders (and sometimes borrowers) behave in ways which shroud transactions in secrecy. This ultimately benefits the banks, which can 'fragment' markets to their advantage as regards the establishment of the terms and conditions of credit. A more perfect flow of information on the details of loan transactions by individual banks can only enhance the bargaining position of developing countries. It must be remembered that the study has found that commercial banks did not act as a homogeneous group; rather in many important ways they displayed distinct modes of behaviour. In the bargaining environment it is important for developing country borrowers to be aware of these distinctions so that they can tailor their interface with commercial institutions in ways which are supportive of national development objectives. However, there is little institutional analysis available on the behaviour of specific lenders and their loan agreements, making it difficult for new borrowers to map out *ex ante* strategies for negotiations with individual institutions. Under present circumstances, borrowers can only begin to know the differences in the behaviour of banks after long experience, and this 'learning by doing' mode can be difficult and full of unnecessary and costly pitfalls. Moreover, the resulting evaluations of the banks may be informal rather than systematic.

To overcome these problems, researchers and international organizations must make a greater effort to analyse the institutional behaviour of commercial lenders. As long as banks remain reticent about revealing the exact nature of their interface with developing countries, the most productive way to go about this would seem to be detailed case studies such as this one, which could accumulate to reveal more about the lending behaviour of specific institutions.¹⁹ Indeed, an international organi-

¹⁸In many cases there are legal restrictions on long-term funding by commercial banks. National regulatory authorities might therefore want to reconsider their policies in this area.

¹⁹CEPAL is following up the Peruvian project with a similar study on Bolivia. See the article by M. Mortimore in this same issue of *CEPAL Review*.

zation such as the United Nations Centre on Transnational Corporations, the World Bank, or a new special institution sponsored by developing countries themselves, could set up a reporting system whereby developing country borrowers would provide copies of credit agreements with commercial banks. Using these data the organization in turn could systematically analyse the evolving behaviour of individual banks both with regard to individual borrowers and groups of borrowers. The findings could be disseminated to governments participating in the system, providing a view on banks that would be more extensive than that available to any single borrower.²⁰ Such an arrangement would allow countries to effectively interchange views and experiences concerning specific lenders and permit them to adjust their negotiations with creditors accordingly. The interchange of information among borrowers about banks would also counterbalance the advantages enjoyed by bankers, who are increasingly gaining access to official data on the countries and who have the opportunity to exchange this information during their contacts in connexion with the organization of syndicates.

Of course, initially there may be resistance to such a system, since some borrowers can be very secretive about data concerning their activities with commercial banks. Thus work will

have to be done to overcome this problem. The advantages of such a system will have to be demonstrated to developing countries and confidentiality on individual transactions will have to be ensured. Notwithstanding these obstacles, a dialogue among developing country governments on this matter should be undertaken as soon as possible.

The last major conclusion of the study is that an unregulated international banking system appears to experience periodic supply-led expansion, requiring borrowers to show restraint in the face of bankers' overtures. In the early 1970s world liquidity and an unregulated Eurocurrency market fostered clear supply-led expansion of lending. After a period of retrenchment in 1975-1977, banks once again, under pressures of liquidity, began actively soliciting clients in developing countries. Since banks sometimes show little self-restraint, then borrowers must be prepared to do so. This suggests that (i) countries must pursue disciplined economic programmes; (ii) they must carefully control their interface with foreign finance in general and commercial finance in particular; and (iii) foreign finance must be viewed only as a complement to a vigorous national effort to generate savings for development. Moreover, when foreign resources are used, care should be taken to ensure that the way they are deployed is consistent with the cost and maturities of the credit. Restraint and sagacious deployment of resources is particularly important for small and medium-sized economies, where offers of commercial credit can easily exceed the real capacity of the economy to match commercial funds with appropriately commercial activities.

²⁰In the case of Peru the World Bank's tabulation of publicized Eurocurrency credits provided only a partial view of transactions with commercial banks. The data also provided only limited information on a syndicate, the conditions of the agreement, and the specific role of each bank in the operation.