

CEPAL

Review

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Renegotiation of Latin America's debt:

An analysis of the monopoly
power of private banks

*Robert T. Devlin**

In 1982 Latin America began to encounter serious difficulties in servicing its external debt and by mid-year most of the countries heavily in debt to the international private banks—their leading creditors—initiated negotiations to reprogramme payments. The Latin American debt was contracted during the 1970s in a highly competitive and expanding capital market, which afforded the countries an opportunity to obtain abundant loans on favourable terms. In view of the present depressive international conjuncture, however, many banks have stopped lending to Latin America. The flow of credit has therefore been severely reduced, and the market has been left in the hands of a few large international banks whose main activity has been the administration of their existing portfolio through the reprogramming of amortization and the refinancing of part of the interest payments, which has led to a drastic deterioration of credit terms and a substantial rise in the cost of borrowing. The present study maintains that this increase in the cost of the debt as a result of the renegotiation is nothing but a monopoly rent which is extracted from the countries by virtue of the emergence of a non-competitive capital market. It is suggested here that countries should explore ways of eliminating—totally or partly—these superprofits, because, in so far as they are rents, their non-payment should not prevent reprogramming of the debt or future access to credit.

In contrast to what happened during the 1930s, the so far bruited cost of weathering the financial crisis has been borne by the debtor countries, a politically untenable situation. To forestall the defaults that everyone would wish to prevent, formulas are suggested which may perhaps permit a more equitable distribution of the cost among the banks, their governments and the debtor countries.

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I

Introduction

Latin America's present debt crisis is very widespread. Since mid-1982 more than half the countries of the region have sought debt relief from their main foreign creditors: the international private banks (see table 1). Whereas the scope of the present crisis has had no precedent since the Second World War, there is nothing new, in contrast, about the problem of servicing bank debt, or the consequent need to reprogramme it. Before payments difficulties—which were highlighted in August 1982 when Mexican authorities officially recognized servicing problems—began to be a matter of general concern, a good many countries of the region which had contracted substantial debts with the private banks had already been faced with a debt crisis. During the 1970s Peru, Nicaragua, Bolivia and Jamaica were unable to meet their external debt commitments and accordingly decided to request from their private creditors a common formula for the relief of their situation.

Although the majority of the new requests for rescheduling are still being dealt with, they largely follow the general lines laid down by the private banks when the above-mentioned countries found themselves up against debt crises in the 1970s. Table 2 presents selected data on the agreements reached with the private banks by those Latin American countries that met with payments difficulties during the past decade. The study of these cases—together with others outside Latin America, such as those of Zaire and Sudan—makes it possible to sketch some essential features which give an idea of the character of the agreements concluded:

a) Negotiations between the private banks and the debtor country constituted a very slow and at times highly conflictive process and it took one or two years to reach the final agreements;¹

¹See W. Glasser and D. Roberts, "Bank lending to developing countries. Problems and prospects", in *Federal Reserve Bank of New York Quarterly Review*, Autumn, 1982, p. 27; and R. Devlin, *Los bancos transnacionales y el financiamiento externo de América Latina: La experiencia del Perú, 1965-1976*, Santiago, Chile, United Nations, 1980, E/CEPAL/G.1124, pp. 201-204.

Table 1
LATIN AMERICA: PROVISIONAL DATA ON THE RENEGOTIATION OF THE
EXTERNAL DEBT OF SELECTED COUNTRIES TO PRIVATE BANKS

(Billions of dollars)

Country	Global debt at end of		Renegotiation of the debt ^a			Credits approved during 1982 and January-April 1983			
	1981	1982	Initiation of negotiations	Amount	Maturities rescheduled	IMF BIS USA			New private bank credits
Argentina	35.7	38.7	Sept. 1982	13.00 ^b	Sept. 1982-1983	2.2	0.5(s)	—	1.1 bridge loan, 1.5(s)
Bolivia	2.5	2.8	Oct. 1982	... ^c	...	0.3(s)	—	—	—
Brazil	71.9	80.2	Dec. 1982	4.70 ^d	1983	6.0	1.2	1.5	4.4
Costa Rica	3.5	4.2	Sept. 1981	0.70 ^e	1982-1983	0.1	—	—	—
Cuba	3.2	...	Sept. 1982	0.34 ^f	Sept. 1982-1983	—	—	—	—
Chile	15.9	17.3	Jan. 1983	3.30 ^g	1983-1984	0.88	0.3	—	1.3(s)
Ecuador	5.9	6.3	Oct. 1982	2.48 ^h	Nov. 1982-1983	0.17	—	—	—
Honduras	1.7	1.9	July 1982	0.23	...	0.11	—	—	—
Mexico	72.0	81.4	Aug. 1982	20.00 ⁱ	Aug. 1982-1984	3.97	1.85	2.0	5.0
Nicaragua	2.2	2.4	... 1982	0.56 ^j	...	—	—	—	—
Peru	9.7	11.6	Jan. 1983	2.40 ^k	1983	0.94	—	—	0.45(s)
Dominican Republic	1.9	1.9	... 1982	0.15	...	0.46	—	—	—
Uruguay	3.1	4.0	Feb. 1983	0.71 ^l	1983-1984	0.46	—	—	0.24
Venezuela	28.0	30.0	Oct. 1982	15.80 ^m	1983-1984	2.8(s)	—	—	—

Source: ECLA, on the basis of official information supplied by countries and by various national and international sources.

Note: New credits are those granted by the international banks during the renegotiation process; (s) = solicited credits; BIS = Bank of International Settlements.

- ^a As at 30 April 1983, most of the countries were in the midst of renegotiation operations, and although significant progress had been made, the process had not been finalized.
- ^b Corresponds to amortization of public debt from 1982 and that falling due up to December 1983 (US\$ 6 billion). It also includes the private external debt guaranteed by Central Bank exchange rate insurance and maturing as from November 1982 (US\$ 5.5 billion), as well as to maturities relating to "swaps" (US\$ 1.5 billion).
- ^c At the end of March 1983 the international banks agreed to defer amortization and interest payments amounting to US\$ 460 million, a plan that will be formalized by the signature of an agreement.
- ^d At the end of 1982 a request was submitted to the foreign banks for new loans and refinancing amounting to US\$ 4.4 billion and US\$ 4.7 billion respectively. In February 1983 the international banks acceded to this request.
- ^e At the end of April 1983 it was reported that a provisional agreement had been signed with the leading creditor banks.
- ^f In August 1982 a request was submitted for postponement of the external debt service payments falling due between September 1982 and December 1983. In March 1983 an agreement was reached with the creditor banks for refinancing to the amount of US\$ 140 million.
- ^g Includes amortization payments falling due in the course of 1983 and 1984 (US\$ 2.1 billion) and the restructuring of short-term financial credits (US\$ 1.2 billion). At the end of April the government stated that it had reached an agreement with the 12 principal creditor banks on debt rescheduling and that negotiations were continuing with a view to obtaining new credits. While the renegotiation process is being completed the banks will extend for a further three months the postponement of payments granted on 1 February 1983.
- ^h Corresponds to servicing of the public debt between 1 November 1982 and 31 December 1983 (US\$ 1 220 million) and about 80% of the private debt (US\$ 1 260 million). In January 1983 an agreement was concluded with the international banks for the renegotiation of the public debt. Between October 1982 and January 1983 Ecuador, by common agreement with its creditors, had made no payments against the public debt.
- ⁱ Corresponds to the postponement of amortization payments authorized by the international banks on 20 August 1982 for a period of three months, subsequently extended to 23 March 1983. In February 1983 part of the external debt was renegotiated, at a period of eight years (a four-year grace period), being secured for the payment of US\$ 20 billion representing commitments between August 1982 and December 1984. Since renegotiation has not been fully completed, a further extension of the postponement of amortization payments up to August 1983 was requested.
- ^j During 1982 renegotiation for this sum was concluded.
- ^k This refers to the refinancing of short-term debt to the amount of US\$ 2 billion obtained in March 1983 and a request to refinance amortization, representing US\$ 430 million in the same year.
- ^l Corresponds to 90% of the amortization of short- and medium-term credits falling due in 1983 and 1984. At the beginning of March payments had been postponed for 90 days in agreement with the creditor banks. In April 1983 an agreement was reached with the committee of creditor banks.
- ^m Relates to the short- and medium-term public and private debt which it is desired to convert into a long-term debt with new guarantees. At the end of March the government stated that it will postpone amortization payments corresponding to April-June 1983.

Table 2
LATIN AMERICA AND THE CARIBBEAN: DEBT RENEGOTIATION AGREEMENTS WITH
PRIVATE BANKS THAT PRECEDED THE MEXICAN CRISIS

Country	Year	Amount reprogrammed ^a (millions of dollars)	Period covered by extension of maturities (number of years)	Amortization period (number of years)	Grace period (number of years)	Margin over LIBOR (%)	Commissions ^b (%)
Peru	1976	430	1	5	(2)	2 1/4	1 1/2
	1978	720	2	7	...	1 7/8	1/2
Nicaragua	1980	480	^c	12	(5)	1-1 3/4 ^d	—
Bolivia	1981	250	2	7	(4)	2 1/4	1 1/8
Jamaica	1982	88	2	5	(2)	2	1 1/2
							1 1/2 ^e

Source: Peru: R. Devlin, *Los bancos transnacionales y el financiamiento externo de América Latina: La experiencia del Perú, 1965-1976*, Santiago, Chile, United Nations, 1980, E/CEPAL/G.1124, pp. 170 and 203.

Nicaragua: R. Weinert, "Nicaragua's debt renegotiations", in *Cambridge Journal of Economics*, Vol. 5, No. 2, June 1981, pp. 187-192.

Bolivia: R. Devlin and M. Mortimore, *Los bancos transnacionales, el Estado y el endeudamiento externo de Bolivia*, Santiago, Chile, United Nations, Estudios e Informes de la CEPAL, No. 26, E/CEPAL/G.1251, 1983, p. 67.

Jamaica: Q. Peck Lin, "The borrower's trump card is his weakness", in *EuroMoney*, October 1982, p. 37.

^a Excluding amounts and terms of payment for that part of the debt which was in arrears.

^b Expressed as percentages of the face value of the loan and represents a flat payment at the time of signing the contract.

^c The entire outstanding balance of the bank debt was rescheduled.

^d The margin gradually increases from 1% to 1.75% while the agreement is in force, ending with an average of under 1.5%. Nicaragua pays a maximum rate of 7% up to the end of 1985. The difference between the current interest rate and the 7% ceiling will be capitalized and amortized between 1986 and 1990.

^e Paid at each maturity date.

b) Whereas the countries had originally contracted their debt in the highly competitive and dynamic credit market of the 1970s, when they began to have difficulties with debt servicing the credit environment deteriorated, since each bank attempted, on its own account, to reduce the borrower's participation in its loan portfolio; thus it was only a small group of very large banks that had to assume responsibility for seeking a common formula to tackle the problem;²

c) The time horizon of the private banks' plan was very limited; i.e., the relief formula provided for an extension of only one or two years of maturities; furthermore, only amortizations were reprogrammed, since the banks insisted that the borrower should not alter the schedule of interest payments;

d) The renegotiation of the debt was

linked to the attainment of a stand-by programme with the IMF;

e) The 'rescue' of borrowers did not include new loans; in effect, the renegotiation *per se* had a negative impact on a country's creditworthiness. Only in one case (Peru) was the borrower subsequently able to regain normal access to external credit; and this, owing to a vigorous reactivation of the country's external sector—mainly thanks to a rise in the prices of mining products, especially petroleum, in 1979-1980—which revived bankers' interests in loan operations;³

f) In renegotiation agreements the countries had to reckon with substantial increases in spreads over the London Interbank Offer Rate (LIBOR) and pay heavy commissions to the private banks on the occasion of signing the corresponding contracts;

²R. Devlin, "Commercial bank finance from the North and the economic development of the South: congruence and conflict", in *CEPAL Review* No. 9, Santiago, 1979, p. 69.

³See R. Devlin, *Los bancos transnacionales...*, E/CEPAL/G.1124, *op. cit.*, p. 204; and W. Glasser and D. Roberts, *op. cit.*, p. 27.

g) During negotiations the private banks exerted influence, in various ways, on the economic policy of the country concerned;⁴ and, lastly,

h) As a rule, the original renegotiations were followed by successive similar operations,⁵ since the relief afforded by the private banks did not lighten the debt burden sufficiently to prevent a rapid recrudescence of debt servicing difficulties; all this, of course, resulted in additional costs for the borrower.

A very significant departure from this general pattern is to be found in one case, that of Nicaragua. The agreement concluded by the Nicaraguan Government in 1981 is of great importance because it established a new principle in the field of renegotiation of external debt. When other countries encountered payments difficulties, the banks rescheduled the debt to avert the precedent of a default. But when they granted a restructuring of maturities, they applied strictly private payment criteria; that is, their aim was to minimize their own risks, to maintain or increase the rate of return on their assets and to impose a measure of 'discipline' on the borrower. The resulting agreement was extremely burdensome for the debtor, and left little or no room for economic growth. In con-

trast, the reprogramming of Nicaragua's debt was largely based on development criteria, as is reflected in the fact that it included a lengthy postponement of a considerable proportion of interest payments and unusually long maturities.

The characteristics of the Nicaraguan agreement can be appreciated in table 2 and in the article by R. Weinert cited in that table. For the purposes of the present paper, a singular feature should be highlighted: the economic authorities of Nicaragua managed to pay neither an increase in the margin over LIBOR nor commissions to the banks on the amount of the rescheduled debt. The present analysis — although it is in any event only a first step in complicated terrain — argues that commissions, increased spreads over LIBOR, and other forms of raising the cost of credit on rescheduled debt are no other than monopoly rents, or superprofits, gained by the private banks. Consequently, the Latin American countries that are currently renegotiating their debt might seriously explore means of totally or partly eliminating these rents — as Nicaragua has already done —, through negotiation of debt reschedulings that do not imply the payment of commissions or increases in the margin over LIBOR.

II

Is there any economic justification for the spreads and commissions charged by the private banks in debt reschedulings?

The Nicaraguan plan should have served as a general pattern for the rescheduling of Latin America's external debt; but unfortunately this has not happened. The renegotiation which im-

mediately followed that of Nicaragua was the one embarked upon by the Bolivian military government under the presidency of General García Meza, in 1980-1981. This country showed many signs of insolvency which made it eligible for a relief formula in the spirit of the Nicaraguan agreement. But that shaky government, which was seeking international legitimization, was willing to accept a rescheduling arrangement at virtually any price. The result was an unrealistic reprogramming of the debt which did nothing to help stabilize the balance of pay-

⁴See R. Devlin, *Los bancos transnacionales...*, *op. cit.*, pp. 162-204; and R. Devlin and M. Mortimore, *Los bancos transnacionales, el Estado y el endeudamiento externo en Bolivia*, Santiago, United Nations, Estudios e Informes de la Cepal, No. 26, E/CEPAL/G.1251, 1983, Chapter 4.

⁵See W. Glasser and D. Roberts, *op. cit.*, p. 27.

ments, and of which, moreover, the cost for the country was very high (see again table 2).⁶

During the present debt crisis, Mexico is the country that seems to be nearest to finalizing a reprogramming operation with the private banks. But once again the terms of the agreement are very burdensome. According to provisional data, the US\$ 20 billions of amortization payments subject to reprogramming will be financed at the cost of a margin of 1.88% over LIBOR and flat commissions of 1% on the amount rescheduled.⁷ Furthermore, the private banks will grant a 'new' loan for US\$ 5 billion, which in practice is a disguised way of rescheduling part of the interest payments on the outstanding debt. The cost of this last 'loan' will be 2.25% over LIBOR and flat commissions of 1.25%.⁸ And since Mexico was accustomed to paying an average margin of approximately 0.65% over LIBOR and commissions of 0.7%, the need to reschedule the debt induced that part of the cost of credit which is subject to negotiation to increase by over 180%⁹ (see table 3).

In most respects the rescheduling of Mexico's debt follows the general pattern outlined in the introduction. Its new feature is that the private banks—under severe pressure from the International Monetary Fund—are now granting the aforesaid 'new' loans to accompany the rescheduling of certain maturities. But, as was also pointed out above, the loan does not imply additional net autonomous resources for investment or for the accumulation of international reserves; rather it is administratively designed by the bankers to permit normal payment of interest in the absence of an official rescheduling of these commitments.¹⁰

In some circles the Mexican formula has

⁶See R. Devlin and M. Mortimore, *op. cit.*, chapter 7.

⁷See *Latin American Weekly Report*, London, 24 December 1982, p. 1.

⁸*Ibidem.*

⁹LIBOR is determined by the forces of supply and demand in the financial market. The cost components subject to negotiation are the following: the margin over LIBOR, flat commissions and the amortization period.

¹⁰Up to now the private bankers have firmly adhered to the principle that interest payments must not be reprogrammed. This attitude partly reflects their concern lest if they reschedule interest payments their government ban-

king authorities may classify loans as non-performing assets. Thus they resort to indirect procedures to serve the same end.

been mentioned as the model that should be followed by other countries in the region for rescheduling their payments to the private banks. In practice, as is clear from table 3, this model is pretty close to what is actually happening in Latin America. Reprogramming terms are very similar for all countries despite the considerable differences in their capacities to pay. The relative deterioration of credit terms for the other countries of the region is not as grave as for Mexico, inasmuch as the latter started with more favourable terms of borrowing; but in any event, the deterioration is serious in almost all cases.

Obviously, the Mexican model ought not to have been taken as a reference point for considering the terms of the region's debt rescheduling. Mexico accepted a substantial rise in the spread over LIBOR and the payment of commissions on the reprogrammed debt. As will be explained later, in that country's particular circumstances it may possibly have been expedient for the authorities to accept these costs; but it is not necessarily the correct formula for all the other Latin American countries.

While ethical arguments can be invoked to dissuade the private banks from increasing the cost of rescheduled debts, there is also an economic argument which calls this practice in question. Higher spreads and commissions paid on reprogrammed debt and interest represent monopoly rents for the private banks, which theoretically, and in practice too, can be appropriated by the borrower countries. It is possible, moreover, that non-payment of these rents may have no significant negative effect on the supply of external financing.

In the first place, the margin over the base interest rate and the commissions are components of the 'negotiated' cost of credit.¹¹ In a normal international credit market this cost is established in a distinctly competitive environment, since a solvent borrower country has many potential creditors.¹² Accordingly, in a

king authorities may classify loans as non-performing assets. Thus they resort to indirect procedures to serve the same end.

¹¹See again footnote 9.

¹²A country like Bolivia, whose prestige in international financial markets has always been relatively low, had

Table 3
LATIN AMERICA: PROVISIONAL DATA ON TERMS OF DEBT RESCHEDULING^a

Country	Margin over LIBOR (percentage)			Amortization period (number of years)			Grace period (number of years)			Commissions ^b			Deterioration of terms (percentage) (2):(1) ^c
	1980-1981	R	AC	1980-1981	R	AC	1980-1981	R	AC	1980-1981	R	AC	
	(1)	(2)		(1)	(2)		(1)	(2)		(1)	(2)		
Argentina	0.67	2.13	2.5	7.5	7.0	5.0	...	3.0	3.0	1.09	...	1.25	...
Brazil	1.62	2.50	2.13	8.5	8.0	8.0	...	2.5	2.5	2.01	1.50	1.50	44
Chile	0.91	2.13	2.25	7.6	8.0	7.0	...	4.0	4.0	0.81	1.25	1.25	125
Costa Rica	1.13	2.25	-	6.0	8.5	-	...	3.0	-	1.23	...	-	...
Cuba	1.00	2.25	-	5.0	8.0	-	...	3.2 ^d	-	0.88	1.25	-	28
Ecuador	0.74	2.25	-	8.0	9.0	-	...	2.0	-	0.97	1.25	-	146
Mexico	0.65	1.88	2.25	7.6	8.0	6.0	...	4.0	3.0	0.70	1.0	1.25	181
Peru	1.12	2.25	2.25	8.2	8.0	8.0	...	3.0	3.0	1.07	1.25	1.25	97
Uruguay	0.98	2.25	2.25	9.1	6.0	6.0	...	2.0	2

Source: ECLA, on the basis of official data and information supplied by various national and international sources.

^a This information is provisional and subject to revision. Columns headed 1980-1981 show average credit terms in 1980 and the first half of 1981. Columns headed R relate to rescheduled maturities. Columns headed AC relate to terms for additional credits. It should be noted that by the end of April 1983 most of the new credits had not been agreed upon and were still at the proposal stage.

^b Calculated as percentages of the face value of the loans and represents a flat payment at the time of signing the loan contracts.

^c Based on an index of the cost components of credit that are subject to negotiation

$$\frac{\frac{C_2 + M_2}{P_2}}{\frac{C_1 + M_1}{P_1}} - 1$$

where:

C = commissions; P = amortization period; M = margin over LIBOR; all of which are weighted by the amount of the loan. It should be noted that the relative deterioration is not in itself an indicator of the quality of an individual country's negotiation, since it is strongly influenced by the initial position of the borrower.

^d Weighted average.

competitive setting like that in which most of the debt was contracted, the spread and commissions paid by the borrower must generate what for the private banks approximates a 'normal rate of profit', which takes into account a margin to cover risks.

In an advanced phase of the credit cycle, however, the borrowing country may find itself faced with debt service difficulties. In these circumstances, the financial market drastically tightens since many private banks try to reduce the amount of their portfolio in the country concerned. As was pointed out before, the country then finds itself in a non-competitive mar-

ket; the cost of credit will now be largely decided by the few large creditor banks that form a committee for negotiating *en bloc* with the borrower.¹³ The collusive nature of the committee invests the private banks with a monopoly power that did not exist at the time when the borrower originally contracted its debt.

In reality, this situation approximates a bilateral monopoly. In other words, the banks and the borrower country open negotiations with one another to decide how the losses will be shared out. The outcome of this situation is uncertain. But the action of the private banks is clear: raising the price of credit on rescheduled debt is a device for shifting on to the debtor

more than a hundred private creditors in 1974-1978. See R. Devlin and M. Mortimore, *op. cit.*, p. 69. Countries whose prestige in financial markets is traditionally high could deal with more than a thousand private banks.

¹³See R. Devlin, "Los bancos comerciales...", *op. cit.*, p. 84. For an analysis of a specific case, see, by the same author, *Los bancos transnacionales...*, *op. cit.*, pp. 163-173.

much of the cost of a weak loan portfolio. In so far as the bank avoids losses—or manages to obtain positive returns—on its weak portfolio, it gains profits tantamount to a monopoly rent.

When a bank issues a loan in a normal market, the risk is theoretically covered by credit rationing, and the charge of a margin over the base interest rate, plus commissions. In other words, at the time of granting a loan, the bank already takes into account the possibility of not recovering it, or at least foresees that the mobility of its portfolio may be affected by a rescheduling of payments. Thus, when a borrower country cannot meet its debt service commitments, the cost to the bank must already have been included in the charges for the original loan. And as regards the reprogramming of the debt *per se* (or of the interest on it, either directly or indirectly), there is no real 'credit' transaction with a supply price, since the operation consists simply in the administration of a loan already granted and not immediately recoverable. Nor does rescheduling imply an additional risk, as bankers assert, since the alternative is a total stoppage of payments and the complete liquidation of part of the portfolio; in practice, rescheduling effectively reduces the risk of default and therefore of major losses. As for the outlays on telex, cables, travel, etc., connected with the negotiation of a rescheduling operation, the banks have already provided for their coverage in the loan contracts, in separate clauses under the head of 'miscellaneous expenses'. Thus, any increase in the margin over the base interest rate and payment of commissions on the amount reprogrammed signifies rent; that is, it constitutes an income in excess of economic costs, which is generated by virtue of the bargaining power of the few large banks that control access to credit for a country of questionable creditworthiness. Looked at from another angle, rent is any payment over and above what is required to induce an economic agent to act as it does. In this case, the bank charges extra for an administrative operation (the rescheduling of debt service) which is necessary in any event to avoid a total loss; therefore, the additional income it receives on reprogramming the debt is a superprofit.

What happened during the 1930s, i.e., when the debtor countries ceased to liquidate

their bonds unilaterally, demonstrates how, in similar competitive conditions, banks would have to accept the losses deriving from the development of an unsatisfactory portfolio, a course which would imply easing the debt burden of the borrower countries and would facilitate their economic recovery. Unlike the current financial instrument, the bond is a means of borrowing in which case the creditors are anonymous, many, and widely scattered, so that it is difficult for them to organize themselves and reach a collusive agreement *vis-à-vis* the debtors. Bondholders were left with no other alternative than to accept the losses determined by the market in the shape of a reduction of the value of their assets.¹⁴

Today, borrowing is channelled mainly through the private banks, and these institutions are in a position to co-ordinate their activities in the international scene in such a way that they can form a monopolistic bloc organized with the aim of averting, or minimizing, losses through: i) reschedulings of the debt and of interest payments; and ii) charging onerous spreads and commissions. In other words, in contrast to what happened during the 1930s, the cost of the adjustment necessitated by a less than adequate management of an international portfolio is now borne by the debtors and not, as before, by the creditors.

In certain circumstances it would be expedient for the borrower country to attempt, as Nicaragua did, to eliminate or reduce the rent paid to the private banks. This is feasible because, as will be seen later, a decline in the superprofits of the private banks, given specific situations, would not necessarily affect the supply of financing.

When debt servicing becomes impossible, the borrower country loses its creditworthiness and therewith its access to autonomous loans from the private banks. It seems that many countries accept the increase in the cost of credit in a reprogramming operation—i.e., pay the rents—in the fear that if they refuse to do so they will forfeit their chances of obtaining fi-

¹⁴This last aspect is discussed in a working paper by Carlos Massad.

nancing in the future.¹⁵ But in normal circumstances the flow of loans is not tied to the concession or non-concession of rents to creditors. Access to credit will then depend upon sound creditworthiness; in so far as a country can recover it, the number of private banks interested in lending to it will increase and the resurgence of competition among them will generate new loans at lower costs.¹⁶ And notwithstanding the negative attitude of bankers towards debt rescheduling, a major factor in the real recovery of creditworthiness is still—in addition to disciplined economic policies, of course—renegotiation of debt servicing in such a way as to reduce the burden it represents; this,

in turn, entails the borrower's not paying the rents and transferring to the lender some of the corresponding losses. Hitherto the creditor has avoided losses and has managed to oblige the debtor to pay rents which have militated against a recovery of creditworthiness and have been partly responsible for the necessity of multiple reschedulings with their additional costs for the borrower.¹⁷ In fact, instead of being a problem for the banks, rescheduling has definitely been 'good business'; thus a paradoxical situation arises where in the midst of a very serious deterioration of their international loan portfolio, the private banks are reporting to their shareholders very high rates of profit.¹⁸

III

Incentives to reduce the cost of rescheduling debt

In the short run, the incentives that the various countries have to accept the higher cost of borrowing involved in renegotiations may differ considerably, and this has major repercussions on rescheduling trends in the region.

In the case of the large countries with a very high absolute level of indebtedness—such as Mexico and Brazil—payment of the higher cost of credit might be expedient. And this because even in an 'administered' credit market,

which characterizes the situation for a State whose creditworthiness is precarious, the economic authorities may possibly think that a substantial volume of new loans can gradually be obtained, since, up to a point, the financial system is a 'hostage' to the borrower: a default by a major debtor would be a threat to the very survival of many banks. Thus, the economic authorities might feel that acceptance of the increase in the cost of outstanding debts would make it easier for them to use their considerable

¹⁵Another reason that may explain, if only in part, why some countries have paid the rent in question is that hitherto, in many instances, negotiations with the private banks have been co-ordinated by national technocrats (not by politicians) who have strong professional links with the international financial community. This situation makes for protection of the *statu quo* as regards debt rescheduling.

¹⁶Peru affords a case in point. Between 1976 and 1978 it had extremely serious conflicts with its private creditors and received no new loans for nearly two years. But despite its troubled relations with the private banks, the country found itself back in their good books when an unexpected rise in its export prices boosted its external sector and, therefore, its image of creditworthiness. See R. Devlin, *Los bancos transnacionales...*, *op. cit.*, pp. 167-172, and 201-204.

¹⁷In so far as the banks increase the cost of credit in a rescheduling operation, the recovery of creditworthiness becomes more difficult, since the borrower country will have to expand its exports still further and reduce its imports in order to cope with debt servicing. Creditworthiness is also prejudiced inasmuch as the cost of the debt rises when the internal rate of return is, in all probability, very low.

¹⁸See R. Lambert, "New York banks show strong gains", in *Financial Times*, 19 January 1983, p. 32; R. Banner, "Banks gain from fees by altering Latin debt", *New York Times*, 10 January 1983, p. D.3; J. Plender, "Of profits and imprudence", *Financial Times*, 18 February 1983, p. 5; and R. Wilkinson, "Banks greedy over Third World", *Financial Times*, 31 March 1983, p. 10.

leverage to extract increasing amounts of new credit from a non-competitive market.¹⁹ Another factor that perhaps influences the decisions of these relatively more developed countries is the consideration that they will be the first to benefit by the positive impulses of any world economic recovery that may occur in 1983 and 1984, with the consequent improvement of their creditworthiness accompanied by a renewed autonomous credit flow and the reduction in costs which this implies. Undoubtedly Mexico, when accepting the cost of its debt rescheduling, assumed that it would relatively rapidly regain its access to credit, through autonomous or administered channels. If within a very short time there is no new net inflow of loans (i.e., a volume of credit in excess of amortization and interest payments), the cost of renegotiation will be more clearly revealed as a monopoly rent and, probably, in that case, the Mexican Government will reconsider its strategy for negotiation with the private banks.

While in the short run the most heavily indebted countries may have their reasons for accepting a rise in the cost of their debt, the creditor banks have motives for augmenting those costs to an onerous degree. And this because they know that the terms of payment established with the major debtors—which are also the countries with the best prospects of regaining their creditworthiness—will form the 'floor' for subsequent negotiations with smaller debtors that are less attractive customers. Thus, the strategies of the banks and of the major debtors in the region join forces in pushing up the cost of the debt for everyone. This, of course, has negative repercussions on the remaining countries.

As regards the small and medium-sized debtor countries, the potential benefits of paying the higher cost demanded by the banks are even more problematical. These countries'

chances of obtaining net inflows of resources through the private banks are much smaller. In a climate of administered credit they have not enough leverage to obtain more money for investment purposes, since individually their debt does not represent a high proportion of the banks' portfolio; in the last instance, creditors could cope with a unilateral moratorium on the part of a small debtor without endangering their own survival.²⁰ Thus, the banks have a firm foundation on which to resist a significant expansion of their portfolio in the country. But still more important is the fact that these countries will be the last to benefit by the return to a normalized international credit market when the world economy recovers. In the case of countries with structural debt problems—for example, Bolivia, Chile, Jamaica, Costa Rica—, even if the international conjuncture takes a favourable turn it will not necessarily suffice to restore their creditworthiness and give them renewed access to autonomous credit.

The preceding remarks suggest that these latter borrowers have less reason to accept the increase in the cost of debt currently at issue in the renegotiations; if they do so, in face of their poor prospects of a rapid and intensive recovery of creditworthiness—necessary for their reinsertion in a competitive credit market—they have few possibilities of demanding as a counterpart any very significant net flow of new loans. If the borrower holds out against an increase in the cost of the debt, its rescheduling will not necessarily be prevented. And this because, although the banks could absorb the losses that would derive from a formal declaration of default on any one country, it is very much in their interest to forestall a precedent of this kind. In the first place, such a declaration might lead to a similar standstill of debt payments on the part of other countries which, as a whole, certainly would represent a threat to the viability of the private banks. And secondly, since it is monopoly rents that are at stake, a policy that tries to obtain debt rescheduling without an increase in the cost of credit still affords the

¹⁹Resources are often extracted indirectly. Initially the country establishes very optimistic balance-of-payments targets in order to conclude a rescheduling agreement with the private banks. Subsequently the targets are not met with the consequent enlargement of the deficit on current account, which is in any event financed by the private banks (or by their governments) on the grounds of not inducing a moratorium in payments.

²⁰See for example, the cases of Peru and Bolivia, in R. Devlin, *Las bancas transnacionales...*, *op. cit.*, pp. 114 to 120, and R. Devlin and M. Mortimore, *op. cit.*, pp. 111 to 116, respectively.

private banks an opportunity to 'gain', i.e., substantially to minimize their losses. All that is really involved is a better distribution of costs between debtor and creditor, as compared with the situation in the 1930s, when the brunt of the

adjustment was borne by the creditors (who were not only banks), and with the present situation, which is characterized by the transfer of the cost of a weak portfolio to the debtor countries.

IV

Concluding remarks

It is worth while to recapitulate what has been said so far. The hypothesis upon which the present article is based calls in question the current practices of the private banks in renegotiation of the external debt, hitherto more or less taken for granted in many circles alike in the North and in the South. Obviously, this is only a first approximation to the subject, and the analytical framework should be extended in the near future both in depth and in breadth. In any case, the increase in the price of credit in current reschedulings of Latin America's debt is a clever tactic on the part of the private banks to evade the costs associated with a less than adequate international lending policy. Their capacity to raise the borrower's costs derives from the monopolistic power which characterizes an administered capital market; and the costs themselves would be rents.

The payment of rents has different effects on the two parties involved in the renegotiation. In the case of the banks, their rates of profit are high even in the face of a marked deterioration in the quality of their portfolio. And the debtors, for their part, are faced with a steep rise in the cost of the debt when their rate of return on investments can no longer carry the burden of servicing it; moreover, payment of the higher cost necessitates an increase in exports and a reduction of imports which are difficult for each country to achieve separately, and virtually impossible for all the debtors as a whole. It has also been noted that, paradoxically, in the short run it is the countries with the most bargaining power that have an incentive to initially shoulder the burden of the increased cost of credit, whereas the debtors with less leverage have less reason to

do so, and are in a better position to resist it forthwith.

Up to now the small and medium-sized debtor countries of Latin America have adopted a distinctly passive position *vis-à-vis* the demands of the private banks for exceptional increases in the margins over LIBOR and for the payment of commissions on the reprogrammed debt.²¹ But perhaps they ought to reconsider their strategy and explore other ways of negotiating a reduction or elimination of the rents paid to these transnational financial enterprises, as many of them have already done in the past with respect to direct investment by the non-financial transnational corporations. And as happened in the latter case, the possibilities of negotiating better terms will depend upon the specific political and economic circumstances of each individual country, on its capacity to co-operate with other debtors and on its success in obtaining the necessary backing from international forums concerned with co-operation and economic development in order to pressure the private banks to change their rescheduling policies.

As a minimum criterion it might be proposed that the negotiated cost of a reprogrammed debt should not be higher than the average of the original negotiated cost on the rescheduled maturities. And in the case of coun-

²¹Even an organ of the international financial press—the *Financial Times* of London—remarked in an editorial that the developing countries have a great deal of leverage with the private banks, but have shown little imagination in taking advantage of it. See "Third World leverage", *Financial Times*, 12 February 1983, p. 12.

tries with structural debt problems, a postponement of interest payments would be necessary, although a still more appropriate measure would be a significant reduction of the cost of credit, i.e., a 'concessionary' interest rate. Furthermore, the formula is not without precedent, since the private banks commonly grant 'soft' credit terms to their domestic customers with debt repayment difficulties, as is exemplified by the treatment of the Real Estate Investment Trusts in the United States.²² A yet more important point however, is that reduction of the rents implicit in the current debt rescheduling formulas still affords the banks an opportunity to avoid most of the losses that creditors would normally incur in a competitive capital market. It is simply a matter of a better sharing-out of the cost of a mismanaged portfolio between creditor and debtor, whereby both parties 'gain'. In addition, this improved distribution of the cost will make for a more rapid restoration of the creditworthiness of the debtors and will thereby enable the private banks to infuse new dynamism into their portfolio.

In conclusion, it is important to mention that the central argument of the foregoing analysis with respect to the cost of debt rescheduling is highly sensitive to the assumptions adopted in relation to risk. It has been assumed that the private banks had already taken into account the risks of default at the actual time of granting loans to the debtor countries. But there are bankers and regulatory bank authorities who assert that the former spreads over LIBOR and commissions were insufficient to cover these risks; and this phenomenon is often attributed to the 'fierce competition' among banks during the 1970s. Thus, it is maintained that the current increase in the cost of credit on rescheduling a debt is nothing but an 'adjustment' on account of the insufficient price of the credit granted during the competitive phase of the international credit market.

This argument is not very convincing. If the negotiated price of credit was insufficient in the 1970s, the cause was not the existence of a highly competitive market; rather it must be at-

tributed to a faulty assessment of risk. The private banks made their loans in the 1970s on the basis of a principle which was then widely accepted by the financial community: that countries (sovereign borrowers) never go bankrupt.²³ This assumption is technically correct, but as a general criterion for loans it seriously underestimates the potential costs involved in the development of a portfolio in developing countries.

In any event, let us assume that —whatever may have been the reasons— in the 1970s the price of credit was not high enough to ensure the long-term stability of the international financial system. Why should the developing countries be responsible for bearing the cost implied in remedying the situation? If the international financial system did not function efficiently during the past decade, in a civilized and interdependent world it is incumbent upon all the members of that system —private banks, central governments, debtor countries— to seek solutions and share the cost. Shifting the cost on to the debtors alone —as is occurring today— is questionable from the point of view of equity and ethics. But it is also questionable from the standpoint of the economic interests of the creditors and their governments: many debtors are clearly unable to bear the whole cost of the adjustment, and, failing more equitable solutions, the dynamics of their internal politics would ultimately involve them in prolonged moratoria which nobody wants to see on the international scene. Accordingly, the present cost that would be implied for the banks in sharing the burden of the adjustment is much lower than might be the future cost of perpetuating the practices now current.²⁴

²³See Morgan Guaranty Trust, *World Financial Markets*, March 1983, pp. 4-5; and Pedro-Pablo Kuczynski, "Latin American debt", in *Foreign Affairs*, Winter 1983, p. 352.

²⁴Fred Bergston, formerly Assistant Secretary for International Economic Affairs of the United States Department of the Treasury, under the James Carter administration, is very well aware of the danger: "...a moratorium by any significant debtor would have a demonstration effect on other debtors, or at least on opposition politicians in such countries, to emulate such behaviour. A 'debtors' OPEC' is unlikely to emerge by design, but could develop via chain reaction". See F. Bergston, "Can we prevent a world

²²See R. Weinert, "Banks and bankruptcy", *Foreign Policy*, No. 50, 1983, pp. 138 to 149.

Of course it is possible that the international banks are not financially in a position to take on the whole of their share of the cost of adjustment with the debtors; if this is the case, it will fall to the central governments to absorb it. There are already a good many proposals that advocate the transfer of much of the international financial problem to the centre's public sector.²⁵ For example, Professor Peter Kenen, of Princeton University, has suggested that the World Bank might purchase a proportion of the banks' portfolio at a discount, which would enable the creditors to divest themselves of weak loans (although, of course, at a partial loss).²⁶ Thus, an international public institution such as the World Bank, which perceives risk in a

broader perspective than private banks would help the debtors to find more satisfactory formulas for the relief of their situation. Again, the Government of Mexico has proposed that the International Monetary Fund provide a special service for the financing of balance-of-payments deficits due to increases in international interest rates; this would make it possible to grant compensatory loans to the debtor countries during the period in which interest rates exceed 'normal' levels, i.e., 2-3% in real terms. There are also other interesting proposals for palliating the pressures faced today by the international financial system and the debt crisis of the periphery. All that is wanting is the political capacity to adopt the appropriate decisions. The underlying reason for the proposal considered here in relation to the creditors' governments is analogous to that adduced in the case of the banks: the cost of sharing the burden of the adjustment between the banks, their governments and the debtor countries would now be much less than it would be in the future in the event of the creditors' perpetuating their current practices, which are seriously prejudicial to Latin America's economic and social development and are politically untenable for the debtor countries.

economic crisis?", in *Challenge*, January-February 1983, p. 10. Furthermore, the potential for setting up a 'debtors' OPEC' in Latin America is very great, since over 90% of the net bank debt of the periphery is to be found in the region. See R. Devlin and M. Mortimore, *op. cit.*, table 1.

²⁵See, for example, "Bad debtors' charter", in *The Economist*, 19-25 February 1983, p. 79.

²⁶R. Weinert, *op. cit.*, also puts forward an excellent practical proposal implying the transfer of part of the private banks' portfolio to the World Bank.