

INTERNATIONAL LOANS: THE NEW INTERAGENCY
EXAMINATION TREATMENT

REMARKS OF
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MEETING WITH
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CORONADO, CALIFORNIA
APRIL 9, 1984

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LDC DEBT PROBLEM

AS YOU KNOW, CONGRESS LAST YEAR PASSED THE INTERNATIONAL RECOVERY AND FINANCIAL STABILITY ACT OF 1983, WHICH CONTAINED PROVISIONS RELATING TO THE SUPERVISION OF INTERNATIONAL LENDING. I WOULD LIKE TO CONCENTRATE TODAY ON SOME OF THE IMPLICATIONS OF THE ACT, ESPECIALLY AS THEY CONCERN THE EXAMINATION TREATMENT OF INTERNATIONAL LOANS.

SOME BACKGROUND ON THE HISTORY OF THE ACT IS USEFUL. EACH OF US IS AWARE, PERHAPS PAINFULLY SO, OF THE "LDC DEBT CRISIS" WHICH, STARTING WITH THE ALARM OVER MEXICO'S FINANCIAL STRAITS IN 1982, HAS RECEIVED A LOT OF PRESS. CONCERNS IN THE UNITED STATES OVER THE AMOUNT OF DEBT OWED TO U.S. BANKS BY LESS DEVELOPED COUNTRIES WERE WIDELY VOICED WHEN THE "CRISIS" FIRST ERUPTED, AND SUBSEQUENT RENEGOTIATIONS OF LDC DEBT HAVE KEPT THESE CONCERNS ALIVE. CONTROVERSY OVER THE ROLE OF U.S. BANKS IN LENDING TO LDCs WAS PARTICULARLY PRONOUNCED DURING THE DEBATE OVER PROPOSALS TO BOLSTER THE INTERNATIONAL MONETARY FUND.

THE CONGRESS AT FIRST WAS QUITE RELUCTANT TO APPROVE ADDITIONAL U.S. SUPPORT OF THE FUND. SOME MEMBERS ARGUED IT WAS A "BIG-BANK BAILOUT," AND IT TOOK A GREAT DEAL OF EFFORT TO PERSUADE CONGRESS THAT IT WAS IN THE UNITED STATES' BEST

INTERESTS TO APPROVE THE ADDITIONAL SUPPORT FOR THE IMF. IN THE LEGISLATION THAT FINALLY PASSED, THE CONGRESS ALSO DIRECTED THE FEDERAL BANK REGULATORS TO TAKE CERTAIN STEPS TO STRENGTHEN THE SUPERVISION OF INTERNATIONAL LENDING. THESE "MARCHING ORDERS," AS IT WERE, WERE CLOSE TO WHAT THE FEDERAL RESERVE AND OTHER REGULATORS EARLIER HAD RECOMMENDED TO CONGRESS AND ESSENTIALLY FOCUSED ON FOUR POINTS. ONE OF THESE -- THE REQUIREMENT THAT THE FEDERAL BANKING REGULATORS CONSULT WITH THEIR FOREIGN COUNTERPARTS ABOUT BANK CAPITAL ADEQUACY -- DOES NOT BEAR DIRECTLY ON WHAT I WANT TO DISCUSS TODAY. I WILL CONCENTRATE THEREFORE ON THE OTHER REQUIREMENTS OF THE ACT, WHICH ARE DESIGNED TO STRENGTHEN AND IMPROVE THE SYSTEM OF U.S. INTERNATIONAL LENDING.

REQUIREMENTS OF ACT

THE FIRST OF THESE IS A REQUIREMENT THAT SPECIAL RESERVES BE SET ASIDE FOR ASSETS WHOSE VALUE IS IMPAIRED BECAUSE OF RISK. A SECOND REQUIREMENT IS THAT THE BANKING AGENCIES SHOULD MONITOR BANK EXPOSURE TO COUNTRY RISK MORE CLOSELY AND ESTABLISH PROCEDURES FOR ASSURING THAT COUNTRY OR TRANSFER RISK ARE TAKEN INTO ACCOUNT IN EVALUATING THE ADEQUACY OF A BANK'S CAPITAL.

I SHOULD NOTE PARENTHETICALLY THAT I WILL USE COUNTRY RISK AND TRANSFER RISK INTERCHANGEABLY THROUGHOUT MY TALK. IN THE PAST, SOME WRITERS HAVE MADE DISTINCTIONS BETWEEN THE TWO TERMS BUT IT IS THE USUAL PRACTICE NOW TO TREAT THE TWO AS ESSENTIALLY

THE SAME, AND I SHALL FOLLOW THAT CONVENTION. BASICALLY, THE RISK I AM TALKING ABOUT IS THE RISK THAT BORROWERS IN A GIVEN COUNTRY WILL BE UNABLE TO OBTAIN ENOUGH FOREIGN EXCHANGE TO SERVICE AND REPAY THEIR LOANS.

I WILL DISCUSS THE FIRST TWO REQUIREMENTS OF THE ACT IN A MINUTE. BUT FIRST LET ME SAY A LITTLE BIT ABOUT A THIRD REQUIREMENT OF THE ACT, WHICH DIRECTS FEDERAL BANK REGULATORS TO CONSIDER ALTERNATIVE ACCOUNTING METHODS FOR HANDLING THE FEES RECEIVED IN CONNECTION WITH EXTENSIONS OF CREDIT. CONGRESS FELT THE PRACTICE OF SOME BANKS OF INCLUDING LOAN FEES ON RESTRUCTURED LOANS IMMEDIATELY IN INCOME OVERSTATED EARNINGS, ESPECIALLY WHEN THE ASSOCIATED LOAN WAS A LONG TERM ONE. AS YOU WILL RECALL, THE ORIGINAL REGULATORY PROPOSALS PUT OUT FOR COMMENT CALLED FOR AMORTIZATION OF FEES ON ALL INTERNATIONAL LENDING. AFTER CAREFUL CONSIDERATION OF THE COMMENTS RECEIVED, HOWEVER, IT WAS DECIDED IN THE FINAL REGULATIONS ISSUED TO AMORTIZE ONLY FEE INCOME ASSOCIATED WITH RESTRUCTURED LOANS. THUS MOST FEE INCOME ON RESTRUCTURED LOANS, OVER AND ABOVE RECOVERY OF OUT-OF-POCKET EXPENSES, WILL BE CONSIDERED AN ADJUSTMENT TO YIELD AND WILL HAVE TO BE AMORTIZED OVER THE LIFE OF THE LOAN. SYNDICATION FEES, HOWEVER, CAN BE TAKEN INTO INCOME AS RECEIVED TO THE EXTENT THAT THEY REPRESENT REMUNERATION FOR SERVICES RENDERED IN CONNECTION WITH ARRANGING THE SYNDICATION. COMMITMENT FEES ALSO MAY BE TAKEN INTO INCOME AS RECEIVED, PRIOR TO THE DISBURSEMENT OF THE LOAN.

INTERAGENCY COUNTRY EXPOSURE RISK COMMITTEE

IN DISCUSSING THE FIRST TWO REQUIREMENTS OF THE ACT, WHICH INVOLVE ISSUES OF COUNTRY OR TRANSFER RISK, IT IS USEFUL TO REVIEW WHAT THE FEDERAL RESERVE AND THE OTHER FEDERAL BANKING REGULATORS ALREADY HAVE DONE IN THIS AREA. IN 1979, THE INTERAGENCY COUNTRY EXPOSURE RISK COMMITTEE WAS ESTABLISHED. THE PURPOSE OF THE COMMITTEE IS TO ENCOURAGE BANKING ORGANIZATIONS TO DIVERSIFY THEIR EXPOSURE IN THEIR FOREIGN LENDING, JUST AS THEY HAVE LONG BEEN ENCOURAGED TO DIVERSIFY OTHER ASPECTS OF THEIR LENDING. THE COMMITTEE, WHICH MEETS THREE TIMES A YEAR, HAS EQUAL REPRESENTATION FROM THE FEDERAL RESERVE, THE FDIC, AND THE OFFICE OF THE COMPTROLLER OF THE CURRENCY.

A WIDE VARIETY OF INFORMATION IS PRESENTED AT THE COMMITTEE'S MEETING -- ECONOMIC BRIEFINGS, A SET OF FINANCIAL AND ECONOMIC RATIOS INTENDED TO GIVE A FIRST IMPRESSION OF COUNTRIES' DEBT-SERVICING ABILITIES, AND SUMMARIES OF INTERVIEWS WHICH FIELD EXAMINERS HOLD WITH BANKERS IN THEIR DISTRICT OR REGION IN ORDER TO OBTAIN THEIR OPINIONS AND TO BE INFORMED OF THEIR CURRENT EXPERIENCE IN THE FIELD OF FOREIGN LENDING. AFTER DISCUSSION AMONG THE MEMBERS, A VOTE IS TAKEN ON HOW A COUNTRY'S TRANSFER RISK WILL BE ASSESSED FOR EXAMINATION PURPOSES. THERE ARE SEVERAL ALTERNATIVES.

FIRST, THE TRANSFER RISK MAY BE CLASSIFIED AS "SUBSTANDARD," "VALUE IMPAIRED," OR "LOSS." SECOND, THE COUNTRY MAY BE LISTED

FOR COMMENT AND DISCUSSION IN EXAMINATION REPORTS (BUT NOT CLASSIFIED). AND FINALLY, THE COMMITTEE MAY DECIDE NOT TO DISCUSS THE COUNTRY AT ALL IN EXAMINATION REPORTS. (THIS LAST SET OF CASES USUALLY INVOLVES COUNTRIES WITH LITTLE OR NO TRANSFER RISK.) IN THE FIRST TWO CASES -- THAT IS, WHERE TRANSFER RISK IS EITHER CLASSIFIED OR LISTED AS APPROPRIATE FOR COMMENT AND DISCUSSION -- THE COMMITTEE PREPARES A STANDARD ANALYSIS WHICH IS MADE AVAILABLE TO AND USED BY EACH FEDERAL BANK REGULATOR.

I MENTION THE COUNTRY RISK COMMITTEE, WHICH I AM SURE MANY OF YOU ARE AWARE OF, FOR TWO REASONS. FIRST, I WANT TO POINT OUT THAT THE FEDERAL REGULATORS ALREADY HAVE BEEN ACTIVELY ENCOURAGING DIVERSIFICATION IN BANKS' INTERNATIONAL PORTFOLIOS. THIS IS ACCOMPLISHED BY THE LISTING FOR COMMENT AND DISCUSSION OF TRANSFER RISK WHERE WEAKNESS IN PARTICULAR COUNTRIES IS EVIDENT. IF "EXPOSURE" IN THESE COUNTRIES APPEARS CONSIDERABLE, THEY ARE PURPOSELY HIGHLIGHTED IN THE EXAMINATION REPORT FOR THE SPECIFIC PURPOSE OF ENCOURAGING EACH BANK'S DIRECTORS TO REVIEW THEIR POLICIES AND PRACTICES IN INTERNATIONAL LENDING, WITH A VIEW TO ACHIEVING GREATER DIVERSIFICATION.

CONCENTRATIONS OF CREDIT, WHETHER IN COUNTRIES SUBJECT TO TRANSFER RISK OR WHETHER IN OTHER PARTICULAR FIELDS OF LENDING, IS ONLY ONE OF MANY CONSIDERATIONS THAT OUR EXAMINERS AND ANALYSTS TAKE INTO ACCOUNT IN ASSESSING THE ADEQUACY OF A BANK'S

CAPITAL. ALTHOUGH THE FEDERAL RESERVE HAS ISSUED RATIO GUIDELINES REFERRING TO MINIMUM CAPITAL, MANY FACTORS ARE TAKEN INTO ACCOUNT WHEN DECIDING ON CAPITAL ADEQUACY -- FACTORS SUCH AS THE AMOUNT AND THE QUALITY OF EARNINGS, THE QUALITY OF ASSETS, THE ABILITIES OF MANAGEMENT, AND CONCENTRATIONS OF CREDIT, TO NAME BUT A FEW.

"ALLOCATED" TRANSFER RISK RESERVES

MY SECOND REASON FOR DISCUSSING THE COUNTRY RISK COMMITTEE IS THAT IT IS THROUGH THE COMMITTEE THAT CONGRESS'S MANDATE TO IDENTIFY ASSETS WHOSE VALUE HAS BEEN IMPAIRED BY TRANSFER RISK WILL BE ACCOMPLISHED. FOR EACH IMPAIRED CREDIT, A SPECIAL OR "ALLOCATED" TRANSFER RISK RESERVE WILL HAVE TO BE ESTABLISHED. THIS RESERVE WILL, OF COURSE, HAVE AN IMMEDIATE EFFECT ON EARNINGS SINCE THE RESERVE ALLOCATION WILL BE CHARGED TO CURRENT EARNINGS. (I WOULD ADD PARENTHETICALLY, WITHOUT GOING INTO THE ACCOUNTING DETAILS, THAT THERE ARE A COUPLE OF WAYS THESE RESERVES MAY BE SET UP.) THE MAIN POINT, HOWEVER, IS THAT IT IS THE CLEAR INTENT OF THE CONGRESS TO ENSURE THAT POTENTIAL LOSSES BE DETECTED AND RECOGNIZED ON AN ON-GOING BASIS, SO THAT A BANK'S REPORTED EARNINGS MORE ACCURATELY REPRESENT ITS TRUE POSITION.

TWO CONDITIONS, EITHER OF WHICH REQUIRES ESTABLISHING TRANSFER-RISK RELATED RESERVES, ARE SPECIFIED IN THE ACT. ONE IS A PROTRACTED INABILITY OF PUBLIC OR PRIVATE BORROWERS IN A FOREIGN COUNTRY TO MAKE PAYMENTS ON THEIR EXTERNAL INDEBTEDNESS.

THE OTHER IS A LACK OF DEFINITE PROSPECTS FOR THE ORDERLY RESTORATION OF DEBT SERVICE.

THE AGENCIES MAY EXERCISE THEIR DISCRETION AND BEST JUDGMENT AS TO THE AMOUNT OF SPECIAL RISK-RELATED RESERVES THAT MUST BE HELD, AND HAVE STATED THAT GENERALLY THIS WOULD BE 10 PERCENT DURING THE FIRST YEAR IN WHICH A LOAN'S VALUE IS IMPAIRED, AND AN ADDITIONAL 15 PERCENT IN EACH SUBSEQUENT YEAR.

IT'S IMPORTANT TO NOTE THAT THESE TRANSFER RISK RESERVES GENERALLY WILL NOT BE REQUIRED, AT LEAST INITIALLY, IN SUPPORT OF NET NEW LENDING IN COUNTRIES THAT ARE IMPLEMENTING ECONOMIC ADJUSTMENT PROGRAMS, SUCH AS PROGRAMS APPROVED BY THE INTERNATIONAL MONETARY FUND, WHICH ARE DESIGNED TO CORRECT THE COUNTRIES' ECONOMIC DIFFICULTIES IN AN ORDERLY MANNER. THE REASON IS THAT SUCH NEW LENDING, UNDER APPROPRIATE CIRCUMSTANCES, MAY STRENGTHEN THE FUNCTIONING OF THE ADJUSTMENT PROCESS, AND THEREBY HELP TO IMPROVE THE QUALITY (THAT IS, REDUCE THE RISK EXPOSURE) OF OUTSTANDING CREDITS. WHETHER THESE NEW LOANS SUBSEQUENTLY WILL HAVE TO BE MADE SUBJECT TO THE RESERVES WILL BE DETERMINED BY THE AGENCIES ON THE BASIS OF THE LOANS' PERFORMANCE.

BANK REPORTING ON COUNTRY EXPOSURE

AS I MENTIONED EARLIER, ANOTHER OF THE REQUIREMENTS OF THE NEW ACT IS THAT REGULATORS ARE TO MONITOR BANKS' COUNTRY EXPOSURES MORE CLOSELY. YOU WILL SOON BE EXPERIENCING THE

RESULTS OF THIS DIRECTIVE, SINCE THE REGULATORS HAVE INCREASED BANK REPORTING ON COUNTRY EXPOSURE TO A QUARTERLY FROM A SEMI-ANNUAL BASIS. IN ADDITION, THE REPORTING TIME HAS BEEN SHORTENED FROM 60 DAYS TO 45 DAYS FOLLOWING THE END OF EACH PERIOD.

THE "GOOD NEWS" IS THAT VIRTUALLY THE SAME REPORT IS BEING USED TO PROVIDE COUNTRY INFORMATION THAT HAS BEEN USED FOR SOME TIME. I SAY "VIRTUALLY THE SAME REPORT," BECAUSE THERE ARE A COUPLE OF CHANGES, INCLUDING A SMALL, BUT IMPORTANT, ADDITION. THE ADDITION IS A TWO-PART SUMMARY WHICH WILL PROVIDE INFORMATION ON EXPOSURE TO ANY COUNTRY THAT EXCEEDS A CERTAIN PERCENTAGE OF THE REPORTING BANK'S ASSETS. THE FIRST PART WILL REQUIRE YOU TO LIST YOUR EXPOSURE IN ANY COUNTRY WHICH ACCOUNTS FOR 1 PERCENT OR MORE OF YOUR BANK'S ASSETS. IN SUCH CASES YOU WILL HAVE TO SHOW THE AMOUNT OF THE EXPOSURE, LIST THE DEBTORS BY BROAD CATEGORIES (BANKS, THE PUBLIC SECTOR, OR ALL OTHERS), AND GIVE THE AMOUNT MATURING IN 1 YEAR OR LESS AND THE AMOUNT MATURING IN OVER 1 YEAR. THE SECOND PART REQUIRES SOMEWHAT LESS DETAILED INFORMATION PERTAINING TO CREDIT EXPOSURES IN COUNTRIES WHICH ACCOUNT FOR $3/4$ OF 1 PERCENT OF YOUR TOTAL ASSETS. IN BOTH CASES, THE INFORMATION WILL BE AVAILABLE TO THE PUBLIC UPON REQUEST, AND I WOULD GUESS THERE MAY BE A LOT OF REQUESTS!

EXAMINATION OF BANKS AND RISK MANAGEMENT

THE REQUIREMENTS OF THE NEW ACT ALSO WILL BE REFLECTED IN THE EXAMINATION OF YOUR BANKS. FOR EXAMPLE, BANK EXAMINERS

PROBABLY WILL BE DISCUSSING WITH YOU, IN GREATER DETAIL, YOUR OWN COUNTRY RISK-MANAGEMENT SYSTEMS. THIS PART OF THE EXAMINATION FOCUSES ON THREE COMPONENTS, AND IS VERY IMPORTANT IN ENABLING OUR EXAMINERS TO REACH THEIR DECISION ON MANAGEMENT ABILITIES AND STRENGTHS.

THE FIRST COMPONENT OF A COUNTRY'S RISK MANAGEMENT EVALUATION COVERS EACH BANK'S OWN PROCEDURES TO EVALUATE ECONOMIC TRENDS, AND POLITICAL AND SOCIAL DEVELOPMENTS, IN THE COUNTRY OR COUNTRIES WHERE BANK FUNDS ARE AT RISK. INFORMATION IN THESE AREAS COMES FROM A VARIETY OF SOURCES, INCLUDING ECONOMIC DATA PROVIDED BY THE BORROWER OR OBTAINED FROM INTERNATIONAL LENDERS, SOCIO-POLITICAL COMMENTARIES, AND REPORTS FROM BANK OFFICERS TRAVELING OR STATIONED IN THE FOREIGN COUNTRY.

THE SECOND COMPONENT INVOLVES THE UNDERTAKING BY THE BANK'S BOARD OF DIRECTORS AND SENIOR MANAGEMENT TO DEFINE THE LEVEL AND TYPE OF EXPOSURE THAT THE BANK IS WILLING TO ASSUME IN EACH FOREIGN COUNTRY. THIS TYPICALLY INVOLVES THE ESTABLISHMENT OF AGGREGATE LENDING LIMITS PER COUNTRY (AND PERHAPS FOR ALL FOREIGN LENDING AS A WHOLE), AS WELL AS LIMITS FOR MATURITIES AND DIFFERENT CATEGORIES OF CREDIT RISK, SUCH AS TRADE FINANCING, LONG-TERM PROJECT FINANCING, AND THE LIKE.

THE THIRD COMPONENT OF YOUR BANK'S OWN COUNTRY RISK MANAGEMENT SYSTEM IS THE INTERNAL REPORTING SYSTEM WHICH IS USED TO MONITOR AND CONTROL COUNTRY EXPOSURE. THE REPORTING SYSTEM

SHOULD BE DESIGNED TO SHOW COMPLIANCE WITH THE BANK'S OWN INTERNAL POLICIES AND LIMITS; IT SHOULD IDENTIFY ANY EXCEPTIONS TO THOSE POLICIES AND LIMITS; IT SHOULD ESTABLISH A METHOD TO REPORT THE EXCEPTIONS; AND IT SHOULD PROVIDE FOR AT LEAST AN ANNUAL REVIEW OF THE PORTFOLIO COMPOSITION OF EACH COUNTRY. SETTING THE BANK'S OVERALL GOALS, DETERMINING METHODS TO ACCOMPLISH THEM, TAKING INTO ACCOUNT THE RISK INVOLVED, DIRECTING MANAGEMENT TO IMPLEMENT THE POLICIES, AND MONITORING THE RESULTS ARE BASIC DIRECTOR RESPONSIBILITIES IN EVERY ASPECT OF BANK OPERATIONS, INCLUDING INTERNATIONAL LENDING. OUR EXAMINERS WILL WANT TO ASSURE THAT YOUR COUNTRY RISK MANAGEMENT SYSTEM IS COMPREHENSIVE AND EFFECTIVE.

I SHOULD NOTE THAT THE ACT CURRENTLY IS BEING IMPLEMENTED THROUGH REGULATIONS WHICH AFFECT ONLY U.S. DOMESTIC BANKS, EDGE CORPORATIONS, AND BANK HOLDING COMPANIES. THE RULES CURRENTLY DO NOT APPLY TO U.S. BRANCHES AND AGENCIES OF FOREIGN BANKS OR COMMERCIAL LENDING COMPANIES WHICH ARE SUBSIDIARIES OF FOREIGN BANKS. HOWEVER, CONSIDERATION CURRENTLY IS BEING GIVEN BY THE REGULATORS AS TO WHETHER THOSE ENTITIES SHOULD BE MADE SUBJECT TO THE REGULATION, AND THE REGULATORS HAVE INVITED COMMENT ON THE SUBJECT.

THIS ISSUE OF WHETHER BRANCHES AND AGENCIES OF FOREIGN INSTITUTIONS SHOULD BE SUBJECT TO THE PROVISIONS OF THE ACT IS A COMPLICATED ONE. ON THE ONE HAND, SOME OBSERVERS POINT OUT THAT

OUR POLICY OF ACCORDING NATIONAL TREATMENT TO ALL BANKING ORGANIZATIONS IN THIS COUNTRY ARGUES FOR INCLUDING THEM. ON THE OTHER HAND, THERE IS OUR AGREEMENT WITH THE CENTRAL BANKS OF MAJOR COUNTRIES THAT THE SUPERVISION OF THE GENERAL SOLVENCY OF BANKS' WORLD-WIDE OPERATIONS SHOULD REST WITH THE HOME COUNTRY SUPERVISOR. THIS AGREEMENT IS BASED ON THE ARGUMENT THAT THE HOME COUNTRY IS THE ONLY ONE THAT CAN ACCOMPLISH SUPERVISION ON A FULLY CONSOLIDATED BASIS. RESERVES AGAINST TRANSFER RISK WOULD FALL INTO THE CATEGORY OF SUPERVISION OF GENERAL SOLVENCY. AS I MENTIONED, NO DECISION ON THIS ISSUE HAS BEEN REACHED AT THIS TIME, AND THE FEDERAL AGENCIES ARE STILL RECEIVING COMMENTS FROM INTERESTED PARTIES.

INTERNATIONAL LENDING TO LDCs

FINALLY, I WOULD LIKE TO MAKE A FEW REMARKS ON THE SUBJECT OF INTERNATIONAL LENDING TO THE LESS-DEVELOPED COUNTRIES. LET ME SAY FIRST THAT THERE IS NOTHING BASICALLY WRONG WITH BANK LENDING TO DEVELOPING COUNTRIES, NOR IS IT WRONG FOR A DEVELOPING NATION TO BORROW ABROAD TO HELP FINANCE ECONOMIC GROWTH. THIS IS A CHARACTERISTIC COMMON TO ALL GROWING CORPORATIONS AS WELL AS TO COUNTRIES IN THE EARLY STAGES OF ECONOMIC GROWTH. OUR OWN COUNTRY RELIED TO A LARGE EXTENT ON FOREIGN BORROWING FOR THE DEVELOPMENT OF THE WEST DURING THE 19TH CENTURY.

WHAT I DO FIND DISTURBING, HOWEVER, IS THE WIDE SWING IN DEVELOPMENT FINANCING IN THE LAST TEN YEARS. THROUGH MOST OF THE

1970s, FUNDS WERE SO PLENTIFUL IN INTERNATIONAL CAPITAL MARKETS THAT INTEREST RATES, AFTER ALLOWING FOR THE RATE OF INFLATION, OFTEN WERE NEGATIVE. FLUSH WITH FUNDS, BANKS WERE EAGER TO LEND; DEVELOPING NATIONS TOOK ADVANTAGE OF THE CHEAP CREDIT AND BORROWED HEAVILY TO MAINTAIN THEIR ECONOMIC GROWTH IN THE FACE OF OIL-PRICE INCREASES AND WORLD RECESSIONS. IN THESE CIRCUMSTANCES, BORROWING COUNTRIES IN EFFECT WERE ENCOURAGED BY THE MARKET TO OVER-SPEND AND OVER-INVEST. HOWEVER, AFTER TROUBLE SURFACED IN 1982, AN ABRUPT SHIFT IN SENTIMENT TOOK PLACE, LEADING TO A STEADY AND LARGE WITHDRAWAL OF FUNDS FROM INTERNATIONAL LENDING, AND LEAVING BORROWING COUNTRIES IN A DESPERATE STRUGGLE TO CARRY AND SERVICE THEIR HEAVY BURDEN OF FOREIGN DEBT. AS EVERY FINANCIAL MANAGER KNOWS, SUCH A FEAST-OR-FAMINE APPROACH IS A DISRUPTIVE WAY TO MANAGE A FINANCIAL SYSTEM. IF OVER-LENDING IN THE PAST IS ONE OF THE CAUSES OF THE INTERNATIONAL-DEBT PROBLEM, I SUBMIT THAT EXCESSIVE RETRENCHMENT HAS EXACERBATED THE PROBLEM.

PERHAPS A COMPARISON WITH DOMESTIC LENDING PRACTICES WILL MAKE MY POINT CLEAR. IN DOMESTIC LENDING, WHEN A LONG-TERM CUSTOMER IS IN FINANCIAL TROUBLE, THE LENDING BANK USUALLY GOES IN, AND JOINTLY WITH THE MANAGEMENT, WORKS OUT A RESTRUCTURING PROGRAM TO ELIMINATE WASTE AND PUT THE CUSTOMER BACK ON TRACK. BANKS DO THIS NOT JUST AS A SERVICE TO SOCIETY, BUT BECAUSE IT IS IN THEIR LONG-RUN INTEREST TO DO SO.

IN INTERNATIONAL LENDING, HOWEVER, THE CONSTRAINTS ARE CONSIDERABLY DIFFERENT. UNLIKE DOMESTIC LENDING, COMMERCIAL BANKS ARE NOT IN A POSITION TO GO INTO A SOVEREIGN NATION AND WORK OUT, LET ALONE STIPULATE, A STABILIZATION PROGRAM WITH THE GOVERNMENT OF THE COUNTRY. SOME BANKS ATTEMPTED TO DO THAT A FEW YEARS BACK WITH PERU AND WERE QUICKLY ASKED TO LEAVE.

SOLVING THE LDC DEBT PROBLEM

WHAT ARE BANKS TO DO THEN, WHEN A SOVEREIGN DEBTOR NATION IS IN FINANCIAL TROUBLE? LEFT ALONE, THERE IS INDEED LITTLE THAT BANKS CAN DO OTHER THAN TO RETRENCH IN THEIR LENDING TO THAT COUNTRY, AND IN THE PROCESS EXACERBATE THE COUNTRY'S DEBT-SERVICING PROBLEMS. FORTUNATELY, HOWEVER, THE BURDEN OF DEVELOPING A SOLUTION TO THE PROBLEM DOES NOT FALL ON BANKS ALONE. THE INTERNATIONAL-DEBT PROBLEM IS A WORLD FINANCIAL PROBLEM BECAUSE THE PROSPERITY AND STABILITY OF THE WORLD ECONOMY ARE AT STAKE. LIKE COLLECTIVE SECURITY, THE INTERNATIONAL DEBT PROBLEM IS ONE THAT THE WORLD COMMUNITY, INCLUDING THE BANKING COMMUNITY, MUST FACE AND JOINTLY RESOLVE THROUGH COOPERATION AND COORDINATION.

IN THIS REGARD, THE IMF-FUNDING BILL WHICH THE PRESIDENT SIGNED INTO LAW LAST NOVEMBER TRULY MARKED A MILESTONE IN THE WORLD'S COLLECTIVE STRIDE TOWARDS INTERNATIONAL FINANCIAL STABILITY. WITH THE BILL'S PASSAGE AND SIGNING INTO LAW, THE UNITED STATES JOINED THE OTHER 145 IMF-MEMBER NATIONS IN

INCREASING THE RESOURCES AVAILABLE TO THE INTERNATIONAL MONETARY FUND. THE RESULT IS THAT THE IMF HAS BEEN BETTER EQUIPPED TO ASSIST THE DEBTOR NATIONS TO HELP THEMSELVES OUT OF SOME VERY DIFFICULT DEBT SITUATIONS. A KEY FEATURE OF THESE EFFORTS IS THE SO-CALLED "CONDITIONALITY" OF IMF LOANS, WHICH MEANS THAT ACCESS TO IMF CREDIT IS CONDITIONED UPON THE BORROWING COUNTRY'S ADOPTING AN APPROPRIATE ADJUSTMENT PROGRAM FOR REDUCING BALANCE-OF-PAYMENTS DEFICITS. IN SHORT, THIS MEANS THAT THE AVAILABILITY OF FINANCING IS MADE CONTINGENT UPON THE IMPLEMENTATION OF ECONOMIC ADJUSTMENTS PROGRAMS BY THE BORROWING COUNTRY. THIS IS PRECISELY WHAT BANKS DO IN THEIR LONG-TERM LENDING TO DOMESTIC CUSTOMERS, AND IS WHAT THEY NOW ARE DOING IN INTERNATIONAL LENDING IN COORDINATION WITH THE IMF LENDING PROGRAMS.

NEVERTHELESS, ULTIMATELY BANKS CANNOT RELY ON THE IMF OR UPON ANYONE ELSE TO ASSESS RISKS IN INTERNATIONAL LENDING, AND NO AMOUNT OF INTERNATIONAL COORDINATION IN LENDING CAN EVER REPLACE INDIVIDUAL RESPONSIBILITY IN RISK-TAKING. THAT IS WHY REGULATORY AGENCIES AND THE CONGRESS HAVE INSISTED ON A HIGH STANDARD OF PRUDENCE IN INTERNATIONAL LENDING. IN SHORT, THE PURPOSE OF INTERNATIONAL COORDINATION IS TO SAFEGUARD THE SOUNDNESS OF THE INTERNATIONAL FINANCIAL SYSTEM; INDIVIDUAL BANKS ARE STILL ACCOUNTABLE FOR THEIR OWN RISK-TAKING.

SUMMARY AND CONCLUSION

LET ME SUMMARIZE. THE LDC-DEBT PROBLEM HAS CAUSED A GREAT DEAL OF CONCERN IN RECENT YEARS. FORTUNATELY, AS A RESULT OF

UNPRECEDENTED COOPERATION AMONG NATIONAL GOVERNMENTS, INTERNATIONAL AGENCIES AND COMMERCIAL BANKS, THE WORLD HAS BEEN ABLE TO WEATHER A SERIES OF POTENTIALLY HIGHLY DISRUPTIVE STORMS IN THE ARENA OF INTERNATIONAL FINANCE. FROM THESE EXPERIENCES, A LOT HAS BEEN LEARNED ABOUT THE HAZARDS OF INTERNATIONAL LENDING, AND THE SUCCESS WE HAVE HAD IN MAINTAINING INTERNATIONAL FINANCIAL STABILITY THROUGH INTERNATIONAL COOPERATION HAS BOLSTERED OUR CONFIDENCE IN DEALING WITH FUTURE PROBLEMS. AS WE CONTINUE TO DEAL WITH IMMEDIATE PROBLEMS, CONGRESS HAS ACTED TO ENHANCE THE LONG-RUN VIABILITY OF INTERNATIONAL LENDING BY MANDATING A STRENGTHENING OF THE REGULATORY AND SUPERVISORY FRAMEWORK OF INTERNATIONAL BANK LENDING. HOPEFULLY, WE ALL HAVE LEARNED SUFFICIENTLY FROM PAST EXPERIENCES TO PUT INTERNATIONAL LENDING ON A SOUNDER FOOTING.