the LEDGER

economic education newsletter

I.O.U. INTERNATIONAL

DATELINE MEXICO CITY, September 1, 1982

The President of Mexico nationalizes the country's banks and imposes foreign exchange controls. Mexico is struggling to pay the interest on its estimated $80 billion foreign debt.

DATELINE BRASILIA, December 1, 1982

The President of the United States makes his first stop on a tour of Latin America. He exchanges toasts with the President of Brazil and announces that the United States will help put together a $1.23 billion emergency loan package for Brazil. Brazil's foreign exchange is nearly depleted, and it owes foreign creditors more than $80 billion.

DATELINE WASHINGTON, D.C., December 3, 1982

The Bureau of Labor Statistics reports that the U.S. jobless rate hit 10.8%. Close to 12 million men and women are out of work. Another 1.6 million are classified as "discouraged workers" who have given up looking for work. "Discouraged workers" are not included in the Bureau's jobless index.

The American economy has fallen on hard times. Business failures are up, and industrial activity is down. Rust and crabgrass are taking over vacant factory sites. People who once produced steel and high-quality durable goods for the entire world now stand in unemployment lines and wonder if the idle factories will ever reopen. America is grappling with the most severe economic downturn since the Great Depression.

The global economic outlook is even more disquieting. Several countries

have borrowed heavily from American and European banks in order to finance economic development. Now they are hard-pressed to repay the loans. Mexico and Brazil, for example, both owe foreign banks more than $80 billion, and both countries teeter on the verge of default.

The prospect that a major debtor nation may default on its loan commitments sends shivers through the world's financial centers. Talk of emergency loans and "bailout" plans is on the increase.

Such talk confounds many recession-shocked Americans. Few express any enthusiasm for the recent $1.23 billion emergency loan to Brazil. Why, they ask, should the United States bail out a foreign country or a big bank at a time when nearly 12 million Americans languish on unemployment?

This question, like so many of the other questions that surround international debt, does not lend itself to simple answers. The issues are complex, and the answers are sometimes frustrating.

During the mid-1970s, an unexpected shock jolted the international financial community. The Organization of Petroleum Exporting Countries (OPEC) asserted itself and oil prices soared. Wealth flowed from the industrialized nations into the treasuries of petroleum producing countries.

As OPEC profits mounted, much of the money returned to western banks in the form of petrodollars. (Surplus OPEC profits that were deposited in western banks were called "petrodollars.") Bankers suddenly found themselves with a vast pool from which to make loans.

A flurry of international banking activity ensued. Lenders aggressively courted potential borrowers, and loan officers journeyed to far-flung destinations in pursuit of new business.

Many of the new loans were made to governments or to nationalized industries that were guaranteed by governments. A relatively small portion of the money went to finance specific projects. Much of it was ultimately used to finance the growing deficits of countries that were hard hit by rising oil prices. This represented somewhat of a departure from past lending patterns.

Prior to the rapid influx of petrodollars, the World Bank and the International Monetary Fund (IMF) made most of the loans to governments of developing countries *(see inset)*. Commercial lenders generally preferred to deal with private corporations that borrowed money for specific projects. Loans to governments of developing countries were considered risky.

As petrodollar deposits increased, however, so did the competition among private lenders. Bankers vied with one another to make new loans, not only in such "safe" countries as Canada and Australia but also in countries that presented a greater degree of risk and uncertainty. Brazil and Mexico soon topped the list of debtor countries.

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For centuries, Brazil was a land of unfulfilled promise. Cynical Brazilians often quipped that, "Brazil is rich, but Brazilians are poor."

Things began to change after a military government took power in 1964, and Brazil embarked on an ambitious program of economic expansion. Much of the money to finance that expansion came from large commercial banks in the United States and Europe. Lenders were attracted by Brazil's economic potential and political stability. In a relatively short period of time, Brazil became a major exporter of steel, footwear, textiles, and agricultural products.

Rising oil prices threatened to end the economic progress, but the Brazilian government took steps to make the country less dependent on imported oil. (Alcohol produced from Brazil's abundant sugar crop now provides fuel for many Brazilian cars.) Economic expansion continued, and increased export earnings helped Brazil to secure more loans from foreign banks. It looked as if the Brazilian economy would recover from the oil price shock.

Then recession struck the United States and Europe. The American and European economies slowed down and so did the demand for Brazilian exports. The sharp drop in exports led to a corresponding drop in Brazil's foreign exchange earnings. (Foreign exchange is generally defined as anything that is acceptable to discharge debts between one country and another. U.S. dollars, German marks, Swiss francs, and Japanese yen are all examples of foreign exchange. Most developing countries need foreign exchange in order to repay foreign debt and purchase vital imports.)

Rising interest rates dealt the Brazilian economy yet another blow. As the worldwide recession deepened, Brazil had to borrow more money just to roll over its existing debt. The new short-term loans carried ever higher interest rates. The cost of servicing Brazil's foreign debt skyrocketed, and its export earnings continued to plunge. By the end of 1982, Brazil owed foreign creditors more than $80 billion, and its foreign exchange accounts were nearly depleted.

Mexico, too, owes foreign creditors more than $80 billion. The Mexicans began to borrow heavily after they struck oil during the mid-1970s. They hoped to repay the loans with money earned from oil exports.

Then worldwide recession slowed the demand for Mexican oil, and Mexico's foreign exchange earnings plummeted. Mexico is now struggling just to pay the interest on its growing foreign debt.

Mexico and Brazil are both strapped for cash. They need to increase exports and thereby earn more foreign exchange. But that won't happen as long as the United States and Europe remain mired in recession. In the meantime, Mexico, Brazil, and a growing list of other debtor nations must borrow short-term at high rates just to service their existing debt.

Lenders and borrowers both have a stake in maintaining international financial stability.

As international debt mounts, so does concern among lenders. Some wonder if they will ever be repaid. Others wonder how much longer they will be in a position to continue lending. In either case, if private lenders suddenly tighten their purse strings, the added strain could push weak debtor countries closer to default.

Against this background, official lenders such as the International Monetary Fund, the Bank for International Settlements (BIS), the World Bank, and even the U.S. Treasury are taking steps to keep borrowing countries liquid. In December 1982, the U.S. Treasury lent Brazil $1.23 billion, and the Bank for International Settlements agreed to provide Brazil with a $1.2 billion "bridge" loan. (Nearly half of the money for the BIS loan came from the U.S. Treasury.) These short-term loans helped Brazil to meet its day-to-day financial obligations while the IMF considered Brazil's request for longer-term financing. The international financial community also banded together during the autumn of 1982 to save Mexico from default.

Loans of this type provide debtor nations with vital financial assistance, but they sometimes create thorny political problems as well. Mexico, for example, will probably have to lower its expectations for economic growth and agree to cut government subsidies of food, fuel, and transportation in order to qualify for a loan from the IMF. Such measures are bound to be unpopular with Mexican voters. Indeed, the Fund's insistence upon financial orthodoxy has helped to create a perception among developing countries that IMF lending practices represent a form of financial domination by the wealthy industrialized nations.

Expanded official lending *(see inset)* has also created sensitive political issues for the governments of wealthier nations. They must decide how much additional responsibility they are willing to assume for the current state of international finances. The United States already contributes more to the International Monetary Fund than any other nation. Any increase in the U.S. commitment to the IMF would have to pass Congress, and Congress might be hard-pressed to approve such an increase.

For a variety of reasons, Americans seem less willing to take on additional international commitments. Some view increased U.S. assistance to debtor nations as yet another bailout of foreign countries. Others see it as a bailout of improvident big banks. The majority are simply far more concerned about high interest rates and record U.S. unemployment.

The world, however, is a far more complicated place than it once was. The Atlantic and the Pacific no longer buffer America from the problems of other countries. Default by a major debtor nation could have a profound impact on the United States. One in six U.S. jobs depends on exports, and about one-third of U.S. corporate profits comes from overseas. In December 1982, the Secretary of the U.S. Treasury told Congress that failure to help debtor countries, "could mean a loss of exports, a drain on international economies, and there is a chance that the countries' political arrangements could change dramatically."

Likewise, if a major bank were to suffer a financial reversal due to default by a debtor nation, the consequences would not be borne solely by the bank and its shareholders. A significant loss by one lender could prompt other lenders to suddenly pull back on international lending. Such action could in turn undermine the position of other debtor countries. Large scale international losses by a major lender could also affect the willingness of lenders to extend credit to domestic borrowers.

In short, the web of world credit ties the fortunes of lending countries to the fate of borrowing countries. Lenders and borrowers both have a stake in maintaining international financial stability.

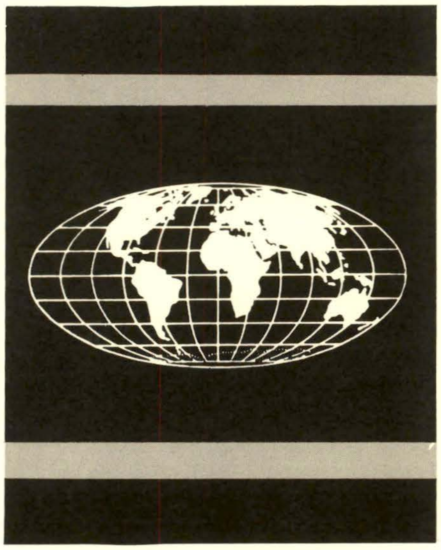
FOLLOW-UP

1) John Maynard Keynes observed that, "If you owe your bank manager a thousand pounds, you are at his mercy; if you owe him a million pounds, he is at your mercy." How does Keynes' observation relate to the current international debt situation?
2) In the words of a prominent U.S. banker, "Countries don't go bankrupt." How does this statement relate to the current international debt situation?
3) If a major debtor nation defaults on loan commitments to a large American bank, what role, if any, should the United States government assume?

THE OFFICIAL LENDERS

The International Monetary Fund (IMF), the World Bank, and the Bank for International Settlements (BIS) are multi-lateral institutions that help to maintain international financial stability. The World Bank and the IMF are based in Washington, D.C. The Bank for International Settlements is located in Basel, Switzerland.

In general, the World Bank makes long-term loans for specific development projects, while the IMF helps its 146 member countries finance temporary balance-of-payments deficits. The Bank for International Settlements is often called "a central bank for central banks." The BIS usually makes short-term emergency loans to developing countries.



Fed Update

Charge Policy

Effective January 1, 1983, the Federal Reserve Bank of Boston instituted a charge policy for certain educational materials listed below. All requests for these materials require payment in advance. Include a check made payable to the "**Federal Reserve Bank of Boston.**"

If your request includes other titles that do not carry a charge, we will process that portion of the request.

State the total number of copies needed, but be sure to send payment only for the priced copies.

Title	Quantity	Price
Introducing Economics	Copies 1 – 9	No charge
	Copy 10 & above	50¢ each
Historical Beginnings	Single copy	No charge
	Copy 2 & above	$1.00 each
16mm Film Rentals	$10.00 rental fee per film per booking	

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to: Joanne Vance
Public Services, T-3
Federal Reserve Bank of Boston
Boston, MA 02106

"AAMARP at the Fed," an exhibition of paintings, drawings, prints, photographs, fiber works, and mixed media imagery sponsored by the African-American Master Artists-in-Residency Program of Northeastern University, will be on view in the Federal Reserve Bank of Boston gallery from January 11 - February 18, 1983.

The exhibition is free and open to the public. Public viewing hours are Monday through Friday, from 10:00 a.m. until 4:00 p.m. The display area is located on the ground floor of the Federal Reserve Bank building at 600 Atlantic Avenue, across from South Station.

Multi-Media

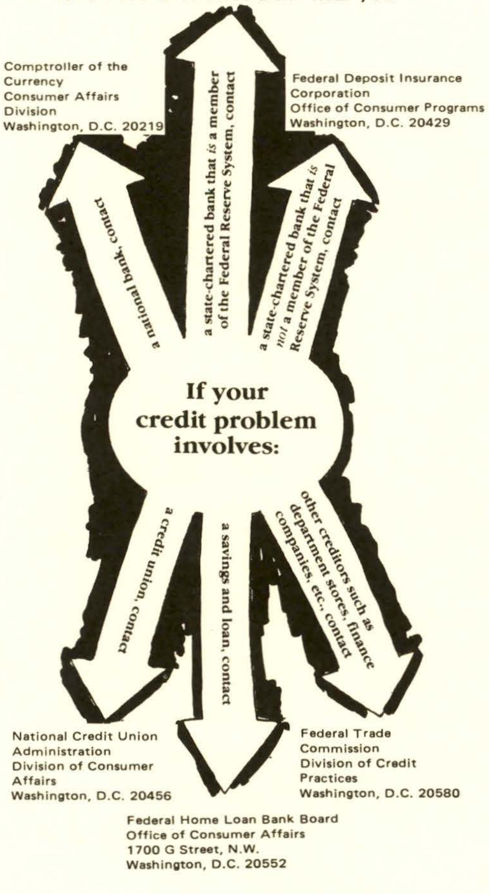
Directory of Home Economics Materials Printed in Spanish, published by Texas Agricultural Service

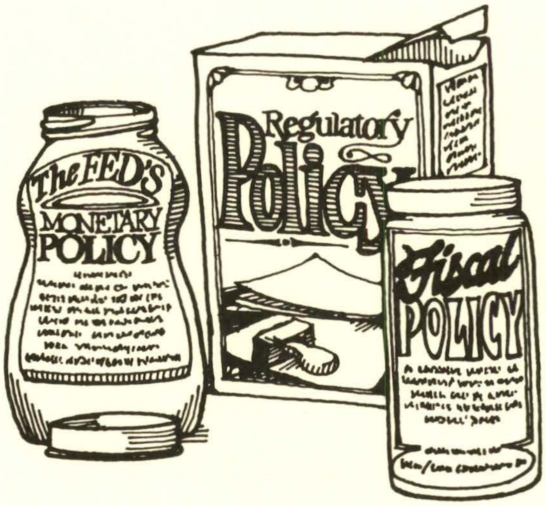
As the title suggests, this 63-page directory lists a wide variety of home economics materials printed in Spanish. The listing covers six major categories: 1) foods and nutrition, 2) family life education, 3) family resource management, 4) clothing, 5) health and safety, and 6) housing and home furnishings. For more information, please contact Texas Agricultural Extension Service, Room 213, Special Services Building, The Texas A & M University System, College Station, Texas 77843.

Credit Guide, published by the Federal Reserve Bank of Chicago

Credit Guide presents basic guidelines for obtaining and using consumer credit. It discusses how a lender assesses a borrower's creditworthiness, and it describes the type of information contained in a credit record. In addition, the publication outlines the safeguards and responsibilities provided under several pieces of consumer credit legislation. Copies of **Credit Guide** are available, free of charge, from the Public Information Center, Federal Reserve Bank of Chicago, P.O. Box 834, Chicago, Illinois 60690.

The Federal Reserve Bank near you





FOCUSING ON THE FED

Focusing on the Fed, published by the Board of Governors of the Federal Reserve System

Focusing on the Fed provides students in grades 7-12 with a look at the Federal Reserve System. This teaching unit complements **The Fed: Our Central Bank,** a 19-minute color film.

Focusing on the Fed uses four activities to help students understand: 1) how the Fed is organized; 2) the role the Fed plays in assuring a well-managed supply of money and credit; 3) the tools the Fed uses to manage the nation's money supply; and 4) how the Federal Reserve and various federal groups work together to curb inflationary pressures and promote a stable economy. The unit also includes a wall chart and four master sheets that enable teachers to reproduce program activities. To order **Focusing on the Fed** and **The Fed: Our Central Bank,** please write to Publications, the Public Services Dept., Federal Reserve Bank of Boston, Boston, MA 02106 or call (617) 973-3459.

New England Update

CONNECTICUT

The Center for Economic Education/Central Connecticut State College will host the second evening of its "Distinguished Speakers Series" on Monday, February 7. The speaker is Lester C. Thurow, author of ***Zero Sum Society.*** His topic is "Economic Survival in the '80s."

On Monday, April 4, Lindley H. Clark, Economic News Editor of the ***Wall Street Journal,*** will speak on "Reordering America's Priorities."

Frank E. Morris, President of the Federal Reserve Bank of Boston, was the series' inaugural speaker. On October 17, 1982, Mr. Morris discussed "Economic Issues — Election '82."

For more information on the "Distinguished Speakers Series" please contact the Center for Economic Education, Marcus White Hall, Room 117, Central Connecticut State College, New Britain, CT 06050.

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