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FINANCIAL MARKETS: A VIEW FROM THE  
PERIPHERY

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Private international financial intermediation has witnessed successive cycles for the last 160 years. In this century, it blossomed before WW-I and through the 1920s. In the 1930s and 1940s, private capital markets went into an eclipse, to reappear timidly in the 1950s, booming in the 1960s and 1970s. Theorizing about financial markets has on the whole followed those cycles. Few are the examples of powerful propositions emerging from general financial theories which are independent of historically-specific institutional arrangements.

This paper discusses the interplay of financial aspects of the history of world capitalism with theorizing about financial markets, carried out mainly in Northern countries. It is organized as follows. Three epochs in financial arrangement and theories are first briefly reviewed, giving special emphasis to their impact on peripheral countries. They are the pre-1929 years, 1944-1973 and 1973-1980. Stylized facts for the 1970s follow. Then some systemic issues of international financial arrangements for the 1980s are discussed. Finally, analytical problems suggested by unexpected consequences of recent attempts at financial reform in Latin America are debated.

Frequent references will be made to orthodoxy. This term is not easy to define; it may be helpful to separate "academic" from "practical orthodoxy". The former is the product of leading academic centers of the time; it tends to be flexible and agnostic. Its leading thinkers often are its own major critics, frequently curious about heterodox notions. Practical orthodoxy is more assertive. It is found in the editorials of the business press, among private or public executives with Masters' degrees, and among some of the more politically or financially ambitious academics. The latter sometimes play a double role: in their Northern universities, disciplined by their colleagues, they are cautious scientists; during their summer tours of the periphery, their libido imperante

unleashed, they become fountainheads of practical orthodoxy.

It is practical orthodoxy that puts the system to work and typically sets the Northern tone in North-South debates. As such it will be the main focus of our analysis.

## I. The Pax Britannica

The pre-1929 international financial order enjoyed a degree of intellectual hegemony which has never been regained. The gold-exchange standard was regarded as the natural regulator of the balance of payments. Current account deficits and increases in international reserves were financed using bonds with long maturities and fixed interest rates as well as via direct investments. Under the long Pax Britannica some countries (Germany, the USA) graduated from the role of capital importers to that of capital exporters. At least until the 1920s, London ruled the waves and regulated the whole system, whose occasional crisis were regarded as passing aberrations or a necessary purging of "excesses".

National financial systems showed greater heterogeneity. In the United States populist pressures blocked the creation of a central bank until early this century. France and Germany developed financial systems more centralized and state-dominated than that of the United Kingdom, as analyzed by Alexander Gershenkron. Apparently, British hegemony in international relations of all types explains the greater homogeneity of the international financial rules of the game, in contrast with those applicable nationally.

African and Asian colonies had little choice in their financial systems, and tended to follow prevailing orthodoxy. Several independent Latin American countries, however, had difficulties adhering faithfully to the

gold-exchange standard.<sup>(1)</sup> Mexico followed a silver standard for many years, while silver depreciated vis-a-vis gold. Argentina and Brazil often resorted to an "inconvertible paper standard", frequently accompanied by fiscal deficits and inflation (the U.S. went through a similar period after its Civil War).

These Latin American experiments with flexible exchange rates were viewed with fascinated disgust by orthodox scholars and bankers. The recurrent need for foreign finance as well as domestic political pressures to keep debt service from taking too much of a share of the budget would sporadically dictate a return to the gold-exchange standard and greater controls over domestic credit expansion. Foreign missions played important roles in attempted returns to orthodoxy. Examples include the Montagu Mission to Brazil in 1924 and those of Professor Krammer to several Andean countries.<sup>(2)</sup> At least in the case of the Brazilian return to the gold-exchange standard in the 1920s, the economic results are regarded as negative (During the 1920s the League of Nations also participated in missions associated with Stabilization Plans, particularly within Europe).

The conditionality attached to international lending before 1929 included not only that linked to the natural desire of bankers to be punctually paid at least the interest due on loans. Political considerations also played a role in regulating access to capital markets. French and German lending were heavily influenced by political factors, as illustrated by the former's loans to Czarist Russia and the latter's loans to the Middle East.<sup>(3)</sup> Brazilian access to the New York market was blocked by Herbert Hoover, then Secretary of Commerce, in retaliation for the Brazilian coffee valorization scheme; Brazilian access to the London market in the late 1920s was also discreetly vetoed by the Foreign Office in retaliation for the Brazilian withdrawal from the League of Nations.<sup>(4)</sup>

direct nature, and a good investment climate involved little more than punctual servicing of the debt. Direct foreign investment, suppliers' credits plus official development assistance of various sorts made up the bulk of capital inflows into the periphery well into the 1960s. All of these forms of finance implied a complex and fairly intimate relationship between lenders and borrowers.

Academic orthodoxy had surprisingly little to say about the benefits and costs of the postwar structure of capital flows between North and South. There was a tendency to aid up all forms of capital flows into one aggregate necessary to finance the "foreign exchange gap". A common attitude was that the greater this aggregate flow, the better all around. This academic complacency was first punctured by peripheral (and Australian, Canadian, and European) criticism of some of the consequences of direct foreign investment and of multinational corporations. Some aspects of official development assistance also came under closer scrutiny, leading to more sophisticated evaluations of the grant element involved in such flows.

As noted earlier, already in the 1950s the IMF and the IBRD began to depart from the vision of at least some of their founding fathers, especially that of John Maynard Keynes. The IBRD stuck to the financing of specific projects, avoiding program lending. The IBRD also refused to lend to oil state enterprises, arguing that there was plenty of private oil corporations willing to invest. The IMF staff increasingly favored fixed exchange rates buttressed by rigorous credit policies, in a pattern similar to the pre-1929 rules of the game. In its dealings with peripheral countries given to heterodoxy, such as several Latin American countries, the IMF missions revived the spirit of Montagu and Niemeyer, advocating stiff stabilization plans. It could be argued that at least during the 1950s the leverage of the IMF missions was not smaller than those of Montagu and Niemeyer, as

The conditionality imposed before 1929 on the weakest peripheral countries included foreign control over their tariff revenues and other aspects of their fiscal and monetary machinery; this was the case of some Caribbean and Central American nations, in a fashion similar to that of Zaire during the 1970s.

The great depression of the 1930s destroyed the gold-exchange standard and international capital markets as they existed before 1929. The prestige of high finance collapsed; in the USA financiers were the target of New Deal attacks, and new legislation limited the flexibility of national and international financial intermediaries. European nazi-fascism popularized exchange and financial controls going beyond those practiced in other industrialized countries. Several industrial countries declared moratoria of domestic debts and witnessed drastic reorganizing of their financial systems.

Peripheral countries with certain political autonomy, such as Argentina, Brazil and Colombia, reacted to the Great Depression with a fairly rapid abandonment of gold standard orthodoxy, wisely avoiding classical remedies. Thus, Brazil was advised by a mission headed by Sir Otto Niemeyer, of the Bank of England, to return to a fixed exchange rate and to maintain convertibility, on July 1931!<sup>(5)</sup> These large or active Latin American countries allowed substantial depreciations of their exchange rate, imposed exchange controls and maintained a reasonable degree of domestic liquidity. Normal debt servicing was suspended in most cases. Partly due to the closing of international capital markets, Latin American countries showed greater interest in mobilizing domestic resources via the tax system and the creation of new government controlled credit institutions. The economic performance of these countries during the 1930s was remarkably good, better than that of major industrialized countries.

## II. The Pax Americana

The international financial order which emerged from Bretton Woods in 1944, lasting until 1973, initially reflected the 1930s disenchantment with laissez faire in financial transactions and was influenced by Fabian / New Deal notions then dominant in the United Kingdom and the United States. The International Monetary Fund (IMF) was born accepting changes in exchange rates to correct "fundamental disequilibrium" and allowing controls over capital movements. The International Bank for Reconstruction and Development (IBRD) reflected pessimism regarding the viability of private financial intermediation in the postwar world. In the USA, the official EXIMBANK, created in the 1930s originally to finance trade with the USSR, was to play an important role in financing US exports of capital goods, and was a critical institution in US-Latin American economic relations. Already in the 1950s and even more so in the 1960s, the original Fabian / New Deal flavor of the Bretton Woods institutions was diluted, but they continued to reflect certain theoretical and practical eclecticism absent in the pre-1929 international financial order.

At least during the late 1940s and 1950s, both national and international financial intermediation received low priority. The ultra-Keynesian notion that "money does not matter" could easily be extended to "financial intermediation does not matter". It was not until the late 1950s that Europe abandoned rigorous exchange controls (the United Kingdom maintained them until 1979)..

Early in the postwar, a new practical orthodoxy appeared regarding capital movements. Especially in the USA, it became common to hear advice aimed at peripheral countries regarding the importance of maintaining a favorable climate for direct foreign investments from the North. Before 1929 portfolio investments had dominated those of

international credit sources in the 1950s were few, and tended to follow the leadership of the IMF (and the US Treasury). The consequences of the practical orthodoxy of the IMF were not very different from those of the Montagu mission.

As late as the 1960s, those advocating greater resource transfers from North to South would call for more official development assistance under various forms. Regional development banks were created, adding new official financial intermediaries. New aid relationships were sought. Hopes were also expressed for a new spirit in direct foreign investment.

In the meanwhile, the great postwar economic expansion which culminated in the early 1970s was creating new conditions eroding the postwar practical orthodoxy. Almost accidentally, a truly international capital market emerged around the mid-1960s, in the form of Eurocurrency credits. Growing macroeconomic disharmonies among the industrialized countries in the late 1960s, the US involvement in Vietnam, and increased capital mobility put enormous pressures on fixed parities. These circumstances led to abandonment by the US of gold convertibility in August 1971 and to generalized floating of key currencies in early 1973. This Annus Mirabilis culminated with the sharp rise in oil prices, putting an end to the postwar era of cheap energy.

### III. Pax Arabica?

The period 1973-1980 has been highly unusual in the history of international finance. A new type of capital exporter has emerged, which has no historical precedent. Consider the following contrast between OPEC capital exporters and those of earlier eras:

a) The military power of major OPEC countries is trivial, certainly insufficient to enforce financial contracts against recalcitrant debtors. It has been noted that every lender ultimately needs bailiffs at his back;<sup>(6)</sup> OPEC does not have them.

b) OPEC countries lack capital goods industries, or indeed an extensive industrial base, to achieve the real transfer ultimately desired by foreign-exchange - constrained capital importers. OPEC's technological base is weak. It is difficult to imagine the equivalent to British exports of railway equipment or US direct foreign investment for the OPEC case. Oil is a non-renewable asset for OPEC, but a current input for importers.

c) OPEC capital exporters have only limited financial institutions of their own; they rely heavily on financial intermediaries of industrialized countries.

d) OPEC national currencies are used only marginally as reserve or vehicle currencies; the influence of OPEC over international monetary arrangements is growing, but is still modest.

e) The major component of OPEC wealth is a non-renewable resource. If investment in financial or real assets yield low rates of return, OPEC countries will tend to adjust by decreasing their oil output, i.e., by investing in oil under ground. Thus, part of OPEC's "home investment" can decrease the world's aggregate supply in the short and medium term.

These considerations imply a good deal of interdependence between the old and the new capital exporters, involving both economic and political aspects. The latter have become highly visible since 1973 in contrast with previous years, when they were discreetly hidden. The network of trade flows has also become more complex and multilateral, involving greater triangularity among old and new capital exporters and the Third World.

The eurocurrency market and international banking, already vigorous before 1973, have turned out to be (on the whole) flexible and efficacious instruments to accommodate the new capital exporters and the major semi-industrialized capital importers. But present arrangements remain historically anomalous and vulnerable in several ways. Besides the contrasts already noted between new and old capital exporters, consider the following points:

- a) The level of OPEC capital exports depends heavily on the real price of oil, rather than on stable long-term saving and investment propensities. During 1974 through 1977 OPEC surpluses were large, but tending to decrease until 1978, when they practically disappeared; in 1979 they rose sharply once again. For many importers of both oil and capital it is unclear whether the inflows are adding to productive capacity or simply maintaining consumption above levels sustainable in the long run (assuming the persistence of high real energy prices). Contrary to much historical experience in the periphery, worsening terms of trade accompany the capital inflow.
- b) The 1973-80 recycling was aided by "money mirage" in the part of capital exporters. Ex-post real yields on dollar-denominated financial assets were low, certainly lower than the yield of oil in the ground. One wonders how long such a money mirage can last. Yet insistence by capital exporters on "normal" positive real rates of return on their financial assets would add to the problems of capital importers.
- c) Political relations between old and new capital exporters are far from harmonious. Tensions between Iran and the USA, leading to the freeze in 1979 of Iranian assets in US-owned banks, had important negative repercussions in the syndicated Eurocurrency market. Catastrophic scenarios are much too easily imagined.

The historical anomalies raised by the emergence of OPEC as the major capital exporter deserve closer empirical scrutiny. The next section presents structural features of

international financial flows since 1973, emphasizing those of special interest to the Periphery.

#### IV. The 1970s: stylized facts and trends

This section is organized as follows. Global balance of payments patterns are reviewed first, emphasizing LDC deficits. Recent LDC financing arrangements are discussed and placed in historical perspective. The analysis of financial flows leads to a consideration of debt magnitudes and of the burden of debt servicing. A discussion of international private banking follows. The section closes with a comparative look at official and other lenders.

##### A. Global patterns

The global pattern of current account deficits and surplus during 1974-79 may be summarized as follows (yearly averages in billion current dollars):

<u>OPEC surplus</u>	<u>50</u>
Deficit of non-oil LDCs	42
-- (of which Latin America)	(14)
Deficit of industrialized countries	2
Deficit of socialist countries	6

Post-1973 net capital flows fluctuated sharply from year to year; the OPEC surplus was only \$5 Billion in 1978 and is estimated to be above \$100 Billion during 1980. The current dollar magnitudes shown above needed to be adjusted for inflation. In spite of these qualifications, the summary pattern of surplus and deficits captures essential structural features of the post-1973 world economy, which are likely to continue well into the 1980s. Indeed, with the indexing of oil prices and more prudent and steadier OPEC development plans, the indicated pattern could be more stable during the 1980s than it was in the 1970s,

institutional arrangements the allocation of debt service between interest and amortization is distorted in favor of the former by dollar inflation, thus increasing the magnitude of current account deficits. (A numerical example clarifies this question. Suppose that net debt at end of the previous year is \$1,000. Nominal amortization remittances this year is zero and the nominal rate of interest is 15 per cent per annum. Dollar inflation, affecting the debtor country export and import prices, is 10 per cent per annum. Consequently, the real value of net debt at end of this year is \$900. Of the \$150 interest paid out, \$50 is real interest and \$100 is real debt amortization. Ordinary balance of payments accounting registers a \$150 outflow in current account and a zero outflow in capital account. Inflation-proof accounting should register \$50 in service payments and \$100 in debt amortization, the latter being a capital account item. Real domestic savings is \$100 higher and real foreign savings \$100 lower than indicated by current accounting procedures.) In the case of Brazil, for example, it has been estimated that using inflation-proof accounting methods the current account deficit for 1978, expressed as a percentage of GDP, is 2.1 per cent instead of the 3.1 per cent given by uncorrected data. For 1979, the contrast is even stronger: 2.2 per cent versus 4.0 per cent<sup>(7)</sup>. Given an investment rate, estimates for domestic savings would have to be adjusted upwards by corresponding percentage points.

Evidence on LDC real capital formation is sketchy for the most recent years; for 1974-77, data indicate a maintenance or an increase in the share of gross domestic investment in GDP relative to 1972-73 for most major groups of countries, including Latin America.

### B. LDC financing arrangements.

Net financing needs during the 1970s have gone beyond

Table 1

CURRENT ACCOUNT DEFICIT OF LATIN AMERICA, EXCLUDING OIL EXPORTERS, RELATIVE TO EXPORTS OF GOODS AND SERVICES.

(percentagens)

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1950 - 54	8
1955 - 59	13
1960 - 62	22
1963 - 66	9
1967 - 69	16
1970 - 73	22
1974	41
1975	50
1976	31
1977	17
1978 (estimate)	19

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Sources: Computed from data presented in Cuadernos Estadísticos de la Cepal, El Balance de Pagos de América Latina 1960-1977, Naciones Unidas, Santiago de Chile 1979, Table 4. The table includes 16 countries; Cuba, the newly-independent Caribbean nations, Bolivia, Ecuador and Venezuela are excluded.

Table 2

FINANCIAL SOURCES FOR NON-OIL LDCs

(Annual averages in current Billion dollars)

Items	All non-oil LDCs		Major exporters of manufactures	
	1973	1974-78	1973	1974-78
Current account deficit	11.3	35.8	4.1	12.9
Net reserve accumulation	9.3	8.1	5.3	4.6
	<u>20.6</u>	<u>43.9</u>	<u>9.4</u>	<u>17.6</u>
Net transfers received by governments	4.5	6.9	1.0	1.3
Net direct investment	4.3	5.4	2.2	2.5
Net long-term borrowing:				
- - from official sources	5.5	12.4	2.3	4.1
- - from financial institutions	4.0	12.7	1.7	5.5
- - from bond issues, net	0.5	1.6	0.3	0.8
- - from suppliers' credits, net	0.4	1.3	0.3	0.7
- - other	1.5	1.7	1.3	1.2
Net short-term borrowing and errors and omissions	-0.1	1.9	0.3	1.4

Sources - Annual Reports and other publications of the International Monetary Fund.

those indicated by current account deficits; dollar inflation, real trade growth and a more uncertain international environment have led to an increase in the demand for reserves. Few LDCs could rely on perfectly flexible exchange rates to do away with reserves. Thus, Table 2 includes net reserve accumulation together with current account deficits to obtain net financial needs. The table covers all non-oil LDCs as well a category, major exporters of manufactures, which includes some Latin American and other semi-industrialized countries (detailed data are not yet available for Latin American alone).

As measured by traditional indicators, the reserve accumulation shown in Table 2 does not appear excessive, either for the group as a whole or for major exporters of manufactures. For all non-oil LDCs reserves amounted to 29 per cent of imports of goods and services during 1967-73; by 1978 the ratio was down to around 26 per cent. For major exporters of manufactures the corresponding figures were 32 and 29 per cent. During the 1970s many LDCs borrowed steadily, letting reserves fluctuate.

Table 2 suggests that two traditional sources of finance, grants and direct foreign investment, reduced their relative contribution during 1974-78. For Latin America, grants have been a very minor part of external finance since the early 1960s; the participation of direct foreign investment in external financial sources is similar to that shown for major exporters of manufactures for 1974-78 (about 15 per cent), a share lower than those for the 1950s and 1960s.

Net medium and long term borrowing from official sources such as the World and regional banks, and from private financial institutions, mainly banks, make up the bulk of the financing of the 1974-78 deficits, especially for major exporters of manufactures and Latin American countries. Table 2 shows a continuing minor role for bond

when the real OPEC surplus declined steadily between 1974 and 1978. Both the OPEC surplus and the LDC deficit can be called structural in the sense that neither could be eliminated within a reasonable time span just by changes in exchange rates and macroeconomic policies.

Non-oil LDCs can be expected to be net capital importers, but it is important to examine how the deficits were financed and whether the inflow went into capital formation. Given dollar inflation and economic growth, it is also of interest to establish the magnitude of financing needs relative to other macroeconomic magnitudes.

The current account deficits of non-oil Latin American countries are presented in Table 1 as a percentage of exports of goods and services since 1950. These deficits resulted from short term fluctuations as well as from the interaction of demand and supply for long term capital. One may conjecture that the deficits for 1960-62 (the heyday of the Alliance for Progress) and 1970-73, in the order of 22 percent of exports, represent reasonable approximations to desired long run capital inflows. The low numbers for the 1950s reflect poor supply conditions in world capital markets, while the extraordinary deficits for 1974-76 indicate special circumstances unlikely to be sustainable over the long run. By 1977-78 the deficit was around 1967-73 levels.

Two remarks may be made about the relative magnitudes of pre-and post-1973 Latin American deficits, with conflicting implications regarding the sustainability of 1977-78 deficits. The GNP growth rate accompanying post-1973 deficits was lower than that for 1967-73; the former was roughly 5 per cent per annum in contrast with 7 per cent for the earlier years.

World inflation, however, is leading to an overestimation of the magnitudes of external savings. Under present

issues and a limited one for suppliers' credits.

### C. Debt accumulation and servicing

The accumulation of net yearly borrowing flows yields the increase in the non-OPEC Third World debt. According to Table 2, medium and long term debt to official and private creditors increased by nearly \$150 billion between the end of 1973 and the end of 1978. Taking the stock of such debt at about \$70 billion at the of 1973 will give a debt of \$220 billion at the end of 1978.

Reported debt figures contain great variety. One source of discrepancy among estimates is whether short-term (less than one year) debt is or is not included. At any one point there is a large float of short-term credits to finance LDC imports; such stock grows with the increase of trade values, but it can be expected to provide little help to financing current account deficits over the long run. Short term policy headaches may arise if normal commercial credits are suddenly curtailed, but this is not what most observers have in mind when discussing the "debt problem".

A second source of difference in reported debt figures is whether or not items other than those owed to official LDC borrowers, or which are officially guaranteed, are included. Published World Bank data, for example, only cover official and officially guaranteed debt. Most medium and long-term credits to the Third World would fall under this category, but some countries (e.g. Argentina) have large private debts not guaranteed by the government. The summation of balance of payments data should give net increases in debt, whether or not officially guaranteed.

A third difference comes about from definitions of "new" Suppose, for example, that all long term borrowing from

financial institutions shown in Table 2 for 1974-78 (12.7 billion) came from banks which also held the increase of LDC reserves (\$8.1 billion). Reported net debt to those banks could then be said to increase only by \$4.6 billion per year. Data on private bank positions vis-a-vis LDCs are frequently "netted" in this fashion. Other differences may arise from geographical or other coverages. There has been a proliferation of ways of grouping Third World countries (oil vs. non-oil, exporters of manufactures vs. other, etc.) complicating the reconciliation of published debt estimates.

For non-oil Western Hemisphere LDCs (an IMF category), total medium-and long-term debt, official and officially guaranteed, increased from \$26 Billion at the end of 1973 to \$83 Billion at the end of 1978. About 61 per cent of the latter was owed to private financial institutions; those institutions accounted for 75 per cent of the increase in debt between 1973 and 1978, generating by themselves an average annual net inflow of about \$ 8.6 Billion during 1974-78 (compared with the \$12.7 Billion given in Table 2 for all non-oil LDCs). The burden to Latin America of servicing the accumulated capital inflows can be placed in historical perspective, as shown in Table 3.

Latin America came out of the 1930s and 1940s with little debt and some direct foreign investment. Pre-1929 debts and foreign investment were sharply reduced relative to GNP by defaults, renegotiations, inflation and war-induced European liquidations. During 1950-54 profit remittances by direct foreign investors exceeded debt service charges. Since then the latter have expanded steadily, even as a fraction of exports of goods and services. Profit remittances also tended to grow relative to exports until 1965-69; since then it has undergone a little-noticed but sharp decline. By 1974-76 profit remittances represented a lower percentage of exports of goods and services than

Table 3

FINANCIAL SERVICE CHARGES OF LATIN AMERICA, EXCLUDING OIL EXPORTERS,  
RELATIVE TO EXPORTS OF GOODS AND SERVICES.

( percentages )

Period	Interests	Amortizations	Profits	Total
1950-54	1.5	2.8	5.9	9.9
1955-59	2.3	7.2	5.2	14.7
1960-64	4.0	10.9	6.5	21.5
1965-69	5.5	13.7	8.8	28.0
1970-73	7.4	17.2	7.1	31.6
1974-76	10.9	16.1	4.8	31.7
1977	11.9	n.a.	4.2	n.a.

Sources - As in Table 1. "n.a." means data are not available.

'Profits' include earnings of foreign direct investments net of taxes, whether remitted abroad or reinvested domestically (p.5 of the source listed in Table 1).

during the 1950s. Another interesting trend reflected in Table 3 is the expansion particularly since 1973 of the share of interest in debt service; as already noted, dollar inflation is the major explanation for this fact. Finally, Table 3 shows that the total of debt service plus profit remittances during 1974-76 was about equal to 1970-73, relative to exports.

#### D. Private banking

Private banks owned by industrialized countries have emerged as the most dynamic agents in international capital markets. Those banks may be located in the country owning them, lending in their own currency, or they may be located offshore, lending in other currencies. The close interconnection among major national and international financial centers makes the distinction of only limited economic interest (although important for the implementation of possible controls and for jurisdictional disputes). Most of the banks engaged in international lending now report to the Bank for International Settlements; by the end of 1978 their lending and borrowing operations (net of inter-bank operations) were as summarized in Table 4. Claims include loans of all maturities and to public and private agents. The importance of major oil exporting countries (mainly OPEC) and other developing countries for international banking is readily apparent.

Table 4 also shows the concentration of lending in a few countries; just Brazil and Mexico accounted for about ten per cent of all of the banks' claims at the end of 1978. A large number of LDCs, including among them those with very low per capita incomes, are net creditors of the international banks, i.e., reserves deposited with those banks exceed the loans received. Note how the net position of 'other developing countries' in Table 4, excluding the eight major borrowers, is near zero.

Table 4

INTERNATIONAL BANKS OUTSTANDING STOCK OF CLAIMS AND LIABILITIES  
(At the end of 1978; billion current U.S. dollars)

Countries	Claims	Liabilities	Net Position
Industrial countries	234	312	- 78
Major oil exporting countries	57	84	- 27
Other developing countries	160	103	57
-- (of which 8 major borrowers)	(85)	(30)	(55)
Other countries and unallocated	89	41	48
TOTAL	\$ 540	\$ 540	0

Source: Annual Reports of the Bank for International Settlements. The eight major LDC borrowers are: Brasil, Mexico, Liberia, South Korea, Peru, Argentina, Ecuador and the Phillippines. The banks' positions via-a-vis the five Latin American countries are as follows:

	Claims	Liabilities	Net Position
Brasil	31.9	10.9	21.0
Mexico	23.4	6.5	16.9
Peru	3.4	0.9	2.5
Argentina	6.8	4.7	2.1
Ecuador	2.5	0.7	1.8

Concentration is also a feature of the lending side, particularly in the Eurocurrency market. Ten banks are said to have arranged half of all publicized Eurocredits in 1976 and 1977, providing about one-quarter of the money themselves; 20 banks arranged two-thirds of the total while providing one-third of the money. (8) So far, enough other banks have hovered at the fringes of this market to keep it fairly competitive, but concentration on both sides of the market suggests a considerable presence of "customer relationships" between banks and countries.

The credit provided by banks is medium-term, e.g., 7 years or so. Technically, credits are renewed every six months but the bank is committed for the full seven years: no cases are known where the six-month "roll-over" has been denied (unless there has been a default). Typically, interest is adjusted every six months; the borrower is committed to pay the fluctuating London inter-bank offered rate (LIBOR) plus a margin, the "spread", usually fixed for the full life of the loan. Some credits provide for an increase in spreads during the latter years of the loan to compensate for longer maturities and to allow for inflation. Eurocredits have been provided almost totally in dollars. Besides LIBOR and spreads, the borrower pays management and commitment fees; some loan agreements also require borrowers to maintain compensating balances with the lending banks, but this is said to be unusual. (9)

Some indicators of lending conditions at the Eurocurrency market are presented in Table 5 for prime borrowers from industrialized countries and for the major third world borrower. It may be seen that LIBOR, the spreads (excluding fees) and the maturities fluctuate considerably from year to year. At any one time the spreads can be quite different as between countries and among borrowers of the same country. At mid-1977 the following spreads were reported for sovereign borrowers (10):

Table 5  
INDICATORS OF LENDING CONDITIONS AT THE EUROCURRENCY MARKET  
(Percentages except for maturities)

Year	LIBOR	Spreads		Maturities (months)	
		Prime borrowers	Brasil	Prime borrowers	Brasil
1974	11.2	1.25	1.39	96	36 <sup>a/</sup>
1975	7.6	1.25	1.78	66	75
1976	6.1	0.94	1.94	69	70
1977	6.4	0.63	1.96	80	68
1978	9.4	0.50	1.21	101	85
1979 <sup>b/</sup>	12.0	0.38	1.12	108	111

a) Last three quarters of the year only.

b) First semester.

Sources and definitions: Spreads over LIBOR exclude fees and refer to the periods indicated. LIBOR percentages refer to full annual averages, including for 1979. Maturities refer to full annual averages, except for 1979 where data refer to the first semester only. Data on "prime borrowers" obtained from Kengo Inoue, "Determinants of market conditions in the eurocurrency market; why a "borrowers" market?", BIS Working Papers, n<sup>o</sup> 1, April 1980, Table 1. LIBOR and Brazilian data obtained from Paulo Nogueira Baptista Jr. "Dívida externa brasileira", Conjuntura Econômica, April 1980, vol. 34, n<sup>o</sup> 4.

Britan, France, Iran, Sweden	0.875
Spain	1.250
Italy	1.375
Mexico	1.625
Philippines and South Korea	1.750
Brasil	2.250
Peru	2.250
Burma	2.500

The criteria used to establish these differences are not transparent and ex-post seem myopic (note the contrast between Iran and Peru). Attempts to statistically explain differences in spreads across countries as a function of quantifiable variables have not been successful so far.

Data on fees are more difficult to obtain than for spreads. Management fees are usually a flat percentage of the loan, about 0.50 to 0.75 per cent, paid only at the time the credit arrangement is signed. Besides this "front-end" fee, borrowers usually are committed to pay a facility fee at an annual rate on undrawn portions of a credit; this may range between 0.25 and 0.75 per cent. It is said that some borrowers trade off higher front-end fees for lower spreads, for the sake of prestige.

Even with the addition of fees, the charges shown in Table 5 at least for 1974 through 1978 appear ex-post quite attractive for average LDC borrowers, bearing in mind that dollar prices of non-oil primary products exported by LDCs rose during those years at around 9 per cent per annum. (Such price increases, however, were highly irregular from year-to-year and among commodities).

By the end of 1978 somewhat more than 60 per cent of the official and officially guaranteed debt of non-oil Western Hemisphere countries was held by private financial institutions, mainly banks, thus being subject to service charges and conditions similar to those described above.

For Brasil, the major borrower, that proportion would be higher, around 55 per cent. It is not surprising then that in these countries fluctuations in LIBOR have become front-page news, together with changes in the prices for oil and major export commodities.

During 1978 and 1979 contradictory trends have influenced the competitiveness of international banking. The freeze of Iranian assets deposited in U.S. - owned banks (regardless of banks' location) decreed by the U.S. government and the resulting legal complications have frightened smaller banks away from international lending. Rivalry among banks of different nationalities has increased, however. There has been a sharp rise in the market share of non-U.S. banks, as may be seen in Table 6. (This table follows recent publications of the U.S. Federal Reserve System, which define U.S. and non-U.S. banks on a charter basis; for U.S. banks this is close to a financial control basis). For the five Latin American countries shown in Table 6, U.S. banks provided only 11 per cent of the net increase in lending between December 1977 and June 1979. For all LDCs, including oil-exporters, the corresponding share is somewhat smaller (near 10 per cent). Japanese and Italian banks are reported to have experienced an acceleration in their international lending; French, Dutch, Swiss, Canadian, British and German banks are also expanding their lending to LDCs.

#### E. Other lenders

Important shares of the debt of non-oil Western Hemisphere nations is still held by foreign governments and international lending agencies (27 per cent) and by private creditors other than financial institutions. The former debt averages more favorable servicing conditions, i.e., longer maturities and lower interest rates. Other private creditors include bond-holders and others who lent

Table 5

SOME OUTSTANDING INTERNATIONAL CLAIMS OF BANKS REPORTING TO THE BIS  
(Billion Current U.S. dollars)

Countries	December 1977			June 1979		
	Total	Non-U.S. banks	U.S. banks	Total	Non-U.S. banks	U.S. banks
Argentina	4.8	1.9	2.9	9.4	5.8	3.5
Brasil	23.8	11.7	12.1	33.9	20.0	13.9
Chile	1.6	0.7	1.0	3.3	1.5	1.8
Colombia	1.7	0.4	1.3	2.6	1.1	1.6
México	19.9	8.0	11.9	26.0	15.0	11.0
-- Subtotal	51.8	22.6	29.2	75.2	43.4	31.8
-- All oil- exporters and non-oil LDCs	137.9	71.1	66.8	194.3	122.1	72.2

Sources: Board of Governors of the Federal Reserve System Federal Reserve Bulletin, Table 3.20, issues beginning June 1979; and BIS, reports on international banking.

at fixed interest rates. A projection made for Brazilian service charges for 1980 illustrates the variety of interest rates which a country's foreign debt may encompass:

- Interest on eurocredits (LIBOR at 16 per cent (plus 2 per cent of spread and fees)	18
- Interest on official credits	8
- Interest on bonds	9
- Interest on other credits	12
- ( <u>Memo:</u> interest earned on reserves, as LIBOR)	(16)

Debt negotiated at fixed interest rates before international inflationary expectations became widespread (say before 1974) generated capital gains for borrowers. About 45 per-cent of non-oil Western Hemisphere debt was to official creditors at the end of 1973. Countries like Colombia must have obtained significant benefits from a debt structure heavy with fixed-interest obligations. On the other hand, a small but increasing share of such debt is being negotiated in currencies other than U.S. dollars; effective interest rates will be influenced by fluctuations in, say, dollar / Deutsche Mark exchange rates. Assuming both purchasing power and interest rate parities to hold between the U.S. and Germany over the long run will not lessen short- and medium-term uncertainties regarding debt service magnitudes.

A rough idea of average interest and maturity conditions for the whole debt of non-oil Western Hemisphere countries and Brazil may be obtained comparing interest and amortization payments to the stock of outstanding debt. This is done in Table 7. The service charges, given world inflation, appear attractive for the whole period in the sense that borrowers should have been able to invest domestically at rates of return exceeding interest charges on the debt. Average interest rates are below plausible estimates for international inflation, indicating that (at least) all interest payments could be included in the

capital account as amortizations if inflation-proof accounting were used. If this procedure were followed the current account deficit of non-oil Latin America expressed as a percentage of exports of goods and services would be as follows (figures in parentheses reproduce the nominal deficits from Table 1):

1974:	33 (41) percent
1975:	32 (50) percent
1976:	18 (31) percent
1977:	5 (17) percent

The nature and conditions of loans from multilateral official sources have also evolved during the 1970s, although more slowly than those from private sources. The world and regional banks have devised new forms of associating their loans to private capital, whether from banks or private direct investors. In politically sensitive areas, such as energy and mineral projects, this association is likely to grow in the future. The World Bank can be expected to move toward program lending, perhaps in combination with the I.M.F. These trends respond to pressures on the international financial system generated not only by OPEC but also by changes in bargaining power between LDCs and foreign investors. We now turn to examination of some of these systemic issues.

#### V. Systemic Issues for the 1980's

The expansion of international capital markets, the adoption of floating exchange rates and the macroeconomic difficulties of many industrialized countries have encouraged the reexamination of academic and practical orthodoxies, as well as some Southern heterodoxies. Already during the late 1950s Northern academic centers witnessed a rebirth of interest in monetary and financial topics. Northern macroeconomic and monetary theories underwent sharp debates during the 1960s, leading to a surge of neo-monetarist and neo-classical positions in the 1970s.

It would be difficult to talk about a monolithic Northern academic (or even practical) orthodoxy on such issues as the desirability of flexible exchange rates, optimum controls over capital movements, the correct strategy to combat inflation or the necessity of regulation over the Eurocurrency market. In these matters there is a "great disorder under heaven". Under these circumstances one may hear Raul Prebisch castigate the evils of international inflation with greater vigor than James Tobin, and find that Robert Mundell defends fixed exchange rates with greater ardor than Antonio Delfim Netto. Many Northern economists discuss both inflation and balance of payments deficits using structural approaches similar to those emanating from Latin America during the 1950s. At a more practical level it is not unusual to find Southern exporters together with Northern bankers (worried about debt service) singing the praises of freer world trade, while Northern trade unionists, together with their "progressive" academic advisers, rediscover all sorts of heterodox arguments for protection.

The Eurocurrency market and international bank lending during the 1970s displayed a number of features which compare favorably with earlier capital market arrangements from the viewpoint of at least some important semi-industrialized countries (as well as several socialist countries). Probably no international capital market in history has had a lower degree of political interference to the dismay of "strategic minds" like Dr. Henry Kissinger. Competition among banks has been keen and, as already noted, ex-post, interest rates and charges do not seem unreasonable. In contrast with pre-1929 Brazilian experience in the New York market, members of the "Bogota group", which combines major coffee producers, have borrowed freely to finance their price stabilization operations. Officials in several semi-industrialized countries have been able to ignore IMF advice without seeing their external credit lines dry up.

Table 7

AVERAGE CONDITIONS OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT

Year	Interest (percentages)		Amortization payments
	Non-oil Western Hemisphere	Brasil	as percentages of debt Non-oil Western Hemisphere
1974	6.6	10.4	12.1
1975	6.7	12.0	9.9
1976	6.2	9.9	10.9
1977	6.1	9.0	13.2
1978	7.1	10.1	15.2
1979 (estimate)	7.6	13.3	13.6

Sources and definitions: Average interest is the ratio of all interest payments in a given year to debt outstanding at the end of the previous year, expressed as a percentage. A similar calculation is made for amortization payments. Non-oil Western Hemisphere data obtained from the World Bank debt reporting system and the IMF; Brazilian data from Paulo Nogueira Baptista Jr., op. cit., p. 91.

It is also clear that the 1973-80 international capital market has contributed little to transferring resources to the poorest countries in the Periphery. It can also be argued that the market still has a number of important gaps limiting its usefulness even to semi-industrialized countries.<sup>(12)</sup> Persistent and erratic inflation in the central currency in international payments, the US dollar, tends to increase uncertainty and reduce maturities, and raises the need for a greater role for financial instruments denominated in other "strong" currencies.

Although quite competitive, the Eurocurrency market, and more generally international bank lending, are alleged to have a number of structural imperfections calling for official regulation. For some years it was argued that the Eurocurrency market generated explosive increases in world credit supply, significantly adding to demand pressures on goods and services markets. This view is now mostly discredited; Alexander Swoboda recently concluded that: "If the concern is to moderate inflation in the world economy, focus on the regulation of the Eurodollar market carries with it the danger that the forest will be missed for the trees."<sup>(13)</sup> The case for greater control, or at least supervision, over all international bank lending essentially rests on the argument that if Northern governments (explicitly or implicitly) insure depositors against all of the consequences of possible bank failures, and politically-important borrowers against default, then "moral hazard" imperfections may exist, i.e., banks may be less careful in their choice of loans than without government "insurance". Moral hazard imperfections also exist in domestic credit markets, and it is debatable whether the U.S. government is less likely to appear "insuring" the bank debts of Chrysler than of Turkey, but it is noted that at present the supervision over Eurocurrency lending is less than that exercised over other international and domestic lending.

The financial press and some authorities have called attention during 1979-80 to deteriorating capital - asset ratios of banks engaged in international lending. Typically, it is concluded that higher spreads and profit margins are needed to expand banking capital. Those remarks erroneously assume (a) that entry of new banks into international lending is either slow or non-existent; and (b) that capital can not grow by other means than the reinvestment of profit. Moreover, the microeconomic rationale for rules-of-thumb about capital - asset ratios are obscure at best; in practice U.S. and non - U. S. banks have very different ratios.

The international loan market, in contrast with say international non-oil commodity markets, is an area where nowadays market imperfections are perceived more clearly in the North than in the South. At first sight it is remarkable how bankers plead for more official lending to LDCs, i.e., seek actions which can take business away from them, and argue in favor of greater bureaucratic control over markets, i.e., seek a larger IMF role in the lending process. (One may contrast this puzzle with that generated by OPEC exhorting its customers to conserve oil). What is sought, of course, is a "rationalization" of lending under IMF planning to reduce "cutthroat" competition. This has already been achieved for state-subsidized export credits, with OECD countries agreeing to guidelines on interest floors, maximum credit periods and minimum cash payments.

Increased international banking competition, under conditions of expanding oil-related credit supplies and a large accumulated debt of non-oil LDCs, creates an important latent demand for technical arguments favoring a Northern-directed rationalization of international capital markets. Supply will not take long to respond, with the practical orthodoxy unearthing all sorts of externalities, distortions and market imperfections to justify Northern

regulation over private financial flows to non-oil LDCs.

In this context, semi-industrialized LDCs which are heavy borrowers from banks face dilemmas of both an economic and a political nature.

From an economic standpoint, the unregulated credit markets of 1973-80 presented great advantages but such a situation may not persist in the 1980s. Oligopolistic forces of restraint may prevail over competitive tendencies to expand in private international banking. As a result, the large volume of credit required by semi-industrialized LDCs, particularly in the early 1980s, may not be forthcoming as expected from the private banking system. GNP growth rates may suffer as a consequence. Behavioral characteristics of private international financial intermediaries may thus have a critical influence on feasible growth rates for semi-industrialized LDCs; this is illustrated in Sketch I.

From a political perspective, semi-industrialized non-oil LDCs have alternative options depending on expected international scenarios. Under conditions of relative tranquility, they may bet that, without the acquiescence of themselves and of OPEC lenders, industrial country governments and private bankers will not be able to find a modus operandi for effective regulation of international banking activities. In this case, those countries may choose to play a maverick role, maximizing their borrowing opportunities, and letting those who dominate the system to worry about systemic issues.

However, OPEC (especially its members with the largest surpluses) may be induced to form a coalition with industrial countries and private banks, to regulate world capital markets perhaps under the IMF umbrella, according to their own immediate interest. Any incipient financial crisis is likely to accelerate the formation of such a

coalition. OPEC would obtain "sound and remunerative financial assets" and private banks would enjoy "orderly market conditions" in which higher interest costs and spreads could be passed on to borrowers with nowhere else to go. Industrial countries would obtain steadier oil flows as opec trades oil underground for the safe financial asset. At marginal costs, the "4<sup>th</sup> World" could be induced to give an appearance of legitimacy to this reestablishment of Northern control over international financial flows. Note that part of the motivation for the proposed Substitution Account at the IMF was to meet OPEC's dissatisfaction with available financial assets. (14) This financial arrangement would be the counterpart of the coalition between OPEC and the traditional oil multinationals, which operates with great tensions and frictions but has been enormously profitable for both sides so far.

Semi-industrialized countries may want to anticipate the new financial coalition, joining their own forces to bargain rules for the international financial game which for them will be inferior to the present free-for-all system, but better than the arrangements that would be set up by creditors under conditions of financial strain. At present, it is not clear which of these two alternative strategies those countries should opt for.

## VI. Latin American Financial Conundrums

A practical orthodoxy vis-a-vis financial intermediation in LDCs developed on the wake of blossoming financial markets in the 1960s and 1970s. It may be synthetized in the saying that "the more financial intermediation the better".

Gurley and Shaw popularized correlations measures between the degree of financial modernization and indexes of economic development. Ronald McKinnon has argued vigorously against "financial repression".

According to the financial reformers, increased availability of financial paper paying positive interest rates should both increase the flow of private saving and divert wealth holding away from non-productive uses (land, housing, consumer durables) into productive assets.

Latin-American experiences with financial reform confirm the prediction on the increase of financial saving; however, private productive investment did not react accordingly. The marginal propensity to save goes up but private investment rates are not larger than before. This reaction to financial reform has been accompanied by persistently high inflation rates, lagging exchange rates and widening foreign debts. Reasons for these Latin-American aberrations are not entirely clear, but some of their aspects are worth exploring.

We consider successively stylized versions of the portfolio decisions related to the composition of domestic currency denominated assets, and of the portfolio decisions concerning the distribution of wealth between domestic and international assets-before and after "financial liberation".

In a financially repressed economy with a history of persistent inflation, wealth is held as money, land and capital. In relative terms, the first two are homogeneous commodities whereas the latter is a collection of heterogeneous goods. Money is held because of its property as a means of payment; capital, because of its expected yield in use; and land, as a shelter against inflation. Expected land yields may be low but they are strongly correlated with inflation rates, and thus safer to hold than heterogeneous capital. The liquidity of land is

higher than capital but much lower than money. The yield of the later is strongly negative. Lack of a high yielding asset with a strong secondary market presumably underlies low observed saving propensities. Moreover, a high proportion of net additions to wealth take the form unproductive land holdings for "speculative" purposes.

In this context, financial reform-mongers typically propose introducing an indexed government bond as an instrument of financial liberation (In McKinnon's terminology this boils down to paying real interest rates on "money"). In the presence of such an attractive asset with a strong back-up market, savings propensities should increase and a higher proportion of wealth be held as "productive" capital. The hypothesis seems to be that the bond will protect wealth-owners against inflation better than land holdings do. Hence, implicit long-term interest rates may be lower and thus capital accumulation will be favored for a given state of long-term expectations.

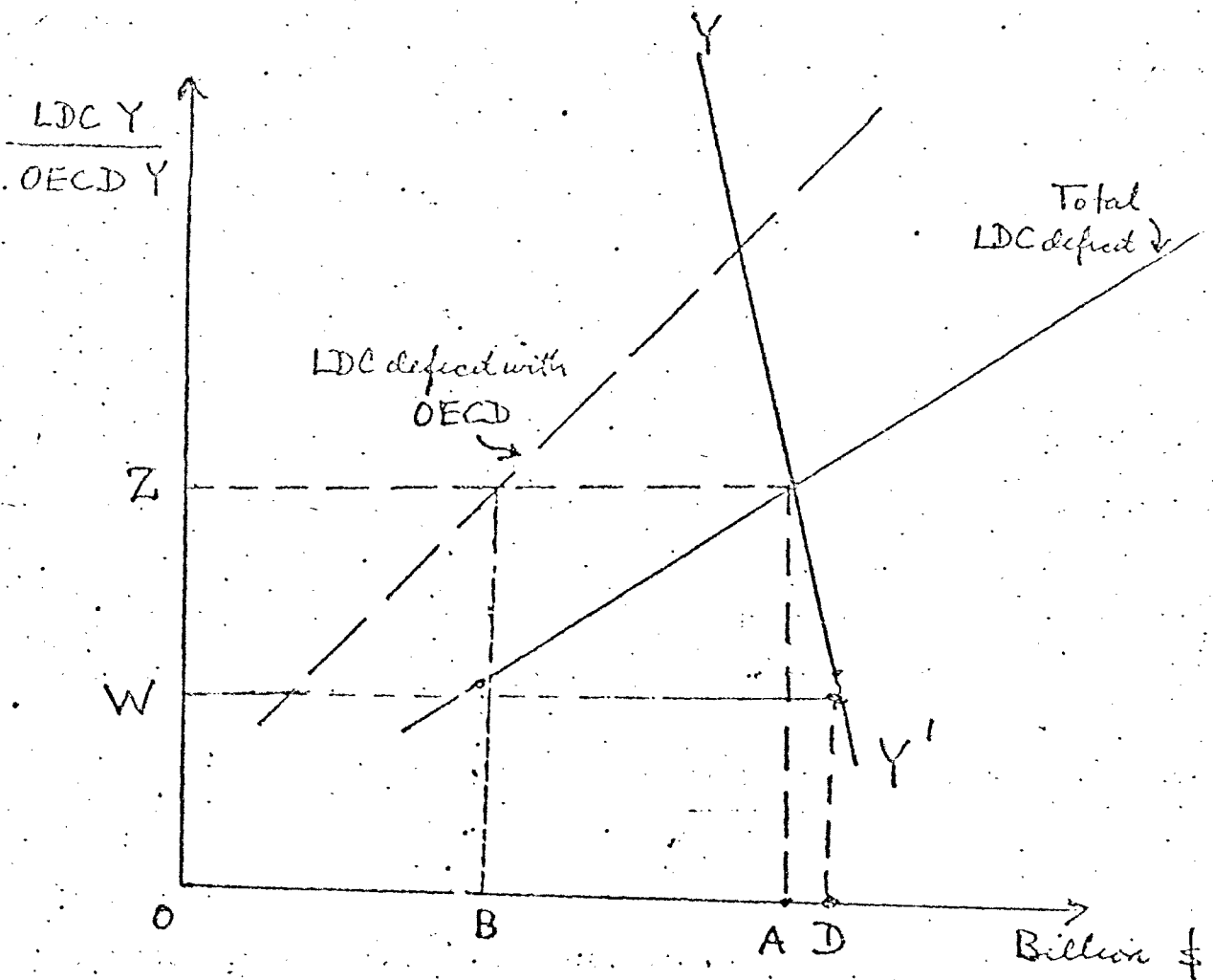
Latin-American experience supports the presumption on saving propensities but not the expectation on private investment rates. The reason is that under certain conditions indexed bonds tend to replace capital (and money) rather than land in private portfolio holdings. Free-market-oriented financial reforms are accompanied by a general liberalization of interest rates, in the context of a demand contractionary package of policies. Bankruptcies in the productive sector and panics and scandals in the financial sector are frequent. As a consequence, there is a weakening in the state of confidence with expectations about future capital values are held. Long-term expectations collapse, the demand price of capital falls and the rate of investment adjust downwards at a time when saving propensities are on the increase. High short-term interest rates tend to raise the supply price of output in the short-run. Excess supply of money may also obtain, in spite of contractionary monetary

policies, if the demand for money (in the appropriate  $M_1$  concept) is sufficiently lowered by the introduction of indexed bonds. Continuing high inflation rates, higher unemployment rates, and lower growth rates of potential output are the short to medium term consequences of ill-implemented financial reforms.

Similar problems may occur with respect to the portfolio decisions vis-a-vis foreign and domestic wealth. Capital market reformers correctly expect that the creation of domestic indexed bonds will induce wealth-owners to shift a higher proportion of their wealth out of foreign and into domestic assets. Experience confirms that gross foreign savings are larger than before, as predicted by the theory, but also that they do not find a real outlet, as domestic absorption goes down following the mechanism sketched in the previous paragraph. Capital account surpluses are not compensated for by correspondingly larger current account deficits. Foreign reserves accumulate and exchange rates lag behind purchasing power parities. "El retraso cambiario" establishes itself, weakening the propensity to export and strengthening the propensity to import: paradoxically enough, the level of activity in the tradable goods sector shrinks in order to absorb the increased flow of foreign savings.

Portfolio reshuffling favoring government debt against private investment is a common characteristic of these examples of financial reform. If the government uses the proceeds of higher bond sales either to increase its own investment or to subsidize private investment, real income growth may be maintained, at the cost of increased government intervention in the economic sphere and expanding foreign debt. If the proceeds of higher bond sales are used to reduce indirect government taxation and to control the growth rate of money supply, inflation rates may subside but the rate of investment and potential output growth do not recover.

"Academic orthodoxy", from Maynard Keynes to James Tobin, has taught that the propensity to invest is not coterminous with the propensity to save. Lack of attention to this basic teaching on the part of "practical orthodoxy" may explain the failures of recent attempts at financial reform in Latin America. Much research is needed on the patterns of substitution and complementarity among assets, in the context of high and varying rates of inflation characteristic of Latin American countries. (15)



## Sketch I

### GNPs, Current Accounts And Financial Intermediation

The interactions of GNP (or GNP growth), current account positions and the preferences of international financial intermediaries are illustrated in Figure 1. Assume the world is divided into three regions: OPEC, OECD and non-OPEC LDCs. Assume further that OPEC GNP (or its growth) is exogenously given by the development plans of those countries, and that the real oil price is also given. The OPEC current account surplus (OA) will then depend on non-OPEC GNP (or its growth from now on denoted as Y), and its composition between LDC Y and OECD Y.

The negatively sloping line  $YY'$  gives the OPEC surplus corresponding to a given non-OPEC Y; if oil requirements per unit of Y were equal in LDCs and OECD the line would be vertical. For each non-OPEC Y there will be a different line  $YY$ . The vertical axis gives LDC Y relative to OECD Y; as this ratio increases (maintaining constant their weighted sum to yield a given non-OPEC Y) it is assumed that the OPEC surplus will decline, i.e., that there is a greater use of oil per unit of Y in OECD than in LDCs.

The positively sloping lines in the diagram show the LDC current account deficit. The difference between those two lines represents the LDC deficit with OPEC. The LDC deficit with OECD is assumed to depend solely on the ratio of LDC Y to OECD Y. The LDC deficit with OPEC will increase as LDC Y increases, so the total LDC deficit will increase as LDC Y increases with a given non-OPEC Y. The diagram supposes that during the time span relevant for our analysis adjustment mechanisms other than changes in Y can do little to affect the structure of world current account deficits and surpluses.

Consider first a borderline situation when the OPEC surplus OA is exactly matched by an LDC overall deficit of equal amount, made up of an LDC deficit with OECD of OB and an LDC deficit with OPEC of BA. OECD then has a deficit with OPEC of OB. Supposing that all capital movements are handled by international financial intermediaries (i. e., assume away grants, direct investments etc), those institutions will witness an increase in their net claims on non-OPEC LDCs equal to OA, matched by increased OPEC claims on the intermediaries.

Consider now a situation when after several years of accumulating claims on LDCs, the financial intermediaries decide that it would be "imprudent" to maintain the same rate of accumulation. A possible outcome, for a given non-OPEC Y, would be a reduction in LDC Y and an increase in OECD Y, from OZ to OW. In the new situation financial intermediaries would reduce their accumulation of LDC debts to OB, while accumulating more reliable OECD paper at a rate of BD. The OECD will become a capital importer. A more likely possibility avoiding an increase in the OPEC surplus would involve both a reduction of non-OPEC Y (leading to a shift of YY to the left) and a reduction of LDC Y relative to OECD Y.

For a given non-OPEC Y, an increase in the real price of oil would be depicted in Figure 1 by a shift to the right of YY'. An opposite shift would result from an increase in the development plans of OPEC. Neither an increase in oil prices nor in OPEC Y would shift the line showing the LDC deficit with OECD, but would of course shift (to the right for oil price increases, to the left for OPEC Y increase) the line showing the overall LDC deficit, reflecting changes in the balance of payments between LDCs and OPEC. The shifts in the line depicting the overall LDC deficit would be horizontally smaller than the YY' shifts.

More vigorous conservation policies would shift YY' to the left; its slope will change if those efforts are proportionally different in LDCs and OECD. LDC conservation efforts would also be reflected in a leftward shift in the line indicating its total current account deficit. remunerative financial assets" and private banks would enjoy "orderly market conditions" in which higher interest costs and spreads could be passed on to borrowers with nowhere else to go. Industrial countries would obtain steadier oil flows as OPEC trades oil underground for the safe financial asset. At marginal costs, the "4<sup>th</sup> World" could be induced to give an appearance of legitimacy to this reestablishment of Northern control over international financial flows. Note that part of the motivation for the proposed Substitution Account at the IMF was to meet OPEC's dissatisfaction with available financial assets. (14) This financial arrangement would be the counterpart of the coalition between OPEC and the traditional oil multinationals, which operates with great tensions and frictions but has been enormously profitable for both sides so far.

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## Footnotes

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1- See especially Celso Furtado, Formação Econômica da América Latina, Lia Editor S.A. Rio de Janeiro, 1969, Chapter IX.

2- For a fascinating analysis of the Montagu Mission see Winston Fritsch, 1924, in ANPEC, VII Encontro Nacional de Economia, Vol. 2, Atibaia, São Paulo, December 11-14 1979, pp.673-732.

3- See Charles P. Kindleberger, "The cyclical pattern of long-term lending", mimeographed, M.I.T., 1980, pp.6-9.

4- Marcelo de Paiva Abreu, "O Brasil e a economia mundial, 1929-1945", mimeographed, Rio de Janeiro, 1980.

5- Marcelo de Paiva Abreu, "A Missão Niemeyer", Revista de Administração de Empresas, Rio de Janeiro, July/August 1974, p. 15. The United Kingdom abandoned the gold standard on September 1931.

6- See M.S. Mendelsohn, Money On the Move; The Modern International Capital Market, New York: MacGraw-Hill Books Company, 1980, p. 55.

7- See Ruben Almonacid and Maria Cristina R. Pinotti, "A inflação internacional distorce os dados do balanço de pagamentos do Brasil", Conjuntura Econômica, January 1980. Vol. 34, Nº 1, Rio de Janeiro, p. 84.

See also Charles Freedman, "A note on net interest payments to foreigners under inflationary conditions" Canadian Journal of Economics, May 1979, pp.291-299.

8- These estimates are said to be based on "circumstantial evidence"; See M.S. Mendelsohn, Money on the Move: The Modern International Capital Market, New York, McGraw-Hill Book Company, 1980, p. 66 and pp.81-82.

The five top eurocredit banks were Citicorp, Chase Manhattan, Morgan Guaranty, Bank of America, and Dresdner Bank.

- 9- This paragraph follows M.S. Mendelsohn, op. cit., pp. 71-72.
- 10- M.S. Mendelsohn, op. cit., p. 76. A margin of no less than 9 per cent is said to have been charged to some Turkish borrowers.
- 11- Paulo Nogueira Baptista Jr., op. cit., p. 90 (full citation in Table 5).
- 12- See the report of the Independent Commission on International Development Issues under the Chairmanship of Willy Brandt, North-south: A Programme for Survival, London, Pan Books, 1980, Chapters 14 and 15.
- 13- Alexander K. Swoboda, "Credit creation in the Euromarket: Alternative theories and implications for control", processed, Graduate Institute of International Studies, Geneva, 1980, p. 45.
- 14- See the address by J. de Larosière, Managing Director of the IMF, in the IMF Survey for June 3, 1980, especially pp. 173-174.
- 15- In this context one should also remember the following point of Kenneth J. Arrow: "... on speculative markets such as those for stocks and commodity futures, a large amount invested in the acquisition of new information for private advantage will yield no social gain, only a zero-sum redistribution... We may have very able people who could be useful spending their time in production instead of trying to outwith others". Challenge. Sept/oct 1979, pgs. 26-27.