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SOME FINANCIAL ISSUES IN THE NORTH, IN THE SOUTH, AND IN BETWEEN

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I. Introduction

From the Wild West of the United States and unregulated Hong Kong, to prudent Bogota and born-again Santiago de Chile, during the early 1980s banks and other financial intermediaries have been experiencing discomfort and even failure. Companies and countries, big and small, announce almost daily incapacity to meet punctually their financial obligations. From financial repression and too little intermediation in the 1950s and 1960s, both national and international markets appear to have swung to bubbly excess, or so the financial press tells us. Mocking bankers and teasing borrowers, as during the early 1930s, have become popular sports across the ideological spectrum. This essay will probe explanations for this state of affairs, focusing on issues of interest to less developed countries (LDCs), particularly semi-industrialized Latin American nations, but will also highlight themes common to the analysis of any financial market. Much discussion on LDC external debt and LDC financial liberalization has neglected those themes, often with seriously misleading consequences.

The major topics to be discussed are: (a) international, private financial markets and their alleged imperfections, and how they favored or penalized different types of LDCs during the 1970s; (b) international exchange rate and liquidity arrangements and how they impinged on LDCs. Experiments in exchange rate policy carried out by Southern Cone countries in Latin America, and their interaction with international capital markets, will also be discussed; (c) the role of international financial institutions, particularly the International Monetary Fund and the World Bank.

Many related topics, such as concessional finance, direct foreign investment, export credits, and the future of SDRs, will receive little or no attention. The most shocking omission is lack of discussion of the financial (and real) plight of the poorest LDCs, particularly acute during the early 1980s and without likely remedies for the rest of the decade. Reflections on easier problems will close the paper.

II. International (private) financial markets

The stylized facts regarding the 1970s upsurge of private lending to some LDCs (primarily the Newly Industrializing Countries, NICs) are fairly well known, so they will not be discussed here. For a discussion of those facts see Bacha and Diaz Alejandro, 1982.

The focus will be on the following questions:

—What is wrong, if anything, with present arrangements of private financial markets? Are bankers, as often alleged in the financial press, short-sighted lemmings (or burros), or are they maximizing agents as clever as the average business person, taking advantage of flaws in market mechanisms? Both microeconomic and macroeconomic considerations will be included in the discussion.

—If those flaws exist, who gains and loses from them at international and national levels, particularly among (and within) LDCs?

Imperfect markets and clever agents. A central argument is that financial markets are quite different from spot commodity markets. The spot market for homogeneous apples can be modelled as one where price summarizes all relevant information for atomistic buyers and sellers. Such textbook idealizations capture the essence of certain types of real-world competitive spot markets. Any individual can buy or sell all the homogeneous apples she wants at the going market price. Everyone is a small price taker.

There are no small lenders or borrowers in the sense that no one can borrow all she wants at going market rates, even when most borrowers will not affect by their transactions standard market rates. No one will lend simply on the basis of the highest "price" offered for the loan. Once apple quality is established and sound cash is produced on the spot, apple buyers and sellers will care only about price. Every loan, however, will necessarily involve other considerations besides a price which includes risk-premia: the size of the loan will be a matter of discussion (i.e., there will be some rationing) and other conditions may be attached. Why? Lenders can never be quite sure whether borrowers intend to repay, and there is no completely credible way borrowers can use to persuade lenders of their honorable intentions. There is no simple way around these informational asymmetries. Such simple, commonsensical fact is a start toward understanding why lending nations want gunboats, the Mafia must break thumbs, and bankruptcy laws exist.

A lender contemplating an international loan will have well-known concerns regarding the soundness of the project and the willingness and ability of borrowers to translate project earnings into foreign exchange. But without grossly departing from usual rules-of-the-game nor taking leave of her senses, she may also think:

1. The project may not be particularly good, but the borrower is likely to have lots of foreign exchange from other national sources. The green light for the loan is more likely if there are many other lucrative links between the bank and the borrowing country.

2. Neither the project nor the prospects for the borrowing country look good but:

—somebody is going to bail the country out in the future, because it is too strategic, or because its failure to service debt would mean an international panic.

—even if the country is not bailed out, my bank cannot be allowed to fail, and ex-post it will be hard to show that the lending was not wise.

—even if my bank fails, my responsibility in the event will be difficult to establish. A loan officer will never go far by letting other banks take a larger share of the business: risks must be taken, especially when blame for failure may never reach me! The money, after all, is not mine (contrast with direct foreign investors), and (some) of the depositors are insured by the government, anyway.

One may note that some of the lenders are either nationalized (e.g., French banks) or are said to be closely attuned to signals emanating from their governments and their exporting or foreign policy concerns (e.g., German and Japanese banks). It has been argued that the failure of most LDCs to sell bonds or floating rate notes to individual investors shows how much more sensitive those individuals are about LDC risk than the banks which manage their deposits. Public utterances of those bankers will tend to project an optimism which may or may not be warranted.

Most of these considerations apply to national as well as international lending, lending to sovereign borrowers or to large companies. This is why Central Banks have "prudential" regulations covering commercial banks and other financial intermediaries, particularly when deposits in those institutions are insured. Few laissez-faire enthusiasts would go as far as eliminating all prudential regulations over national financial systems (although in some Latin American countries ill-conceived experiments in financial liberalization came very close to that, with lamentable consequences). In general, regulations over domestic lending seem greater than those over international lending occurring from off-shore centers, e.g., the Eurocurrency market.

While concerns as to whether a borrower really intends to repay the loan lead to rationing of credit and presumably to less lending than under full-information circumstances, the other thoughts a loan officer may have may lead to more lending that is socially desirable. "Socially desirable" loans are defined here as those financing activities yielding a rate of return higher than a hypothetical interest rate generated by fundamental thrift and productivity data for the world economy, both adjusted for risks which could not be avoided even by the wisest cosmopolitan planner. See Ohlin 1976 for an early discussion of moral hazard and expectations of public subsidies in international lending. As a result of these market imperfections, some induced by governments, others intrinsic in capital markets with incomplete information, some borrowers may be shut out, while others are showered with loans, depending on specific characteristics of lenders and borrowers, as well as the stage of the business cycle.

On the borrowing side, public agents signing up the loan, not always high minded and patriotic, often do not face much of a liability if things go wrong. Private agents on the borrowing side will typically have their loan repayment guaranteed by the public sector. In some cases (which will be discussed below), exchange rate policy may induce private agents to borrow abroad, insuring them against devaluation risks either explicitly or implicitly. The incentive structure for both public and private agents often contains strong inducements to borrow abroad more than is socially desirable, in the sense defined previously. To check these tendencies, and to avoid turning the terms of borrowing unduly onerous, many countries will attempt to exercise central control over external borrowing.

Even before the Great Fear of August-September 1982, there was considerable discussion in the United States about the optimal regulation of banks and other financial intermediaries. The dangers of combining generous explicit or implicit deposit insurance with the lifting of supervision over portfolios has been generally recognized. A strong case can be made that the deregulation of financial intermediaries in any country must be accompanied by the substantial reduction in deposit insurance and the requirement that those intermediaries provide the public with information about their portfolios. Under those circumstances it is conceivable that depositors could pick and choose among banks according to their preferences in their risk-return trade-off; a weakened deposit insurance would not allow depositors to think that "one bank is as good as another." Whether a more transparent and less regulated banking system would be a reliable supplier of the public good, money, remains a moot point. This discussion involves macroeconomic considerations, to which we now turn.

Macroeconomic considerations and some history. The consequences of informational and moral-hazard imperfections listed above will be found in an Indian village as well as in Bogota or New York, in national or international credit markets. They go on all the time, in spite of supervision by Central Bank authorities, without unduly exacerbating the pains of the human condition.

But financial markets have also been found both to aggravate and initiate macroeconomic instability. Kindleberger (1978, especially chapters 1 and 2) has provided a masterful description of a typical financial crisis, as insightful for 1982 as for earlier years. As a consequence of shocks of sundry nature "the temptation becomes virtually irresistible to take the money and run." Such behavior by individual

lenders, of course, aggravates the crisis, which can only be stopped by someone acting as lender of last resort. At this aggregate level there are complementary informational and practical game-theoretic considerations making Central Banking more of an art than a science: "the lender of last resort should exist, but his presence should be doubted." One may note that not only is economic history full of examples of financial manias, panics and crashes, but there is also a growing industry of model-building showing that markets composed of perfectly rational agents can generate bubbles with dramatic bursts. Those markets could be for foreign exchange or for other financial assets (including future claims on apples). See Dornbusch 1982, for a survey of bubbles, runs, and peso problems. Both the new theories and the historical record are open to various interpretations. Discussing the need for a lender of last resort Solow cautiously notes (1981, p.241):
"All the theorist can say is that there is a potentially sound argument that rests on the unstable propagation of disturbance through the financial system, beyond the bounds of what ordinary prudence can be expected to cope with... One could argue, with some justice, that a confidence-worthy and confidence-inspiring monetary-financial system is a public good."

Do crashes result mainly from the accumulation of inevitable microeconomic imperfections or mainly from macroeconomic mismanagement by foolish governments? The 1920s and 1930s provide experiences very much in the mind of today's financial actors, and it may be useful to dwell briefly on that experience, which witnessed massive defaults by Latin American LDCs. The literature is replete with stories of microeconomic imperfections in the financial markets of the 1920s, which in many instances is an overly polite way of describing what went on between bond salespersons and borrowing tyrants. Yet when all is said and done, one comes back to sharing the conclusion of young Wallich: "If the depression of the 1930's had been mild, and if the steady expansion of world trade and capital exports had continued thereafter, defaults probably would have been infrequent and could have been settled without much difficulty..." (Wallich, 1943, p.321). This, one may add, seems quite plausible even though in those days there was not an International Monetary Fund. There were plenty of mechanisms intermediating between bondholding "widows and orphans" and borrowing countries, which were used to carry out what today we would call debt rescheduling exercises and stabilization plans. These include the Ottoman Public Debt Administration, the Financial Committee of the League of Nations, and the several ad-hoc financial missions to Latin American countries, representing bondholders associations, but closely linked to authorities in lending countries. See Frieden 1981, Fritsch 1979, and Ruggie 1982.

Other similarities and differences between bond lending in the 1920s and bank lending today offer a promising field for research. Price level expectations then were, of course, different from those of today, encouraging longer term contracts denominated in dollars and pounds. Inflation in key currencies has eroded even domestic bond markets in major countries, and indexing has proven to be a far from adequate substitute for stable price level expectations. News about major borrowers were then quickly translated into changes in open-market bond quotations, while today bank secrecy helps to hide such news, or at least delay their dissemination (also fueling rumors and fluctuations in the prices of bank shares which may be more destablizing than fluctuations in bond prices). Borrowing by issuing securities restricts the risk of default to specific investors who bought bonds; bank finance has created a situation richer in externalities, where the damage of any default could go well beyond the defaulting country and its creditors. Bonds offered, of course, the more sensible arrangement of financing long-term investments with long-term debt, while bank financing has engaged in remarkable feats of maturity transformation. It remains to be seen whether the regime of bank lending coupled with discreet scheduling to handle unforeseen shocks will prove more resistant to defaults and repudiations than the old bond system, and whether the avoidance of educative crunches and bankruptcies is a "slippery slope leading down to widespread state support for, and bailing out of the banking system" (See Colchester 1981; also Cooper and Truman 1971; Diaz Alejandro 1981; Eaton and Gersovitz 1981; and Sachs and Cohen 1982). These conjectures were tested during 1982, but under circumstances different from those of 1928-33. It is ironic that the shift toward bank lending was partly induced by the regulations introduced during the 1930s to avoid abuses in bond and security markets. Note also that during 1982 the names making bankers and their supervisors nervous were not only Mexico and Poland, but also International Harvester, AEG-Telefunken and Dome Petroleum.

<u>Gainers and losers</u>. Assume first that lenders of last resort exist, that real interest rates are at their "normal" long-run levels, and that rules of the game for trade and credit are steady and allow substantial international flows of goods and bonds. Who gains and loses from informational imperfections in credit markets? In particular, do LDCs gain or lose from them? And who within LDCs reap the gains or bear the costs?

The 1970s showed that most LDCs did not receive significant amounts of medium-term private credit. In some cases (e.g., India) there is a presumption that government authorities chose not to borrow at commercial terms. In others, even if demand existed (at less than astronomical interest rates), the presumption is that lenders simply rationed out borrowers not regarded as creditworthy, i.e., no private loans were forthcoming at "any" price. It is difficult to believe that in these LDCs there are no projects yielding sufficiently high social rates of return, including suitable calculations for the foreign exchange needed to service loans, to justify commercial borrowing. There is a *prima facie* case that either informational imperfections, or other type of imperfections, clog up lending channels. Among the latter one can imagine organizational flaws among potential borrowers, including misguided economic policies. On the lending side one can add the conjecture that information-gathering could have significant economies of scale, and the potential market of some LDCs may not be large enough to justify the necessary allocation of loan officers.

Other imperfections, however, appear to offer potential gains for the more creditworthy LDCs (e.g., the NICs), in the sense that those flaws discussed earlier tend to expand the supply of credit at going market rates. That credit comes with few strings attached during the hypothesized normal conditions, allowing the borrower substantial room to carry out its spending plans. The latter, of course, may be sensible investment projects, or even involve a wise smoothing out of consumption (not all consumption loans are necessarily "deadweight", see Eaton and Gersovitz 1981), or loans may be used upon arms consumption, or foolish investments. In the latter case, repayment problems are likely even under tranquil macroeconomic conditions.

Leaving aside "sensible" consumption loans, a good test of any financial system is how successful it is in transferring resources toward capital formation earning sufficiently high social rates of return to compensate lenders and leave a surplus for borrowers. Under these non-zero-sum circumstances everyone benefits, or at least no one loses.

There is some evidence that much LDC borrowing during the 1970s went into capital formation and that it did not reduce domestic savings effort. See Sachs 1981 and Bacha and Diaz Alejandro 1982. The evidence, however, is soft for several reasons. Such aggregate data, particularly on domestic savings, is notoriously shaky. One wonders, to give an example, how Argentine arms purchases since 1976 are registered in the national accounts. Even if accurate regarding aggregate amounts, the data are silent on the quality of investment projects. Casual empiricism will turn up doubtful investment projects carried out by both public and private agents in many NICs which borrowed heavily during the 1970s. Note that a negative correlation betweeen risk spreads charged to different countries and those countries' ratios of investment to gross domestic product (obtained by Sachs 1981, p.245) may simply reflect that both variables are sensitive to a third one: shocks from commodity price fluctuations or similar disturbances originating in the world economy or in nature. A frost, for example, may increase coffee prices, relaxing Brazilian balance of payments constraints: this will both allow higher investment rates in Brazil, and could also make the country appear more creditworthy, leading to a decline in risk spreads.

The safest generalization appears to be that whether NIC borrowing went mainly into ex-ante sound investment projects or into extravagant expenditures (of either a consumption, investment or military nature) depended more on borrowing country policies than on banker's selectivity. The moral-hazard flaws and expected subsidies described previously blurred in bankers' eyes differences between Brazilian hydroelectric dams, Chilean shopping centers and Argentine mirages.

Who benefitted <u>within</u> LDCs from wise borrowing or who bore the burden of extravagance are difficult questions, having as much to do with politics as with economics. Ironically, it seems that in many cases private international credit helped strengthen public enterprises in LDCs. Even the 1982 nationalization of banks in Mexico was (partly) explained by the need to reassure international capital markets of the soundness of those institutions. The incidence of extravagance can also be disconcerting: those politicians responsible for excessive spending and borrowing in Mexico during 1981-82 may end up their tenure as heroes, while those who follow may have to face unpleasant economic choices. Behind the politicians, of course, a myriad of economic agents will benefit from successful investment programs or suffer from "after the fall" stabilization plans.

Many LDC borrowers, both public and private, benefitted during the 1970s from credit conditions which, until 1980, turned out to be quite attractive, even when taking into account risk premia, fees and commissions. The price of either extravagance or sensible capital formation was low. This, of course, changed since 1980, with the sharp rise in real interest rates. The major losers of the low 1970s real rates of interest appear to have been oil-rich countries, whose financial investments at that time earned less than oil left underground.

At least during the 1970s, those were countries which were not in dire financial circumstances.

<u>Macroeconomic and financial collapse?</u> The dilemma between confirming and strengthening moral-hazard considerations and risking chain-reaction financial bankruptcies becomes salient during recessions and depressions. During the early 1930s the United States monetary authorities allowed massive bank failures aggravating recessionary trends; during 1982 they seemed to have (temporarily and wisely) decided to cast to the winds concerns about moral hazard and about inflationary expectations. In the very short run such action by lenders of last resort stems the urge to 'take the money and run' felt by smaller and weaker banks, which, by drying up short-term credit and halting normal roll-overs, can generate very large swings in net lending. The effectiveness of the international financial system during the 1980s, however, depends more fundamentally on the rapidity and vigor of the recovery by industrialized countries from the recession of the early 1980s, and the containment of protectionist pressures observed in those countries.

If recession deepens and/or protectionism advances further in industrialized countries, defaults, reschedulings and even repudiations will be unavoidable. Rescheduling, under those circumstances, is unlikely to be feasible at market conditions, even if real interest rates are at long-term normal levels. A more complex and intriguing scenario for the 1980s would involve neither deepening Northern recession nor vigorous recovery, and neither galloping protectionism nor a return to liberalizing trends in international trade. What will Brazil and South Korea do in this 'mediocre' scenario, which could involve a slow growth in their exports, but also low real interest rates? Will they continue to service punctually their debt even though net capital inflows may be meager and prospects for rapid export growth would be poor? Note that the default and repudiation option becomes less attractive to major debtors (who do not fear Marines any longer) not only the higher the expected excess of gross capital inflows over debt service payments, but also the better its export prospects to major creditors, and the faster the expected frontier technological change in those industrialized countries. Even if expected net inflows are low, Brazil will be reluctant to default and repudiate its debt for fear of having its links to suppliers of advanced machinery and technology cut off, and its other trade links harassed. Besides the turmoil which would be created in the short run by the drying up of even trade credits, the option of violently cutting off capital account links while maintaining trading ones with major creditors does not seem open for the foreseeable future.

Whatever happens, however, it is clear that no one is going to cart away debt-financed Brazilian hydroelectric dams, and that there are limits to the austerity and policy measures which can be dictated from abroad to countries like Argentina, Brazil, and Mexico. Complex and even dangerous bargaining games between large borrowers and those acting on behalf of lenders are already under way, covering not just balance of payments and macroeconomic policies, but also home-country regulations over direct foreign investments and even foreign policy stances. Some LDCs may be able to maintain a greater degree of policy autonomy than others, under these circumstances, just as during the 1930s Brazil enlarged its room for policy maneuver,even as that of Argentina shrank. The IMF could play an important role during the 1980s, but much depends on how it adapts to the times, a matter to which we will return below.

III. International monetary arrangements and domestic financial markets in some LDCs.

Exchange rates of key currencies and LDC optimal pegs. LDCs expressed unhappiness with floating rates among key currencies shortly after their adoption. This was regarded by many observers as yet another sign of LDC economic obtuseness, though reasons for such an LDC stance were fairly obvious, even if the wisdom of their advocacy of fixed rates for major currencies was debatable (see Diaz Alejandro 1975). Today unhappiness with flexible exchange rates has become widespread, as foreign exchange markets appear as turbulent as stock and other asset markets. Yet alternatives to floating, under present and likely circumstances, remain unappealing for key currencies. LDCs have been forced to reconsider their exchange rate policies even in the few cases where their domestic circumstances were tranquil. Traditional "peggers" have had to think about their optimal peg. External and domestic shocks, as well as changing priorities of domestic policies,have also led to reconsideration whether to crawl without preannounced rules, or to preannounce schedules of minidevaluations, or to have multiple rates, or even to float like the big boys.

Although faith in stable big brothers has eroded, optimum-currency-area considerations still lead most LDCs to peg: 90 out of the 114 LDCs whose exchange rate policies were classified by the IMF as of June 1980 declared themselves to be pegging, generally to the U.S. dollar, the French franc, the SDR, or to other basket currency. Careful empirical work has established that for the vast majority of countries maintaining a peg vis a vis another currency or basket, externally induced instability (e.g., fluctuations among key currencies) in effective nominal and real exchange rates increased between 1966-1971 and 1973-1979. Seeking greater stability, a growing number of LDCs have switched their pegs to foreign currency baskets. (See Brodsky, Helleiner and Sampson 1981; and Bacha 1981). The trend and gyrations of the U.S. dollar since 1979 have shown that the choice of a peg is far from a minor matter, as Central Bank officials in Argentina, Chile and Uruguay have belatedly found out.

There has been a <u>prima facie</u> case that the increased instability of LDC effective exchange rates induced by key-currency fluctuations has a harmful incidence on LDCs, increasing terms-of-trade instability, and complicating the management of LDC international assets and liabilities. Quantification of these effects, however, has proven elusive, so the magnitude of the welfare costs imposed on LDCs by the floating rate regime is moot, and could turn out to be minor at least for those LDCs with relatively sophisticated policy tools at their disposal.

Basket-pegging, of course, can offset some of the instability arising from key-currency gyrations. The 1970s witnessed a vast expansion of the literature on the optimal peg, mercifully surveyed by by John Williamson 1982a. Williamson argues that one point on which there is (almost) complete agreement is that choice of the unit to act as peg should be made with the aim of <u>stabilizing</u> something, rather than with the object of <u>optimizing</u> anything. He argues that there are two distinct aspects to exchange rate policy: the unit to which to peg, and rules governing changes in the peg. He concludes that the choice of the unit to which a country pegs its currency should be guided principally by the pursuit of internal balance (being content that external balance is satisfied on average over the medium term), and that this requires pegging to a basket of currencies reflecting the direction and the elasticity of total trade. Longer-term questions, notably neutralizing inflation differentials,promoting payments adjustment, and imposing an external discipline, should be handled by changes in the value of the peg, rather than by influencing the unit to which the currency is pegged. Finally, he notes several attractive features, from a cosmopolitan viewpoint, of pegging to the SDR.

Some qualifications may be made to these conclusions. The distinction between stabilization and optimization is debatable: why stabilize unless there is some optimization justifying it? For many small and very open LDCs the distinction between the choice of peg and the rules for changing the peg may remain academic: their size and possible feebleness of monetary institutions may rule out anything but fixed exchange rates, for optimum-currency reasons. Having ruled out "forever", a la Guatemala, changes in the peg for the sake of preserving the moneyness of the local currency, longer term considerations, such as a desire to minimize local inflation, could influence whether to peg to, say, the U.S. dollar, to the Pound sterling, or to the French franc (a choice not so theoretical for small Caribbean islands, for example). A second qualification involves the need for further work on how the capital account should influence the choice of the peg; with the exception of Turnovsky 1982, the literature so far has focussed almost exclusively on the current account. Suppose a country trades mainly with Germany but borrows in New York: how should this affect its choice of peg? Given the high degree of capital mobility since the late 1960s, the short-run swings in the capital account have become a major preoccupation of Central Bankers in semi-industrialized LDCs, an issue worth some discussion.

<u>Some dilemmas and experiments</u>. Particularly in LDCs with a history of erratic inflation and macroeconomic turbulence, the interaction of exchange rate policy with local and international financial markets has become a matter of serious concern during the 1970s and early 1980s. A permissive international monetary system has allowed room for experimentation; as with borrowing, the experimentation has resulted in some hits and some errors.

A central policy question is whether to attempt to loosen the links between domestic and international financial markets. Floating rates perform some of this delinking function in industrialized countries, although experience has shown that their performance in this respect has been far from satisfactory, and some observers have called for policies to widen the breach (Tobin 1978). Note that among industrialized countries, with the major exceptions of Germany and the United States, there is a widespread recognition that short-term financial flows can pose problems for macroeconomic management; most of those countries do in fact maintain restrictions of various sorts on short-term banking operations, restrictions which are accepted in the OECD Code on Capital Movements (Bertrand 1981) and of course by the IMF.

The most spectacular LDC experiments have involved the combination of liberalization of domestic financial markets, a loosening of links between domestic and international capital markets, <u>and</u> the use of pre-announced or fixed exchange rates as weapons to reduce domestic inflation. Examples include Argentina, Chile and Uruguay since 1978, culminating in assorted catastrophes around 1981-82. Those policies did lead to a (temporary) reduction in inflation, massive capital inflows and increases in foreign exchange reserves. They also led to a trend toward real appreciations of the exchange rate and, eventually to reversals of the capital flows, financial panics, crisis devaluations and a renewal of inflationary pressures, in a context of severe recessions. During the euphoric 'miracle' phase the external debt and reserves expanded with great speed; the busts also proceeded with remarkable momentum, reducing reserves but leaving behind serious debt servicing problems. Ex-post explanations for these melancholy results include external shocks, failures to bring public sector deficits under control, and excessive generosity to workers (full wage indexation making real wages rigid downwards). Of greater importance were errors in assuming that domestic financial markets needed no more effective control than spot apple markets, faith in crude versions of the Law of One Price, and in automatic mechanisms of adjustment for obtaining balance of payments equilibrium with full employment. It is remarkable that those advocating and implementing Southern Cone domestic financial liberalization overlooked or ignored the fact that in the case of the paradigmatic experiment in successful domestic financial liberalization, that of South Korea during the 1960s, most of the financial institutions were owned or controlled by the government, facilitating prudential supervision of both national and international financial transactions and giving the government a powerful influence over credit allocation. (See Gurley, Patrick and Shaw 1965, p.45.) Indeed, much of the literature advocating financial liberalization has compared LDC "repressed" markets with mythical perfect credit markets with full information, misleading policy makers into believing that if only ceilings on interest rates were removed, a sound, competitive and vigorous financial sector would spontaneously appear. Little attention was given (until the 1981-82 catastrophes) to irreduceable informational imperfections, nor to the rich variety of financial systems and regulations which exist in the industrialized countries, most of which are hardly perfect credit markets with full information.

Tendencies found in industrialized countries toward the generation of oligopolistic financial groups and conglomerates, checked in some of those countries by regulatory legislation, became virulent after LDC financial liberalizations whose analytical underpinnings went little beyond demand and supply schedules for credit (Foxley 1982). It may also be noted that the related misuse of the small country assumption for borrowing in international credit markets led to a Southern Cone belief that the current account consequences of increasingly overvalued exchange rates could be easily covered by tapping the infinitely elastic supply of external funds. The liberalization of domestic financial markets under Southern Cone circumstances generated considerable short-term transactions, but no substantial and permanent increase in private fixed capital formation. Real interest rates, measured in a number of plausible ways, remained inexplicably high. Beyond fairly predictable explanations, an interesting conjecture links those high interest rates to moral hazard imperfections emphasized in this paper: financial intermediaries in trouble, shielded by portfolio secrecy and expectations of a bail-out, seek fresh deposits from the public by offering ever-higher interest rates (Baeza Valdes, 1982).

The control and elimination of inflation has proven to be quite difficult and costly in both industrialized countries and LDCs. The experience of Southern Cone countries, in particular, has highlighted the dangers of dogmatic liberalizations in the midst of macroeconomic turbulence. It is now widely recognized that maintaining macroeconomic control during the transition toward more stable conditions is a difficult task which is likely to require some form of exchange controls over capital outflows and inflows. See McKinnon 1982. Given the frequently large differentials in domestic and foreign interest rates, taxes, rather than purely quantitative control,seem the proper instruments for the task of reducing destabilizing short-term capital movements. Enormous rents could be captured by those arbitraging between local and international capital markets; because of both macroeconomic and prudential considerations it would not be desirable to eliminate those rents by simply allowing more private agents into the business. Taxes or controls will not doubt have many leaks and will introduce inefficiences; the point is that under some circumstances they may avoid worse ones.

International liquidity, the LDCs and the great gold swindle. At least under some plausible definitions, aggregate international reserves increased dramatically during the 1970s, while reserve composition was also drastically altered. Neither event was foreseen during the 1960s,much less planned. The increase in the price of gold was the major cause for both events; by the late 1970s gold had become *de facto* the major international reserve asset, although its price fluctuations limited its classical reserve function.

During the 1960s the LDCs were encouraged, if not pressured, to hold reserve increases in the form of interest-earning key-currency-denominated assets. The dollar was said to be not just as good as gold; as it could earn interest, it was said to be better. Choosing gold was regarded as an unfriendly act, and LDCs were lectured on the irrationality of gold-holding. Three-fourths of the world reserve gold remained in the hands of the United States, the Federal Republic of Germany, France, Italy, Switzerland, the Netherlands, and Belgium, countries which registered massive (paper) profits as a result of gold price increases. Brodsky and Sampson, 1981, estimate those profits at more than $300 billion. Gains to LDCs from the gold price increase, including those from the liquidation of IMF gold, are tiny next to that figure.

The instrument intended as the principal reserve asset of the international monetary system, the SDR, accounted for around 2 percent in the growth of international reserves during the 1970s, and the figure is unlikely to be much higher during the 1980s. Even without the "link", LDCs would be today better off had the increase in international liquidity registered since the late 1960s taken the form of expanded SDR allocations. Ironically, the countries which benefitted from the increase in gold prices during the 1970s now argue that further SDR allocations are not needed and would be inflationary. By the early 1980s non-gold international reserves had fallen sharply relative to trade; during 1982 some LDCs were reported to be selling some of their meager gold holdings. IMF quotas have slipped way behind world trade and payments imbalances, reducing access to its low-conditionality facilities.

Not surprisingly, the fashionable nostalgia for the gold standard found in the industrialized countries has found few echoes in LDCs, most of which remember those days as involving subjugation to colonial powers or as imposing on their sovereign but weak economies substantial instability (Triffin 1964).

IV. International financial institutions

The International Monetary Fund and other lenders of last resort. Those who launched the IMF in 1944 expected a world with adjustable but mostly fixed rates, and a low degree of international private capital mobility. Is the IMF really necessary in a world of floating rates and in which private finance seems plentiful? Before 1944, after all, there were some periods of tranquil international prosperity without an IMF.

Earlier pages noted that many small countries (not all LDCs) prefer to maintain parities pegged to key currencies or baskets of them. Even authorities in charge of key currencies have not foresworn intervening in exchange markets. Exchange rates, in other words, will not bear the full burden of adjusting to shocks to the balance of payments in the foreseeable future. There will remain deficits and surpluses generating financial transactions. Earlier pages also noted microeconomic and macroeconomic reasons which indicate that purely private financial markets may not be optimal for handling deficits and surpluses; informational and organizational flaws may lead to circumstances where the required finance will not be forthcoming at a reasonable cost when it is most needed. Countries could be pushed into emergency adjustment measures with substantial externalities and which are less than optimal from both national and international viewpoints. This is why leaving aside advocates of a return to the gold standard, immediate world revolution, or free banking, there is widespread agreement that a desirable international monetary and financial system should have at its center something like an IMF, to act as a lender of last resort to national Central Banks, in a manner partly similar and partly different to how those Central Banks act vis-a-vis their commercial banking and financial systems. This systemic consideration also explains why LDCs which are harsh critics of the IMF also advocate a large increase in its quotas. Events during the second half of 1982, when the U.S. administration used its muscle as international lender of last resort (ILLR) partly to undermine the foreign policy independence of Brazil and Mexico, confirmed the importance to LDCs of multilateral financial institutions.

Neither at the national nor at the international levels there is a robust theory of lender of last resort; we have instead history and ad hoc judgments (see Solow 1981). First note differences between the IMF and Central Banks: the latter have in most countries a good deal of power over their national financial institutions, even when located abroad, while the IMF must generally wait until Central Banks come to it before it can influence their policies. National Central Banks, however, have tighter limits on their ability to "print" internationally-acceptable money than the IMF has. It appears plausible to argue that whoever acts as international lender of last resort should have enough of those funds which are likely to be demanded during a crisis to make its reassurances credible. It should also be on speaking terms both with potential customers for funds, and with those providing its financial muscle. It must be able to move very fast during emergencies. Since at least the first oil shock there have been doubts, on all counts, whether the IMF is really up to an ILLR role. Its lending potential has not kept up with possible balance of payments deficits, and its authority has been eroded by proposals for ad hoc "safety nets." Its long estrangement from many LDCs, including key ones like Brazil, has not been overcome. Its rules call for time-consuming negotiations and procedures.

During 1979-1980 the IMF seemed on the way toward enlarging its lending capacity and adopting more flexible lending conditions, culminating in a large loan to India. This trend was suddenly stopped during 1981, under pressure from the new U.S. administration. Events during 1982 have persuaded at least some skeptics of the wisdom of the 1979-1980 initiatives, although it remains to be seen how forcefully those initiatives will be pursued. The crucial issues remain both a major increase in the IMF financial resources and a substantial improvement in its lending practices.

John Williamson has given us another helpful survey of crucial points in this area (Williamson 1982b). His discussion can be criticized as minimizing past IMF inflexibility in dealing with LDCs, especially in the Western Hemisphere, and as exaggerating the theoretical (in contrast with the practical) grounds for advocating the use of credit ceilings in stabilization plans. However, his estimates indicating the need to raise IMF resources to at least SDR 100 billion (from SDR 61 billion) and most of his suggestions on how to liberalize IMF lending practices are persuasive. Indeed, his characterization of the IMF theoretical position as eclectic and his conclusion that criticisms of the IMF are largely misplaced will be tested, inter alia, by how that institution reacts to his proposals over the next few years.

Few would deny that the IMF, or any ILLR, should attach some form of economic 'conditionality' on its loands. (See Dell 1981 for a masterful review of the evolution of conditionality). Given the lack of consensus on macroeconomics, not just among academics but also among Fund patrons (contrast macroeconomic policy in France and the United States), the case for IMF conditionality focused narrowly on balance of payments targets is strengthened. It is true that observed performance in the balance of payments is the result both of domestic policies and factors beyond the country's control. Yet a number of indicators, such as staple prices and market shares, could be used to evaluate performance, and failure to meet agreed targets. Note that the compensatory facilities of the IMF have accumulated experience in this area.

It is the business of the Fund to insist on balance of payments targets consistent with the repayment of its loans, to monitor closely performance in this area,and to suspend its credit(either subsidized or cheap relative to alternatives)to countries which do not repay promptly without a good reason, such as unexpected exogenous shocks. It is not the business of the IMF to make loans conditional on policies whose connection to the balance of payments in the short or even medium run is tenuous, such as food subsidies, utility rates, controls over foreign corporations, or whether the banking system is public or private. It was a brilliant administrative stroke for the IMF staff to develop "the monetary approach to the balance of payments" during the 1950s, allowing the translation of balance of payments targets into those involving domestic credit, but for many LDCs the assumptions needed to validate such translation have become less and less convincing.

Focusing on balance of payments targets would keep the IMF away from the more political aspects of short run macroeconomic policy making. Countries could, of course, actively solicit IMF advice on those aspects, and under those circumstances the IMF staff could give full expression to its views on inflation control, optimal trade regulations, food subsidies, etc.

Balance of payments flow targets will be naturally intertwined with estimates of the stock of a country's foreign debt; a country asking the IMF for a loan will have to discuss its other outstanding loans, if nothing else, to clarify priorities in debt servicing. IMF conditionality thus inevitably involves this institution in discussions about debt limits and servicing, including rescheduling exercises. All of this could in principle be handled so as to reduce uncertainty and informational flaws, so that both private lenders and borrowing countries, as well as innocent bystanders, could on balance gain relative to a laissez faire counterfactual. As noted earlier, lack of resources and overly intrusive notions of conditionality have kept the IMF from fully playing that constructive role. Until there are clear indications that a 'new' IMF has come into being some countries may continue to handle their debt, and possible debt reschedulings, on their own. To make even a 'new' IMF a kind of central committee of an international credit cartel would under normal circumstances be a remedy worse than the disease, at least from the viewpoint of many borrowing countries.

Difficulties servicing the Mexican external debt during 1982 showed that not even the Reagan administration expects financial crises and potential bank failures to be handled by the magic of the market place. As noted by the managing director of the IMF, in a commendable brief period the central banks, the Bank for International Settlements (BIS), the United States Treasury, the commercial banks and the IMF acted in full cooperation. Similarly, the government of the Federal Republic of Germany appears to have had an influence in containing the impact on German banks of Polish difficulties with punctual debt servicing. While these two cases showed the efficacy of lenders of last resort, the melodramatic collapse of the Luxembourg subsidiary of the Banco Ambrosiano and the failure of the Bank of Italy to back any of its debts underline the ambiguities of the 1975 Basle concordat among key central banks, which laid down a division of responsibility designed to prevent any element of an international bank escaping supervision, and presumably having access to some lender of last resort. So far the quantitative and psychological impacts of the rescue operations for Poland and Mexico exceed by far those of the Ambrosiano affaire, so much so that one detects among some concerned observers an eagerness to witness "exemplary" bankruptcies for banks and "exemplary" stabilization plans for countries, so as to avoid validating much too obviously the subsidy expectations and moral hazard features of international lending. The search must be on for victims too weak, unpopular, or small for their sacrifice to shake the financial system. In the meanwhile, low quotations for their shares and difficulties in the inter-bank deposit market are expected to give the boldest banks a salutary fright.

The key lesson of the second half of 1982 may turn out to be that under present political and economic conditions the real ILLR is the United States government, whose Treasury and Federal Reserve can mobilize, by the proverbial stroke of a pen, vast sums of dollars with more secrecy and speed than the IMF, or even the BIS. The mechanisms available to the U.S. executive for these purposes are plentiful and free from ex-ante Congressional checks. Big and politically centralized LDCs, such as Brazil and Mexico, will prefer in a crisis to deal directly with the U.S. government. IMF blessings to bilateral deals may or may not come ex-post. One may conjecture that big borrowers will trade off foreign policy autonomy (less opposition to U.S. policies in Central America and in GATT) for more resources and somewhat more lenient economic conditions.

Over the longer term, an IMF counting with both ample resources as well as the trust of most of its members could help not only to complement the lender of last resort facilities of national central banks but also serve as a forum for effective coordination of national macroeconomic policies. During 1980-1982 LDCs were severely hit by the side effects of anti-inflationary policies in industrialized countries, particularly in the United States, without having the opportunity to have their case heard in potentially responsive fora. Extravagant interest rates directly increased the debt burden, and indirectly led to low primary product prices and a lower demand for LDC manufactured exports. Recession in the North induced protectionist pressures, which even when resisted harmed the outlook for LDC exports, and hence reduced their creditworthiness. A reinvigorated IMF, perhaps together with a new GATT, could act as a forum where the interconnections among macroeconomic, trade, and financial policies, North and South, could be discussed, and brought under a minimum of coherence. It is conceivable that such an IMF could play a worldwide countercyclical role, as visualized by some of its founding fathers, using its power to issue SDRs and by a more vigorous use of its compensatory financing facility, which could become an important automatic stabilizer for the world economy.

While a renewed IMF would have substantial 'mutual gains' for North and South, it would also involve zero-sum aspects, making one pessimistic as to the immediacy of this 'second coming'. One cannot increase the voting weight of the South, for example, without reducing that of the North. A more technical and "built-in" approach to debt scheduling could reduce opportunities for some Northern groups to have their governments link credit rollovers to changes in host country rules on direct foreign investment and in their energy and even foreign policies. Those in the Reagan administration, for example, who have successfully exploited the financial difficulties of Brazil and Mexico to advance U.S. political hegemony in the Western Hemisphere would naturally be reluctant to work for an expanded and autonomous IMF.

Other multilateral institutions as financial intermediaries. As with the IMF, one may question whether the 1944 justifications for creating a World Bank remain valid for the 1980s. In what follows the role of the World Bank and of other multilateral lending agencies, such as the Inter-American and Asian development banks, as financial intermediaries will be separated from their role as dispensers of concessional finance, or aid, as with IDA and other "soft" windows.

Why should the World Bank borrow in more-or-less open financial markets to lend to Brazil, which has had direct access to those markets on its own? Why would Brazil want to use the World Bank as intermediary, anyway? The answer must be sought again in the informational imperfections of capital markets, which can be reduced by multilateral banks, whose solvency is backed by financially powerful countries and who can exploit economies of scale in monitoring borrowers. Faced with rationing or steeply rising marginal borrowing costs, Brazil could welcome indirect borrowing channels which may expand credit availability and reduce costs. Brazilian borrowing from the World Bank, in turn, will increase its creditworthiness among private lenders. These considerations apply a fortiori to LDCs whose direct access to international private credit markets is less fluid than that of Brazil. While international capital markets revived since the 1960s beyond 1944 expectations, the World Bank still has the role assigned to it in Bretton Woods, i.e., to substitute partly for private international markets for long term bonds, which collapsed in the 1930s. Note that even in industrialized countries with fairly well developed credit markets, there are public institutions acting as financial intermediaries or guarantors to channel resources toward borrowers overlooked or neglected by purely private markets; examples include the Small Business Administration and student loans in the United States.

In contrast with the IMF, then, the role of multilateral banks is not to engage in short-term crisis lending but to finance investment opportunities with high social rates of return which are not being banked by private sources. They will want to have their own form of "conditionality", which may range from a minimalist one dealing with specific projects, to a maximalist conditionality involving all aspects of development policies of borrowing countries. This is not the place to rehearse the stale 1960s arguments on this form of conditionality, nor the related debate on project vs program lending. (See Diaz Alejandro 1971 and Albert O. Hirschman and Richard M. Bird 1968 for discussion of these issues.) New circumstances during the early 1980s, however, warrant a few remarks.

While Brazil may want to borrow from international markets both directly and via multilateral banks, the option to do either reduces the leverage which the latter institutions have over that type of borrowing country. At the same time, abrupt 'graduations' of NICs from multilateral banks during the circumstances of the early 1980s appear unwise. Multilateral banks during the 1980s could pioneer in experimenting with financial instruments and loans with flexible repayment schedules (e.g., contingent on commodity prices) and various forms of indexing. Co-financing of loans with private lenders, as practiced by the International Finance Corporation, could play a useful but modest role in expanding the volume of finance, so long as this practice does not distort priorities in the rest of the World Bank system.

LDCs without direct access to international credit markets will have to rely on both the intermediating role of multilateral banks, and on multilateral and bilateral aid, if they want to invest beyond what they save, either temporarily or for a longer term. Among LDCs, the dependence of sub-Saharan Africa on multilateral institutions and on aid remains singularly acute, and worthy of special emergency attention (Helleiner 1982). Willy-nilly, this type of LDC will continue to participate in a "dialogue" with multilateral lenders and donors about their investment plans and other development policies. Apparently correct conventional wisdom argues that such a dialogue is best handled multilaterally rather than bilaterally; it is therefore strange that the Reagan administration appears to favor both tighter "development conditionality" and a weakening of multilateral institutions.

V. Memories, dreams, reflections.

International monetary and financial arrangements have been throughout history an aspect of the world economy most obviously connected to political power. The Pax Romana, the Pax Britannica and the Pax Americana had counterparts in coinage and credit. Between Pax and Pax chances for panics and depressions grew (Kindleberger 1973). It may be argued that although in the early 1980s the hegemonic power of the United States has been seriously eroded, a great deal of consensus among capitalist industrial powers remains regarding desirable international economic arrangements, so that a repetition of past inter-Pax catastrophes may be avoided (Ruggie 1982). Yet the diffusion of commercial, financial and political power of the early 1980s remains historically unprecedented, generating large actual and potential frictions among major international actors, including those arising from attempts by the United States to reassert hegemony and discipline among its allies. This dangerous situation, however, can also be interpreted as a necessary precondition to building a more equitable and participatory international economic system.

Most LDCs having economic development as their highest priority are passive spectators in this turmoil. They are often lectured to "adjust to the realities of the 1980s". If the adjustment is compatible with the maintenance of a minimum rate of development, they are likely to go along. Most, however, are unlikely to put up with a pseudo-adjustment involving long periods of stagnation. Rather, they will face possible new international realities by reorienting their development strategies. Quite sensibly, they will not for very long "adjust" by having high rates of unemployment and excess capacity, and wasting opportunities for capital formation. Some LDCs, of course, are in a better position to carry out such reorientation than others, due to larger domestic markets and a greater availability and willingness to use policy instruments. As a participant at the IMF/World Bank Toronto meeting of September 1982 put it: "Brazil is too big to fall into the abyss."

A reorientation of LDC development policies would involve, as during the 1930s, a greater emphasis on import substitution, this time perhaps involving more South-South cooperation. The new strategy could also involve import-postponement and investments intensively using non-traded goods (e.g., housing); these elements are consistent with greater attention to the welfare needs of the population at the bottom of the income scale. If stagnation and protectionism in the North become chronic, hampering the reverse real transfer involved in debt servicing, financial arrangements would have to be reexamined and renegotiated. The IMF, the World Bank and other multilateral lending agencies would have to exercise some imagination to serve as more than debt-collecting agencies.

This scenario, gloomier for the North than for some development-prone LDCs, still remains an unlikely one. Whatever happens, the combination of business cycles in major capitalist economies with contractually rigid loan agreements will continue to generate periodic North-South financial frights which were almost forgotten during the 1950s and 1960s by relatively smooth and high growth and the miniscule debt with which LDCs emerged from World War II. It is doubtful that there will be much success in smoothing the Northern business cycle during the 1980s, so that instability in the prices of Southern export commodities (almost declared a non-problem during the 1960s) is also likely to remain high. Note that among highly indebted LDCs one finds both oil-importers and oil-exporters; a fall in oil prices may help some (e.g.,Brazil) while provoking a crisis in others (e.g., Mexico). Instability in that price is likely to hurt both. One would imagine that in a cyclical world financial arrangements would emerge which include provisions to deal with contingencies such as sharp fluctuations in the prices of key exports of borrowing countries, rather than establish fixed repayment schedules, come hell or high water. Historically, lenders have preferred to use ad hoc rescheduling rather than ex-ante flexible conditions, probably because of moral hazard considerations. Bank regulators in lending countries have also preferred, so far, to deal with the issues raised by more or less forced rollovers in an ad hoc fashion.

Both at the national and international levels, banks and other financial intermediaries have come under closer academic and public scrutiny during the 1970s and early 1980s. After early enthusiasm for ending "financial repression" and most regulations, sober second thoughts have appeared. Few would argue in 1982 that financial intermediation is just one more competitive industry, with no more externalities than the apple industry. At the national level, financial reform could take sharply divergent paths, depending on macroeconomic strategies and also on the confidence policy makers have on their own administrative capacities, versus their faith on the public's capability to sift information and make wise decisions regarding risks and returns. France has ended up with nationalized banks while the United States may reduce deposit insurance and force banks to reveal more information about their portfolios. Deregulation in the United States will involve some subtle rhetorical exercises; Henry Wallich, as a member of the Board of Governors of the Federal Reserve System, can speak of "...building a more flexible and more competitive banking system..." almost in the same breadth that he urges banks "...to remember that their actions in troubled situations impinge on all other banks. Their interests will be best served if they stand together in defense of a common position." He also advises that "...in analyzing [LDC] creditworthiness,...banks should seek out and make available to each other the necessary information." (Wallich 1982, pp. 1,2 and 3). Singular advice for the promotion of competition!

No country, developed or developing, can afford not to think through these dilemmas in the context of their own specific national circumstances; just copying the financial laws and practices of another will not do, and relying on old practices may not be enough for the 1980s. The LDCs, preferably acting as a group, also have a large stake in monitoring and influencing how changes in industrial countries financial practices affect international capital markets. Regardless of how each country handles its domestic financial system, what are the interests of LDCs, or of different types of LDCs, regarding international financial markets? Should they lobby for laissez-faire international banking or for greater controls, inevitably to be exercised mostly by parent industrialized countries?

For semi-industrialized and socialist countries the late 1970s represented a golden era of borrowing, cheap both in economic and political terms, thanks to the uncontrolled segment of international banking. It may be argued that the early 1980s proved that such a golden era was a passing mirage, bound to end in collapse, as in Southern Cone domestic financial liberalizations. Granting that the ease of borrowing tended to encourage domestic mismanagement and overspending by public and private agents in weak projects (as in the cases of Argentina and Mexico), in others the unexpected severity of macroeconomic circumstances during 1981-82 is largely responsible for payments difficulties (as in the Brazilian case). During 1982 many LDCs saw the dollar value of their exports fall sharply, even as the export quantum grew, provoking charges of dumping by industrialized countries. Yet in other cases, such as Colombia, very prudent policies have kept the country out of the financial pages of international newspapers. During 1982 it has become clear that while an international lender of last resort is at hand, it will extract its pound of flesh.

Indeed, there are hints that the 1982 crisis may be used by some industrialized countries, particularly by the United States, to reassert "discipline", i.e., cartelize bank lending not just to socialist countries but also to LDCs. The cartelization could bring some paternalistic benefits: making the system less vulnerable to crises and eliminating some foolish loans. But the dangers to self-reliant borrowers, confident of their own economic and political management, are obvious.

Somewhat paradoxically, both semi-industrialized and other LDCs would be wise in the near term to fight for the integrity of the IMF, even as they press for more rational IMF "conditionality". The same could be said regarding the World Bank and other multilateral lending agencies (and indeed for the GATT). The imperial pretensions emanating from Washington during 1981-82 have underlined the potential benefits to many

LDCs of both a lightly regulated international banking system and a set of supporting multilateral financial agencies, including an IMF which could act as a genuine ILLR. The multilateral financial agencies should play a particularly important role vis-a-vis the poorest LDCs during the 1980s.

How much pressure can LDCs exercise in international financial bargaining? Can Southern debts be aggregated into one powerful bargaining chip? One is skeptical: Mexico is unlikely to want its debt lumped with that of Bolivia or even Brazil for bargaining purposes. Yet demonstration effects among debtors could occur during a severe international crisis, leading them to suspend sequentially normal debt service, as during the early 1930s. This may be enough to give at least some semi-industrialized LDCs a bit of influence to press for a reexamination of rescheduling and ILLR arrangements. Ideas put forth at the UNCTAD Manila conference on rescheduling and on how to ameliorate the real consequences of periodic financial scares inevitable in private financial markets are worth a fresh look. The sharing of costs between lenders and borrowers of loan decisions which ex-post turn out to have been mistaken also needs reexamination both to check moral hazard and on equity grounds; at present the burden is disproportionately borne by borrowers, with private banks often doing quite well in reschedulings.

In spite of troubles in formal South-South integration schemes, intra-LDC trade grew vigorously during the 1970s. Such a trend could be encouraged and accelerated during the 1980s by bolder cooperation among LDC central banks. More generous reciprocal credit lines could particularly important for encouraging trade in machinery and other capital goods. This type of relatively modest step in financial cooperation, say among the Central Banks of Brazil and Mexico, may be quite useful in the environment of the 1980s and may indeed pave the way toward joint bargaining vis-a-vis third parties.

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