# Reschedulings, defaults shape 1981

*Third World debt seems under control in the medium term, but short-term pressures are acute.*

The government of Sudan and five international commercial banks representing a larger number of creditors announced Oct. 28 that agreement had been reached on the first phase of a reorganization of $600 million in Sudanese privately held debt. Since July, Turkey, Bolivia, and Nicaragua have also reached debt reorganization accords. The Turkish reorganization was the largest debt reorganization in history, involving rescheduling of payments on $6 billion owed to governments and private banks.

American and British banking sources report that during 1981 they expect a rise in such reschedulings, as well as "controlled defaults" on Third World debt. Among the countries cited as slated for partial debt reorganization is Brazil, the world's largest debt holder, accounting for 16 percent of total debt owed.

Will such debt reorganizations have an adverse effect on international credit? Most international bankers will agree with the emphatic assertion voiced this week by a U.S. Treasury official involved in public debt reschedulings: "One of the beauties of the current financial system is its unlimited flexibility . . . it doesn't all have to be defaulted at once. I don't see anything getting out of control."

There are two different kinds of trends currently at work to force these debt reorganizations. To the extent that international financial officials say they are confident they can iron out debt payment stoppages with their borrowers, they are only taking into account the medium-term or half, the picture. It is the recent, short-term developments, led by the renewed rise of dollar interest rates to the 14 to 16 percent range, which threatens to produce uncontrolled crises.

The interaction of medium- and short-term economic trends on Third World economies can be illustrated through two case examples: Peru and Brazil.

On the level of medium-term growth prospects, Brazil remains one of the best credit risks for international investors. Although its official debt will touch an astounding $70 billion by 1981, the country has vast mineral wealth and a growing industrial sector. If Brazil implements its standing plans for nuclear power development, it will be able to generate sufficient wealth for debt repayment.

Brazil's problem is the rapid rise in debt service since 1979, when payments on interest and principal to banks jumped $3 billion from the previous year to over $6 billion. Every time dollar interest rates rise 1 percent, Brazilian debt service jumps $600 million. In 1981, debt service alone could reach $10 billion.

These debt service payments, issued on a half-yearly basis, work as a tax on the economy, producing periodic, serious cash-flow problems. One California creditor to Brazil reported this week that some time during 1981, the Brazilian central bank will probably call in several hundred million dollars in loans due for rescheduling on a longer-term basis to reduce the cash drain.

As our interview with a Federal Reserve official documents (see p. 11), some New York and London forces are ready to knock Brazil off its feet through a merciless interest rate squeeze. The country is already paying over 16 percent on many categories of loans, compared to 10 to 12 percent a year and a half ago. If, as expected, U.S. interest rates stay at their current levels for the whole of 1981, the Brazilian rescheduling may have to be much larger than the under $1 billion level bankers are confident they can handle.

The case of Peru documents the uglier side of international payments problems. In 1975, Peruvian borrowings jumped $1.8 billion. By 1979, Peru suspended payments on a portion of its $4 billion in commercial debts, which were then rolled over by a new medium-term loan. Unlike Brazil, Peru has not used these loans for domestic project investment. As it enters into a zero-growth economy, Peru is being cut off by international lenders.

In early October, Lloyds Bank chairman Sir Jeremy Morse stated in a speech in London that the number of countries for which lending will be "choked off" will also rise during 1981. One effect of "marginalizing" such economies is that it knocks them out of international trading relations, aggravating the already projected 2 percent downturn in world trade expected for 1981, and making the entire world debt load more vulnerable.