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Debt for sale

The world's financial statesmen have chalked up a real success in subduing rampant inflation. Yet on the morrow of this much-lauded victory, those same statesmen are dangerously near to creating conditions that will help fuel yet another round of rapidly spiraling prices.

It has all happened before. In the 1950s and early 1960s, there was general agreement that what had begun in the 1950s as the "dollar shortage" had developed into a "shortage" of world liquidity. Neither gold nor dollars were plentiful enough, the statesmen agreed, to finance burgeoning world trade and lending. New money was required. And so from the newly created IOUs of the member nations the IMF invented as new money Special Drawing Rights.

But the wheels grind slowly in international diplomacy and the first SDR issue did not appear until 1970. By that time, however, the world was awash with liquidity. The dollar shortage had turned into a dollar glut. The timing was impeccably wrong. Issues of new SDRs throughout the 1970s added liquidity to the spreading inflationary fires.

Fortunately, in spite of the pressures from the Third World, there is little risk of another large SDR issue today. I suspect that the SDR lesson has been absorbed. But there is a present threat that, in responding to the liquidity shortages of Third World countries, we shall create such permanent paper credit that the world will be battling once again with a runaway inflation in a few years' time.

Many Third World and communist countries, like junkies, had become hooked on deficit financing and cheap foreign money. They desperately needed time if they were to kick the borrowing habit. It is difficult not to sympathize with those countries friendly to the West (such as Mexico) that are making a determined effort to live on less credit. There is a good argument for a temporary increase in IMF and other international credits to enable these countries to mend their ways.

Prime Minister

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market yield. In short, the truth would be revealed.

When these market values are entered in the accounts of banks, the balance sheet will tell us the true market value of its assets. Then the capital erosion of individual banks will be clear for all to see. There is no doubt that the U.S. banking system could easily survive this orgy of true confession. The reality is the same; it is just a matter of recognizing it. And, in one important respect, things would be improved. There would be a new market and an extension of that valuable right of individual choice. That is worth a lot.

The danger is that when the crisis is over, the new IMF credits will not be withdrawn. The Western world has suffered enough from the inflationary effects of permanent increases in the world money supply which were designed to deal with transitory problems. We do not want to see a rerun of the unhappy decade of the 1970s.

Also in the banking system there is a great temptation, in dealing with the effects of these dubious debts on bank balance sheets, to resort to short-term expedients which will have dire long-term consequences. Bankers are reluctant to acknowledge that they have made mistakes and recognize that their loans have gone sour.

Formally, a loan is "performing" and recorded in the accounts as worth 100 cents to the dollar if interest is not overdue for more than 90 days. The banks have been making new loans so the debtors can pay the interest due, thus perpetuating the fiction that the loans are performing. But they are not. The balance sheets are, in the true sense of the word, fantastic.

It will be difficult to construct balance sheets which tell the plain truth rather than politic fiction until one knows what the debts are really worth. Such bank loans are bought and sold, but it is a covert and highly restricted market. For various but obvious motives, the market remains in the closet.

The U.S. government should insist that this market emerge from the closet. Make it overt, not covert. To encourage such open behavior, Washington should insist that the banks which hold, say, more than 100 percent of their capital in dubious foreign loans, sell off a small fraction (perhaps only 2 percent) to the non-bank investor. This could be represented as no more than a very modest requirement of normal prudential control. But it would enable the world to see what the promises of Mexico, Brazil, Chile, Poland and Romania are worth!

Anyone, including the indebted countries, could buy such debts. Countries who wish to raise more credit would have to pay the overt

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