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BOOK REVIEWS

A DANCE ALONG THE PRECIPICE: THE POLITICAL AND ECONOMIC DIMENSIONS OF THE INTERNATIONAL DEBT PROBLEM. Edited by William N. Eskridge, Jr. Lexington, Mass.: D.C. Heath and Co., 1985, 283 pp.

Throughout the 1970s, U.S. commercial banking institutions lent unprecedented amounts to Latin American countries. On August 12, 1982, Jesus Silva Herzog, the Mexican Minister of Finance, met with representatives of the Federal Reserve, the Treasury Department and major U.S. commercial lending institutions in New York City and informed them that Mexico was simply unable to service its external indebtedness. Mexico had long been considered the darling of the international lending scene and Herzog's admission sent shock waves throughout this country, Japan and other major European lenders. A rescue effort consisting of new and concessionary credits to allow Mexico to continue doing business as usual was arranged during one weekend, later proving to be insufficient. Falling in line behind Mexico, however, Brazil, Argentina and most major Latin American countries announced that they, too, had reached similar status. Mexico's announcement coupled with other factors began an international financial crisis unparalleled in recorded history in terms of volume of debt and number of countries.

A complex series of negotiations aimed at restructuring each country's external debt began. The debtors, the lenders, their governmental agencies, their respective counsel, and the multilateral financial institutions such as the International Monetary Fund and the Bank of International Settlement played roles in attempting to structure programs which would satisfy each country's desire not to forego completely future growth and lenders' demands for austere measures and quick repayment. The origins of the debt crisis, the process of restructuring, and the future course of the crisis are matters which spark heated debate. In *A Dance Along the Precipice*, Professor Eskridge challenges the reader with a collection of brilliant essays dealing with the international debt crisis, focusing primarily on Latin America. The collection is concerned with the political and economic origins, the dynamics of restructuring a country's debt and future prospects. More importantly, a recurrent theme throughout the book, which deserves greater attention in political and other circles is that the United States should place resolution of the Latin American debt crises among its highest priorities. This is called for because of the crisis's political and economic implications on U.S. national security.

The author is an assistant professor of law at the University of

Virginia. This book is the result of the Eighth Sokol Colloquium held at the University of Virginia in March, 1984. Professor Eskridge is Director of the Sokol Fund for Colloquia in Private International Law. As editor Professor Eskridge has collected a series of essays by scholars, bankers, counselors, and other international lending experts which will introduce the reader to the various issues surrounding the debt crisis. The book is divided into three parts, but the reader will notice recurring themes in each of them. The first section examines the sources of the problem in a political and economic context. The inner workings and approaches of the players' different perspectives are examined in the second part. The third section explores future developments in dealing with future crises and the effects of the current one.

Roughly, during the period from 1973 to 1982, Mexico, Argentina and Brazil (the major borrowers) and other Latin American countries went on a borrowing spree. Taken together, the outstanding debt of Mexico, Argentina and Brazil increased from $28.8 billion in 1973 to $208.2 billion in 1982, for a compound annual growth rate of 24.6 percent. U.S. financial institutions continued to lend at a furious pace; in most cases, a particular bank's exposure was significantly high relative to that bank's capital position. Additionally, a bank's exposure to lesser developed countries (LDCs) as a whole exceeded its capital base.

A number of experts, and indeed most debtor countries, place the blame on the banks for the crisis, claiming lending by the banks should have been curtailed. While there is no question that bankers' lemming instincts were a major factor, this reviewer does not ascribe to the theory that the banks are solely to blame. A number of factors are responsible for the bankers' lending attitudes during that period.

During that period, OPEC nations were generating an incredible amount of deposits and bankers, where able, sought out loan opportunities. A national recession during the middle 1970s had effectively curtailed borrowing by corporate and traditional bank borrowers. Federal agencies in the United States did not discourage lending these deposits to LDCs despite the lack of an official governmental policy. Encouraged by profit requirements to shareholders and the competitive nature of banking, many were forced to go overseas where they were beginning to generate a substantial portion of their earnings.

The herd instinct, which causes, among other things, banks to move in unison when the prime rate changes, causes them to lend to the same countries or same industries in the same relative volumes. Finally, a prevalent belief among bankers, having myself heard it expressed on numerous occasions, is that countries simply do not go bankrupt.

Even if one accepts the thesis that perhaps banks were somewhat generous, lending was either trade-related or project-specific for build-

ing programs whose underlying assumptions were not then questionable, and on the basis of the rapid growth being experienced by most countries. In his essay, Roger Kubarych outlines a number of mistakes made by LDCs during the period which exacerbated the problem. For instance, LDCs based plans for growth on assumptions which were overly optimistic and never materialized. Deficient financial planning which included too large a portion of debt at floating rates, inadequate currency diversification, a lack of diversification of lenders, and policies which discourage direct foreign investment fueled the fire. It is arguable, however, that interest rate fluctuations during the period were largely controlled by U.S. monetary and fiscal policy.

Lending institutions were encouraged by their respective countries to make loans to LDCs. The LDCs themselves made a significant amount of policy mistakes, including subsidies to special groups, overvalued exchange rates, acceptance of substantial inflation and negative savings rates, which, coupled with completely uncontrolled budget deficits, laid the groundwork for the impending crisis.

Finally, Mr. Kubarych estimates that approximately forty percent of all bank lending to Latin American countries from 1979 to 1981 was exported as flight capital. Not only does flight capital diminish a country's foreign exchange reserves, it also indicates that investment capital is simply not being used properly or productively. Of the massive flight capital experienced by most Latin American countries, only a small amount is legitimate flight capital. This reviewer believes that capital flight is a major problem which has not been adequately dealt with by the international financial institutions. Indeed, as Louis Schirano points out in his essay, "capital flight has reached outrageous proportions and is misnamed; it is no longer flight but theft in vast amounts directly by public servants or with their assistance."

In his essay, Professor Eskridge compares the validity of the debt crisis within the context of various theoretical development models. He believes that external shocks such as high interest rates and deteriorating trade levels, coupled with the poor planning described above, are not sufficient to explain the debt crisis. The structuralist explanation suggested by Eskridge is a broader historical perspective which examines the causes of the debt crisis other than external shocks or mistakes, such as the collapse of the Bretton Woods System. He concludes that a better recognition of international lending risks will not unnecessarily preclude further crises. Eskridge closes by warning international financial institutions that the day will come when Latin American lenders will create a debtor's cartel and declare a unilateral moratorium on servicing their loans, an extremely valid thesis.

The second section of the book contains three essays which discuss the dynamics of restructuring debt from various perspectives. This sec-

tion is especially valuable to lawyers and to those who have not been involved in the process before. Alfred Mudge and James Hurlock, partners in well-known U.S. law firms, describe the process itself from the point of view of bank counsel and debtor counsel, respectively.

Mudge describes the various roles of the Agent Bank, the Bank Advisory Groups and Servicing Banks and the monumental task it is to build consensus in a process which may require agreement among two hundred financial institutions and several governmental and multilateral agencies. The process of restructuring is one which is extremely delicate due primarily to the on-going nature of the negotiations. The problem is further compounded by the fact that the banks cannot realistically perfect security in any sort of collateral and a shadow of sovereign immunity (or irrationality, as the case may be) looms imminent.

James Hurlock complains that often creditors' negotiating positions are inappropriate and insensitive to the debtor nation. He believes that creditors stress short-term solutions which proscribe long-term rehabilitation. For instance, lending institutions generally insist that debt service be current as a condition of the restructuring of the debt. As a result, what in fact appears to be new money is used to repay arrearages. Also banks insist on a number of up-front fees which further erode the balance. Thus, the austerity measures demanded by the multilateral institutions often restrict the country's freedom to trade, curtailing essential imports and the accumulation of foreign reserves and restricting further growth.

The final essay in this section focuses on the political maneuverings that occur behind the scenes in debt crises. The author correctly illustrates that money center banks' greatly influence the regional banks and the bail-out politics which are part of almost any process. The author draws the conclusion that the money center banks are able to muster, by their sheer size, the support of other players by relying on political forces. The political component to the restructure is perhaps the most underplayed. There is fierce competition among the banks to lead a given restructure. Once a country becomes credit-worthy again, the lead bank will be viewed largely as a savior and accorded preferential treatment.

The final section of the book contains three essays which discuss the future implications of the debt crisis and the broader political implications it holds for the United States. In this section, a case is made for restructuring programs which are not prejudicial to the borrower, including but not limited to: concessionary interest rate levels approximating the lender's cost of funds, longer grace periods in the repayment of principal, maturities which extend well beyond those that lenders currently offer, realistic new money components, and reduction of trade barriers. Debtors, on the other hand, would be required to follow

sound adjustment policies, encourage domestic and foreign direct investment, and discourage capital flight.

In one essay, Riordan Roett, a Latin American studies scholar, argues that an analysis of the debt crisis looking solely at economics is insufficient. He posits that the national security interests of the United States are best served through the encouragement of democracies in Latin America. Latin America is in the throes of redemocratization and he contends that the debt crisis threatens to destabilize the process. The stern measures mandated by the process will undoubtedly create resentment and dampen economic prospects. Existing governments will be radicalized, creating instability in the region and undermining U.S. diplomatic interests. Peru's recent replacement of a moderate government with a leftist one by election attests to Roett's thesis. Clearly, the debt crisis calls for a comprehensive initiative by the U.S. government.

The international financial crisis is the result of historic trends and recent mistakes and it involves a myriad of participants. Professor Eskridge has done a formidable job of presenting a collection of essays which stimulate the reader and propose challenging approaches to the problem and its prospects. In December, 1985, the country's leading financial journals reported that the eleven nations comprising the Cartagena Group[1] had overcome ideological differences and concurred on a platform determined to win concessions from international lenders. Their proposed plan included inflation adjusted real interest rates, concessionary terms on existing debt and market rates on new debt, increases in annual lending indexed to inflation, and a formula tieing debt service payments to a country's minimum growth targets. While the countries have not declared moratoria, the debtor's cartel which Professor Eskridge warned us about has come of age and the United States should sit up and take notice.

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1. Brazil, Argentina, Mexico, Peru, Colombia, Chile, Ecuador, Bolivia, Uruguay, Dominican Republic, Venezuela.

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