Chapter III

WHAT IS AT STAKE FOR CANADA?

The way the Third World debt problem develops will significantly affect the state of the world economy and thus the Canadian economy. The impact is both indirect and direct. As the economies of the world have become increasingly interdependent, the prospects for improved economic conditions in OECD countries rest, in significant measure, on the economic progress made by the developing debtor countries. One development flows from another. When the strain of servicing the debt becomes sufficiently serious to cause disequilibria in the balance of payments, economic growth in these debtor countries is constrained. As a result they are less able to import from developed countries, world trade shrinks, and declining market opportunities create protectionist pressures in OECD countries, which in turn hurt the developing and developed countries, Canada included. The effect is significant and cumulative and international economic growth experiences a severe setback.

The entire mechanism for maintaining a stable international balance-of-payments system is also threatened when the foreign exchange reserves of the debtor developing countries are run down dangerously, a position which limits their access to foreign borrowings. Moreover, there is a risk that the debtor developing countries, faced with making heavy payments to OECD banks and governments with little visible effect on their debt burden, will become alienated from the established international payments system and may choose to take unilateral radical measures that could undermine the entire system.

Strains on the Commercial Banks

The commercial banks have been subjected to continuing strain since 1982, as the indebtedness of the Third World countries to them has steadily grown. In major borrowing countries such as Mexico and Argentina, banks are still faced with the prospect of non-payment of interest unless they lend more funds for this purpose. Brazil suspended interest payments in February 1987 on loans from commercial banks and on trade credits, and early in 1987 Ecuador cancelled payments on its debt for the remainder of the year. Furthermore, few of the large debtors (with the exception of Venezuela) have been making payments on the principal of their loans.

It has been pointed out in chapter two that, quite apart from their Third World debt portfolios, North American banks are also over-exposed in some areas of their domestic lending. They are carrying a heavy load of bad debts in the