held most of the debt instruments of a small number of countries, it is individuals and institutional investors which hold the bulk of the bond and portfolio equity financing in these countries. While this helps to diversify risk, and trading of these securities helps give investors price signals about possible future difficulties, it also makes a concerted response more difficult since the debt instruments are so widely held.[27] Foreign direct investment is also diversified amongst a number of different companies, reducing the risk of systemic failure if problems should arise. This means that the international financial system will not be threatened if these countries again have debt-servicing problems. Furthermore, previous commercial bank lending put all the risk on the borrowing countries since they had to assume all interest rate and exchange rate risk. Today, this risk is assumed by foreign debt and bond holders.

Third, whereas in the 1980s, commercial debt was held by governments or state-owned enterprises and was used to finance fiscal deficits and consumption, today funds are being channelled into the emerging private sector where they are presumably being used for more productive investments. The World Bank estimates that private-to-private flows now account for 60% of the net inflows to all developing countries.[28]

Fourth, the countries that have been the largest beneficiaries of capital inflows are the ones that have reformed their economies and have been successful at absorbing the massive inflows. One of the mechanisms of coping with the flows have been to increase international reserves. The international reserve position of Mexico, for example, improved from US $4.2 billion in 1980 to over US $19 billion in 1992.[29] This allows debtors to weather a sudden reversal of capital inflows, at least over the short-term, while still maintaining import levels, debt-servicing payments and defending domestic currencies.

Outlook

What will we witness in the near future? Some of the optimism which surrounded commercial bank lending in the previous two decades has now infected

[27]In the 1970s and the early 1980s, official debt was held by a few countries and international financial institutions. Likewise, commercial bank loans were made by a few large banks (with the participation of a number of smaller banks). When these loan portfolios went bad after 1982, a concerted response through the London and Paris Clubs was manageable because of the relatively small number of debt holders. Today, by contrast, debt and equity instruments are held by thousands of individuals, companies and institutional investors, making such a response logistically more difficult.

[28]World Bank, *op. cit.*, p. 3.

[29]World Bank, *World Debt Tables, 1993-94, Vol. 2* (Washington: World Bank, 1993), p. 298.