countries and their improved current account balances created an environment where lending to Third World countries was accepted as prudent banking. With real interest rates remaining low and inflation reducing the burden of the debt, the risks associated with such loans appeared to be quite manageable.

As the volume of petrodollars accumulated, competition between banks for Third World business became intense. Mr. David Ibarra, Minister of Finance of Mexico until 1982, recounted, "I had many bankers chasing me trying to lend me more money." (8:25)* In fact, during his tenure, Mexico increased its borrowings by some $30 billion. The large U.S. banks led the way, encouraged by the fact that loans made from the banks' large Eurodollar deposits, where most of the OPEC money was placed, were outside the control of U.S. bank regulatory authorities. In particular, such loans to customers outside the United States could be made without having to put aside non-interest bearing reserves and were therefore more profitable.**

One of the Committee's witnesses, William Cline of the Institute for International Economics, has written that, at the time, "some prominent bankers have asserted that sovereign lending has no risk at all because countries do not disappear."*** To avoid the risk that interest rates might rise and squeeze the margin of profit or "spread" between the loan rate and the rate paid to depositors, the banks opted for variable "floating" rate loans, which provided for interest rates to be adjusted periodically to conform with current interest rate levels. Whatever happened to interest rates, the bankers were assured of a profit.

In this process, loan syndications, involving the grouping together of a number of banks to make loans, played a part. These syndications netted large fees to the lead banks for negotiating, organizing and managing the loans. Unfortunately, as the 1985 OECD Development Assistance Committee (DAC) review has pointed out:

> The syndication technique itself appears to have reduced the incentive to base lending decisions on objective risk assessment, since the fees and margins of lenders and participants in developing-country loans depended on volume rather than attention either to prudent exposure limits or to the economic policies of borrowing countries. (p. 167)

Although the large U.S. commercial banks took the lead in lending to developing countries, they were followed by banks in Europe, Japan and Canada. Subsequently hundreds of small U.S. regional banks were persuaded to become involved in the syndications. As statistics in the next chapter demonstrate, Canadian banks were enthusiastic participants in this lending fever, "swept along in the upsurge of international deposits and loans" according to Mr. Alan Hockin,

* Footnotes after quotations in this report refer to Committee proceedings and indicate the issue number and page number of evidence taken during the First Session of the Thirty-third Parliament, 1984-86.

** U.S. banking regulations require U.S. banks to keep non-interest bearing reserves on deposit with the Federal Reserve Bank to cover deposits in their U.S. branches or for loans to U.S. customers. Because they do not have to keep reserves on Eurodollar deposits loaned to customers located outside the United States, overseas lending became more profitable for U.S. banks than domestic lending.

*** *International Debt and the Stability of the World Economy*, p. 99.