

# [The world economy and growth of debt]

An Address by

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Good morning. It is a pleasure to be here and visit once again with many friends from my years in the copper industry.

At first glance, the copper and banking industries would seem to have little in common. On second glance, you would find you have some common ground. George Hartley spoke of the new world of global competitiveness, the importance of Japan and the need to develop an international perspective. One would hear similar comments being made at a bankers convention.

U.S. banks are facing increasing competition -- much of it spurred on by technological development. U.S. banks have lost their dominance of world financial markets. Only four of the world's 50 largest banks are American. Now Japanese banks dominate. In this country, banks are losing market share to domestic and foreign competitors. Thirty years ago, banks provided over 80 percent of the short and intermediate term credit to U.S. corporations. Now that share is down to 60 percent.

World competition and new products have jeopardized the old order. The 3-6-3 banker--pay three percent, lend at six percent and on the golf course by three no longer exists.

As many of you may now have come to realize, there are many new ways to go about financing international business in this global economy. If not, there is no shortage of domestic and foreign bankers and investment bankers anxious to work with you. Competition and financial innovation, while tough on the banks, benefit all users of financial services.

Let me qualify that statement somewhat. We all stand to benefit, provided

we don't get carried away. Just because floating debt is getting easier, it doesn't mean it's sound for the system. The unparalleled growth of debt in this country is a subject which deserves the attention of all businessmen here and abroad.

In fact, growth of debt in the economy is a world-class concern. Before looking abroad, we need to review our situation at home. All of industry and finance is operating in an environment of increased risks because of the unprecedented increase in debt in the United States and the world. Consider these facts:

- The growth of U.S. debt during the past few years exceeds that of any other period since World War II. All sectors of the economy have participated in the increase. Public and private debt has doubled since 1980 to more than \$7.7 trillion today.

- At the Federal level, debt has more than doubled from \$800 billion in 1981 to \$1.8 trillion today. In 1981, Government debt equalled 28 percent of GNP. Since then it has jumped 28 to 43 percent in six years.

- Household debt has reached a postwar WWII high -- equal to 89 percent of after tax disposable income. Prior to 1985, this ratio had never reached 80 percent. Consumer credit also reached a postwar high of over 25 percent of disposable personal income. Lately, the level of consumer credit has declined slightly but most analysts believe this represents more a shifting to home equity loans than a reduction in overall debt levels.

- Debt service now exceeds 30 percent of personal income. Interest payments relative to personal savings now exceed 90 percent compared to a historical average of only about 30 percent.

- Between 1981 and 1985, business debts have grown twice as fast as their assets. Corporate debt, for example, jumped from 35 percent of net worth to almost 47 percent. Debt of nonfinancial corporations has risen to 91 percent of income, another postwar high. The prior high was only about 80 percent back in the mid-70's.

Overall in our society, there is now about 40 cents more debt for every dollar of income than there was just five years ago. Today, the debt level in every sector of our economy is a record when compared with income to repay. That is why overall levels are setting records.

Debt growth has been accompanied by a decline in personal savings. The U.S. savings rate, which averaged 7 percent between 1950 and 1985, dropped to 3.8 percent in 1986. Blue Chip forecasters predict a further decline in 1987.

The growth rate of debt in this country is a trend businesses cannot ignore. Certainly the debt ratios I've just mentioned would have been alarming not that long ago. Whether or not they should be today is a point upon which knowledgeable people will disagree. Most will agree that higher debt burdens increase vulnerability to adverse financial events. But some will argue the current debt levels are within manageable bounds.

The fact is, no one really knows just how much debt our economy can accommodate. I can think of two events though that could quickly put current debt levels to the test -- a continued jump in interest rates and/or a general business downturn.

We need only look to the agricultural and energy sectors of our economy to see the effect of high debt levels. You may have read about the high rate of bank failures we have been experiencing. The vast majority of these failures are in banks heavy in farming and energy. The problems in these sectors have been exacerbated by the unusually high levels of indebtedness.

As many of you know well, debt repayment becomes much more onerous in a deflationary business environment. Please don't misunderstand. I am not predicting a fiscal crisis. But there are some disturbing trends and we should not ignore them. Unfortunately, it is usually too late to act when we determine that debt levels have become unsupportable. The yellow caution light is flashing.

What will be the effect of these conditions on international finance? As you are all aware we have had problems in Latin America with debt levels. Incidentally I came to this discussion without clean hands. I was in the White House when most of this was put on the books. It was called "recycling." Here are some of the facts today:

- Total U.S. bank cross-border exposure is down since 1982 but Latin America exposure is up slightly and now totals almost \$70 billion.

- The nine largest money-center banks represent 65 percent of the U.S. bank Latin America exposure.

- Fourteen other large banks account for an additional 18 percent. Thus 23 banks account for 83 percent of the total exposure to Latin America.

- Capital and reserves at these banks have increased dramatically relative to their Latin American exposure.

- Latin America exposure at the nine money-center banks has declined from 180 percent of primary capital at year-end 1982 to 100 percent in September 1986. Not good, but a substantial improvement.

Let's look at Brazil. Estimates of the Brazilian situation on the nine money-center banks, in the aggregate are as follows:

- Brazil's suspension of interest payments will result in approximately \$1.1 billion in foregone interest income or about 20 percent of pretax earnings.

- Brazil's loans must be placed in nonperforming (troubled) status before they become more than 90 days past due. This would cause the aggregate percentage of nonperforming loans to almost double to over six percent at the nine money center banks.

To be sure, U.S. banks have a lot of exposure to Latin American countries. It's no wonder then that people become concerned when they hear about

countries like Brazil not repaying their loans. On when they hear talk of "debtor cartels" where countries band together and stop paying their loans. Clearly such an event would have unfortunate consequences for banks in this country.

As the head of the banking industry's insurance fund, you might think the prospects would cause me lots of sleepless nights. But no, I sleep like a baby -- I wake up every four and cry. Seriously though, I think things will work out because frankly the alternative is unacceptable. In this regard, it's like nuclear war. There would be no winners, only losers.

The banks obviously would suffer major losses but the damage to the debtor country might be even greater. A developing country that wants to be a seller in the international arena must have access to funds. If a debtor country is shut off from the credit facilities of the industrialized nations, it will not prosper and the risk of political unrest rises dramatically.

Look what's happened to Brazil. Former Finance Minister Funaro initiated a unilateral move by Brazil to stop paying on its loans. He expected to use this a leverage in negotiations to get concessions from the bankers, but the bankers stood firm.

They made it clear that prospects for future loans appeared threatened. This threatened prospects for Brazilian economic growth. Mr. Funaro is gone now and the new finance minister is showing greater willingness to negotiate. I think things will work out because each side knows they cannot gain from a breakdown in the international debt market. Only irrationality, or mistake,

can bring that marketplace to a standstill. The private sector is, in fact, making progress. Overall the debt situation shows more improvement in the foreign debt situation than we find in the trends in the domestic debt level.

We must remember that this rapid growth of public and private debt has been made possible, in part, by importing capital from Western Europe and Japan. Our net investment position -- the excess of U.S. gross claims abroad over foreign claims on the U.S. -- has deteriorated from a surplus of \$149 billion in 1982 to a deficit of \$220 billion at the end of 1986. 1985 was the first year since before 1914 that the U.S. net investment position has been in deficit.

While disturbing, the buildup of foreign claims on the U.S. at least partially reflects the fact that the U.S. is considered a good investment by the world. Our economic performance has been good relative to that of most countries particularly in employment where we have created millions of new jobs in the last six years.

The key to working out future financing is to put in place policy to continue to improve our economy while reducing the strain of excess debt -- a tough assignment, but one that can be accomplished. How? With growth, saving, productivity, hard work, moderation, determination and courage. Thus, there should be no problems, for these are all well-known, historic American characteristics. Now we need to renew them.

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