O N T H E D R Y S I D E XXXIV John Hyde

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D E B T

Lending, borrowing, and the accompanying debt fulfil an important economic function. It is a process by which the holders of wealth place their resources under the management of the producers of wealth. Except for some lenders who are the government's captives, debt is a mutually advantageous voluntary arrangement. It plays a major role in the production of goods and services, enabling entrepreneurs to find the resources to make good use of their skills and energies.

Borrowing and lending enable individuals, businesses and nations to smooth out their cash flows, tiding over troughs and using the peaks to gain some benefit. Changing circumstances or just changing inclination can be smoothed out over time. It is normal for most individuals to be both borrowers and lenders over their life time, lending at both ends of life and borrowing when they are putting together the family home. Lending is often the small unskilled investor's only opportunity to get some return on his savings. Most lenders and borrowers would look back on a lifetime's financial transactions with some satisfaction even though with hindsight they might identify better bargains than those they actually made. Debt, in short, most often adds to the sum of human wellbeing, benefiting both parties.

Between the buyers and the sellers of money are the usual middlemen who pool the risks, bring buyers and sellers together, provide advice and draw up the contracts. These are the financial intermediaries-- the banks, building societies, hire purchase companies etc. Like all other middle-men, no one is forced to use them should they not provide a service that is worth the price they charge. Their use by both lender and borrower is, like the loan itself, voluntary.

In view of the apparent benefits which flow from this whole process it is remarkable that it should over centuries have been singled out for so much critical attention by the kind hearts and soft heads cadre. Literature provides us and them with the most outrageously prejudiced portrayals of bankers by a picture of borrowers who are the poverty-stricken victims of circumstance, and lenders who are avaricious villains. Nothing could be farther from the truth, but it is great material to work with to foul up a process that by and large serves us very well.

The cause of over-committed national debtors-- Mexico, Brazil, Poland, Argentina, etc.-- was recently taken up by the ABC programme Four Corners,and the cause of over-commited individuals by the Australian Law Reform Commission. Both, motivated by a proper sympathy for the ill-informed, unlucky, or unwise borrower, sought to make default easier. Both paid scant attention to the inequity that inevitably attends default. The recent TEA collapse showed how relatively innocent people can get badly hurt when an intermediary's debtors default.

Both also paid scant attention to the obvious point that lenders only lend in the expectation of repayment plus interest. Without that expectation there are no loans. Any weakening of the expectation must raise the price of money or encourage holders of wealth to be their own entrepreneurs, and may well increase the numbers of bankruptcies. Neither report was complete without some estimate of what easier default would do to the interest rate, and an evaluation of whether easier default did in fact yield net benefits at the end of the day.

If the consequences of default are reduced it is surely reasonable to assume that the changed circumstances will encourage attempted borrowing in circumstances where default is more likely, but will cause the prudent lender to withold his loan until he knows more than he presently requires to know about the borrower's circumstances, and to insist on more control over the borrower once a loan is granted.

Commerce depends upon the expectation that parties will meet their contractual obligations. Any weakening of that expectation will not stop commercial transactions entirely. It will however complicate the process by requiring lenders, including suppliers of trade credit, to acquire an intimate knowledge of the affairs of borrowers and so reduce the supply of loanable funds to the extent that commerce is greatly slowed down and less efficient. The consequences of inefficiency are lower growth rates, a lower standard of living, and more unemployment. No reasonable person would wish to be vengeful to over committed debtors, who are much more often fools, or merely unlucky, than knaves, but sadly there is a high price to pay for making default too easy.

When nations are the potential defaulters similar considerations arise. Four Corners told us that Brazil considered repudiating her obligations to the Morgan Guaranty Bank, and actually sounded out other over-committed Latin American States to see if, in the event of Brazil defaulting, they would follow suit. We were told that they refused, and Brazil, unwilling to default on her own, entered into negotiations with the International Monetary Fund to reschedule her debt. Successful repudiation would have been only a temporary advantage; the flow of western world capital would have promptly dried up and would have stayed dried up until Brazil convinced lenders that she would not behave that way again. Those Least Developed ~~Nations~~ Countries which, in the fifties, nationalised foreign investments without generous compensation have tended to remain LDCs, whereas the "Koreas", "Singapores", "Japans" and "Australias" have profited from comparison of our reputation with theirs. The point is so obvious that I cannot believe it was lost on the Brazilian authorities and I wonder if the ABC programme did not reflect the prejudices of some ABC people as much as Brazilian prejudices.

The T.V. programme went to great lengths to paint Morgan Guaranty in the truest Shylock colours but in the event of wholesale debt repudiation the losers would not be the big bad bankers but depositors who, in the case of Morgan Guaranty, would in the main be the oil rich investors on the Euro-dollar market but would also include some little old ladies with their bonds, kids with their pass book accounts, and superannuation funds.

The truth is that some people, and much higher proportion of governments, do not borrow money to invest to generate income which will more than service the loan. They borrow to consume the capital, buying a better life style now at the expense of the future, or buying votes with unproductive handouts or, what passes for votes in some of the relevant countries,- guns.

If families or States will not adopt sensible domestic policies or, for any other reason, do not have the capacity to generate surplus income, there is no way that credit will assist them. They need, and in some cases should get gifts, not loans. Lenders are not geared to conduct charities. If they have the role thrust upon them they will fill it badly, and worse, they will not provide capital for people who would make good use of it.