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Introduction to International Debt: How Can Developing Countries Regain Creditworthiness?

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ing is asking for an arbitrated or adjudicated settlement. So there is actually no lack of claims with respect to the U.S.-Canada acid rain issue.

The Chernobyl situation is indeed perplexing. I think some of the responses of the states can be explained in terms of politics; the Eastern European countries, for example. And Dr. Gündling's statement regarding precedent reminds me of a statement by Ian Browlie. He said, and my own inquiries have supported this, that many European countries were afraid of what he calls a "normative boomerang"—that is that they would make this argument vis-à-vis the Soviet Union, and other European countries, for example Finland with respect to Sweden, would turn the argument around and use it back against the initial author of the statement.

ALICE M. NOBLE-ALLGIRE*

INTERNATIONAL DEBT: HOW CAN DEVELOPING COUNTRIES REGAIN CREDITWORTHINESS?

The panel was convened by its Chair, Cynthia C. Lichtenstein,** at 4:00 p.m., April 5, 1989.

REMARKS BY CYNTHIA LICHTENSTEIN

Let me say that this discussion is extraordinarily timely, since the U.S. Department of the Treasury announced on March 10 a shift in the U.S. policy approach to the debt crisis. This shift was expressed in a speech by Secretary Brady at a meeting before the Brookings Institution and the Bretton Woods Committee Conference on Third World Debt. The speech was issued as a press release and has been very much written about in the press.

In the absence of a representative on the panel from the government to speak for the Treasury Department, I shall have the temerity to try to tell you, by what I have gathered from the text of Secretary Brady's talk, what the "Brady Plan" is, and then our panelists will comment further and relate their prepared talks to the new initiative.

The debt crisis became public in 1982 with the admission by Mexico that it would be unable to meet, on a current basis, its external debt denominated in external currencies, and rescue was arranged. It was at that moment that the true situation, both of the developing country debtors and their private bank creditors, became public. Since 1982, there has been what has been referred to as "ad hoc management" of the debt crisis. The reason there has not been any overall solution to the debt crisis is that if the major banks, and particularly the U.S. banks, that had lent to the Latin debtors had attempted in 1982 to write down or to forgive the debt, or to admit that the debt was, in effect, in default, they would have become publicly insolvent. This was not a possibility, because if the major U.S. money center banks, which also participate in the international payments system and run the global dollar payments system for the world, were to become insolvent, there suddenly would be no international payments system and no international trade. Everyone, as a result, shouted "Of course the Emperor has clothes! Of course these debts will be paid, somehow, someway, and therefore we do not have to recognize that these banks are technically insolvent." In the

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meantime, of course, very quietly, the central banks of the countries of the creditor banks had gotten together and were beginning to insist on improvement of the capital positions of the creditor banks. These improvements have reached the extent that it is possible today for the Chairman of the Federal Deposit Insurance Corporation, Mr. Seidman, to say that if in fact the banks today have to write off the debt in toto, they could afford to do so. They would not like to do so, but they can afford to do so without becoming insolvent.

This new capacity for debt reduction by the private creditor banks has provided, institutionally and systemically, a real opportunity. Those of you who have followed this area know that in the World Bank/Fund meetings in Seoul, South Korea, in 1985, then Treasury Secretary Baker had produced a plan for dealing with the debt crisis that was based on the notion of growth, that is, each of the middle-income indebted countries should adopt appropriate policies that would permit their economies to grow out of the debt difficulties utilizing additional funding from the multilateral international institutions and much new money from the creditor banks. There has been a problem with the scheme; the creditor banks, to say nothing of the multinational institutions, had difficulty explaining to their stockholders why they should voluntarily lend more money to debtors who probably could not pay, and why funds so lent should be used to pay themselves interest that the debtors owed. So in fact, the Baker Plan went no place.

Indeed, as our economist Mr. Williamson will detail, with the increase in interest rates that we have seen in the last six months, and most of the private bank lending on a floating rate basis, the situation has deteriorated extraordinarily. In fact, at this point the Latin countries are paying out more in interest than they are taking in in terms of external currencies. Therefore, Secretary Brady's announcement, while it purports to be an extension of the Baker Plan, is in fact a great change. What the Brady Plan says is that it is absolutely necessary, in order to enable these nations to return to creditworthiness, that they *reduce* the total amount of debt and debt service. New lending, while it may be necessary temporarily, only adds to the total amount of debt service. We must therefore find a way to help these countries to reduce the total amount of debt. However, the reduction in debt is to be voluntary, that is to say, Secretary Brady is not suggesting that the governments require the private banks to write down their debt, nor is he suggesting that the governments should rewrite the debt contracts for the banks. Instead, Mr. Brady suggests that multinational lending institutions could provide the kind of instruments that banks (or at least some of them) would be willing to exchange for the debt and hold in their portfolios. These instruments—bonds—would be issued in effect at a discount. The details of calculating this discount will be discussed by Mr. Williamson. There is a second device for reducing debt, something called "buy-back," a concept that also will be explained by Mr. Williamson.

We should recognize that the Brady Plan does in effect shift the responsibility for paying off private debt to public funding, in the sense that it is tax monies that ultimately go to fund the International Monetary Fund. Some of the industrialized countries are concerned about this aspect. Otherwise there has been great general support for the Brady Plan.

How much in fact this new approach will help, and whether or not the Brady Plan will be sufficient to make a dent in the debt situation, which is absolutely desperate for the Latin nations, we shall not know for some time. Mr. Williamson will also describe to you other approaches that might be used in meeting these issues. That is the background of our topic.

Before turning to our panelists, I did want to mention one thing upon which I have not seen comment in all the press coverage concerning the Brady Plan. There has been a concerted attempt to increase the capital of the multinational banks. The interesting point about the Brady Plan is the call for guarantees, or collateralization of bonds that might be issued by the debtor nations in exchange for the debt, to be given by the multinational financial institutions. Under the Basel agreed-upon capital standards, as implemented for instance by the U.S. Comptroller of the Currency, U.S. national banks will be required to hold far less capital against an obligation that has been guaranteed or collateralized by a multinational institution than they would against an obligation by one of the debtor nations that is not so collateralized. Thus, in fact the new capital rules are providing a very serious incentive to the banks to exchange.

REMARKS BY TOBIAS M. C. ASSER*

The issue before us is a complex one. The amounts of international commercial debt outstanding are staggering. The amounts of debt relief that are being suggested are much larger than was proposed some years ago under the so-called Baker Plan. Hundreds of commercial banks from many jurisdictions are involved in debt reduction operations. There are significant differences in the laws that apply to the various loan contracts. Loan covenants covering the same substance show remarkable textual variety, following differences in applicable law as well as the predilections of their drafters. Finally, there are important differences between the various borrowers. It is against this complex background that the recent proposals of Treasury Secretary Brady must be evaluated.

As part of his remarks to the Brookings Institution and The Bretton Woods Committee Conference on Third World Debt on March 10, 1989, Secretary Brady proposed several steps to revitalize the current strategy for dealing with the international debt crisis, as follows. First and foremost, debtor nations should focus particular attention on the adoption of policies that can better encourage new investment flows, strengthen domestic savings, and promote the return of flight capital. Second, the creditor community should provide more effective and timely financial support, including debt service reduction.

Starting from the premise that sharing and negative pledge clauses in existing loan agreements are a substantial barrier to debt reduction, Mr. Brady specifically proposed as a key element of his approach "the negotiation of a general waiver of the sharing and negative pledge clauses for each performing debtor, to permit an orderly process whereby banks which wish to do so, negotiate debt or debt service reduction transactions."

Secretary Brady suggested that such waivers might have a three-year life, to stimulate activity within a short but measurable timeframe. He expected the waivers to accelerate sharply the pace of debt reduction and pass the benefits directly to the debtor nations. Several days later, Assistant Treasury Secretary David Mulford made similar statements to the U.S. Senate and House Banking Committees and to the Annual Meeting of the Inter-American Development Bank in Amsterdam. Secretary Brady repeated and expanded on his proposals in his remarks on the international

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