Editorial

Mike Faber and Stephany Griffith-Jones

It has been said that 'the liberty of the subject is secreted in the interstices of procedure'. In other words, resounding proclamations about the rights and freedoms of citizens are worthless unless procedures exist that are known, accessible and affordable which will enable the individual to exercise those rights through due process of a court of law.

This dictum came sharply to mind a year ago when reading an account of the speech which US Secretary of the Treasury Nicholas Brady had given to a conference of the Brookings Institution and the Bretton Woods Committee in Washington on 10 March 1989. What struck us immediately about Secretary Brady's proposals was the extent to which their success or failure in achieving their declared object of LDC debt reduction would depend upon the decisions and actions of parties outside the US government's control. Those decisions and actions by foreign and US bank regulators, tax authorities, company auditors and legal advisers will establish 'the interstices of procedure' which must determine whether individual banks in different jurisdictions will or will not participate in Brady-type schemes in a manner that would achieve Brady's declared objective. One of us predicted, based on a first tentative analysis, that 'the Plan's early results will probably give rise to frustration and disappointment' and 'the amount of debt extinguished in exchange for their accepting new obligations towards the World Bank and the IMF is likely to seem to debtors disappointingly small'.[1]

It was that line of thought, namely that the success of any scheme of debt reduction would depend upon an accurate assessment of the reactions and initiatives of many types of actors in the Third World debt drama, that gave rise to the idea behind this *Bulletin*. The *Bulletin's* purpose is to enable readers to learn something of the considerations which will determine how such actors are likely to respond not just to Brady, but to other forms of debt reduction initiatives. For that understanding to be complete, we have thought it necessary to enable our contributors not just to talk about their reaction to the Brady proposals, but also to explain their perception of the role of their own institutions and their interpretation of what it was that gave rise to the problems of excessive LDC indebtedness in the first place.

Our scheme of presentation proceeds as follows:

We start with a general overview of the LDC debt situation ('The Debt Crisis at the Turn of the Decade' by John Williamson) and then follow it with a chapter ('Development vs Debt: Past and Future' by Richard Portes) which both looks back to the repudiations of the 1930's and forward to the effects changes in Eastern Europe may have upon the position of Latin American debtors in the 1990's.

Robert Devlin's chapter ('The Menu Approach') traces the introduction of various forms of voluntary debt reduction during the second phase of the Baker Plan while the following chapter ('The Shaping of the Brady Proposals' by Mike Faber) attempts to explain how the Brady proposals evolved out of the widely shared perception that the Baker Plan had simply run out of credibility, and what the similarities and differences are between the two approaches.

In Chapter Six the first three deals to give effect to the Brady approach are analysed. The Mexican Finance Minister, Pedro Aspe Armella, describes the Mexican deal in terms that are markedly more positive than those quoted later in this *Bulletin* from the McMahon-Morse memorandum. Reginald Green assesses the Philippine deal in the broader context of the country's overall foreign exchange needs if target growth rates are to be met. Stephany Griffith-Jones describes the Costa Rica deal and readers may be tempted to conclude that, in its way, it is the sweetest of the lot.

In the following two chapters Robert Russell ('The New Roles and Facilities of the IMF') and Anthony Toft ('The New Roles and Facilities of the World Bank') explain the participation of their two institutions in schemes of debt or debt service reduction, but both do so in the broader context of the full range of measures that the multilateral financial institutions can employ to encourage policy reform and to finance stabilisation, adjustment and development.

Peter Mountfield's chapter ('The Paris Club and African Debt') provides a historical account of how working procedures evolved, informally but very effectively, in that very influential but still slightly mysterious association of officials. 'English practices run by Frenchmen' is how one diplomat has described it.

[1] This quotation is by Mike Faber from 'Success of Debt Plan is beyond Brady's Control' (The Independent, 28 March 1989).

Chapter Ten is made up of extracts which exhibit the reactions of five prominent commercial bankers to the choices which have been forced upon them since March 1989. They are in some ways markedly different, reflecting what are not only differences in perception and interpretation of the current debt situation but also differences in future intentions and differences in the regulatory and tax regimes under which they have to operate. The three British bankers, Jolyon Larkman (Barclays), Sir Kit McMahon (Midland) and Sir Jeremy Morse (Lloyds) are a good deal more critical of the Mulford/Brady proposals than the North American, William Rhodes (Citicorp/ Citibank). The approach of the late Alfred Herrhausen (Deutsche Bank) towards solving the Third World debt crisis was by no means typical and he had the advantage of speaking from what was at the time the strongest and best provisioned of European banks. We include his extract as a tribute to his imaginative approach and as evidence that his assassination has deprived the 1990's of a mind and personality that will be badly missed.

The difference in approach betwen US and UK bank regulators is, if anything, broader than the differences between European and North American bankers. Chapter Eleven exhibits this by contrasting an address by Gerald Corrigan (New York Federal Reserve Bank) with an analysis of the January 1990 version of the Bank of England matrix by Stephany Griffith-Jones. In the following chapter Mitchell Hogg ('Some Accounting and Tax Aspects of LDC Debt') takes a more detailed look at tax and provisioning requirements from the point of view of an accountant and bank auditor.

In Chapter Thirteen, Gerald Breach ('The Role of Export Credit Insurance') discusses the impact of the debt crisis on Britain's ECGD and describes how ECGD is responding to that situation. In Chapter Fourteen, Masahiko Agata ('Japan's Attitude Towards External Debts of Developing Countries') explains how the Japanese Export-Import Bank is playing a far greater role in facilitating schemes of debt reduction than the bank's name itself might indicate.

Chapter Fifteen stands on its own. In it, a practitioner and dealer, Gordon Wood, introduces us to the arcane and somewhat unusual characteristics of 'The Changing Secondary Market', a market whose size and influence have grown and whose activities — at least earlier in its life — were often resented by respectable commercial bankers.

Our final two chapters are different in character again. In Chapter Sixteen Stephany Griffith-Jones describes how Midland Bank, UNICEF and the Sudan Government put together a deal that produced 'Debt Relief for Child Development'. In Chapter Seventeen John Denham (War on Want) explains why non-governmental organisations (NGO's) concerned with Third World development consider debt reduction to be both just and necessary and describes a campaign that is being prepared to expedite appropriate measures of debt relief.

A word about the provenance of the articles we have included in the Bulletin. Chapters 5 (Faber), 7 (Russell), 8 (Toft), 10(b) (Larkman), 13 (Breach) and 15 (Wood) are derived from presentations made at a conference at the London Press Centre on 25 and 26 October, 1989, organised by International Business Communications (IBC), and Chapter 12 (Hogg) has been updated from a presentation to an earlier conference organised by IBC. Chapters 3 (Portes), part of Chapter 6(a) (Aspe) and 10(a) (Rhodes) are derived from presentations made at a conference at the Hyde Park Sheraton, London on 22 and 23 February, 1990, organised by the International Herald Tribune (IHT) and the Inter-American Development (IADB).

We are grateful to International Business Communications, to the International Herald Tribune, to the Inter-American Development Bank and to the individual authors for permission to include these pieces. Chapters 2 (Williamson), most of 6 (Green and Griffith-Jones), 14. (Agata) and 17 (Denham) were written specifically for this *Bulletin*. Chapter 9 (Mountfield) is an updated version of a paper originally presented at an IDS seminar, and Chapter 16 (Griffith-Jones) is an edited version of a paper originally prepared for the Society for International Development. The remaining extracts from Chapters 10 and 11 are from papers which are in the public domain but which are not readily accessible, particularly to readers in Third World countries. It was the chairman of the Treasury and Civil Service Committee of the House of Commons (Terence Higgins, MP) who not so long ago castigated academics for not noticing how much valuable, up-to-date data was being produced in evidence to parliamentary select committees, and those of us who took the hint must acknowledge that he was right.

In what follows we would like to pose some questions about the objectives of the Brady proposals and about their likely effectiveness.

We pose first the question of what should now be the main objective of debt management? The main objective of the Brady strategy must surely now be to restore strong and sustained growth in the debtor nations, so that the 1990's will not be another decade lost to development. In this sense, those whose prime concern is with development are bound to disagree with those who still stress the restoration of creditworthiness and the resumption of voluntary bank lending as the major objective. The restoration of debtors' creditworthiness may be an end in itself for bankers, but for the populations of the indebted countries it is only a means for achieving a greater end, which is a lifting of the poverty in which so many are

condemned to live.

Except for special activities, such as trade or project finance — it is now acknowledged that bank lending at variable interest rates is not usually a good way to fund development; nor does it seem likely that banks will wish to return in the near future to new lending to countries that have suffered debt crises. Because genuinely new bank lending in the sense of providing net additional resources on a large scale is neither desirable nor likely as a major way to fund development, significant debt reduction must play a key role in reducing negative net transfers from LDC's. Both editors have taken this line for several years, when many still believed that the debt overhang was merely a liquidity problem. Events have now led many other analysts and policymakers to accept the need for debt reduction.

But many who support the intention behind the Brady initiative, and in particular its clear emphasis on debt/debt service reduction as an important element, are still worried that the resulting changes in financial flows will be 'too little and for too few countries'. To some there seems to be, within the Brady initiative, acceptance of the principle of debt/debt service reduction, but without the provision of sufficient resources in place to allow sufficient restoration of growth in indebted countries, as well as to provide sufficient incentive for appropriate policies in these countries.

In one sense, debt and debt service reduction is already happening faster than the Brady Plan is being implemented. In 1989, the majority of countries in Latin America and the Caribbean were in arrears on their commercial debt; these included several of the largest debtors — such as Brazil, Venezuela, Argentina and Peru, as well as most of the small debtors, Bolivia, Costa Rica, Cuba, Ecuador, Guatemala, Haiti, Honduras, Nicaragua, Panama, Paraguay and Dominican Republic; amongst the large or medium debtors, only Mexico, Chile and Colombia were servicing their debt in full.[2]

As regards the particular mechanisms through which the Brady proposals will actually be implemented, those concerned with the restoration of development will want to be satisfied on two issues.

[2] Source: ECLAC *Preliminary Overview of the Latin American and Caribbean Economy*, December 1989, Santiago de Chile.

First, is the use of public flows to achieve limited debt reduction for a few countries through a comparatively slow process, the best possible use of international public funds? Might such funds not be better used to achieve a lightening of the burden of debt owed to governments? Might it not be the case that such international funds could be more productively used to finance *new* public lending either for investment in new projects or to rehabilitate existing capacity?

Another of the assumptions on which the need to provide public funding or guarantees for debt/debt service reduction is based is the need (in the context of the Brady proposals) for these operations to be 'voluntary'. The question arises whether this 'voluntary' element for the banks is compatible with large enough debt reduction to ensure sustained growth in LDCs? And is it either fair or sufficient to require commercial banks to make sacrifices that will get rid of the debt overhangs when comparatively little is being done in that direction by either the bilateral agencies or possibly even the multilateral financial institutions?

As the Williamson article in this *Bulletin* suggests, should not the export credit agencies of developed countries be funded so as to allow them also to grant some debt reduction, possibly an equivalent proportion of the debt to what the banks will be granting in debt relief?

Is enough being done to change banking and taxation regulations, so as to encourage greater voluntary debt/debt service reduction? Particularly in Europe and Canada, why are tax incentives not modified so as to encourage both banks' provisions (as at present) and greater debt/debt service reduction?

Last, how can countries that have continued servicing their debt regularly, and have pursued relatively more prudent macro-economic policies than the rest of the highly indebted countries, be enabled to share in whatever benefits may follow from the implementation of the Brady proposals? The highest prices on the secondary market for debt in Latin America are those prevailing for the debt of Chile, Uruguay and Colombia; these are countries with relatively prudent macro-economic policies and a continued record of punctual debt servicing. If other countries are to be encouraged to follow their example, is there not some perversity in the sequence — the 'better' the behaviour, the lower the discount, the less the benefit? Should there perhaps be a supplementary to Brady to reward the 'good performances'?