

C. The Time is Ripe*

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Efforts are no longer centred on rescheduling and fresh money actions, but on debt reduction and debt service reduction, i.e. debt relief. This takes account of the changed perception of the problem's structure and of the fact that a solvency crisis cannot be overcome by making the insolvency criteria, i.e. the debt burdens, even heavier. This insight represents a hope-inspiring breakthrough towards a new type of solution after a long period in which, for quite understandable reasons, it was taboo even to think of debt relief as a possible strategy.

But the question arises as to whether a strategy which is more likely to produce a solution can now be developed and realised on this new basis. The risk that this will again not succeed, despite the more realistic conceptual approach, is obvious.

The banks are now called upon to embrace the basic objectives of the Brady initiative and proceed with their implementation. For this to happen, however, generally valid positions will have to be formulated which allow scope for tailored refinements in specific cases and concrete measures within a broader range of options. Quick and resolute action is imperative.

What is to be done? One can hardly ignore the weakest link in the chain because that would mean waiving the indispensable solidarity of creditors.

But one may ask whether these links do have to subsist. The answer to this is: no. Two of them are, as it were, 'amenable' to reshaping, i.e. surmountable to a degree conducive to solving the problem. These two are the connected scenarios of the creditor banks and their governments and supervisory authorities. The differences within these scenarios can be eliminated by decisions on the part of those involved; they can be 'levelled'. The result of this would be that all links in the chain on the creditor side would become equally strong in terms of the described criteria, and a 'common denominator' would be possible, which, in terms of quality and quantity, would be adequate to the debt problem and thus this time — at least on the side of the lenders — bring a solution within reach.

This common denominator should be structurally uncomplicated and take effect quickly. It should be

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expressed in a general offer from the creditor banks, supported, i.e. made possible, by 'their' governments and supervisory authorities and be available to all debtors who 'qualify' for it.

Which debtor countries 'qualify' in this sense would have to be decided by the Bretton Woods institutions, i.e. World Bank and International Monetary Fund. They would have to examine very closely what economic policy means the debtor governments intend to use to solve their economic and political problems, i.e. overcome their insolvency crisis, and thus practise effectively and on a lasting basis the 'self-help' that is to be shored up by the help of the creditors. *Conditionality would remain indispensable as the basis for any accommodation by lenders; its fulfilment would be the decisive contribution to solving the debt problem!* Conditions would have to be defined on a case-by-case basis, and their implementation, as agreed, monitored by the Fund and the World Bank.

So there are two things that debtors must do: develop and put forward an adequate economic programme and implement it with resolve. This complex cannot be dismantled. It can only be surmounted through the application of efficient economic policy measures; it must be 'worked off' — using the resources released as a result of the bank creditors' offer.

What form could such an offer take? It should consist of three parts and focus on the three criteria which characterise any debt:

- a) amount
- b) interest rate
- c) maturity

It should also envisage a series of phases, i.e. be given a sequential structure, in order to allow adequate monitoring.

The negotiation basis could be as follows:

1. During a five-year period, the interest rate on original indebtedness will be reduced in stages to e.g. 70 per cent, 60 per cent, 50 per cent of its present level (with the exception of specified obligations, such as short-term trade financings). During these five years, the creditor banks — where they have not already done so — will create tax-deductible provisions in respect of their capital claims in the amount of up to 50 per cent. Provisions already created by some banks in excess of this rate will, of course, remain unaffected

by this.

2. After five years, interest rates will be restored to the then prevailing market level in order to bring the debtors back into the normal international interest rate context. At this juncture, capital claims representing original indebtedness will — always assuming that conditionality has been complied with — be reduced, either immediately or in stages, to e.g. 70 per cent, 60 per cent, 50 per cent, as relief and with recourse to the provisions which have meanwhile been accumulated.

3. The maturity of loans outstanding at the start of such a scheme will be fixed generally at 25 or 30 years, with a grace period of five to seven years.

Creditor banks which feel that they are currently unable to participate in such an offer will basically have the option of contributing by means of new money. Apart from recycling interest payments, such banks will also enjoy a variety of other options.

In addition, agreements with debtors should include the following features:

- An option to issue convertible bonds in currencies other than the US Dollar.
- Betterment clauses which would take effect in the event of a particularly favourable development in a debtor country's external economy (due to factors like the price of oil or the level of interest rates).
- 'Claw-back' clauses which would take effect in the event of non-compliance with conditionality.

The material effects of debt relief of between 10 per cent and 50 per cent for 15 highly indebted countries show that the arrangement I have described would put the countries concerned in a position to switch a considerable volume of resources so far earmarked for debt service purposes to areas which would help put their domestic economies back on a healthy footing. It has been pointed out repeatedly in the debt debate that the borrowing countries need money for their ongoing development. It would be more correct to say: they need resources. Because what they do not need under any circumstances is new debt; the simple reference to the need for money fails to make this critical distinction. The changed allocation of resources, made possible by this offer from the creditors, could be of great assistance: the biggest debtors' 'savings' may be larger in the first five-year period than the fresh money injections they have so far requested. They will obtain net resources for therapies that will support economic recovery. Here, the debtor countries have the special responsibility to correct the distortions which have arisen in production and debt as a result of excessive weight given to their public sectors. Debt/equity swaps, privatisations and further measures to strengthen the private sector should therefore remain important elements of the still valid menu approach.

The international creditor banks' offer, the basic structure of which is outlined above, presupposes, if it is to materialise, that the responsible state authorities make it possible. By means of appropriate fiscal and accounting legislation, they must harmonise the starting situations of the banks involved with respect to the debt problem. This means in concrete terms: firstly — the provisioning required under the offer described must be tax-deductible, i.e. eligible for deduction from taxable income. Secondly — these provisions must be accorded the status of a provision *sui generis* in that capital resources remain unimpaired in the year they are utilised.

Over and above that, a further arrangement could be examined: such generous 'help towards self-help' by the creditor banks raises questions in two directions — forwards (into the future) and backwards (into the past). As far as the future development is concerned, it probably has to be assumed that any further capital requirements on the part of debtor countries can no longer be met in the foreseeable future, with assumption of the full credit risk, by the banks which now participate in the debt relief scheme. Here, the Bretton Woods institutions and/or the governments of the industrialised nations would have to provide the funds required. At best, the banks would sustain their engagement in short-term trade financing, project finance and co-financing.

As far as the past is concerned, the banks face the question as to the value at which they should report in their balance sheets claims remaining after possibly granting partial debt relief. In principle, of course, their value depends on the creditworthiness of the debtors. But as this creditworthiness does not exist at the present time and the actual purpose of the approach described is to initiate its restoration, there will still be a risk for some time, a risk which the banks should take account of at their own discretion by creating provisions. Appropriate guarantee commitments from creditor governments (credit enhancement) could cover this risk for as long and insofar as the creditworthiness of the debtors has not been restored.

One can therefore establish that:

1. A debt service and repayment relief offer would be in keeping with the insolvency character of the debt crisis.
2. Such a general offer on the part of the creditor banks would put their involvement on an equal footing.
3. A *conditio sine qua non* would be the creation of appropriate tax and regulatory regimes by the governments and supervisory authorities responsible for the creditor banks. This would then harmonise banks' starting positions.
4. The Bretton Woods institutions and/or the governments of the industrialised nations would have

to meet any further capital requirements on the part of debtor countries (with exceptions such as short-term trade financing), as long as market forces, including autonomous movements of private capital belonging to the countries themselves, do not begin to work.

5. The residual claims of the banks could be secured by credit enhancement.

Assuming this overall scenario, the future problem structure of the international debt crisis will be concentrated on the following criteria:

The 'help towards self-help' from the banks involved would take effect in the form of interest rate reduction immediately after the World Bank and the Fund confirm qualification. With regard to the relief on principal foreseen for later on, the banks will have enough time to take the necessary balance sheet measures.

There still remains the debtor's duty to qualify, i.e. precisely those problems which form the actual core of the crisis are still there. In the discussions which will have to take place between Fund and World Bank on the one side and borrowers on the other, the subject of negotiation will no longer be debt, but economics, i.e. the only field that can eventually give us a once-and-for-all solution to the debt crisis: the right economic policy strategies! They cannot be superseded, but only supported — here and there perhaps made possible in the first place — by 'accommodative action' on the part of the banks. But if such policies are not successfully established and implemented, there will be no solution! This fact places a heavy burden of

responsibility on the negotiating partners involved. At the World Bank and the Fund, this will lead to what is virtually a standing international economic conference, the results of which will decide the fates of entire countries.

The creditor governments, for their part, should clearly recognise the geopolitical relevance of the new phase of the debt crisis and accept it by assuming an obligation of their own. The distribution of roles, to be understood in appropriate dimensions, between banks and governments transcends 'burden-sharing' — i.e. support of the Bretton Woods institutions, adjustments in the banks' legal/tax environment, generous reschedulings by the Paris Club and a flexible policy on the part of national export credit insurers — and must have qualitative and political substance. In view of the urgency of finding an effective solution this time, reproaches such as 'bailing out the banks' are inappropriate. They are incorrect anyway. If it is argued that by participating in the losses incurred by the banks, the state is thereby putting some of the burden of these losses on society as a whole, then one should be fair and admit that society as a whole also continually benefits from banks' profits, because the state is always, unavoidably and rightly so, one of the main recipients of a portion of these profits through income taxes. It is the typical characteristic of a balanced taxation system that good and bad are shared: profits and losses. The socialisation of negative company results corresponds to the socialisation of positive results.