
Documentation

Pérez puts self forward as spokesman on the debt

Excerpts from the inaugural speech of Carlos Andrés Pérez in Caracas on Feb. 2:

If we want an economically solid country, independent and invulnerable . . . we must assume the consequent responsibilities. This will not be achieved except through discipline, productivity, and sacrifice. . . . To this difficult and serious situation we must add the deterioration in the standard of living of workers, who have suffered an important relative loss of well-being. The minimum wage has fallen more than 25% in the last five years and the average real income has fallen almost 40%. . . .

The failure of the present Latin American strategy to deal with the debt problem has stimulated the appearance of a series of alternative proposals. . . . The common characteristic of these global proposals is the emphasis on a substantial reduction of the debt and the debt service burden, by means of capturing the discount on the secondary markets. The Ministers of Finance of the Group of Eight have also just come out responsibly for this approach. . . .

The hour has arrived to intensely seek a single definite commitment of the industrialized countries and Latin America to work together, to facilitate initiatives that will permit pushing forward on an integral, global plan that definitively breaks with the vicious circle of debt and stagnation. The proposal I presented last Jan. 27 at the World Conference of Businessmen at Davos, Switzerland, fits this criterion.

U.S. 'narrow' approach

Excerpts from testimony to U.S. Congress on Jan. 5, 1989 by Harvard economist Jeffrey Sachs:

Several members of this committee have made important contributions towards a solution to the debt crisis, most importantly in putting forward the provisions in the Omnibus Trade Act of 1988 calling for the establishment of an International Debt Management Authority (IDMA) to facilitate a reduction of the developing country debt to manageable proportions.

That proposal remains the most feasible and realistic approach to resolving the crisis that has yet been found. . . . I would urge this committee, in the strongest possible terms, to push forward this innovative and important proposal, despite the likely opposition that can be expected from the

Treasury Department when it reports to this committee next month.

The Treasury's past failure in managing the debt crisis is not the result of an accident. The Treasury has failed because it put the short-term and narrow interest of a small number of U.S. banks above the interests of the U.S. banking system as a whole, and above the interests of American economic and foreign policy more generally. The crisis has been managed for, and sometimes even by, four or five large banks, who have resisted all meaningful compromises with the debtor countries. Citicorp has led the hardline approach, and has been backed to the hilt by the Treasury in recent years. This approach has worsened the position not only of the debtor countries, but also of the majority of U.S. banks, and the U.S. taxpayer as well. . . .

A real solution to the crisis requires an across-the-board reduction of the debt-service burden that is shared in by *all* of the commercial bank creditors. This reduction could come in the form of sub-market interest rates or a reduction of principal. Contrary to the various assertions of the banks surrounding this issue, sub-market interest rates or principal reduction are *standard* banking practices in financial distress situations.

Importantly, one case of partial debt reduction has slipped through, that of Bolivia. And the outcome of the Bolivian case to date demonstrates the remarkable gains that can be garnered by a realistic approach to debt . . . the country has been able to end hyperinflation . . . restore economic growth, and stabilize its democratic institutions. . . . For the other countries, such realistic solutions have been blocked by Citicorp, and a handful of other large banks, working in conjunction with the U.S. Treasury . . . [Citibank] is interested in pressuring governments on a one-to-one basis to trade away valuable domestic assets to Citicorp . . . in so-called debt-equity swaps and similar schemes. . . . These swaps are beneficial for the banks, but actually harmful for the countries undertaking them. . . .

Governments that have tried to 'play by the rules' of the U.S. Treasury find that they cannot control their economies, and therefore that they cannot hang on to power, or can do so only with fraud and violence. Interestingly, populist movements are taking hold in countries that have tried to follow the U.S. line. . . .

One inevitable result is a deep decline in the average value of commercial bank claims of the developing countries. The secondary market value of the LDC loan portfolio has collapsed in the past two years. . . . For the regional banks, and the smaller money center banks, the loss in value of the LDC loans translates almost directly into losses. . . . Another implication is that the U.S. Treasury is committing growing amounts of taxpayer dollars to bailing out the banks. Since it is clear that Argentina, Brazil, and Mexico have been pushed to the wall, and cannot be squeezed more without very serious political risks, the U.S. Treasury is now

coming up with larger amounts of official money to be lent to these countries so that they can meet their interest payments. . . .

The Treasury has often stated three criteria for guiding the management of the debt crisis: 1) the solutions must be case-by-case; 2) the solutions must not involve a taxpayer bailout of the banks; and 3) the solutions must be 'voluntary and market-based'. . . . [But] in practice we have the opposite of a case-by-case approach. . . . Under the ostensible case-by-case approach, every case is treated like every other case. Countries that obviously need debt reduction, like Argentina, Costa Rica, and Ecuador, are denied it, and given terms that are nearly identical to, or often worse than, those of the other countries. . . .

There is a growing list of phony solutions to the crisis, some of which, like debt-equity swaps, have already been implemented extensively. The debt-equity swap is Citicorp's favorite, but is also the worst possible arrangement from the point of view of the debtor country. . . . It is highly inflationary . . . the *budgetary* burden of the debt-equity swap is several times the burden of interest payments on the debt. . . .

There are two ways to proceed on the crisis. . . . The first is to put in place the mechanisms for a general solution, which I believe can be provided by the IDMA. . . . Contrary to the assertions of the Treasury, an IDMA would not be at all costly for the taxpayers, since the losses on the debt would be absorbed by the commercial banks, not by the creditor governments. . . . The other [way] is to foster more progress in the context of individual country negotiations. . . .

'Chapter 11 for debtors'

The article excerpted here, "Chapter 11 Workouts for Latin Debtors," by Shafiq Islam, international finance fellow at the Council on Foreign Relations, was published in the Wall Street Journal on Feb. 3:

With heightened crisis further destabilizing Mexico, Brazil and Argentina, the Third World debt problem is dominating the meeting of officials of the Group of Seven. . . . The problem is that the Treasury's "whole new look" is still avoiding coming to terms with a simple unpleasant fact: the troubled countries are overindebted. . . . This obligation-capacity gap is not temporary, but will persist . . . under all reasonable future scenarios . . . the debtor countries are not suffering from a liquidity shortage resulting from a temporary decline in their capacity to pay, but a solvency problem. . . . Therefore, what these debtors need is not more "new money" but less "old debt"—they need debt relief. . . .

An effective strategy must aim at closing the capacity-obligation gap with economic restructuring to improve the debtors' capacity to pay, and debt restructuring to reduce

their obligations to pay. The official debt strategy has been doing the opposite—widening the solvency gap by forcing debtors to transfer resources through policy adjustments that weaken their capacity to pay, and at the same time forcing them to take on "new money" that increases their obligations. . . .

Debt-equity swaps and schemes involving local currency payments widen the debtors' budget deficits, compounding the existing fiscal and inflationary pressures. . . .

The first principle [of a solution] follows the logic of Chapter 11 of the U.S. bankruptcy code, where contracts are rewritten to protect private corporations in financial distress. Mechanisms should be put in place to induce the troubled debtor to improve its capacity to pay through growth-oriented policy reform, and to encourage the banks to reduce the present value of their claims to a level that is fully serviceable.

The second principle should be one of burden-sharing. Taxpayers in the creditor governments should not bail out the banks, because banks themselves should take losses. . . . Most banks are quite capable of absorbing major write-downs on their LDC exposure. . . .

Here are the key building blocks of [a solution]:

- A Debt-Restructuring Advisory Committee is set up to act as a political mediator and economic adviser. Committee members are chosen from major creditor governments, the IMF, the World Bank . . . and non-governmental experts from the Third World. . . .

- When a middle-income debtor country decides it needs debt relief, it submits an IMF-style "letter of intent," prepared in consultation with the Committee, detailing a program for policy reform supported by debt-service reduction. . . .

- The banks exchange their floating-rate, longer-term, public-sector loans for bonds issue by the country with long (10-15 years) maturities and fixed below-market rates. . . .

The debt 'hemorrhage'

Excerpts from "The Need to Staunch the Hemorrhage," by Robert Graham and Stephen Fidler, Financial Times, Feb. 2:

The present crisis revolves round the ability of democratic institutions to survive in such countries as Argentina and Brazil. . . . Since 1984, Latin America's per capita growth has scarcely averaged 1%. . . . The cumulative effect of reduced state spending is already being felt in poor maintenance of public utilities and lack of imported spares. Plant is deteriorating faster than it is being replaced. . . . The axe on public spending has fallen where it has been easiest to wield—on education, health and housing. . . .

As a result there is fertile ground either for the military to return . . . or for a new brand of populist like Carlos Saul

Menem, the Peronist candidate in Argentina's May election, or Leonel Brizola, the left-wing leader in Brazil. . . .

'Bury the Baker Plan'

This commentary by Jim Hoagland appeared in the Washington Post on Feb. 3:

It is time for Washington to lean on American banks to offer relief on a debt burden that is now sharply distorting global trade flows and contributing significantly to the persistent U.S. trade deficit. . . . Until now, U.S. debt strategy has dictated that the bankers should not be asked to take losses on mountains of debt they built in the 1970s. Manufacturers should. The rescues designed by the U.S. Treasury and the International Monetary Fund have been based on the principle of keeping the banks whole. . . .

When [the Baker Plan] was introduced nearly four years ago . . . [it] was supposed to trigger fresh loans and other capital flows into 15 targeted debtor nations. . . . Instead, there has been a net flow of \$43 billion from the 15 Baker Plan countries back to the banks. . . . Sen. Bradley (speaking at the Davos conference) attributes the loss of many of the 1 million jobs eliminated in U.S. manufacturing over the past decade to the closing down of markets in indebted developing countries. They can no longer afford to import American technology or goods because they are forced to spend 30 to 50% of their foreign-exchange earnings on repaying debt. It is the American manufacturer rather than the American banker who has been paying the price of the current debt strategy. . . .

Jim Baker did a logical and fair thing by giving the first crack at fixing the debt problem to the people who had created it: the bankers and their Third World clients. The plan didn't work. Time for a quiet burial.

Interview: Jeffrey Sachs

'Harsh adjustments' needed to stop inflation

The interview excerpted here with Professor Sachs, a monetarist economist from Harvard University, was conducted in Venezuela on Feb. 2. Venezuelan President Carlos Andrés Pérez has contracted Sachs to design a plan for "the progressive liberalization of the economy."

Sachs: I think that the time has come for a united Latin American position, the time has come to reduce the debt, rather than to continue to build the debt, and I must say that, in that regard, I'm not absolutely happy with Mexico's negotiating position right now, because it's tending too much

toward [getting] new money and not enough toward debt reduction, and as I understand from press reports, the government is saying that it needs about \$7 billion a year. . . . I think that's a mistake. What Mexico needs is debt reduction, it doesn't need new debt, and it should be working, absolutely single-mindedly, for reducing the debt, not for new loans right now. It's a big mistake to be going after new lending.

EIR: And why not negotiate a new world monetary system?

Sachs: I don't think so. . . . I think that the monetary relations among the big countries are under control right now. There is a target exchange rate system that is operating. . . . The big problems in the world right now are the debt and U.S. macro-policies, not so much the need for global monetary reforms. . . .

EIR: When you are talking about "harsh, serious real adjustments," you are talking basically about the IMF conditionalities, aren't you?

Sachs: No. I believe in certain parts of the IMF program, which is budgetary control and liberalization of the economy, and I think that Mexican economic program is in the right direction, very much so. But what I disagree with the IMF on, is the amount of debt that can be paid. I don't believe this foreign debt can be paid. So I want to look at an IMF program that means a real adjustment program, and a real reform program, rather than just a collection agency for commercial banks. And my problem with the IMF comes down to the fact that they're trying to defend the banks, rather than to help the countries.

EIR: So, you don't see the IMF adjustment program as a debt-collection policy in itself?

Sachs: No. . . . What I'm saying is the IMF programs are directed too much toward repaying the bank debt; they ought to be directed toward helping the countries to grow. The kind of measures that the IMF recommends are basically in the right direction, in the sense that budgets have to get under control, trade should be liberalized, exchange rates should be at realistic levels. But the populations of Latin America are being squeezed to the bone, and as you said, they're starving right now in many countries. So, the time has come to recognize that the debt is unpayable, and has to be cut sharply.

EIR: Not a new monetary system?

Sachs: They don't need a new monetary system. They need a new arrangement for the debt, and on that I think that Mexico and the other countries ought to work together. And that's what Carlos Andrés Pérez called for today, and I wholeheartedly back. And it's time for a Latin American approach to this issue, with tough negotiations, serious negotiations, united negotiations, all directed toward one goal: reducing the debt.