Some Open Questions: Preliminary Comments

On the Brady Proposal For Debt Relief For LDC's

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TESTIMONY BEFORE THE

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I think one of the reasons why it has proven to be difficult to evaluate the impact of Secretary of Treasury, Nicholas Brady's, proposal for the international debt problem is because the terms used -- "debt relief", "debt reduction", and "debt forgiveness", really don't tell us very much about the transaction. The terms are too meaningful and the major players interpret them in different ways -- usually, in a manner favorable for themselves.

Perhaps, therefore, it might be best to leave those terms for a few moments and ask some straightforward questions.

1. Who puts up the money to permit debtors to buy back their debt? How much is available? Who takes the risk on the guarantees or credit enhancement? Do debtors pay market rates for the money or the guarantees? If not, who bears the cost?

2. How is the loss on debt reduction shown, i.e., what are the accounting, regulatory and tax implications for creditor banks? How does the loss appear on the books of creditor banks? How are the guarantees or the credit enhancement, loans or pools shown on the books of the international institutions?

3. What the the precise real cash flow consequences for debtors and creditors before and after the transaction?

4. How are the debtor countries chosen: Is it first come, first served; is it for those in the best shape who are able to service their debt or those in the worst condition?

5. Is it contemplated that after debt is formally reduced some or all of the remaining debt will be credit enhanced, or is the credit enhancement only applicable to new lending? For interest, principal or both?

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My sense is that when the answers to these questions are fleshed out, we can then assess the policy implications of the recent U.S. initiatives. I suspect that the issues governments and the private sector will focus on are the following:

1. Will debt reduction or debt relief, as defined, increase the incentives for further structural economic reform in the debtor country or is it likely to create disincentives?

2. Is debt reduction or debt relief compatible with new lending in view of the visible loss to banks and the legal implications of making further loans under such circumstances?

3. What are the likely implications for the credit standing of the World Bank in the private market place, e.g., does it depend on what is guaranteed, how much and through what mechanism?

4. What the implications of the proposals for ongoing lending programs of the World Bank and IMF? Will borrowers wait on negotiations and signing of loans pending the resolution of how their specific circumstances will be treated under the new initiatives?

5. What is the likelihood that the international lending institutions and direct government lending programs will also have to provide for debt relief to parallel the costs likely to be borne by commercial banks?

6. What are the implications of taking debt out of the commercial banking systems and providing for bearer bonds which can be purchased by pension funds, insurance companies and the general public?

7. Will the proposals increase or decrease the pressure from commercial banks to insist on quick disbursements to debtors from the international lending institutions, irrespective of the success of the economic program of the LDC's.

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These issues are not easy ones. Reasonable and wise people will have differing views. They cannot be assessed, however, until more information is on the table. I would hope that the latest proposals of Secretary Brady are defined and implemented in a way which encourages not only new lending, but also provides incentives for economic reform and the attraction of direct investment.

Permit me to conclude by suggesting that we put these matters in perspective in human terms. Right now, there is a lot of tension in the developing world, a sense that there is not much chance for growth, or for a decent standard of living for the next generation. Many debtors also face the prospect of high unemployment and runaway inflation for a long time. There is a lot of pain out there. At the same time, expectations are being raised by the recent initiatives. If it turns out the money is not there or the initiative does not fairly allocate pain, risk and advantage, then it is not likely to work. Given the raised expectations that, in turn, could exacerbate an already volatile environment. I sense we would all be well served by more definition, modesty of anticipated results and clarity.