Opinion

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Searching for Solutions

THE PROBLEM IS INTEREST GROUPS NOT INTEREST RATES

By Eugene H. Rotberg

I can think of no public policy issue which deserves greater attention than the international debt crisis, and yet, probably because the definition of the problem comes from so many different constituencies, often in conflict with each other, it is little wonder that a "solution" is not forthcoming.

The international debt crisis is one of those issues which, in my view, will be a direct cause of political instability, the weakening of democracies, the movement of countries to the far left or right, the increase in drug exports — as countries with fragile political systems are faced with untenable choices for their future. And yet, none of us here are likely to be held accountable for not taking steps whose only visible positive effect is found in the absence of such untoward events from occurring. It is hard to get credit for bad events which don't happen. And it is particularly difficult to fashion a solution when it is not likely to fully satisfy everyone where risk and pain will have to be shared and where it will be visible. The problem is not made easier by the fact that no entity has been given the mandate to allocate that pain and risk so as to avoid far worse outcomes down the road.

I have said before that a "solution" must deal with the honest concerns of the various constituencies. And the shared pain cannot be so high, either in quantitative terms, or in terms of appropriate public policy, that it will be rejected by any one of the powerful players. New initiatives must be subtle enough so that although there is risk and pain, it is not of a type or a magnitude which should cause any of the players to withdraw support.

I believe it is useful to set out some objectives:

- There is new lending to LDCs. By "new," I mean that amount which reduces the substantial negative cash flows, permits servicing of debt during periods of adjustment, supports reasonable growth and facilitates trade.
- LDCs remain politically viable. Whatever the "solution," it doesn't prompt a collapse of fragile democratic political processes in the country.
- Banks can continue to attract capital, with the prospect of earning a reasonable return, and can continue to diversify their activities with broad-based support for their own funding activities.
- The "solution" is not, in fact, nor perceived as, bailing anyone out.
- The solution is politically workable/practicable. That means accounting professionals, stockholders, legislators in industrialized countries, and a broad range of the body politic in LDCs find it fair.

The fact is, it takes no great financial expertise or wisdom to implement techniques which would cushion commercial bank losses, or protect them from further loss on their lending to LDCs — though some of the measures, undoubtedly, would raise political as well as significant public policy concerns. The techniques and methods are available. It is more difficult, however, to fashion an initiative (absent protecting banks from loss), which would encourage them voluntarily to lend new money. That is more subtle as it involves factors relating to pressures on banks from stockholders, boards of directors, regulatory agencies and, indeed, the long-term strategy of the commercial bank itself.

But the most difficult challenge is to fashion an initiative which would encourage the developing countries to make difficult structural adjustments in their economies with the prospect that by so doing, new funds would later be forthcoming and investment and savings would increase. From their perspective, the results of "belt-tightening" are quite uncertain. Their political systems are fragile and the attitude of the external world to the positive steps they might take is, in fact, unknown.

Indeed much of the debate on debt crisis initiatives centers around the difficulty of knowing whether it is best — in the best interest of LDCs — to reduce LDC debt service obligations which, in my view, would thereby discourage any commercial bank lending, forcing the LDCs to come to grips with a very painful immediate environment. They would then have to work their way out of a period of negative growth until their domestic economies, without outside support, became sufficiently attractive to encourage new external inflows and investment. In fact, many LDCs prefer that approach for it is politically quite attractive to point to moratoria or debt service reduction to domestic constituencies. The alternative approach is to lend new resources now

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and to forge links between the banks, the LDCs and the international lending agencies, which would encourage new private lending while avoiding the potential pitfalls implicit in providing, directly or indirectly, some form of safety net or credit enhancement to the private sector for their new lending.

I personally opt for that school which would not put LDCs in the "sink or swim" category. In my view, it is too dangerous an alternative. Rather, I would suggest initiatives which have a high probability of encouraging new commercial bank lending.

The proposal I have suggested is designed to protect the World Bank and the U.S. government from the moral hazard, the financial risk and the political backlash arising from an allegation that commercial banks were being bailed out or that it involves putting more good money after bad.

I define success as that which avoids political instability in LDCs and facilitates a sense that people feel that their lives are worth living, with a prospect of growth for themselves and their children. That is not the case now....

But whether that proposal is the best one is really unimportant. What is important is to recognize that the situation in Latin America is not sustainable. The subject we discuss here goes beyond finance; it relates to the viability of nation states which are quite close to us. Once that is recognized, I expect that reasonable people will address initiatives which have the highest probability of success. I define success as that which avoids political instability in LDCs and facilitates a sense that people feel that their lives are worth living, with a prospect of growth for themselves and their children. That is not the case now and, in my view, it is the fundamental proof of the existence of a debt crisis. Our neighbors — tens of millions of people — feel hopeless, with little positive prospect for the future or a sense of expectancy. That is not a healthy environment anywhere — certainly not on our borders.

Let me summarize in one sentence: What must be done is the implementation of initiatives which are specifically designed to break the impasse which now exists between the U.S. government, the commercial banks, the LDCs, the multi-national agencies and the regulatory agencies. I am convinced that can and must be done.

The preceding is excerpted from the previously unpublished testimony of Merrill Lynch Executive Vice President Eugene H. Rotberg, former vice president and treasurer of the World Bank, before the subcommittee on International Finance and Monetary Policy of the Committee on Banking, Housing, and Urban Affairs, United States Senate, August 2, 1988.