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"AID AND THE DEBT CRISIS"

TRANSCRIPT OF THE PROCEEDINGS

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ORIGINAL

AGENCY FOR INTERNATIONAL DEVELOPMENT

ADMINISTRATOR'S SEMINAR

ON

A I D AND THE DEBT CRISIS

Washington, D. C.

Friday, March 17, 1989

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AGENCY FOR INTERNATIONAL DEVELOPMENT

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ADMINISTRATOR'S SEMINAR

ON

AID AND THE DEBT CRISIS

FRIDAY, MARCH 17, 1989

Administrator's Conference Room - Room 5951

U. S. State Department

21st and Virginia Avenue, N. W.

Washington, D. C.

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. . . The Administrator's Seminar on AID and the Debt Crisis convened in the Administrator's Conference Room, U.S. Department of State, Washington, D.C., at 9:30 o'clock a.m., Cliff Lewis, presiding . . .

MR. LEWIS: Let's get started.

On behalf of Alan I would like to welcome you all here. Alan is not able to join us. Alan's schedule is still between having testimony on a regular basis, between trying to recruit new people, between trying to figure out what is going on and organization that, unfortunately, can't close down while all these sorts of things get settled. He has got a rather full calendar. Although by his lack of presence, I don't think that that reflects any lack of priority to what we are going to talk about.

I would just say a few brief points of general introduction. I will have Mike Unger say a few words and we can introduce ourselves.

Basically, as most of you know, and some of you may even have had the misfortune to try to read, the agency recently put out a report that tries to discuss some of the broader issues about the U.S. relationship with developing countries. It's not focused per se on development assistance, nor is it focused certainly narrowly on AID as an agency.

But, rather, what our intention was, what Alan's intention was, was to try to lay some of the intellectual underpinnings for what in the world the United States as a country, the United States as a government as well as whatever agency is responsible for managing development assistance policies, what are the issues that must be addressed in a reconfiguration of that.

Now the name of that report is the "Development and the National Interest," and very much our purpose was to try to relate these issues to the national interest. And more than that, it was also trying to relate it in a prospective sense, which was trying to say well not just what happened 20 years ago and not just what the problems are now, but what are the problems of the future.

Now obviously the reason we're all together is part of the follow-up to this initial exercise which relates to that future agenda. And what we would like to do today is have a discussion about -- well, if writing reports about foreign aid is a cottage industry, then I guess writing reports about Third World debt is probably a Fortune 500 industry.

Our intention is not to add another report or even so much to have another meeting generally about

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Third World debt. Ours is a more modest goal, which is basically to try to focus in the context of being responsible for designing a program for the United States economic assistance program, and it's to try to bring in some of the best minds from various different perspectives that work on this, along with some of our key operational people that are involved in this and have a general discussion.

With that general introduction, let me turn the meeting over to Mike Unger for a few minutes. Mike is basically in charge of the Budget and Planning Office in our Private Enterprise Bureau, and the Private Enterprise Bureau, as you all know, are the guys picking up the tab for this meeting.

MR. UNGER: And Chief Economist for that Bureau.

MR. LEWIS: And he says he is Chief Economist for that Bureau.

(Laughter.)

I'm not so sure I would want to take a lot of pride in that.

(Laughter.)

Mike has a couple of administrative things to discuss as well as we would like to go around, after Mike is done, and introduce ourselves and explain our backgrounds.

MR. UNGER: Thanks Cliff. Again, the idea behind this was not to have just another meeting on developing country debt, but really was to define a strategic role for AID, and hopefully by the end of the day we will have a sense of where we want to go at the next step.

As you know, this meeting was initially planned for the 3rd of March, and unfortunately due to scheduling problems, it was pushed back two weeks, which turned out to be kind of a bitter sweet experience. The benefit is, or the sweet part is the fact that we have had the Treasury's announcement on the Brady debt initiative, if you call it a debt initiative. The unfortunate part is by postponing the meeting for two weeks we lost three very important people that we had hoped to have in this group, Pierre Bierban from Shearson Lehman Brothers, who is the head of their International Advisory Service, also George Voighta from Bankers Trust and John Williamson from the Institute of International Economics. They will be kept in the loop in terms of future discussions, meetings and so on with respect to future work.

What I would like to do is go around the table and have you basically identify yourselves and your marysimons affiliation and then we'll go around the room so we have a chance to meet everyone.

The first time that you speak, please give your name. We are having this recorded, and we will be preparing proceeds which will be distributed later on. So the first time you speak, please give your name.

You know Cliff Lewis from PPC, and I'm Mike Unger from the Bureau for Private Enterprise.

Phil, why don't you go ahead.

MR. WELLONS: Phil Wellons of the Harvard Law School at the Harvard Institute for International Development.

MR. FOX: Jim Fox, Latin American Bureau of AID.

MR. RAUSSER: Gordon Rausser, the Administrator's Office.

MR. BENCH: Bob Bench, Price Waterhouse.

MR. La PEDIS: Jerry La Pedis, PPC.

MR. BATCHELDER: Alan Batchelder, Office of Economic Affairs, AID.

MR. MULLEN: John Mullen. I am Deputy General Counsel of AID.

MR. GHADAR: Fariborz Ghadar, George Washington University.

MR. FULLER: Bill Fuller. I'm with the Asia marysimons and Near East Bureau of AID.

MR. FROOT: Ken Froot, MIT.

MR. GILLIS: Malcolm Gillis, Duke University.

MR. LESSARD: Don Lessard, MIT.

MS. BALCOM: Jeanne Balcom, Price Waterhouse.

MR. RUSSELL: Chris Russell, AID's Bureau for Private Enterprise.

MR. MOORE: David Moore with PPC.

MR. DRY: Jim Dry, AID's Bureau for Private Enterprise.

MR. HORWITZ: Len Horwitz, Price Waterhouse.

MR. CAMSTRA: Mark Camstra, Price Waterhouse

MR. BREEN: Dick Breen, Price Waterhouse.

MR. SAIERS: Larry Saiers, AID's Africa Bureau

MR. SCHAFFER: Peter Schaffer, Consultant for the Administrator's office.

MR. UNGER: Thank you.

A couple of other pieces of information. The restrooms are just out this door to the right. Secondly, we will be having a catered lunch served up here I think about 12:30. You all are invited to stay through lunch. Basically we have until 3:30. We may conclude our business before then, but I suspect we will certainly go until at least 3 or 3:30 this afternoon.

I think we want to start first with a few

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prepared comments. We want to keep prepared comments to a minimum. Ken Froot from MIT will be making some remarks, then I believe it's Phil Wellons and then Don Lessard.

I will now turn it back over to Cliff to see if he has any further introductory remarks to make.

MR. LEWIS: Yes. I was just going to say a couple of things to try to put this in some perspective for you that are not involved in the agency as well as probably for some of you that are.

Ours is a program, like most operational programs, that tends to become very compartmentalized both in program terms but, more importantly in geographic terms. And when you're dealing with an issue as broad as international debt of course, the fact of the matter is it's easy to forget, notwithstanding the Baker Plan's emphasis on a country-by-country case approach, that indeed the country circumstances vary greatly.

Now all of you who have been involved in this, of course that's not news, although I must also admit that one of the other introductory points that I would make from my own personal experience is up until 13 months I was the World Banks' Senior Trade and Finance Specialist in the Latin America region. I actually go in on the ground floor of the policy conditionality business marysimons at the Bank, which if you're interested, if I could have just gotten a commission on the money I was moving, I wouldn't have had to consider working again.

The fact of the matter is that I remember quite vividly in effect inventing that business as we went along at the World Bank, the notion of policy conditionality, the notions of structural adjustment in large countries, the Brazils, the Mexicos and the Argentinas.

And of course I also remember quite vividly the tendency, the sort of, if you will, somewhat schizophrenic attitude by the staff towards this, which on the one hand was a marvellous opportunity to hire more economists and get rid of those technical types that would go out and all they thought development meant was building roads and dams and things like that and didn't understand the bigger picture.

And, also, the other thing that I remember sort of vividly about that experience was the tendency to be glad that people didn't look back at what you predicted was going to happen. You know, I can remember in fact getting to the point where the announcement that Brazil had turned the corner really was the kiss of death in terms of where their program was going to be.

It seemed to me that through the period since

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'81 the amount of time between being the darling of the international debt workout community to being really in the pits began to compress. So that, for example, in Argentina where it might have taken a year for Argentina in the 80's to have gone from a success story to a failure, now I guess it's only taking, you know, three or four months for some of these countries to make that transition.

So one of the things I would caution us about is that one of the nice things about the group that you're talking with here, which is the agency responsible for development assistance, is we really are in the business of taking a bit longer-term view on this. That's one thing I note.

A second thing I would note is that we also don't have the moral hazard problem that some of our other colleagues in the Federal Government have, which is to say that we don't actually have anything terribly important to do with the domestic financial system. In fact, we don't have anything to do with the domestic financial system.

So what we are talking about here is we don't really need to get all worried about what is this going to mean to Chemical Bank, what is this going to mean to Manny Hanny or B of A. Our interest is essentially an marysimons interest in the long-term growth, the sustainable growth of particular less-developed countries, and in a sense that's quite a different perspective I think than the perspective that most of the other agencies that are much more involved in the debt issues are.

I would make one last point before turning it over to Ken Froot from MIT and that's basically as follows. We also need to think a little bit in terms of AID's country group that we operate in, and I think in some of the papers we introduced this concept, but basically there is a very simple typology that I would just leave with you, and there are three sets of countries in that typology and AID has quite different relationships with countries in each of these three groups.

In the first instance there are the low-income countries, and more specifically Sub-Saharan Africa. For convenience sake, Nigeria has made such a botch-up of its economy that it in fact has gone from being a middle-income country to a low-income country so we no longer have to qualify when we talk about Sub-Saharan Africa. Everybody in Sub-Saharan Africa now is a low-income country, and everybody in Sub-Sarahan Africa is in the position of being IDA eligible, foreign aid eligible. Everybody in low-income Africa has almost no prospect of

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attracting significant flows of commercial resources in the foreseeable future and, indeed, most of the outstanding stock of debt in low-income Africa, in Sub-Saharan Africa is owned by official creditors.

So we are dealing with a somewhat different situation than the situation in the next two set of developing countries I talk about.

I might also add, and Larry is the guy who really has the lead on this with AID, that this is an area where we are actively involved, and in fact this is the area where there is recent interest on debt forgiveness. In fact, it has been obvious for some time that debt forgiveness was going to be the principal mechanism for addressing some of these issues in low-income Africa if, for no other reason, that nobody was paying a nickel to anyone, and it was a little bit difficult to see how you were going to have any alternative.

And, in addition to that, it's already the taxpayers that put up the money rather than private banks. So it was pretty clear that it was going to be a government-to-government operation.

It's also worth noting that in fact our most recent Foreign Assistance Act provide explicit legislative authority to in fact do debt forgiveness for

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U.S. Government debt in low-income countries, and let us say Larry and others are working out the details of that.

A second group of countries, and this one may surprise you a little bit, is a group of countries where in fact AID, and these are high-debt countries who in fact are members of the Baker Plan, and let's say Baker Plan 17. The Baker Plan 15 forgot about a couple of debtors. That's what happens when you write the speech in the hotel room the day before you give it. But, in any case, let's talk about the Baker 17. Now of those seven, there are in fact some countries, and they include Bolivia, Costa Rica, Ecuador, Jamaica, Morocco, Peru and the Philippines, high-debt countries where AID basically is right now either the principal or only source of additional capital.

Indeed for these countries as a whole the net flow of resources to these countries in 1987, and we have preliminary estimates for '88, was probably negative. Indeed, the flow of resources from the IMF and World Bank was significantly negative.

AID's flow of resources, on the other hand, was about $500 million, and indeed if you look at what we were doing, in fact pretty clearly for many of these countries we provided the resources that permitted them to meet their World Bank and IMF obligations and a little

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bit more on top of that.

They are not thought of as the major countries of the debt crisis, but they are obviously terribly important to us, and obviously as you think about the it, they are terribly important from a political standpoint to the United States. Basically it's Central America and some of the other South American countries and the Philippines.

In all of these cases, by the way, the new Administration is considering various development initiatives, and I think you all have read one way or another about the discussions in both Central America as well as in the Philippines. So I won't belabor the point. But clearly, how we are going to address the debt issue in the context of major development initiatives in Central America and the Philippines is going to be terribly important.

Well, lastly, there is another set of countries, which are the ones that I guess in the popular imagination is what everyone is talking about when we say the high-debt countries. These are guys that I used to work with when I was at the Bank, and they are the Argentinas, Brazils and Mexicos. In those cases obviously AID has in terms of resource flow a marginal role, and in some cases a zero role.

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Although, interestingly enough, we do have in fact modest presence in terms of mission, two or three guys located in the capital, and, funny enough, one of the stories we talk a little bit about in the development of the National Interest Report is the fact that in the 60's we graduated all these countries from U.S. foreign assistance on the grounds that they had now made the cut and had become on the tract of sustained growth and would really become developed countries and it was no longer appropriate for us to maintain large foreign aid presence in those countries.

In a sense, the Nigeria story is the more extreme example of that as well where we closed out a mission presence on the grounds that they had turned the corner and they were rich enough that they didn't need it. Now they are back to being IDA eligible.

Venezuela in a sense is another example of a country which has become IBRD eligible again.

I would just make one last introductory point. And as I said at the beginning, we have the luxury of taking a long-term view, but also what we are really most interested in is how does one reignite the process of economic growth in these countries. That isn't something everybody talks about a lot. In fact, Baker for a long time tried to get his plan, and rather

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than people calling it the Baker Plan, he liked the idea of having it called the Growth Plan. So that this is something that has been a hallmark of these exercises, and I won't bore you with the numbers.

Let me just say that in terms of the statistics in terms of economic growth we haven't had a lot of luck since '81. Indeed, in aggregate these countries are really behind where they were in real purchasing terms in the 70's. So you have a situation, as I think some of you have pointed out previously, which really is comparable to what happened with the Great Depression in the States and in Europe, and indeed for some of these countries really in terms of the impact that is made on living standards it's probably much more serious than what happened during the Great Depression. And obviously for political and for economic reasons this is a very high-cost problem for the U.S.

And without further ado, let me introduce Professor Froot.

MR. FROOT: I didn't prepare anything very formal. So let me just chat for a few minutes informally about kind of an overview I suppose of the debt problem, the burden on LDCs and maybe a little bit about the distribution of the burden of cost of different country types.

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I think everybody is probably very aware that aggregate measures of debt, debt GNP, debt exports, debt interest and interest to export measures, debt has grown substantially since the debt crisis and all these curves basically move upward.

It seems as though if you look at them that things started to improve in 1987, only again to get worse in 1988. The drops in debt service or in debt export ratios in 1987 are actually just a statistical fluke. They are due to reschedules and arrearages. So the fact is the debt problem was actually getting worse and not getting better.

So whether or not you take as a benchmark 1982 when the crisis began, or 1985 when the Baker Plan was first initiated, by either benchmark things are not looking up.

In fact, things are substantially worse for countries such as Sub-Saharan Africa. When you look at their ability to pay as measured say by debt exports, you see that their debt export ratio has actually doubled, close to doubled since early 1985. For Latin America the increase is somewhat more modest, but nevertheless it's still an increase running around 20 percent, and of course for the Asian debtors, they have made substantial progress.

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So really what you're talking about is fairly skewed, and overall these debt export ratios have not changed very much, but that it's very highly skewed away from Sub-Saharan Africa toward the Asian countries and leaving the Latin American countries and the HICs basically slightly worse off.

In terms of net transfers, and everyone probably is also aware of the story that net transfers have been substantially declining, and I have picture of that here. As you can see, the dark line is the net transfer from private creditors and the top jagged line is from the multilateral creditors.

If I were to put 1988 on this picture, it's somewhere down here from private lenders. So that even since what appeared to be a slight upturn in 1987, things again have gotten substantially worse. The net outflows overall from the HICs, from the highly indebted countries, amount of $44 billion. So that more than ever we are extracting on net resources from these countries, and predominantly that is going to the private sector.

If you look at the multilateral lending and the bilateral lending, you find that there is some decline in bilateral lending, official lending to these countries of $4- or $5 billion and a smaller decline in the multilateral lending, but one that doesn't amount to

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much, depending on exactly the set of countries you use, and overwhelming the change comes up from private creditors.

So the basic point is that there has been a failure to generate funds using kind of the concerted lending strategy that was the hope both of the 1982 kind of firefighting packages and also of the Baker Plan that that ability to coordinate and generate funds has failed. In fact, everybody is probably aware as well that there was not one single major rescheduling where new money was put up in 1987 that actually came to fruition.

The concern of course about the fact that multilateral creditors are on net putting money in and that private creditors are taking money out, and this probably bears on Cliff Lewis' point about the AID flows themselves, is stressing sort of implicitly this fact that the burden of the debt problem or resolving the debt problem has shifted and is continually shifting as this moves toward the taxpayers in the developed countries.

So we do have to ask whether or not in fact in the end this sort of mission of the World Bank and other multilateral and bilateral agencies, whether or not the kind of recycling that we've seen in the past of their flows to these countries, which then are recycled into marysimons private creditor interests, whether or not that should persist.

Just moving over to the outlook from the debtor countries themselves, of course everybody knows investment has fallen down the stairs, falling by about seven percent of GNP, six and a half percent of GNP for the most indebted countries. That corresponds dollar for dollar to the change in the current account surplus for these countries.

So what we are seeing essentially is that the tail that is wagging the dog here is that investment is taking the hit each time we ask for another dollar in current resources.

This actually poses an interesting problem I think and one that hasn't gotten enough attention, and that is the following, that if you think that squeezing a lot now out of these countries is a bad idea because in the end they don't grow, and of course the secondary market prices are telling you that this fall in investment is indeed forecasting a reduction in growth for these countries, then it may not be that forgiveness is the best thing. It may not be that a 25 percent or 30 percent reduction in the overall level of debt is quite what's necessary.

Instead, because of the very sensitivity of marysimons investment currently to what you see in the current account surplus, that might suggest that what's really important in the short term is, again the same thing that is behind the Baker Plan, is increasing these flows in the short run and the medium run to these countries, that is getting down this net resource transfer from something that looks like 2.5 percent of GNP to something that looks more like 1.

That kind of strategy it seems would have a very important effect on investment in these countries, would have a very important effect on future growth, would stimulate secondary market prices and may make the burden of debt forgiveness somewhat less.

So that I think what we have to think about as we talk through this is not just the sense in which we want to reduce overall the net present discounted value of payments, but whether or not there is still a lot to be done by tilting kind of the payment schedule in a way such that the liquidity of these countries is not so direly short.

I guess, finally, I think the recent announcement by Secretary Brady and the developments in the short run I think reflect an increasing tension, one that essentially would have exploded I think with Mexico in the next few months, and I think that we are basically marysimons running out of time. Mexico is certainly the first to come and is going to be the most serious because it's posture right now in the short run is very dramatic, but I sense that there is need for movement now in a way that didn't exist in the past.

MR. LEWIS: We are going to have a couple of other general presentations. I'm wondering if anybody would like to ask a few specific questions of Ken.

MR. GILLIS· Ken, why do think Marty Feldstein argues, I mean I hear you say that all the bad ratios are increasing, and Marty says that conservative debtors are building up an unserviceable debt burden is wrong because the real inflation adjusted value of the debt has not increased. In Brazil, for example, the ratios of debt and GNP and of interest payments to exports declined after 1984. What's Marty doing here?

MR. FROOT: I'm not sure exactly what he's doing there?

(Laughter.)

There are a number of ways to adjust what you want look at as being the real value of the debt. One thing you can do is just deflate it by some price index and get an idea of what the change in the real value is. That I guess is what he is referring to in there. Of course you have to wonder what the price index is marysimons exactly. For differing countries it's going to look very differently. Commodity prices still for many countries are not moving upward. They are still moving downward. So it's going to depend very much. That's one point.

The second point is you don't want to just deflate by some some price index. You also want to measure how onerous this debt burden is in real terms in comparison with the aggregate amount of activity in those countries. So to the extent that GNP per capita is actually shrinking, that that would suggest that these debt GNP ratios might be getting worse than that kind of calculation.

As for Brazil, I can tell you in a minute.

(Laughter.)

MR. LESSARD: We talk about debt to GNP ratios or debt service to net export ratios, but obviously this country has also had major fiscal crisis internally and, you know, what fraction of tax capture or tax effort are we really talking about, because that seems to me to be the much more critical thing. My sense is we are talking about a third, roughly a third of the fiscal budget as a debt transfer, and what fraction of GNP is really captured in fiscal terms that is not directly earmarked for certain things, and it's hard to measure.

It's not the total government budget, but you would like to say of the government's effort to capture resources and have them available for public purposes, what fraction of that capture in a sense is now earmarked, or a fourth, and looking at the basic problem of these countries in building up fiscal capacity anyway, and now you say a fourth of fiscal capacity is trapped for payment of foreign debt services, that is probably the more dramatic measure in terms of can these countries pay or not.

You talk to people at the bank, and they say, look, Mexico is doing well, we see new investment everywhere, and they are saying they can't pay. But on the other hand, if you say that you've got a fiscal system that is barely keeping pace, it's not keeping pace and is having a hell of a time increasing its capture resources ---

MR. GILLIS: And the interaction of inflation from the debt and the fiscal system.

MR. LESSARD: --- and the interaction of inflation, and now we have said the fiscal system has to do, you know, 35 or 40 percent better than what it needs to do just for domestic needs. Imagine what would happen in our fiscal system we put that burden on it.

MR. FROOT: Remember that you would expect in a sense, to the extent that these debt equity swaps and

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local currency conversions are actually successful, you would expect that the tradeoff between public sector deficits and inflation is actually going to be worsening. These things are off the balance sheet and we now no longer see them in the debt numbers, but there are these liabilities that need to be serviced.

MR. LESSARD: Well, it depends upon what they are traded for. Are they traded for government obligations or are they traded for private obligations that are serviced directly by the private sector, because my sense is there is a huge friction of capturing resources into the public sector.

MR. FROOT: That's right, to the extent that they become local currency obligations that increase the base for inflation taxes.

MR. LEWIS: The debt equity thing is something that there is enough interest in that I think we'll talk about that specifically with Phil because it's one that this agency has gotten involved in in sort of back door without looking at the macro implications of it.

I have a question or a comment, too. I'm always troubled as a former banker, and no bankers turned up at this, did they, so I represent a banker's view on this. It's cash flow that matters. All this talk about stocks being the big deal is not really the way the world marysimons works. It's like the way we work, which is well do I have at the end of the week $5 or do I not have a few dollars.

In a sense one of the things that I just can't understand is the official statistics on these things because clearly they are wrong. Now having written a report that used a lot of numbers, maybe I've become overly skeptical about these statistics, but I would really ask somebody, I mean one of the people that looked at this in some detail what in fact, just on the external cash flow, what these numbers are telling us, two questions. First, you know, we've got these numbers floating around that Morgan put up and everybody is excited about and the Secretary was shocked with he was told them.

The story goes something like when Brady was doing the first briefing on this, he said, you mean that these countries have more assets abroad than they owe the banks? I said yes, Mr. Secretary, that's right. By the way, the Treasury's estimate comes from the Morgan study and not any U.S. Government work. And he said, what are we talking about debt crisis, which is one of the reasons why there were a couple of paragraphs in Secretary Brady's speech about this.

Now my question is in a situation where you have large, not knowable how large flows, capital flows that nobody controls completely and you have the ability through transfer pricing, under invoice and so on and so forth to move capital around, what's actually going on with these net transfer numbers cash flow lines?

MR. FROOT: I don't know. The Brady emphasis on capital flight I just find very much like emphasis on tax evasion or something, you know, that these private citizens have their money abroad and public sectors have the debts. I just don't see, I mean, first of all, it's only true for a very few countries that the aggregate amount of capital flight is greater than the amount of borrowing.

But, in any case, it seems to me that that's a problem, that reflects the fiscal problems in these countries and reflects the fear of individuals to keep their assets at home. It's something that needs to be resolved, but needs to be resolved essentially through the easing of the fiscal crisis there and not through some kind of automatic repatriation of these amounts.

MR. LESSARD: Having spent a little time on this capital flight problem myself again, I think it's a red herring. I mean these countries do not have assets abroad. The residents of these countries have assets abroad. The problem is government capacity to capture marysimons resources, fiscal side or any other side, a basic problem, No. 1.

No. 2, the concerted efforts of the Fund, Treasury, the World Bank and the commercial banks to enforce general obligations in fact cause capital flight because the local capital is a subordinated claim on the enterprise, there is no question, and all of the international institutions are set up to enforce the senior claims.

Now you are a shareholder in a firm that is worth $60 and it has senior debt outstanding of $100 and you're asked to put in more money. What do you do? You take it the hell out.

(Laughter.)

I think that's the essential problem.

It's also true that Mexico and Argentina let's say compared to Brazil have regularly ripped off domestic savers and they have made it a conscious, conniving part of their economic policy, opportunistic, and some international leverage probably ought to be applied on behalf of domestic savers, but at the moment all of the international leverage is applied on behalf of holders of general obligations and in a sense we have denationalized the financial systems of developing countries.

The crossover point in Mexico is about 1981.

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What you want to look at is the stock of claims against Mexico, Incorporated held by Mexicans versus held by foreigners, and '81 was the year that it crossed over, that in a sense Mexico owed more to the rest of the world than it owed to its own citizens, and in a sense claims by Mexicans on Mexico became untenable and Mexico went into international receivership.

So to say that these countries must solve capital flight in order to resolve the debt crisis is a little bit backward. On the other hand, to argue that we shouldn't be concerned about capital flight is equally weak because it seems to me that we have a major concern with domestic capital formation. Domestic savings and domestic investment, that's the thing then when you said what does AID really care about, AID ought to really care about the conditions required for private capital formation in LDCs period.

MR. GILLIS: There are two things to me relevant about the stock of assets held by Argentines, Mexicans and so forth and the U.S. and Europe. One is minor, and that is you have to realize that in several countries the only connection that has in the public sector is a lot of those people are public officials.

(Laughter.)

That's the minor one.

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The second one is you want to go look at the experience of countries who after successful reform programs attracted the capital that has flown back rapidly, and that was Indonesia '67 to '69. You want to see what caused the turnaround and then it becomes a resource, but only after you have done other things.

MR. WELLONS: Well, there is another piece of that. If you get to your point about whether we want new money or debt forgiveness, if new money is simply going to go right back out of the country, then we are concerned about the injection of new money. So you're just funneling it in and right back out again. It's not as though the stock is fixed. It could grow under certain conditions.

MR. BENCH: Well, I just want to pick up, I don't want to lose something that you started on the statistical thing, and that is that if we are going focus a lot on the internal fiscal problem, we want to remember that some of those numbers came from nationalization, nationalization of the banking system, and during the rescheduling process there was consolidation of debts. I mean some of this is very mechanical stuff.

If you go ahead and selectively privatize certain firms, all that debt comes off the government balance sheets and goes back on the firm and suddenly you don't have a fiscal problem. So you've got to be careful of how you use those fiscal numbers because of what has happened since '82 in terms of debt consolidation and nationalization.

But it does raise an issue. I mean what stimulated me here is, and God knows, I don't know enough about AID programs honestly, but if you could find a few companies that were the very best and work with them to privatize and restructure them, No. 1, down go your fiscal numbers. So statistically you've solved the problem.

(Laughter.)

MR. WELLONS: But the company takes the debt with it.

MR. BENCH: That's what I'm assuming and that's the point. I think you can validly assume that. If you were to pick selected firms and restructure them, they issue new debt, it becomes private debt and not fiscal debt, you could do a lot of things at once, but inherent in that is -- well, I'm saying it in too simple a way. It's a problem to go take some of these firms and restructure them because of the patronage problem and what do you do with those people, the redundancies and that sort of thing. But we want to be careful when we say it's a fiscal problem or it's a banker's problem. A

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lot of these problems are absolutely internally driven by national psyche and that national psyche follows on by promoting the capital flight problem as well.

The national psyche is promoting at least two big problems, and it's not the bankers and it's not the IMF or the World Bank or the White House that's doing all that. It's those people that are doing that, and there, I think that's where the Secretary is coming from. The Secretary might not have it right in terms of the capital flight issue, but his instinct is correct because he has been taking all this money for years up at ---

(Laughter.)

So he has an honest to God cash flow experience seeing this stuff come in the door in suitcases. You always get back to the national psyche as the fundamental problem, and to blame everybody else for that I think is a wrong thing to do.

MR. FROOT: But, you know, in the accumulation of the debt to begin with it's certainly true that these fiscal problems existed all during the 1970's when the debt the accumulated as well. It's very true, and everybody I think agrees that reform is necessary in these countries. You don't get fiscal reform overnight, and it's certainly true that by privatizing some of the debt you don't solve the fiscal problem and therefore don't get that good company even out of the woods.

MR. BENCH: Well, you do get fiscal reform overnight through revolution.

(Laughter.)

And that will happen, and this is the other issue and the other linkage that we're talking about.

MR. LESSARD: My sense is you get a clearer linkage through between the macro issues in terms of the aggregate flows and the aggregate obligations and the ultimate need for some rather major micro level changes both in real terms and in terms of conditions for saving, conditions for contracting, et cetera, and both are interactive.

The capital flight can be crowded out by excessive general obligations, but if you simply reduce those, it would not come back unless you made some of the micro changes as well.

So if you are going to be successful, you're going to have to change contracting relationships and fiscal risks within the country as well as probably adjust the stock of general obligations. So there is both an aggregate problem and there is a structural problem which you have at the level of the national psyche and I think there is no question that both of those things are going on.

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MR. LA PEDIS: I wanted to ask you a question. You gave us a lot of numbers that specified the problem in terms of aggregates. There is a lot of variation in an aggregate on a cross-country basis. Have you or anybody here tried to identify or distinguish among those countries that have been relatively successful and relatively unsuccessful in maintaining consumption and investment in real terms above a floor level while simultaneously be able to service their debt?

MR. FROOT: I think that group of countries probably looks like the Asia mix. There are a lot of things we can identify there I think as being very important and helpful for solving these kinds of problems, an open economy oriented towards export growth, relatively stable and flat income distribution, relatively stable political systems, all those things seem to weigh very highly in favor of their ability to keep basically larger net inflows occurring and to fund more investment.

MR. LEWIS: Although you also have to add that in the case of Korea's earlier debt crisis they were prepared to absorb a hell of a cut in the standard of living as part of the adjustment program. Now it proved to be a short-term cut, but that reduction in standard of living was much greater than what any of the other Latin debtors were prepared to accept in the short term.

MR. GHADAR: If you looked at the capital flight issue and not aggregate, and in fact the issue of "SWAPS" was on capital flight. We interviewed a whole series of people and looked at the Morgan study. The Morgan study looked at the Baker 15 and said that accumulated flight capital assets are equal to more than 57 percent of their outstanding debt. But if you look at them country by country and region by region there are really some interesting things. If you look at the ones that have the smallest amount, and I've got the list in front of me, Chile is in fact the smallest amount, 10 percent.

MR. LESSARD: The smallest amount of capital flight?

MR. GHADAR: Capital flight as a percentage, assets abroad as a percentage of total debt. That's 10 percent. Now I have problems with these numbers. I don't like the numbers, et cetera, but at least they are consistently gathered. If you look at that, it's 10 percent for Chile, 26 percent for Brazil, 14 percent for Morocco, and if you look at the high ones you get 166 for Venezuela, 77 for Argentina and 78 for Mexico. I mean that tells you, you know, it tells you something.

It tells you that the guys who have really

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tried to privatize and really have tried to put systems in place to make the capital market at least responsive, interest rates reasonable, et cetera, are doing better than the ones that have sort of thrown up their hands and forgotten about it. And I'm not just talking about one year or two years, but I'm talking about over the last five years.

MR. LESSARD: Which also relates very nicely to expost real returns on savings assets.

MR. GHADAR: Absolutely.

MR. LESSARD: With Brazil and with a couple of others it's about even. You look at Mexico and Argentina and there is approximately a 70 percent decline in the purchasing power of savings deposits over two years. So the internal contracting structure and the treatment of domestic savings is a core issue.

MR. LEWIS: Why don't we turn now to the next discussion, and thanks very much for the introduction, which I guess basically can be summarized as watch out.

(Laughter.)

Let's turn to the next discussion on which Phil is going to give a presentation. Phil has the odd background of being both a lawyer as well as being involved in economic issues. I'm not quite sure where that fits in on the credibility scale.

MR. WELLONS: Well, I should tell you that I learned when I was among lawyers it was wise not to admit that I had anything to do with economists or business schools, and when I was among businessmen the last thing I should admit was that I had legal training. So I think the answer is there is no credibility at all. So maybe I should stop talking.

MR. UNGER: But you're among friends here today, Phil.

(Laughter.)

MR. WELLONS: Good, I'll keep talking.

(Laughter.)

MR. LEWIS: As a small introductory, one funny story I heard the other day at the Treasury staff meeting is the so-called Brady Plan was referred to by the Secretary and the Mulford Plan.

(Laughter.)

Now I'm not sure what one should read into that, except that I guess everybody has a good sense of risk management.

(Laughter.)

Phil, go ahead.

MR. WELLONS: Thanks, Cliff.

I'm supposed to be talking about the new approaches and focusing on the regulatory aspects or some marysimons of the regulatory issues. I've got to admit that I feel with this group that I'm just a focus for some major topic points where many of us know the same sort of things. But with the same qualifications again, let me proceed.

I thought of comparing the situation back in '82/83 to '84 with the situation today to see what major changes I could observe, and it seems to me there were at four and we will probably find more that are relevant for AID and AID's possible new role in debt restructuring.

One is the shift to market-based solutions. If you go back to '82-83, it's clear that the solutions were organized largely by the U.S. Government and a few major banks and that attempts to have market-based solutions failed miserably.

The first attempt to deal with the Brazil crisis was an attempt by Morgan City Bank working with Brazil to help the country work out without help from the U.S. Government, and that just fell flat on its face. We saw the clear need for government intervention.

Now obviously the government role is still important, there is no doubt about that, but at the same time we see sort of more options or a menu of options being discussed, we see some choice in here for the creditors, we see some more secondary market activity and

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of course the swaps that we have been talking about a bit already.

So the shift to market-based solutions I think comes about with several other important changes. One is the diffusion of power in all of this. Again, if you go back to '82-83, where was the power in the groups that I just described, the U.S. Government and a small number of banks that were leading all of this, and on the debtor side most of these negotiations seemed to be through the Finance Ministry, focused in the Finance Ministry obviously with correspondence with the President, but that was about it.

Look at the situation today, and I would say it's quite different. In terms of the official side, the Japanese are beginning to be interested in this and in having a policy role as well as just providing funds. The Steering Committees seem to be weakening and broadening a bit, particularly on the Japanese side, and just recently we have seen the Bank of Tokyo now is going to be supplemented by at least one other major city bank in those workouts.

The debtors team now is maybe led by the Finance Ministry, but it's very plugged into the Presidential level and in many countries you get the sense that the President is actually leading the fight, and he is doing it in the context of a much more vocal and informed opposition and of course his own party as well when it comes to the debt question.

There is another group that are a new entrance in here. The investment bankers are here much more active than they were five or seven years ago playing a role of intermediating some of these debts.

So diffusion of power and at the same time there has been a concentration of interest compared to if you say who were the creditors before, widely dispersed and much more concentration in the big banks, and among those big banks there might be more diversity of opinion as well. But we have seen the regionals withdraw and probably more polarization, more active polarization on the part of the creditors side.

So diffusion of power, concentration of interest and I think a different perception of the threat.

I was reading through John Williamson's piece in the material you sent out to us, and very early on he says, look, the threat to the U.S. financial system is much less than it used to be.

That may be true certainly if you look at some of the numbers, it hasn't disappeared, but I would say there is a much stronger sense of threat in terms of marysimons political stability. Obviously people were concerned with political stability in the past, and we responded to Mexico as we did because of that concern, but that is now in a sense more important than our concerns about the threat to the U.S. financial system.

So I see at least these four major changes that have taken place in the last five or seven years, and I think they argue for a different U.S. Government response. And I think, you know, it's nice it fits in a sense with the meeting, but it argues that there needs to be a more diverse representation of U.S. Government interest in the formation of U.S. Government policy and that it's appropriate for AID to be holding this meeting right now. That's one bottom line from all of this.

What it means, it seems to me, for the players' actions in all of this is that they are going to be driven much more in the future than the past, and this is all relative of course, but much more in the future than in the past by prudential concerns and tax concerns. That's what the source of activity is. That's what is going to drive activity in these markets now, and that it seems to me leads to a focus of attention on questions of what can be done or what needs to be done in these areas to facilitate -- well to improve restructuring. Is there anything that we can do, marysimons particularly AID, but certainly the U.S. Government broadly to make changes on the regulatory and tax side that will facilitate change, and that doesn't necessarily mean that the U.S. Government pick up the full tab at all I don't think.

Now some things that can be done on the U.S. side, and I think it's worth looking at this from the perspective of three different groups, the U.S., the U.S. side, the international markets and then debtor country markets. So you want to think in those terms.

On the U.S. side I suppose there are some opportunities for clarification of rules. It's not clear to me that lenders, for example, know exactly where such things as Securities and Exchange laws and the Glass-Stiegal Act are going to kick in in their behavior, and it might be appropriate to pay attention to some of those issues.

More likely, we are going to start tinkering around with some of these rules, and as we try to modify them we're going to want to, it seems to me, keep track of the modifications' effect on not just the immediate activity but the broader development issues in the case today and others will be concerned about other things. For example, there is a lot of talk about swaps.

The bankers I have talked to are unhappy with

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the IRS Debt Equity Swap Rules. Does that need to be addressed and is there a role for AID in this kind of thing? I don't know, but maybe there is.

On the question of interest capitalization, which is a major proposal, you don't capitalize interest when it's a bad loan. Do we need to address that question or should we?

How about reserves, building reserves? Bank lawyers are concerned about the effect of the alternate minimum tax rules on reserves and taxation over the long run, and we can discuss this somewhat. I don't say that I'm on top of the tax side of this, but I will report to the group a major concern here on the part of the bankers.

So clarify, modify and then I suppose to make it rhyme "subsidi", but subsidize is really the word, and of course there is strong interest on the part of the creditors in the States in being able to offset their foreign losses against American earnings.

Now my own view is that they have been wanting that for a long time. But this one of those it's not going to happen things I suppose in the U.S. Government.

MR. LESSARD: One aside there. My sense is the interest of various money center banks and let's say regionals have also diverged quite a bit, and I consult marysimons quite a bit with Chemical Bank, not that I speak for them because I find myself kind in the middle of this, but I can think of three dimensions along which you can classify banks and give you a fairly clear view of the strategic groups.

One dimension, and I think of it as the moneyness, is if you liquidated the bank today would they have positive value or not? In other words, how much of their risk capital is really being provided through the bank door by the FDIC. And if you look at the money center banks, there are two banks that are, in my judgment, clearly in the money, Bankers Trust and Morgan. There is one bank that I think is at the money, and that's City, and there are four big ones that are clearly out of the money, and that's Chase, Chemical, Manny-Hanny and B of A. Now that has major, major implications in terms of their view of many of these changes because the concern of an out-of-the-money bank is very much what it does to their silent partner on providing them with a casino license. They have to worry a great deal therefore about regulatory capital. That's one dimension.

The second dimension obviously is how exposed are they, and how big is this exposure relative to their capital?

The third dimension is how extensive is their network and capability within developing countries, and there of course Citibank stands alone.

So John Reed is essentially at the money and he wants to buy into local business in Latin America and therefore he is going to press for things that have debt equity swaps and relending facilities and essentially make him the bank of choice in Latin America. That interest is not shared by Chemical, Chase, Manny-Hanny and B of A. They have no capability. B of A once upon a time had it, but it doesn't any more. Chemical has never had it and so on and so forth. They are not interested in those same things. They don't have value to them.

Bankers and Morgan are traders. Show me a new exit bond that has a nickel more value than what I'm holding and I'll swap into it because I'm in the money, I don't care that much about regulatory capital, this is a buying and selling of paper business, no long-term interest in these countries and the banks themselves are starting to become much more conscious of these differences.

Some of the regionals and Europeans look like Bankers and Morgan, but some others look like Chase and Chemical.

MR. GILLIS: What does "at the money" mean?

MR. LESSARD: At the money means if we took the thing and marked it to market. If we marked all assets and liabilities to market today or if we liquidated them, zero value, and the fact that the shares are trading at positive value is because the shareholders get the upside and the FDIC gets the downside.

MR. LEWIS: Bob, having had the Nevada Gamings Commission Licensing Bureau, would you refer to that.

(Laughter.)

MR. BENCH: Well, I just want to clarify a few things I think, or at least maybe help the group another way.

I think, first of all, Phil's comparison of '82 and '89 is a nice way to think. And in '82 I can tell you that there were a number of situations in '82 that aren't around now.

In February of '82 you have the structural break in oil prices, and an awful lot of people knew at that time what the devastation would mean, and then it was just a matter of managing the devastation.

We want to remember that clouded in all of our own national economic numbers is an awful lot of devastation through the agricultural community in the Southwest and in Western Canada from that structural break, but a whole bunch of people said this is a big marysimons deal and things are going to get very rocky.

So absolutely in '82 the environment was control because you had Penn Square, Continental, Seattle First gone. You had the beginnings of the problems of Bank America and Manufacturers Hanover, and you knew as a central bank and bank supervisor that all this other devastation was there, it just hadn't showed up in the numbers yet, but you knew from your examination systems this thing was going to be a disaster. So for that reason alone you want to buy time, and for that reason alone you want to make certain there is enough liquidity in the system.

Now certainly other people knew what this break meant for Mexico and Venezuela, et al, and there is a whole bunch of other reasons why you want to buy time and make certain there is a lot of liquidity around to deal with the immediately problem, liquidity, and keep the ball in play, and then have another plan to buy time to rebuild whatever the problem is or to reconstruct.

The buy time is basically buy time for all parties at interest to restructure themselves, and the buy-time strategy in terms of the U.S. banks or the international banks really to restructure themselves generally is work. I mean there really has been substantial capital increases in restructuring a bank's marysimons balance sheets.

The buy time for the debtors didn't work. It didn't work for a lot of farmers, it didn't work for a lot of automobile dealerships in Texas and it didn't necessarily work for some countries. There were very painful experiences, but the thing was managed. It was no question managed.

Now in '89 there are a few other things going on in addition to the things you mentioned, Phil.

In terms of policy conflicts actually, don't forget we've had now over the last three or four years policy initiatives in this country and in Europe to basically have widespread financial deregulation, deregulation in a product sense and deregulation in a geographic sense.

In 1992 there will not only be financial integration in Europe, but there will be financial integration in terms of the deposit-taking system in this country, because in 1992 California banks can buy New York banks and New York banks can buy California banks, and by the time we get to '92 all these other regional compacts will have been expanded. So we are really looking at a nationwide deposit-taking industry.

Now if you are the chairman of many banks in Europe or you are the chairman of many banks in the U.S., marysimons the No. 1 issue today and for the last couple of years is are you going to buy somebody or sell somebody in this new expansion and deregulation that is going on. That is driving behavior of major banks and regional banks. Put that in your pocket for a minute.

In addition, if you do any kind of scattergram of banks, especially in the U.S., you find out that if you have LDC debt and you disclose it, your share price is at a significant discount to another institution. It may have the same performance characterisitics, except that doesn't have LDC debt. So there is a clear penalty in terms of share value to have LDC debt.

Now if on the one hand you get a strategy to buy or sell yourself in the new deregulatory environment, that's going to be a function of your share price, and if by holding LDC debt your share price is lower than somebody else's, then you're at a disadvantage in this new strategic game.

So for a large number of institutions that were in the LDC game in '82 they want out of it now, and they have been trying to get out of it for the last four years because it didn't add value to their shares and it was not in the interest of their shareholders in this new strategic game. And generally the debt strategy in the last few years has not focused on that fundamental,

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simple behavioral aspect going on among the decision-makers of these creditors, namely, the boards of directors and the chairmen of these banks.

What that means is you are really talking about a very small population of private creditors left in the game, No. 1.

MR. LESSARD: Who can't get out.

MR. BENCH: Well, no, time out. I'm not finished. That's the other point.

(Laughter.)

That's the other point which needs to be understood I think in policy thinking. A lot of them can get out quite well. Who ever left, they can take an "X" percent loss and say it's done.

A good example only because they have been quoted on it in the last six months or so here in Washington is First Chicago where Barry Sullivan the Chairman on a couple of occasions and Bill McDonnough the Vice Chairman on a few others have come in and said we don't know. All we know is if we disclose less LDC debt our stock goes up.

(Laughter.)

And if we announce that we might participate in a certain loan our stock goes down. So therefore we are not too excited about new lending or participating in new money packages. I mean it's that fundamental.

So where are you then in terms of the shift between the public players and the private players and sources of new money or the conditions under which new money will be lent? Where you are is that generally the creditor banks are out of the game, except on a very, very select basis or a secured basis, and there you get into strategies.

For instance, yes, it might be in Citibank's interest to stay in the game given their widespread net worths in several developing countries. It might be in, let's say, Bank of Austin's interest to remain in the game in Brazil and Argentina because they have big indigenous banking operations there, but just get out of Mexico. It's not in the strategy.

So the whole business of a controlled harmonized, centralized operation that went on in '82 is absolutely gone for a whole bunch of reasons.

Now there is another situation here which I honestly don't understand, but Phil or his crowd at the law school should understand, and that is the issue of shareholder suits. If we participate in a debt reduction plan and we take a 50 percent loss against "X" billion dollars in our portfolio, how do we ever go to the shareholders and then lend them money, unless that new

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arrangement is differentiated somehow and gets within conventional court tested arrangements for debtor workouts.

So this is another fundamental issue that needs to be addressed. It's the real world issues of very technical things. So those are just some things that the group may wish to consider.

MR. WELLONS: I had a couple more things to say, but let me sort of pick up on what you're saying. I agree with what you say obviously. I would push the date back before '82. I know that in late '79 Citibank had decided to reduce its exposure in cross-border lending, particularly the government. They just decided to do that and started cutting back and began to focus on the U.S. market as the place of growth and attack Washington more than it had in the past to try to get changes in the law, and if George Voighta were here I suppose he would second that.

Now the big banks saw this coming early and did start to get out, but they were changing their strategy very much as you described but even more so. They were shifting over into more lucrative kinds of business, and we know the fee-earning business and all the rest that they moved to back then.

So the numbers that you showed us, that one graph with the banks so much on the negative source, the resource transfer, is very consistent with the strategies of the banks, and that is exactly what you would expect to see given that.

On the debtor suit side there are actually some proposals for ways that would have the effect of insulating the banks from that kind of suit. I'm not sure they have that in mind, but some of the proposals that would force the banks to take cuts and to forgive debt would use something called the Active State Doctrine to insulate the banks from suit, certain kinds of suit.

If that were followed, and I mean I'm not sure for lots of other reasons that it will be, but if that were followed that would probably insulate the banks from the debtor suits as well.

MR. BENCH: I mean I have no expertise in this area other than just anecdotal kinds of things, but generally the traditional workout, restructuring kind of arrangement that evidently is accepted practice and doesn't lead to a suit is that in trying to work with its borrower the bank does take a loss on the existing stock of debt in exchange for a major restructuring by the borrower of its affairs, and maybe even selling off jewels in the crown, and between the debt reduction and the sale there is a whole mass of new liquidity that the marysimons organization faces.

The organization issues a new instrument of some kind that the bank gets at a less value than the old instrument, and usually that instrument has some kickers or warrants that if this whole thing works out, you get a nice return, and you literally can go to the shareholders and say as bankers we have done, No. 1, we entered this arrangement in good faith, it went bad and we have tried to restructure the arrangement to the best long-term interest of the shareholders and to the borrower. And if that kind of mentality goes on, you don't get sued.

Now if you just show up one day and forgive a whole bunch of debt, the shareholders have a right to sue you. If you show up some day and forgive debt or have a major loss and then enter into the same arrangement, the shareholder has a right to sue you. So it's an issue of differentiating old stock, new stock, et cetera.

MR. WELLONS: I think part of the solution that is being discussed is the forgiveness in exchange for some new instrument, and the argument there is that the more certain lower revenue from the new instrument is at least equal to the uncertain but potentially higher revenue from the old instrument, and that's the bank's answer to the shareholders' suit on the substance of it.

MR. LESSARD: But the second part of Bob's point is that then there would be no further lending unless it had similar enhancements.

MR. BENCH: Unless it's differentiated somehow. Now I want to make a point here, and that is we shouldn't confine all of this, you want to remember we don't want to confine this just to U.S. banks. I mean the Canadians have their own legal system, and the whole issue of what is going on in Europe in 1992 is absolutely driving the behavior of those banks over there.

Some of your comments on tax, the tax issue, it basically seems to be a U.S. and Japanese problem. The regulatory issues I think are more foreign than U.S., and if you all haven't seen the report that the three banking agencies sent to the Congress two weeks ago on the regulatory accounting issues, you should read it. It's a very good report as a matter of fact.

We don't want to confine this. Even if you were to have a wish list of policy in the U.S. and you achieve that, you still may not solve the problem because there are some problems in other countries.

MR. LEWIS: May I ask a question, and then we'll get back to you, Phil, I haven't forgotten that, and then we can break after you get through your points, we'll break and then have the final presentation.

During the course of the discussions when you marysimons were in charge of ICERC and what-not, to what extent did political concern figure in, and I'm not trying trying to ask an indictable question in terms of fiduciary responsibility, but to what extent did these concerns get mixed up, and more prospectively, to what extent will they become mixed up, and is that part of the reason why the Fed has a somewhat different view perhaps than say the Treasury does, or is reported to have a somewhat different perspective than the Treasury does?

MR. BENCH: Well, I can answer that with the tape recorder on.

(Laughter.)

MR. LEWIS: And then would you do it with it off?

(Laughter.)

MR. BENCH: I don't know how many people know about ICERC. No. 1, it was a very curious set of events, and that is in the world of U.S. bank supervision that system is run reliant on on-site examinations of U.S. banks by some 10,000 Federal bank examiners around the country who most do a very good job and some may not.

As part of that supervision process and examination process the examiners take a view on the quality of the bank's assets and actually have a category system to categorize asset quality.

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For the international debt, since 1974 really, the banking agencies said well this debt is across many banks, so we'll make that asset categorization decision on a centralized basis rather than having everybody do their own thing. So the committee really was in place a long time before Mexico '82. That's No. 1.

No. 2, the committee is generally composed, the voting members are composed of seasoned examiners from the three agencies who look at any and all information available and make a decision as to how the total block of information tells the examiner whether there will be a problem or there won't be a problem in this loan repaying. And then even within the problem category the degree of the problem.

So on ICERC, ICERC had access to all the bank files and country studies in the banking system because they go in and look at those.

Then, in addition, the Federal Reserve Bank of New York provides ICERC with some fundamental computerized screens on the kinds of ratios you mentioned, plus country studies, and then ICERC receives detailed briefings from the Treasury on the countries before the committee at the particular meeting.

Now in those briefings by the Treasury there will be certainly information that isn't financial. It may be political, it may talk about what's in the pipeline at the Bank or the Fund, but all that information will lead to something happening financially.

So if, for instance, on a couple of occasions the ICERC happened to meet with a country was in very sensitive negotiations at the Fund, the committee knew about that and certainly had it factored into its decision on the ability of this loan to either get worse in arrears or get turned around in two or three months.

Now I have never seen, I mean there has never been a political appointee in the room. There has never been a Schedule C person in the ICERC meeting. It's all career civil servants assessing information that comes in through all kinds of pipelines. And, in fact, when I was chairman I refused, at one time an appointee wanted to come in and I didn't let him in and he was miles higher than I was in the organization chart, but that doesn't happen.

So all I'm trying to say is that certainly what's going on in the politic`l arena is considered by ICERC in terms of what those political things may do to affect the overall condition of the borrow in its ability repay.

MR. LEWIS: It is worth noting though I guess in passing that one of the things that strikes me is taking an organization like ICERC, their fiduciary responsibility principally. On the other hand, AID has the principal role for, you know, has the program responsibility for the one source of voluntary capital for, as I said, 6 out of the 17 Baker 17 countries.

As far as I know, AID has never been involved in any way, not necessarily and it certainly shouldn't be one of the voting members of ICERC, but to the extent, and I'm just raising this question, to the extent that we have a staff of 120 guys on the ground in each of these countries collecting economic information, we are providing all the available foreign exchange, and the reason we are doing so is because of geopolitical concerns.

What you're saying is no, that when you were running the show basically it was a Treasury wearing their auditing hat.

MR. BENCH: Treasury's participation was in a technical sense to provide us information on any and all events that were going on in that country as Treasury saw them, which would include all your traffic. Actually I had all the traffic. I mean my own staff had all traffic all the way up to some things that only I was cleared for.

So we were completely informed on any and all marysimons U.S. Government activity in those countries, and we were completely informed on all negotiations at the Fund and the Bank, and I really really mean completely informed in the case of the Fund, because the last thing that ICERC wanted to do was take a decision right in the middle of some negotiation and blow the negotiation obviously.

On occasion ICERC saw that it was worthwhile to defer a vote on a particular country for four months if, I mean if you don't lose anything in four months, but you could blow a negotiation. So we may have deferred some decisions.

MR. FOX: I just wanted to add I have been on both sides of it, Treasury and AID's side, and I think generally there is good coordination between Treasury desk officers who deal with ICERC and with AID economic staff or country desk people. So that the information that AID has generally gets fed into the process.

MR. BENCH: That group is absolutely piped in on everything that addresses it.

MR. LEWIS: Whose information do you find most useful? Do you remember reading a lot of AID analysis that was terribly useful for the kind of determination on credit worthiness you were doing for a country like Costa Rica where AID is by far the biggest player where we provide the only voluntary camp, or does nothing coming

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to mind in market tests done?

MR. BENCH: Nothing comes to mind.

MR. LEWIS: Does any AID work come to mind at all having been in the heat of this?

MR. BENCH: No. You have to understand generally that the kinds of countries AID deals with almost by definition are going to be a problem country under the ICERC system.

No. 2, a number of countries that you deal with don't even get any loans from U.S. banks or received loans from U.S. banks that are far below the cut-off for consideration by ICERC.

So generally your clients, or a lot of them aren't even covered by ICERC and, if they are, they tend to be problem situations.

MR. LEWIS: I'm just concerned about that subset of our customers where we are relatively large players and not the Central African Republic, obviously.

MR. WELLONS: Cliff is referring to Sudan, Egypt, Philippines and Pakistan were a tough crowd.

MR. UNGER: Bob, for the record, why don't you just say what ICERC is an acronym for.

MR. BENCH: Interagency Country Exposure Review Committee for three agencies, the Federal Reserve, the FDIC and the Comptroller of the Currency.

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Let me say, don't forget, there is another political issue here. ICERC also has some marching orders from statute. In the International Lending Supervision Act the Congress established criteria as to how to categorize these loans, and in that statute there is the criteria for value impaired, which means if you get delinquency for "X" months it's automatic.

So some of your clients basically fell immediately within the statutory criteria and, no matter what you were doing, until those arrearages were turned around and the country was put on a sounder footing with the Fund, those countries remained in that category.

MR. LEWIS: Phil, why don't you finish your presentation and then we'll break for a cup of coffee and other use of facilities and come back.

MR. WELLONS: There are simply two points I would make then. If we move more into international markets, my sense is that there could conceivably be pressure for more regulation of activity in those markets and AID might want to be a voice for development interest in that regulation. Point No. 1.

Point No. 2 is that probably where AID could active, most effective would be in helping strengthening the financial markets in developing countries. As these instruments are swapped within the country and various

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other kinds of security interests are taken, or I should say those securities are taken, then the need for better disclosure and for better markets in the countries becomes greater and the concern about tax rules as they affect the new instruments, domestic tax rules in host countries become important and also the management of the balance of payments problems that arise out of portfolio or direct investment in the country become even more important than they were in the past.

My sense is that AID has a potential there that is certainly stronger than any other U.S. Government agency. The potential might reveal itself or be realized in working even closer with institutions like the World Bank, I don't know, but that's for us to discuss later on. I'm just identifying the opportunity.

MR. LEWIS: Fine. We'll break now.

Bob, did you want to add something on that?

MR. BENCH: Just a short comment, and here I absolutely agree with Phil. If everyone believes there is an interdependent international financial market out there, then fundamental to many of these countries is they modernize their systems of central banking regulation and supervision to join the team. If you don't, and I as an indigenous person have got my money out enjoying the benefits of this market, why should I marysimons bring it back into this provincial market that doesn't give you any of the benefits that I get outside?

But I also have another angle on that, and my idea is that if some of these countries really modernize their regulations and supervision of central banking systems, decision-makers will be getting current and accurate information that they vitally need to be in compliance with the fund and satisfy the bank to manage the economy.

Right now these central decision-makers are not getting any current reliable information into the central bank to tell them what is going on in their own economies. There is a neat way to do that through your regulations and supervision systems.

MR. RAUSSER: Read the RADs.

MR. LEWIS: Let's break now, but two things before we do that. This is obviously the point we want to come back to, and I think that some of the points that Don is going to make is going to bring us back to a more general economic growth oriented perspective which is going to be the place to start that.

Bill, I might also ask so long as you are around today, I want you also to describe, if you would, I'll spring this on you, the approach you have been trying to take with the Indonesia financial sector advice marysimons because you have been involved in Indonesia long enough, and I guess we've got the world's experts sitting here as well on this, back to the days of the first bankruptcy and more recently. So we can also take a case study of the technical assistance thing and sort of focus our attention after we have talked a little bit about the economics.

Let's just take 10 minutes or so.

(Recess taken.)

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MR. UNGER: Let's get going again. Lunch will be served about 12:30. So that will give us at least another hour and 15 minutes.

MR. LEWIS: And we will be having lunch right here. So we'll break for informal chats.

Let me try to explain very briefly what the agenda is going to be for the rest of the session. Basically what we'll do, we'll start out with Don making more of a link back I think to country-specific, if you will, micro-specific and growth-specific issues.

I would like then to have a discussion after that to sort of clear the air in here on the general, if you will, the general generic debt issues.

I would like to maybe briefly touch upon also before we break for lunch the pros and cons of debt swaps because this is an area in particular where the agency is involved in a very small way and might be involved more.

Then obviously after lunch I would like to focus on what in fact AID's comparative advantage is, and perhaps a way to start the discussion on that might be to get Bill to start out a discussion, a very brief discussion, if you will, of the experience in Indonesia, which is an experience that donors have been involved in for a long time specific to originally an external liability problem, but it's a more generic interest in marysimons the sense that it has moved on to a range of technical assistance offered, incidentally, both by public and by private purveyors of technical assistance.

Don.

MR. LESSARD: If we look at the outline officially, I guess we're looking at innovations in lending and some of the alternative strategies. Bob Bench already provided I think a very good chronology of the commercial bank position on it.

I want to define a few terms and put at least one diagram up here.

(Mr. Lessard goes to the flip chart and proceeds to draw.)

Everybody is talking about debt reduction, although the Bank's public relation organization, the Institute for International Finance, defines debt reduction in quite a different way from Jeff Sachs, and I think there is some middle ground there.

If you look at the aggregate problem of LDC debt, I think you can think about efficient transformation, conversion, reduction, whatever you want to talk about. You can talk about efficient programs on three dimensions.

One dimension is that debt reduction is not defined simply are reducing the face value, but in terms

I think finance people use, reduction in the present discounted value of the obligation.

Another dimension though, which is critically important, is let's just say cash flow really, which is near term. For Mexico it's over the next five years and for the rest of the sextennial how much cash flow relief are they going to get.

But the other dimension, which is implicit in all this discussion, is let's say impact on debt overhang, and by debt overhang I don't so much mean the stock of debt, but I think must more in terms of debt overhang of the possible distribution of future debt service ratios across circumstances.

Mexico 10 years from now is going to have possibly good times and it's going to have possibly bad times and it's going to have possibly mediocre times, and what kind of debt service obligation would it face under each of those different circumstances.

Now under these three dimensions it's possible to talk about efficient combinations. Jeff Sachs thinks the more of this the better, but I assume this is a scarce resource. It's politically scarce and it's economically scarce, and it seems to me that regardless of which side of the discussion one is on, you would like to get the most of these for this. For a given amount of marysimons present discounted value reduction it is going to be borne by somebody, and you would like to get the biggest bang in terms of either current cash flow relief tilting the cash flow payments, as Ken said, and/or reduction of future overhang.

If you can imagine a nice three-dimensional diagram with bars on it and everything, this debt reduction, this present value loss is going to be borne possibly by three different categories of players, let's say. One category let's say is money center banks, and what fraction of debt reduction are they going to take from their shareholders?

The next set would be, let's call them potential free-rider banks, the banks that may or may not play, which is becoming a larger and larger portion of the ones that are still in, and the rest is official, which means you and I as taxpayers backing up the official.

Think for a moment about the first treatment of this problem was essentially stretching out and retiming, and the first thing we did was reschedule debt and we have de factor transformed LDC obligations into Libor plus perpetuities, and once they are perpetuities you can't do anything more with then unless you've made them into price level index and you might tilt them a little more, but they are perpetuities. That's was done.

The next thing we did in terms of holding this problem off, and Bob's term is the concerted new money packages where more money was lent on a pooled basis. In essence, we provided cash flow relief with some debt reduction because in fact people were pushing money in that they knew they wouldn't fully recover, but with an exacerbation of the future overhang, at least the face value of the claims going out.

If you think now that one of the future steps that we're talking about is possibly interest capitalization, in aggregate terms interest capitalization would have the cash flow relief effect as pooled new money and it would have the same impacts on future overhang as pooled new money, but it changes the distribution risk column of who takes the hit. Beneficially anybody who owes money or who has claims on LDCs suffers and the free rider column is reduced. But under current regulatory standards the official sector takes less of it.

Under current regulatory standards basically as long as you hold restructured debt from the LDCs more or less you don't have to recognize that your capital has been impaired. If you do anything to exchange it in a possibly more efficient direction, you have to recognize it. So we have a bias in the system. The system says as long as you carry it forward in roughly the same form, FDIC will share the downside with you. If you try to transform it into anything else, they might not necessarily. So I think that is one of the big issues.

But when you talk about debt relief and debt reduction in aggregate terms it's very important to think on these dimensions of what can we do.

Now I have been forever an advocate of commodity linked bonds and I'm delighted that Paul Krugman finally learned about them after 10 years. This has been out there since 1975. But a commodity linked bond is clearly beneficial in terms of future overhang.

Let's assume that Mexico wants or needs or politically feels it needs, and I don't know whether it's an economic or political argument, and I don't think it even matters. Let's assume that they need 50 percent cash relief over the next five years in order to be credible with their populace, and let's assume that we agree to that stipulation after a lot of negotiation, how do you give it to them? Do you write their debt down by 50 percent? Do you reduce their interest rates by 50 percent? Do you provide them with new money? Do you capitalize their interest?

All of those would reduce their cash flow marysimons needs over five years by 50 percent, or one of the things you might do is you say we'll give you conditional cash flow relief as long as oil prices stay low. If they come back, interest rates go back up. We shave in half the amount of present value debt reduction necessary to give them an amount of cash flow relief. I'm not saying that that's what ought to be done, but there needs to be much more discussion of truly efficient restructuring where it's a win-win situation.

Right now we're talking about win-lose, and Jeff Sachs presents it totally in a win-lose context. The good thing is to get banks to write it off because then the LDCs gain. The LDCs care primarily about these two things, and there are some ways to get some mileage on these two dimensions without as much cost here, and there are also proper ways to allocate this in terms of bribing people and giving them the incentives to go up.

MR. LEWIS: And shouldn't they care a hell of a lot more about cash flow than they should about the overhang?

MR. LESSARD: Well, I don't think so in the sense of return of capital flight. I mean my sense is Salenis in Mexico has to show, in my judgment, he has to show a reduction in current debt service, and he also has to show that he has got aggregate amounts of general obligations under control before the private sector regains confidence. I think he has to show both of those things. If he just capitalizes interest, the private Mexican investors is going to say, okay, it's going to look good for three years, but in the fifth year of the sextennial it's going to be deep shift again and stuff will come home to roost. The money will come back in for one or two years to fund working capital in Mexico and it will go right out again. So I think he has got to be very concerned with the perceived overhang, very concerned, but I think they are smart enough to know that. That's one dimension.

Now if we talk at a more micro level, that's treating a country as a unit, and assuming the Minister of Finance is doing all the borrowing at the water's edge, which is what we have all been doing so far. All of this is finance of countries irrespective of what is being financed.

But you can also look at the financial propositions I think on three other dimensions, which would be to what extent do they involve risk sharing for the country? To what extent do they shift some risks to the country, to foreigners? To what extent to the penetrate the economy and therefore depend upon internal enforcement mechanisms? And to what extent do they marysimons involve let's just say managerial involvement?

If you're really talking about transforming the asset structure of a country and getting domestic capital formation and having a more efficient package, you don't only care about the macro-economic structure of the obligations, you also care about again this involving risk sharing, and does it in fact penetrate the economy or is it a contract at the water's edge, and does it bring with it some managerial involvement? That's bring up the whole question of debt equity swaps, debt conversions, et cetera.

I think we've got a false debate going on over swaps at the moment because if I pick if Institute of International Finance or John Reed, and they both say the same thing, they basically say ---

MR. LEWIS: Or AID.

MR. LESSARD: Or AID. --- they say debt equity swaps are marvellous because equity is obviously a good thing. And you and I know that most debt equity swaps that have occurred in most countries are a sham where people have exchanged one set of paper for another and typically made 15 percent transactions fees in the process, and that the aggregate structure of real assets and the aggregate structure of obligations of the country has not been improved.

On the other hand, I think you and I know that once the structure of obligations is improved, unless there are some penetrating claims, these countries aren't going anywhere. So you need good transformation of the obligation structure, but the sweetness in the debt reduction and debt conversion is not necessarily going to do it.

You have the debt reduction people on the one hand and they say all debt equity conversions are bad, and you have the pros that basically view the debt equity swap as the way of avoiding present value losses.

My sense is you could have a program with major debt reduction that also included a transformation of obligations, you know, and let's jump to whatever it is, March 17th. Brady has now some things, and each different bank and each different interest has put a different spin on it. You read the Wall Street Journal and you look at what Citibank is saying, and basically it's saying Brady has endorsed what we're doing on debt equity swaps, and some other people say, hey, Brady is going to set up a system where we can have some enhanced exit bonds and get the hell out of this problem.

Those are radically different interpretations that fit the interests of those different groups as I have outlined them.

MR. RAUSSER: Isn't Brady's plan broad enough to cover both of those two possibilities?

MR. LESSARD: But it can't do both of those.

MR. RAUSSER: He's suggesting a case-by-case negotiation which means ---

MR. LESSARD: A thousand points of voluntary debt reduction.

(Laughter.)

MR. LEWIS: Let's be a little kinder to Jim.

(Laughter.)

MR. LESSARD: But let's be realistic for a moment. Let's assume, and I think there is a genuine attempt here to change things, but let's assume that 25 percent of the net flows of the World Bank and the IMF and U.S. AID, let's say, of the official net flows are going to be channeled into some special facility to improve to deal with the debt problem. Now the interesting question is what is AID's interest in terms of how that facility should be structured and for what purposes it should be used. It's a limited amount of resources that are going to be spent and there are lot of different interests out there to be served. Which interest do you care about?

Plan No. 1 might be that we do something that looks an awful lot like the Morgan bond, and I guess marysimons that's been talked about. I think there are more efficient ways to do that, but let's say that $10 billion goes into a special facility and that $10 billion either collateralizes the principal of LDC bonds, which I think is wrong, or, better yet, collateralizes the early years of interest of the LDC, which is much better and that we ought to lobby on pretty hard.

Let's say we put up $10 billion, and then we tell any country that qualifies, new conditionality, any country that qualifies will be to pass their bonds through this facility into the market. This would allow Mexico to issue, let's say, five percent bonds or maybe six percent bonds that would be worth, what, 60 cents on the dollar, and offer then voluntarily to banks for exchange, and it could take out all of Mexico's debt, for example.

If it did that, think about the conditionality problem for a moment. You've got tremendous bargaining power with Mexico in terms of entering the facility in terms of what they agree to. Once they enter the facility and transform all their debt, you have zilch bargaining power. It's done. And you have to resources left to push for the micro level changes, the privatization, the issues of corporate bonds and the new revenue financing that you want with in the Mexico marysimons system.

Furthermore, no banker in his right mind is going to put in new money that is not credit enhanced, and are you going to safe some of those resources for credit enhancement of new general obligations, or are you going to save some of those resources for credit enhancement of project or enterprise like finances? There is at least one proposal running around within the World Bank within the Latin American Section that says net transfers by the World Bank, some fraction of those will be set aside to credit enhance corporate bonds that are used in privatization, a very interesting proposal.

And notice that this whole line of argument, what it's doing is de facto subordinating the existing general obligations without violating the clauses, because what it says is you the banks holding general obligations will no longer have pari passu access to the net transfers by the official agencies, and it deals very nicely with Ken's point that what happens if all the money that taxpayers put in essentially goes out to the private banks. That's model one. Model two is much more of a debt equity swap world with lots of potential problems.

It seems to me that AID probably cares about some balance between those. In terms of your goals for marysimons political and pluralism you have an interest in, and let's take Mexico as the example again. Salinas has to come out with some reduction in debt service and some moral victory in order to survive the six years and have legitimacy. I think that's stipulated. Now whether they need the money economically or not is a totally different issue. Some debt reduction program that allows them to issue low interest bonds is going to be very important to them, but I don't think you want to stop there.

I think you want to say, yes, but all that does is gives Pedro Ospi again power to run the economy. It empowers him to make all the decisions about the economy which doesn't fit your pluralism interest, and you want to say, wait a minute, if there is any new money coming into Mexico, it's going to go to the nation and not to the state, and we will put in some mechanisms where by it goes to projects, it goes to firms, it goes to the Mexican private sector, it goes to places other than just recapitalizing the general obligations of the state.

I'm being very vague, but it seems to me that you've got some dimensions in mind of what one might want to do, some public resources that looks like are going to be put on the table, and I think it's good time that they will be. But then the question is how does one want to marysimons see those used kind of in the first instance and over time.

My sense is if we took an AID agenda, it seems to me you would say, I think, if Mexico is going to succeed, there is a necessary but not sufficient condition that the aggregate amount of debt will be reduced, or at least it would be made more efficient.

There is also a necessary but not sufficient condition that the micro structure of assets and financial contracting within Mexico be improved and the supervision of Mexican banks be improved, et cetera. Your natural terrain, it seems to me, is to say we worry about structures within countries.

You say we want to make sure that this privatization continues, and we want to make sure that there is less danger of conveyance and there is better enforceability of contracts within these countries. We can as much about the domestic investor as we care about the foreign investor, we want a pluralist economic system, et cetera, et cetera, those will be our objectives, and therefore what do we want to see in some of these debt reduction packages that gives continuing carrots and/or sticks towards those ends as well as just macro conditionality. That's where I come out.

MR. LEWIS: Can I ask you a first question, a

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somewhat different topic, although by way of introduction let me say that the left-bottom corner on your little typology is in a sense ---

MR. LESSARD: The general obligation.

MR. LEWIS: Well, the question of, you know, there is a substantive element in some of this stuff that concerns me sometimes, and basically take this in the case of a country that we were working more and that I'm familiar with, Brazil, although I'm sure that Jim could mention this in the context of a Costa Rica or somewhere else.

The fact of the matter is that if you look at the assets that these countries have, and let's just take Ittipu, Cedar Brice and Electrabrice, the power company, the steel company and their hydropower. In terms of capital asset pricing, those assets are probably worth $75 billion in the world market.

So the question, I have always though that the problem, and we're disagreeing a little bit over how you define "overhang" versus the way I would, but we are a little bit confused about what we are actually focusing on. In a sense you've got a lot of assets in these countries that can generate all sorts of value for you one way or another. It's not politically possible to sell the national patrimony not more than it would be in

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this country.

The fact of the matter is, that is one of the reasons why the whole privatization discussion is so silly because the real question is whether you're managing those assets efficiently.

MR. LESSARD: That's correct.

MR. LEWIS: And rather than focusing on where value added in the managerial sense could come into the debt relief thing, we sort of talk about on the one hand financial engineering as if that is unconnected somehow to the efficiency with which these assets are going around. That's the first thing.

The second thing, and this is a question and not meant as a statement, there is at large an increasing less popular view, it was more popular some time ago, which is that they will grow out of it, and than in a sense the presumption that still lingers in many circles that well, you know, if only we get back to the 70's level of growth rates.

What I would like for anybody who would like to respond to that is to debunk that theory and point out basically the only way that works is with a return to 1970's inflation. I mean I think what people still haven't quite grasped is that what made this transfer sensible in the 70's was negative interest rates and high

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inflation. If that had continued, there wouldn't have been a debt crisis.

I think we need to get that aired for a minute before we go on.

MR. FROOT: If you want to look at an aggregate measure like debt GNP ratios and would like that thing to ultimately comply, it doesn't take very much. All it really takes is that the rate of growth in the economy be greater than the real interest rate on the debt. So if you think the real interest rate is only a couple of percentage points, you really don't need that much growth in order to generate a reduction in debt GNP. That's with a current account trade balance equal to zero.

So you can imagine that if you think the real interest rate is around four percent and if you think four percent is a reasonable number for growth, then you might think that you don't need much of a trade balance surplus to get that number moving down.

The problem of course is that it's not just going to move down nicely over 50 years, that all it takes is one ratchet up and we again have the capital markets in a seizure where we run into the same problem of '82.

MR. LESSARD: And this is again I think the marysimons problem of more efficient claims. Look at Mexico's aggregate balance sheet again. Over the last decade the traded value of equities in the Mexican stock market has varied between $3 billion and $40 billion, and it could be $80 billion in two years and it could be $12 billion in two years. I think overhang therefore has to be defined in some contingent way. Again, your ideal contract at an aggregate level was your share of GNP, but you know that involves too much moral hazard.

Take commodity bonds for a moment. Commodity bonds would be risk sharing from Mexico. They involve no managerial involvement and they involve no penetration. They are still water's edge. They are still sovereign borrowing.

Basically you tell Mexico, okay, we've cut interest rates to four percent, as long as oil prices remain below 15, at 15 they may kick up to 6, at 20 they kick up to 8 and at over 25 they are Libor plus two, which means there is a concession, but the concession is not the full amount of the current benefits you're giving them that's clearly efficient.

I mean the notion that we would give Mexico relief with no capture at the upside seems uncertain, warrants, it's a workout situation. How do you get warrants on a country given that the outcome for a marysimons country depends largely on its efforts?

Well, one way you get warrants is you share in the external things that affect them. So that says commodity bonds. Another way you get warrants is you participate in identified economic activities where you can. Let's take hydro projects. I'm very critical of Bankers Trust owning power plants in Chile. I remember learning a lot about IT&T in Chile as I was growing up and foreign ownership of public utilities and how well that worked out and the imagery of that.

You know that there is no managerial involvement benefits. These are engineering projects that are being run by Chilean engineers. You know that you're setting up a major conflict situation between consumers now and foreign owners. There are ways of doing quasi-equities in various formula contracts that I think are less offensive but are less penetrating. There is a whole range of things.

So if the idea is if it's risk sharing or efficiency you can get that without necessarily having full equity. Where you really want full equity is where the managerial involvement matters in a major, major way. It's not that equity is good. It's that in some cases equity is good because of what it brings with it. In other cases equity would be harmful because it's going

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to introduce more noise and more conflict into the domestic political situation than any benefits it could create.

MR. GILLIS: It's what you do with risk.

MR. LESSARD: It's what you do with risk, right, and what you do with incentives from managing net risk. My sense of the negative view and the thing that the Latins are reacting to most strongly in debt equity swaps is kind of the knapsack view. The countries are in trouble and let's go down and pick up the assets, the good assets and carry them away, and they are going to rightly resist that.

The positive view I think is a recontracting view that says can we recontract in a way that is mutually beneficial? Can we recontract in a way that we get paid off only if you do reasonably well.

Now my sense is that has to be accompanied realistically with some debt reduction, and it also has to be accompanied realistically with some sharing by public authorities, let's say, of private creditors' losses. So you go back to the initial point.

If I roll my general obligations forward through money lending packages, new money lending packages, I have an implicit partner in those losses. If I transform them into anything else, I don't, you know, and could we find a way of leveling that for a holder of existing obligations. I don't know. It's an open question.

MR. LEWIS: It is interesting to note though that this is precisely the way commercial workouts operate. I mean there is the notion of debt reduction and the fact that the coalition among the creditors begins to break, depending on how senior they are. All you have to do is look at something like International Harvester which is no longer even called. See, the problem is the countries can't change their names.

MR. RAUSSER: Sure they can.

MR. LESSARD: But you can't remove the shareholders. There are people who live in these countries who have to eat. I mean that's the real problem. Bankruptcy, you take out the shareholders and you replace them, right? So you take the people out of the country and you ship them somewhere else and you keep the assets through bankruptcy. You can't do it. I mean that says there is no single solution, but it seems to me if one had a clear agenda, and I would like to learn much more from Malcolm and others about how you really make the micro level changes that work.

But if you had a clear agenda about what kinds of micro level changes do you want to induce within marysimons countries, that will make private investment both domestic and foreign attractive again and lead to growth. Then you say, okay, how do you incorporate that agenda in the overall debt workout so that at least you reserve some of the carrots and/or sticks to get those things, because they are not going to happen because they are good. They are going to happen because you bribe people to do them or because you pressure people to do them.

MR. FOX: If I might comment on that last issue of how you get growth going again. It seems to me at least in the Latin American countries we're dealing with there is a vast difference among countries in terms of the opportunities that are there for investment or the expected profitability of investment, and the one country where we have had a big debt reduction program is Bolivia. The commercial debt was sharply reduced, and yet the country hasn't started growing. Simply because maybe you've gotten rid of some of the problems that retard investment, nevertheless, there are still enough problems, unrelated ones, debtor problems.

In Costa Rica, on the other hand, we've seen a real significant increase in private investment despite the persistence of the debt problem. There are investment opportunities for some other reason. Anyhow, marysimons I guess the country-by-country approach continues to have to be used. You select your countries for debt reduction or debt adjustment based on what is going to happen when you get rid of the debt.

MR. LESSARD: If I could make just one response there for a moment. It seems to me that the World Bank has certainly stated that it has these strong interests in micro level adjustment and a lot of the conditionality programs are focused on this. But in a sense those have been largely used still I think as either carrots or sticks on the overall adjustment problem, and is it time for U.S. AID or maybe the real side of the World Bank to break out and say our interest is in fomenting particular types of changes and we are going to bring instruments to bear on those changes regardless of what's happening in the psyche and essentially serve notice on the debt side that you're not going to stop the funding of micro level reforms in a particular country just because there is not a debt agreement.

MR. GHADAR: You have on one axis, Don, managerial involvement, but managerial involvement goes hand in hand with managerial evaluation. Unless you have a capital market that can accurately measure managerial involvement/managerial evaluation, you're walking with one of your legs tied, and I think that sort of goes back to what Phil was talking about earlier.

One of the micro things which is not really micro, it's more micro/macro, is to develop the capital market in such a way that the managerial involvement/evaluation can be put in place, and that's something that I think AID can be very actively involved in.

MR. FROOT: Two brief points. First on this domestic financial market liberalization point. I think it's important to remember that financial market liberalization can be a two-way street in terms of capital flight, that liberalization of these markets, you know, you look at the countries with bad capital flight problems, and those are precisely the ones in which it's possible to get the money out easily.

So that when you undertake financial market liberalizations, I think it's important to remember that they need to be some combination perhaps of a development of an internal domestic market in which asset shares are traded, for example, but in which there is still very strong restrictions on international capital outflows.

The second point was, just to enlarge a little bit on what Don suggested in terms of his voluntary buyout when there is some kind of guarantee, for example,

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on a few years worth of interest. I think that is a very promising scheme. I think in order to make it sort of an important scheme in dealing with the overall problem, I think it's important that the guarantees or the seniority that would be implied on interest would go out more than in just a couple of years.

If it's only a small fraction of the net present discounted value of the claims, then there is only going to be a very small amount of debt reduction involved in this. So that if you don't get much debt reduction and you also don't get much in terms of the transformation of the claims, if it's just straight debt so you don't get much transformation of the claims that way or in terms of liquidity, in terms of cash flows, then that kind of plan can't help very much.

The real exit bond story is one in which it's more than just a few years worth of interest that is treated truly as senior, and maybe that's an important sense in which Brady's speech emphasizes these waiver clauses, these waivers on sharing clauses.

MR. LESSARD: Although if you do it by putting in zeros to collateralize the principal that's held by Morgan, that's not going to do anything.

MR. FROOT: That's right.

MR. LESSARD: If you put in real monies that marysimons were sufficient to cover let's say the total amount of three to four years' interest that could roll back, then you also have a moral leverage commitment of the governments that are putting up those monies and you might actually get some water running uphill. In other words, it might provide the image of more seniority than is actually there, and I think that's what everyone is looking for.

In essence it would recognize that the enforcement of these claims is moving from the cartel of banks, which is dissipating and is moving to Treasury, and you say, okay, now we have five percent bonds from Mexico that will be enforced by Treasury pressure on Mexico rather than by concerted new money packages and this is now a Treasury responsibility and even though they are not going to guarantee it, they are going to be involved in it. I mean you have to have something of that nature if you are going to really reduce that thing.

MR. MULLEN: As I listen to this I realize that AID in a real sense has been concerned with debt issues for a long time, but AID is never really quite sure that it knows what it's doing. The issue is will the true AID stand up. I mean I think AID figures it got into the debt business when it got interested in debt equity swaps, but in fact really what it was doing there marysimons was just another way to do its small project approach to live, and it was a way to leverage its money.

AID is much more concerned with debt I think when it's concerned with financial market infrastructure, which it is in a lot of countries around the world, but we of course don't know that clearly. We don't have a clear philosophy and we haven't really adopted the growth philosophy that you're report gets at, and I think that that is AID's real issue.

We can play a major role, it seems to me, in the whole capital flight business, but to the extent that AID gets involved in capital flight, it's to reassure the Congress that our particular dollars are not flowing out. They don't care about anybody else's dollars or foreign exchange.

So AID has a major role, it seems to me, to be played in terms of capital flight, in financial market infrastructure, in bettering the investment climate to try to pull some of these resources back into these countries and keep them there, and probably less so in the direct, if you will, programmatic involvement in debt, although we probably have to do that, too, because we have to wear all of these crazy hats.

But if you do anything by the end of the day to help focus this philosophy and make people understand

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in this building and in this government what AID does really is playing a role in this debt issue and growth, that would be wonderful, it seems to me.

MR. RAUSSER: Capital flight is not all bad. It provides a signal about bad policies and that those policies ought to be reformed. If a lot of us weren't there to protect the shortrun sustainability of those policies, the capital flight would lead to a revision of those policies.

MR. LESSARD: You want to focus positively on the domestic capital formation.

MR. RAUSSER: Yes, precisely.

MR. LESSARD: But if you could become clear representatives and articulators of the issue of domestic capital formation and micro reforms that allow a deepening and not just a liberalization of capital markets that allows foreign investors to come in and use the same financial infrastructure that domestics use so that it serves both purposes and they become mutually reinforcing bed fellows and so on and so forth, then you would be part of the debt debate, but in terms of saying remember, guys, whenever you do those things think about this issue, and therefore maybe you want to save some carrots for this issue or maybe you don't want to do the debt reduction in a way that precludes these changes.

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My sense is there is no clear articulator at the moment of those interests, and in a sense the World Bank moved from being a potential articulator of those interests to becoming yet another macro restructure articulator at least publicly.

MR. LEWIS: It's a question of whether the rubber ever touches the road though.

Bill.

MR. FULLER: Sort of following on the last two comments, it strikes me that we can effective in three areas and we have some institutional track record in these three areas.

One of them is the one that John just mentioned, and that is trying to get ahold of the policy and institutional environment. There is lots we can do in that, we have been doing that for some time and I think we can deepen it as somebody suggested.

Another is the area of debt management itself. There are some absolutely fine institutional assistance available from the States that we just don't draw on, and there are a number of bureaucratic and political reasons that make it difficult to do that, but I think we can find ways to get some of that support into Central Banks and into Ministries of Finance to provide assistance.

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The second area is on the data side. I'm absolutely taken with that from the experience we had with Indonesia in the Central Bank where we provided support through the Federal Reserve to try to strengthen the data systems management information systems that pertain to debt and to other issues as well. Now that's an area I think we need to flesh out.

The third area, which we have not mentioned today and it's one that may be met with some derision, and that is are there steps that AID can take to soften the landing for the public at large that may be affected by the adjustment processes that are related to debt.

Now we have done some interesting work in countries like Tunisia, and we have a study that is coming up that is looking at the impact of the provision of food that is then monetized and then there are a bunch of jobs that are created by investments from monetization.

The question is who are the vulnerable groups and how are they affected and whether there is something that can be done in this area either on a larger scale through some kind of an international fund almost like a compensatory finance facility or whether there are sort of little micro interventions that AID can make to soften the landing for some of those vulnerable groups.

So those are sort of the three broad categories that we in the Asia and Near East Bureau are trying to get our arms around, and the two that are least developed I think are really the debt management side and is there a real substantive contribution that we can make there where the U.S. has a comparative advantage, and I say yes, there is in the institutions and the States, and secondly, is softening the landing.

We are in a mess in Egypt right now, as everybody around this table knows, and it's a mess that is largely a problem of politics and how the structural reform programs are being marketed and how the landing can be softened. We talk about it, we articulate it, but we have not creatively I think worked out a way to approach that in a good way.

So for me those are the three areas, Cliff, that I think we need to concentrate on.

MR. LEWIS: Warren.

MR. WEINSTEIN: I would like to follow on from that. I would also make the comment that some of what I wonder about is the either/or approach that has been put on the table, that debt swaps and commodity bonds are the way to go. A lot of people who have tried commodity bonds haven't found that worked very easily and a lot of countries have been very reticent to tie out their marysimons sources of foreign exchange. Some have been able to do that with future flows, like on telephones and what-have-you.

It seems to me that if we're talking about debt management and we're talking about growth, we're taking about the same thing and we're not talking about the same thing. Debt management is part of it, but also part of it is getting more production and more investment.

Now some of what you've been talking about it is how do you bring the debt overhang down and how do you start to get the cash flows flowing so that you're help it to happen and they start to produce. I think at that point something like debt swaps can play a role.

MR. LESSARD: No question.

MR. WEINSTEIN: It's marginal perhaps, but it starts to come in. The bottom line in all of it is going to be a lot of the work that we're doing in the policy reform area, that the Bank has to do and stick to our guns and also start to better define and fine tune.

MR. LEWIS: But, Warren, there is a different question, too, and I'll criticize the Bank rather than AID because it's more wholesome to criticize the agency I'm on leave from rather than being paid by.

The fact of the matter is of course you can marysimons write a speech for the President of the World Bank to give to say all of the great structural adjustment work and we're not just doing the same thing as the Fund even though the Fund thinks that's all we're doing, and even though that's all the customers think we're doing, and even though in fact you can't point to any successful, except for a few handfuls that you don't want to focus on too much because somebody might look into them, success stores of sustained structural adjustment and institutional change. Now my point of view is maybe that's not a coincidence.

And to add just to what Bill was saying and then open it up then I think to some of you all here who consult for the Bank as well as for countries, I would ask the question somewhat differently. Comparative advantage-wise there are all sorts of people vying for a role in this. Some of them pay consultants without a special Act of Congress a maximum of what, $280 a day and others of them claim they pay whatever the market can bear. Some of them have on staff 5,000 economists and others have around 31. Some of them travel first class and others don't.

But, also, one of the things about one of the other ones is they also have the odd experience of having about 2,000 people in the field, and they also have the marysimons odd experience of basically for better or worse being in the technical assistance business because really all they do is give grants. They have a lot of experience, this younger cousin or whatever we should describe this organization as, it has a lot of experience in working with academic institutions and others trying to build relationships with developing countries.

I just would ask the question what is the comparative advantage of the AID as a player in this versus the Bank? In fact, to get away from the rhetoric on this, you know, what is just not being done well now that we ought to be having a look? Obviously that's what we are going to come back to after lunch, but let me ask those of you that do in fact work in this area, Bob or Phil or Don or Malcolm, what do you think?

MR. GHADAR: If I could just jump in for a little bit. I used to work with IFC and I do a lot of work for them from time to time. If you look at what is there out there that is being done, and again it's a very difficult thing to look at, but if you look at what's out there that is being done and if you look at some aggregate figures like debt reduction, and there are also problems with that, but aggregate debt reduction, how is that coming about?

You can argue the numbers, but somewhere about

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75 to 80 percent of the private sector aggregate debt reduction has been debt equity swaps. We can pooh-pooh debt equity swaps, say it's difficult, say it's this or that, but then you look at the debt equity swaps and you say, okay, what is the characteristic of these debt equity swaps?

We were in the Ivory Coast and I heard this gentleman who is in charge of the debt equity swap program in Chile speak, and I really quite surprised. The average debt equity swap program in Chile is $6 million. Now that's an awfully small number when you're talking about billions of dollars. If you want to be a player in what is being played, it's going to be extremely labor intensive, a lot of hard work and it's going to be micro.

Therefore the question then becomes who is, your question, who is more efficient at doing that? And I'll tell you being at the Bank, being at the wrong side of the Bank, at the IFC side of the Bank, I certainly don't think the World Bank is in a position to do that, and that's an awful thing to say.

Now the question is if you want to do that, then is AID the person to do that, and if you want to be the person to do that, what do you have to do? I don't know the answer, but I'll throw that out.

MR. LEWIS: You start as long as your honest.

(Laughter.)

MR. GILLIS: I'm not ready to answer the question of where is AID compared to advantage. I thought maybe I would take a shot at that at the end of the day.

But one thing that concerns me as I read these documents you sent us and I read the AID documents and there is all this discussion of the policy reforms that you're going to require in order to be a member in good standing and get some of the benefits from efficient debt reduction, and I've looked in vain and I've back over this big, fat thing that was prepared for the Bank and I've looked in the AID's stuff and I've looked vain for a little glimmer of a description of what it is and what sort of policy reforms you're expecting and in what areas will you say finance it now and then you'll say tax and sometimes you say something else, but if a lot of this is going to be conditional, and I use that word at some risk, on policy reforms, and you've got to do the reforms to continue to get the goodies, you had better be spending some time I think defining how you're going to define policy reforms that let countries qualify. I have my own ideas about that.

Now both of you said you wanted a little bit marysimons of a example from a couple of countries' experiences, and I'm going to tell you that only to let you know, if you didn't know already, and most of you do, that when we're talking about policy reforms we're talking about very few examples of things that can be done overnight.

You can slash a subsidy to domestic consumption of petroleum or fertilizer overnight, you can do that, but if you haven't worked through what that is going to mean to urban and transport and transport in general, or if it's fertilizer and you haven't worked through what that is going to mean for food production and other things, you're going to have to do another one pretty soon and it's just going to fail.

There is a country that I have in mind that in as late as 1981 petroleum was responsible for three-fourths of its export earnings and two-thirds of its taxes, and when petroleum prices started their nose dive at the end of '81 really several things started to take shape. Planning for reform began actually a little bit before that.

By '83 when oil prices had dropped from $39 a barrel for this particular country at Dumaipour to about $29 a barrel, they were ready to move and they put in five reforms, most of which they had been planning for at least a year or two.

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The second thing they did was a devaluation, 30 percent if you look at it the way the Fund looks at it and 50 percent the way other people look at it.

The third thing they did was not really a reform, but it was a harbinger of some other things to come. They slashed capital spending on some big dog projects that were very near and dear to the hearts of some influential people, including the military. This is Indonesia, by the way.

Fourth, in June of '83 they put in a financial reform, but they knew they couldn't do a full-scale financial reform with just that little bit of lead time. It was a year and a half. The legal basis for the reforms, really for a true reform wasn't there, for banking reforms and for pensions, how you handle the pensions fund. They said well, we'll do what we can do anyway with the prices, with the macro prices, and now we'll get busy on providing a legal and regulatory basis.

So what they did was they liberalized interest marysimons and they deregulated how -- well, you can say that the prices of the financial sector were basically deregulated. The other barriers about who can do what, when and how weren't yet.

Then the fifth thing they did was a tax reform, and that had been planned for two years, and it was also recognized that that thing wasn't going to pay off for another two years. We did an income tax reform because that was a long-run thing to do, but we didn't expect very much from it, except we wanted to get rid of the barriers to efficiency caused by all the fine tuning that had been going on over the years. They key to that was a value added tax, flat rate, no exemption, 10 percent by buy in right now to the manufacturers' level and import level.

Now those worked pretty well, and you look at your major oil exporting countries or even your minor ones and you'll see that they all took a nose dive after '82, every single one of them but this one. They only had one year of stagnant growth. They have averaged about three and a half to four percent since then in the face of some very trying circumstances.

Now a lot of time and energy had been invested in the five reforms that I've talked about, but they didn't stop there. The '83 reforms were basically, these are macro prices, oil subsidies, tax rates, interest rates, exchange rates and these are all very important, but we know what happens when you don't do anything but change macro prices, you run out of steam pretty fast.

So they focused in '84 to '88 on the micro level, and that is deregulation, not only of shipping, inter-island shipping, very important in an archipelago nation, but also on deregulation of entry terms for foreign investors, deregulation of equity rules and a whole bunch of other things about internal trade. They focused on trade policy reform apart from exchange rates and worked steadily on that for the next four years.

All the while they were working on providing a legal basis to make the reforms in finance work, and that's in banking and pension funds and other things, and that's now in.

Now people have asked me many times what are the lessons from Indonesia, and I used to say, well, the lessons from Indonesia are that it's very important to have continuity in policy-making, but, you see, that has two sides. I used to say that the people who designed economic policy and implemented it in Indonesia had a good track record and it was long, and it was long because it was good, and it was good because it was long, and that's true.

(Laughter.)

But what are the lessons there? We say we can't have that kind of continuity, this just won't happen. Well, that wasn't the only factor at work, and I keep reminding AID of this every four years, it's a cycle of four years about the things you do very, very well.

One reason why these things so far have worked pretty well, and I think even critics will say they have worked pretty well, is that we were able to rely on large numbers of trained countries that have been trained in the United States primarily by U.S. AID, first a group from '60 to '66 and then from '69 to '88. We have 500 people we could count on, and about 70 of those were people with Ph.D.s and the rest were MA or failed MA who had nevertheless picked up a lot of statistics and basic economics when they came back, and we had no shortage of people to get in the trenches and implement this stuff.

Now where can you say that's happened, where otherwise? Well, maybe in Brazil, I don't know, but these chickens came home to roost, not turkeys, but chickens came home to roost because this infrastructure was there. I'm afraid that AID is going to forget about this when it's working in some of the poor African countries and when it's working in Paraguay and other places because this is the essential element and partly it's responsible for continuity. It has many features and I won't get into it.

So that's one lesson from all of this. I do not think it's irrelevant for you when you're talking about your role in debt to reassess your role in providing opportunities for specialized education for people who are needed to make these things work because the universities certainly aren't doing it in any of the countries that I know, with one exception now, Chile, where that is happening at the master's level and maybe you know of others.

The other lesson is these reforms all take time to do when they are done right, and they also are difficult to put into a list of requirements about this is what you want to do.

I mean there is only thing I'm very sure about, and that's how you want to define tax reform in such a way that you're beneficiaries can quality, and to my way of thinking there is only way to do that. I mean I think now we understand that a tax system can do one job well, and only one job well, and that's raise money or transfer resources from the public sector if you want to split hairs.

It doesn't help with in-country distribution, and it damn sure doesn't help in redirecting flows of

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resources to critical parts of the economy. You just screw it up for revenue purposes when you do that. It doesn't do anything but raise money. That means that you want a tax system that is central, very, very central, and that means you don't want to be messing around with rates that are uninforceable. And it turns when you have one that is simply you can collect substantial amounts of revenue.

The history of tax reform now in the past 15 years, every single country, every single developing country that has had indirect tax reform has moved to a simple kind of value added tax, every single one. Those who have been having problems have been tinkering with their simple taxes. Argentina, their tax is a mess because they have tried to make it look like an income tax and do all kind of crazy things with it. I don't know what's wrong with the Brazilian one, because that one is easy to define and I defy anyone to say that there should be any other definition of a tax reform that you put in the basket of the list of qualifications. You would have a long argument with me and a lot to prove.

Then what kind of financial reform to you want? Well, you say you want to free up interest rates. You had better be real careful about that. If you're not doing some other things simultaneously, you can get yourself in a lot of trouble.

Look what happened to Chile in '79-81 with thinking that you could put trade policy reform in one box and financial policy in another and look what happened to them, two years of growth averaging minus 12 percent. So you've got to be careful about that. You may not have an institutional basis to do that just yet, and that's where you want to get, but if you do that overnight, you sometimes are going to be in for some huge surprises, and I could name some other places where that has happened when the proper preparations weren't done.

On exchange rate policy, well, Dick Cooper and I have been having words about this for years and years, if the currency is overvalued, and there are benefits from doing it if you do it right. Now that's kind of pretty obvious, but once again you've got to be careful what you're doing at the same time.

If you are not taking steps immediately to begin to remove these institutional obstacles and these bottlenecks like, for example, heavy regulation of shipping and trade or a Customs Service that requires 95 signatures to clear a box of pencils, then devaluation is not going to do you a damned bit of good, not any, if you don't take steps.

So AID gets involved here by helping out with the follow-up, and perhaps in some countries helping out and getting the people together to help do this. In the follow-up in Indonesia is another reason reforms were apparently able to work, and I say that just so you won't ask me five years from now why I was so positive about it.

Once we did these things, we could to U.S. AID and we could go to the IMF and say, look here, now we need help. From the IMF we got to have help on computerization of the tax system. We got it all set up and we got the hardware and the software, and we need you now to help train people and get them to look at these things in a systems way and do it all over the country. Fine the IMF says great.

So we go to U.S. AID and say, look here, now we know what we're going to do and we need your help in implementing, we need your help in implementing some of these reforms particularly in banking law and pension law, and that I must say has worked pretty well. And as soon as we got a new governor of the Central Bank we got our package through on new banking laws and pension laws and that's all it took. Everything else was there.

So you've got a big comparative advantage particularly in countries where you've got track records, and where you've got the best track record is where marysimons you've trained a lot of people and don't every forget it. Don't forget it. Where you've got a track record people will come ask you to do things, and that's when you're work is going to be important. When you go in and say well, we can send you Don Lessard and two or three others this next week to tell you all about how you ought to do the commodity link bonds, if they haven't asked for Lessard, that's not going to do any good I'm afraid, you see.

I happen to think you should send him around the world for about six months to talk to people about what their options are.

Look, when I was talking with the Chinese about this in '86 I was dumbfounded that none of the modern concepts of risk had percolated into the Central Bank or the Minister of Finance. I was absolutely overwhelmed. I junked everything I was going to do and spend two days talking about modern corporate finance and not about tax reform at all.

MR. LESSARD: This is frameworks and it's not which thing is right.

MR. GILLIS: Yes, it's how do you look at these things, and that's something you can do, too. I don't know how to tell you to organize to do it, but in the old days you had a stable of people. The USA had a marysimons stable of people that you had to this. The Harbergers and the Gun Rannises and you run them from country to country and, believe it or not, they were very, very effective. They were very, very effective, particularly in countries like Ghana, the AID Director you had there in the 60's who kept bringing Gus Rannis out, and kept bring Harberger to Chile and Uruguay and other places. Believe me that worked. It had an effect.

Certainly when you brought Gus Rannis to Ghana when I was a very young economist, it stopped me from making a terrific error on the advice I was giving and that was very good, and now I've learned.

So you've got these things you can do that are different from country to country and you need to continue keeping the kind of flexibility you've got. What is going to work for one AID mission, and I know you're not talking about where you've got missions, but that's where you're most effective, and you know that. What is going to work where you've got one AID mission is not going to work so well in another. It's the tailor making of it is the things that makes AID effective, the U.S. AID agency effective.

Now later I'll tell you if I have any ideas about where your competitive advantages are other than this. I'll let you know.

MR. LEWIS: Well, I wish the sandwiches were here because it would be a nice time to break, but they are not so we can't. But the fact of the matter of is it's nice to hear somebody that has involved as many years as you have in actually doing policy conditionality work before anybody was stupid enough to call it policy conditionality.

MR. GILLIS: I was doing it in the government.

MR. LEWIS: Exactly. The marvellous part about this thing is the some of the terminology gives away how silly the nature of the business is, but that's a question for a rainy day and not a nice day.

MR. BENCH: But an observation on your reaction in China, that there were a whole bunch of things they didn't know. The World Bank, what do they call it, the Economic Development Institute of the World Bank help a seminar last year for a week, and we all got locked up in some old estate, and generally the level of person that was there was a Deputy Minister or a Deputy Governor of the Central Bank and there were some 20-odd developing countries represented, generally some mix and indebted countries and some basket-case countries.

On the program on a Thursday morning for an hour and a half was something that everyone was questioning the value of, and that was the regulatory and accounting environment in which all of this debt is taking place. So we ended up starting at 9 and finishing at 1 only because we had to eat, we could have gone all day, and what kept it going were the questions from these people about very basic and simple things that why the hell they hadn't been briefed by somebody else in their own government, God knows. But here were guys, and in some cases we had a Governor and a Minister, but most of them were Deputy Governors and Deputy Ministers, and you could see their frustration in saying why the hell didn't somebody tell me, is that the reason why Citibank is doing this and now I understand why Rhodes wants this, and clearly there was a major gap in nut and bolt plumbing kinds of information getting to that level.

I would agree that that probably isn't a bad area to get involved in.

MR. GHADAR: As a matter of fact, there is a program that AID has co-sponsored recently on capital market development, and we bring in people exactly at that level of the Deputy Governor, Deputy Vice Minister and Vice Minister level and they come over for two weeks and talk about capital markets. We started off by getting really into it, and they said wait a second, wait a second, what do you mean by that? So we have to go from step one going up and it would take two weeks.

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So you're absolutely right, many of these people need the fundamentals before we get into the exotics.

MR. BENCH: Just another observation about this thing. What was really cute was all these guys were locked up for a week and we really couldn't go anywhere. We were just prisoners on this estate, and you had the Thais beating up the Brazilians and you had the Malaysians beating up the Peruvians, but you basically had developing countries that were borrowing at libor plus a 12, and developing countries that were being rescheduled and rescheduled, and just the dialogue of the successful developing country with the not so successful developing country was extremely worthwhile.

MR. GILLIS: Do you know what the difference is? I used to love to get these arguments started among my foreign students at Harvard. I would get them started on what was causing the differences, and basically the Asians ended up telling the Latin Americans and the Africans, they would say basically you're looking outside for your problems, you're looking outside as a source and solution, and we're looking inside, and we're looking inside for the sources. That's what they concluded.

MR. RAUSSER: Coming back to your Indonesian example for a moment, you said that they had the plan on the table for a year before the crisis, before the oil crisis.

MR. GILLIS: For the tax reform, that work started January '81.

MR. RAUSSER: My question is a bit different. If you look at their experience, I would think that it's generalizable to any government that has good bureaucrats. They are going to have plans on the table. The question is whether the environment is receptive to the plans.

MR. GILLIS: Most governments don't have plans on the table. When Shultz and Dam ---

MR. RAUSSER: No, no. I said when governments that have well trained support staffs, people with this sort of training, they are going to be talking about plans of one type or another, aren't they?

MR. GILLIS: Shultz and Dam wrote that book and went to great pains to point out the need, and their audience was the U.S., the need to have good economics on the shelf, good economic proposals on the shelf ready to put in when the time came to do something, and I don't think our country is a very good example.

MR. LEWIS: I would say in Latin America where you would have had no dearth of Harvard trained or MIT trained economists ---

MR. GILLIS: There were a lot of plans on the table. They've got think tanks down there ---

MR. LEWIS: What I'm saying when in Brazil or Mexico the crisis hit, you know, and Chile is a case I think a bit like the Indonesian case and Turkey is a bit like that, but in fact even where there was a reasonably homogeneous technocratic crew, in fact there was just panic. There wasn't a plan. Now maybe that was partly the political system, but the longest time arising, and I was down there in '82 really when the fur flew, and the first thing that happened was the President of the Central Bank had a heart attack and the second thing, the Director of the Foreign Exchange Department went into his office, closed the door and wasn't seen again. So that basically they had to send two people down from the Fed in New York to run the Foreign Exchange Department at the Fed because all transactions had been transferred to the government, but there was nobody there literally and the paper just kept coming in and it was like the Italian Post Office.

MR. RAUSSER: If they hadn't had the oil crisis, would those plans have been put in place?

MR. GILLIS: Would they have been put in place?

MR. RAUSSER: Yes.

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MR. GILLIS: No.

MR. RAUSSER: So you need the external crisis to ---

MR. GILLIS: The chief architect of all this, who is no longer a Minister, in early '81 we were talking about this and how the oil price was and we agreed that something is going to happen pretty soon. He actually started rubbing his hands that now we'll begin to get things done. He actually rubbed his hands.

MR. GHADAR: I don't think that's unusual. I mean my background is not in Brazil, although I have done some work in Indonesia. I've worked in East Africa and West Africa, and I'll tell you, if there is a plan there, I have never seen it. I don't want to be too negative here.

MR. LESSARD: Indonesia had financed its oil development with production shares. It didn't do it with general obligation borrowing. So there are two sides. The macro structure was efficient and there was micro structure work.

MR. GILLIS: And another country that he and I were working in at the same time was trying to do exactly the opposite, take all the market risk in oil investments and let the companies just supply the money.

MR. LESSARD: So when people include commodity

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risk sharing I guess they'll say wait a minute, a key element of success in Indonesia was they had done it right.

MR. GHADAR: I hear this conversation, which is very interesting, and I compare my experience in Ghana. They came over and they said oh, we're going to have to do something and do some debt rescheduling. We went into the Central Bank to look at their debt files, and the debt files were piled in the corner and some of them had fallen down and the paper had been picked up and put in the wrong folder, and after three weeks of trying to organize that, they decided to forget about that and telex the banks and say, gee, tell us how much we owe you.

MR. LEWIS: Actually the Argentines in fact, if you want a great success story, one of the major things they asked was if they would please use the Fed's macro model because they wanted to check the numbers on the plan, and it was done at that level and Volker said of course we'll let you use our model, and that's the reason Argentina is such a success today.

Why don't we do this because it's not a bad time to break, even though the sandwiches are coming imminently, why don't we take this opportunity to break and then come back this afternoon and follow up on I marysimons think Malcolm's not-to-be-improved-on summary, which in effect links the question of debt to the more broader question of what in the world development role we should be in.

Let me say that that conclusion was the conclusion we were looking to get out of all of this as well. So this doesn't come as a great shock to us. But what we do need to do is to think about how we make this more tangible to us poor simple minded bureaucrats here at AID, which is to say let's get much more specific about the sorts of products, the sorts of skills and the sorts of specific opportunities.

Now obviously we're not in a position to link that in the most useful ways to talk to specific countries. Obviously that's not what is so useful here, although it seems to be that there are a range of generic kinds of products that fit into a sort of rough typology of countries. Clearly you're talking about quite a different thing when you're talking about Mali than when you're talking about Thailand. So we don't have to feel like we're talking about everywhere the same sort of model.

But AID does operate in quite an extraordinary range of countries, from the Indonesias and Thailands through to the Malis. So maybe that's where we'll pick

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up.

Gordon, did you want to say something?

MR. RAUSSER: We've covered almost everything except one element, and that's protection policies in the developed world. That's part of their policy to use this as a vehicle for putting the GAT negotiations back on track, and in terms of your commodity bonds, too, I would think that if we eliminated the protections in the develop world that would certainly increase ---

MR. LESSARD: It would change prices.

MR. RAUSSER: Yes, it would change prices and there would be a lot more interest in the upside potential there. But with all the protections that exist, the upside potential isn't all that great for many.

MR. LESSARD: This was intended to be a pitch for commodity bonds. It was a pitch for thinking about the dimensions, all these different dimensions.

MR. LEWIS: Gordon, it's more a model of the collateralization. It's how you get credit worthy again. That's what this is going to be about.

MR. LESSARD: Collateralization, but also linkage ---

MR. LEWIS: And risk sharing.

MR. LESSARD: --- because you've got the

marysimons knapsack model again that says let me have your assets to back up my claims versus the risk sharing model that says you pay only when you can, and you pay more when you can a lot. In the 1930's everything in Latin America, remember, was asset linked, every single municipal transport system, every power plant and every port facility was mortgaged but on fixed interest obligations. I'm overstating it, but I mean the government had very little flexibility and lots of things were backed but not linked by assets. There is a big difference.

MR. LEWIS: When you're dealing in a gold clause. The United States Government used to have gold clauses, too. We didn't default exactly, we just changed the ---

MR. LESSARD: Well, don't push me too hard.

(Laughter.)

MR. LEWIS: Anything administratively?

MR. UNGER: Well, if any of you need to make telephone calls to your office or outside people, the Executive Sect's office is just a couple of doors down here and there is a telephone in there that you can use.

MR. LEWIS: There is plenty of time. The sandwiches will be here imminently.

(Laughter.)

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. . . The AID and the Debt Crisis Seminar recessed at 12:25 p.m., to reconvene at 1:05 p.m. the same day . . .

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AFTERNOON SESSION

. . . The AID and the Debt Crisis Seminar reconvened at 12:35 p.m., Cliff Lewis, presiding . . .

MR. LEWIS: One of our colleagues is going to have to leave early, and I'm going to propose to start up now and try to end maybe a little bit early and certainly try to end by 2 say so people can get out.

Obviously, this is the beginning of a process, and we say that a lot about various things, and we've been trying to be honest about that. I notice certain snide looks.

(Laughter.)

What I would like to do now is almost generate two things, one of which is a list of specific areas in which we ought to be looking into very much following up where Malcolm was talking about specific things that a program of action should address where we ought to be investing in the first instance staff resources to getting up to speed on in order to be in a position to provide the sources of help in the field that we were talking about before we broke for lunch.

Now before we do that, and also, by the way, I also would like to ask the question more specific to the kind of meeting today as to whether there is some sort of follow-on to the sort of discussion we were having today

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that people might find to be useful, either going much more specific to commodity linked securities or another direction to the kind of technical assistance that should be provided Central Banks or whether that sort of thing is not the kind of question that lends itself to a discussion by a group like this.

Before we do that though, because one of the geographic areas that has gotten short shrift in the discussions today is Africa, and basically while Larry is here I thought that Larry might just take a few minutes, not more than 10 to do two things, to try to put what we're doing in the countries that have already been recognized where debt relief is dai ragure(sic), I mean there is no question that that's the direction we're taking in Africa, and to link that to the agency's first explicit approach, because we have done it very successfully in the 60's and more recently in East Asia, with policy reform, with supporting a process of policy reform. Note that I don't say policy conditionality because I don't mean that, but it's basically -- Larry, why don't you describe it.

MR. SAIERS: I'm sorry I haven't been sort of participating in this morning's thing. So I'm not sure I'm going to be quite on the same wavelength to the discussion, but there I think two things to say.

One, on the African side on this whole question of debt and linked to reform and structural adjustment, I think there is kind of an ominous trend that is going on in Africa, and that is that since the debt sort of relatively for these countries is even more overwhelming than in some of the Latin countries, it really drives an awful lot of what the prospects for Africa are as well.

First and foremost, I think that the most ominous trend is that through the World Bank with its special program of action to the debt distress countries and with what other donors have been doing about trying to put up more fast dispersing assistance to help at least lay out a growth possibility for these countries since they are much more import dependent for growth prospects that a Brazil would be or an Indonesia would be just by the nature of most of their economies, what seems to be happening is that as sort of the donors on one end try to expand the foreign exchange availability for important, the system on the other end of IMF targets, of repayments, of Paris Club tend to be very much working in the opposite direction, and that is to continue to put a fairly low-level cap on the actual availabilities of foreign exchange for growth purposes.

It strikes me that we are becoming more and

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more shortsighted in that case because what we are doing, as probably 75 percent of the African countries at least are now doing something in one way or another on structural adjustment are beginning to get the idea and there are a few at least short-run turnarounds that look pretty good.

I think, on the other hand, we are putting such a tight noose on these guys that as soon as it looks like there is any free foreign exchange showing up they want to change, well, won't give these guys Toronto conditions at the Paris Club, we don't have to any more. I don't have a tally, but it would be interesting to tally when the IMF does its financing gaps, you know, sort of where they start in the growth scenario, and I think it's generally not very much per capital positive growth at all.

Instead of seeking a seven or eight percent growth rate, they are happy with a three or four percent growth rate that holds things even so that it maximizes repayments and it minimizes the financing gap which the Fund has to be able to close.

MR. LESSARD: And that's on the high side out of the policy framework papers.

MR. SAIERS: That's on the high side out of the policy framework, yes. In the African setting it's a marysimons different process to some extent because so much of it is official debt and so much of it is unreschedulable, but we've got a system in place where as a donor group led the the World Bank is pushing very much away from the project mentality and toward structural adjustment and broader sectorial assistance programs, and at the same time we work against ourselves on the other side because in effect all we really finance is lessened Paris Club terms or faster workouts with the IMF.

I'm afraid what we are going to see in a lot of African countries is they are going to quickly get the same idea and decide what the hell is all this worth, we are running a lot of risks and you guys are capping us no matter what we do for the better we perform, the faster you want paid back. So what's the effort really worth.

I think that's an issue that is going to have to more and more start getting dealt with in the broader community because I think it is going to undermine seriously the credibility of trying to get these economic signals straight.

When it comes to the AID side more directly, we have been moving away from sort of the traditional conditionality concepts that in the early 80's we had jumped in with following in with the Bank and the Fund and getting ourselves in a lot of hot water with

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countries on political grounds in trying to force them to do things they weren't prepared to do and not having the resources to back it up.

I think we have moved much more into a mode, and I only caught part of Mr. Gillis' comments, but I think more in a mode that is compatible with what you were arguing, and that is taking a much sort of longer-term view of the policy adjustment period that is going to have to take place in Africa. A lot of it is institutional adjustment not just policy pronouncement, and trying to set sort of three or five-year agreements on where we would like to see the agricultural policies be at over a five-year period, where are they today or what ought your overall sectorial budgetary policies be and then working with the government to adjust that as we go through the process and set sort of intermediate benchmark targets against which to begin to work.

You're raised the issue of the training, and that clearly comes home to Africa with a vengeance. One of the problems with training in Africa is that in a lot of these countries the terms of employment are so poor that you can train half a dozen people and not get any of them to stick where you tried to get them placed. I mean it's not from a dearth of training that the Africans still have real shortcomings, but it's from terms of marysimons employment that just aren't satisfactory to someone who now has a marketable skill that he can sell to the international community some place, and that's a major problem, or he can sell in the more informal market in his own country and not be under government employment.

An awful lot of what we've been doing is matching in a sense not even being so crystal clear in what the end product is supposed to be, but refining that concept over time in the sense of a fairly heavy dose of studies and short-term consultancies to look at particular issues and to refine the questions.

In one case, I think in Gambia, we had actually gotten back toward the concept of the Gus Rannis or the Harberger model with people from HIID who would come in on sort of short-term visits, make recommendations, have communications directly with the hierarchy in the policy-making levels of the Gambian Government. Unfortunately, the Finance Minister just passed away in the last week or two, he was Princeton trained and very comfortable with it. A lot of very useful things began happening in a broader context where things really were beginning to be linked and not just taking one isolated policy and changing that and then watching how the whole rest of the system adjusted to it, but really trying to look at it in a more systemic way.

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It's easier to do in Gambia with a half a million people than in Nigeria.

What we've been trying to do is therefore not to sort of have the typical conditionality, you have to do this, something you're not prepared to do, but we are going to grease the skids if you'll do it, but to be more much in a collaborative mode with these countries, one, trying to educate them more by hands-on participation and, secondly, by setting more realistic time frames in which to try and get things accomplished and to move ourselves away.

We have a particular problem just because of the normal size of our own staffs. Because they are small countries, we don't have big staffs and we tend to get the younger people out of the agency with less experience because they don't have high-school aged kids or whatever. So we have a different kind of a mix than one can find in Indonesia or in some of the Latin American countries. So it's an awful lot of learning experience for our own people as well.

I think working much more closely with the World Bank has been a help as well. I'm not touting the World Bank as being an absolutely best source of all this. I think they have an awful to learn, and having people on the ground is a help, having our people on the marysimons ground is a help to them understanding this kind of thing.

It's much more in a mode of helping them understand their own issues and taking things at a pace they can afford to take now that some of the worst of the macro-economic distortions are beginning to get ironed out in some of these places and they have already taken a lot of the most difficult steps and it's now more trying to get on a longer-term process of adjusting to what is going on in the system to get into a situation where in fact they perhaps can start encouraging private sector investment of outsiders or are going to begin to look at some of them.

I think it is a long-term proposition, it's not a short-term turnaround, and this concept of trying to get the IMF to start looking longer term with its policy framework paper thing is one step in that direction, but I think in fact for most of the important functions going on they are still looking at a very short-term time horizon and in fact are keeping all these countries on a very short leash. I think that's an issue that is going to end up driving a lot of these countries back the other way.

MR. LEWIS: Thanks, Larry. Larry has got to leave early. It's not out of a lack of interest.

MR. GILLIS: You've got this great advantage of being much more flexible than anybody else on the scene that's on the helping side.

You know the most effective foreign aid I've seen in Africa or know about in Africa in the last 10 years is a form of technical assistance where AID brought a group of people from Oak Ridge National Laboratory to take a look at the oil sector, and one of the things they go into was a refinery.

In making the arguments to closing the refinery and having it done raised Liberian GNP four percent. That's how much the waste was. You know, you can't think of aid like that in a month. There are other things that they did on wood lots that made a hell of a difference. I would do things a little differently in Africa than I would in Asia, and you have the flexibility to do it. The Fund doesn't.

There are other aspects of that Liberia story that are very interesting, too, and you all probably know a lot more about it than I do, some of the longer-term stuff on certain crops and grains, you know, what to do with the old river trees.

MR. GHADAR: If we take a look at Africa, Africa I think has got some unique things. I remember when I went to Africa they would ask me which area are marysimons you in, and I Africa, and they would say oh, I'm sorry to hear that. One of the reasons is we had a hell of a time putting a project together in Africa. The project tends to be very, very small and the transaction costs for the project is very, very high.

Now we look at the debt problem, and the debt problem is 80 percent public sector debt. You have to go to the Paris Club, and the Paris Club can even go to infinity I mean in rescheduling, but as long as they insist on interest payment or what happens, you can't really do anything for them. So if you can't do anything with them, we're tying our hands dealing with Africa right now. That's really what's happening now where the transaction costs on the project is very, very small.

If we want to be effective without injecting to much new money, we need to take the debt that is already there and use that as a leverage to influence either projects or economic conditions.

One idea would be to accept local currency in lieu of the Paris Club rescheduling. You're not getting paid anyway. So why don't you accept local currency. Now once you have that local currency you can then in effect bring about the equivalent of a debt equity swap program. You, the U.S. Government, the French program, et cetera, can take this currency and say either I will sell it in the secondary market for projects that you and the local government agree with, or if you don't want to sell it at a discount, it doesn't look very good, you can give it as a grant to projects that you identify as worthwhile.

Now what you're doing is that the debt that has been constantly rescheduled is being used as a way to promote projects that you are denying the local government. Now I'm not sure whether that can be done.

MR. LEWIS: In fact, under the most recent Foreign Assistance Act there is a specific legislative mandate for doing precisely what you're talking about, which to old-timers around here from AID will sound like the Cooley Loan Program which was in effect precisely the same thing and was very successful in the terms under which it was done in places like India and Korea, and it was also very important in terms of some of the development of early projects.

But it was ended I guess, and correct me if I'm wrong, I mean, Dick, you know this story, it was partly over accounting problems as to who actually owned the money?

MR. GILLIS: It was partly over the Congressmen coming in and walking away on junkets with bid wads of cash.

MR. LEWIS: But I mean it's the same sort of thing that gets in the way of any idea that has reasonable flexibility. If somebody can find an instance of abuse somewhere, it will be eliminated, and with an Inspector General function that we spend far more on that than we do on economic policy work, it's not surprise that we do better at finding waste, fraud and abuse than we do at finding the right policies.

MR. BREEN: Remember though that in the 50's we had huge amounts of P.L. 480 generating a huge amount of rupees, and that was reversed sometime, and, Bill, you know this better than I probably, sometime in the 60's, and we were forced by Congress to start, or I think it was by the early 70's ---

MR. GILLIS: The early 70's.

MR. BREEN: --- and we had to start using that in programming, which is a ridiculous concept in most terms.

MR. GHADAR: But, Dick, that is not an unusual worry, and it is handled by all the countries who are doing debt equity swaps. They are worried about inflation and they try to either sterilize it or take steps to do that. So you're concern is very valid, but there are ways to deal with it I think.

MR. BREEN: I have heard some reference

recently to the fact that the Brazilians losing control of the debt equity swap process has contributed in major ways to this recent state of inflation.

MR. SAIERS: On the African side relative to the size of the economy there are very large sums in local currencies being generated by P.L. 480. I mean we were just looking at Mozambique the other day and we have about $40 million worth of local currency generated, and that's something like a quarter of their recurrent budget. We are supposed to program those back into the country one way or the other.

The IMF argues sterilize it basically, you know, however you have to do that, to literally burn the currency or whether you just put it all back into straight budget support and the Fund calculates that as part of the receipts and accordingly sets new ceilings.

But in fact most donors, and we ourselves, and it's not only us that generates these local currencies, end up trying to program them for development purposes. That generates more projects which, if you ask most people, they say there are already too many development projects in Africa as it is. They can't maintain it and you're diverting resources away from maintaining the current stock rather than trying to add to it.

But that's the tendency and that's what

marysimons everyone wants people do to. So, on the one hand, we jump behind the IMF and say we really need these stringencies on credit and, on the other hand, we take these wads of local currently and we pump them back in in some crazy kinds of ways which undoes all of the IMF's attempts to bring some order on the financial side.

MR. GILLIS: They have to make adjustments that fit within the overall monetary ----

MR. SAIERS: Either they have to make the adjustment and then therefore we decide what the government's budget will be, or they don't make the adjustments and the Fund comes in and slaps them on the hand one way or the other, and it has been a very haphazard process. AID tries to program it better than some of the others, but the Bank doesn't program it and it doesn't decide it just as a wad of money which may be on budget and may not be on budget.

The EEC has big chunks of dough that come in and they don't pay any attention to what happens, whether it even gets generated or somebody just walks off with it I'm afraid sometimes.

But you end up with this massive wad of local currency that sloshes around in these places and undermines real efforts at times to help straighten out a particular budget thing and we end up coming at things

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from two very inconsistent ways, and that's certainly one thing that has to be done.

What we have done is by using those things it has allowed us to reduce the cost of projects. Donors can finance a particular, whether it's constructing something or whatever it is, they can finance it cheaper in their foreign currency terms and in their budgetary terms and they can do more in that country because then they take somebody else's local currency and put up the local costs with it. But it's exactly the wrong thing to have happening.

We shouldn't be expanding all of these kinds of things. It should be in a sense sterilized and it really should be used to reduce the overall deficit, whatever, but we haven't come around to dealing with that issue in any substantive way yet. This Section 572 that allows us to collect in local currency and the local currency is supposed to be programmed back in. So it's going to be another wad of dough that's going to get pushed. It's a thing that is basically not under very good control at this time by anybody.

MR. LESSARD: The facetious suggestion is to allow especially the western African countries to give back to the World Bank the projects that were financed at face value financing. That's a realistic way to do it,

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all the putting of all projects for one year and then let them privatize them for whatever they are worth.

(Laughter.)

MR. GILLIS: That's a form of debt equity swaps.

(Laughter.)

MR. LEWIS: Well, what do you say that we go on, having brought African in a little bit, why don't we just start collecting some of the things that people think we ought to be focusing on by way of conclusion areas. This is wide open and we'll just take notes. So anything that comes in, particularly on the outsiders, but for that matter those of us that worked on this, areas that we ought to be doing.

Let me ask Bob the first question on this. From the standpoint of strict financial technique, and we have touched on that in a couple of instances, and Malcolm mentioned the thing in China, but from a regulatory standpoint or even the extent to which some key players in developing countries understand the most important regulations that affect the Bazil Committee's new capital adequacy standards, say the effect that that's going to have on LDC trade finance that I don't think anybody has been following, but I mean are there so many people that are doing this kind of work already that

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there is no market? And if there is a market, then what specific things should we be thinking about?

MR. BENCH: Well, actually some of my recommendations will even be at a lower level of plumbing. You first of all have a problem of -- you have several problems. First of all, in many of the developing countries you have in essence a busted banking system. You've got banks all frozen up with bad assets or frozen assets or maybe assets of farmer groups, et cetera.

New money goes into the countries from the Bank or the Fund or from wherever and where does it go? It goes into those banks and what do those banks do? They lend it on to these frozen borrowers who turn around and pay it back to the bank for interest, but there is no real catalytic effect for a lot of this new money going into these countries because it's going through a bankrupt banking system.

One of the things that really needs to be done in a number of countries is to go through that banking system and start carving out all these frozen assets or create one big bad bank. Basically you do a fundamental bank reorganization program not unlike what is going on in this country, and there is plenty of technical assistance there that would be useful I think for a number of countries.

For instance, just take Argentina. I mean Argentina has a bunch of state-owned provincial banks that probably could use a real house cleaning. Argentina has got 20,000-odd bank employees, and it has got the most expensive place to make a deposit in the world. One could easily argue that a reform of that system would have tremendous benefits on the Argentine economy, on the fiscal problems of Argentina, and all it requires is a bunch of accountants. I mean it doesn't have to be Price Waterhouse ---

(Laughter.)

--- but it just requires a decision to go out and go into those places and carve out the problems, or identify the problems, make decisions what to do about them and reinvigorate your basic banking system.

But if you go that far, there is only 20 more yards to go, and that is you go in and put in just a very simple, modern reporting system, basically a microcomputer reporting system where you have all the banks report regularly and accurately and uniformly to the central bank on a wide range of things that the central bank need to know generally under the guise of bank supervision, but you can get a lot of economic information through that system as well. So that then

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the authorities, at least they would be able to respond to the Fund and the Bank in a lot better way as to what is going on in their systems.

I don't see it as a very expensive kind of thing to do. It's a very "techy" thing to do and requires some big decisions by politicians to go ahead and start carving out problem assets in the banking system, but wherever that has been done it has really led to tremendous results.

I mean basically one of the biggest problems in Spain was a corrupt banking system, and a political decision was made to go in after those groups that owned those banks and carve out all the bad assets. And fundamental to Spain's whole economic recovery has been blowing up the old banking system and starting all over again. I think it's like the developing countries where the banking systems have bee well maintained, and there has to be a reason why some of these countries have performed so well.

MR. UNGER: If I could, I would just like to mention a case in point. Right now with AID, and I know Larry is very much aware of this, the work is going on in Senegal. AID is really kind of at the threshold of doing its most comprehensive work in the financial system of that country, and it could be as much as $100 million program, $50 million from the World Bank, about $20 million from the French and about $30 million from the U.S.

MR. LEWIS: Who is going to do the technical assistance?

MR. SAIERS: We just got the first paper in and we're half way through looking at the first round of paper. Who is going to do the technical assistance?

MR. LEWIS: Yes. Is that part of the pie that we're working on?

MR. SAIERS: Well, I think so. We're looking to both FDIC and the Bank to work with the West African Monetary Authority and not just the Senegalese end of it, but also the Senegalese banking system itself in terms of the oversight and cleaning out the banking system, the French, the Bank and ourselves.

MR. LEWIS: Where do you go for the kind of plumbing or the kind of plumbers that you describe to do this sort of work?

MR. BENCH: Well, he just said the FDIC and the Bank of France has provided people for French-speaking developing countries, but there are U.S. Government officials and officials in some other countries, career people that are very well disciplined and trained in that area.

MR. GILLIS: There are lawyers in this town with a billing rate of $250 an hour who are so bored they are happy as hell to get away and work on an interesting problem. I've used a lot of them.

MR. LEWIS: At $250 an hour? So that explains what is going on these countries.

(Laughter.)

MR. BENCH: In this country there is a cadre of Federal bank examiners that are available, either retired or active, and there there are the accounting firms. In some other countries, the Italians and the French, they have career civil servants that are bank inspectors that go out on these assignments. The biggest problem is just getting the country to say we'll do it. It doesn't require an awful lot of people. It just requires the seasoned people.

The World Bank is trying to do this in some countries, but they are not going out and hiring seasoned people, and that's the problem.

MR. WELLONS: I think as a part of this you want continuity among the suppliers of this.

MR. BENCH: That's true.

MR. WELLONS: And if you can get people who will be in and out of a period of years I think you're stronger.

MR. BENCH: The best of all worlds would be some regional systems.

MR. GILLIS: There is a fundamental cheat though in the pattern of World Bank technical assistance. You guys are fortunate now, you don't have all that much money behind you. So when you make your arguments you have the hone them very carefully. The Bank's different. They've got all that money behind them and people are brought in who aren't very seasoned, a couple of young professionals on every team, and they do have all this money behind them and they don't hone their arguments, but they are using the leverage of the Bank's finances behind them.

MR. SAIERS: Carried to an extreme, don't let Mr. Gillis talk to Congressman Obey, that you do a better job if you don't have any money behind you.

(Laughter.)

MR. LEWIS: What about more specific, and we've talked about this before on the central banking question. Are people working systematically to raise the level of skills by say the guys running the domestic or foreign debt desks at central banks in developing countries, the kind of thing that we had described for us for Indonesia, or is that done catch as catch can?

MR. LESSARD: We've got an effort at the World

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Bank, right, I mean some.

MR. WELLONS: The IMF provides people with central banking experience from various countries who go and work for a period of time. We don't necessarily have the continuity.

MR. LESSARD: Then how do you get into the gray area between a business sector, corporate finance, deepening of capital markets, this whole area, and let's go back to debt equity swaps, which my sense is they are a double edged sword. You certainly would like to transform the obligations and you may be able to use those mechanisms that are subject to all sorts of abuses and usually the arguments are not very clearly articulated. To do those right one needs a fairly sophisticated technical superstructure that is sophisticated and is not now just a banking side thing. It's linking the business and the finance. It's almost a government merchant pension function.

I mean Chile has got a set of people in the central bank who know how to do it, but who else does? The answer is probably no one of the other debt equity swappers, and there you are talking about some very basic skills formation and track records and a very different set of incentive problems because you have people who are always interested parties, and they have to be interested marysimons parties because they are getting involved in activities where you want them to be interested parties.

I don't know the answers, but it seems to me that if one says debt equity makes sense, then one ought to say, okay, what is the infrastructure that is required to make that successful and not just to be another lever for government bureaucratic power, but also not to be another place for bicycles. I mean how do you get in between the two extremes?

I mean you're working on writing something along those lines for the World Bank, but we don't have basic materials or manuals or background in terms of how one should think about these things. Are they useful in the aggregate or not and how do you decide when their done, how do you set up the option systems and how do you set up systems to do this relatively efficiently. There are a whole set of things that strikes me we're just beginning.

MR. WELLONS: I think there are a variety of financial instruments and instructions that are necessary for this, but that sort of gets me to a broader question that several of us have talked about before, and a question for you in your experience with HIID, I'm a relative newcomer to it, but I'm going from the assumption that AID lacks vast human resources. AID has,

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let's say, is not liquid in terms of finances, and I don't know, is not liquid in terms of people as well maybe.

MR. GILLIS: There are 2,100 people overseas.

MR. WELLONS: That maybe a lot or not, but my sense is that more and more AID has been counting on outside, on economists and other experts from outside. So my question was whether AID can and should continue to build that, build on that using those people in ways that are useful and helpful on the debt restructuring and the debt problem and how it would work. Can you tap the people, can you get them and can we get the continuity that we were talking about a little while ago?

MR. FULLER: That's a very important point. When I look at the staff in our Bureau, for example, we don't have staff that even, I'm going to overstretch it, that don't even have the lingo yet in this area. There are a few, but it's not institutionalized. It's going to take a long time to get people to a point, if we were to really focus on training, to get a few people to have some understanding of the frameworks and some of the instruments that could be used.

I have wondered whether there aren't possibilities of arrangements with organizations like HIF, financial housing in the U.S. or insurance companies

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in the areas of health finance, to get some of these people in to work with us in the field elbow to elbow like staff because we are never going to get our own staff up to a level of technical confidence to really provide the kind of advice both to us and to field programs that we need. You know, we don't want to say it, but we're basically managers even though all of us claim expertise in something.

MR. LESSARD: We also don't have the, my sense is the educational infrastructure. You look at kind of macro-economics and government planning and let's say the policy conditions. There are lots of universities in both the United States and developing countries that focus on those issues. You and lots of other people have spent money on management schools.

We're talking about an in between world here. We're talking about development finance in a very different way, and you can't point to a single institution, in my judgment, that really is in depth on that either in the developing world or here.

Where would you send someone to a one or two-year program to really master the financial aspects of development? I would be hard pressed to make such a recommendation.

MR. WEINSTEIN: AID has done a little of

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this. For example, in the case of some of the banks, Citicorp has some of the courses that it does and we have sent some people there, on debt swaps for example, and I agree with you that we have to know what we're doing. We have had some seminars and workshops with follow-up that have been pretty extensive and intensive to start getting at this.

And I think it doesn't have to be just one instrument. I think there are several that are available to us. In fact, Price Waterhouse should be mentioned because they are a key, the contract that we now have through the Private Enterprise Bureau precisely to get at a variety of practitioners as well as thinkers. So I think something can be put together that can work and that AID can use and that has a certain continuity, at least a continuity for about five years.

MR. LESSARD: Let's say that the Chileans are relatively good at financial engineering in their economy and why doesn't AID fund the program at Catailica(sic) or something that draws in Latin Americans?

MR. WEINSTEIN: We're starting to.

VOICE: We started two days ago.

MR. LESSARD: All right, fine.

(Laughter.)

MR. WEINSTEIN: We are organizing a thing with

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Chile and there is also a possibility with the Moroccans and others. The Chileans, we spoke with them about a week ago, and they are putting together a program. So I think these things are happening.

MR. RAUSSER: My question is how serious are the impediments?

MR. WELLONS: They are plenty serious unless we can do what Malcolm does and touch on people who are willing to work for $250 bucks a day.

MR. RAUSSER: Can you do it?

MR. FOX: I think there are more problems for economists in this economic policy and these kinds of issues than it is for AID in its traditional sectors.

It was suggested that AID are managers. Well, the fact is that economists tend not to be managers, and we don't have a bureaucracy that negotiates through an extremely complicated, arcane contracting system. We don't get nearly as much as we ought to in the economic services simply because we the economists don't have the administrative structure that some of the other parts of the agency have. The agricultural people and the educational people have got armies of bureaucrats who can negotiate this mine field.

My own feeling is that the agency has got to deal with that problem. It's not a question of funding,

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but it's a question of mechanisms that allow us to do what we want to do and get people aboard.

MR. GHADAR: If I can break this down. We are talking about educating the guys, for example, to do a debt equity swap program. Now we were in the Ivory Coast and the Nigerians based on the Chilean example put together what I thought was an excellent debt equity swap program.

I don't think we need to influence that many people to be able to implement -- let me backtrack -- to get a debt equity swap program and to sell that within the organization and to have continuity, which again there is a whole series of studies that looked at debt equity swap programs and said that continuity, building on what Malcolm said and others, was the most important thing. If continuity is the most important thing, and it's not difficult to have them educated to know what a debt equity swap program is, I think that's doable.

MR. LEWIS: Just a second. How in the world or what process was it in Germany in a scarce resource period that it was educating the officials at Kestahn(sic) and Codiwar(sic) on debt equity swaps was where we were going to deploy our resources, because whoever thought about that was out of his mind clearly.

MR. GHADAR: The ADV and the Ivory Coast was marysimons one of the countries involved.

MR. LEWIS: Well, that's great, but what in the world are we talking about with a set of issues where we can even exercise quality control over how we deploy our resources to start with because nobody has got the expertise to make a judgement on what in fact is the No. 1 or 2 or 3 or 4 and we could make mistakes. It's a menu driven thing, sure, but Codiwar has got a set of problems and debt equity swaps is not high on the list of things that I would identify for their workout. You talk about a country with things like commodity index securities and risk sharing, and there are a lot of things that would be high on the list for Codiwar and this ain't one of them.

It's consistent with the problem that I'm trying to see how we answer, which is one of the things we've got to do I guess is upstream is how do we bring to bear first-class outside expertise on the project identification phase of things. In other words, may be can get good plumbers in when we realize we need a plumber and not a refrigerator technician, but how do we make that first determination, because pretty clearly we need people of broad experience with a certain amount of technical experience and also frankly, guys, with some credibility to the customers. So it's not the sort of things you can use kids for.

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MR. WEINSTEIN: Let me go back to some of the mechanisms that I think the Private Enterprise Bureau has. You can tap some very good people, and one of the first components of the workshop or rather the project is to tap credible individuals who would go into a country and in fact do an assessment and try and figure out what is the agenda, what should you tackle first and what things should you look at.

I think if one wants to, for example, go along with the agenda that you're saying how, should it be working with commodities, should it be tapping into debt with commodity prices, should it be swaps or should it be some other form of securitization, it would seem to me that we have a mechanism that exists now where we could do it. The question is can we identify the people who are capable of going in and helping us walk through that and helping the country walk through it. But I think the mechanism is there.

I don't think we should make certain problems more than they are. I thin'' the mechanism already exists and has been established. I think the real issue is can we find the kinds of people who could walk us through, and then perhaps you want to ask the next question, how easy would it be for us to put together the project or the activity that does the follow-up analysis.

MR. FULLER: Actually I would like to get off the mechanism. I think we have a staffing problem here and there are a number of ways of getting at it, and I don't mean to sort of cut it off.

There is a bigger question that has really troubled me in the Bureau, and that is we have two monster institutions out here dealing with this problem, the Fund and the Bank, and they have got a monopoly on action in the area.

The question I want to ask is, and it's really coming back to something, Cliff, that you had raised, and that is are there things that we should be looking at that we can use in our discussions with Treasury, with the Bank and with the Fund. Is there more than simply the boiler room pipeline stuff, or not pipeline, that's the problem we have in Egypt, but the piping system that we should be working on.

(Laughter.)

That's sort of the highest order question. Then we can come down and we can talk about improving economic institutions and policies, and we do that all the time. Then the next question about that is this debt management question, whether we're really got something to offer that's specific and that AID would have a comparative advantage in. I think we shouldn't escape from those broader questions, and then let's talk about mechanisms and staffing, because in my own mind I'm not sure we've got a lot to offer, although I think we do in some areas.

I would like to hear some discussion on those points. That takes care of point one.

(Laughter.)

MR. RAUSSER: We're in the business of policy reform at least in terms of our work on trying to promote economic growth, and if you look at reform in the context of economics, there is a market for reform. One of the demands in that market for reform comes from us greasing the skids, and maybe greasing the skids comes in the form of the performance measures that Don had up earlier, debt relief, debt reduction overhand and reduction in debt, and the question is how to design those instruments in such a way that the reform happens.

Now obviously there are obstacles to implementing the reform and that requires a long-term view, but we're supposed to be in the game of policy dialogues, providing technical assistance and helping these host governments design new policies, policies that are more effective in promoting economic growth, which in part solves the investment climate and hopefully solves the investment climate down the road and also provides

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the right set of incentives and signals for effective management.

That's what we're in. So the question is how to link these things, how to link the new instruments for working out way out of this current debt problem, and using that, I hate the word, as leverage for getting the policy reform, the right set of policies, because we're not going to solve any problem unless we get the right policies.

MR. LEWIS: That's right, because the point is it's not leverage in the way it's usually used by the Bank or Fund. The fact of the matter is this is the positive feedback you get, and it's not by withholding resources that give us change, but it's by providing incentives.

MR. RAUSSER: It's using these new debt instruments as the incentives to do the reforms. Coming back to the Indonesian example, the external stimulus there was the change in the price of their major export. Well, maybe the external stimulus here is a change in the price of that debt and that's what will motivate this reform. Obviously there is a question on the implementation side that some of these countries, Honduras, for example, doesn't have the wherewithal to implement a policy. The Pakistanis talk about a whole marysimons bunch of different reforms and announce them, but they are never implemented. Costa Rica has the ability to implement them and so does Egypt.

MR. BENCH: I want to pick up on that, and I'm sorry, I begin to regret that I started this plumbing story.

(Laughter.)

But above the technical things, for instance, you know, the Bank and the Fund will say well we really think the central bank should do "X", "Y", "X", but they really don't seem to exercise any real conditionality in a lot of these policy areas. I mean the Fund sends somebody out from a Central Banking Division to set in the central bank for two years, but if that person opens his mouth somebody barks at him and he goes back to his room and sits there until his time is up. They don't really exercise the clout one would think that AID might be able to exercise in a discreet way to carry out some kind of policy reform. If it was married to a package with the Fund or the Bank, would you guys be the heavy or would they have more clout to do that?

I really do think this whole area of financial intermediation in these countries, and we're essentially talking about banking reform, needs to be looked at. There are a number of institutions in the marketplace, marysimons the dominance of one institution and the dominance of groups, the passivity of the central bank, the quality of the information that these places send in for economic management, and there is a whole stream from policy down into the technical lines that could be looked at.

The Fund just kind of wants to look at some monetary things, and the Bank would like to get into that longer list that I mentioned, but then they send out somebody who doesn't have the experience to really deal with it, but at the Bank somebody checks it off that we did it, you know, it was on the mission team, but it really doesn't get to the heart of what needs to be done.

MR. WELLONS: See, to me that gets back into the staff question and I don't think they are complete independent. That's why it seemed to me your flexibility in tapping people who were much more knowledgeable outside of your own agency gives you a competitive advantage versus the Bank.

The Bank people told me they had something like, what was it, 19 or 21 different units in the Bank that were dealing with finance in one way or another, and we know finance is important to them because of the world development report that they've putting together.

So you're big question has been how do we compete with the levithon, and my assumption is to the extent you compete you compete by being to draw on resources that they can't drawn on and skills that they are not going to be able to pull together. That seems to me is your advantage.

Then having said that, you want to focus, and you don't have that many resources that you can do everything, so you want to focus there.

MR. LEWIS: Freeze there. Now obviously we are not going to do that today, but let me ask a more specific question, and I'll go around to our guests and ask them what is the right process in reasonably quick order. We obviously all agree on fundamentals and we agree on the link between we need to focus on country-specific growth policies, and this is not an end in itself that we've been talking about in terms of financial engineering or what a former Red Skins' coach would refer as silver bullets or gimmicks, say. Gimmicks don't win ball games. All right, fine.

How do we identify those areas that are worth building some capital in because, frankly, like Fuller, I'm more skeptical than Warren is about how great our resources are and how great is our ability to tap the greatest people. I think that is just nonsense, but that's a different question because there is no demonstration that we've been able to do that any time

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lately.

So my question is, putting that aside, how do we identify the list of things that are worth building capital on?

MR. LESSARD: Again, I would go back to maybe some regionally focused education and/or research programs in large part. I mean you have the ability to stick with an institution for a fairly long time and you are providing AID funds rather than credit. I mean the whole notion of the World Bank providing credit to build institution is fraudulent because that's not a credit problem, that's a transfer problem.

So you pick a couple of key places and you work with them and you learn by doing and by being involved with the bureaucracies, but you would also be either a free-standing institute or a piece of the university ---

MR. RAUSSER: You provide a grant for an institute.

MR. LESSARD: You fund a grant for an institute which is tied in with some real ongoing work. Pick Senegal for Western Africa, and I don't know if it's the right place or not, and you do take advantage of some people who are on the street who happen to be Senegalese that you can get back there for a few months at least that you can't afford. You can attract those people to go in and work in that kind of an environment for short periods of time. It's a fun thing to do and you create a setting that people will cycle through, and they're not just sitting in the office in a Ministry looking through reports. So you create a focal point and a center of action.

Go back to, you know, UN programs in the economic development in the 50's in setting up centers. Here you're talking about a new set of linkages and insights, techniques, technologies and building cadres of people. I would think that AID has a strong comparative advantage there because you can have a relatively long-term focus and you can decide to focus on six places instead of on 30, you don't have to solve that year's budget problem like the World Bank does. So you don't have a different time cycle.

It seems to me that would be one place, and maybe it's done with a major policy component and having a minor training component, or maybe it's done with a primary training component and a minor policy component. I mean I don't know enough about the particular settings.

MR. WELLONS: The assumption is that you can't use your missions in any active way. I don't know, is that assumption correct?

MR. RAUSSER: That's correct.

MR. WELLONS: They can't say, listen we've got a set of financial problems that are important in this country, we don't even know who we need or exactly what we need. Can they take you that far? Can your missions help you that much?

MR. LEWIS: I think there are very few instances.

Dick, you would know.

MR. BREEN: A couple of the ones that I've visited recently, I can say that the old days of very competent staffing with people that were really grounded in all of these areas, there are a few places where there is a little bit left. In Bolivia there are one or two people that have been around a long time and have certainly been through all these issues. I wouldn't make any comparisons about them, but I think they've got some talent there. In Honduras, I don't see anything there, and the other countries I'm not really up to date on.

But I think, as you say, over the years you've just basically moved that whole skill bank. There used to be a lot of people around here called economists.

MR. RAUSSER: Well, there are a lot of people who are called economists, but how many are doing research.

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MR. WELLONS: Well, I wasn't thinking only of research.

MR. GHADAR: If you're going to argue for debt equity swap, which is -- and hear me out, you're not going to agree with it.

(Laughter.)

MR. LESSARD: If you want to argue, argue for equity and not for debt equity swaps. Argue for the asset linked financing and not for it's link to the conversion process. Once you get into debt equity swaps, everybody sees water running up hill because of discounts and they act as if it's free.

MR. GHADAR: You've got to pick your niche, and if you disagree with my niche, that's fine, but pick your niche and what do you need. You need a group of people to implement it, and that's educating 5, 10 or 15 people, and you need to change the attitude towards that niche, which is a lot more massive education. That's what you need.

MR. LESSARD: We've made a serious mistake linking equity to swaps. There is an agenda to change the financial intermediation structure. That agenda is orthogonal to the agenda of restructuring existing debt and it may or may not coincide with it. When you mix them, then we are back in the world of it's either debt

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reduction, Jeff Saches, or it's debt equity swaps, John Reed. Now it's kind of as if we have no choice.

(Laughter.)

It's one side, it's let's protect the Bank's claims through debt equity swaps and let's privatize them or, on the other hand, let's not transform anything, let's just write it off. My sense is that it's not at either extreme. So do ourselves a disservice by linking those two in the debate.

MR. LEWIS: Under the existing contract one thing that might be very useful on the technical financial engineering side and supervision side, I would think it would be good to have as a starting point a little paper saying who is doing what and where the pool of technical resources are and actually inventorying the sorts of overseas technical assistance programs that the Fed or FDIC or others are doing both with the regulators as well as with the central bank operators.

The the other thing you might do is inventory where, because there are a couple of places like the Indonesia effort where we're doing it as well, it would just be nice to have a sense of what is going on, and it would even be nice to go back to, what was the guy that used to do this in the 20's, Kemmer ---

MR. BENCH: He was the one that went through

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Latin America and ---

MR. LEWIS: He set up these things.

MR. BENCH: Well, he put in a whole new accounting scheme across Latin America, a regulatory scheme, and it's all outdated now. He was a missionary. He just went through the whole continent putting in a whole new scheme of regulations and supervision of banks.

MR. LESSARD: We could identify the interesting things, not necessarily that even you're doing, but we look at Chile and we talk about Chapter, whatever it is, 18 and 19, but the pension fund reform is far more basic in terms of treating the demand for assets and the banking reform. So we from the outside, the self-serving U.S. perspective is Chile is working because they are honoring their bank claims and exchanging those for equity. Chile is working to reform fundamentally their financial system.

MR. GILLIS: But it's going to vary so much. In Madagascar if you're not in the business of trying to show rural dwellers what's left of the forests and how the forests can be valuable left intact, well, you're not doing your job, and in the northern Philippines, too, and that's something that nobody else is doing. Nobody is trying to pull this together.

Now there's evidence, unless destruction has

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gone so far, that the net present value of leaving the forests intact, providing there has been a stream of non-wood products, like oil, fibers and so forth, and say that stream is 13 percent the value of wood exports, at a discount rate of 6 percent that perpetual stream of income from the forests in present value is 2.1 times greater than the value of wood that you can get from it.

In Madagascar and in the Philippines and the Ivory Coast -- well, it's too late on the Ivory Coast, if you haven't identified that opportunity for you or for those countries, please come see me and I'll help you identify it in those cases and desertification in others.

Marrying people, marrying the Australians and the Israelis and you in those places where you have the Israelis on desertification work, and more and more you can now in Africa, and pulling these people together who are doing all this good work on the desertification, I would like to see more in these environmental areas that's too small for the Bank to worry about or too complicated or too intensive in human resources, and the Bank is not interested in marrying people, either, and you can be just like the Ford Foundation a few years ago was in a mode of marrying donors and they got away from it because it wasn't fashionable.

MR. RAUSSER: Well, there is an example of the marysimons debt environmental swap, Bolivia, and maybe that's another opportunity in terms of reform.

MR. GILLIS: It's not being done right anywhere and you can help, and for that you need people who have legal training, you need economists, you need climatologists and botanists.

MR. LESSARD: And that's a way to make the Paris Club feel good about forgiving the money and sterilizing it.

MR. GILLIS: But debt swaps aren't for every country. They're not going to work for every country. There are other areas of the environment where you can also score, by the way, heavy points with some people in Congress and a hell of a lot of environmental groups and do good at the same time. What more could you ask.

None of the big land grant universities are coming to you to help support our people who do desertification. They want to, you know, here are our people and we want to show you how to grow oats.

MR. LEWIS: Now the land grant universities come to us for support full stop.

MR. WELLONS: Could we come back to an entirely different function, unless we haven't exhausted this one, and that is the question of whether you have any role at all within the U.S. Government, and you may not.

MR. LEWIS: Phil, we've got two more things to talk about about and let's just close on this last one.

Are there any other points that people want to add to the list? I think I understand where we stand on that.

Let's talk about two things then by way of conclusion.

The first is let's pick up on the interagency. We have talked about comparing the advantage of what people aren't doing. Are there some things that you all think that are just not being done currently within the government that we might be thinking of investing, not on some false assumption that we've got a lot of clout and not because anybody is going to pay any attention to us necessarily, but because it's just some work that is very important to be done.

MR. WELLONS: My question is simply who is doing the work on rescheduling in Treasury? Who is articulating to Treasury or any of the other people with clout development concerns? Should they be doing that or is there any way to doing it, or is there any way to start doing it? Maybe it's impossible, but, if it isn't, I would be curious to hear some discussion on that. I don't know about Washington, I don't know how you do it, but it seems to me that that concern needed to be articulated before with earlier plans for solving the problem that didn't work and continues to need to be articulated.

MR. LEWIS: Is this one that is worth revisiting or is it really just pie in the sky like some Congressmen referred to about our rewrite of the Foreign Assistance Act, that what you want is a Constitutional amendment against Congressional meddling. He said, come to think of it, what you want is a Constitutional amendment abolishing Congress is really what you would like. So I mean is this unrealistic or could something useful come out of a further discussion?

MR. WELLONS: It's quite possibly unrealistic, but if it's true that we are much more concerned with stability, political stability in borrowing countries than before and relatively less concerned with the stability of the U.S. financial system, it seems to me somebody has to be saying these things.

MR. RAUSSER: That's being said. Treasury is saying that.

MR. BREEN: Well, there is another aspect I think, and I hate to draw an unfounded analogy, but you know what happened in Venezuela, and it scared the hell out of a lot of people in policy around here.

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MR. RAUSSER: . It's didn't scale Chastin(sic).

(Laughter.)

MR. BREEN: Nixon's visit stimulate the Alliance for Progress and a concern for growth. I don't think this country has had a concern for growth in Latin America as a country since somewhere I think in '69 or '70, something like that, and I'm not sure whether or not this is the beginning of another resurgence in that interest or whether the debt is just going come down to a financial tradeoff analysis or something like that.

But I think it's at least possible that growth and development may become as important as the financial tradeoff calculations going on in Treasury now.

MR. RAUSSER: There are some signs that there will be a working group that will be formed and it will include Treasury and State that will point to the summit, that there will be a serious attempt to put on the table before the Group of Seven some proposal that they can all sign off on, and there will be a working group that will be established by the Economic Policy Council within a month and they will have to reach some conclusion by the end of May.

MR. LESSARD: My sense is the themes you articulated in your report are fairly small steps played out well, and what does, let's say, economic pluralism

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mean and what are some of the support programs, just like Malcolm said, on the environmental side, and if you said those are not quick fixes, but we have some long-term programs on these dimensions and we're building capital to deal with these problems, and these human capital and institutions that will generate human capital and we're doing it in terms of picking a few places where there is high leverage to see how they do it and hope to diffuse it, maybe not in those words, but there are a couple of critical themes and we've focused on those themes.

I mean you're trying to purchase legitimacy at the table on those four themes, and if you're credible in saying we've got the best two or three environmental programs going, then you will be listened to on that fact. It's the niche play, it's differentiating and it's narrowing on a few themes.

MR. RAUSSER: Summarize those four themes again.

MR. LESSARD: Well, you have them here. You have growth and it's the stability and pluralism that I think go together in a very nice way. There is a certain kind of mix of what you want to see in political and economic development. You want growth, but you want pluralistic institutions, et cetera. That's not just privatization. It's not just primarily the privatization of everything. It's a more effective melding and sharing of responsibilities for things, but whatever.

My sense is those were fairly well stated, and then you want to put some reality behind them in terms of projects.

MR. WELLONS: But within the government it's not going to be enough just to pass that pamphlet around.

(Laughter.)

MR. GILLIS: I'll tell you what though, this emphasis on building capital is something that the other agencies or agents in the process aren't talking about. You take the problem of deforestation and basically we have until the end of the century to do something about it. In the Bank you already know what's happening to the big hydro projects, and just for an illustration, the silting up of the reservoirs that is occurring not in 70 years but in 6 or 7. You've got until the end of the century.

Now that's a development problem, too, because if something is not done on these economies who are so resource dependent on their soils now, not their energy and their tin and copper, but their soils, then you're talking about a state of perpetual dependence of about 40 economies on the rest of the world, the solution to which could only be approached by a complete abolition of all

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emigration laws in the developed world. So that's how long you've got. You've got until 1999, and that's no joke.

MR. FULLER: Can I follow up on a point that Phil made. It was a point I raised earlier and nobody responded to it, so there may be no real good answer, and that is softening the adjustment process. I know this is difficult ground, but you're a politician and you're faced with a fund that says austerity, tight ceilings on borrowing and you've got the Bank that says okay, we're going to have a little growth on the supply side economics here, but, hell, it's only going to take 15 to 20 years. Is there anything that we can offer that politician to make it easier on constituent groups that he has got to deal with?

MR. LEWIS: Bill, it's a bit like the environmental thing, I don't think was to cover the whole front.

MR. FULLER: I understand, but think of how we deal with Treasury and some of these other institutions that onto this particular problem.

MR. LEWIS: The problem is, and it would be nice to pick this issue up again, but I mean people have been saying this, and they were saying that in the 60's the last time we had policy reform. We have food aid and

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we've been doing studies of the nutritional impact of this and that, and the only nutritional impact is the people that do the studies eat well.

(Laughter.)

And we continue to spends tens of millions of dollars on this sort of stuff with nothing to show for it. Now at some point I would be prepared to bet the solution may not be so nice, that in fact the notion of soft lending in a sense, and this is part of the East Asian story is that a consensus about where the country is very important to having people being able to absorb cuts in standards of living without going to the streets, but it's as much a political thing I think as a technocratic fix, but clearly that's one of the other ones that ought to be worked more systematically rather than just talked about.

I mean it's got to be action oriented because they are always going to say the right things, adjustment with a human face or let's buffer the effects on poor people, but the fact that nobody has figured out what makes sense on that score, and that's an overstatement, but that's go to be worked, but I don't think that's what we do at this group.

MR. GHADAR: Let me ask a more fundamental question. Do you think we are in a position with this marysimons diverse a group to pick a niche? I mean when you sit in a company and you decide to pick a niche, you dash it out, you pick the niche and go after it. If you're not in a position to go after a niche ---

MR. GILLIS: I think what you're interested in deciding is how you pick a niche and not picking a niche. You know, countries are so varied and what are the things we want to be looking at when we're deciding what our possible niches are here.

MR. LESSARD: Things that have decade-long horizons that require human capital and institutional building and policy reform that will make major structural changes in those economies. It's not solving the adjustment problem next year.

MR. RAUSSER: The focus is quite right, it's policy reform and it's a question of moving away from the myopic player. We're a player who can look at the long term and there are a lot of players who can't.

MR. LEWIS: And ironically enough we have to have a modest amount of resources. In fact, if were the World Bank and we were trying to move $25 billion a year, we couldn't afford to do this.

MR. GILLIS: You wouldn't be able to to.

MR. LEWIS: That's right, you can't do it. You're just too important to get the money moving to be able to do that. So people around here, it seems to me, have to get used to the idea that being the poor relation is not necessarily an all bad thing.

Malcolm, do you want to say anything more about the process of how you identify those needs or not?

MR. GILLIS: You've have 90 percent of it in that one sentence as far as I'm concerned.

MR. RAUSSER: Well, let's hear the other 10.

MR. GILLIS: Well, that takes longer.

(Laughter.)

Well, I would just add with a premium to be placed on those areas in which you have built up some past relationships other things being equal. In Liberia in the energy sector, for example, nobody but AID should be doing work in the energy sector in Liberia. Why? Because AID has got a good track record there.

MR. RAUSSER· They have credibility.

MR. GILLIS: Yes.

MR. GHADAR: But, you know, you can cut it three ways. You can cut it by country, you can cut it by sector, you can cut it by instrument, et cetera, et cetera.

MR. LEWIS: By way of summing up, and I wouldn't try to do that, but I might just say that I appreciate every much everyone taking the time to come marysimons and do this.

We started out this morning basically trying to get some of the background information straight on what was an issue and wasn't wasn't an issue about international debt, and I think that we did a good job at that because I think we got back to the conclusion that we're most interested in, which is trying to see how that phenomenon links into the causes of it which basically relate to development problems.

And out of that comes the discussion this afternoon, which is in effect linking back to the development agenda and more specifically to what AID's comparative advantages in that broader set of issues are. In a sense, it's inevitable that any discussion about that would be a bit frustrating because, as Dick said, you get into an awfully big picture, or to put it somewhat differently, I think as Gordon and I know Alan emphasized, it's a lot smaller than that, too, it's country-specific in every instance. So it's not clear what utility there is to broad-brush discussions outside the setting of specific countries.

We won't belabor this discussion because we are now to the point where to be useful, it seems to me, we've got to get on to talking much more specifically. I think that what we will do is use some of these good marysimons flexible vehicles we've got to continue the discussion, and it's incumbent upon us I think to put some things on paper, perhaps a little bit more narrowly, about some of the gimmicks or tools that are worth looking at, some of the products, let's say, that may be applicable to particular countries and run that by you all.

The other thing that I would also add is that to the extent that other suggestions comes up in your mind as we go forward, and not tomorrow afternoon, but in the coming weeks, if you see market opportunities that aren't being exploited right now either in a specific country setting more more generically, you know, this is designed to start a process of talking about that. So don't view the discussion now as having ended.

Thanks.

. . . The "AID and the Debt Crisis" Seminar concluded at 2:20 p.m. . . .

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