Folder Title:	President Barber Conable - Liaison Files - Commercial Banks - Correspondence - Volume 1
Folder ID:	1104057
Series:	Liaison files - Non-governmental and international agencies
Dates:	10/14/1987-05/23/1989
Sub-Fonds:	Records of President Barber B. Conable
Fonds:	Records of the Office of the President
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COMMERCIAL BANKS

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Comm. Rlcs.

May 23, 1989

Dear Mr. Reed:

Thank you for your letter of May 8, 1989 regarding Argentina's recent interest in the Multilateral Investment Guarantee Agency.

As you astutely observed, the Argentine Government's interest in MIGA represents a shift in its attitude towards issues related to foreign investment. We are encouraged by the Argentine Government's readiness to enter into negotiations with MIGA, and we hope that such negotiations would lead to a positive outcome.

Thank you for offering Citicorp's support on this matter.

Sincerely,

(Signed) Barber B. Conable

Barber B. Conable
President

Mr. John S. Reed
Chairman
Citicorp
399 Park Avenue
New York, New York 10043

cc: Messrs./Mme. Terasawa (o/r), Qureshi, Stern, El-Rifai, Hollywood, Voss, Haug

SHume:cs

MH

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/08 DUE DATE : 89/06/02
LOG NUMBER : 890518021 FROM : John Reed
SUBJECT : Citicorp: re MIGA's important contribution to the economic well being of Argentina & Citicorp to offer full support.
OFFICE ASSIGNED TO FOR ACTION : Mr. Terasawa (P-4001)

ACTION:

______	APPROVED
______	PLEASE HANDLE
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______	PLEASE DISCUSS WITH ______
✓	PLEASE PREPARE RESPONSE FOR BBC's SIGNATURE
______	AS WE DISCUSSED
______	RETURN TO ______

COMMENTS :

cc: Mr. Qureshi, Mr. Stern

*IMPORTANT

Citicorp
399 Park Avenue
New York, NY
10043

John S. Reed
Chairman

May 8, 1989

Mr Barber B. Conable
President
Multilateral Investment Guarantee Agency
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear Mr Conable:

We at Citicorp have been following with considerable interest the progress of the Multilateral Investment Guarantee Agency (MIGA) of which you are President. The grave economic difficulties currently being encountered by many of the World's developing nations are of great concern to the international financial community, and most of the governments of the OECD countries. It is a major goal of Citicorp to give maximum support to initiatives which can help place troubled developing economies on the road to recovery.

Over the years through our international operations, we have become increasingly convinced of the critical role that foreign investment plays in developing an economy. As investors ourselves, we also know how important the availability of sovereign risk insurance is in encouraging the growth of foreign investment. We have therefore been heartened by the establishment of MIGA, and we commend The World Bank on this forward thinking initiative in a somewhat neglected area of international finance. We sincerely believe that MIGA will be of great importance to the long term development of many nations.

On a more specific note, we have been made aware of President Alfonsin's invitation for MIGA to enter into negotiations, made at a seminar in Buenos Aires on April 6th of this year. This is even more impressive considering the contentious history of public debate over sovereign risk insurance in Argentina. We interpret the President's remarks as a clear confirmation of the extent to which Argentina means to take the necessary steps to attract foreign investment.

We believe that this offer to commence negotiations represents an historic opportunity, and we urge MIGA to respond as fully as possible to President Alfonsin's opening. Conditions now appear appropriate to deal with issues that traditionally appeared as obstacles. Negotiations will prove complex, but in our view, not impossible. If successful, MIGA will enhance its stature in developing nations considerably, and will have made an important contribution to the long term economic well being of Argentina.

At this time we would like to offer the full support of Citicorp in whatever areas you think will prove helpful to bring the negotiations to a successful conclusion.

Yours Sincerely,

John S. Reed
Chairman

CC Mr Yoshio Terasawa
Executive Vice President
MIGA

Commercial

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/11/02 DUE DATE : 00/00/00
LOG NUMBER : 881102003 FROM : Mr. Stern
SUBJECT : BRIEFING: Meeting for breakfast with Mr. Bergford of Chase Manhattan on November 4, 1988.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

__________ APPROVED
__________ PLEASE HANDLE
__________ FOR YOUR INFORMATION
__________ FOR YOUR REVIEW AND RECOMMENDATION
__________ FOR THE FILES
__________ PLEASE DISCUSS WITH ____________________
__________ PLEASE PREPARE RESPONSE FOR _______________ SIGNATURE
__________ AS WE DISCUSSED
__________ RETURN TO ____________________

COMMENTS :cc: Mrs. Haug, JV (for follow file)

November 2, 1988

<u>Mr. Conable</u>

Barber -

You have asked for a briefing for your breakfast with Mr. Bergford of Chase Manhattan on November 4.

We do not know the specific purpose of the visit, but it is likely that Mr. Bergford will want to discuss his views on debt. Mr. Bergford is an active discussant of this topic, but neither he nor Chase have been in the lead on any creative thinking to deal with the debt problem. His general line has been that the "Bank ought to do more" which translates into (a) a firm role in assuring appropriate policy changes, (b) increased Bank lending, and (c) credit enhancement. He also believes the advisory committee system does not work and that the Bank should take a role in developing an alternative in which the commercial banks could have a more active role in the policy dialogue with debtors. While there is broad agreement on the problems of the advisory committees, as far as is known, Mr. Bergford has no specific suggestions for change supported by the other major banks. He has, in the past, discussed analogies to consultative groups -- i.e. regular meetings with a debtor country and its major creditors, chaired by the Bank -- but this idea has never surfaced among the banks.

As you know, the Chase Manhattan Corporation operates through the Chase Manhattan Bank and various other subsidiary companies. The corporation has over $95 billion in assets and employs about 47,000 employees in 65 countries. Chase provides a comprehensive range of financial services to individuals, corporations, financial institutions, and governments through its three major business components: (1) Global banking, which includes commercial banking, corporate finance, securities, and electronic capabilities; (2) Individual banking, in the U.S. and worldwide; and (3) National banking, which includes leasing, real estate finance and regional banking. We have little financial dealings with Chase aside from our trading in the Investment Department.

The bio-data of Messrs. Bergford and Kovacs are attached.

ES.

Ernest Stern

JAMES W. BERGFORD

(Biographical Summary)

James W. Bergford is an executive vice president of The Chase Manhattan Bank, N. A. In October 1983 he was appointed international financing executive with responsibility for global debt restructuring. Prior to this post he was in charge of Chase's Western Hemisphere Area.

Mr. Bergford joined Chase in 1949. Upon completing the Bank's Special Development Program he was assigned to the then International Banking Department. He was appointed assistant treasurer in 1953, second vice president in 1957 and vice president in 1959.

In 1965 he was promoted to senior vice president responsible for the International Department's activities in the U. S., Canada and the Caribbean and for the commodity and international trade services division. In 1968 he was named area executive for Europe.

He was named executive vice president in 1971 and was placed in charge of the Community Banking Department in New York. In 1977 he returned to London as area executive for Europe and the Middle East. He was appointed area executive for the Western Hemisphere in 1980, with headquarters in New York.

(Cont.)

As international financing executive he is responsible for the direction and supervision of Chase's global debt rescheduling activities. He is the Bank's primary senior contact with the International Monetary Fund, the World Bank, and The Bank for International Settlements, and other financial institutions on issues involving debt rescheduling. He is also a member of Chase's Credit Risk Management, Country Risk, Capital Project Review and Asset/Liability Management Committees.

A native of Duluth, Minnesota, he is a graduate of the United States Merchant Marine Academy and of the School of Business Administration of the University of Minnesota. In 1966 he completed the advanced management program at the Harvard Business School.

Mr. Bergford is chairman and director of Chase Manhattan Overseas Banking Corporation, a director of the Bankers Association for Foreign Trade, the Institute of International Finance, Libra Bank, and Thyssen Steel Corporation.

Charles J.L.T. Kovacs joined the Chase Manhattan Bank in 1971 after graduating from Clark University and the Fletcher School of Law and Diplomacy. After completing the Global Credit Training Program in New York and Frankfurt, he served in a series of lending and credit positions in Singapore, Beirut, Athens and London. His last overseas assignment was in London as Manager, Strategic Projects and Strategic Planning, Middle East Area.

Mr. Kovacs returned to New York in late 1983 when he was appointed Secretary of Chase's Country Risk Committee and Manager, Country Risk Administration. Since 1986, he has been working mainly on new initiatives for the rescheduled debt problem as Manager, International Financing Programs. He is the author of *The Competitive Challenges Facing U.S. Banks*, a research paper published by the American Bankers Association in 1987.

Commercial Banks

① ~~DMH~~
② ~~RBC~~
③ MF

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

ERNEST STERN
Senior Vice President, Finance

October 14, 1988

Logged out on 10/17 CP

Mr. Barry F. Sullivan
Chairman of the Board
First Chicago
One First National Plaza
Chicago, Illinois 60670

Dear Barry:

Thank you very much for your letter of September 22 which Mr. Conable has asked me to answer following my return from our Annual Meeting in Berlin. I appreciated your taking the time to let me know how our credit policy is perceived by First Chicago. Let me, therefore, take this opportunity first, to describe our credit policy in very broad terms and then address some of the specific concerns you have expressed concerning major American banks, in general, and First Chicago, in particular.

As you correctly surmise, our credit policies regarding both investments and swap operations rely on the findings of four rating agencies. We use a composite of these ratings initially to determine what kinds of exposure we are prepared to accept with the rated institution, provided we are not aware of any other specific information concerning that institution. That rating, coupled with factors related to the size of the institution and to our desire to keep our portfolio well diversified, is then translated into upper credit limits for each kind of exposure. We have generally taken a quite conservative approach in dealing with each of these elements.

We could theoretically make exceptions in cases where there was some evidence that the rating agencies were being unduly restrictive. But, as you can imagine, several banks---and certainly not only American banks---feel that we should be making exceptions for them. Once we started down that route, however, we would quickly become embroiled in full-scale credit analysis of specific institutions. This would be prohibitively expensive, given the many hundreds of banking institutions that we might deal with on a world-wide basis. We have, therefore, opted for our present policy, with no exceptions on the up-side. If banks have problems with the rating agencies, we have suggested that they take them up with those agencies directly.

You might be interested to know how our policy affects American banks, in general, and First Chicago, in particular. Our current list of eligible counterparts includes 97 U.S. commercial banks for investment operations and 85 for swap transactions, the latter accounting for almost half of our world-wide list of eligible institutions (currently 182).

With respect to First Chicago, the current rating situation with the four agencies gives us composite rating just sufficient to place First Chicago on our list of eligible institutions for investment purposes. But, a rise in the composite rating to 2.75 would enable us to enter into swap transactions.

I trust that this brief description of some aspects of our credit policies has dispelled any impression that U.S. banks in general, and First Chicago, in particular, are unduly penalized under our credit process.

I want to conclude by stressing the appreciation that we have for the continued interest of First Chicago in the activities of the World Bank. We look forward to continued business together and hope that it will shortly be possible for us to become swap partners.

Sincerely,

Ernest Stern
Senior Vice President
Finance

cc: Mr. Conable

MH (7R)

10-6
10/3/88

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/09/22 DUE DATE : 88/10/07
LOG NUMBER : 880929032 FROM : Barry Sullivan
SUBJECT : To renew in the future, their term trading relationship with the institution.
OFFICE ASSIGNED TO FOR ACTION : Mr. E. Stern (E-1227)

ACTION:

	APPROVED
	PLEASE HANDLE
	FOR YOUR INFORMATION
	FOR YOUR REVIEW AND RECOMMENDATION
	FOR THE FILES
	PLEASE DISCUSS WITH ______
✓	PLEASE PREPARE RESPONSE FOR BBC's SIGNATURE
	AS WE DISCUSSED
	RETURN TO ______

COMMENTS :Note--please date the response October 11, 1988.

ES replied 10/14/88

FIRST CHICAGO
The First National Bank of Chicago

One First National Plaza
Chicago, Illinois 60670
Telephone: (312) 732-4040

Barry F. Sullivan
Chairman of the Board

September 22, 1988

Mr. Barber Conable
President
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear Barber:

It was great seeing you in Chicago at the Foreign Relations meeting. The audience enjoyed your remarks and I was pleased to have the opportunity to visit with you.

I wanted to follow up on the concern we had that the World Bank's credit process for determining qualified counter-parties to engage in term transactions is unnecessarily restrictive. The process has caused the majority of top U.S. banks, including First Chicago, to be precluded from competing for swap transactions with the World Bank.

Apparently the eligibility criteria relies heavily on the composite rating of four different agencies. Unfortunately those rating agencies continue to penalize American banks for their LDC portfolios. As I think I mentioned to you, the agencies are slow in recognizing that many of us have already faced up to the problem. At First Chicago, for example, our reserve plus writedowns for which claims exist was 45% of total LDC claims and 66% of term/ restricted LDC claims. So we and some other major American banks have fair reason to think that the rating agencies are slow in giving us credit for having greatly strengthened our positions.

On a daily basis, The First National Bank of Chicago enters into long-term commitments with many world class institutions on a basis of how well our trading and risk insurance products and services meet their needs. We would like to believe that these same resources could selectively benefit the World Bank, profitably and safely.

It is our objective to be able to renew, in the future, our term trading relationship with your institution while remaining sensitive to the need for continuing cooperation and responsibility among financial institutions in the management of the LDC debt problem. With this in mind, we plan to maintain our dialogue with the Treasurer's Department and Credit Analysis Group of the World Bank.

Thank you for allowing me to share my views with you on this issue. I look forward to seeing you again during the IMF proceedings in Berlin later this month.

Sincerely,

Barry

CP – for filing
as per MH

THE WORLD BANK

ASSESSING THE FUTURE ROLE OF COMMERCIAL BANKS IN THE CONCERTED LENDING PROCESS

ABBREVIATED PRESENTATION

OCTOBER 20, 1988

OUTLINE

INTRODUCTION

Approach

- Interviewed 42 commercial banks

- A global, not U.S., perspective

  . 28 non-U.S. banks: 4 French, 3 Swiss, 3 German, 3 Dutch, 4 British, 8 Japanese, and 3 Canadian

  . 14 U.S. banks: 7 money-center and 7 super-regionals

  . Others, e.g., JCIF, IIF

- Voluntary questionnaire - 31 responses

I. INTRODUCTION

Objectives

- To identify and evaluate commercial banks' strategies relative to existing LDC debt exposure

- To assess likelihood that commercial banks will continue to participate in future new money programs

  - Case-by-case approach

  - Reflecting debtors' improved economic policies

  - Will banks provide sufficient new money

    - To avoid net transfers abroad?

    - To promote domestic investment?

BANKING ENVIRONMENT

Concerns of Banks

Center on issues that impact financial performance and risk profile

- Existing exposure and reserve levels
  - Absolute amounts
  - Concentrations
  - Proportion of capital
- Receipt of interest on a current basis
- New money

BANKING ENVIRONMENT

External Forces

Banks' attitudes about LDC debt are influenced by important third parties:

- Bank Regulators
- Central Banks/Finance Ministries
- Tax Authorities
- Accounting Standards Boards
- Multilateral Agencies (e.g., IMF and World Bank)
- Institutional Investors
- Rating Agencies and Securities Analysts

Banks feel unable to affect any third parties, and are directly affected by stock/bond markets

- . Debt rating
- . Market-to-Book ratio
- . Relative P/E ratio

BANKING ENVIRONMENT

Important Considerations

A. Taxes and Accounting Practices

- Tax treatment of provisions for loan losses have major influence on reserve levels

    - Non-U.S. banks are reserved near maximum levels that are deductible by local tax authorities

    - Deductibility of additional reserves is somewhat uncertain

- U.S. banks have most stringent accounting policies

    - Impasse on interest capitalization
    - Rules now clearer than in 1982-1985
    - Debt sales/swaps more widespread

BANKING ENVIRONMENT

Important Considerations (Cont.)

B. Capital Guidelines

- New BIS risk-adjusted capital guidelines are important at the margin
- Reduces relative attractiveness of new money

C. Interest Rates/Margin

- New money at lower margins unattractive to banks
- Concern about higher interest rates

D. Foreign Exchange Rates

- Most debt is U.S. dollar-denominated
- New money dollar burden-sharing increases if home currency appreciates vis-à-vis the U. S. dollar
- Local currency exposure decreases

E. Free Rider Issue

- Some U.S. money-center banks welcome smaller banks' exit
- European banks and other U.S. money-centers want free riders to participate
- Japanese banks didn't raise issue
- Canadian and U.K. banks favor interest capitalization

BANKING ENVIRONMENT

Important Considerations (Cont.)

F. Menu of Options

- Increasing menu is a step in the right direction
  - Options provide banks with a sense of choice and control
  - No single option uniformly attractive
- Partial solution to debt problem

G. Bank Advisory Committees

- Only workable option
- U.S. Regionals feel Committee Banks self-serving
- European and Japanese feel U.S. banks are disproportionately represented
- Citicorp's valuable role recognized

BANKING ENVIRONMENT

Important Considerations (Cont.)

H. Debt Redeployment

- May 1987 reserving

- Debt/debt swaps promoted

- Debt sales are conducted primarily by U.S. regionals
  - Debtor countries believed to be ultimate purchasers
  - Prices generally have been above published prices at the time of the transaction

- Debt/equity conversion activities concentrated in U.S. money-center banks and handful of European banks
  - Motivated by multinational customers
  - Fee-income potential
  - Purchasing debt on open market

BANKING ENVIRONMENT

Strategies (Cont.)

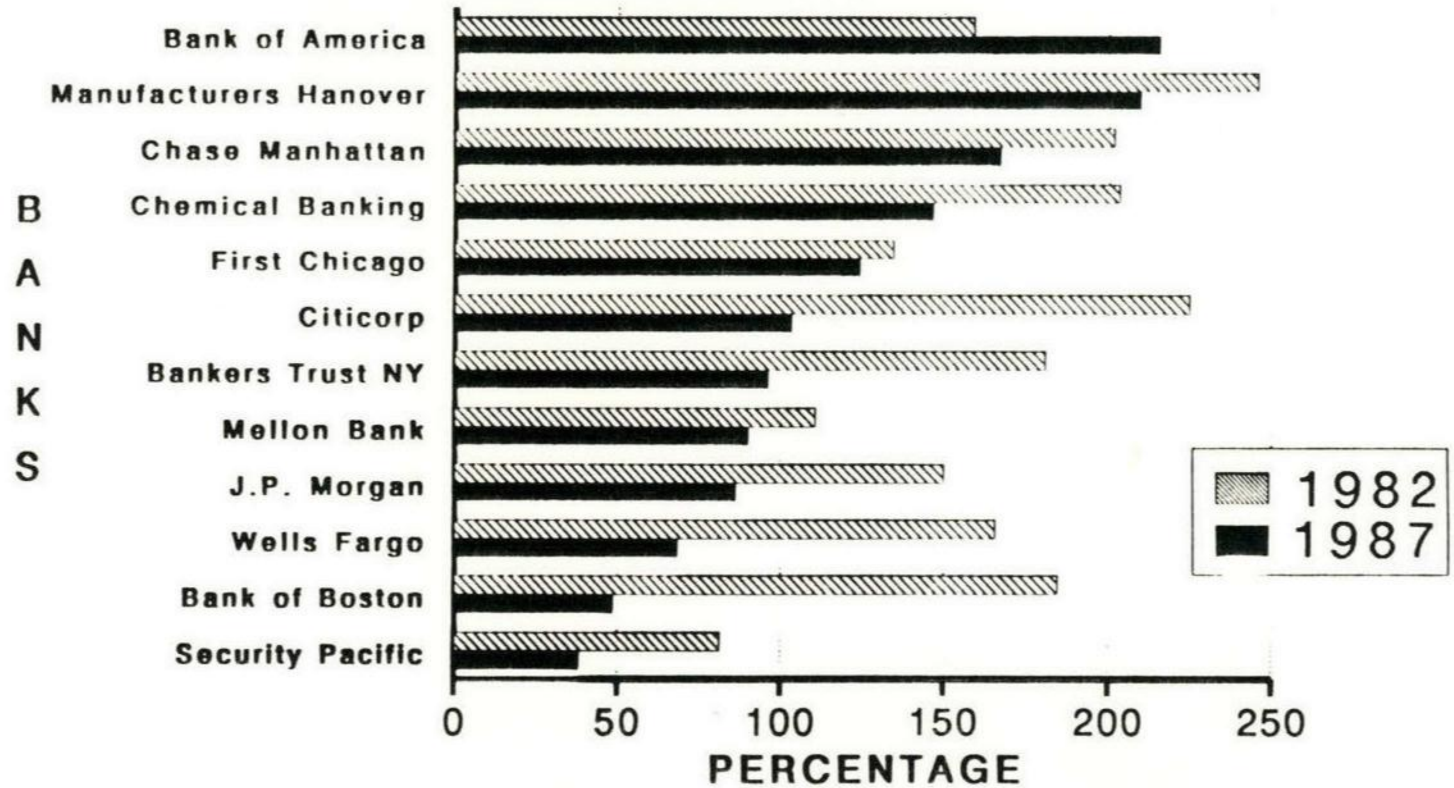
Since 1982, problem has declined in importance

- Higher reserves
- Capital increases (New Capital and Retained Earnings)
- Increased profits from other banking activities
- Growth of domestic assets
- Decline of dollar to domestic currency
- Debt sales/swaps

Some European and Japanese banks view as "U.S. bank problem"

BANKING ENVIRONMENT

GROSS EXPOSURE TO SELECTED LDC COUNTRIES AS A PERCENTAGE OF EQUITY[a]

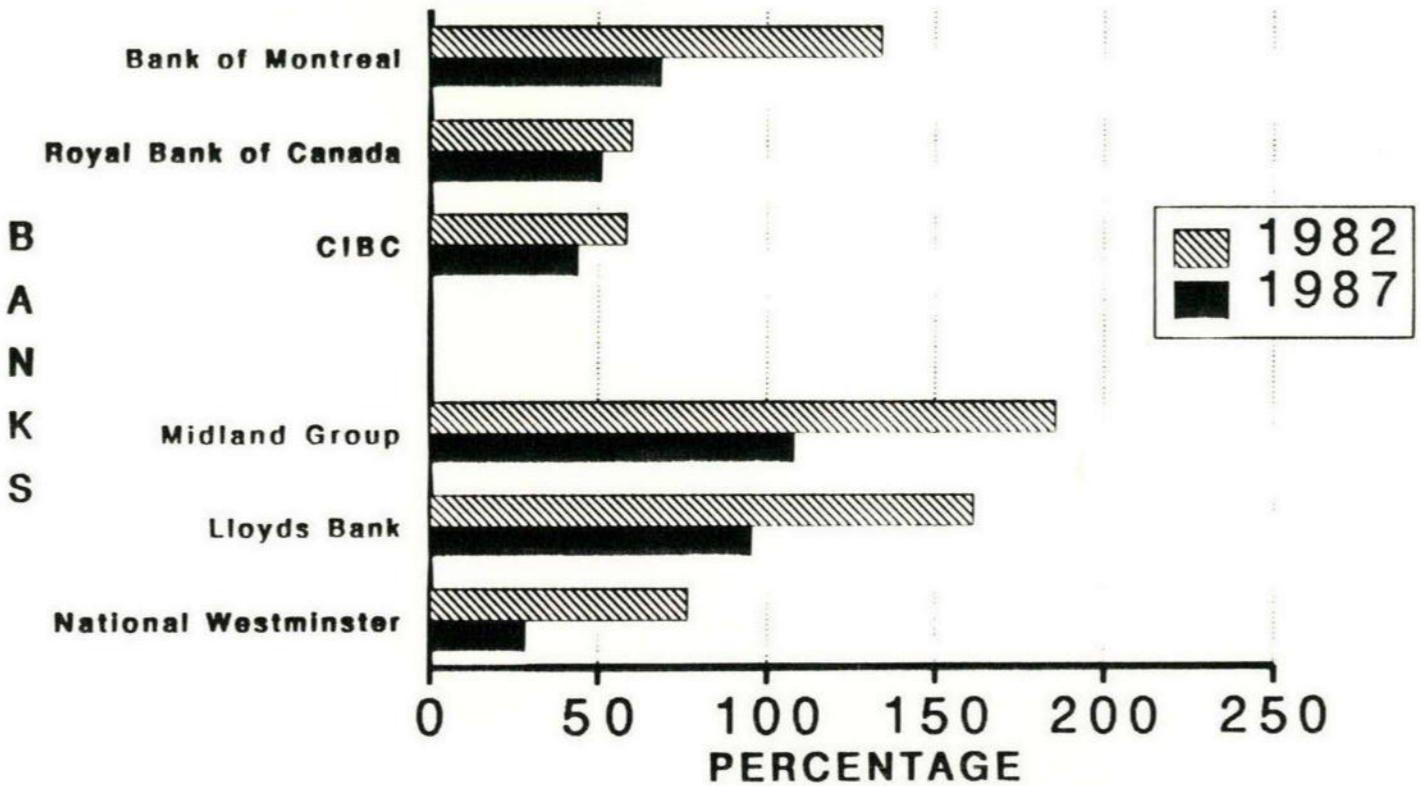


(a) Gross exposure to Brazil, Argentina, Mexico, & Venezuela

Source: Annual Reports, Salomon Brothers Inc.

BANKING ENVIRONMENT

GROSS EXPOSURE TO SELECTED LDC COUNTRIES AS A PERCENTAGE OF EQUITY[a]



(a) Gross exposure to Brazil, Argentina, Mexico, & Venezuela

Source: Annual Reports, Salomon Brothers Inc.

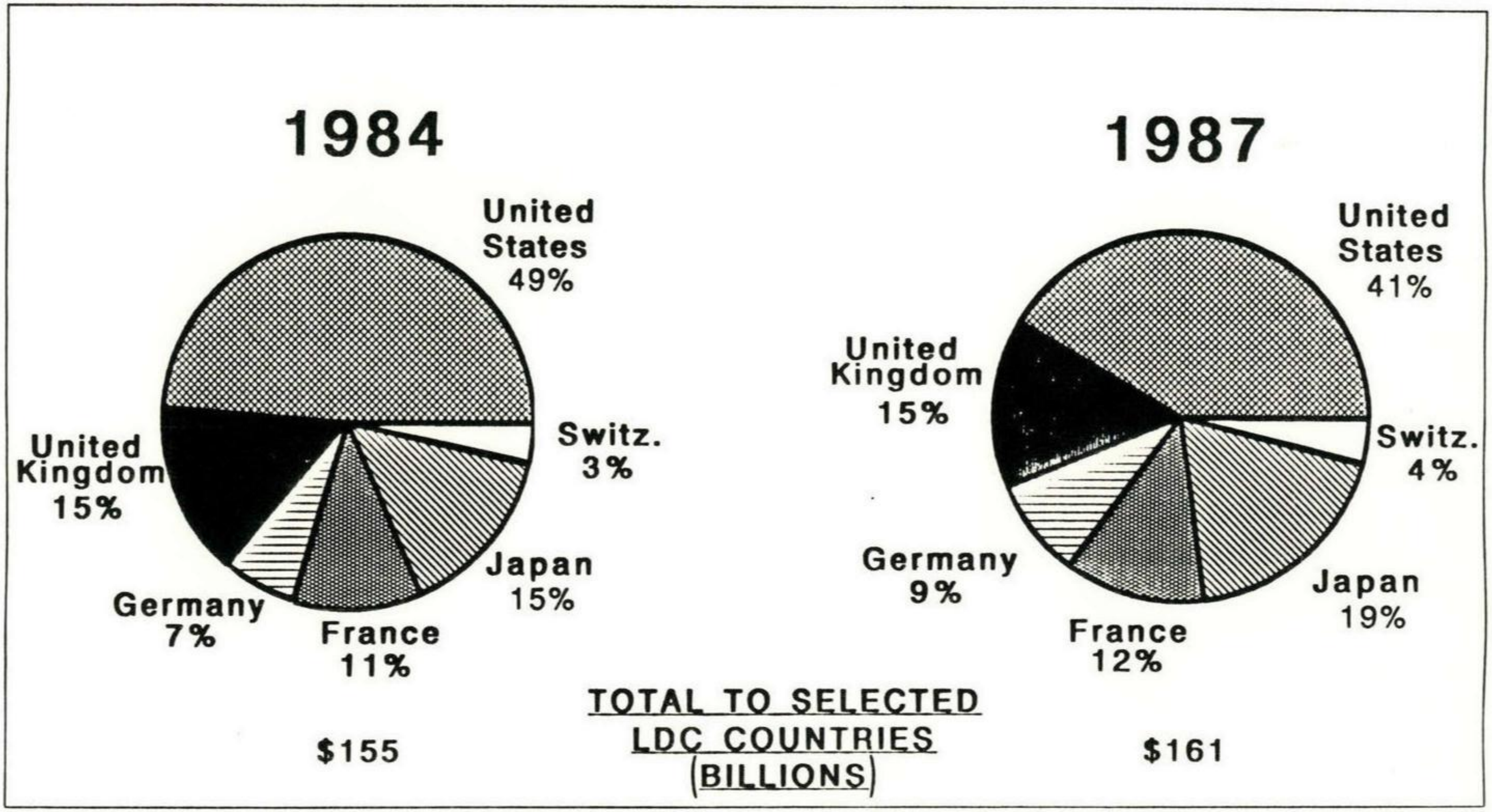
BANKING ENVIRONMENT

Strategies (Cont.)

Japanese Banks Reflect Decline in Importance of LDC Exposure

Fiscal Year	LDC Exposure Dollars (Billions)	LDC Exposure Yen (Trillions)	Exposure as Percent Assets	Exposure as Percent Equity
1982	27.4	6.5	2	77
1983	32.0	7.1	2	77
1984	32.7	8.1	2	81
1985	34.9	6.2	1	56
1986	36.8	5.3	1	43
1987	39.5	4.9	1	32

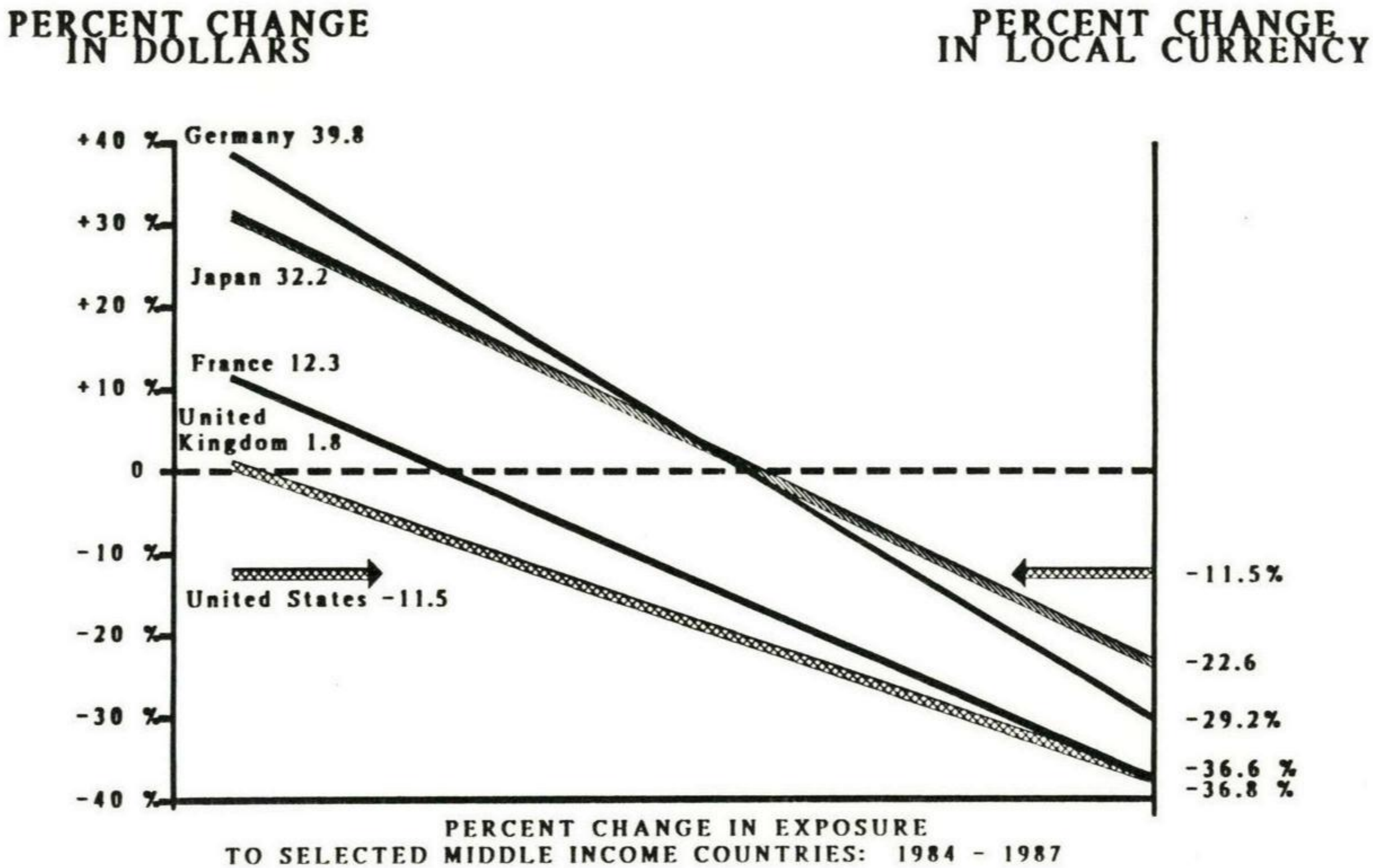
COMMERCIAL BANK EXPOSURE



Note: Selected countries include Mexico, Brazil, Argentina, Venezuela, and Chile

Sources: U.S. Federal Reserve Bank, Bank of France, Japan Center for International Finance, Bank of England, Swiss National Bank, Bundesbank

DOLLAR DECLINE REDUCES IMPORTANCE OF LDC DEBT TO NON-U.S. BANKS



NOTE: Selected LDC Countries: Brazil, Mexico, Argentina, Venezuela, Chile
* Japanese figures are derived from March 1987 data instead of December 1987 data

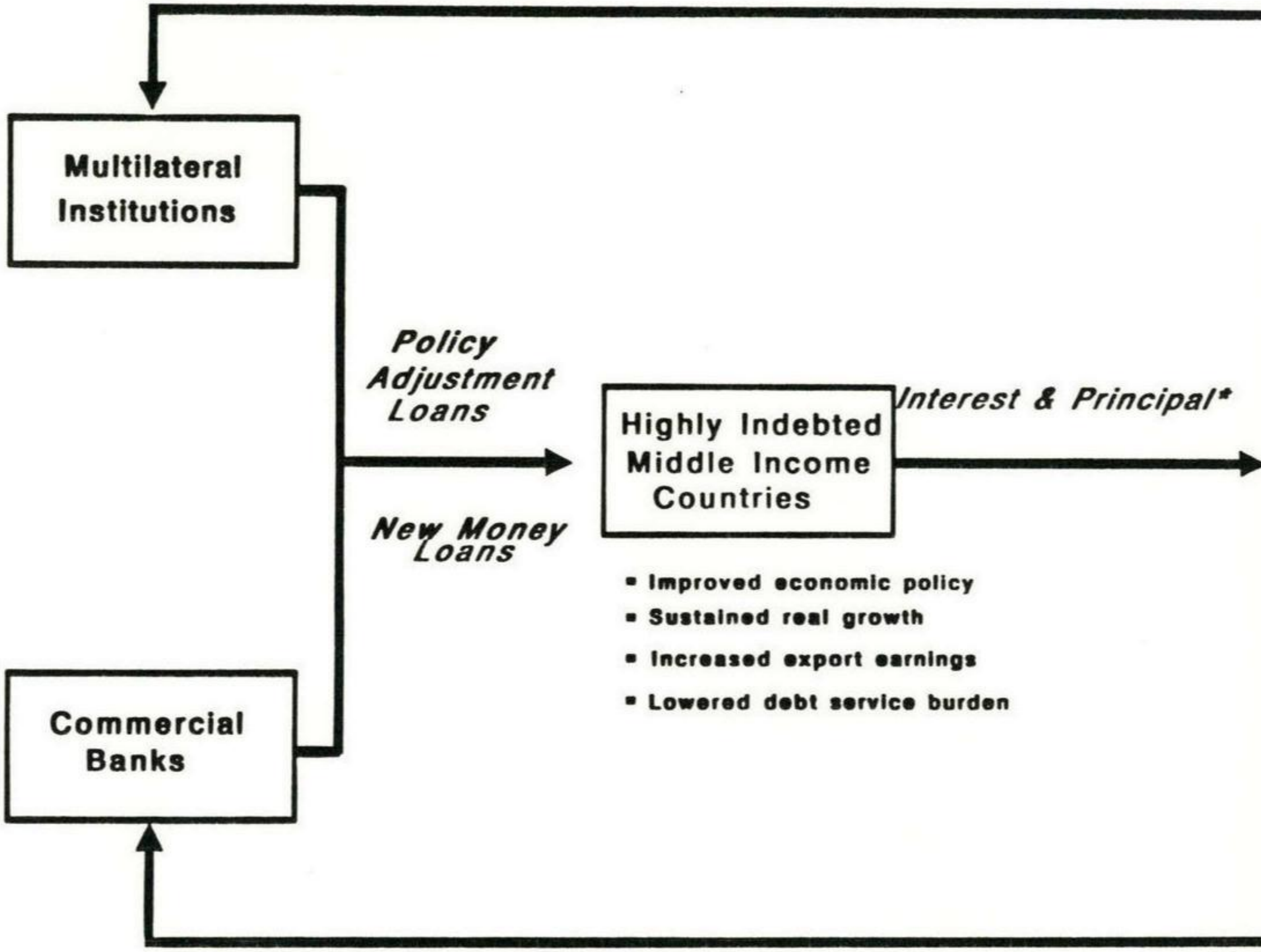
III. CONCERTED LENDING PROCESS

Organization of Report

- Issues in process
- Findings from interviews/survey
- Conclusions of study

CONCERTED LENDING PROCESS

Net New Money (Cont.)



- Improved economic policy
- Sustained real growth
- Increased export earnings
- Lowered debt service burden

* New money, new old money, and rescheduled debt

CONCERTED LENDING PROCESS

ISSUE: Where does LDC lending fit in banks' strategic plan?

FINDINGS: Interviews and survey suggest banks do not expect to provide net new money to 19 countries

Types of Lending	Percent of Banks Expecting to: Decrease Exposure	Maintain Exposure	Increase Exposure
Trade Finance	38%	42%	20%
Project Finance	58%	36%	6%
Medium-Long Term Private	79%	18%	3%
Medium-Long Term Sovereign	75%	23%	2%

CONCLUSION: Banks do not plan to resume balance of payments financing

CONCERTED LENDING PROCESS

ISSUE: Is LDC debt preoccupying top management?

FINDINGS: No systemic concern

- Debtors cartel improbable
- LDC debt reduced as percent of assets
- Banks' capital strengthened
- LDC debt exposure reduced
  . Small increase in gross exposure
  . In local currency exposure decreased
  . Strengthened reserves

Management concerns on competitive environment

- Europe: 1992 integration
- U.S.: Interstate banking/securities powers
- Japan: Continuing deregulation/U.S. and European acquisitions

CONCERTED LENDING PROCESS

Preoccupation (Cont.)

Current actions focus on strengthening bank for increased competition

- Global banking and industry
- Securities houses
- Profitability for Japanese and American
- Reducing bank vulnerability

CONCLUSION: LDC debt no longer a top management preoccupation

CONCERTED LENDING PROCESS

ISSUE: Are banks less cohesive today than in the past?

FINDINGS: No concern of systemic threat

- Maintain debtors liquidity (1982-1987)
- Now question debtors creditworthiness (1987-1988)

Most dwell on policy failures (Argentina) versus success (Chile)

Accounting, regulatory, tax rules now clearer

Individual bank initiative and interbank competitiveness predominate

CONCERTED LENDING PROCESS

Bank Cohesiveness (Cont.)

"Coordinated Action"	"Go It Alone"
French	Canadian
Swiss	U.S.
Japanese	U.K.
German	

Lacking systemic threat, little motivation to increase exposure or act cooperatively

CONCLUSION: Banks now will participate only for self-interest, Japanese for "international cooperation"

More and more banks convinced they must take care of problem themselves

CONCERTED LENDING PROCESS

ISSUE: What is the future of the Advisory Committee process?

FINDINGS: Mixed reactions on role to date

- "Necessary evil"
- "Best that can be done"
- "Only serves Committee Banks' interests"
- "Too U.S. dominated"

Non-committee banks not well informed

Individual competitive interests emerging

- Existence of "in-country branch system"
- Shift burden to Japanese banks

CONCLUSION: Advisory committees are viewed as increasingly self-serving

CONCERTED LENDING PROCESS

ISSUE: Can Advisory Committee produce "new solutions"?

FINDINGS: Invention is outside committees

- Morgan -- Mexican Exchange Proposal
- Bank of America Costa Rica Proposal
- IBJ "time for change" proposal

U.S. money-center banks bias

- Low reserves therefore new money
- Debt-equity for own in-country investments
- Oppose interest capitalization
- Promote World Bank involvement
  . Guarantee
  . Mandatory cross default

CONCLUSION: Advisory committees will innovate at the margin

CONCERTED LENDING PROCESS

ISSUE: How well do banks understand country adjustment programs undertaken to date?

FINDINGS: Understanding varied widely

- Lead Advisory Committee Banks - Very well
- Advisory Committee Banks - Mixed
- Non-Advisory Committee Banks - Not well

Except for Chile, banks did not discriminate in survey; most countries rated "slightly weaker than average"

CONCLUSION: Most banks don't appreciate progress to date or adequately distinguish on case-by-case basis

CONCERTED LENDING PROCESS

Adjustment Programs (Cont.)

Banks rated 19 countries' ability to:

	Implement Macroeconomic Policies	Maintain Political Stability	Develop Attractive Private-Sector Opportunities
Highest Three	Chile Colombia Uruguay	Algeria Uruguay Venezuela	Chile Mexico Brazil
About Average	Mexico Venezuela	Egypt Ivory Coast	Philippines Colombia
Lowest Three	Egypt Argentina Peru	Peru Bolivia Philippines	Yugoslavia Poland Peru

CONCERTED LENDING PROCESS

Adjustment Programs (Cont.)

Banks' views on "most creditworthy"

Highest Combined Weighting	Banks Reducing Exposure Last 12 Months	Banks Interested in Increasing Medium- or Long-Term Credits	
		Private	Sovereign
Chile	45%	13%	4%
Uruguay	40%	5%	0
Mexico	65%	0	0
Venezuela	42%	8%	8%
Colombia	35%	4%	4%

CONCERTED LENDING PROCESS

ISSUE:	Are banks tiering new money decisions?
FINDING:	Interviews suggest countries with larger private sectors more likely for new money Survey confirms tiering
CONCLUSION:	All countries will have increasing difficulties obtaining new money, but smaller countries may not get new money

CONCERTED LENDING PROCESS

Tiering (Cont.)

Banks are more positive toward Tier I countries

Type of Lending	Percent of Banks Expecting to		
	Decrease Exposure	Maintain Exposure	Increase Exposure
Trade Finance	11%	48%	41%
Project Finance	61%	29%	10%
Medium-Long Term Private	65%	30%	5%
Medium-Long Term Sovereign	42%	42%	16%

CONCERTED LENDING PROCESS

Tiering (Cont.)

	TIER I	TIER II	TIER III
COUNTRIES	Mexico Brazil Venezuela Chile	All other	"Poorest of the Poor" Sub-Saharan Countries
CHARACTERISTICS	. Significant natural resources . Foreign banks have presence . Multinational investments . Policy to increase private sector	. Limited exposure . Non-accrual/write-offs not threatening to banks . Limited presence by multi-national corporations	. Mostly official credits . Limited sources of export earnings . Impoverished economies . No foreseeable bank involvement
LIKELIHOOD OF COMMERCIAL BANKS CONTINUING TO PARTICIPATE IN NEW MONEY PROGRAMS	Moderate	Low Probability	Nonexistent

CONCERTED LENDING PROCESS

ISSUE: How are official institutions viewed?

FINDINGS: Reaction is slightly positive, but mixed

- IMF generally credible, except Argentina
- World Bank
  - . Parallel financing not highly valued
  - . All banks want guarantees
- Banks split on rationale for World Bank action
  - . Canadian, French, and U.S. banks will book as loan to a multilateral, not LDC
  - . British, U.S., and Japanese view as reducing capital adequacy requirements

CONCERTED LENDING PROCESS

<u>Official Institutions (Cont.)</u>

Banks assessed World Bank conditionality as less restrictive than IMF

	Percent of Banks
More Restrictive	8%
About the Same	25%
Less Restrictive	67%

But banks felt World Bank more accurately reflects developing countries' economic realities than IMF

	Percent of Banks
More Accurately	40%
About the Same	52%
Less Accurately	8%

CONCLUSION: World Bank conditionality can be as credible as IMF in policy lending

CONCERTED LENDING PROCESS

ISSUE: Will new money be more difficult in the future?

FINDING: Factors combine to impede new money process

- Higher reserves
- BIS capital guidelines
- Current pricing
- Tiering

CONCLUSION: Banks will act in own financial interest

IV. IMPLICATIONS FOR DEBT STRATEGY

- *Debtor countries should continue to:*

  . Exhibit strong political leadership

  . Demonstrate continued domestic structural reform

  . Promote private-sector investment

- *Creditor banks should devise ways to:*

  . Supplement new money shortfalls with optional debt service stabilization/reduction programs conditional on country's policy reform

  . Expand their menu of options for non-U.S. banks, with burden sharing equivalent to U.S. banks

Implications for Debt Strategy (Cont.)

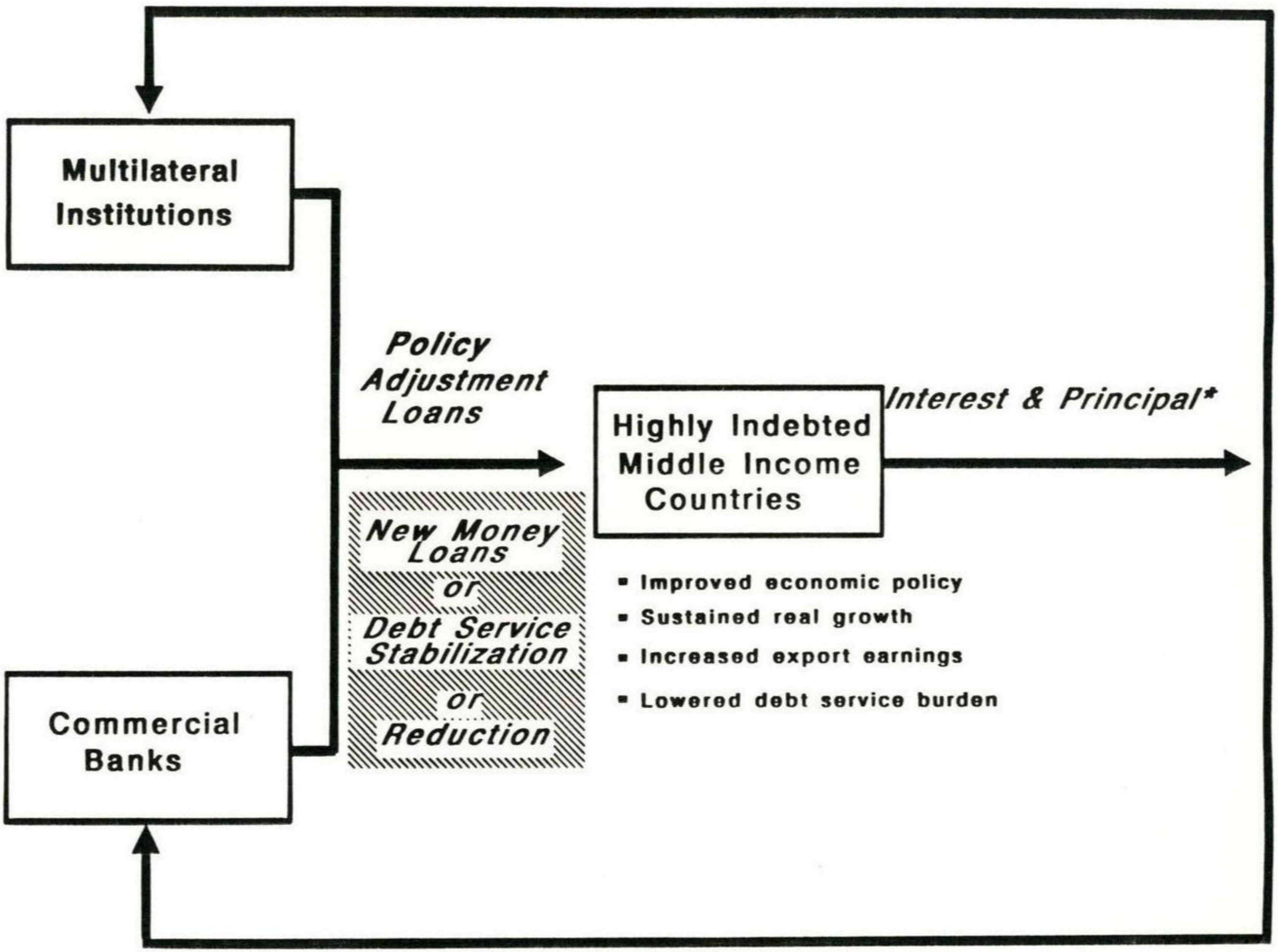
Multilateral institutions should seek to:

- Strengthen their catalytic role to promote development and private-sector investment/lending

- Provide institutional framework for developing debt service burden stabilization/reduction techniques for debtors and creditor banks

- Develop integrated longer-term conditional adjustment programs for countries with sustained domestic economic policy reform to provide new money or debt service stabilization/reduction

MODIFIED DEBT STRATEGY MODEL



* New money, new old money, and rescheduled debt

THE WORLD BANK

ASSESSING THE FUTURE ROLE OF COMMERCIAL BANKS IN THE CONCERTED LENDING PROCESS

ABBREVIATED PRESENTATION

OCTOBER 20, 1988

OUTLINE

I. **INTRODUCTION**
- Objectives
- Approach
- Scope of Activities

II. **BANKING ENVIRONMENT**
- Banks' Objectives
- Concerns
- External Forces
- Important Considerations
- Strategies

III. **CONCERTED LENDING PROCESS**
- Issues
- Findings
- Conclusions

IV. **IMPLICATIONS FOR DEBT STRATEGY**

INTRODUCTION

Approach

- Interviewed 42 commercial banks

- A global, not U.S., perspective

  . 28 non-U.S. banks: 4 French, 3 Swiss, 3 German, 3 Dutch, 4 British, 8 Japanese, and 3 Canadian

  . 14 U.S. banks: 7 money-center and 7 super-regionals

  . Others, e.g., JCIF, IIF

- Voluntary questionnaire - 31 responses

I. INTRODUCTION

Objectives

- To identify and evaluate commercial banks' strategies relative to existing LDC debt exposure

- To assess likelihood that commercial banks will continue to participate in future new money programs

  . Case-by-case approach

  . Reflecting debtors' improved economic policies

  . Will banks provide sufficient new money

    -- To avoid net transfers abroad?

    -- To promote domestic investment?

BANKING ENVIRONMENT

Concerns of Banks

Center on issues that impact financial performance and risk profile

- Existing exposure and reserve levels
  - Absolute amounts
  - Concentrations
  - Proportion of capital
- Receipt of interest on a current basis
- New money

BANKING ENVIRONMENT

External Forces

Banks' attitudes about LDC debt are influenced by important third parties:

- Bank Regulators
- Central Banks/Finance Ministries
- Tax Authorities
- Accounting Standards Boards
- Multilateral Agencies (e.g., IMF and World Bank)
- Institutional Investors
- Rating Agencies and Securities Analysts

Banks feel unable to affect any third parties, and are directly affected by stock/bond markets

. Debt rating
. Market-to-Book ratio
. Relative P/E ratio

BANKING ENVIRONMENT

Important Considerations

A. Taxes and Accounting Practices

- Tax treatment of provisions for loan losses have major influence on reserve levels

  . Non-U.S. banks are reserved near maximum levels that are deductible by local tax authorities

  . Deductibility of additional reserves is somewhat uncertain

- U.S. banks have most stringent accounting policies

  . Impasse on interest capitalization

  . Rules now clearer than in 1982-1985

  . Debt sales/swaps more widespread

BANKING ENVIRONMENT

Important Considerations (Cont.)

B. Capital Guidelines

- New BIS risk-adjusted capital guidelines are important at the margin
- Reduces relative attractiveness of new money

C. Interest Rates/Margin

- New money at lower margins unattractive to banks
- Concern about higher interest rates

D. Foreign Exchange Rates

- Most debt is U.S. dollar-denominated
- New money dollar burden-sharing increases if home currency appreciates vis-à-vis the U. S. dollar
- Local currency exposure decreases

E. Free Rider Issue

- Some U.S. money-center banks welcome smaller banks' exit
- European banks and other U.S. money-centers want free riders to participate
- Japanese banks didn't raise issue
- Canadian and U.K. banks favor interest capitalization

BANKING ENVIRONMENT

Important Considerations (Cont.)

F. Menu of Options

- Increasing menu is a step in the right direction
    - Options provide banks with a sense of choice and control
    - No single option uniformly attractive
- Partial solution to debt problem

G. Bank Advisory Committees

- Only workable option
- U.S. Regionals feel Committee Banks self-serving
- European and Japanese feel U.S. banks are disproportionately represented
- Citicorp's valuable role recognized

BANKING ENVIRONMENT

<u>**Important Considerations (Cont.)**</u>

H. <u>Debt Redeployment</u>

- May 1987 reserving

- Debt/debt swaps promoted

- Debt sales are conducted primarily by U.S. regionals

  . Debtor countries believed to be ultimate purchasers

  . Prices generally have been above published prices at the time of the transaction

- Debt/equity conversion activities concentrated in U.S. money-center banks and handful of European banks

  . Motivated by multinational customers

  . Fee-income potential

  . Purchasing debt on open market

BANKING ENVIRONMENT

Strategies (Cont.)

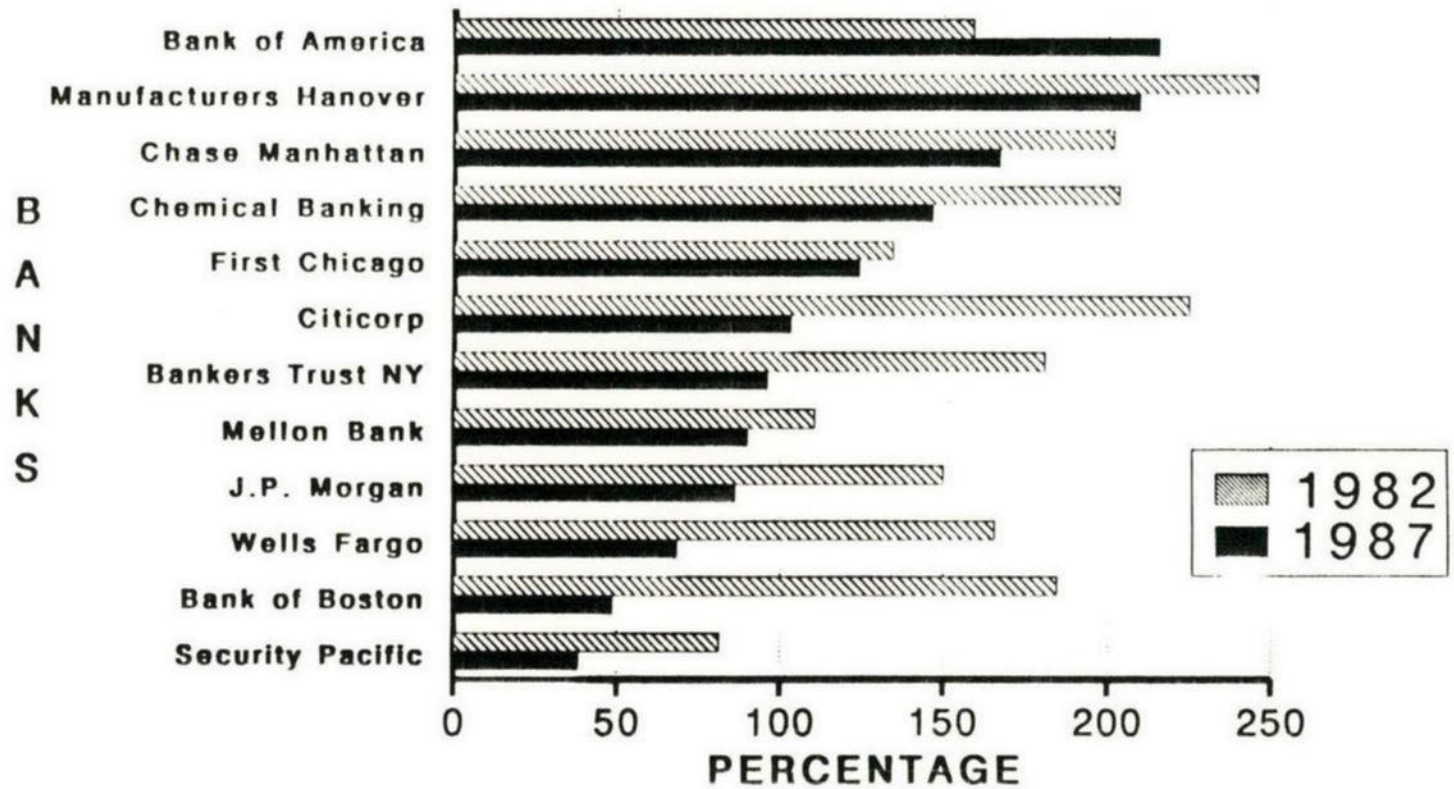
Since 1982, problem has declined in importance

- Higher reserves
- Capital increases (New Capital and Retained Earnings)
- Increased profits from other banking activities
- Growth of domestic assets
- Decline of dollar to domestic currency
- Debt sales/swaps

Some European and Japanese banks view as "U.S. bank problem"

BANKING ENVIRONMENT

GROSS EXPOSURE TO SELECTED LDC COUNTRIES AS A PERCENTAGE OF EQUITY[a]

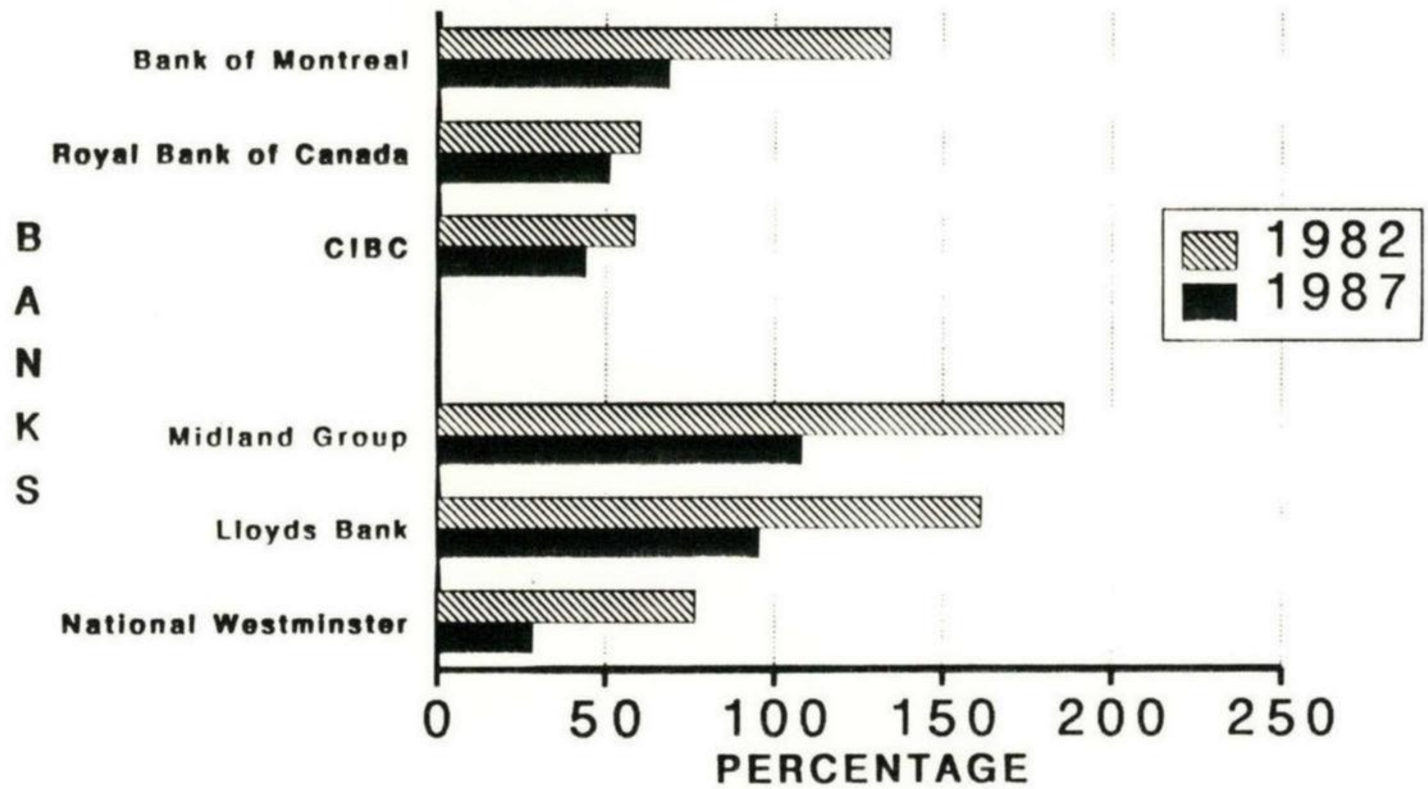


(a) Gross exposure to Brazil, Argentina, Mexico, & Venezuela

Source: Annual Reports, Salomon Brothers Inc.

BANKING ENVIRONMENT

GROSS EXPOSURE TO SELECTED LDC COUNTRIES AS A PERCENTAGE OF EQUITY[a]



(a) Gross exposure to Brazil, Argentina, Mexico, & Venezuela

Source: Annual Reports, Salomon Brothers Inc.

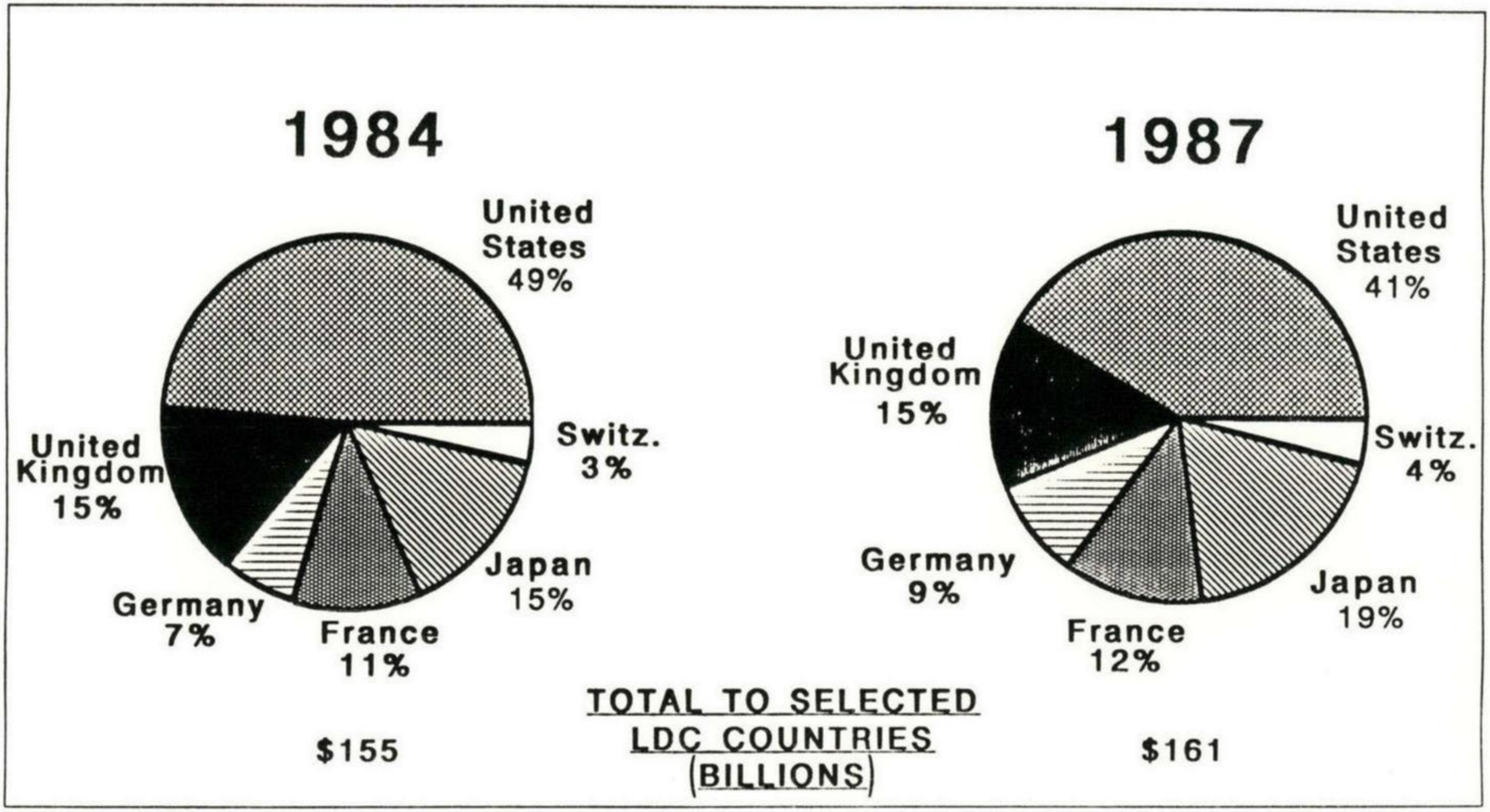
BANKING ENVIRONMENT

Strategies (Cont.)

Japanese Banks Reflect Decline in Importance of LDC Exposure

Fiscal Year	LDC Exposure: Dollars (Billions)	LDC Exposure: Yen (Trillions)	Exposure as Percent: Assets	Exposure as Percent: Equity
1982	27.4	6.5	2	77
1983	32.0	7.1	2	77
1984	32.7	8.1	2	81
1985	34.9	6.2	1	56
1986	36.8	5.3	1	43
1987	39.5	4.9	1	32

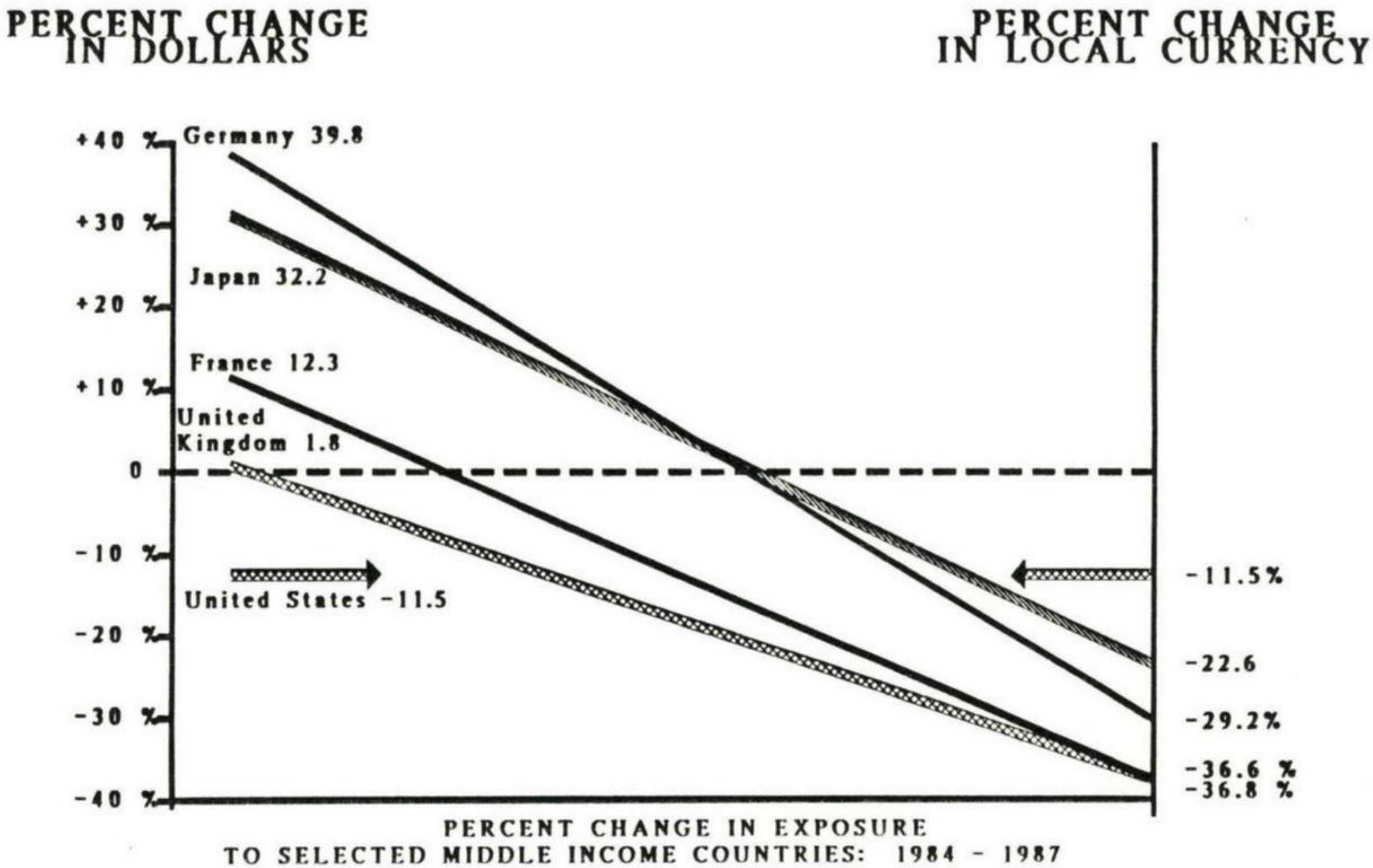
COMMERCIAL BANK EXPOSURE



Note: Selected countries include Mexico, Brazil, Argentina, Venezuela, and Chile

Sources: U.S. Federal Reserve Bank, Bank of France, Japan Center for International Finance, Bank of England, Swiss National Bank, Bundesbank

DOLLAR DECLINE REDUCES IMPORTANCE OF LDC DEBT TO NON-U.S. BANKS



NOTE: Selected LDC Countries: Brazil, Mexico, Argentina, Venezuela, Chile

* Japanese figures are derived from March 1987 data instead of December 1987 data

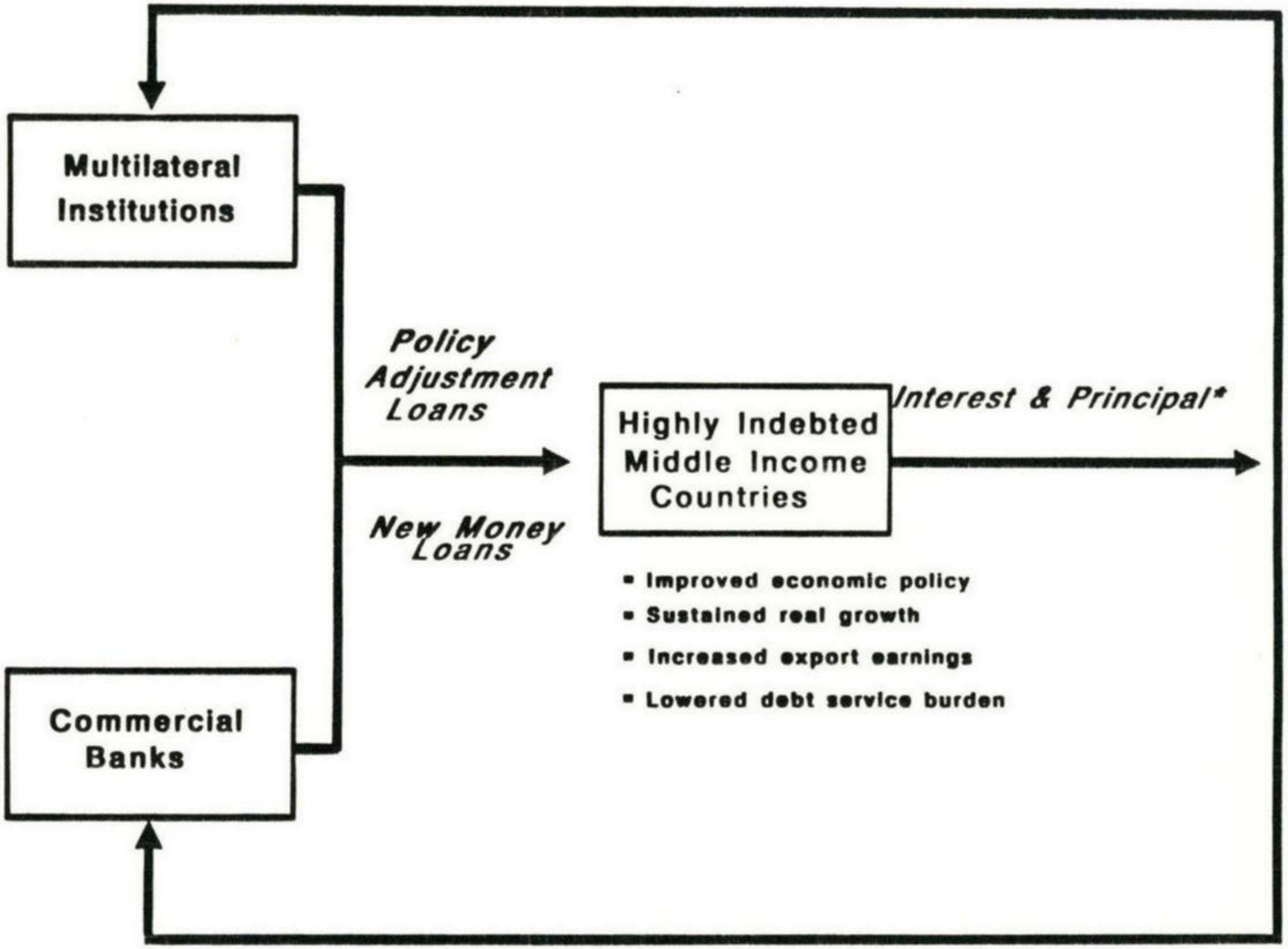
III. CONCERTED LENDING PROCESS

Organization of Report

- Issues in process
- Findings from interviews/survey
- Conclusions of study

CONCERTED LENDING PROCESS

Net New Money (Cont.)



* New money, new old money, and rescheduled debt

CONCERTED LENDING PROCESS

ISSUE: Where does LDC lending fit in banks' strategic plan?

FINDINGS: Interviews and survey suggest banks do not expect to provide net new money to 19 countries

Types of Lending	Percent of Banks Expecting to Decrease Exposure	Percent of Banks Expecting to Maintain Exposure	Percent of Banks Expecting to Increase Exposure
Trade Finance	38%	42%	20%
Project Finance	58%	36%	6%
Medium-Long Term Private	79%	18%	3%
Medium-Long Term Sovereign	75%	23%	2%

CONCLUSION: Banks do not plan to resume balance of payments financing

CONCERTED LENDING PROCESS

ISSUE: Is LDC debt preoccupying top management?

FINDINGS: No systemic concern

- Debtors cartel improbable
- LDC debt reduced as percent of assets
- Banks' capital strengthened
- LDC debt exposure reduced
  . Small increase in gross exposure
  . In local currency exposure decreased
  . Strengthened reserves

Management concerns on competitive environment

- Europe: 1992 integration
- U.S.: Interstate banking/securities powers
- Japan: Continuing deregulation/U.S. and European acquisitions

CONCERTED LENDING PROCESS

Preoccupation (Cont.)

Current actions focus on strengthening bank for increased competition

- Global banking and industry
- Securities houses
- Profitability for Japanese and American
- Reducing bank vulnerability

CONCLUSION: LDC debt no longer a top management preoccupation

CONCERTED LENDING PROCESS

ISSUE: Are banks less cohesive today than in the past?

FINDINGS: No concern of systemic threat

- Maintain debtors liquidity (1982-1987)
- Now question debtors creditworthiness (1987-1988)

Most dwell on policy failures (Argentina) versus success (Chile)

Accounting, regulatory, tax rules now clearer

Individual bank initiative and interbank competitiveness predominate

CONCERTED LENDING PROCESS

Bank Cohesiveness (Cont.)

"Coordinated Action"	"Go It Alone"
French	Canadian
Swiss	U.S.
Japanese	U.K.
German	

Lacking systemic threat, little motivation to increase exposure or act cooperatively

CONCLUSION: Banks now will participate only for self-interest, Japanese for "international cooperation"

More and more banks convinced they must take care of problem themselves

CONCERTED LENDING PROCESS

ISSUE: What is the future of the Advisory Committee process?

FINDINGS: Mixed reactions on role to date

- "Necessary evil"
- "Best that can be done"
- "Only serves Committee Banks' interests"
- "Too U.S. dominated"

Non-committee banks not well informed

Individual competitive interests emerging

- Existence of "in-country branch system"
- Shift burden to Japanese banks

CONCLUSION: Advisory committees are viewed as increasingly self-serving

CONCERTED LENDING PROCESS

ISSUE: Can Advisory Committee produce "new solutions"?

FINDINGS: Invention is outside committees

- Morgan -- Mexican Exchange Proposal
- Bank of America Costa Rica Proposal
- IBJ "time for change" proposal

U.S. money-center banks bias

- Low reserves therefore new money
- Debt-equity for own in-country investments
- Oppose interest capitalization
- Promote World Bank involvement
  - Guarantee
  - Mandatory cross default

CONCLUSION: Advisory committees will innovate at the margin

CONCERTED LENDING PROCESS

ISSUE: How well do banks understand country adjustment programs undertaken to date?

FINDINGS: Understanding varied widely

- Lead Advisory Committee Banks - Very well
- Advisory Committee Banks - Mixed
- Non-Advisory Committee Banks - Not well

Except for Chile, banks did not discriminate in survey; most countries rated "slightly weaker than average"

CONCLUSION: Most banks don't appreciate progress to date or adequately distinguish on case-by-case basis

CONCERTED LENDING PROCESS

Adjustment Programs (Cont.)

Banks rated 19 countries' ability to:

	Implement Macroeconomic Policies	Maintain Political Stability	Develop Attractive Private-Sector Opportunities
Highest Three	Chile Colombia Uruguay	Algeria Uruguay Venezuela	Chile Mexico Brazil
About Average	Mexico Venezuela	Egypt Ivory Coast	Philippines Colombia
Lowest Three	Egypt Argentina Peru	Peru Bolivia Philippines	Yugoslavia Poland Peru

CONCERTED LENDING PROCESS

Adjustment Programs (Cont.)

Banks' views on "most creditworthy"

Highest Combined Weighting	Banks Reducing Exposure Last 12 Months	Banks Interested in Increasing Medium- or Long-Term Credits	
		Private	Sovereign
Chile	45%	13%	4%
Uruguay	40%	5%	0
Mexico	65%	0	0
Venezuela	42%	8%	8%
Colombia	35%	4%	4%

CONCERTED LENDING PROCESS

ISSUE: Are banks tiering new money decisions?

FINDING: Interviews suggest countries with larger private sectors more likely for new money

Survey confirms tiering

CONCLUSION: All countries will have increasing difficulties obtaining new money, but smaller countries may not get new money

CONCERTED LENDING PROCESS

Tiering (Cont.)

Banks are more positive toward Tier I countries

	Percent of Banks Expecting to		
Type of Lending	Decrease Exposure	Maintain Exposure	Increase Exposure
Trade Finance	11%	48%	41%
Project Finance	61%	29%	10%
Medium-Long Term Private	65%	30%	5%
Medium-Long Term Sovereign	42%	42%	16%

CONCERTED LENDING PROCESS

Tiering (Cont.)

	TIER I	TIER II	TIER III
COUNTRIES	Mexico Brazil Venezuela Chile	All other	"Poorest of the Poor" Sub-Saharan Countries
CHARACTERISTICS	. Significant natural resources . Foreign banks have presence . Multinational investments . Policy to increase private sector	. Limited exposure . Non-accrual/write-offs not threatening to banks . Limited presence by multi-national corporations	. Mostly official credits . Limited sources of export earnings . Impoverished economies . No foreseeable bank involvement
LIKELIHOOD OF COMMERCIAL BANKS CONTINUING TO PARTICIPATE IN NEW MONEY PROGRAMS	Moderate	Low Probability	Nonexistent

CONCERTED LENDING PROCESS

ISSUE: How are official institutions viewed?

FINDINGS: Reaction is slightly positive, but mixed

- IMF generally credible, except Argentina
- World Bank
  - Parallel financing not highly valued
  - All banks want guarantees
- Banks split on rationale for World Bank action
  - Canadian, French, and U.S. banks will book as loan to a multilateral, not LDC
  - British, U.S., and Japanese view as reducing capital adequacy requirements

CONCERTED LENDING PROCESS

Official Institutions (Cont.)

Banks assessed World Bank conditionality as less restrictive than IMF

	Percent of Banks
More Restrictive	8%
About the Same	25%
Less Restrictive	67%

But banks felt World Bank more accurately reflects developing countries' economic realities than IMF

	Percent of Banks
More Accurately	40%
About the Same	52%
Less Accurately	8%

CONCLUSION: World Bank conditionality can be as credible as IMF in policy lending

IV. IMPLICATIONS FOR DEBT STRATEGY

- *Debtor countries should continue to:*

  . Exhibit strong political leadership

  . Demonstrate continued domestic structural reform

  . Promote private-sector investment

- *Creditor banks should devise ways to:*

  . Supplement new money shortfalls with optional debt service stabilization/reduction programs conditional on country's policy reform

  . Expand their menu of options for non-U.S. banks, with burden sharing equivalent to U.S. banks

Implications for Debt Strategy (Cont.)

Multilateral institutions should seek to:

- Strengthen their catalytic role to promote development and private-sector investment/lending

- Provide institutional framework for developing debt service burden stabilization/reduction techniques for debtors and creditor banks

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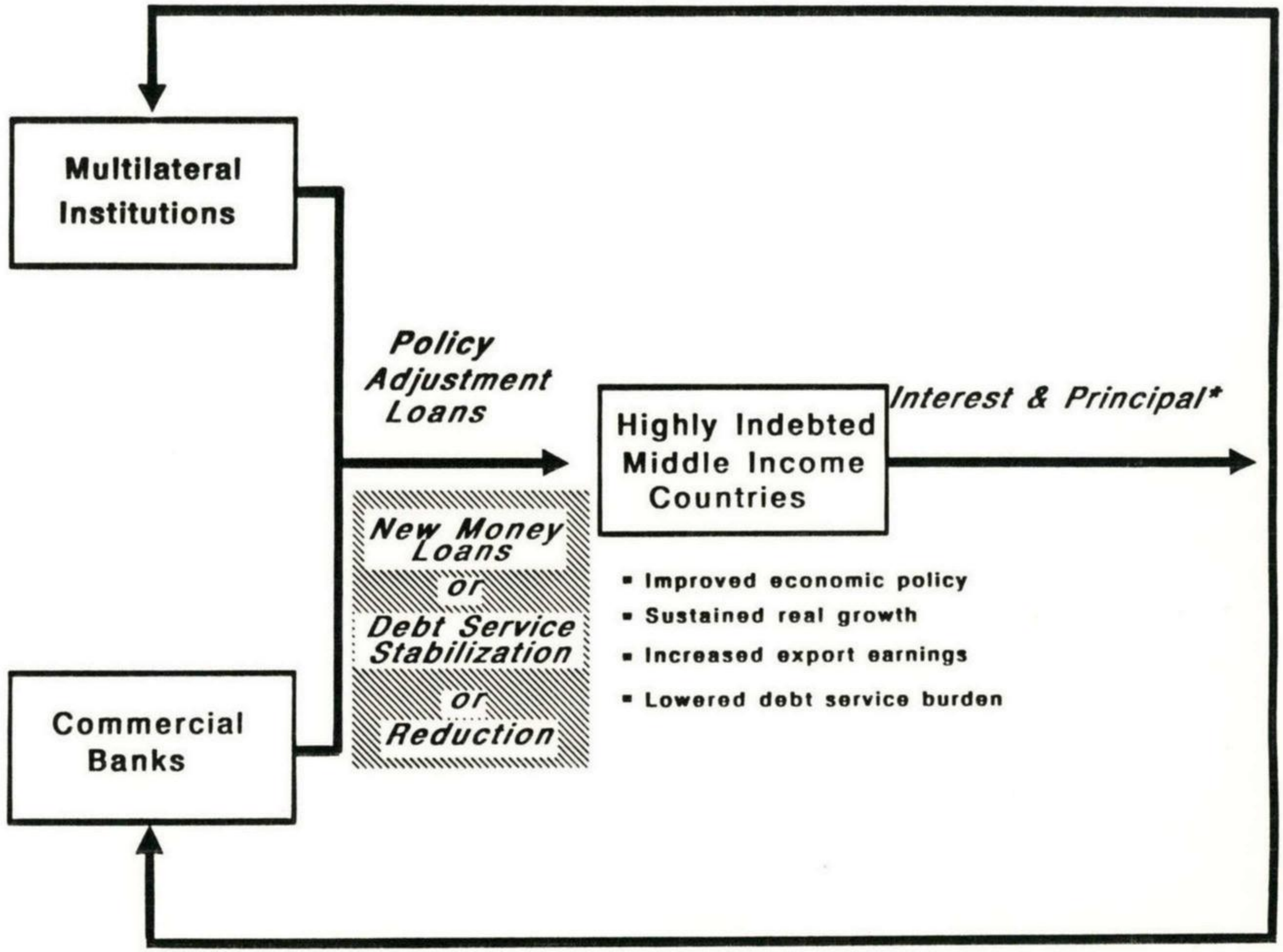
MODIFIED DEBT STRATEGY MODEL



* New money, new old money, and rescheduled debt

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

May 31, 1988

Dear Mr. Nichols:

Thank you for your letter of April 20th requesting Special Guest status for Mr. Frederick Heldring, Chairman of Philadelphia National Bank, at The World Bank/IMF Annual Meetings this September in Berlin.

We are experiencing a sharp increase in the sizes of the official Delegations for the Annual Meetings. As a result, it has become necessary to reduce the number of Special Guest invitations, and it will not be possible to issue a Special Guest invitation for Mr. Heldring.

The Joint Secretariat has arranged for Mr. Heldring to attend the Annual Meetings as a listed Visitor and, in addition, on an exceptional basis this year, for him to attend the Chairman's Reception scheduled for Sunday, September 25, 1988. I have asked Mrs. Beth Hines, our Officer for Special Guests, to contact Mr. Heldring directly regarding these arrangements.

I appreciate knowing of your Chairman's interest in the Bank/Fund Annual Meetings, and hope he will be able to attend.

Sincerely,

Barber Conable

Mr. Steven S. Nichols
Senior Vice President
Philadelphia National Bank
International Division
Broad and Chestnut Streets
FC 1-2-90, P.O. Box 7618
Philadelphia, Pennsylvania 19101-7618

xcc
77H

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/04/20 DUE DATE : ~~88/05/02~~ 5/9/88
LOG NUMBER : 880425007 FROM : Steven Nichols
SUBJECT : Re Mr. Frederick Heldring as a Special Guest for the IMF meetings this Fall in Berlin.
OFFICE ASSIGNED TO FOR ACTION : Mr. Thahane (D1130)

ACTION:

______	APPROVED
______	PLEASE HANDLE
______	FOR YOUR INFORMATION
______	FOR YOUR REVIEW AND RECOMMENDATION
______	FOR THE FILES
______	PLEASE DISCUSS WITH ______
✓	PLEASE PREPARE RESPONSE FOR BBC SIGNATURE
______	AS WE DISCUSSED
______	RETURN TO ______

COMMENTS :

B. Hines (prep. reg.) - Linda saying Stanton's office

Heather checking (wcb - 5/17)

Philadelphia National Bank
International Division
Broad and Chestnut Streets
FC 1-3-90 PO Box 7618
Philadelphia PA 19101-7618
215 629 3967
Telex 244477

Steven S Nichols
Senior Vice President

Philadelphia National Bank

April 20, 1988

Mr. Barber Conable
President
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear Mr. Conable:

Recently I had the occasion of speaking to James Orr, Executive Director of the Bretton Woods Committee. During the course of our conversation, I asked Mr. Orr for his thoughts on how we might assure ourselves that our Chairman, Mr. Frederick Heldring, will be designated as a Special Guest for the IMF meetings this Fall in Berlin. Mr. Orr advised that although the final list will not be prepared until late June, it might be appropriate to notify you well in advance of Mr. Heldring's desire to attend the meetings in this capacity.

If you forsee any problems regarding Mr. Heldring's designation please don't hesitate to have one of your staff members contact me. Thank you in advance for your assistance. With kind regards, I remain,

Sincerely yours,

Steven S Nichols

SSN/dm

The World Bank
Washington, D.C. 20433
U.S.A.

May 19, 1988

Federal Reserve Bank of New York
33 Liberty Street
New York, N.Y. 10045

Attention: Mr. Sam Cross
Executive Vice President

Gentlemen:

As you know, Congress authorized the President to accept membership for the United States in the Multilateral Investment Guarantee Agency ("MIGA") in the continuing appropriations legislation enacted last year (Public Law 100-202). This legislation also authorizes a Reserve Bank to act as a depository or fiscal agency for MIGA.

Although the board of directors of MIGA has not been formally instituted, it is necessary that a U.S. dollar account be established on behalf of MIGA at this time to accept subscription payments from its members. Accordingly, until such time as the establishment of a comprehensive account relationship for MIGA shall have been duly authorized, it is requested that the Federal Reserve Bank of New York ("Bank") open a U.S. dollar deposit account to be designated "Multilateral Investment Guarantee Agency (MIGA) Account General" for the receipt of subscription payments subject to the following terms and conditions:

- The account will not bear interest and the Bank will advise MIGA of transactions in the account and report balances under the same procedures as may be in effect with respect to the dollar accounts of the International Bank for Reconstruction and Development.

- Disbursements from the account will be made by tested telex only.

- It is understood that the handling and collection of checks, drafts, and other "cash" or "non-cash" items deposited in the account, and transfers of funds to or from account, shall be governed by the relevant terms and conditions of pertinent regulations of the Board of Governors of the Federal Reserve System and the Bank's Operating Circulars.

- MIGA agrees to indemnify the Bank and hold it harmless from and against all liabilities, charges, losses, costs, damages and expenses, including counsel fees, arising out or in connection with the account or other transactions contemplated by this letter.

I would appreciate your prompt confirmation if these arrangements are acceptable to you.

Very truly yours,

Barber B. Conable

Barber B. Conable
Chairman of the Board of Directors
of the Multilateral Investment
Guarantee Agency

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Date: May 19, 1988

To: Distribution

From: Barber B. Conable, Chairman, Board of Directors, MIGA

Extension: 72001

Subject: MIGA - Signature Authority

Pending further notice, each of you is hereby authorized in the name and on behalf of the Multilateral Investment Guarantee Agency (MIGA) to sign instructions and other instruments for or in connection with:

(a) the opening and closing of accounts in banks and other depositories of funds;

(b) the deposit of funds into and the withdrawal of funds from such accounts;

(c) the purchase, custody, sale or encashment of short-term investment securities issued by the authorities of countries whose currencies are designated as freely usable under the Convention Establishing MIGA; and

(d) the sale of federal funds and investments in certificates of deposit and other unconditional obligations of banks and other financial institutions.

In exercising this authority, you will apply the policies, procedures and mechanisms established for IBRD.

Barber B. Conable

Distribution:

Mr. Yves M. Balcer (INVD2)
Mr. Hywel M. Davies (CSHDR)
Mr. Mohsen Z. Fahmi (INVD1)
Mrs. Araceli A. Gonzaga (INVSC)
Mr. Bernard J. Holland (INVDR)
Ms. Veronique Lavorel (INVD2)
Mrs. Katharine E. Pan (CSHDR)
Mr. Walter Peyerl (CSHCO)
Mr. John Poulsen (CSHCO)

P-1867

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Date: May 19, 1988

To: Mr. Barber B. Conable

From: Ibrahim F.I. Shihata

Extension: 74945

Subject: MIGA - Receipt and Investment of Payments on Subscriptions

Attached for your signature, in your capacity as the Chairman of MIGA's Board, are:

(1) a letter to the Federal Reserve Bank of New York, which they need to receive in order to open an account to accept dollar payments in respect of the paid in cash portions of MIGA members' subscriptions; and

(2) a limited authorization for the relevant officers of the Bank's Cashier's and Investment Departments to invest such funds, pending the adoption of a comprehensive investment policy by MIGA's Board. This authorization will enable the cash subscription payments, which became payable last month, to be invested as soon as they are received and thus help to lessen MIGA's financial dependence on the Bank in 1988.

Attachments

cc: Messrs. Stern and Wapenhans

P-1867

The World Bank
Washington, D.C. 20433
U.S.A.

May 19, 1988

Federal Reserve Bank of New York
33 Liberty Street
New York, N.Y. 10045

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Executive Vice President

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I would appreciate your prompt confirmation if these arrangements are acceptable to you.

Very truly yours,

Barber B. Conable
Chairman of the Board of Directors
of the Multilateral Investment
Guarantee Agency

Drafted by: IFIShihata/AParra:ap

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

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From: Barber B. Conable, Chairman, Board of Directors, MIGA

Extension: 72001

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Mr. John Poulsen (CSHCO)

Drafted by: IFIShihata/AParra:ap

The World Bank
Washington, D.C. 20433
U.S.A.

J. WILLIAM STANTON
Counselor to the President

April 22, 1988

Mr. Conable:

An appointment has been scheduled for you to see Barry Sullivan (Chairman of the Board of First Chicago) at 3:30 p.m. this afternoon.

He wants to touch base with you having just returned from Japan in his capacity as present Chairman of the International Institute of Finance. The IIF's annual meeting ends today with a lunch at the Ritz Carlton where Gerry Corrigan is the Speaker.

Horst Schulman, the Managing Director of IIF, made a major speech a couple of weeks ago in which he called for more guarantees from the World Bank to aid in the debt crisis. Barry Sullivan is aware that Mr. Volcker will be present this afternoon.

Ernie Stern, when I discussed this matter with him, encouraged the meeting.

Bill

Bill

Dear Bill:

Thank you very much for sending me a copy of the English translation of Mr. Simonsen's article on the current situation in Brazil. It contains many interesting insights which, even though expressed in unconventional terms, I found stimulating. I also think it is a fine testimony to the Brazilian spirit of free debate that such an article appeared as the cover story in Veja Magazine.

Sincerely,

(Signed) Barber B. Conable

Mr. William R. Rhodes
Chairman, Restructuring Committee
Citibank, N.A.
399 Park Avenue
New York, New York 10043

Log No. 880202020
cc: Messrs. Qureshi
Husain
Choksi, LAIDR

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CORRESPONDANCE DATE : 88/01/26 DUE DATE : 88/02/16
LOG NUMBER : 880202020 FROM : William Rhodes
SUBJECT : Enclosing recent cover story in Veja Magazine by Mario Simonsen on the situation of Brazil today.
OFFICE ASSIGNED TO FOR ACTION : Mr. M. Qureshi (E-1241)

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William R. Rhodes
Chairman
Restructuring Committee

January 26, 1988

Mr. Barber Conable
President
The World Bank
1818 H Street N.W.
Washington, D.C. 20433

Dear Barber:

I am enclosing an English translation of Mario Simonsen's recent cover story in Veja Magazine in case you missed it. I think you will find it an impressive, and well written, appraisal of the situation in Brazil today.

Best regards,

Bill

encl.

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Veja, October 14, 1987

THE RISK OF OPTING FOR BACKWARDNESS

The prodigal and irresponsible pharisaical machine that dominates the State can lead the country to collapse

by Mário Henrique Simonsen

The New Republic is embarking on a perilous adventure - the attempt to reinvent the wheel. Last year it produced the Cruzado Plan, which could have been proper anesthesia on the eve of anti-inflationary surgery. As the anesthetist forgot to call in the surgeon, the plan was filed away as one more frustrated attempt to combat inflation by its symptoms. Once the messianic euphoria was over, the Brazilian economy became a sort of catalogue of viruses: three-digit inflation rates, record public deficits, futile attempts at price freezing and the toughest wage tightening in history.

For those who like anarchy, it became a minor masterpiece, but this year we decided to do still more. The perilous adventure continued when the Government came up with the idea of playing hard with the creditors of our external debt, by declaring an interest moratorium and shouting in all directions that we would be renegotiating the debt with a discount, as if a yellow promissory note might be worth more than a green promissory note, exactly with the same characteristics and guarantees - or, more precisely, lack of guarantees. To err is no proof of lack of intelligence. It is by trial and error that one learns, and only one who does nothing does not err. It is foolish to repeat proven errors, and that is the syndrome that today appears to be infecting the dominant Brazilian elite who, if they ever were brilliant, were rarely so creative in their capacity to fabricate disasters as now, in the late 1980's. Unfortunately, all that is happening in a year when Congress is preparing a new Constitution, conceiving a new regime, inventing a new tax system and designing a new paradise. Brazil is today confronted by the risk of simultaneously ratifying an irrational option for technological backwardness, xenophobia, statism and the most wicked of the types of bureaucratic capitalism that have in the past debased our history. All that in the name of a "progressivism" that no one knows the meaning of - because, in truth, it means nothing else but a state of mental confusion.

A piece of paradise, that of the Archangel Funaro, is now gone. To end inflation by decree does not work, of course, as has been known since the times of the Code of Hammurabi who, 1,700 years before Christ, froze two basic prices in Assyria, that of oil and that of salt, and established that transgressors would, justly, be burned in boiling oil. The problem is that, with the freeze, the product rose in price and it all ended up in a shortage of oil to exterminate the saboteurs of the Cruzado Plan of Babylonia. Sixteen hundred years ago the Roman Emperor Diocletian attempted the same experiment, on a smaller scale, and in spite of his recognizably divine powers, the freeze followed the classic cycle: brilliant idea-shortage of supply-speculation-collapse.

It may be argued that Hammurabi and Diocletian are figures out of the past, from ancient history. But not long ago, and not very far from Brazil, the Chilean president Salvador Allende and the Argentine divinity Juan Perón tried, in the early 1970's, similar schemes, whereby they would be capable of keeping down prices and raising wages. Allende ended up with a bullet in his mouth, in a burned out palace and in a ruined country. Perón escaped to life everlasting before the collapse of his plan, leaving to the military the task of deposing his widow and vice president Isabelita and precipitating the country into the most inept and sanguinary dictatorship of its history. As God is Brazilian, after the Funaro Plan, which was intended to freeze everything forever, instead of the Apocalypse, along came the Bresser Plan, which was intended to freeze, who knows what, let alone for how long. One thing is certain: in today's Brazil a system of economic administration is alive, in which the formula most frequently resorted to in order to combat inflation is undoubtedly the decree.

That intellectual poverty, product of a mixture of political opportunism with absolute disregard for the consequences, also took into account the treatment that the Government - ostentatiously supported by its party, the PMDB - accords the external debt. Our moratorium of 1987 is a delayed rehash of the Argentine attempt to shake up international finance at the beginning of the Administration of Raúl Alfonsín. With the difference that the Argentine president and his Minister of Economics, Bernardo Grinspun, preferred to create confusion to appearing arrogant. They delayed payments and presented the creditors with wild proposals, but when they came before the circle of creditors, they were cautious enough never to declare the moratorium formally. Finally, Alfonsín realized that better than quarreling with the creditor was to throw Grinspun out of the Ministry of Economics, appointing in his place economist Jean Sourrouille, whose first measure was to initiate negotiations with the International Monetary Fund, IMF, which for the Brazilian Government and the brass band of the PMDB is a kind of inferno fed by the flames of arithmetic.

Our Brancaleone army (read the economists *of the* PMDB, economists *in the* PMDB, PMDB adherents *in the* economy or however it may be understood) was convinced that Brazil had a lethal weapon. The weight of our 109 billion dollars in debt could shake international banking, bringing it to its knees on the Market of the Three Powers. One arithmetical detail and a new fact were overlooked. The arithmetical detail is that 109 billion dollars are a fortune in Portuguese, but do not come to so much in other languages: they account for just 1.5% of the annual GNP of the three major economies of the Western world, the United States, Japan and Germany.

The new fact is that not even the world championship in external debt belongs to us. The United States snapped it up and today owes nearly 300 billion dollars to the rest of the world, which are indeed enough to destabilize the international economy. It is not surprising, at this stage, that Minister Bresser Pereira has been unable to meet his American peer James Baker with the success with which David confronted Goliath. Especially because David was astute enough to take his rival by surprise. If he stuck a loudspeaker in his mouth, announcing to the world his skill in handling a sling-shot, the biblical story would be different. Let us be fair to Minister Bresser. He has plucked up the courage to reconcile rationality with the economic program of the PMDB. But as it takes more than courage, its exercise, however patriotic, is not very encouraging.

The cruzado and moratorium, however irrational and disastrous, are still reversible mistakes. They leave scars, but do not condemn us to metastasis. What is really serious is the sword of Damocles that our Constituent Assembly has placed in orbit above the 8.5 million square kilometers of Brazilian territory. The so-called "progressivism" of the bill of the Systematization Committee is the confluence of subculture with opportunism. Subculture is the contradictory feeling of one who, in seeking good, does wrong, that is, that set of good intentions that pave the way to hell. Opportunism is the attempt to preserve what no American rightist has the courage to defend - bureaucratic capitalism. It is precisely in the preservation of that system of favors, whereby Congress pretends that it believes the State is able to solve all national problems, that the most serious risk to the future of the country lies. Actually, few are so foolish that they are about to believe that the State is going to do much for those who have nothing. What is believed, and that is precisely what it is desired to maintain, is the capacity of the State to solve the problems of a political, economic and financial elite by using the taxpayer's money and making believe that the public welfare is being promoted. They play the fiddle to be able to continue sipping champagne. In that strategem, curiously enough, the extremes of right and left meet, the analogy of the cobra that bites its own tail.

In that ode to the do-everything State, the idea that everything it does is intended to improve the lives of the unfortunate is always built in. We were one of the last countries to abolish slavery, and we have one of the most distorted patterns of income distribution in the world, but the division is always the same. "I shall sell the last diamond in my crown, but no northeasterner will die in the drought," said Dom Pedro II. The crown, intact, rests in the Imperial Museum of Petrópolis. The northeasterners of the great drought of 1870 rest in the cemetery.

It is evident that only the uncaring are not moved by the misery and injustice. For that, it is not necessary to read the Communist Manifesto or the pungent descriptions by Karl Marx of the subhuman lives of the English workers in the coal mines of the past century. It is sufficient to take a walk, even now, through the favelas of Rio de Janeiro. And even the more intelligent uncaring, if they are not moved, will at least be disturbed by the nearness of the absolute misery, for there is no Pretorian Guard to protect us from an eventual descent from the hills.

Especially because it is cheaper to give jobs to the residents of the favelas, and therefore let them leave the favelas, than to pay the Pretorian Guard. It is also safer, because throughout history the pillage promoted by guards has always been more devastating than that perpetrated by the poor.

It is therefore not surprising that some of the arguments of our present Left, especially those that offer shorter paths to equality, are fascinating to priests, artists, and, to some extent, scientists. It just so happens that the tears of the intellectual do not fill the bellies of the poor, just as the emptiness in the bellies of the poor does not destroy the European holidays of the intellectual. This being so, an intelligent uncaring person can be more useful to the poor than an inarticulate vicar, who very often offers the kingdom of God while making a hell on earth for those who fail to meet the test. The well-intended preferential option for the poor frequently degenerates into an inescapable option for impoverishment.

Only if it improves the life of the poor by enabling them to have access to wealth - and the essential problem of wealth lies, not in the difficulty of distributing it, as at a charitable event, but of creating it. Modern capitalism only survived because it grew. And it grew by bringing to society the means of social balance that, almost half a century ago, proved effective and, above all, boosted the democratic development of Western societies. The progressive income tax is the civilized way of taking from the rich and giving to the poor. Prior to that , the mythological John D. Rockefeller could announce, at the beginning of the century, that "the capacity to earn money is a God-given gift (...) and, having received it from him, I find it is my duty to earn more and more money, using it for good, as my conscience dictates." Today, fortunately, most of that golden slice of conscience of the Rockefellers is in the Federal Treasury of the United States Government. Free basic education, unemployment insurance, health insurance and social security form part of modern capitalism, seeking to equalize opportunities. Between the capitalistic world described by Marx and that existing today, there is a very great difference. The world in which we live is infinitely more prosperous, because where the laws of the market work, it has become much more difficult for the wealthy to believe that they personify the preferential option of God.

Equalization is not - not will it become - complete for one pragmatic reason: absolute equality is only achieved through downward equalization. The famous socialist utopia of "from each according to his abilities, to each according to his needs" never worked for one obvious reason: work is not a hobby, except for a privileged minority. This having been established, if what everyone receives has nothing to do with what he produces, production is reduced to scarcity, because nobody will be interested in producing more or better. All that is left, therefore, is to apportion the needs, eventual pseudonym for misery. There is nothing original about those remarks; they are even dated, almost trite. If they have to be repeated in the Brazil of 1987, New Republic, transition government, PMDB economists and Constituent Assembly, it is just because of the intellectual needs of the debate being waged today in the country. Unfortunately, many of the more current questions of the national debate at this time have been obsolete elsewhere for decades. But, as we suffer from a certain historical lag, which brings us back to the European Theater of Operations after D-Day and only enabled us to realize the existence of the People's Republic of China in 1974, it is still necessary to try restoring reason, precisely because of the origins of the irrationalism, however archaic.

The great question that has to be debated in Brazil now is what we prefer: to impoverish the rich or to enrich the poor. In order to accomplish the first objective, it is sufficient to adopt the draft Constitution of the Systematization Committee and to enter history as the land of the two Cabrals, the one who discovered Brazil and the one who kept it a secret. If the objective is to enrich the poor, now is the time to abandon the inconsistent, declaratory and inept sentimentalism and bury the myth that the Left has an exclusive copyright to the idea of progressivism - when it is evident, rather, that the greatest progress in the real world is today accomplished in the open capitalistic and democratic societies.

That inconsistent sentimentalism is hinged on the presumption that the State is capable of creating resources from nothing. In reality, as the State does not have divine powers (even though our Constituent Assembly members frivolously declare they are under God's protection), all it can do is take from one and give to another. In that process, let it be said in passing, there is a cost, for it is necessary to appoint at least one civil servant to make the distribution. In other words, the State is never able to take 100 cruzados from a rich man and give the same 100 cruzados to a poor man. Along the way, part of the 100 cruzados remains with the bureaucracy. In a recent estimate, Deputy Antônio Delfim Netto calculated that, at the end of one of those operations, if the poor man receives 60 of what used to be 100, everything is going very well. In some cases, the bureaucracy ends up costing *more* than the 100 cruzados - which means that it ends up being supported not just by the rich man, but by the same needy person in whose name it is acting. Furthermore, in many cases the State takes money from the poor as well as from the rich, starting with the Goods Traffic Tax, the ICM. Take one example: if entrepreneur Sebastião Camargo, whom the magazine *Fortune* has just crowned as the richest man in Brazil, went to buy one kilogram of beans at the same store as the humblest of the peons he employs, both will pay 17% Goods Traffic Tax on the bag carried under the arm. It will do Sebastião Camargo no good to insist ~~with~~ to the grocer, the prefect, the governor or even the President of the Republic in case he would like to pay more and thus increase his contribution to the poor. Likewise, if the peon does not have the cash and is short two cruzados to carry off his beans, it will do him no good to talk to the prefect, the governor or the president, asking for a 5% discount in the ICM. Either he gets the reduction from the storekeeper or he does not eat, for the ICM, like all taxes, is intended to feed the poor, and if he does not pay, the Government swears that the poor will be left without beans.

The Brazilian Government systematically conceals the workings of its proclaimed distribution network. Always, through expensive publicity campaigns or hypocritical speeches, it paternally identifies those who receive its benefits, but it is ever careful to create confusion about who pays the bill. The taxpayer is the chief party absent from all the governmental accomplishments. Who built Brasília? Juscelino Kubitschek. Who built the Rio-Niterói Bridge? Minister Mário Andreazza. Neither of the two, of course. The party responsible for those projects - for better or for worse - was the Brazilian people, who paid for them.

The mystification of the source of funds is a profoundly undemocratic practice, but commonplace in the history of Brazil and firmly taken over by the New Republic. The poor are hurt the most, for they are the ones who pay taxes the most without knowing about it. And as if that did not matter, when a prefect, governor or president appears at an inauguration ceremony, especially for expansion of services, he behaves as if the money had come out of his own pocket. The proof is that public works bear the names of chief executives. No one remembers any bridge that was ever named after the Brazilian who paid most income tax that year.

How many people realize that, out of each 100-cruzado bill, the Government grabs 6 to 10 cruzados per month for inflation alone? And how many perceive the monumental mystification practiced by the Government when it says that the blame for inflation lies in a distorted social mentality prevailing in the country? It is the lack of transparency in public accounts that nourishes the inconsistent sentimentalism, which only scores goals in the net of the poor.

Let us see other concrete examples. In 1984 a Financial Housing System subsidy was granted, for thanks to the disastrous Decree-Law No. 2065 middle class wages were intensely squeezed in real terms. In 1985 the New Republic decided to raise that benefit, by changing the annual monetary adjustment of 235% to just 112% for borrowers, who thereafter accepted a semiannual adjustment of their loans. The bill was to be paid by the Wage Variation Compensation Fund of the BNH. Only the Fund had variations, but had no funds. Therefore, the Financial Housing System was left without resources and with no motivation to grant new loans. Result: there is no more financing for public housing and for the middle income brackets, except for the trickling disbursements of the Caixa Econômica Federal (Federal Savings Bank). The population is therefore crowding more and more into favelas. Worst of all, with the atrophy in building the favela dwellers are left without jobs. That situation is attended by a further outrage, disguised as philanthropy.

Imagine one of those high-rise middle class buildings in São Conrado in Rio de Janeiro. Now imagine a worthy citizen who, having amassed his savings, applied to buy an apartment in one of those buildings. A diligent man, he keeps careful accounts and, in spite of having suffered some wage loss in 1984, has enough to pay his installments to the BNH. The Government, meanwhile, granted the subsidy broadly, sweepingly and unrestrictedly. Opposite the apartment of that subsidized borrower is the favela of Rocinha. There, throughout the time that the policy of subsidies for middle class buildings prevailed, the prices of huts were at the mercy of the fluctuations of a capitalism gone wild. And anyone in Rocinha who was thinking of buying a little suburban house with financing has to wait perhaps a decade, because the Government in 1984 wanted to help the poor.

In the Brazilian Government, in fact, there is always very little left over for the poor, because a long line is waiting in front of them. Brazil has today 8.5 million civil servants. How many of them are productive is not known for certain, but it is suspected that a good many of them have jobs without work. It is known moreover that the New Republic was extravagant in making appointments, since that appears to be the fundamental objective of our politicians. It is obvious that those who are not functionaries are grappling with the cost of the civil servants. Therefore, the more functionaries named, the poorer the rest of the population becomes. Just as no one knows exactly who is supporting whom, no one protests when the functionaries go out on strike and obtain juicy wage hikes, as just occurred at the Banco do Brasil. Just think, if necessary, that the biggest strike provoker in Brazil is the State. Capable of demanding that employers of private enterprise resist the unions of their workers, it is most lavish in granting concessions when the strikes occurs at home. Why? Now, simply because the bureaucrat who yields does not pay a cent. He sends the bill to the one called "the widow" in Brasília, the nation.

Another example: last year the Government decided to play the miracle worker with the Cruzado Plan, attempting to transform Brazil into "Jaíça," the country that grew at double the rate of Japan with the inflation of Switzerland. The consumer festival rendered vast electoral dividends for the PMDB, which waged its campaign with the sincerity and public spirit of a program jury of novices. It so happened, however, that with the damage done to the State enterprises and sectors caught in the freeze, the plan was condemned to failure. At that stage the PMDB economists (or "pemenomistas do ecodebē," which also means nothing, but is at least a new jargon) discovered that the salvation of Brazil lay in suspension of interest payments to the greedy international bankers. We declared a moratorium and this is what happened: a vast recession combined with an unprecedented wage tightening. Which shows that, in the matter of stagflation, the PMDB managed to be more inventive than the Figueiredo Administration. The greatest invention of the PMDB, however, is the idea that it is doing everything for democracy, for social justice and in the name of national sovereignty. The sad part is that the Government as well as a segment of the party believe that the strategem is effective.

To ask favors from the Government is a cultural habit that we inherited from the Iberian Peninsula. The story begins with the letter of Pedro Vaz de Caminha, who beseeches employment for his son-in-law. It progresses with the division of Brazil into hereditary captaincies. In the last century the pioneer of big private business in the nation, the Baron de Mauá, transformed into the patron of industry in the Republic, failed because he did not obtain sufficient favors from Dom Pedro II. The same thing happened after World War I to the pioneer of the São Paulo textile industry, Jorge Street. It is not surprising that, with that culture broth, a degeneration of Brazilian capitalism should emerge: the bureaucratic enterprise, protected by the Government with two hands. The hand of the strongbox, guaranteeing it against losses, and the hand of protectionism, freeing it from competition. In the modern version, the bureaucratic enterprise is the one that profits more by sending its executives wandering through the Government offices and ministerial peninsulas than by concentrating them in the improvement of productivity. They are persons of importance who always bring a smile to the lips, an order in hand and the blackmail of imminent unemployment: "If my business should fail, thousands of jobholders will be put out on the street." The interaction between the officeholder and the bureaucratic capitalist is socially odious. First, because it is an invitation to corruption. Second, because it is a denial of capitalist philosophy itself, in which profit is justified only in compensation for risk. Third, because it is a discouragement of efficiency. Fourth, because it is a means of taking from the poor and giving to the rich. In general, after all, the peninsula executive guarantees only one job, his own, leaving to the officeholder the task of scratching money from the taxpayers.

Curiously enough, true capitalism was planted in Brazil by entrepreneurs who had no access to court, generally immigrants, Italian "carcamanos," German "colonões," Syrian and Lebanese "turcos." Below the line of bureaucratic prosperity of the Paraíba Valley, where a vulgar aristocracy lived off the black and danced on mortgages, the Brazilian capitalistic venture took hold through small businesses where free labor was the key to success. Natural selection operated there, efficiency being the condition indispensable for survival. It is not surprising that, for that very reason, the southern capitalist made broad strides, while the bureaucratic and welfare-oriented Northeast proceeded at a snail's pace. In the 19th century the northeastern sugar mill was bankrupt even in terms of a slavocrat society, but that never detracted from the splendor of the Baron de Cotegipe. Today the sugar mill is again bankrupt, which will certainly not curtail the pomp of the future Viscount of Sudene or Baron of Suvale.

The question that arises is whether, after the generation of the immigrants, the southern entrepreneurs or a good many of them also adhere to bureaucratic capitalism. It is sufficient to recall that in the 1950's and 1960's two bastions were erected against the invasion of Brazil by the multinationals. On the one hand, the Left, which exorcised the foreign companies that would come here to exploit cheap labor and bleed our balance of payments with remittances of profits abroad. On the other, the Federation of Industries of the State of São Paulo, whose members simply did not want their profits to be touched by competition from the gringos. Curiously, the extreme left and the right joined forces against the common enemy. The classic episode was the blocking of the American Can plan to produce cans in Brazil during the Kubitschek Administration. The Left took the initiative in raising hell, the Right continued with the privilege of producing more expensive and worse quality cans in order to fatten their profits and the consumer paid the bill.

What supports bureaucratic capitalism, whose most recent masterpiece is the Data Processing Law? Obviously, the interested parties are the officeholders, who increase their power, and the heads of bureaucratic enterprises, who increase their profits without creating genuine progress. Outside of that circuit there are today tens of thousands of businessmen who have more to do and cannot go wandering the corridors of the "Funs," "Pros" and "Bans," through which the State maintains funds, programs and banks with the money of others. The Brazilian business class, which thirty years ago could fit into the rooms of the Rio de Janeiro Country Club, today embraces vast numbers, when one thinks of the figures projected at the frequent official dinners. Today, as at the end of the last century, there is a trend, led by the State, that is pushing the Brazilian business class backward, through court intrigues. Another trend, followed by entrepreneurs who are only able to understand profit as the product of work, who do not know the powerful and are unfamiliar with law or even where the BNDES is, points the way for the country to pursue a freer economy, the only one in which, it is perceived that it will be able to survive.

The victims of the predominance of the retrograde welfare state are the consumers, who pay dearly for what could be sold cheap. It is not surprising that, with so many bureaucratic offices, real wages are so low in Brazil. Bureaucratic capitalism is a crime against the poor, which is perpetrated on the margin of a myth: the State as an entity capable of extracting resources from nothing. A myth that conceals a cruel farce; the State that refuses to explain who is really financing its benefits.

Leaving myth and farce aside, Brazil needs to become aware that the world is getting to be more and more pragmatic and less and less ideological. The reason is simple: ideology is the stuff with which the voids of science are filled. The heart can dictate reasons as long as they are not contradicted by the facts. But concrete facts cannot be ignored by ideological options and any such attempt is the road to schizophrenia. The Holy Inquisition, on condemning Galileo because he said the earth revolved around the sun, was unsuccessful in consolidating its idea that it was the sun that revolved around the earth. It was just successful in aborting scientific research in Italy and transferring it to England, Germany and France. In the 1960's Mao Tse-tung decided to subtract from Chinese culture everything that might cast doubt on the dogmas of Marxism, starting with mathematics and bookkeeping, since 2 + 2 = 4 is a conclusion disturbing to rigid Marxists. The result of the Cultural Revolution was a tremendous setback for China, which today is trying to recover with the pragmatism of Deng Xiaoping. One of the most obscurantist, repressive and retrograde dictatorships of this century was practiced in China. In the 1960's - who does not remember? - it was chic to be a Maoist. Now that Maoism and imbecility are synonomous, especially because the Genial Guide, at the time of his revolution, was neurologically impaired and intellectually senile, it is pretended that it was no more than a bad influence on the regime of 1964.

The tragedy of the Brazilian Left is that, with honorable exceptions, it appears to have stopped thinking in 1960. Today's theses, largely incorporated in the draft of the Systematization Committee, are the same as were heard in the João Goulart Administration. With one difference: in 1960 they were false, but bore the benefit of doubt. Today the doubts are dissipated and Mikhail

Gorbachev looks like a rightist by comparison with the Brazilian Left.

Let us recapitulate some of the theses of the Left Brazilian style. The first, apparently without any ideological connotation, postulates that economic growth must be based on "strengthening of the domestic market," to the point that the Systematization Committee draft, in the chapter on technology, affirms that the "domestic market integrates the national patrimony," in a fantastic confusion between active and passive. The problem is that of the egg and the hen — only that in this case it is easy to find a solution. If there were ample idle capacity in all sectors, it would be sufficient to distribute money to the poor, for everything to improve: the poor would buy more, living better and generating employment for the rest of the poor , in a beautiful chain reaction. The rich would also be satisfied, for they would sell more and maintain their profits, with lower margins per unit, but amply compensated by the increase in volume. It is the magic of Kalecki, a Polish economist especially venerated by the Brazilian Left. It so happens that in poor countries it is not customary for idle capacity to exist, except on chance occasions. Therefore, the main problem is to increase production capacity and not to absorb the existing capacity. In other words, funds are needed in order to invest, in order to produce more and then, yes, expand the domestic market. Those funds do not fall from heaven; it is necessary to create them, through either domestic savings or foreign savings.

The second thesis is that State capitalism, subject to the coordination of central planning, is more efficient in the long term than private capitalism, guided just by market forces. The debate was really valid in the 1950's, for capitalism had suffered the shock of the Great Depression of the 1930's and the Soviet Union, in Stalin's regime, had transformed itself into a great industrial power. The price had been much higher than any military dictatorship would dare: a tremendous wage squeeze and the total suppression of individual liberties, not to mention the purges that made Stalin the head of government who killed more Communists than anyone else in human history. The fact though is that the Soviet Union grew by giant strides, to the point that it astonished the world by placing the first Sputnik in orbit in 1957 and led ~~leading~~ Nikita Khruschev to predict that in the 1980's the Soviet national product would surpass that of the United States. Today, as is evident, the debate has become totally meaningless and the Soviet leaders are the first to acknowledge defeat. The United States soon recovered its lead in the space race and in 1969 placed man on the moon, in scenes transmitted by television all over the world. Khruschev's vision of the future was a bust and the Soviet Union, instead of winning first place on the international scale of economic powers, fell back to third place, yielding second place to tiny Japan, emerging from a war in which two atomic bombs had fallen upon it, poor in natural resources, but extremely rich in discipline, economy and training of human resources. What made the Soviet Union lose the race for progress was a regime that was spending too much on the bureacracy and was not awarding individual initiative. Notwithstanding the enormous cultural heritage that had been passed down to it by Czarist Russia, the regime was capable of building fantastic hydroelectric power plants and steel mills, but it was a disaster when it came to the development of agriculture, services and high technology.

The third thesis is that it is necessary to stop the invasion of the multinationals, which are only interested in exploiting our cheap labor, bleeding the balance of payments with remittances of profits abroad, subjecting us to technological dependency and transferring decision-making powers over production and investments outside the nation's borders. What the multinationals really want is a question that will be discussed presently. In any event, they do not have to be so diabolical, since today the United States is the country that absorbs most foreign capital, and since Gorbachev recently spent money on nine pages of advertisements in *The Wall Street Journal* inviting the Americans to participate in joint ventures in the Soviet Union, especially in the high technology sectors. For the bosses of the Ministry of Science and Technology, where there are more experts on plum brandy than on computers, Gorbachev must be a surrenderer, and not a statist.

The fourth thesis is that real estate speculation, rural and urban, is the great source of economic inequalities and social injustices. It is said that wild capitalism buys up lands to develop them artificially, at the cost of the misery of the people, which demands two solutions, agrarian reform and urban reform. That the capitalist should invest in land purchase is understandable. What is not understood is why he should refuse to exploit lands which, properly cultivated and built up, would yield profits and would be worth even more. At that stage, the Left thinks that the capitalists are as unimaginative as it is itself. Certainly, some are and the natural antidotes are the property tax and expropriation in the public interest. But that is the exception, and not the rule.

In short, the Brazilian Left is urgently in need of an intellectual retread. The option for the poor is a manifestation of dignity, as long as it is not based on the inconsistent sentimentalism that does harm on seeking good. Our leftists need to act effectively as thinking animals and not as parrots that repeat ideas so old and repudiated that today they are worth little more than slogans. Either they get that intellectual retread or else, before long, for lack of anything to say in stock, they will come out shouting "Omo washes whiter" or "Coca-Cola is it" as the formula for salvation of Brazil.

The greatest manifestation of poverty of the leftist demonology and of angelic ignorance that are combined to form an incoherent majority in the Constituent Assembly and in the Government lies in the discussion of the role of the multinational companies. What the so dreaded multinationals want is obvious: to remunerate their stockholders and to diversify their operations geographically, so as to reduce costs and risks. The idea that they are weakening national power by transfering the centers of decision making abroad arises out of conceptual confusion between private capitalism and State capitalism. An IBM or a General Motors is not controlled by the Government. Actually, they have no controlling stockholder, for their capital is dispersed among a multiple number of small stockholders. Therefore, their executives, in order to keep their jobs, try to defend the interests of their stockholders and not those of the American Government.

The same thing is done by the domestic private companies, which defend the interests of their owners and not those of the PMDB. If the Government wishes to subject them to given economic policy objectives, it is sufficient to adopt tax incentives and disincentives, and that is true for the domestic private company as well as for the multinational. The phantom of denationalization, the vagaries of which produced a deceptive definition in the Systematization Committee draft, overlooks the fact that what is of interest to the country is not the residence of the capitalist, but where his capital is invested. Recently, the Spanish premier, Felipe Gonzãlez, whose socialism led Spain to sell its highly inefficient State automotive industry, SEAT, to Volkswagen, exorcised the fears of denationalization with an answer that was loud and clear: they would make sense only if, at nightfall, agents of Volkswagen could disassemble the factory in Spain and carry it off to Germany without anybody knowing. As that danger does not exist, SEAT continues in the same place, providing employment for Spaniards, paying taxes and producing cars without burdening the public treasury of the country.

Logic, though invented by the Greeks in the Northern Hemisphere, also applies below the Equator. One of the insistent assertions of the Left in the 1950's and 1960's was that the multinationals would only come to Brazil to conquer our domestic market, and never to export, for that would thwart the interests of the workers of the parent companies. A funny mistake, as is evident from the exports of the automotive industry and of countless other multinationals, which defend the interests of their stockholders, and not of the unions - they are responsible today for 28% of all exports of Brazilian manufactured products. Another authoritative opinion was that the multinationals would only come to Brazil to exploit our cheap labor. This involved an exchange of nonsense with a pompous councilman.

Really, no multinational is a charitable institution and, as such, would have no incentives to invest between the Oiapoque and the Chuī if wages here were higher than in the United States and Western Europe. The fact is that contending for cheap labor creates jobs, and the creation of jobs makes labor less cheap, and that is exactly what interests the workers. It is also exactly what happened: on the average, the multinationals in Brazil pay their employees 39% more than domestic companies, whether private or State.

The Brazilian worker, like that of any other country, has not the slightest interest in knowing whether control of the company belongs to Americans, Belgians, Turks or Indians. What interests him is the wage and the treatment he receives. That multinationals send ~~interests~~ interest abroad is obvious. It so happens that, in order to remit dividends, it is necessary to have profits and for the country to have foreign exchange availabilities. No country becomes internationally illiquid by remittances of profits, for if there is no foreign exchange, there are no remittances, and the multinationals know that: they are partners in balance of payments problems. What makes the country internationally illiquid or even insolvent is the inability to renegotiate the external debt.

In that connection, the opinion of our Left in the 1950's and 1960's - that foreign lending capital was preferable to risk capital - proved to be one more dramatic historical mistake. That the country should strive to dominate modern technology is a point beyond discussion. Only the positive solution is not to reinvent the wheel, expelling the mutlinationals that develop that technology. But simply to train engineers, physicists, mathematicians, chemists, biologists, to develop well equipped research centers and to promote manufacture of the products of modern technology in the country, by domestic companies as well as by foreign companies. In the 1950's Juscelino Kubitschek had the intelligence to invite multinationals to come and implant the automotive industry, shipbuilding and other industries in Brazil, instead of creating a national SEAT, as in Spain, or an SEA (Special Bureau of Motor Vehicles). The Spanish experiment had a Brazilian first cousin, the Fábrica Nacional de Motores (National Engine Factory), dreamed up in the 1940's to produce airplane engines. Those engines were not produced, and the factory became a white elephant, manufacturing trucks at tremendous loss to the Public Treasury. Until, in a gesture of good sense, the Costa e Silva Administration decided to sell the Fenemês factory to Alfa-Romeo and the taxpayer at least stopped paying for that loss. It would be good if those and other lessons were learned by the leaders of the New Republic.

Selling off State enterprises is, indeed, the order of the day, not just in Great Britain, France, Italy and Spain, but even in Nigeria and Tanzania. Of the first four programs, the most daring is the British, which puts State enterprises up for sale on the stock exchange by public bidding. Behind the program there is a clear ideological context, but the truth is that it has been extraordinarily successful, millions of Britons contending for purchase of the shares of British Telecom and British Petroleum. On the books, the Government is registering losses, in the sense that the stock market value of the companies is less than the net worth posted in the financial statements. It is a question, however, of establishment of a simple fact: the British State enterprises were not worth what their financial statements showed, just as no one would buy Angra I for the adjusted value of the dollars, cruzeiros and cruzados tied up at the plant.

The democratic sense of British privatization is easily perceptible. Before, they belonged to the people, as collective entities. The problem is that two rights of the people were being pilfered. First, the right to sell to third parties what belonged to everyone, since ownership was indivisible. Second, the right to choose the company executives and to demand results. Once privatized, the companies then belong to those who really want to own their shares. There are many Britons who do, but not the whole population. And they decide, by public tender on the stock exchange, how much the company is really worth. In France the program is a pendulum reaction against the nationalizations of the romantic phase of the François Mitterand Government, which started off dominated by inconsistent sentimentalism, but knew enough to retrace its steps in time, for the French, accustomed to Carthesian logic, would never embark on a cultural revolution like that of Mao Tse-tung.

In Italy it is recognized that nationalization went too far, and companies are being returned to the private sector that should never have fallen into the hands of the Government, like textile plants and many others. The most curious case is that of Spain. It is not a question of an ideological privatization, like that of Great Britain, where the main objective is to diminish the presence of the State in the economy. It is a pragmatic privatization, led by a Socialist Government. But it is also a reversal of a process of nationalization conducted by a regime of the extreme right, that of Generalissimo Franco. The motivation is not that of Margaret Thatcher, but that of the lucid Left: if the State wants to concentrate on its social function, it has to rid itself of the waste and of part of the public debt. The solution is to sell assets to the private sector, especially enterprises that only show losses, like SEAT which, between 1980 and 1985, devoured up no less than three billion dollars in the Spanish Treasury. SEAT is the most glaring example, but along with it there were textile plants, hotel chains, etc.

The Brazilian Government complains about its huge debts, externally and internally, which is the absolute truth. According to the economists of the PMDB (or "ecodebistas do penemê"), our deficit is "predominantly financial," due to interests on the external and internal debt. It is a question, more than anything else, of accounting nonsense, for a deficit is an excess of expenditures over receipts, and the myriad items of expenditures do not bear rubber stamps, differentiating those that cause and do not cause the deficit. In any event, however, if part of the public debt could be liquidated, the deficit would diminish considerably. For the Shiites, the solution is the unpaid debt with no intention to pay it back. That great discovery would work very well if it were possible to couple it with an attack of amnesia among the creditors. They would be confiscated, but, with loss of memory, would continue lending money to the Brazilian Government the following day. It remains to be determined how that state of amnesia of the confiscated can be brought on, a subject about which Shiite medicine is absolutely silent. Discarding the Shiite prescription, let us see how a company heavily in debt heals itself: it sells off assets and opens up its capital. Which, in the case of Brazil, would mean coupling a program of privatization with another of conversion of the external debt into risk capital. The nationalists do not need to tremble in their boots. It is not a question of privatizing Petrobrás or Eletrobrás, especially because it would be hard to find buyers. There is just no reason for Aços Finos Piratini, Mafersa, Cofavi, Caraiba Metais, Acesita and many other steel mills to continue at Government expense. As there would be no problem selling Telebrás to the domestic and foreign public, Brazil would not be any poorer for that, since the steel mills as well as the telephones would remain exactly where they are, that is, here. Only, the State would be less in debt. As for the conversion of debt into risk capital, this is the time to get rid of preconceived notions. It is the way to convert creditors into partners. It will be said that the conversion will cost somewhat more in terms of monetary expansion, since the Central Bank will have to deliver cruzados to the new investors. That can be avoided by delivering certificates and not cruzados, after the fashion of what is being done in Chile.

As for the rest, it is worth remembering that the Central Bank receives cruzados from Brazilian private debtors who punctually honor their external obligations. In fact, the moratorium does embrace the private debtors of foreign banks, but rather the Central Bank. The former bring it cruzados which, instead of going into a common pool to finance the public deficit, could well be reserved for a program of debt conversion.

With daydreams and nonsense, the New Republic and its illustrious Constituent Assembly are putting the Brazilian people on the express train to Bangladânia, a land as poor as Bangladesh and as isolated from the world as Albania. With the superindebted Government, with the politicians concentrating on distributing jobs without work and with the idea that slogans will fill the bellies of the poor, we are heading backward. We have no illusions: whatever the projections of the BNDES and PAG say, the fact that we have grown 7% per year in the last forty years does not mean that we are destined for progress and that the feat will be repeated in the next forty years. We are threatened by a stagnation similar to the Peronist populism implanted in Brazil since 1945. With the difference that our distribution of income is much more unequal than that of Argentina and our population is growing at an explosive pace. For almost the last three years we have wasted time telling economic bunk that has been out of date since the 1960's. The problem is that in that same period of time Brazil has added 10 million inhabitants, who cannot be fed or educated on the basis of myths. In contrast to our neighbors to the south, we have not yet signed a truce with the spermatozoid.

Can we detour the express train from Bangladânia? The answer is positive, but depends on a surgery capable of extirpating our bad cultural traits. Let it be said in passing that it is not a question of an ideological transformation. The great national debate is not between the Left and the Right, but between the modern and the archaic. The wording of the privatistic speeches of President José Sarney is modern. The wording of his decrees that reserve markets and sponsor PAG's is archaic.

At the root of the archaism is a myth to be destroyed: that the State can create resources from nothing, as if it were possible to ballast the currency in the national anthem. Therefore, it becomes essential to explain who pays the State's bills and how. The consumer sales tax in the United States is a good example of how that transparency is achieved: the tax is collected on the price of the product to the customer, 8% in New York, 4% in Florida, in an annoying transaction, but which makes the taxpayer aware of how much the State is costing him. The Brazilian tax system does not permit that explanation, since taxes like the IPI and ICM are collected at various stages of production and are hidden in the price charged the consumer. It would be desirable to establish that, on every product with the sales price marked on the package, the tax item should be identified. At that stage it would create an awareness in the taxpayer, who with time would be less and less inclined to vote for candidates who distribute public jobs at his expense. The Government, in turn, would explain in transparent budgets what it spends and at whose expense.

Without clarifications of that type, democracy is a farce. The Constituent Assembly is working to preserve an intricate system of transfer of funds from the Union to the States and municipalities, through which, in addition to the money to be collected, responsibilities are diluted. The greatest contribution of the PMDB and of the present Administration, because of the democratic construction, is the full freedom established to talk nonsense. The truth is that the Government is slaughtering the business class and confiscating in heretofore unprecedented proportions the wages of the workers - all that in the name of democracy, which is an injustice, for it has nothing to do with that.

The myth of multiplication of the loaves by the State having been undone, the people could really express themselves as to their preferences: to have more schools, more medical assistance, more police protection, or else pay public officials who win jobs without work, finance sugar mill owners and claim damages from State enterprises. Welcome multinationals that bring capital and technology and generate jobs, or antagonize them in order to protect the bureaucratic capitalism of Brazilian companies that grow fat at the expense of elimination of competition. Participate indivisibly in State enterprises, without the right to sell their shares and without the capacity to vote at stockholders meetings, or transform them into real corporations with capital open to the public and dispersed, at which any stockholder, however small, has the right to complain and protest. Democracy is it, and that is not to be confused with Coca-Cola. The reason why the fragile plant to which Otávio Mangabeira referred needs to be cultivated with care is that there is no democracy that can be supported like a blank check of the people in favor of any class.

The systoles and diastoles to which the healthy General Golbery do Couto e Silva referred are a metaphor that describes the political cycle of countries not structured for democracy. He perceived, as early as 1981, that the systole of the AI-5 regime, with its centralizing degeneration, would be matched by a diastole of remanipulation of power. Beside that, Golbery pointed out, was the process of political opening. The opening is a condition necessary for Brazilian society to go forward, but it is not sufficient. A democratic regime built on the centralized, pharisaical, prodigal and irresponsible machine that was superimposed on the State will have the same fate as its predecessor: collapse.

Mário Henrique Simonsen is head of the Postgraduate School of Economics of the Getúlio Vargas Foundation; he was Treasury Minister from 1974 to March 1974 and Minister of Planning from March to August 1979.

CAPTIONS

Page 25: Simonsen: Brazil is confronted by the risk of an option for technological backwardness, for xenophobia, for statism and for a type of bureaucratic capitalism with dire effects. The Cruzado Plan tried to combat inflation symptomatically and, consequently, ended in disaster. The perilous adventure of interest moratorium was initiated and the error of the freeze was repeated with the Bresser Plan. At this time, when a new Constitution is being written for the country, the problem is not the choice between ideological paths. The true option is between the modern and the archaic.

Page 26: The patriarch John D. Rockefeller with his clan, early in the century: for him, his capacity to earn money was a God-given gift. Capitalism today speaks another language.

Page 27: Mao Tse-tung, 1960's: he was the leader of a phase of profound regression, from which China is attempting to recover today. Maoism and imbecility are now synonomous. The world is becoming much more pragmatic.

Page 28: Brasília: the State built the city with the money it collected from the people, but the project bore the signature of a single man, Juscelino Kubitschek. The taxpayer is the principal party absent from the Government's accomplishments.

<u>Page 29</u>: Rocinha favela: it is not necessary to read about the sub-human conditions of the workers of the last century to get a picture of absolute misery. It is sufficient to visit a Rio favela.

<u>Page 30</u>: Mikhail Gorbachev: he published nine pages of advertisements in *The Wall Street Journal*. He invited Americans to invest in the Soviet Union, especially in high technology sectors.

<u>Page 31</u>: Felipe Gonzãlez: he sold Volkswagen the Spanish automobile factory, SEAT, an inefficient State enterprise. He created socialism without burdening his country's treasury.

<u>Page 32</u>: May 1st rally in São Paulo: the Brazilian Left stopped thinking in 1960. Its theses are the same as were heard in the times of João Goulart.

<u>Page 33</u>: On the assembly line: the creation of jobs makes labor cheaper - and that is exactly what interests the workers. The mistake is to try to divide up the poverty.

<u>Page 34</u>: The headquarters of Sudene in Recife: the genuine capitalism was created in Brazil by entrepreneurs without access to the court. Today, barons and viscounts, with the seal of Suvale or Sudene, display their bureaucratic splendor.

<u>Page 35</u>: The Constituent Assembly: a new paradise is being designed on the foundation of a progressivism, the meaning of which no one knows, because it only expresses a progressive state of mental confusion.

You might be interested in the section on LDC debt starting on page 10.

E. GERALD CORRIGAN
PRESIDENT

FEDERAL RESERVE BANK OF NEW YORK

No Acknowledgment Necessary

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 4, 1988

Dear Jerry:

I have just seen a copy of your speech to the New York State Bankers Association on January 28th. I think it is a first class speech, perhaps somewhat because it concurs exactly with my position on the LDC debt problem.

I think I may pirate some of your wording because it is so good.

Best personal wishes.

Sincerely,

Barber

E. Gerald Corrigan
President
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

REMARKS BEFORE THE
60TH ANNUAL MID-WINTER MEETING OF THE
NEW YORK STATE BANKERS ASSOCIATION
THURSDAY, JANUARY 28, 1988

BY E. GERALD CORRIGAN
PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

I am pleased to have the opportunity once again to address the Mid-Winter Meeting of the New York State Bankers Association. In contemplating the occasion, it struck me that this would be my fourth such appearance before this gathering which, if nothing else, reminded me of how fast time passes in this turbulent era. For example, only a year ago I unveiled before this audience my essay on a longer-term view of the emerging financial and banking structure in the United States. In the intervening period, we have seen some decided momentum in the Congress and elsewhere toward a much needed modernization of our banking system. But, the hard fact of the matter is that progressive legislation has yet to be enacted even as the force of events here and around the world makes the case for progressive change still more compelling. Under these circumstances, I believe it is crucial that the banking industry, including all of the institutions represented in this room, lends its full support to enacting legislation along the lines of the Proxmire-Garn bill now before the Senate Banking Committee.

Legislation of this nature would not be the final word in efforts to adapt our banking and financial structure to the needs of the future, but it would be a giant step in that direction. To squander that opportunity in an effort to forge a more sweeping approach that, for example, would permit a blending of banking and commerce is, in my view, politically insensitive and substantively wrong.

As important as developments in the banking field in 1987 may have been, or may turn out to be, I suspect that with the passage of time they will earn little more than a footnote in the historians' recounting of the past year. Indeed, there have been developments in the domestic and international economy, in financial markets (and, I am not merely referring to the events of mid-October), and in ongoing efforts to cope with the debt problems of the developing world, that have taken on new and far-reaching dimensions over the past year which must command our attention. Accordingly, I would like to take this opportunity to share with you my thoughts on the economic situation here and abroad with particular emphasis on the tasks that lie ahead in maintaining non-inflationary growth, restoring better balance in international trade and capital flows, and working toward further gains on the LDC debt front.

In looking first at the U.S. economy, the situation is one with both good news and bad. The good news, of course, is that we are now into the sixth year of an economic expansion. That expansion has been extraordinary, not just because of its duration, but also because it has been maintained despite very difficult conditions in some regions and in some sectors of the economy and because it has been maintained without any significant rise in the underlying rate of inflation. The bad news, however, is that we have serious imbalances in the economy which simply must be dealt with if we are to sustain non-inflationary growth into the next decade.

While the nature of these problems is not new, allow me as a matter of emphasis to cite several examples of things that lie at the heart of our difficulties:

-- in the late 1970's, general government budget deficits in the U.S. consumed, on average, only about 10 percent of our net private domestic savings. By 1986, and despite large surpluses in state and local governments, overall government deficits were consuming almost two-thirds of net private domestic savings with the federal deficit eating up an astonishing 90 percent of net private savings. While these figures fell somewhat in 1987 they remain far, far too high by any reasonable standard.

-- As recently as 1981, the U.S. was the world's largest net creditor nation. We are now its largest net debtor and sometime this year, our net external indebtedness will cross the

$500 billion threshold. To put it differently, by the end of 1988 our net external indebtedness will reach or exceed the accumulated public debt of the United States from its inception through 1974.

-- Since the end of 1983, non-financial corporate America has retired a cumulative total of almost $300 billion in equity while over the same interval corporate debt has increased by more than double that amount.

-- On a global basis, the U.S. trade and current account deficits, and their mirror-image, surpluses in several of our major trading partners, are of unsustainable proportions.

These examples reflect the harsh reality that for too long we in the United States have been borrowing more than we save and consuming more than we produce in an environment in which debt, deficits and leveraging have become a way of life for government, for business and for individuals. Fortunately, we have both the underlying economic strength and the opportunity to remedy these problems -- but only if we heed the warnings of the recent past and get on with the task now.

The task that lies ahead in seeking to address the imbalances in the U.S. and the world economy in a context of growth is, to put it mildly, formidable. To illustrate what is involved, it would be useful to consider what would have to happen between now and, say, mid- to late 1991 if, over that time frame, the U.S. were to eliminate or largely eliminate its trade deficit -- keeping in mind that even that result will leave us with a not inconsequential current account deficit. At the risk of oversimplification, and assuming no major changes in inflation, interest rates or exchange rates, achieving that result would entail something along the following lines:

-- In the U.S., the growth in real GNP would, for the period as a whole, have to average something like 2.5 to 3.0 percent -- not an easy task in its own right. But -- and this is a very large "but" -- there would have to be a major and sustained change in the composition of GNP growth. That is, over this entire period, the <u>rate</u> at which the U.S. economy consumes goods and services relative to GNP must <u>fall</u> if net exports are to rise, as they must if our trade deficit is to be eliminated. It is in this sense that we are facing a long period in which our standard of living must rise at a slower rate than it has in the past. To put it differently, we must make the very difficult transition from an economy paced by consumer spending to one in which export-oriented activities and investment in hard productive capital are at the cutting edge of sustainable and therefore moderate growth.

-- In the rest of the industrialized world, a growth rate in GNP of about 3 percent for the period as a whole would have to be coupled with a rise in domestic demand in those countries to about 3.5 percent. For the large surplus countries the spread between domestic demand growth and GNP would have to be even wider. Here too, we are talking about rates and patterns of growth that are, in general, quite at odds with the experience of recent years.

-- In the U.S., growth in manufacturing output -- both to displace imports and provide the needed export growth -- would have to average, at the very least, 4 percent in a context in which manufacturing capacity will have to rise significantly. While these results can be achieved they will not come easily nor without clear risks of higher inflation, especially considering that we start with little slack in labor markets and with capacity constraints already in evidence in several key manufacturing industries.

-- In the U.S. we must achieve a reduction in the domestic savings gap about equal to the reduction in the current account deficit implied by the sharply reduced or eliminated trade deficit. Thus, the domestic saving gap must be reduced by an amount well in excess of $100 billion. That reduction can be achieved by a rise in the rate of domestic saving rate, by a reduction in the rate of private investment, by a reduction in the budget deficit, or by some combination of all three. Since the rate of private investment is, if anything, too low, the answer is not to be found there. Similarly, while a gradual rise in the private saving rate would be most welcome, it is by no means assured. To the extent it does occur, it would be far better to see the added savings used to help finance a highly desirable increased rate of private investment. Therefore, the great bulk of the reduction in the saving gap must come from cutting the budget deficit over the next several years. Sadly, and despite great effort, the details of a credible budget deficit reduction program in the needed amount are not yet in place.

-- Finally, even if all of the conditions I have mentioned were realized, the external indebtedness of the U.S. would continue to rise, though at a slower pace, over the entire period. Indeed, under a scenario along these lines, the U.S. external indebtedness by the second half of 1991 could easily be in the area of $850 billion, and still rising by the amount of the residual current account deficit remaining at that time. This means, of course, that over the period as a whole foreign investors will have to be willing to accumulate, in net terms, something like $350 billion of additional dollar-denominated assets on top of the $500 billion they will hold sometime this year. It also means that we as a nation must conduct our affairs in a manner that will command the continued confidence of our current and prospective external creditors. Current account deficits are always financed; the only question is at what price.

If the scenario I have just laid out sounds challenging, it should, because surely it is. While the numbers I've cited are broad estimates, they do give a sense of the order of magnitude of the adjustment processes that lies ahead. Moreover, they reflect an adjustment process that, in some respects, leans toward a best case scenario. The key point, of course, is that even under such a scenario there is no quick and painless fix for our current economic ailments. For example, it would be nice to think that the U.S. could somehow manage a sufficiently rapid growth in GNP to have both a rise in net exports and a rate of increase in domestic demand that is in line with earlier experience. However, in my view, such an approach would carry with it the virtual certainty of renewed inflation that in the end would be highly destabilizing here and abroad. In fact, I know of no surer way to create a truly nasty recession than to fall victim to the illusion that we can inflate our problems away.

Similarly, it would be tempting to think that a further fall in the dollar would somehow make life easier. I, for one, simply don't see it that way. Indeed, in my judgment a further fall in the dollar would only serve to magnify inflationary dangers (in part by placing a further burden on the output and investment needs of the U.S. manufacturing sector), impede much needed growth prospects abroad, and complicate the task of financing our prospective current account deficits. Accordingly, the economic fundamentals -- including the need to maintain an environment conducive to capital investment here and abroad -- point strongly to the need for a sustained period of stability in exchange rates.

The point I am seeking to make is, of course, that at the end of the day we must come to grips with our underlying economic problems, not merely with the symptoms of those problems. To repeat, we simply cannot go on borrowing more than we save and consuming more than we produce just as other countries cannot go on producing far more than they consume. The issue, therefore, is not whether the necessary adjustments -- including the major changes in the composition of output and spending in the U.S. -- will take place; those adjustments will take place one way or another. The issue is whether we will have the vision, the will and the discipline to recognize the constraints we face and to conduct our affairs in a manner that permits the necessary adjustments to occur in an orderly way and in a context of growth.

Success in maintaining non-inflationary growth in the industrial world is also central to efforts to cope with the LDC debt crisis. As an extension of that, it is also true since, today as several years ago, the LDC debt situation still poses a major threat not just to the debtor countries or their creditors but to the prospects for growth and stability in the global economy and trading system.

For reasons that are understandable, we have reached a point in the evolution of the LDC debt situation in which frustrations and fatigue are very much in evidence on all fronts. However, the past five and a half years have not been without important progress; bank exposures relative to capital have been cut in half or more; growth in the LDCs, even if uneven and at subpar rates, has re-emerged; major improvements in debtor country current account and trade positions have been achieved; public sector deficits have been cut and, I might add, for the so-called "Baker 15" these deficits are not wildly out of line with our own deficit relative to GNP; and, in general, interest rate and exchange rate policies have become more realistic. Despite all of this, however, the crucial debt and debt service ratios of most of the LDCs have not improved in any material way relative to the situation at the outbreak of the debt crisis in the early 80's.

While there are many reasons -- both economic and political -- why we have not seen definitive turns in the various debt ratios of the LDCs, three economic factors strike me as particularly relevant: first, for the decade of the 80's as a whole, the LDCs have experienced a sharp and protracted deterioration in the terms of trade; second, despite slack conditions in domestic economies, inflation rates in most of these countries have remained high and in some cases alarmingly high; third, fresh financing flows from official and bank sources have, if anything, been too modest. Moreover, even when financing has become available it often comes only after inordinately long and costly delays in the negotiation and syndication process.

Under these circumstances, the yearning for that mystical master-stroke that will put the problem behind us becomes all the more evident. I'm sorry to say, however, that such a master-stroke simply does not exist. Today, as a year ago or five years ago, there are certain fundamental prerequisites that must be a part of efforts to resolve the LDC debt problem. Those prerequisites -- in addition to growth in the industrial countries as cited earlier -- include, among others, the following:

- First, growth in the debtor countries in the five percent range they have all experienced in the past must be attained. Needless to say, achieving such growth presupposes appropriate macro-and micro-policies on the part of the debtor countries.
- Second, the maintenance by the LDCs of businesslike relationships with their creditors, which means the timely servicing of financial obligations. In that regard, in a context in which a country has an established track record of servicing its obligations, innovative steps such as the recently announced voluntary Mexican debt repurchase plan can play a constructive role, especially if such efforts are viewed essentially as exit-type vehicles. But here too, we must be realistic. Such efforts can be a constructive step in appropriate circumstances, but no more than that. They are not, nor will they ever be, either a substitute for the willingness and ability of debtor countries to service their debts or a sustainable channel for needed financing.
- Third, a reasonably stable and predictable flow of appropriate amounts of external finance -- including bank credit -- to the

LDCs must be maintained. Approaches to the LDC debt problem that fail to take explicit account of the need to provide new financing to the LDCs over time should be viewed with skepticism. At the extreme, a debt strategy that cannot hold out the hope of renewed debtor access to market sources of external finance is no strategy at all. The object of the exercise is to restore creditworthiness and confidence, not to further impair it.

-- Fourth, strong and well-funded multilateral official institutions are a must. These institutions are central to the process not only because they can provide the added financing needed to close external financing gaps in the LDCs but also because they and they alone can be the locus of policy coordination and conditionality -- a process which should become more flexible but which remains a crucial ingredient for success.

-- Fifth, an appropriate degree of solidarity and commonality of purpose among private bank creditors, and especially major bank creditors, must be maintained. This means, among other things, that the advisory committee process or something like it is still needed, but that process must find ways to expedite procedures and decision making.

In saying that the fundamentals have not changed, I am not suggesting that the process as a whole has been or should remain static. Clearly it has not and it cannot. Indeed, we have already seen important adaptations on all fronts including fresh and constructive ideas from the Secretary of the Treasury, the President of the World Bank and the Managing Director of the I.M.F as well as from debtors and private creditors alike. But as new ideas and approaches emerge, it seems to me that such ideas must be put to the test of how well, over time, they will serve the basic prerequisites I laid out a moment ago.

I said earlier that frustration and fatigue regarding the LDC problem were understandable: they are. But defeatism is not! Success in containing and gradually reducing the debt problem is not assured but it is attainable. But, to achieve that success will require cooperative and complementary efforts on all sides and it will require vision. To cite just one example, the case for further strengthening of bank capital and reserve positions is clear but how that result is achieved can matter. That is, to the extent that reserving decisions by individual banks or groups of banks have the unintended effect of encouraging debtors to disregard their obligations or to abandon efforts aimed at sound policies, or to the extent they imperil the needed flow of new money to the debtors, they can become self-fulfilling prophecies.

The theme of this address is mutuality: whether we live in Buffalo or Buenos Aires, Ticonderoga or Tokyo, Freeport or

Frankfurt, we all have a mutual interest in how well each of us, and all of us, face up to the challenges of maintaining growth and stability in the national and international economy. But, that mutuality cannot be used as an excuse to postpone needed initiatives at the national level or to place the blame for national problems at the doorstep of others. The essential things that need to be done -- eliminate the budget deficit and the saving gap in the U.S., achieve more rapid growth in domestic demand in the other industrial countries, promote growth and efficiency in the developing world, and firmly resist the seductive appeal of inflation on all fronts -- happen, as I see it, to first coincide with national interests. From an international perspective they are mutually reinforcing. But, the reverse is also true. Failure on any one of these fronts will surely jeopardize prospects on all others. That is the essence of mutuality.