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It might be useful first to describe the current environment faced by the heavily-indebted developing countries.

- There is little new lending from commercial banks to the heavily-indebted LDCs, nor has there been over the last two or three years. They want to sell off their loans -- not take on increased exposure.

- For most LDCs, their interest payments alone exceed by two to three times the amount of money being lent to them. This means there is a transfer of resources from poor to rich.

- From the commercial bank perspective, however, they find it inappropriate that they should increase their credit risk exposure by lending the borrowers the resources needed to pay back the interest. They consider that unwise and unsustainable.

- As a result, there is little new external private resources available to the LDCs for building their infrastructure, or to sustain economic growth. Clearly, however, the developing world is not in a position to export capital to

industrialized nations. That, too, is unsustainable.

- There are political pressures in LDCs to service all debt in order simply to keep the country viable and creditworthy, at least for short-term trade finance -- and there are great political pressures not to service debt, the costs of which are borne in their domestic economies.

- Banks are gaining leverage and power in the negotiating process, i.e., how much "new" money must they lend in order to assure they can continue to receive interest income and avoid capital impairment. Banks have gained leverage because (a) the amount of their LDC debt is being reduced as they sell off their loans to others; and (b) they are provisioning or writing off the loans because of the uncertain prospects for payment.

- Despite the increasing leverage of the commercial banks, they are not yet out of the woods. The fact is they cannot readily take the losses which would be made explicit if they decided not to lend anything to help reduce the interest rate burden. But even if they took those losses, it would, in my view, be a destabilizing development, as it would virtually assure that there would be no money made available thereafter for a protracted period of time.

- LDCs make the case that much of the borrowings in the late '70s and early '80s were the result of factors <u>outside</u> of their control: high interest rates in the U.S., falling commodity prices, deterioration of terms of trade, higher oil prices, and recessions in the west -- factors which made it impossible for them to properly conduct their internal domestic economic affairs. And they argue, now, that the debt service burden as a result of those external factors are being borne by them -- some of the poorest people in the world.

Permit me now to define the debt crisis -- or, rather, set out the definition of the crisis from the perspective of the different players. For the reality is that the honest concerns of a very diverse constituency have resulted in a paralysis of action as each constituency offers or rejects "solutions" to a problem defined usually only from their own perspective.

- To the banks, the crisis is that they are not likely to receive interest unless they lend a portion of the money to pay it.

- From the developing countries' perspective, the crisis is that they already are transferring large amounts of hard currency from their work product -- their exports -- to international banks outside their country and are getting little new money for growth or productivity.

- From the U.S. Treasury's perspective, they want to avoid the establishment of a precedent whereby the U.S. taxpayer, directly or indirectly, pays for losses sustained by banks should they have to subsidize those losses. They are understandably concerned with how or where to draw the line -- are all banks taken care of? strong ones? weak ones? Is it for all LDC debt or just for friendly countries? For those who are trying to restructure their economies or those who can't or won't? And why not take care of banks who have made bad loans to farmers, real estate operators, energy producers?

- For those having the responsibility for foreign affairs, the crisis is simply that poor countries are vulnerable and potentially unstable, immensely complicating the conduct of our relationships with those countries, whose political processes are fragile, at best.

- For the regulatory agencies, the crisis is reflected in their concern over the implications of a lack of confidence in the banking system should the public -- domestic and international -- become further concerned over the banks' credit exposure to LDCs.

- For economists, the crisis is often defined in terms of its implications for trade, whereby the U.S. loses even further

its natural markets in Latin America because LDCs, locked into no growth, do not have the resources to pay for goods and services.

- And for those concerned with overall social, humanitarian and health aspects, they look at the crisis as one in which there is a wasting of the human spirit because there is no potential for growth, a wasting of human capacity, poorness below the level of human decency with all that portends, illegal immigration across borders, and increased reliance on drug trade as the only certain cash crop for export.

I can think of no public policy issue which deserves attention greater than the international debt crisis, and yet, probably because the definition of the problem comes from so many different constituencies, often in conflict with each other, it is no wonder that a "solution" is not forthcoming. I think it is reasonable to conclude, first, no solution will satisfy everyone; second, not all problems can be solved; third, risk and pain will have to be shared; and finally, and perhaps most important, some entity must be given, or must take, the mandate to make a decent and fair attempt to allocate that pain and risk.

I have said before that a "solution" must deal with the honest concerns of the various constituencies. And the shared pain cannot be at a level, either so high in quantitative terms, or in

terms of appropriate public policy, that it will be rejected by any one of the powerful players. New initiatives must be subtle enough so that although there is risk and pain, it is not of a type or a magnitude which should cause any of the players to feel that they cannot support it.

I am convinced that the approach lies in the following:

- There is new lending to LDCs. By "new," I mean that amount which stems substantial negative cash flows, permits servicing of debt during periods of adjustment, supports reasonable growth and facilitates trade.

- LDCs remain politically viable. Whatever the "solution," it doesn't prompt a collapse of fragile democratic political processes in the country.

- Banks continue to attract capital, with the prospect of earning a reasonable return, and can continue to diversify their activities with broad-based support for their own funding activities.

- The "solution" is not, in fact, nor perceived as, bailing anyone out.

- It is politically workable/practicable. That means accounting professionals, stockholders, legislators in industrialized countries, and a broad range of the body politic in LDCs find it fair.

I will not take the time here to describe how that should be done. I have submitted to you a quite specific proposal which involves a realistic assessment of what is workable within the context of the above objectives. I must say, though, I do not believe it is meaningful to develop financial engineering which solves the "problem" as defined by one of those constituencies, but is quite damaging to another, or politically out-of-bounds for a third.

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

But the most difficult challenge is to fashion an initiative which would encourage the developing countries to make difficult structural adjustments in their economies with the prospect that by so doing, new funds would later be forthcoming and investment and savings would increase. From their perspective, the results of "belt-tightening" are uncertain. Their political systems are fragile and the attitude of the external world to the positive steps they might take is, in fact, unknown. Indeed much of the debate on debt crisis initiatives centers around the difficulty of knowing whether it is now best -- in the best interest of LDCs -- to reduce LDC debt servicing obligations to banks and discourage, for a while, commercial bank lending, thereby forcing the LDCs to come to grips with a very painful immediate environment. They would simply have to work their way out of a period of negative growth until their domestic economies, without outside support, became sufficiently attractive to encourage new external inflows and investment. The alternative approach is to lend new resources now and to forge links between the banks, the LDCs and the international lending agencies, which would encourage new private lending while avoiding some of the potential pitfalls implicit in providing, directly or indirectly, some form of safety net or credit enhancement to the private sector.

There is uncertainty and debate as to which approach is the wisest one. We, in western countries, endlessly debate the fascinating and challenging alternatives. Those in Latin America, however, become poorer and more volatile in the interim.

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

The proposals I have suggested are designed to protect the World Bank and the U.S. government from the moral hazard, the financial risk and the political backlash arising from an allegation that commercial banks were being bailed out or that it involves putting more good money after bad. But whether the proposal before you is the best one is really unimportant. What is important is to recognize that the situation in Latin America is an accident which has already happened. The subject we discuss here goes beyond finance, but relates to the viability of nation states which are quite close to us. Once that is recognized, I expect that reasonable people will reconcile their differences of views and approaches and address initiatives which have the highest probability of success. I define success as that which avoids political instability in LDCs and facilitates a sense that people feel that their lives are worth living with a prospect of growth for themselves and their children. That is not the case now and, in my view, it is the fundamental proof of the existance of a debt crisis as our neighbors -- tens of millions of people -- feel hopeless, with little positive prospect for the future or a sense of expectancy. That is not a healthy environment anywhere -- certainly not on our borders. Let me summarize in one sentence:

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

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