Christine A. Bogdanowicz-Bindert,
SOLVING THE GLOBAL DEBT CRISIS,
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A Debtor's Approach to the Debt Crisis

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> There may, therefore, be ahead of us a long, silent process of semi-starvation, and of a gradual, steady lowering of the standards of life and comfort. The bankruptcy and decay of Europe, if we allow it to proceed, will affect everyone in the long run, but perhaps not in a way that is striking or immediate . . . . The assertion of truth, the unveiling of illusion, the dissipation of hate, the enlargement of instruction of men's hearts and minds, must be the means . . .(John M. Keynes, *The Economic Consequences of Peace*)[1]

In the 1980s, the Brazilian economy has been faced with the most serious crisis in its industrial history—a crisis defined in the long run by the stagnation of per capita income and in the short run by inflation rates that, at the time this paper is being written (December 1988), are coming dangerously close to hyperinflation. In this article, I will argue that Brazil will only be able to overcome this deep crisis if it makes a strong fiscal adjustment, and at the same time unilaterally reduces its foreign debt approximately by half, in order to eliminate the public deficit and recuperate its capacity for savings and investment. A unilateral reduction of the debt, which would press the governments of the creditor countries to adopt a global solution for debt relief, for which there already exist detailed proposals and analyses, should be followed by negotiations with the creditor banks. The official approach of the creditor nations for the debt is a combination of adjustment and financing. In this article, an alternative approach is proposed—a strategy of combining adjustment

1. John Maynard Keynes, "The Economic Consequences of Peace," *The Collected Papers* II (London: Macmillan, 1971).

with debt reduction, given the fact that the debt has become too excessive to be completely paid.

This article deals specifically with Brazil, but I believe that the analysis and proposal discussed here could also apply, with slight adaptations, to all of the highly indebted middle-income countries.

The Crisis Defined

The crisis facing the Brazilian economy in the 1980s is probably the most serious in its history of capitalist development. In fact, with the exception of some small fluctuations, the Brazilian economy had not stopped growing since the 1840s, when the development of the coffee industry made it possible to overcome a long-term crisis dating from the middle of the previous century, when the gold cycle was exhausted. Brazil has undergone one hundred and fifty years of extraordinary growth. According to a recent study by Angus Maddison,[2] Brazil has presented the highest rates of growth of GNP since 1870, compared to several selected countries, among which are the United States, Japan, and the Soviet Union. Beginning in 1981, however, the Brazilian economy entered a period of stagnation that has lasted up to the present. Per capita income, which in the previous eight years (1973–1980) had grown 52.7 percent, has remained almost constant (increasing about 2.8 percent) since 1981. It should be noted that this trend has shown no signs of changing recently—the government forecast for this year is for a reduction of 1 percent in per capita income, and of around 2 percent for 1989.

The growth rate of the Brazilian economy has decreased to an average that is very close to the population growth in the last eight years (around 2.6 percent growth for the GNP), whereas it had been approximately 7 percent a year since the 1940s. This cannot be considered accidental or temporary, as it is directly related to the decrease in the investment rate. This rate, which was an average of 22.9 percent in the 1970s, has gone down to 17.4 percent since 1981. We are really faced with a structural crisis, whose basic symptoms are the stagnation of per capita income and the drastic reduction of the capacity for savings and investment (see Table 1).

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2. Angus Maddison, "Brasil tem o crescimento mais rápido do PIB desde 1870." *Folha de São Paulo* (October 27, 1988): B-6.

Table 1. Internal Macroeconomic Variables

(%)

Year	Gross National Product	Investments/ Gross National Product	Resource Transfer/GNP	Inflation (Consumer Price Index)
1979	7.2	23.0	(2.1)	77.2
1980	9.1	22.5	(2.2)	99.7
1981	(3.1)	21.0	(0.4)	93.5
1982	1.1	20.4	(0.7)	100.3
1983	(2.8)	16.1	2.4	178.0
1984	5.7	15.5	5.6	209.1
1985	8.4	16.7	5.1	239.1
1986	8.0	18.5	2.6	59.2
1987	2.9	19.7	3.0	394.6
1988[a]	1.0	17.0	5.0	900.0

Source: Instituto Brasileiro de Geografia e Estatistica (IBGE), *Conjuntura Econômica*, No. 42, September, 1988.

a. Estimated.

Given an investment rate of around 17 percent, and the capital/product ratio of 3 generally used in Brazilian macroeconomic studies, it is certainly still possible to have an annual growth rate of 5 percent of the national product, that is, a growth rate considerably higher than that of today.

At this point, it is necessary to introduce a third symptom of the Brazilian economic crisis of the 1980s: the soaring inflation rate. A capital/product ratio of 3 can even be conservative when prices are stable or the inflation rate moderate. In the 1970s, for example, growth was possible with an average annual inflation rate of 32.6 percent—a moderate rate. However, in 1980, inflation rose to almost 100 percent; in 1983, to around 200 percent; and finally, after the interregnum of the Cruzado Plan, it went to almost 400 percent in 1987 and nearly 1000 percent in 1988. In fact, if we annualize the inflation rate for August to October 1988, inflation in Brazil today is 1200 percent. With inflation rates of this order, it is completely unfeasible to think about economic growth. The capital/product ratio itself no longer makes sense, because the economy has become disorganized and inefficient despite indexation that tries to neutralize the disruptive effects of inflation.

The Fiscal Crisis

The main cause of the Brazilian economic crisis is the fiscal crisis—the structural financial imbalance of the public sector—which in turn is mainly caused by the excessive size of the public foreign debt. This fiscal crisis has already been widely analyzed.[3] It is erroneous, however, to imagine that this crisis can be boiled down to only a high public deficit, as is possible to infer from the current discussion on the Brazilian economy. Actually, the fiscal crisis has three dimensions: (1) a flow dimension: the public deficit itself; (2) a stock dimension: the internal and the foreign public debt; and (3) a psycho-social dimension: the lack of state credit, which can be defined in objective terms by Brazil's inability to finance its deficit for a period greater than that of an overnight open-market operation.

The flow dimension of the fiscal crisis is the one that is most commonly analyzed. It can be measured in two ways, both appearing in Table 2: by the operational public deficit and by the savings capacity of the public sector. The former includes the state corporations and corresponds to the real increase in indebtedness of the state, that is, to the real (discounted of inflation) increase of the public-sector borrowing requirements. Aside from measuring the financial imbalance of the government, it could also be a macro indicator of excess demand.

The second flow measure of the state's financial imbalance is in its capacity for savings. This measure cannot be directly compared with that of the public deficit because the national accounts in Brazil exclude the state corporations from the public sector. However, the two measures are related. Public savings, which were around 5 percent of the GNP in the mid-1970s, had already declined to 3.8 percent in 1979 and became negative (−1.2 percent of the GNP) in 1987. This means that in the 1970s the public sector was able to collect forced savings and invest it—to carry out the role par excellence of the state in the development process—while in the 1980s, although it still had to invest, as it was

3. Rogério F. Werneck, "A Armadilha Financeira do Setor Público e as Empresas Estatals," in Adroaldo Moura da Silva, ed., *FMI x Brasil: A Armadilha da Recessão* (São Paulo: Gazeta Mercantil, 1983); Werneck, *Empresas Estatals e Política Macroeconômica* (Rio de Janeiro: Editora Campus, 1987); Luiz Carlos Bresser Pereira, "Mudanças no Padrão de Financiamento do Investimentos no Brasil," *Revista de Economia Política* 7, no. 4 (1987); Ministério da Fazenda, *Plano de Controle Macroeconômico* (Brasilia: Finance Ministry, 1987).

Table 2. Public Sector Accounts

Year	Tax Collection	Personal Expenditure	(% of GNP) Interests/ Internal Debt	Interests/ Foreign Debt	Public Savings	Public Deficit
1979	24.3	6.9	0.55	0.29	3.8	8.3
1980	24.2	6.2	0.74	0.36	2.2	6.7
1981	24.6	6.5	1.08	0.29	2.3	6.0
1982	26.2	7.3	1.21	1.18	1.8	7.3
1983	24.7	6.5	1.65	1.57	0.6	4.4
1984	21.6	5.6	2.05	1.83	0.8	2.7
1985	22.0	6.8	2.24	1.51	0.3	4.3
1986	24.3	7.0	1.14	1.35	1.9	3.6
1987	22.6	7.7	1.15	1.44	(1.2)	5.5
1988[a]	22.1	7.8	1.48	1.85	(1.9)	4.0

Source: First four columns, Instituto de Planejamiento Econômico e Social (IPEA); last, Central Bank.

Note: The first five columns refer to the public sector in the strict sense; the last includes state corporations.

a. Estimated.

still responsible for a good part of the productive infrastructure of the country, it began to present negative savings. Thus the public sector had to increase its financing with the private sector (public deficit) in order to maintain a minimal level of investments.

These two flow imbalances cause a growing stock imbalance of the state finances, namely, the public debt. In the 1970s, this debt was basically foreign. In the 1980s, when the international banks began to reduce, (1979/80), and then finally to suspend (1982) the rollover of foreign debt, the internal debt began to grow explosively. The public foreign debt, however, has continued to grow, as the public sector was able to and allowed to pay or to pre-pay its foreign commitments in cruzados. Today, with a GNP of nearly $320 billion, we have a public foreign debt of about $100 billion (almost 85 percent of the total foreign debt), which, added to an internal debt of around $70 billion, gives us a total public debt of almost $170 billion, corresponding to more than 50 percent of the GNP.

Both the flow and stock imbalances are very high in relation to the GNP. However, this does not necessarily imply a fiscal crisis. In Brazil, the public sector is insolvent, whereas in some other countries, such as Italy and the United States, although the rates of fiscal imbalance are even greater, the state is not bankrupt. This is possible because in those countries the state still has credit: It is able to obtain financing from the private sector for a period of one to two years, in the case of Italy, or for at least ten years, in the case of the United States, while in Brazil, the state has almost no credit. Almost all of its internal financing is carried out for the period of one night, on the "overnight" market, transforming the bonds of the Treasury into quasi-money.

The fiscal crisis was underestimated in Brazil for a long time. The Cruzado Plan adopted at the beginning of 1986 is an example of this attitude. This plan was a well-designed attempt to eliminate inertial inflation, but right away a populist administration of the economy permitted a strong increase in real wages, consumption, and investment, while the real interest rate was maintained negative and the exchange rate appreciated. As a result, less than one year after it was enacted, the Cruzado Plan had become a huge disaster.

Although it was partly a contingency of the loss of reserves due to the macroeconomic imbalance provoked by the Cruzado Plan, the Brazilian moratorium was an act of courage by the Finance Minister of that time.[4] It served as the basis not only of the Brazilian strategy for reducing the debt via securitization in the second half of 1987,[5] but it was also important in leading significant sectors of the elites of the creditor countries to review their position on foreign debt and

4. See Nogueira Batista, Jr., *Da Crise International à Moratória Brasileira* (Rio de Janeiro: Paz e Terra, 1988), p. 199, on the merits of the February 1987 Brazilian moratorium instituted by Finance Minister Dilson Funaro. This book makes an error in criticizing the interim agreement with the banks, which was aimed at showing Brazil's good faith in negotiating, unfairly confusing it with a suspension of the moratorium. The fact that the moratorium was not being suspended was even communicated in writing to the Secretary of the Treasury of the United States, James Baker. The moratorium would only really have been suspended if the final agreement with the banks had been closed by January 29, 1988. Right after the signing of the agreement, the banks showed themselves to be unwilling to negotiate. It was then decided that, the deadline having expired, the measures necessary to complete the moratorium through a unilateral reduction of the debt would be taken.

5. Fernão Bracher, "Relatonio Reservado," *Revista de Economia Politíca* 8, no. 4 (1988). This material was originally presented as a report to the Finance Minister of Brazil when Bracher resigned his position as Advisor for the Negotiation of Brazilian External Debt; Luiz Carlos Bresser Pereira "Uma Estratégia Alternativa para Negociar a Dívida Externa," *Senhor* no. 380 (1988). Published in English in *LASA Forum* 19, no. 4 (1989).

to take more seriously the debt-relief schemes aimed at reducing the debts of the highly indebted countries. The statement of the Brazilian Finance Minister in February 1988 that the Brazilian moratorium had brought more losses than gains, as the gain in reserves obtained by the suspension of interest payments was more than compensated for by the loss coming from the various forms of retaliation (reduction of short-term credits, reduction of disbursements from the World Bank, increase in the capital flight), is totally unfounded. It can only be explained by his desire to justify his decision to suspend the moratorium and make a conventional agreement with the banks. This statement, however, had worldwide repercussions, as it came out in the media of the creditor countries and confused their elites.[6]

The Debt and the Internal Imbalance

Actually, the external debt is the background to the Brazilian economic crisis. The reduction of the economic growth rate in the 1980s to an average very close to the population growth rate can be explained, in terms of direct causes, on the one hand by the reduction of the investment rate, and on the other by the acceleration of inflation, which disorganizes investments or makes them inefficient. Both phenomena are directly related to the foreign debt. The first column of Table 3 presents Brazil's real transaction surplus, that is, the transference of real resources to the creditors, which has a direct effect in lowering the internal savings and investment capacity of the country.

The external debt is also an important cause—certainly not the only one—of the structural financial imbalance of the public sector, as one of the first reactions of the private sector to debt in almost all of the highly indebted countries is to transfer it to the public sector. In Brazil at the end of the 1970s the public sector was responsible for a little more than 50 percent of the foreign debt; by 1988 that had risen to more than 85 percent. Similar growth, although not always as dramatic, can be seen in all of the debtor countries. As a result, the interest charges of the public foreign debt begin to appear directly in the public deficit. In 1988, the interests on the foreign debt in Brazil corresponded to 2.8 percent of GNP, that is, to almost 70 percent of the 4 percent public deficit.

6. See, for example, Riordan Roett, "Latin America's Debt: Problems and Prospects," *International Journal* (in press); or William Cline, "Divida Internacional: Progresso e Estratégia," *Finanças & Desenvolvimento* 8, no. 2 (1988).

Table 3. Brazil's Foreign Accounts
($ millions)

Year	Real Transfers	Current Account	Foreign Debt	Debt/ Export %
1979	(5,199.4)	(10,741.6)	49,904	327.4
1980	(5,774.9)	(12,807.0)	53,848	267.5
1981	(2,863.2)	(11,734.3)	61,411	263.6
1982	(2,816.1)	(16,310.5)	69,654	374.6
1983	4,170.6	(6,837.4)	81,319	381.3
1984	11,515.7	44.8	91,091	337.3
1985	11,017.2	(241.5)	95,857	373.9
1986	6,302.4	4,476.9)	101,759	454.4
1987	8,889.0	(812.0)	107,514	409.9
1988[a]	16,170.0	4,570.0	106,052	320.6

Source: Central Bank.

a. Estimated (commercial balance $19 billion in 1988).

The need to pay interest on an excessively high debt leads to a reduction in the capacity for savings and investment, to an increase in the public deficit, and to inflation. The process of adjustment demanded by the creditors to ensure payment of interest becomes self-defeating. When a country is faced with a debt that is too high, the more it tries to adjust, the more distorted the economy becomes.[7]

Actually, there is a perverse chain effect of the foreign debt: nationalization of the debt; reduction of public savings; increase of public deficit; increase of internal debt; increase of inflation rate; increase of internal interest rate; reduction of investments; reduction of capacity to export; reduction of growth rate. Table 4 presents the basic macroeconomic variables that illustrate the perverse effects of the debt.

It would certainly be possible for the highly indebted, middle-income

7. Jeffrey Sachs was one of the first economists to call attention to the fiscal effects of the foreign debt, as well as to the self-defeating nature of adjustment measures when a foreign debt is excessively high. Dionísio Carneiro and Rogério Werneck developed a formal model to demonstrate this point in "External Debt, Economic Growth, and Fiscal Adjustment," Texto para Discussão no. 202 (Rio de Janeiro: Pontifícia Universidade Católica, 1988). Pierre Salama has written a book, *Dollarisation et Desindustrialisation? Les Effects Pervers des Politiques d'Adjustement* (Paris: La Decouverte, 1989), which focuses on these self-defeating effects.

Table 4. Macro Variables of the 15 Highly Indebted Countries

Year	GNP Growth	Investment/ GNP	Inflation	Public Deficit (% GNP)	Current Account/ Export.
70-79	5.9	24.0	31.7	(2.6)	(17.0)
1980	5.4	24.6	47.2	(0.8)	(18.0)
1981	0.1	24.0	53.7	(4.3)	(30.7)
1982	(0.5)	21.5	55.9	(5.9)	(35.8)
1983	(2.7)	17.4	91.6	(5.0)	(11.2)
1984	2.3	16.6	118.4	(3.6)	(1.0)
1985	3.8	17.1	121.8	(3.4)	(0.2)
1986	3.8	17.8	77.2	(4.8)	(11.9)
1987	2.5	17.1	116.2	(6.5)	(6.1)
1988	1.5	18.1	222.9	(5.1)	(6.4)

Source: International Monetary Fund, *World Economic Outlook*, October 1988.

countries to pay their debts fully if economic policy could be reduced to a kind of economic engineering. Then all that would be needed in order to make total payment of the interest on the debt consistent with growth and price stability would be to strongly reduce wages and internal consumption, allowing for a large increase in exports. I demonstrated this quite clearly while working with the macroeconomic simulation that was part of the Macroeconomic Control Plan.[8] Frenkel and Rosemwurcel arrived at the same conclusion by developing a macroeconomic simulation for the debtor nations of Latin America.[9]

The Conventional Solution

When any debt becomes excessive, that is, it becomes too high to be paid, there is only one solution: Reduce it. In the case of private corporations, there are two alternatives; aside from reducing it through the legal means of agreement (Article 11 of the Bankruptcy Code

8. Ministério da Fazenda, *Plano de Controle Macroeconômica* (Brasilia: Finance Ministry, 1987).
9. Roberto Frenkel and Guillermo Rosenwurcel, "Restrición Externa y Generación de Recursos para el Crescimiento en América Latina" (Paper presented at the conference, *Beyond the Debt Crisis:* Latin America Strategies for the 90s, Caracas, June 28–30, 1988). (Mimeo.)

in U.S. law), there is also bankruptcy. As this second case is impossible for nations, there is no other alternative than to reduce the debt.

It is clear that the creditor's first tendency will be not to recognize that it is unfeasible to pay the debt fully. First they will define the problem as transitory, a problem of liquidity, asserting that a combination of financing and adjustment, with emphasis on adjustment, would solve the problem. This was the first phase of the creditors' strategy for the debt, beginning in 1982. Once they saw that the ratios of indebtedness tended to increase rather than decrease, as would be expected if it were only a problem of liquidity (see Table 5), the creditors perceived the impracticality of this strategy. The government of the United States, which took the lead in dealing with this problem, then tried to give more emphasis to adjustment with structural reforms and with additional financing so as to ensure growth (Baker Plan, 1985). But there was no financing, because the banks did not agree to make new loans, and, since the adjustment was self-defeating, what could be said for trying to implant structural reforms when the debt is excessive?

The deterioration of the countries' capacity to pay came to a halt in 1987; the main indicator of indebtedness (debt/exports ratio) remained stable in this year and was reduced in 1988. The creditors know that the increase in exports attained by the debtor nations in 1988 was due to exceptional growth in the developed countries that could not be sustained

Table 5. Debt Ratios of the 15 Highly Indebted Countries

Year	Debt/ Exports	Interests/ Exports	Debt/ GNP
1980	1.7	0.29	0.33
1981	2.0	0.39	0.38
1982	2.7	0.50	0.42
1983	2.9	0.40	0.46
1984	2.7	0.40	0.46
1985	2.9	0.39	0.45
1986	3.5	0.43	0.47
1987	3.4	0.35	0.50
1988	3.1	0.41	0.47

Source: International Monetary Fund, *World Economic Outlook*, October 1988.

Table 6. Discount in the Secondary Market

	(%)				
	Jul.85	Feb.87	Oct.87	Jul.88	Oct.88
Brazil	19-25	24-26	60-65	48-50	56-59
Argentina	35–40	35–38	62–66	75–78	78–82
Mexico	18–22	42–43	51–54	48–50	50–53
Chile	31–35	31–34	47–50	40–43	41–43
Philippines	–	24–28	40–43	47–50	46–50

Source: Shearson Lehman Hutton Inc.

in the following years. The increase in the discounts in the secondary market in 1988 (see Table 6), notwithstanding the reduction in the debt/export ratio, is a good indication that the creditors did not take this improvement into account. They were more impressed by the increasing internal difficulties faced by the debtor countries.

Actually, the creditor banks have understood for some time that they will most likely not be able to collect the debt (only this can explain the broad, increasing discounts in the secondary market), but they are still not willing to recognize this officially. They prefer to ignore the problem while they strengthen their own capital ratios. Given this, the creditors' strategy can no longer be called the "financing and adjustment" approach. Instead, it is now called the "muddling through" approach by the creditors themselves. It is a strategy of postponing the real solution to the problem while the banks gain strength. From the debtors' point of view, however, this strategy merits a different name. Perhaps it should be called something like the "slavery-collection approach" as it is reminiscent of the old-fashioned forms of collecting credits: When a debtor was unable to pay, he or she was reduced to slavery. Stagnation and high inflation rates are the modern forms of enslavement to which the countries that face a debt they cannot pay have been reduced.

The Voluntary and the Negotiated Solutions

Today there is almost a consensus among the elites of the creditor countries that the debt will not be fully paid, that additional financing is illogical as well as unfeasible, and that the solution is to reduce the debt.

More precisely, the realistic approach to the debt crisis is no longer a combination of financing and adjustment, but rather a combination of debt reduction and adjustment.

The creditors naturally fear that rather than debt reduction being taken together with adjustment it will instead substitute for it. The populist practices in the debtor countries are well known, and reinforce the suspicion that the adjustment policies will not be carried out.[10] But if this doubt is justifiable, it is also applicable to the present "muddling through" approach, which the creditors continue to use. It is equally possible that the debtor may try to escape its commitments to adjustment after receiving additional financing as after being benefited from debt relief.

On the other hand, as Jeffrey Sachs noted, when a debt becomes very high, it can act as an important incentive against adjustment in a debtor country, for the adjustment serves mainly to pay the creditor and not to promote the increase in investment and consumption in the debtor country.[11]

The substantive discussion today among the elites of the creditor countries is no longer about whether or not the debt can be paid, but about what form the reduction of the debt should take. There are basically four possibilities, all of which are for the securitization of the debt; that is, for the transformation of the present debt into new securities or bonds, whose face value or respective interest rate will be reduced in loose accordance with the discount in the secondary market. These four possibilities are: (1) market-oriented voluntary reduction; (2) negotiated partial reduction; (3) unilateral reduction; and (4) a global solution via the creation of an International Debt Facility.

The voluntary reduction of the debt is a market solution. It can take the form of debt-equity conversion, of repurchasing a debt at a discount, and mainly, of debt-bond conversion (voluntary securitization). Such voluntary reduction is an attractive alternative for the creditors' govern-

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10. Adolfo Canitrot, "La Experiencia Populista de Redistribucion de Ingresso," *Desarrollo Economico* no. 15 (1975); Luiz Carlos Bresser Pereira, "Os Limites da Politica Econômica," *Revista de Economia Politíca* 8, no. 2 (1988); Jeffrey Sachs, "Social Conflict and Populist Policies in Latin America" (Harvard University, 1988). (Mimeo.) To be published in Renatu Brunetta, ed., *Market Institutions and Cooperation* (International Economic Association, forthcoming).

11. Jeffrey Sachs, "Conditionality, Debt Relief and Debt Crisis" (Harvard University, 1988). (Mimeo.)

ments and, given its market orientations, is being increasingly accepted by the banks,[12] but by its nature it is a limited form of debt reduction. Debt-equity conversion has additional serious inflationary limitations, because it implies an increase in the money supply or a substitution of internal debt for external debt. The repurchase of the debt requires an amount of reserves that is inconsistent with a debt too high to be paid.

Debt-bond conversions have a built-in limitation, as do the two other market or voluntary forms of debt reduction, for as the conversion takes place, the discount in the secondary market will tend to decrease. With this in mind, the major banks usually decide to be the last to convert, expecting that, when their turn comes, the discount will have disappeared in the secondary market and they will receive the full value of their credit. In this way, the market for a voluntary solution is artificially small and tends to diminish, even though the banks know that there is little possibility that they can *all* receive the full value of their credits.

The limitations of voluntary securitization may be expressed in terms of time. The debt crisis is a pressing problem. It might eventually be solved voluntarily through the market. But that could take ten or more years, which shows this alternative to be mere nonsense.

The second alternative of reducing the debt—the negotiated partial reduction of the debt—was used in the original Brazilian proposal in 1987. The idea was to negotiate with the banks to transform part of Brazil's long- and medium-term debt into bonds with a discount. In the original 1987 Brazilian proposal, the initial securitization was to be for 20 percent of the total medium-term debt with the commercial banks; the discount would have been approximately 45 percent. I say "approximately" because the discount would have been not on the face value of the bond but on the interest rate, which would be fixed and below the market rate. As the interest rate in the market fluctuates, it is not possible to state with accuracy what the discount would have been.

It is only possible to reach this kind of solution if a country decides to make full use of its only weapon in bargaining: the unilateral decision to suspend interest payments. A negotiated partial reduction could be a good way to test the good will of the banks in negotiating. It could also be a way for a debtor country to begin to move towards a simple

12. Economic Policy Council, "Third World Debt: A Reexamination of Long-term Management" (Report of the Economic Policy Council of the United Nations Association of the USA, New York, 1988).

unilateral decision to reduce not part of the debt, but the whole thing. The negotiated solution obviously does not represent a definitive solution, as only part of the debt can be reduced. The banks and the governments that represent them would probably strongly resist this kind of negotiated solution, as in the case of Brazil. Once the proposal is rejected, the debtor country that had firmly decided to reduce its debt would have recourse only to a unilateral solution to reduce its whole debt, with the moral strength of having tried a negotiated solution with the banks beforehand.

The unilateral solution to reduce the whole debt can be seen as an end in itself or as a means of pressuring the creditors to adopt a fourth possibility: the global solution. It is better, therefore, that we first clarify this solution.

The Global Solution

The global solution of debt reduction most generally accepted today was proposed in a broad outline by Brazil on September 4, 1987.[13] A detailed proposal did not make sense for Brazil at that time because it is not a proposal that can be negotiated by a debtor country alone. At the beginning of 1988, however, two complete proposals along the same lines appeared: that of the president of the American Express Bank, James Robinson III, and that of the IMF director for India—a developing country with a small debt—Arjun Sengupta.[14]

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13. See Luiz Carlos Bresser Pereira, "The Debt Problem: Postpone it or Solve it?" (Statement presented to the Congressional Summit on the Economic Agenda for the Nineties, Vienna, 1987). (Mimeo.) This statement was published in Portuguese in *Revista de Economia Politíca* 8, no. 4 (1988).

14. James Robinson, III, "A Comprehensive Agenda for an Institute of International Debt and Development," *The AMEX Bank Review* no. 13 (1988). Published in Portuguese in *Revista de Economia Politíca* 8, no. 4 (1988); Arjun Sengupta, "A Proposal for a Debt Adjustment Facility" (Paper presented at the International Monetary Fund, Executive Board Seminar, Washington, 1988). See also the proposal from the president of the Bank of Nova Scotia, C.E. Richtie, "Developing Country Debt" (Toronto, 1988). (Mimeo); and the analyses of Edmar L. Bacha, "Capturing the Discount: Towards a Debt Facility at the Bank and the Fund," Texto para Discussão no. 197 (Rio de Janeiro: Pontifícia Universidade Católica, 1988). A pioneer study on the reduction of the debt, taking advantage of the Japanese surpluses, was made by Saburo Okita, Lal Jaywardena, and Arjun Sengupta, in "Mobilizing International Surpluses to World Development: A WIDER Plan for a Japanese Initiative," WIDER Study Group Series no. 2 (1987).

The first detailed proposal suggested the creation of a new institution, a debt facility, linked to but independent from the World Bank and the IMF, to administer debt. The second assigned this role directly to the IMF, which would have fiscal advantages in securing resources in the international financial market.

In all of the proposals the basic mechanism for transferring the discount in the secondary market to the debtor countries is the same. Once it is created or authorized by the creditor countries, basically by the Group of Seven (G-7), the International Debt Facility would buy the debt of each highly indebted country, exchanging the present credits of the banks for long-term bonds it would issue with a discount. This discount would then be transferred to the debtor country, with a small margin for the debt facility to cover its costs and risks. The discount would be given by the banks which, in return, would have the total guarantee of receiving their new credit. The debt facility, and therefore the creditor countries through the IMF and the World Bank, would carry the risk in case the debtor countries do not pay the debt in spite of the discount.

This is a global solution, but the case-by-case approach in dealing with the individual debtor countries would be maintained and reinforced. The discount obtained from the banks for each debtor country would be based mainly, but not exclusively, on the discount in the secondary market. This benchmark is a good indicator of the capacity of each country to pay, but the board that would direct the debt facility should make its decision on the value of the discount after a careful evaluation of the economy of each country, and after broad, informal consultations, mainly with the creditor banks. Once a discount is fixed, there would be no other alternative for the banks. They would receive a firm "take it or leave it" offer from the International Debt Facility. Naturally, they would accept it, since most of them would already have agreed with the idea, and because those who don't agree would have few other possibilities, if any, for receiving their total credits directly from the debtor countries.

The debt facility would naturally only transfer the discount to the debtor country if the country had committed itself to make the necessary adjustments. The system of conditions would therefore be very similar to that presently used by the IMF and the World Bank, but stronger. To increase the strength of the conditions, which is always relative, it would be possible, as foreseen in Robinson's proposal, for the discount to be transferred a little at a time.

The financial mechanism proposed in the global solution is, therefore, very simple. It is based on the solution proposed by Felix Rohatyn for the near-bankruptcy of New York City in the 1970s; the banks, therefore, are acquainted with such a mechanism. For them, there is no possibility that they will receive the whole debt. If they agree to a discount, they could probably receive more than they would if they continue to lead the debtor countries to stagnation and inflation. They will certainly receive with more security, freeing themselves from this interminable and exhausting process of negotiation that only postpones the solution to the problem. On the other hand, the economic advantages for the creditor countries in reestablishing the growth of the highly indebted countries are very clear. They are losing around $20 billion every year in exports to the debtor countries. According to figures from the World Bank and the IMF, for each million dollars of debt service received from the debtor countries, the creditor countries lose 25 jobs.[15]

In 1988, a kind of quasi-consensus was formed about the convenience of a global solution. On September 10, the General Secretary of the United Nations, Perez de Cuellar, invited fifteen experts from all over the world for an informal consultation on the foreign debt. At this consultation, at which the Managing Director of the IMF, Michel Camdessus, and the Executive Vice President of the World Bank, Moeen Qureshi, were present, the final consensus was that a global solution for securitization is the most highly recommended way to solve the debt problem. The Managing Director of the IMF even stated that the word "securitization," which was considered "pornographic" by the international financial community when it appeared in 1987, has become the base for any solution to the debt in 1988.

The Resistance of the Creditors

Why then is the global solution not adopted, if for both the banks and the creditor governments its advantages seem to clearly outstrip its disadvantages? It is for two main reasons: Because the United States government, supported by the United Kingdom and Germany, is against it; and because the debtor countries do not exercise the necessary pressure to obtain it.

15. Arturo O'Connell, "External Debt and World Economic Recovery," in Miguel Urrutia, ed., *Latin America: Towards Renewed Growth* (London: Inter-American Development Bank and International Herald Tribune, 1988).

The government of the United States has been consistently against a global solution. Even at the IMF meeting in Berlin (September 1988), the new secretary of the Treasury, Brady, was emphatic in his opposition, going against the governments of Japan, France, and Italy, which since the summit meeting of the G-7 in Toronto in 1988 have taken a position clearly in favor of the adoption of a global scheme of debt relief.

The United States and England are against a global solution because some of their biggest banks—especially Manufacturers' Hanover, Chase Manhattan, and Bank of America—are still having difficulties in absorbing the losses all at once.[16] Actually, the creditor banks are divided into two groups: On one side are the banks from continental Europe and Japan and the regional banks from the United States, which favor or do not oppose a global solution for the debt because they already have large reserves to cover themselves for the debt, and, on the other, the big North American and English banks, which don't have these reserves.

The argument that the taxpayers would have to pay for the guarantee given by the debt facility is unsubstantiated, as the costs of this guarantee would be very low. The long- and medium-term debt of the highly indebted countries to the commercial banks (the debt that is eligible for a discount) is approximately $260 billion. This debt is much less than the one trillion dollars generally mentioned in the press, which includes all kinds of debts, whether they are from highly indebted countries or not. If the average discount obtained was 50 percent, the debt facility would have to guarantee $130 billion. To guarantee this, a paid-in capital of 20 percent would be enough: $26 billion (twice the sum projected in the American Express proposal). Assuming that this capital would be subscribed for a ten-year term (half the term of the bonds that would be issued by the debt facility), the creditor countries would then have to pay $2.6 billion annually over the next ten years. Considering that the GNP of the industrial countries, according to the classification of the World Bank, was $12,224 billion in 1987[17], and considering that the industrial countries can be identified as the creditor countries, their annual contribution for ten years would be 0.2 percent of their GNP. This is an extremely small amount, and it would probably be made up for by the higher level of employment and by the greater growth of the

16. See Bacha (note 14).
17. World Bank, Annual Report.

world economy. Using slightly different criteria, Jeffrey Sachs arrived at very similar conclusions to those we just presented.[18]

Lack of Pressure from the Debtors

The second reason that the global solution to the debt has not been adopted yet is the lack of pressure from the debtor countries, which is a result of the disposition of their elites, as well as of the press and the governments, to try to pay the debt, even though they do not have the objective conditions to do this. This phenomenon was obvious in Brazil at least twice: (1) when most of the businessmen placed themselves against the moratorium at the beginning of 1987; and (2) in 1988, when the moratorium was suspended and a conventional agreement was signed by Brazil and the banks. This agreement solved none of Brazil's problems and was a very negative agreement for Brazil—though very positive for the banks in the short-run—but the elites and press in Brazil hailed it as a positive development and a "normalization" of Brazil's financial relations with the creditor countries. The creditor banks, however, were not fooled. They perceived that although the agreement benefited them, it only harmed Brazil, and they made this fact clear by increasing the discount of the Brazilian debt right after the agreement was signed from 49 to 58 percent (Table 6).

This attitude on the part of the elites of debtor countries is naturally not monolithic. There is a growing number of businessmen and economists—and a greater number of politicians, usually for populist reasons—who understand that the debt cannot be paid. The awareness that Brazil signed a bad agreement in 1988 is growing today in Brazil. The Finance Minister who signed it, Mailson da Nóbrega, recently admitted in the newspaper *Folha de São Paulo* that this agreement does not represent a solution to the problems of the country, and that it is necessary to return to debt reduction.[19]

However, notwithstanding the growing evidence of the impossibility of paying the entire debt, the majority of the elites in the debtor countries continue to be willing to try to pay it for a number of reasons.

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18. J. Sachs, "Social Conflict and Populist Policies in Latin America." (See note 10.)
19. Mailson Ferreira da Nóbrega, "Dívida Externa—a Nova Etapa," *Folha de São Paulo* (Nov. 2, 1988).

The first reason, which is economic, is fear of retaliation. The creditors are always threatening to cut the short-term credits, or to take even stronger steps against debtors who take unilateral measures, and the capitalist elites in the debtor countries believe these threats. It doesn't matter that recent historical evidence clearly belies these threats. In the case of Brazil's moratorium, for example, the retaliation was insignificant. Actually, the banks have neither the power nor the interest to retaliate. Cutting short-term credits is very bad business for them for two reasons: They would no longer receive the excellent profits from these loans with very high spreads, and the only result they would achieve would be to see their short-term loans, which suffer almost no discount in the secondary market today, become subject to the same discount as the medium- and long-term ones. Their loss would be immense.

The second reason is the fact that it is not the capitalist elites of the debtor countries who suffer most in the debt crisis. The workers and the middle classes are much more affected. In fact, for certain sectors of the capitalist class, as Susan George noted correctly, the debt is a chance for speculation and profit.[20] The elevation of the internal interest rate as a result of the debt obviously interests rentiers and the financial institutions inside Brazil. Formal and informal (illegal) debt-equity swaps make it possible for some to have huge gains from speculation.

The third reason, of an ideological nature, is fundamental. The capitalists in the debtor countries want to be part of the first world, to see their economies integrated with those of the advanced capitalist countries. This integration should not only mean more development for the country, but also more political security for the local capitalists. They assume that any kind of confrontation with the banks, any kind of unilateral action by Brazil to increase its pressure on the creditors, will threaten this desired integration. We have here two errors of evaluation: The first is a confusion of the interest of the first world with that of the bankers, and the second, the failure to grasp that integration with the first world is not accomplished through good manners but rather through economic growth and price stability—precisely the two goals that are made unfeasible by the debt.

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20. Susan George, "Global Economic Security and the Political Implications of the Debt" (Paper presented to the Seminar on International Security, sponsored by *South* magazine, Moscow: August, 1988). (Mimeo.)

This motivation of the elites in the debtor countries to try to pay the debt is also based on a more general ideological factor: their cultural subordination to the central countries. This subordination, this belief that the truth is always in the industrialized countries, is one of the characteristic par excellence of underdevelopment, and is expressed in many and varied ways. One example is calling a measure to unilaterally reduce the debt *calote* (a deprecatory Portuguese word for the immoral nonpayment of a personal debt), when it actually has all of the characteristics of a juridical statute of agreement (Chapter 11 of Bankruptcy Law).

The fourth reason, which is strictly political, is that the capitalists in the debtor countries tend to think of those who demand a firm position in relation to the debt as extremists, both leftists and nationalists. They imagine that only these sectors, which talk about "auditing the debt," and actually want a pure and simple repudiation of the debt, are in favor of the unilateral measures. They do not perceive that debt relief has become an accepted subject among the elites of the creditor countries.

This then brings us to the fifth reason: The elites in the debtor countries are very poorly informed about the debt, even less informed than the elites of the creditor countries, although it is much more in their interest to stay well informed. They simply don't know anything, or only very recently learned that the elites in the central countries are divided about this subject, and that a growing number of these elites are already favorable to a global solution to relieve the debt.

Unilateral Reduction of the Debt

Without pressure from the debtor countries, however, and especially from Brazil as the country with the largest debt, it is very unlikely that the creditors will adopt a global solution. On the other hand, if Brazil doesn't reduce its debt by about half, it is very unlikely that it will be able to overcome its fiscal crisis and the prevailing high inflation rates.

Therefore, there is one very clear solution to both problems: A unilateral decision from Brazil to reinstate the moratorium and, moreover, to unilaterally reduce its medium- and long-term debts with the commercial banks to a level compatible with its effective ability to pay, that is, to about 50 to 60 percent of its present value. Once this decision is made, it would only be necessary to send a telex to the banks communicating the decision; at the same time it would mean again suspending interest payments. The telex would also dispense with the Bank Advisory

Committee (as this is an "advisory" committee and as all of its costs are paid by Brazil, we can and should dispense with it), and declare that the Central Bank will then negotiate conditions for the issue of new bonds bank by bank, with terms of about twenty-five years, to substitute the present debt contracts. A fund would be created wherein the funds for paying the banks, while they are deciding whether or not to adhere to the new scheme, would be deposited. An incentive for those who adhere first would also be created.

The first reaction of the banks would probably be indignation. None would adhere. However, we would probably not have greater retaliations, because these would only harm their authors. After a while, either isolated negotiations with certain banks would begin, or the pressure represented by the measure would lead to the adoption of a form of a global solution similar to that which we discussed earlier, to which Brazil would adhere immediately. This should be made explicit in the telex originally sent to the banks.

This measure may appear radical, but it is very far from being so. The history of past debt crises is full of similar moves.[21] In 1953, for example, the conservative Christian Democratic government of Germany unilaterally reduced its foreign debt by 25 percent.[22]

The creditor banks expect firmer measures from the debtor countries. Unilateral measures will not surprise them. While negotiating in the name of their respective banks, the bankers are professional administrators obliged by their stockholders and boards to defend each cent, to fight for each hundredth of a percentage point in a spread. They are debt collectors. But as soon as a debtor country not only decides on a moratorium—that should always be decided in low profile, without seeking internal demagogic political gains with it, nor unduly offending the banks—but also decides approximately how much a reduction it will make in its debt, the bankers, along with their governments and the public opinion in their countries, will understand the reasons that led to this decision. They are prepared for this.

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21. See Gonzalo Biggs, A Crise da Divida Latino: Americana e Alguns Precedentes Historicos (Rio de Janeiro: Paz e Terra, 1987); and Marcelo Paiva Abreu, "On the Memory of Bankers: Brazilian Foreign Debt, 1924–1943," Texto para Discussão no. 194 (Rio de Janeiro: Pontifícia Universidade Católica).

22. United Nations Conference on Trade and Development, *Trade and Development Report, 1988* (Geneva: United Nations Conference on Trade and Development, 1988).

It is clear that a solution of this kind can and should be made only if, at the same time, the country has firmly decided to adopt very hard, internal fiscal adjustment measures. These measures reinforce each other, not only at the economic level, but also at the political level. The internal adjustment measures would be made legitimate to the people of the country by a unilateral cut in the debt, while this reduction of the debt would be legitimized to the public opinion in the creditor countries by the internal adjustment.

In November 1987, after having signed the interim agreement with the banks in order to avoid classification of the Brazilian debt by the U.S. government and thus to demonstrate Brazil's good faith to negotiate, those responsible for the negotiation were convinced of the banks' total lack of willingness to reach an agreement minimally reasonable for Brazil. In view of this, I proposed to President Sarney, who accepted, that if our negotiating team and the banks did not reach a final agreement before February 29, 1988 (the term established in the interim agreement of November), to then dispense with the Advisory Committee and start individual negotiations with each bank based on the principle of securitization of the debt. However, although the President remained firm in his decision, one month later, on December 20, 1987, I definitively submitted my resignation because of his refusal to accept the measures for fiscal adjustment that I proposed.

I hope that I have been able to make it clear in this article that the need to reduce the debt emerges from the fiscal crisis, one of whose basic causes is the excessive foreign debt. Also, that rather than financing with adjustment, as the creditor governments propose, what Brazil needs is a debt reduction with internal adjustment. Reduction of the debt without adjustment is populism that solves nothing. In order to guarantee debt reduction, unilateral decisions will most likely be needed, but the final goal is a global scheme of debt relief.