85
702/1

RECONSTRUCTION

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Mr. Secretary, Mrs. Taft, distinguished colleagues.

Forty years ago, at a Harvard commencement, Secretary of State George C. Marshall announced an offer of American assistance to Europe in post-disaster reconstruction and recovery. The European Recovery Program, later known as the Marshall Plan, was one of the most acclaimed and successful initiatives ever undertaken by the United States. In only a few years, a major recovery of war-torn Europe was effected, a recovery which became the cornerstone of European economic unity. Though it benefited recipients and donors alike, it was viewed universally, in the words of Winston Churchill, as "a genuinely unselfish act".

Since that time, the term "Marshall Plan" has come to denote major coordinated efforts to rebuild or reshape war-torn, disaster stricken, or economically depressed regions. There have been many calls for Marshall Plan-like efforts, usually coming in the aftermath of widespread natural disasters, such as the recent African famine; and after civil conflicts, such as Lebanon; but also to help revitalize strategic areas, such as the Caribbean Basin initiative. Despite these calls, most of the programs have fallen far short of their goals.

It is important, as we celebrate this anniversary, to review the lessons of that momentous program and see how we might apply them to some of the situations we are facing today. Historically, we view the Marshall Plan as at an end, a program which is completed and which can fade back into history. I feel, however, that we should re-examine that effort, divine its lessons and use them as a bridge to help resolve problems which confront us today. Specifically, these lessons can be applied to:

> Reconstruction following natural and man-made disasters in the Third World. Annually, the United States is called to assist dozens of nations in reconstructing and rehabilitating their countries and economies in the aftermath of large-scale devastation caused by famine, earthquakes, hurricanes and civil wars. Despite our best humanitarian intentions, however, a combination of short-duration commitment, bureaucratic delays and unclear responsibility has resulted in a failure to produce meaningful, long-term results.

Regional revitalization of depressed developing countries with common problems is the second area where the lessons of the Marshall Plan can be applied. Assistance programs to the Caribbean, Central America, and particularly to famine-prone Africa could all benefit from a re-examination of the Marshall Plan approaches and strategies.

The third and most important area where the lessons of the Marshall Plan can be applied is in addressing the international debt crisis.

While all of these are important, I will focus on reconstruction after disasters and what I consider the most serious need: international reconstruction stemming from the world economic situation.

What was the Marshall Plan and what were its lessons? First, it was an offer of assistance; an encouragement to those war-torn countries to develop their own plans to recover. It was not a pledge of specific sums, but rather a national commitment to do what we could to help.

It was bipartisan. Forged by Acheson, Bohlen (who were Democrats), Lovett and Clayton (Republicans), it was supported by both parties, the press, and, of course, the beneficiaries. It was not really a plan, nor even a program. Rather it was a framework under which the countries could suggest approaches for the U.S. to consider, the guiding criteria being that they promote rapid recovery and regional stability. Publicly, the policy was "directed not against any country or doctrine, but against hunger, poverty, desperation and chaos... to permit the emergence of political and social conditions in which free institutions can exist". While there was undoubtedly a large degree of self-interest -- the original draft of Marshall's speech by Bohlen had specifically called the program an effort to prevent the spread of Communism in Europe -- General Marshall and others quickly saw that the program should be offered to all, democratic as well as socialist countries, in order to be accepted in a skeptical Europe. Initially, its framers hoped that the program would be a means of lessening postwar tensions; later, it was justified as a bulwark against Communism, and finally it was seen as the cornerstone of containment.

What distinguishes the Marshall Plan from its proposed successors is that it was an offer to countries which, while devastated, were politically and, prior to the war, economically highly developed. It contained a mix of programs -- some public, some private -- all developed with the full input of the beneficiaries.

A review of the Plan shows many strengths -- and a few weaknesses. Among the strengths? It was bipartisan. The Administration had close cooperation from Congress, especially the leadership. At a time when many Americans wished to withdraw from the world, when mothers and wives demanded that occupying forces be brought home from abroad, the framers of the plan worked carefully to develop a consensus, not only in Congress, but among the public at large, to support the program. Few efforts since have had anywhere near the same degree of bipartisan support.

The program operated through both the private and public sector. It openly pursued benefits for both the lender and the borrower. It took an area-wide approach, instead of a country-specific scheme. It was guided by long-range planning. Despite strong U.S. guidance, its <u>appearance</u> was that of an equal partnership between the borrower and the lender. Finally, it had its "czar", Averell Harriman. (Anyone who doesn't believe that Harriman had ultimate authority in negotiating with his counterparts in Europe during this period only needs to look at the State Department cables, or rather the lack of them, to see how independently he could operate.)

The weaknesses of the program were chiefly political. It was immediately seen by the Soviets as an instrument of the emerging U.S. containment policy. As such, it hastened the permanent division of Europe. Despite the openness of the language and the intent of at least some of the authors, there was no real attempt to involve the Soviets or their satellites in the planning and execution of the program. In retrospect, it appears that, while an offer was extended for Soviet participation, there was no real planning about <u>how</u> to involve them. Had the Soviets agreed, the program may have even been doomed to failure and so it's surprising that no "what if" studies were done. As perceived by the Soviets, the only action left to them was to ring down the iron curtain and to prohibit their satellites from participating. Poland and Czechoslovakia, which had previously indicated a willingness to participate, suddenly terminated the discussions and withdrew.

In summary, the Marshall Plan can be viewed as a very good program with some decidedly negative and unforeseen consequences.

Now let's have a look at how reconstruction has been handled since the Marshall Plan. When the ERP ended, so did the era of long-range planning. Planners, in general, were viewed with suspicion. After the "New Deal" and strict wartime controls, the economy was ready to loosen up and so were the conservatives who wanted more freedom in economic, especially industrial, sectors. McCarthyism was also on the rise and, with it, a deep fear of centralized planning. Indeed, even before the Marshall Plan ended, the effort and its authors were criticized for "promoting socialism".

In the next decade and a half, there were no major reconstruction demands except for Korea, and even that received limited attention. We disbanded the bureaucratic machinery for aiding reconstruction, except for the World Bank. The industrialized West could now handle its own disasters, and responsibility for reconstruction needs in the colonial world was left to the imperial powers.

In the 1960s, the Third World began to emerge and expand rapidly. With the independence of each new country, new problems arose. First the U.S. expanded its aid programs, but on a piecemeal and country-by-country basis. An aid pattern evolved. Infrastructure and capital-intensive programs would be supported by the government or intergovernmental agencies such as the U.N. or World Bank; people-to-people and more direct aid programs on a smaller scale would be handled by the voluntary agencies or nongovernmental organizations.

Almost immediately, economic problems in the developing countries began to get out of hand. New trends aggravated the inequities of weak economies. There was a virtually spontaneous shift of populations with rapid urbanization and increasing marginalization of rural sectors predominating among the concerns of all the LDCs. Increasing birth rates and the construction of dense, overcrowded shanty towns on marginal sites increased the vulnerability of the populations to disasters.

In discussing reconstruction after natural disasters, it is important to understand the linkage of these trends (urbanization, marginalization of the rural poor, and increasing birth rates) to vulnerability, the linkage of vulnerability to disasters and, subsequently and most importantly, the linkage of disasters to development.

Typically, the urbanization/disaster cycle works as follows: Government policies support industrialization and the urban dwellers. The farmers, whose crop prices are often kept artificially low to help urban consumers, suffer declining profits while receiving reduced levels of services. Economically marginalized, they quickly see that they can find a better future in the cities. Therefore, they migrate.

Land demand in the cities increases as more people arrive. Prices rise. Since good land is too expensive, the poor settle in hazardous areas. The costs of building materials also rise, so people are forced to build marginal housing. This combination of poor sites, poor houses and overcrowding means that when an earthquake, cyclone or flood strikes, thousands of the poor will be affected. Recognizing poverty as the primary root of vulnerability and the poor as the primary victims are the first steps towards understanding a need for change in current disaster response practices. For if disasters are an outgrowth of widespread poverty, how can we expect to reduce their impact by concentrating on emergency assistance of a short-term, limited duration?

In the 1960s we began to establish our disaster assistance mechanisms. First, the Foreign Disaster Relief Coordinator's Office, now called the Office of U.S. Foreign Disaster Assistance, was established in AID to guide American response overseas. However, disasters were viewed as an aberration, an abnormal situation. AID administrators wanted to get on with development, their primary task. Disasters were viewed as a short-term event, anti-developmental, something to compete with development funding. Universally, there was a failure to link disasters with the causes of underdevelopment or slowed or retarded development, and a failure to understand that a disaster, responded to improperly, could even set back development efforts. Most important, especially in the last decade, has been a failure of planners to understand the link between disasters and the growing debt of the Third World.

A de facto separation of emergency response from reconstruction occurred which was later institutionalized. Reconstruction was rightly seen as a development issue and therefore primarily a Mission responsibility. The emergency was wrongly seen as a separate set of circumstances to be guided by specialists who would get in and get out without participating in reconstruction decisions. To make matters worse, Congress set a 90-day limit on emergency aid, segmenting disasters into artificially-defined phases, and thereby ensuring that much of the aid money would be spent unwisely.

The results? We focus attention on what, in the long-term, is really unimportant. Over the years, I've met with dozens of chief executives immediately after major disasters. What presidents and prime ministers want to know is not "how do we distribute plastic sheets?", but "how the hell do I pay for rebuilding from this mess?"

Compartmentalization of the disaster ensures that we are unable to respond quickly with time-sensitive aid. We have no basis for providing emergency relief that will lay the groundwork for rapid reconstruction. We are unable to capitalize on the opportunities created by the disaster (and there are many, not the least of which is the collective will to make things happen to benefit the victims). We fail to address the real and underlying problems. Any assistance that can be provided within 90 days is unlikely to have a major impact on mitigating the next disaster.

We waste money. No matter how good our intentions, it is simply impossible to do good project planning for meaningful programs, go through the participatory process that is so vital to the success of a good project, and execute and complete a program within a 90-day period. Programs planned under these conditions will inevitably be cost-ineffective.

The most serious problem, however, is that we may inadvertently create or fuel long-term problems for these countries. This is especially the case regarding external debt.

There is a growing awareness of these problems. In October 1986, a GAO report entitled "Time-Critical Aid" questioned AID's ability to provide meaningful and timely reconstruction assistance. The report discusses AID's administration of reconstruction projects in three Andean countries after floods and droughts induced by El Niño. It suggests steps that the agency can take to improve the future delivery of time-critical reconstruction assistance. In general, the report found that reconstruction was slow, primarily due to the Agency's:

- not fully utilizing alternatives available for flexible funding and programming;

- applying regular development assistance programming and implementation procedures instead of emergency procedures;

- applying standard procurement and contracting rules to obtain certain commodities; and

- not establishing high priorities for time-critical components.

I generally agree with the findings of the GAO report. However, even if these problems could be corrected, there would still be long delays and ineffective response. This is principally due to:

- The administrative compartmentalization of disasters and assignment of responsibilities to different entities within AID. Compartmentalization could be overcome if sufficient "bridges" between the emergency and reconstruction periods are established and both OFDA and AID Mission personnel are jointly trained and prepared for the transition from one to the other.

- There are no standard or even preferred approaches or programs for reconstruction assistance. Most reconstruction activities can best be described as "reinventing the wheel". In most cases, U.S. reconstruction assistance follows the same patterns. Our actions are usually proscribed by the type of disaster and the type of damages incurred. The development of standard reconstruction approaches for housing, agriculture, and small business sectors and the development of guidelines and standard procedures, integrating many of the contracting recommendations spelled out in the GAO report, would go a long way toward speeding our reconstruction assistance.

- There has been a consistent lack of appreciation for the opportunities that are available for linking reconstruction programs to post-disaster emergency assistance. For example, housing reconstruction commonly involves self-help reconstruction of housing. In the emergency phase, the groundwork could be laid by providing building materials such as CI sheets which could be used for temporary shelter and later incorporated into permanent housing through the self-help process. This could be even further speeded if the standard approaches and programs mentioned above were developed.

In recent years, AID has been a pioneer in promoting disaster preparedness as the best means of improving management and coordination of emergencies. It only follows that by laying the groundwork during emergency operations, we can establish a linkage to more effective and timely reconstruction assistance.

These comments should in no way detract from the fine work of OFDA. Under the leadership of Mrs. Taft and her predecessor, General Becton, tremendous strides have been made in the field of emergency preparedness and improving emergency response. There has been much progress in preparedness and mitigation efforts in many of the most disaster-prone countries. Likewise, the task force on the African drought shows that AID can draw the best and brightest of its staff together to effectively manage crises in remote and difficult regions. Recent work by Food-For-Peace, especially evaluations of their response to emergency situations, has gone a long way toward improving our aid in that sector. But, despite these improvements in emergency response, the efforts in reconstruction and long-term planning to alleviate the causes of disasters still lag far behind.

Let's compare the way we handle reconstruction today with the Marshall Plan. Does it have the key strengths? First, is it bipartisan? Yes. Americans of both parties are unanimous in showing their concern for victims around the world.

Second, is there a national commitment to reconstruction efforts? Emergency assistance can capture the emotions of the world, as demonstrated by the "Band Aid" and "We Are The World" concerts. But long-term reconstruction gets lost in donor burnout.

Do reconstruction efforts today operate through both the public and private sectors? Only marginally.

Is there a partnership between the U.S. and the recipients? Marginally, but generally we dictate the responses or provide a rigid framework under which countries can borrow money.

Are we guided by long-range planning? Definitely not.

Is there interagency expertise for reconstruction? No.

Do reconstruction efforts, at the country level, have a "czar" or even a coordinating body? No.

On the positive side, our reconstruction efforts today still exhibit one of the principal strengths of the Marshall Plan. In other words, they are still seen as genuine humanitarian concern, not an instrument of U.S. policy. This is surprising, especially when viewed in the context of where our aid monies are spent. Yet, it would seem that reconstruction assistance is usually seen as a positive intervention by all concerned. This is a key point, for if reconstruction aid is still seen as a positive and unselfish act, we had best get our house in order so we can continue to capitalize on goodwill.

Therefore, I challenge AID to reconsider our reconstruction approaches. I recommend that reconstruction be given a higher priority than relief. I further recommend the establishment of a focal point for reconstruction coordination at a senior level in AID with a small permanent staff and, when the need arises, a temporary staff drawn from, among others, <u>Treasury</u>, AID, State, and Commerce.

Notice the emphasis on Treasury. Reconstruction is primarily a financial matter. More and more, a country's ability to reconstruct is affected by its debt situation. This is the most important area where lessons of the Marshall Plan can and should be applied today, for I believe the international debt crisis we are facing now calls for major economic reconstruction.

It might be helpful to review the origins of the current debt crisis. In the early 1960s, demands for development funds increased. As newly-independent countries came out from under their colonial umbrella, the resources of those countries, especially the mineral and petroleum resources, were no longer "captive" and could be used as collateral on the international banking market. Fed by a feeling that countries couldn't default, and encouraged by the World Bank and the lending countries, private banks began to loan more and more money to developing countries. In the 1970s, with the rising price of oil, it appeared that many of the oil-producing Third World nations would have unlimited access to capital to repay the large notes that were piling up.

Countries overborrowed; banks overlent. Many of the projects that were financed were ill-conceived, poorly planned and poorly executed. In too large a number of cases, corruption was rampant. Yet, the loans continued to flow.

By 1980, we were beginning to see the signs of trouble and by 1982, when Mexico announced that it would be unable to meet its interest payments, shock waves jolted the banking community.

We at INTERTECT began noting the problems in 1979 in Jamaica. In the aftermath of minor flooding in the western part of that country, the government was unable to obtain even small loans to help the disaster victims. In 1981, while working in Fiji, we discovered that 42% of the national budget was spent servicing debt contracted to finance cyclone reconstruction programs. In 1984, in Madagascar, a simple program to reconstruct housing in two cities in the aftermath of a cyclone was severely hampered when the government informed us that its foreign currency reserves were less than $1 million. The situation was so bad that the government couldn't release the large amounts of its own currency from Title I food sales for reconstruction for fear of putting so much money back into circulation that it would contribute to the inflationary spiral.

In 1985, in the aftermath of the Mexico City earthquake, the government of Mexico couldn't begin reconstruction until it refinanced its debt. (To illustrate the seriousness of the debt problem in relation to reconstruction, the Minister of Finance once showed me President de la Madrid's calendar the week following the earthquake. Almost 60% of his time was devoted not to earthquake response, but to meetings to find a solution to the debt problem!)

I am not an economist, just a specialist grappling with reconstruction. But I can see where the debt crisis is leading. My concern is that we are running out of money and options at the same time. In the aftermath of emergencies, we are increasingly unable to finance reconstruction and rehabilitation projects. Even if we can begin the work, it is very rare that we can complete it. For example, in Mexico City, the government was only able to rebuild and repair approximately 40% of the housing that was damaged. The rest lie waiting (only a mile's march away from the National Palace).

If a country does not have immediate access to cash, debt refinancing must take precedence, which in turn slows the reconstruction process. This, in turn, leads to cheap, quick-fix solutions that usually don't work. In some cases, the programs only add to the existing debt and, in those cases where the quick-fix solutions are inadequate, the return of another earthquake or cyclone can put countries in the position in which Fiji now finds itself -- having to borrow once again to replace houses rebuilt after an earlier disaster, but not yet completely paid for.

The sum of these problems is felt most acutely by the poor. Our traditional approach to resolving the debt crisis is to encourage governments to take broad austerity measures. However, austerity means cutbacks for the rural poor. In Mexico, it led to reductions in tortilla and milk subsidies and a drop in the construction of rural roads and rural schools. With these cancellations there was a loss of jobs. In reality, austerity never results in a reduction of a government's work force, as envisioned by the IMF and others, but a loss of work for day laborers, contract employees, etc. Let's be honest; government workers don't lose their jobs....they vote!

With the loss of jobs, people in rural areas are forced to move to the cities. Studies in Mexico showed that, with each subsequent cutback, migration to Mexico City and the larger towns increased substantially. Also, if Mexico is any example, the costs of supplying basic services in the cities is much higher than if the people had stayed in the countryside. Therefore, austerity produced no short-term benefits and actually increased the problems and the cost of resolving them in the long-term. In short, the poor are being unfairly burdened with a debt from which they derived little or no benefit.

I believe the debt crisis is the most serious challenge we've faced since the post-war period. Growth in the LDCs is halted. The Inter-American Development Bank has reported that output in Latin America increased 3.9%, although most of that was in Brazil. But the net loss, because of population increases and a decrease in buying power, has resulted in an 8% <u>decline</u> of output per person. Most alarming, the gap continues to grow between the rich and the poor. A greater number of resources are being concentrated in the hands of a few and this maldistribution of wealth is worsening. Capital flight has become a major problem. It has been reliably estimated that $1 million per hour leaves Mexico.

The political price for these conditions will be high. New civilian democratic governments face strong political pressures to avoid austerity measures required or advocated by lenders. Those paying for the crisis are the already-marginalized poor whose standard of living is falling even further. President Sarney of Brazil has said, "A debt paid with misery is a bill that will eventually be paid by democracy."

The debt crisis also has a major impact on the United States. The instability it has caused to our banking system is but a small part of the problem. On the domestic scene, it has hurt American exports. With most of the money in developing countries tied up in paying debts, they have little purchasing power for American products. Particularly hard-hit are American farmers.

Pressures in the developing world to export at any price in order to obtain the needed foreign currency to service the debt have resulted in dumping in U.S. markets. The Joint Economic Committee reports losses of over one million U.S. jobs and billions of dollars to our economy.

Internationally, our failure to take the lead and resolve the crisis is generally seen by the LDCs as a major failure of U.S. policy, and the U.S., whether rightly or wrongly, is blamed for the problem.

In response to this crisis, there have been a number of actions and proposals to try to resolve the situation. These can be divided into individual approaches, usually developed by borrowers; comprehensive proposals, offered by the lenders; and unilateral actions, taken by both troubled lenders and borrowers who have run out of maneuvering room.

Among the individual approaches are:

- Debt-for-equity swaps, whereby a loan is sold at a discount to a second party, say sixty cents on the dollar, and then is redeemed at the central bank of the debtor country for local currency to invest in specified enterprises within the country; profits repatriated at a later time;

- Debt-for-commodities, where the lender accepts locally-produced commodities in lieu of cash which the lenders then sell; and

- Other approaches such as factoring companies, exit bonds, investment notes, retiming of payments to give the countries a bit more grace between payments, and other individually-negotiated solutions.

However, the most successful of these -- debt-for-equity swaps -- have only been successful in wiping out about $5 billion of an $800 billion total debt. Furthermore, many debt-for-equity swaps are worrying financial analysts. They could prove to be inflationary. After all, what's to stop a central bank from just printing more money? Others have pointed out that it simply replaces foreign debt with domestic debt which usually carries a higher interest rate. They have also been criticized as a subsidy for businesses who would have made the investments anyway, in foreign exchange. There is also some criticism within the countries that they are being forced to sell their natural resources at a discount. Leftists have been especially vocal, calling it "a new form of economic imperialism and intervention".

However, there are some bright spots. Some countries have limited debt-for-equity swaps to investors willing to match local currency with equivalent hard currency. There have been some innovative programs proposed in Mexico where debt will be exchanged for projects to develop vital infrastructure, such as toll roads. There are also proposals to securitize loans, in other words, convert them to securities and sell them in a broad secondary market like home loans or insurance. Potentially, this could increase the number of people and companies investing in the Third World.

Without a broader framework, however, individualized approaches will have only a limited impact. So, let's look at comprehensive approaches. First and foremost, there is the

Baker Plan. Presented last year in Seoul, the plan consists of three parts. First, the development banks would boost their lending by $9 billion for three years. Second, the commercial banks would boost their lending by $20 billion in three years. Third, the debtors would restructure their economies to encourage growth with emphasis on privatization, liberal trade policies and foreign investment. Essentially, the Baker Plan divides loans into old money and new money. It was initially hailed because it recognized that the countries need to continue to receive new money in order to stimulate their economies. The basic premise of the plan is that the new money could stimulate enough growth that both old and new debt could be retired -- an assumption which many analysts now view as questionable. Basically, the Baker Plan can be summarized as a strategy to manage the crisis with the same tools: principally, more lending. Unfortunately, this also leads to more debt.

The second comprehensive approach that has received widespread notice is the Bradley Plan. As proposed by Senator Bill Bradley of New Jersey, the development banks would boost their lending by $3 billion, which would be $6 billion less than under the Baker Plan. Furthermore, there would be no commercial lending. At a world "debt summit", lenders and debtors would <u>jointly</u> work out agreements that would lead to a 3% interest rate reduction plus a 3% per year principal reduction for three years. In order to qualify for these reductions, borrower countries would make internally-generated reforms. In other words, they would not be dictated by the United States or other lenders. Senator Bradley's plan is essentially the beginning of a programmed write-down of the loans, and he rightly points out that, without some interest rate reductions and some forgiveness of principal, it will be impossible to recover many of the loans and still keep the countries solvent. By reducing the amount of interest and principal slightly, the amount of new money that needs to be provided will thereby be less. One of the primary advantages of the program is that the commercial banks will be given some time to get their own financial houses back in order.

Other comprehensive plans have been proposed. Some Europeans have proposed recognizing the difference between old and new debt and allowing a partial and temporary interest deferral on the old debt. Chairman Leutols of the Swiss Bank has been particularly vocal in advocating this approach.

Representatives Morrison, LaFalce and Faunteroy have proposed an International Debt Management Authority: a public agency that would buy loans at a discount and hold or convert them to securities to sell on a secondary market. The Authority would pass the discount on to the debtors in the form of principal reductions.

Owing to the failure of lenders to settle on a workable comprehensive approach, a number of countries and lenders have unilaterally taken steps to resolve the crisis. Peru has limited its payments to 10% of its export earnings, a move which at first sent tremors through the banking world, but which has not triggered a wave of similar actions by other debtors. Nonetheless, unless a comprehensive approach is adopted soon, countries with larger debts, such as Mexico and Brazil, may seek similar solutions.

In May of this year Citicorp, one of the largest lenders, unilaterally chose to increase its loss reserves by $3 billion and to reduce its loan exposure to the Third World. In other words, it is now treating $3 billion of its debt as uncollectible.

The Citicorp action has forced other money center banks to increase their reserves. This is okay for the larger banks, but it threatens the weaker ones -- the smaller regional banks, the Bank of America, and especially banks in Texas. This move has been widely interpreted as "sending a message" first to borrowers that the money centers will no longer go on forever restructuring loans and, second, to governments that broader government participation is required to resolve the crisis. The major casualty of this move, however, is the Baker Plan. For now one of its three pillars -- commercial lending -- is out. Another casualty may be the loan advisory committees, the supervising structure of multi-bank loans, since Citicorp operated independently without consulting its partners in this move.

So where do we stand? As I said earlier, I feel that we are facing a worldwide crisis. Restructuring of debts is not enough. A bold stroke is needed. Only through an all-out effort on a worldwide basis can we pass from talk to action. We are now in an adversarial relationship, lender against borrower and, in some cases, lender against other lenders. If the U.S. doesn't take the initiative, others will. In the best case, we will lose face for not taking action. In the worst case, the debtors will take actions which could severely threaten our banking system.

There are remarkable parallels in the crisis today to the situation faced by Lovett, Acheson, Bohlen and others in 1947. So, let's review the lessons of the Marshall Plan once again and see how they might apply.

Is our approach to resolving the crisis bipartisan? Not really.

Is there a national commitment to resolve the crisis? No.

Are we seeking solutions through public and private action? Partially, though not effectively.

Is there a partnership between lender and borrower? Not yet.

Are we guided by long-range planning? No.

Is there <u>interagency</u> expertise? Not in sufficient numbers at a sufficiently high level.

Do we have a "czar", someone totally dedicated to resolving the debt crisis? No.

So where do we go from here? Secretary Baker has challenged his critics to come up with an alternative to his plans. Using the lessons of the Marshall Plan as a guide, I believe we need to address the problem on two levels. We need an interim approach to resolving the current crisis and a long-term approach to decide what's going to follow after we get out of the mess that we're in now.

As an interim approach, I propose, first, the establishment of an International Debt Recovery Program within the U.S. Government. It would draw staff from State, Treasury, AID, and Commerce. Next, the U.S. would call for proposals from debtors. We should make it clear that we are willing to put up the money and to take bold action to resolve the crisis, but that the plan must come from the Third World. While supplying the means, we cannot be seen as dictating the terms. Third, at a series of international <u>regional</u> summits the U.S. would receive and discuss the proposals. At the same time, the U.S. should consider the following suggestions:

- That regional, sub-regional and bilateral joint ventures should be sought as a means of stimulating action throughout the developing world.

- That countries pool their resources in debt-for-equity swaps.

- That debt-for-equity be focused on revitalizing development projects and infrastructure that directly aid the poor, such as roads, electricity, etc.

- That debt-for-equity be focused on labor-intensive and small-scale businesses, as well as revitalizing the industrial sectors.

- That a cap on interest for old debts be sought. This may be the most controversial of the suggestions. But to continue to allow the interest to accumulate compounds the problem. Interest rate reduction is not enough. The growth of the old debt has simply got to be stopped so that the debtor countries can pay off the notes.

- That debtor governments be encouraged to buy into the loan packages. By purchasing a share of the loan and joining the loan advisory committees, a country would become an equal participant and would have a stake in resolving the situation amicably.

In order to position U.S. banks to participate and to get our own house in order, we need to take several measures. First, we need to provide special tax relief for banks agreeing to reduce interest and principal and especially to cap interest. This relief could be a credit to be "played against" taxes above their normal operating losses. Credit could be given in the form of a certificate which could be redeemed against profits sometime in the future.

Next, we need to establish a loan pool to provide new money needed for investment. However, this would be limited to about half of the Baker Plan requirements, i.e., $4.5 billion. The pool would be a combination of development bank and private bank monies administered by an international committee of lenders and borrowers.

Finally, we should revise the security regulations so as to promote individual investments and stimulate the development of a secondary market for debt-for-equity swaps and investment.

The goals of these interim measures are:

- to end the adversarial relationship between borrowers and lenders;

- to disperse the risk and reduce it to manageable levels; and

- to involve the borrowers to a greater extent in resolving the problems.

It is imperative that the Administration and Congress seize the initiative and work together to develop a bipartisan approach to resolve the crisis and (working closely with the lending institutions, especially the regionals) develop a national commitment for taking the tough measures that are required.

While we are working to resolve the immediate crisis, we need to begin working on long-term solutions. I recommend that we establish a long-range economic planning committee to look at how we will provide new money into the 21st century. Principally, we need to explore new loan structures. Loans should be divided into two groups: those that have social benefit, especially those that directly attack poverty; and loans that provide economic benefit but which may have only limited immediate impact on resolving economic or social problems. Loans given for true development projects should have a vastly different loan structure and interest rates. We need to explore new incentives for commercial banks to participate in these types of loans. This may require special tax breaks or other means of helping the banks profit for giving loans at a much reduced rate.

Finally, we need to develop new methods to monitor debt and to develop corrective mechanisms that can slow debt growth if danger levels are reached. Our failure as a nation to recognize the warning signs and to let the situation develop as it has is a major failure of government economic monitoring. Every administration since 1960 is guilty.

In summary, it's time for action. We cannot continue to treat poor countries as commercial clients, and we cannot allow an unjust and inequitable system to force the poor to carry the burden for all of our mistakes. We must take action now to relieve the burden on the poor, and we must find ways of providing new money and giving priority to projects that alleviate poverty and improve living conditions around the world. If we allow the situation to continue, the concentration of wealth in the hands of a few and the continued marginalization of the poor, in both urban and rural areas, will lead to problems which we cannot even begin to comprehend.

George Kennan, one of the authors of the Marshall Plan, saw that trend developing in Europe and issued a warning whose words ring clear today... "Maldistribution of wealth nurtures totalitarian movements of both the left and the right. Unless the U.S. effects fundamental economic change, world peace will be threatened."