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**PRINCIPLES FOR EMERGING MARKET FINANCE
A NEW APPROACH FOR COOPERATION**

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I have been asked to focus on past experience, going back to the early 80's when I was heading the IMF. This is logical since I am the oldest !

My two colleagues will give their own views and perspectives on the "Principles" which have been adopted in November 2004 and broadly endorsed by the G20.

When the crisis broke out, in August 1982, it was clear that the financial system was in danger. The international banks' exposures to Mexico, Brazil and Argentina exceeded by far their equity base. The system was on the verge of collapse.

What did we do ?

On the very day the Mexican authorities informed me that they could no more meet their debt obligations, we agreed to send a Fund mission to Mexico to start negotiations on a program. And Paul Volcker and I asked the main interested banks to roll over their maturities for the coming weeks, and the BIS to provide bridging facilities so that a formal default could be avoided. Trade and interbank lines were kept intact.

In the meantime, banks were asked to prepare for a significant debt restructuring that would be consistent with the payment capabilities of the country as determined by the IMF program.

The strategy was simple :

When a debt problem arises, the way out is to ask the debtor to make the necessary economic policy adjustments in order to restore balance of payment viability in the medium term and to ask creditors to provide enough time and assistance to let the economic program bear its fruits.... This was called the "cooperative" debt strategy. Both parties to the debt problems were encouraged to sit down together and to work out solutions that were acceptable to both sides.

The IMF played a crucial part in this process. Let me elaborate a little on this, because what was obvious to me at the time may seem less evident today :

1. The Fund negotiated with the debtor country a program that was viable : i.e. it was aimed at correcting imbalances (notably fiscal) while preserving, as much as possible, growth potential ;

2. The Fund did not provide massive financial assistance (quota limits were constraining at the time). And I didn't see any reason why the Fund -which had not loaned significant amounts to the Latin American countries- (this is very different today) should "bail out" the private banks ;
3. Therefore the bulk of the financing of the countries programs was ensured -on top of the fiscal efforts made by the debtor country- by the restructuring provided by the creditors ;
4. The debt restructuring was negotiated between the country and the creditors. Bill Rhodes played a crucial part in leading the "steering committees" ;
5. The Fund played an active role in those negotiations :
 - the program was discussed with the creditors (economic subcommittees of creditors committees were set up and had a opportunity to study and comment on the rationale of the program¹) ;
 - the Fund would not provide its own financing if the creditors had not assured a "critical mass" of the restructuring program (at least 95 %).

This strategy worked.



I know, as well as all of you, that conditions have changed since 1982. The markets are not the same. Instead of bank credit, the debt is essentially held in the form of bonds traded on the market. The bonds are thus dispersed all over the world in millions of hands. Some holders have bought the debt on the primary market, some have traded the bonds at large discounts on the secondary market...

This is indeed a huge difference.

But does this difference justify that :

- The Fund should provide large financial "packages" as it did in the 90s to countries struck by debt problems, therefore running the risk of becoming a "major creditor";
- Or, more recently, that the Fund remains silent and passive in the context of a default without providing the "backbone" of a program that contains an acceptable balance between adjustment and external financing ?

I do not think so :

- bondholders committees have always existed (see the experience of the XIX and XXth centuries) ;
- they can be organized (see the Argentinean case where the GCAB represents some 40 % of the debt in default) ;
- they must be part of a true negotiation process ;
- the Fund program should be a reference point for the negotiations.

The renegotiation process will, technically, take the form of an exchange.

¹ Experience showed that no economic subcommittee ever asked for a « tightening » of the programs negotiated by the IMF.

But that exchange must not be prepared and imposed unilaterally by the debtor, even if it is assisted by major investment banks.

The “fait accompli” (take it or leave it) is not the way out. As we see it in the case of Argentina, it will lead to large hold-outs, encourage litigation and therefore make more difficult the return of the debtor to the market.

So my view remains that, when a crisis breaks out :

- negotiations in good faith are the name of the game ;
- the Fund cannot remain indifferent to the outcome of these negotiations. It has a policy of “lending into arrears” and should stick to it

The Fund is responsible for the integrity of the financial system at large. It must not put itself or be allowed to be put in a situation where the protection of its own balance sheet supersedes its fundamental duties as guardian of the system.

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In fact, the “Principles” aim at filling the present gap, and have been set up by a large group of emerging market issuers and representatives of the private market with the broad endorsement of the G20 but without the direct intervention of official authorities.

It is the result of a market oriented dialogue between the issuers and the creditors that have reformulated the basic principles of a voluntary and “cooperative” debt strategy. This is a unique example, in my view, of such a collaboration in our financial globalized world. In this respect, we owe this much to the leadership of Charles Dallara and of his team.

Now that the official authorities have broadly endorsed the “Principles”, it is our challenge to implement them and overcome the remaining obstacles with the support of the multilateral financial system.