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INTERNATIONAL DEBT CRISIS

There are a number of ways in which the creation of a market in debt would help solve the international debt crisis.

One way would be for the authorities to set up a market in all international debt from a stated date. All banks would be required to convert a specified proportion of their international bank syndicated loans into tradeable bonds - with the same maturity and interest rate as in the original loan agreements. These would be marketed, and from the prices achieved, banks would be able to work out the true value of their loan books and make appropriate write-offs in their balance sheets. Any bank short of cash would be able to sell off some of its assets.

A second method would be to wait until a bank was in difficulties and then allow it to try and sell on some or all of its international debt. This would not require the same intervention of the authorities nor such a major upheaval as in the first scheme. The individual bank suffering a run on its cash reserves would get temporary assistance from the central bank involved only on the condition that it took action to sell on some of its assets, quantified its losses, and wrote off its shareholders' reserves to pay for the mistakes.

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<u>The third variant</u> would be for the authorities and the leading banks to get together and to decide on a case-by-case introduction of a market in debt. They could decide to take a medium-sized country making progress towards recovery as their starting point and convert all or some of the syndicated loans into tradeable bonds. They would also seek buyers from the institutional funds around the world to help make a good two-way market and establish a true price. If they were successful with the first they could then move on to other territories or other groups of banks or a further tranche of the syndicated loans for the territory concerned, thereby gradually quantifying the losses and increasing the liquidity of the international banking system.

Of all these routes the only one we would recommend is the third. The first is fraught with difficulties. It would be a major operation to try and mount. Some banks and countries may not wish to co-operate. The losses it could reveal for any individual bank could precipitate an immediate run and thereby enforce further federal lending to the banking system. The sums of money involved are so large that it would be difficult to establish a satisfactory market in all the debt in one go.

The second system is even worse than the first. Any bank taking the unilateral action to try and sell on some of its syndicated debt would be making a public statement that it was in grave trouble. This would immediately precipitate a

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run on that bank and probably enforce its closure or bankruptcy. At the same time, that bank's loans would not be very attractive to the potential buyers, who would realise that the bank was a forced seller.

The third system is the best because:

i. the sellers will not be acting under duress;

ii. care would be taken to ensure that there were possible matching buyers from amongst the institutional funds;

iii. it would build on the case by case approach, attempting to deal with some of the easier territories or syndicates first;

iv. it would take it at a pace where agreement and co-operation was feasible;

v. it would, however, gradually return the system to honesty by quantifying precisely what the losses were on categories of debt and giving banks a yard stick by which they could adjust their capital base.

We would therefore welcome a scheme of marketable debt and suggest that the third route is the appropriate one. Such a

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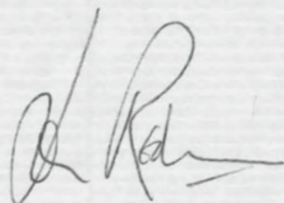
scheme should <u>not</u> become a backdoor means for central banks to subsidise their clearing banks by buying debt from them at unrealistic prices.



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Indebtedness