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INTERVIEW

External Indebtedness of Developing Countries

Interview with Walter Salomon, Chairman of Rea Brothers Ltd., Merchant Bankers, London

IE: Mr. Salomon, in recent months the problem of the external indebtedness of non-oil exporting developing countries has rapidly gained weight in the public discussion. Insolvencies have occurred, or threaten to occur, in a growing number of Third World countries. Which were, in your opinion, the reasons for this development?

SALOMON: Well, the obvious reason is that in the past loans have been given to developing countries which, to put it mildly, were not necessarily loans that should have been given. For, if you want to make credits available there are certain criteria which you have to apply. Firstly you have to examine whether it is really a credit or whether it is in fact capital which is required. If the answer is in the affirmative and it is a credit you have to check whether the country, or whoever you intend to give the credit to, is really credit-worthy. You have to make sure that the cash flow in the country or enterprise which is applying for the credit is sufficient to allow for repayment within the terms of the agreement. Where a credit to a foreign country is concerned you must of course know whether the necessary foreign exchange is available. With regard to these criteria both kinds of sources of credits for development, those belonging to the public sector like the World Bank and its affiliated institutions and those belonging to the private sector like the commercial banks, have in my opinion frequently been very negligent indeed.

IE: What do you think made lenders neglect these criteria which have certainly been known to them?

SALOMON: As far as governments are concerned they have of course been under severe pressure from the officials of the developing countries. At World Bank meetings, for instance, to me one of the interesting features was the highly intelligent and persuasive way in which the representatives of the developing countries presented their case for more aid. Of course, the theme was always the same, namely that they could demand it by right and with no strings attached. Demands for explanation of what they were going to do with the money were usually rejected as interference in their internal affairs.

To me it seems completely unreasonable to expect countries which have a sound economic policy to be committed to subscribe to expenditure of other countries on which they are not consulted and with which they might be in total disagreement. Lenders should know exactly for what their money is going to be spent and they should demand certain guarantees that it is really spent in this way. This, however, has happened in the rarest occasions.

That there be no mistake, I am not at all against helping the developing countries. Quite the contrary, I am all for it, but I don't believe that there can be any advancement if these countries do not help themselves which very often they don't. I find it absolutely ridiculous to finance countries who do not use the money for their development but spend it on armament and subversive propaganda. This is a totally irresponsible behaviour which, to my mind, can be traced back to a large extent to political bribery.

IE: Would you please explain this in some more detail?

SALOMON: Certainly. Let me refer to the American companies which are now accused of having given bribes to people in countries of the Middle East, to promote orders for their factories. Now, everybody who has done business in the Middle East will be able to tell you that if you are not prepared to give them what they call their "bakhshish", you will get nowhere. This is an established custom there, as old as *anno domini* and if firms don't play this game they simply don't get the order even if they cut their competitors' prices by half. What I consider far worse, however, is what governments are doing: they lead the corruption by promising developing countries extra loans at favourable terms in exchange for these countries' votes at, let us say, the next UN meeting. By these practices they are really setting a very bad example. To put it bluntly, in the old days politicians were accused of buying votes with their own money. Today they are accused of buying votes with the public's money. Perhaps it might be better if we go back to the old system.

I would like to mention another point which is important in this context and due to which our whole monetary system is not working properly. The central banks of the western world have been nationalized and are today with few exceptions more or less completely in the hands of their governments, so that one of the major independent balancing forces in the economy has been eliminated. Among the central bankers there are a large number of

highly intelligent and knowledgeable representatives; but what can they do? They are representing organisations which are government-controlled and have therefore to follow an official line dictated by the political conditions in their countries which means, in effect, by the politicians who will not necessarily operate the central banks in the way which is the best for the country and for the people but according to their own questionable motives.

IE: You are drawing a dark picture. Do you have any suggestions as to what should be done in this matter?

SALOMON: Well, the safety valve has been taken away and you cannot put the clock back. What can be done, however, is to introduce machinery by which it would be made impossible for the politicians to use the central banks at their discretion. What I believe to be needed is the creation of an autonomous agency, let us say an international central bank, which would have the same disciplinary powers over the national central banks as the national central banks have today over their commercial banks.

If such an international central bank existed it would give each national central bank the opportunity to say "no" to the government when it wanted to print more money or issue more treasury bills or give more credits. Then the governor of the central bank could say that they were not able to grant the facilities demanded as it would upset the liquidity ratio they had agreed with the international central bank.

The creation of such an autonomous international agency would give the central bankers a much more independent position, because their actions would be determined by an outside body and they would be able to express their views and

explain their actions without the constant fear of unpleasant political repercussions at home. Of course, the major difficulty in realising my proposal is that it would take power away from the politicians and yet it would be the politicians who would have to create such an instrument.

IE: Loans have been given to developing countries not only by the public sector but also by commercial banks which should be guided by commercial considerations. What made them engage in such a risky business?

SALOMON: Some of these banks were just too greedy. They wanted to make profits at any price and thus sadly neglected some of the good old banking principles. As I mentioned before, the condition of the borrowers was frequently not examined as closely as it should have been. Moreover, some of the lenders re-financed themselves against their commitments by short-term borrowing in the Eurodollar market. And if you see that these credits were in many cases given for five or ten years — not for current bridging finance but for capital investment — there could in most of the cases never have been any reasonable expectation of repayment within the agreed time limit. From my point of view as a banker these were very grave mistakes indeed and if you really think it through to the bitter end, the banks should use all their profits now to build up reserves against the contingencies which may come up to them in connection with these loans.

IE: The developing countries have called for debt re-negotiations, in a number of cases even for cancellation. What do you think should happen in this regard?

SALOMON: Well, Lenin once said that there was no need to

worry about the capitalist countries because they would destroy themselves by disintegration of their monetary system. So the whole matter will of course be used by the communist countries, particularly by Russia, to stir up trouble. And under the influence of the Russian propaganda some of the developing countries might well say, "Why should we pay at all? Originally that money was stolen from us." On the other hand, such an attitude would not lead them anywhere for the simple reason that they need more money in order to develop.

But even if they recognize their debts this doesn't alter the fact that they are not able to pay. So I think that large recyclings will take place which means in effect that lenders are practically left no choice than to change the terms of repayment and probably give more money on top of it. This could of course easily amount to "throwing good money after bad". I believe that in future these things should be dealt with on a more commercial basis, much sounder than it has been in the past. And they should be handled by practical people rather than by academics whose chastity has never been broken by any spell of practical experience.

To the people in the developing countries it must be made clear that in the first place — although with our assistance — they must help themselves, that they must reduce their immediate demands and make their own contribution towards them and then their demands could be increased gradually with the growth of the economy. Otherwise further considerable stresses and strains will develop, unrest will grow and in the end totalitarian states might be introduced everywhere; and being a believer in freedom and liberty this is the one thing which I fear most.