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Has the Baker Plan Failed?

One year has passed since the effectively stage-managed appearance of US Treasury Secretary, James Baker, at the annual meeting of the World Bank and the International Monetary Fund in Seoul, during which he indicated a political reorientation by the USA with regard to the international debt problems. After years of restraint on this issue the USA seemed ready to adopt the role of international leader. Baker forwarded the – in many respects rather vague – proposal for a major internationally concerted move aimed at defusing the debt crisis, which had broken out into the open in 1982. In the meantime, the so-called Baker initiative seems to have lost its momentum and many observers feel that it will simply peter out ingloriously. One year after the meeting in Seoul is the Baker plan still a feasible conceptual model with a promising future? Or are new initiatives needed to break the continuing deadlock?

The diagnosis, which was by no means new even a year ago, that in the long run only sound economic and fiscal policies in the heavily indebted developing countries can create the preconditions needed to overcome this crisis, is still valid. It is and will remain absolutely imperative to make fresh loans conditional upon the elimination of unrealistic exchange rates and distortions on commodity and factor markets, the removal of obstacles to domestic and foreign investments, the scaling down of excessive budget deficits, the prevention of capital flight, etc.

A diagnosis is of little use, however, if the “patients” in question are unwilling or unable to draw the conclusions and act accordingly. The USA's lack of determination during the last twelve months with regard to the reduction of its horrendous budgetary and balance-of-trade deficits has not only set a poor example to debtor countries, but has also shown that inability or short-sightedness in the economic policy field is not necessarily a “prerogative” of developing countries.

The fundamental shortcoming of the Baker plan, however, was and is that it was also unable to point towards a practicable means of adequately strengthening the interest of the parties involved in cooperating to overcome the crisis. The appeal for cooperation was nothing new. What was new in 1985 was that Baker suggested that the efforts of the international community should concentrate on 15 countries and that he called upon the commercial banks to provide \$ 20 billion in “fresh money” for this group of countries between 1986 and 1988. In addition, Baker proposed that the annual lendings of the World Bank and other international development banks be increased by 50% during the same period, i.e. \$ 9 billion per annum instead of the \$ 5.9 billion per annum expected at that time.

This US initiative was and is unreservedly welcomed and endorsed only by international financial institutions such as the World Bank and the IMF. This is understandable from the point of view of these institutions' own interests. The important role assigned to these organisations by the Baker plan promised in the medium term to further reinforce their position in the international financial system, even though the USA continued, for the time being, to take a negative stance towards a massive capital increase, for example, in the World Bank. Up to now, the Bretton Woods institutions have been the only organisations whose action fully complies with Baker's intentions. The net lendings of the World Bank to the 15 countries on Baker's list, for example, which amounted to approx. \$ 2 billion in 1985, will increase to \$ 4 billion this year.

There was a by and large negative response to the Baker plan, on the other hand, by the developing countries. This is hardly surprising, since, after all, the US initiative is not primarily

geared to the interests of the Third World, but aims to stabilise the international financial system, i.e. to a substantial degree to stabilise the ailing US banking system. The fact that the USA backed down for the first time from its official doctrine that a strict austerity policy in the debtor countries is the only thing needed to resolve existing problems was perhaps some consolation for the developing countries. Since Seoul, at any rate, there has been talk of the need for new loans and for a "growth-oriented adjustment strategy".

Finally, the reaction of commercial banks to the US proposals was hesitant to disappointed. Their hopes were for direct or indirect government guarantees and/or massive government lendings to debtor countries in order to resolve the precarious situation for which these banks themselves were partly to blame. Understandably, they had and have little interest in throwing good money after bad. Another major aspect is the clash of interests between the Japanese, European and US banks concerning which share of the \$ 20 billion net loan figure proposed by Baker each group and each institution should take on.

The fact that the banks are the weakest links in the chain of the Baker plan becomes particularly clear in the case of Mexico, which was the primary candidate for the testing of the Baker initiative right from the start. Up to now there is no guarantee of the tangible success urgently needed here in order to add new impetus to Baker's proposals elsewhere in the world. Certainly, under the leadership of the IMF and the World Bank a financial package worth over \$ 12 billion was pieced together, containing provisional promises of over \$ 1.6 billion in IMF loans and approx. \$ 3.5 billion in World Bank loans up until the end of 1987. This arrangement involved a clear moderation by both institutions of their otherwise strict lending policy conditions. In all probability, this was partly out of consideration for the USA, which was pressing for a presentable result. Instead, a new type of conditionality is to be found. The payment of the loans by the two Bretton Woods institutions was inter alia also attached to the condition that the commercial banks contribute \$ 6 billion towards the planned \$ 12 billion rescue package. This demand, however, was clearly rejected as far-fetched during a meeting of international banks in London at the end of August. This rejection is not even unjustified from the point of view of the banks, as it is still not clear how Mexico intends preventing the still huge outflow of capital to the USA. Under these circumstances all parties involved will probably go on playing poker for a long time to come.

In view of this situation is it fair to claim that the Baker plan has failed? Bearing in mind that the US initiative was introduced after three years of hectic crisis management, at a time when there was a growing feeling of helplessness, pessimism and resignation, the answer can hardly be yes. With hindsight, the positive psychological effects triggered in that situation by the US initiative should not be underestimated. These effects are probably a major reason why it has been possible to continue pursuing the previous policy of "muddling through" during the last twelve months without major disruptions. This means that at least one of the major objectives of the Baker initiative has been achieved.

However, there is still no sign of a lasting solution to the international debt crisis. Once again, Baker's basic idea points in the right direction: the best solution would undoubtedly be for debtor countries to "grow out" of their debt-servicing problems, i.e. to boost their economic strength via internal structural adjustment and with the aid of the inflow of new foreign capital to such an extent that their debt-servicing again became an acceptable burden for their economies. For many debtor countries, however, this solution is just as far off as it ever was. This situation is reflected in their continuing internal problems, their annually falling per capita income levels, the persistent depression on world raw materials markets and the still virulent protectionism of industrialised countries in the field of manufactures and semi-manufactures.

In some cases, therefore, there is perhaps no alternative but to opt for the second-best solution, namely to gain more time to enable the lenders, in particular the commercial banks, to "grow out" of their problems, i.e. via sufficient revenue or capital increases to move into a situation which allows the writing-off even of larger outstanding debts which have gone into default. It might then be possible, and necessary, to discuss a question which today is still nervously treated as taboo, namely for which countries and to what extent debt cancellations, and not just further reschedulings, are unavoidable.

Rainer Erbe