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WORLD BANK HISTORY PROJECT

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Transcript of interview with

NICHOLAS C. HOPE

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By: John Lewis, Richard Webb, Devesh Kapur

FOREWORD

The following is a transcript of an oral interview conducted by the authors of the World Bank's fiftieth anniversary history: John P. Lewis, Richard Webb and Devesh Kapur, *The World Bank: Its First Half Century,* Washington, DC: Brookings Institution Press, 1997. It is not a formal oral history, and it is not a systematic overview of the work of the person interviewed. At times the authors discussed the planned publication itself and the sources that should be consulted; at other times they talked about persons and publications extraneous to the Bank. Some interview tapes and transcripts begin and end abruptly. Nevertheless, the World Bank Group Archives believes that this transcript may be of interest to researchers and makes it available for public use.

Nicholas C. Hope
September 30, 1992 – Final edited

[Begin Tape 1, Side A] [1]

HOPE: In P & B, on the policy side, Chandra Hardy and Dave *[David R.]* Bock were the division chiefs, and essentially it was a policy secretariat that John Adler had set up to serve *[Robert S.]* McNamara and to give him a response capability that Hollis Chenery and the boys weren't doing satisfactorily.

I mean, it's a caricature to say it, but the perception from our side of the Bank was that if you asked Hollis--with the exception of Mahbub ul-Haq--but if you asked Hollis's shop for a reaction on something, then they would say, "This is very interesting. We should have a committee." And after the committee met they'd say, "We need so much in research funds, and we'll get back in six months."

And McNamara said, "You've got two weeks to give me a position paper."

And John Adler stepped into that, and he got this wonderful resource to his hand: he got Joe *[D. Joseph]* Wood, who not only is very smart but was extraordinarily plausible in written argument, to essentially provide a service to McNamara. And McNamara never had any doubt about what he wanted to do, but he did, frequently need a justification for doing it. And so P & B did it. I joined that, and my function there was very much financial flow analysis. [both speaking at once]

LEWIS: P & B is the . . .

KAPUR: Policy and Budget.

HOPE: It was P & B then; now it's different, but there was the budgeting side and the financial policy side, and on that (the policy) side there was financial studies and financial analysis. What I did were bits and pieces of policy work, but mainly my day-to-day job was monitoring aid flows, export credits, direct investments. So I did a lot of work on international financial flows there.

KAPUR: Which year was this?

HOPE: This was '77 through '79, August. And then I went to the *World Development Report*--that was Paul Isenman's year--I went to do the international economy part. Initially they planned not to have one. They were going to do human resources, which was so important that it was going to occupy the whole report. [both speaking at once]

LEWIS: The whole book.

HOPE: The whole book. And then the oil price went up rather substantially, and McNamara insisted. So I got pulled in at the last minute to draft the first bit. That was an interesting experience, but that was a prelude unless you want to talk about that. But then I went on from there. Helen Hughes offered me the Debt Division, and

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[1] Original transcript by Brookings Institution World Bank history project; original insertions are in [ ]. Insertions added by World Bank Group Archives are in *italics* in *[ ]*.

after the *WDR* was finished I became chief of the external debt division in July of 1980.

LEWIS: Helen was in charge then of this unit?

HOPE: Helen was in charge of the Economic Analysis and Projections Department.

LEWIS: Under Hollis, huh?

HOPE: Under Hollis, yes. I mean, it was the old set-up: Jack *[John H.]* Duloy, Ben *[Benjamin B.]* King, Helen Hughes. Who was the other? Oh, Merv *[Mervin E.]* Muller, the computing activities department. But that was the old structure before they had the first reorganization that put Everardus Stoutjesdijk on top of the Development Economics Department, and then Ben King--I mean, Ben retired, I guess, and Jack Duloy became the front office person. And that was done, I think, with Ernie's *[Ernest Stern]* help shortly before Anne Krueger came on board and Hollis left. I mean, Helen at that point controlled, ran this department, and it was mainly for—well, the debt division was certainly just a data-gathering operation, and they also had national accounts division, what was called economic and social data division, and they had the modeling division and the commodities division, had a systems unit and might have had other things that I've forgotten. But I went over there in July of '80, and I stayed there until August of '86, perhaps a little later than that, August of ‘86. So I was there a bit over six years working on debt issues.

KAPUR: So the debt division itself had been started way back?

HOPE: The debt division was, yeah, it was there in ancient history.

KAPUR: Drag *[Dragoslav]* Avramovic?

HOPE: I don't know whether Drag started it or not. I mean, Bob *[Robert A.]* McPheeters had come from OECD *[Organization for Economic Cooperation and Development]*. You should talk to Bob about the initial history, and under Wouter Tims he ran this combined division for a long time, debt plus social data. And then they split it, and Jo Saxe—or, actually, initially, Bob took the social data division, and Helen Paulson, who'd been really the woman who managed the data clerks, she was promoted to division chief, and she ran a data-gathering division.

LEWIS: You were the primary source on debt data, were you, in the Bank?

HOPE: The Bank was and is the primary source on debt data. I mean, almost everything else is derivative. Now, that's not quite true in the sense that the BIS *[Bank for International Settlements]* produces these aggregate bank statistics, but in terms of loan-by-loan information the World Bank is the only source of that information in any reliable detail, and it comes . .

LEWIS: It's official? Or all debt?

HOPE: No, it's official debt. The private debt is reported in aggregate with a report that's improved a bit, but not everybody reports. But, I mean we went through a

period in the ‘80s when of course the question of--this compiler's workshop was put together while I was there, and Bevan Stein from OECD and us, a BIS—*[Michael G.]* Dealtry, I guess, made the decisions but they, the working level people I've forgotten. In the Fund *[International Monetary Fund]* it was the Bureau of Statistics that was involved under Werner Dannemann and John McLenaghan, and initially, I guess, the division was run by John O'Conner. When they started this initiative for the Fund to collect the offshore debt information, John was there. And then he left and Peter Joyce came in while I was there, and then Peter was replaced by--oh, the name won't come! I could work it out very quickly, but, I mean, another fellow.

I was there through the start of this process, and the compilers talked a lot about what was debt statistically. This was one of the things that was a sideline to all this process. And we had a series of meetings. In the end, after I’d left--then Charles Larkum took over our division here--they produced this book basically to define what debt was and to say what the international statistics that we collected actually meant. And that's quite a useful little book, you know, that came out to try and instruct people on debt.

But we went through a period—and I mean, we asked initially for official debt. And that was far and away the largest part of it, and then it became evident that private and unguaranteed long-term was important and short-term was important and that Fund credit was important in some countries. In the end you got to where we are today with a much more comprehensive view. But the quality of statistics that you get are mixed, to say the least. I mean, they’re still--the hardest data are the ones that we track in the Bank on this loan-by-loan reporting of what's going on.

LEWIS: You brought in the short-term stuff during your time, or were you . . .

HOPE: Yes, we started in my time. I think initially I was making guesses as much as anything else and then forcing the people to go back and try and justify them. But we did this ad hoc adjustment on BIS information. Jean Baneth was the one that really insisted that the short-term data be included. We'd always had estimates, but as the BIS information and the Fund information became more and more widely available, you could make the estimates more systematically and for more countries. They've got lots of problems in them, but it wasn't that when I came that, you know, something was suddenly invented. People had known about this capacity before, but they’d never really utilized it. In fact, the whole division largely was a group of data-gatherers and not data-users. And that's still partly true, even allowing for the fact that it's much bigger. There's still a group of people today over there who see their function as putting together data. They would never—they really wouldn't care if the data were never used.

KAPUR: So when you arrived in all of it, there wasn't any major concern about debt within the Bank.

HOPE: No, there certainly was no concern within the Bank, but there certainly already was the beginnings of the debt problem for Africa and for Central America and the Caribbean. The Paris Club had already become quite active. Countries like Zaire, of course, which had been every year for five or six years, but Zaires, Sudans--I'll forget, I’ll get the countries wrong, but you can look back.

KAPUR: Poland? When did that happen?

HOPE: That happened in '81. Togo, Jamaica. There are several countries that were having quite severe debt problems, some of which were related to commercial banks. Particularly Horace Barber, the governor of the central bank in Jamaica, was running around trying to get the data fixed. I guess there were problems in some parts of South America, too, Richard, weren't there, even in 1980?

WEBB: Well, I'm not familiar with--the commodity prices were very high. Oil imports *[inaudible]*. Maybe Uruguay.

HOPE: Didn't Bolivia have a problem by then?

WEBB: I'm not . . .

HOPE: Anyway, a lot of these countries began to have problems pretty soon after that.

LEWIS: Were you focused on variable interest rate debt and the shift towards that during the '70s?

HOPE: We did a lot of that work. I mean, one thing, a lot of this was done by Helen Hughes. Helen got me in there and basically what she wanted was an analysis. She had all these data, but they weren't being used for anything, and we began to look at different ways to produce it. So one of the things we did was completely redesign the World Debt Tables, and we did it with the notion that we going to put these tables into an analytical format. I mean, the way the thing was presented initially, it was simply a compendium of debt by category, and they had these large volumes that said how much was in bonds and how much was suppliers' credit and how much was from banks. You know, painful levels of detail. And we put most of that information onto tapes, data tapes, and redesigned the book.

Now, initially it was just a redesigning of the data presentation to be more useful to analysts. Then it became, "Well, let's have a little essay that will actually tell a story." And that initially was a bit of a "rah-rah" type of thing. It's varied, in fact, the debt tables, I think, in quality and certainly in influence, depending on who wrote it and what year. But initially it was very much the sort of this-went-up-and-that-went-down sort of thing. But after that we tried to get a little bit more policy-oriented in what was written there.

But Helen initially sort of steam-rollered this thing through. She didn't pay much attention to Hollis. And when she had a draft she was happy with--we used some outside edited stuff--she went ahead and she published it, produced essentially something that went to Publications and got sold. And that was started early in the '80s. You know, we began to sell this thing rather than just pass it around, give it away.

So Helen wanted this piece, and she constantly put pressure then to expand the estimation capacity. She wanted more comprehensive information so she wanted

better data on private debt. Jean Baneth, when he took over from Helen, continued that process. He wanted private debt expanded. He wanted pressure on the countries. He wanted us to use our leverage: if they wouldn't report, to basically say we wouldn't agree that the projects could go to the Board *[of Executive Directors]* until we knew more about the debt situation. And on short-term debt Jean pushed very hard again. But . .

LEWIS: When did Helen--Helen left in . . .

HOPE: She left shortly after Anne Krueger came.

LEWIS: I'm sure.

HOPE: I would guess it was about June of '83 or perhaps . . .

LEWIS: '82, maybe?

HOPE: '82. Could have been.

LEWIS: Because I saw her in Manila in May of '83 and she was already back in Australia.

HOPE: That could be right. Yes, so it is ten years she may have been gone already. But when did Anne actually come? Was it '82?

LEWIS: It was '82.

HOPE: Okay. Well, she left shortly after Anne came, but . . .

KAPUR: But by this time--there's one study which came in '82; this is the first thing that I've seen of a concern at the very top.

HOPE: Yeah, this was the CPD *[Country Programs Department]* study which was spectacularly unsuccessful.

KAPUR: Under [both speaking at once] whom was this?

HOPE: Actually I was involved to some extent.

Let me come back to a point you made because you made a very good point. You said had Poland happened yet. When Poland happened--and that was before Mexico--and that didn't create the problem because the U.S. wasn't so drawn in, but it was already evident to Europeans that they were going to have real difficulties. And I think the Germans and others were quite concerned by then. And, you know, after 1980, as soon as the *[Paul]* Volcker recession—I mean, it's not fair [all speaking at once]

LEWIS: That's quite fair.

HOPE: But, I mean as soon as the Volcker recession began to take hold, I mean, Africa was falling apart. We had countries there who thought that debt restructuring was a good thing. They thought somehow this was a free lunch.

I mean, this was something we've got to combat in Indonesia because they say, “All these countries are getting debt relief. We should want the same thing.”

I say, “You're crazy!”

But we had countries like Senegal that might have been able to muddle through and, I think, went out there and misbehaved for an extra year so that they could actually get into the Paris Club. I mean, how short-sighted can you possibly be!

But this was beginning to happen. But, you know, I think Poland to my mind was really the sense that this was going to cause a lot of trouble.

KAPUR: Right.

HOPE: By the time we got to Mexico--and this was before Mexico, so there were a lot of problems there already.

KAPUR: And there was a conference in--the Ditchley conference in April ‘82 that Ernie went to.

HOPE: Yes, I got invited to one of those Ditchley conferences, but that's right. I think Ernie went.

But, well, let's work out why this was happening. When this debt study was done, my recollection of this was that Basil Kavalsky did the bulk of the work under Bevan Waide’s direction, and in Shahid Husain’s vice-presidency. And as I recall the paper was not very well received. Ernie didn't like it; I think he ripped it. And I think for that reason Shahid was unhappy, and that that reflected badly on both Basil and Bevan Waide.

But my recollection of this exercise--and I was only involved peripherally, providing information and reading it--was that nobody really knew what they wanted to write. I mean, there was no perception that--at this time I don't think Ernie felt that the Bank had a role to play here, and I think that was something that *[Jacques]* de Larosiere encouraged strongly. I mean, this was a stabilization problem. The U.S. Treasury said it was a stabilization problem. We were writing bits and pieces--trying to get bits and pieces into the debt book, into the world debt tables, to say, "We have some problems here, particularly for African countries. This is not a stabilization issue." I mean, all you had to do was play with the numbers to see that if you've got 300 million of debt service due and you can't pay it and you have to rationalize it down to 50 or 60 million, and that 300 then adds 50 or 60 million to the 400 that was due the next year, then you know that this isn't going to work.

And yet they’ve set up a process which involved the only competent financial officials in most of these countries, and it was virtually a full-time negotiation. They negotiate the multilateral agreement in, say, June. Then they spend the next year

agreeing the bilateral agreements, and by then of course they can't meet the next year's debt service obligation, so it's back to Paris again. And I mean this process was criticized, but the French were extremely sensitive to any criticism from the Bank that the Paris Club might not be the best possible mechanism. And the Fund was also quite sensitive at that time about the suggestion that the Paris Club wasn't the way to go.

LEWIS: Was *[Michel]* Camdessus already running it?

HOPE: No, no, no. Oh, Camdessus was running the Paris Club, and of course the Paris Club was an important—well, how important, I mean, it seemed important to me at the time. How important it really was in the French perspective is a difficult thing to say. It was clear that the Paris Club was very closely related to French foreign policy interests. I mean, you could see this in the way some of the deals got worked out in the Paris Club. Some countries would come, and they wouldn't be prepared. They might not even get a deal. Some of the French interest countries would come with all sorts of preposterous numbers, and usually a deal would manage to get worked out because it was in the French interest to do so. And a fellow that you really should talk about for that, of course, is a new Bank staff member, Chuck *[Charles]* Meissen, because Chuck was the . . .

KAPUR: How do you spell that?

HOPE: M-E-I-S-S-E-N. I think he's advisor in *[Koji]* Kashiwaya's shop, isn't he? Chuck Meissen was the U.S. representative in the Paris Club. I don't know whether he was called . . .

LEWIS: Meissner?

HOPE: Oh, Meissner! I said Meissen. Oh, I'm sorry! [both speaking at once]

LEWIS: Yes, he was in State, deputy assistant secretary of state [both speaking at once] and he went to Chemical Bank.

HOPE: Well, yes, that's right. He left to go to Chemical, but Chuck can tell you much more.

LEWIS: He's a very good guy.

HOPE: Yeah, he was fantastic. He went there, and he was the U.S. side of it, and of course he's protecting U.S. foreign policy interests in this exercise. But I mean the Paris Club was remarkable for its lack of generosity in certain respects, for people perhaps who came in naively thinking that if people gave a lot of aid, then they were interested in the country's doing well. But this is a different group, as Richard knows only too well, I suspect. I mean, these were the moneylenders; they weren't the aid people. And even where there was concessional assistance involved these guys absolutely wanted to get paid back, and the reason was very obvious: they were going to be decapitalized—ECGD *[U.K. Export Credits Guarantee Department]*, ex-im *[export-import]* banks, not so much COFACE *[Compagnie Francaise d'Assurance pour le Commerce Exterieur]* because the French were very mercantilist in their

trading posture. They were quite willing to keep on financing exports into countries that were in trouble because they saw the losses as necessary in the pursuit of national interests. So in that period, anyway, the French were, I think, rather more aggressive at continuing to provide financing. But I think a lot of the export credit agencies were starting to get very worried about their long-term solvency because they saw these losses building up, and in ECGD--although I think at the top level this was never acknowledged--I mean, at the working level guys were keeping two sets of books: the book in the national interest and the book of commercially justifiable insurance.

But, you know, I'm off the track.

LEWIS: Oh, no. You're right on the track.

WEBB: It wasn't just the, their institutions that were *[inaudible]* they themselves personally . . .

HOPE: Oh, yes. I mean, it was pretty scandalous. At one point the losses from ECGD in Britain were running at a billion pounds a year--I mean that they had to acknowledge. Now, for a long time, of course, when you talked about Africa it was pretty evident. They didn't want to make a precedent of an African country. They wouldn't take the CAR *[Central African Republic]* and write off the debt, even though it would have involved hardly any cost, because, I mean, Sudan was there with seven billion or so. But there was always Nigeria, and at what point did the Nigerians want to come in? And they were big enough to cause problems in the financial system.

But the perception through this period--and it was one that I had working in the Bank--I mean, when Ram Chopra was over us as assistant director, we tried to put together a little group which we called the debt coordinating committee and tried to pull all the work that was going on in the Bank under some framework and say, "Look, this is what's being done. Can't we give some coherency to this?" Well, the operations complex—it was Basil, actually, from CPD--they came and basically shot this down. It was obvious that no one in operations wanted any sort of coordination to come from the Economic Analysis and Projections Department under Anne Krueger, but it was equally obvious that no one really wanted to be coordinated at all. I think after reorganization when Dave *[David R.]* Bock tried to set up this debt group that was going to be the big over umbrella group, it was pretty obvious then that no one in the Bank wanted to coordinate. And I remember Lars Kalderen, who ran the Swedish debt office and I worked with him a lot in this period, coming back and talking to me after I'd left and said, "You know, it used to be difficult knowing who you talked to, but now it's impossible!"

Now, at least I could come back . . .

WEBB: You mean, Ernie--what was Ernie's attitude to this?

HOPE: You know, Ernie didn't talk to me, but I think Ernie's position at the time was this is a problem that the Fund's got to deal with. And for us [both speaking at once]

WEBB: I mean with respect to this committee.

HOPE: Oh, I don't know. I don't know whether Ernie was ever aware that it existed. I mean, this is something that was done at director level and chief economist level. I mean, the notion that the operational complex would want to have their work program in part governed by the needs of an institutional view of the debt situation was anathema!

KAPUR: But also it seems that, as an example, the initiative for the first debt study analytically seems to have come from Shahid Husain's shop.

HOPE: Oh, it did. It came from CPD.

KAPUR: And whereas Ernie was still—because at least I've seen 'til May-June of '82 where he's doing the annual program allocation for various countries, and he's talking Mexico graduation.

HOPE: Yes.

KAPUR: Or for a reduced program for Mexico.

HOPE: Oh, absolutely correct. I mean, I don't think the Bank--Mexico wasn't foreseen. The things I was writing at the time were basically saying--and even after the crunch--we basically said, you know, "These are liquidity problems in these countries." I mean, Mexico looked like it. I mean, they had oil, and they spent themselves into a problem with massive Keynesian deficits.

LEWIS: Is it too simple to say that there was a dispute between whether it was a liquidity problem or a solvency problem? That was the chatter at the time, I think, and everybody seemed to think--not everybody, but the establishment seemed to think it was a liquidity problem.

HOPE: Well, I would have agreed with that.

LEWIS: You did?

HOPE: Yeah. But in terms of--I mean I was writing bits and pieces of stuff periodically and looking at *[Jonathan]* Eaton and *[Mark]* Gersovitz and people who were writing. I mean, it did--you looked at the reasons countries borrowed, and I mean what appeared to be happening here was that for the major borrowers--not for Africa; Africa was insolvent; some of Central America was insolvent--but Mexico, Brazil, Venezuela, Argentina, Philippines, you might have argued, "This is liquidity."

Now, what we quickly learned was that if you had a liquidity problem for more than three or four months, liquidity and solvency issues were indistinguishable because once you [both speaking at once] lost creditworthiness whether you were solvent in some long-term sense was irrelevant to your situation because you couldn't grow anyway if you were in that situation. Daniel Cohen did some very interesting work on this for our division and outside, but I mean with his assumptions and models he was basically saying, "If the country can pay you back, it shouldn't have to. Any

ratios, anything, is reasonable as long as they can make some payment." So in that sense they were solvent, and there's an ex-ante presumption of solvency if the country can do this. And I mean, if you go through all the old Ben *[Benjamin B.]* King stuff, there was quite a bit of analytical work suggesting that these countries were not really insolvent.

The most insightful comment which suggested insolvency at around this time was one that Bob *[Robert Z.]* Aliber gave in testimony to one of the House committees, and he said, "Argentina's insolvent." And the reason he gave, which I thought was a very interesting reason at the time, he said because the benefits of this borrowing have been privatized and the costs have been socialized in the sense that capital outflow had removed the money and the government couldn't capture the assets to offset against the liabilities. And his argument was that there was not enough political strength within the country to tax enough or to obtain enough resources to actually borrow the foreign exchange, even if it was available. So he was saying, "This is not a foreign exchange issue in the case of Argentina. It's a domestic resource mobilization issue, and for that reason they are insolvent."

LEWIS: How about the U.S.?

HOPE: Yeah, it could be.

Now, he may have been wrong in the sense that Argentina eventually may repay a lot, but, I mean, they're obviously into concessional reorganization. But Bob came out quite early on and said this, I think, in a period in which we still had hopes. Now I was . .

LEWIS: That would have been, what? '82?

HOPE: '82 or '83, yes.

WEBB: Who was this?

HOPE: Bob Aliber [all speaking at once]

LEWIS: A-L-I-B-E-R.

HOPE: Chicago business school. Now, he was . .

WEBB: He was writing out of Chicago?

LEWIS: He was testifying.

HOPE: This was testifying to the committee.

LEWIS: U.S. House of Representatives.

WEBB: How early was this?

HOPE: '82 or '83. Around that time. I mean, I've got all this, but it's all at home in storage because we're away. It's somewhere in Washington stored away. But, I mean, if you looked at the files of the debt division, then somewhere in there you'll get this article.

Now, I mean we were writing here, basically, "Africa needs write-offs and the Paris Club has to adjust." The Paris Club didn't like that. The Fund didn't like it. For the other countries we were saying what we believed everyone did: they need a longer rope, for lots of reasons. I mean, you didn't want economies like Mexico and Brazil, both in the largest fifteen economies in the world, to be excluded from the system. You didn't want them to lose creditworthiness. Equally, you had to recognize that in order for them to make the adjustment that they needed, they were going to have to do it more gradually, but that was a position that wasn't taken. De Larosiere was responding very much to the U.S. Treasury position, the *[Ronald W.]* Reagan Treasury, and of course we had Don *[Donald T.]* Regan there, who was just hopeless. So there was no leadership from the U.S. Treasury on this issue. We then had as well, I think, in Europe very muted support at best for major initiatives that would help these countries. And it was all perceived—I mean, it was naively viewed--and of course it was much more subtle than this because de Larosiere is a great politician--but it was, talking to the Treasury people at the time and the Fund at the time, it was as if you were in a situation in the '60s where they felt that, you know, here we've got a global economy growing five or six percent a year and trade growth at ten percent, and if these countries devalue and cut back their expenditures, their external sector's going to get itself back in shape, instead of which you had negative trade growth, very deep recessions, all countries in the same situation at the same time.

Now, lots of work was done at the Fund over a period—David Goldsworthy (if memory serves) and people who say that there wasn't a fallacy of composition and that all countries could contract and this wouldn't in the end be detrimental to the interests of all. But these sorts of questions were not really being asked in a systematic way. And as the global economy began to pick up again in '83, I was very confident that it would be shown that it was a liquidity problem and that we would get Mexico, Brazil and everybody fixed up.

Now, the trouble was that as we came out of that recession only the U.S. grew strongly. I mean, this was probably where the U.S. deficit really began to accelerate, but the U.S. grew quite strongly through that period. But even by '84 things were beginning to peter out.

Now, in that period from '82 through '84 the only focus, I think, of the Fund and the G-5 or G-7 was the stability of national financial systems. Nothing was done on Africa; there were no initiatives there. Nothing on Central America. It was all focused on the major borrowers and the extent to which they could destabilize the financial system. And I think realistically that's only thing that could be done.

KAPUR: Within the Bank were there sort of more and more sharp debates on the role of the Bank?

HOPE: No, I don't think so. It's just what became more evident was that this was something that was really going to pinch substantially on our operations and the way

in which the Bank functioned. I mean, structural adjustment has already come in and it was gearing up, and an awful lot more of our money was going to structural adjustment. So issues of creditworthiness and whether we got repaid were there, but of course a lot more political concern arose as well.

KAPUR: CPD, I believe, put out another debt report in about '84, '83, '84 . .

HOPE: Yeah, they wrote another one.

KAPUR: . . which was, which tried to show that it was structural problem and that Ernie basically said, "It's none of our business."

WEBB: [all speaking at once] That's *[Frederick Z.]* Jaspersen report?

KAPUR: Jaspersen was LAC *[Latin American Region]*.

HOPE: But when Fred wrote that report he wasn't working with LAC, was he?

KAPUR: There were two reports. One was by Jaspersen and one was just prior to his, which came out of Shahid Husain's shop.

HOPE: Okay. I can't remember the transition. Guy Pfeffermann was the chief economist for LAC at the time. And was Fred working for him when he did that? [all speaking at once]

KAPUR: That's right.

HOPE: Fred afterwards moved across to—he then moved across to, was it development economics? Or somewhere over there anyway. That may not have been until after reorganization.

But you're right. Now, there was this Jaspersen report which did say some of these problems are structural, and it became evident they were. And as I said, I think in many instances this is how you get from a liquidity problem into a solvency problem. If things persist for a long time, then you get yourself into a situation where this is a structural concern.

Now, at that point these other studies began to be done, and the realization was that this wasn't going to be easy. You know, the Fund around that time—I mean, in '84 I went off, and Jean Baneth had asked me--and I don't know who had suggested to him--to talk to some bankers in Europe and ask them whether they would be interested in supporting a structural adjustment program of providing debt relief as a support--a multi-year debt relief--as a complement to a World Bank structural adjustment program rather than a Fund standby arrangement.

LEWIS: In general, not . . .

HOPE: Just as a general thing. I mean, would this be attractive? So there was some concern that the Fund was too short term and that these countries needed longer term support. We provided longer term support. And the question is what would happen.

Now, the answer was (a) from people like Christopher Johnson at Lloyds Bank and others, "You have no credibility in these programs. Only the Fund is acceptable to the banks for these sorts of restructuring operations;" (b) the question was moot anyway because by the time I came back de Larosiere had gone up Pennsylvania and declared victory in some senses and--I think under the influence of Paul Volcker and *[James A. III]* Baker--had then come out and said multi-year restructuring was okay. Now, this came from the Fund where, you know, up until two weeks before they'd been telling us that, with this sort panglossian overlay, that everything was of course for the best in this best of all possible worlds, nothing could be done differently. And within a couple of weeks of Volcker and Baker deciding that really they had to do longer term arrangements, this thing happened that the Fund said, "Yeah, it's fine" and gave its blessing to multi-year reorganization.

And then they did the Mexican MYRA *[multi-year restructuring agreement]* which I thought was the absolute turning point, fifty billion in debt restructured, Mexico's going to get out of the woods. Everything's terrific. They'll do the same thing for these other countries. We'll settle the big five debtors, and then we won't have to worry and we can get on with the business of the countries that really were structurally bound, and we can get some attention and creativity directed back towards Africa and Central America because the MYRA helped Mexico for awhile, but it didn't solve the problem. And for the other countries, not even MYRAs could solve the problem because the global economy started to peter out again, and the political pressures of containing expenditure in the face of the negative net transfers that had been imposed, particularly on Latin America, were simply unsupportable. So a lot of these countries couldn't stick to the programs.

Now, at that point you began to get a lot of inputs on this. You got the *[Peter]* Kenen and the *[Felix G.]* Rohatyn proposal, all that sort of stuff coming in, thinking of massive ways to spend other people's money. You've got the John Williamsons, and Bill *[William R.]* Cline did a lot of interesting work at that time.

WEBB: *[Jeffrey D.]* Sachs.

HOPE: Jeff emerged here as probably the most articulate spokesman initially on the macroeconomic structural problems involved in this, and Rudi *[Rudiger]* Dornbusch also did some very interesting stuff. But then Jeff quickly moved on to become an advisor, and then he became--I mean, I was always regarded in the Bank as a bleeding heart for the developing countries, but Jeff became more bleeding heart than I could ever hope to be. And he also began to become a little bit careless of what he was doing with people's money. I mean, some of these proposals that suggested you take all these bad loans and you put them into this shell, and then this shell is backed by the international community, and they go out and borrow money, and they get this money, and they've bought the assets, the banking system's stable--and this sort of naive notion that there are all these investors around who wanted to pour their money into a multilateral group that was backed by these unsound assets in developing countries, I--this was cloud cuckoo land! It was just extraordinary how people were saying you can leverage up this little bit of capital into this, you know, massive pool of assets that are worth virtually nothing. It was crazy! But people actually believed all this--or thought it would work.

WEBB: You mentioned Cline now. Cline in ’83, ’84 wrote a study that had a very strong liquidity argument.

HOPE: Yes, it did.

WEBB: It had a lot of influence.

HOPE: Yeah. Bill wrote the study looking mainly at Mexico but at other countries to say this is a liquidity situation. These countries have to stabilize. I mean, hell, obviously Mexico has some problems. It's got its fiscal deficit of 18 percent of GDP or whatever it was. It's got to stabilize. Now, the question is give it enough money so it can stabilize at a reasonable rate. Then everything should be all right.

I mean, I still believe that Brazil should not have got into trouble. And what happened with Brazil, in my recollection--this is probably again, you know, colored by history and starlight--but in '82 Brazil had--it had always serviced its debt well. It had always managed externally as well as it managed badly domestically. So it had a terrible domestic system, credit system was disastrous, all these subsidies, public enterprises. They had to control all this stuff, the Latin American people will tell you. But internationally they have always managed to devalue at the right time, export growth was always satisfactory, they serviced their debts well, they paid premium spreads. They even went--you know, some borrowers like India could go to the market and get money at seven-eighths or something, and Brazil was paying one and three-quarters for access.

In the first three quarters of 1982 Brazil went in and borrowed what they needed to borrow, and in the fourth quarter they come in to borrow. Mexico had just happened, and the banks said, “We haven't got any money for you.”

Brazil said, “What do you mean, you haven't got any money?”

They said, “No, no, Latin America is no longer ‘flavor of the month.’” You've got [all speaking at once]

WEBB: In '82?

HOPE: Fourth quarter of '82. They said, “You guys have got to pay us back.” Now, Brazil then had a liquidity problem. And once you've got that liquidity problem, if you can't work your way out of it fast, then you're insolvent because they couldn't service 88 billion dollars (or whatever it was at the time) of debt. They were stuck.

WEBB: That's one of the basic facts of the whole debt crisis. The banks withdraw; then you have a major debt problem that you didn't have before.

HOPE: Yeah. Absolutely! This is what I'm worried about in Indonesia now because they've got 80 billion of debt. Their economy looks wonderful except for this debt overhang. And, you know, they’ve had this big increase in private debt; the debt service ratio has gone back up to 32 percent on medium and long-term debt. Exports are growing well. Imports are growing well. They've done all the right things, but you think, “Geez, let's not have any destabilizing factor here.” I mean, let's not have

anything bad happen because if creditors say, “Gee, no more Indonesia paper, we're out of there” . .

KAPUR: Then it would go and become a self-fulfilling prophecy.

HOPE: Absolutely. I mean, “Hope's hypothesis” has been, you know, after the debt crisis, can you ever again have a major Fund stabilization program that does not involve the restructuring of external liabilities? And when you think back to the '65 and ‘70s, a lot of Fund standbys were done. They devalued. It was all real economy stuff, and the countries kept servicing the assets because they didn't have a lot of borrowings from private sources. But they didn't have to restructure much. When they did get caught up, you know, there's the Argentina, the Brazil one in the ‘60s that was so traumatic that they didn't go back to the Fund until they were driven back in '82. And Indonesia the same. I mean, the Indonesians are saying--because they had this experience in '66--that was all Paris Club stuff, mainly--but they were saying we wrote far too--as Widjojo *[Nitisastro]* puts it, “We wrote far too many letters that begin ‘Dear Mr. *[Pierre-Paul]* Schweitzer.’ We're never going to get in that situation again.”

But Brazil tried to avoid that because of the trauma of the restructuring in the ‘60s, and in the ‘60s it was easy. I mean, by the ‘80s it was impossible.

KAPUR: The number of players was so few.

HOPE: Too many people chasing too few bucks, and no money. I mean, the banks pulled out, but what—you know, by contradistinction, when you look back to the ‘70s and you say, “Gee, we made a terrible mistake after the first oil crisis, perhaps”--and my little bits of, attempts at analysis I think point this out in some way--after everybody was paying more for oil, the banks lent massive amounts of money. They were recycling like crazy. The World Bank and the bilaterals hopped in and provided huge amounts of money. People spent like mad and inflated the, probably inflated the terms of trade loss away--their income loss--as much as they could through global inflation. But the World Bank, you know we pumped money into these countries. Now, with hindsight you would have said, “Gee, if the commercial banks can provide so much money to the Brazils and Mexicos, we don’t need to lend them anything.” We should have waited.

KAPUR: And the Bank was also price seeking in the ‘80s.

HOPE: Well, by contradistinction--no, I think in the ‘80s it was much less evident, we were much less evidently price seeking because the commercial banks weren't providing any money, and the Bank in some senses had to go in with something. But the big absentee in the ‘80s is the bilaterals. There was no money. The countries couldn't get any support from the bilateral governments. You take a look at this peaking--I mean, you've tracked this, John--the peaking of real transfers in '81, you know that was largely banks. But even on the aid and other official flows side, there's a big peak in transfers in '81 and since then downhill all the way. It's come back a little bit in the last couple of years because direct investments kicked in and some banks have come back, but we had a tremendous turnaround in the availability of

funding in a period in which, if it was a liquidity problem, countries really needed liberal access to finance.

I mean, after the MYRA decision, I mean we wrote (I think) in the world debt tables of '84-'85, you know, everybody said this is all over which means that the financial system isn't going to break down. The banks have provisioned. Even if Brazil goes to the wall, Mexico goes to the wall, this is not going to cause any trouble. But my perception still is we haven't won anything. These countries are not back, and the trouble was the global recovery is petering out, and these countries are not yet part of the economic system again. If we miss this opportunity, God knows how long it's going to take. We know how long it's taken; it's taken another five or six years or more because they're still not in a situation where they can get voluntary access to the day-to-day financing that they need just to run their economies.

So we had that problem, that as the Fund declared victory we were trying to sound in a modest way because of the--by then Helen's charge-through approach has been completely overthrown. We had then, of course, a very visible document that even the Board wanted to get involved in censoring because debt was a big issue, and there was no way Ernie was going to let anything out of the Bank that he didn't look at. So our little study, which had started off as a modest attempt to put an analytical front piece on this set of tables, that had become, you know, what was viewed as a statement by the Bank on the debt issue. So it was--became sanitized a great deal and, I mean . .

KAPUR: That was in '84?

HOPE: Oh, it began in the early ‘80s. By about '82 or '83 the French were intensely interested in what we wrote. The Fund wanted to look at what was coming out before we put it out. There was an enormous difference in here. I mean, we gave the Fund stuff perhaps a month ahead of publication so they could give their inputs. If we got stuff from the Fund, it was typically the night before they presented it or the French presented it to the Managing Director. So we didn’t—we had almost no ability to influence what the Fund was doing, but they were in the saddle. It was their job, and the fact that we were nay-sayers a little bit, I mean, we were branded with the absolutely unacceptable brand of being like UNCTAD *[United Nations Conference on Trade and Development]*. You know, you'll *[inaudible]* Terrible. So even with the fact that it was a deck-chairs-on-the-Titanic situation, the Paris Club was difficult to deal with.

But *[Phillippe]* Jurgensen at that point had complained about the Bank's role in this, and as a response to that Ernie took participation in the Paris Club away from our division which was meant to be--the debt division was meant to be there purely in a technical sense [both speaking at once]

LEWIS: Jurgensen was the chairman, the French chairman, is that right?

HOPE: He became chairman after *[Michel]* Camdessus. And he only stayed a short time, got unhappy because he didn't get promoted, and he left and *[Jean-Claude]* Trichet took over and is still there.

But at that point Ernie said that the representation at the Paris Club will move to CPD, and I think Kavalsky or somebody under him went. Now, we'd been going for long enough that the novelty was no longer there. The way it had been done before was a Bank loan officer or some economist down the line would go. In fact, I remember when Nicaragua was renegotiated towards the end of '80, Eugenio Lari, who was then the director went, and Paul Meo, who was then I think the principal economist or lead economist, they went. And Ernie subsequently said they shouldn't have gone. He didn't want that high profile involvement of the Bank in Paris Club. It was meant to be working level. We were there to answer questions. We'd make a statement in support of a country's position, but it was the Fund's show.

LEWIS: I remember you said, say in '82, Mexico, did you have a strong feeling in your group that the Bank was sort of stuck in the water, that as de Larosiere and Volcker ran off with the problem, that you should, that your institution somehow should have been in there, or do you accept the kind of a sentimental role?

HOPE: Yeah, I mean, look. I had no influence within the Bank. So the notion that if they are allowing me to have influence outside the Bank, I think my view would have been, I mean, "We're not going to do anything for you." I was surprised that the Bank didn't offer more leadership, and I think by staffing my division at the time more strongly to put some analytical capacity in there, we might have been better placed to do it.

But, I mean, Ernie would have been quite right to look at what we had to offer over what we were. I mean, I don't think he and Helen necessarily got along all that well to begin with, but I mean to look into another--Ernie was never, I think, that willing to put important things like this into another vice presidency and rely on what they would do. That's why this controlling tendency to pull everything centrally, so that he's got the oversight. And this is what reorganization tried to do in some sense is take the CPD oversight function away, have the operations people do their thing but keep the oversight and the rule makers separate from them, but Ernie wanted the rule makers, the oversight, and everything all under him. He was the president, and the only thing he didn't run that was important was the financing side. But at that point . .

[End Tape 1, Side A]
[Begin Tape 1, Side B]

HOPE: . . the Bank didn't have much to contribute to this. This was something where the G-5 had given a very clear signal that they wanted the Fund to manage the process and that their principal concern was nothing to do with growth in developing countries or investment levels. It was entirely directed at stabilizing the financial system. And that was a two, two-and-a-half year process.

KAPUR: But still, I mean, one sees this even in the Bank's stuff. I mean, the thing, after all, the Bank's--what seems to emerge—if you look at the Bank's role, the Bank's real clientele was, seemed to be more concerned with the Treasury and the G-5 than the concerns of its resulting efforts [both speaking at once] . . .

HOPE: No, I wouldn't argue that. I mean, the only issue I think--you know, it's easy with hindsight, but it wasn't that difficult at the time--the question was common sense.

You see, anybody sat down with the data and looked at debt service and said, “We're going to have a one-year restructuring of this debt,” now you can talk about short leashes, but when you recognize that what this does to planning the economy and in particular for Africa where, as I said, where there were no financial skills except these two or three people--or Jamaica with Horace Barber, who subsequently became executive director in the Fund. Horace Barber is a very clever guy, but there's no way that man should have been doing anything except sitting in the Jamaican central bank and making damned sure that the economy was being managed effectively, instead of which he was all around the world trying to get agreements on how they restructure debt.

So in a commonsense way we could have said, “A lot of this stuff doesn't make any sense.” But a lot of it, the Paris Club and the restructurings, were let's-defer-the-evil-day type responses. They were buying time. They were buying time for the banks to provision. They were buying time for the G-5 to think about how they wanted to deal with some of the countries. They were even buying time in a sense in Africa and other countries for having to declare that you've got a financing problem with your export credit agencies.

So in a lot of this it was--there wasn't any inspired leadership or there wasn't any perception, but you didn't have to be Albert Einstein to look at the situation and know what was there. You see, my concern at the time was to say, “Look, for four or five major borrowing countries, we have to bring them back inside the system.” As soon as you begin to do what became inevitable, the Jeff Sachs solutions, once you're writing off, you've lost. I don't know how much you've lost--it's not quantifiable--but you've lost in the sense that these countries are outside the system and there's no guarantee that they're going to get easy access to bonds refinancing within a reasonable time period.

Now we could have hoped in '84-'85 that that could happen. In '92 we're still not there, although obviously on the margin people are coming back into Mexico. Chile's doing very well. Brazil's still struggling, but barely. Argentina's still struggling. But I mean in '84 there was a realistic prospect that if they could get enough slack, these countries could do it.

Now, someone would say to me, “Your test is common sense. Is it commonsensical to think that those governments were strong enough--particularly newly-elected democratic governments in Argentina, Brazil--to put in place a policy regime of such draconian measures that they could in fact get creditworthiness back,” I'd probably have to say, “No, I was overly optimistic.” I was saying--it wasn't really possible. But we lost.

LEWIS: Do I hear you saying that the Bank really was not expected to be out front in '82 because it was perceived as a system, financial system problem, and the Fund had gotten the assignment, but in '84-'85, though, hypothetically there was a role the Bank could have played?

HOPE: Well, we started to then, I think, John. I mean, the Bank had a role in Africa even before that. I mean, we could have stepped forward and said, “Look, if you're interested in African growth, you know we know you've got Mobutu *[Sese Seko]*, you

don’t have to forgive Zaire, but for these little countries that are trying pretty hard--Malawi and Togo and Benin (well, in Benin you don’t agree with socialists)--but these countries, why do you want to screw them? Make the costs high. Tell them you're going to forgive the debt, but they're not to borrow from commercial banks at more than one-year maturity. It's all got to be self--and they can't even have export credits. They’ve got to open to direct investment, let the private sector take the risk, and IDA *[International Development Association]* money, cheap money, grants. Just don't let these countries . . .” I mean, obviously, you can't be so paternalistic and controlling, but you could have said, "The quid pro quo is that you're not ready to borrow commercially."

LEWIS: Could you do this through the Paris Club?

HOPE: I don't think you could have easily, but you could do it through the programs. See, you put together a program, if it had been an IDA program rather than a Fund program which was—in many instances in Africa the Fund became the problem creditor. They were the person providing funds on hard terms, and they were doing it only because they thought they had to be there in order to put the framework for debt renegotiation in place.

In fact, I heard Ed *[Eduard]* Brau say that in a meeting. I was staggered. He said, “Here's a country that doesn't even have a central bank, but we've got to go in and help them restructure and give them Fund financing so they can have a debt restructuring.”

I said, “Good God! Why not let IDA do it? The Fund doesn't have to be out front. You don't have to give them a hundred million SDRs *[special drawing rights]* at Fund rates that they can never pay back in order to play the lead role in this.” But there was no common sense on the Fund side there, either.

And I mean by then--this is two or three years after Mexico--by then I can't believe that the Fund really felt that this was a problem. I mean, at one point--because I used to monitor these things--we had about 45 billion outstanding on Bank loans and the Fund had about 40, 45 billion. I mean, we were partners in development because the Fund wasn't going to get that money back. And of course they didn't. The standbys were falling apart hand over fist. I mean, it was a lottery. How long can a standby hold together? Can it hold together long enough for us to get to the Paris Club and restructure the obligations so we can make some payments to pay us back for the last year to pretend the assets are good for another 12 months so we can get on to the next country? And this was the sort of game that was being played.

But by '85--at least we got one tremendously important thing that happened in '85: the U.S. Treasury recognized that you couldn't get out of trouble without growth, and the Baker Plan was only important for one reason. It said you can't have solvency or recovery of creditworthiness in these countries unless they can grow. And it was like night and day. Anne Krueger, who is a dear friend of mine and somebody--I mean, she was very pro-Treasury. And she and Ernie together, I think, were listening to the Treasury line, and they were taking the position these countries have to stabilize, stabilize, stabilize, and that was the only way out of this.

"Adjustment" to the Fund meant "stabilization." In fact, when I've said that I've got myself into some problems. Within the Bank, though, adjustment I think had to mean many different things. I mean, you know, adjusting to the price shocks, you--certainly you had to stabilize, but then you need a reallocation of resources both domestically and internationally because comparative advantage had changed radically. And that process wasn't coming about.

But Anne--once Jim Baker said it's all right for countries to invest and they've got to grow and here's this plan, I think Anne then changed her tune, and she said, "Yeah, that's what we've got to do." And the Bank then became much more directed, and you saw these new classifications: severely indebted countries and the major middle income countries and the group of seventeen major debtor countries emerged, and we began to analyze these countries in the context of the Baker plan.

The Baker plan I thought was immensely significant because here was a country that ideologically said, "These countries have just got to belt-tighten," and finally they said, "That doesn't work. I mean, these countries have to grow, and they're not going to be creditworthy until they can grow." Now, unfortunately, when they said that, we were in a situation where the global economy didn't go into recession but it was just staggering along. Trade growth wasn't particularly strong. There was very little money coming from the private sector to help these countries. And the Baker plan—the real problem with the Baker plan is damn all bilateral money! I mean, they wanted the multilaterals to do it, but when you looked at what they were talking about, it was a joke. You could have put all the money that they put up into one country, Mexico or Brazil, and it still probably wouldn't have been enough.

Now, again you can--and I mean I've got more--I've got a harder line, actually, over a period, particularly seeing what a country like Indonesia can do when it has to do it. But I'm not sure I'd have been prepared to do it, either, because I wasn't--if I'd been involved with Mexico or Brazil because you had absolutely no assurances that those countries would adopt the policies--or could adopt the policies politically--that were necessary to get them out of the hole that they'd put themselves in. But what was clear from the Baker Plan right from the start was that it was totally under-funded.

LEWIS: It was also dependent on private funding, didn't it?

HOPE: Well, but small amounts. I mean, no, by then the banks, they were sick of it. I mean, they hated it! And I think initially the banks got a free ride. I think with Mexico and the de Larosiere agreement, the seven million in new money, et cetera, the banks got a free ride. I mean, if the Fund hadn't been around, the banks would have lost pots of money. I mean, Mexico would have gone into default. I mean, they would have got their money back in the end, which is what the write-off people and a lot of the more--there's no such thing as left-wing anymore--but the more radical thinkers about how other people's money should be spent to help the developing countries. I mean, their reaction was enormously naive in this sense, that they thought that these countries could simply default and that was the end of it, walk away from it.

Now, lots of bankers tell me, "Well, they can. There are plenty of people who'll give them trade financing once they've defaulted; they're instantly creditworthy for trade financing on very handsome terms, three or four percent spreads. You'll find small

banks that . . ." But you'll find a lot of banks, I was persuaded--and I'm still persuaded--they remember. They don't throw away their loan documents. They keep them in a drawer because they know you'll be back. Peru's the best example, isn't it?

KAPUR: But wasn't it the case—because I think there've been a study under David Knox on Peru which actually showed that *[Alan]* Garcia would do better if he defaulted.

HOPE: But only if there's no repercussions. I mean, Anatole Kaletsky wrote a book at that time which--you know he was with the *Financial Times*--and Kaletsky wrote this interesting book. And he said, "Here's this default, and let's everyone default. Look at how much better off the countries will be." Absolutely correct. Why? Because he assumed that if you defaulted, people were going to be terribly gentlemanly and civilized towards you. It looked more like an agreed long-term restructuring of the debt. I mean, if everyone agreed concessionally, "Yes, we're going to write down our debt, and then of course we're going to come back the next day and provide you with adequate financing on a voluntary basis," terrific!

I remember when I'd left the debt division, Jean Baneth wrote a piece in which he was proposing debt write-offs of around 80 or 100 billion dollars. And I think at that point the CPD people came back and said, "That's much too much," and then they said, "Perhaps 40 or 50 billion was what we needed to write off," et cetera.

Now, I had lunch with Jean at that point and said, "This is crazy!"

And he was shocked! He said, "Why would you of all people say this? I mean, you've been saying for ages, you know, what, that this was needed."

I said, "Look, if Brazil can't pay back 100, service 100 billion, how do we know it can service 80 or 75? And what damage is done if you go to the banks and you say, 'All right. You're going to write down your assets. And you'll take these losses and formally recognize these losses, not just on the balance sheets, but you're going to tear up the loan documents. You're going to say 100 is only 75.' What if they can't service? How can you then go back the next year and say to the banks, 'Oh, by the way. We screwed you last year. Now we're going to screw you again.'"

And this is what, the banking reaction I got after the Mexican concessional write-down. No one was happy. Mexico didn't get much out of it, and if you did the algebra, as I did, it was evident that it probably couldn't work. The banks didn't get much out of it. I mean, it didn't help them. All of the benefits that Sachs and others talked about--recovery in the secondary market, the assets that were only worth 50 were worth a hundred--none of that happened. And it was probable that they'd have to come back again because they really didn't do that much. They didn't cut them that much slack. As it turned out, it's finally worked. But what is--what concerned me with Baneth particularly was that the Bank would get itself behind a proposal which, I mean no matter how good your analysis is, was based on a pure speculation!

KAPUR: But the countries were not getting the money in any case.

HOPE: No, by then there had to be write-offs of some sort. I mean, there's no question about that. But I would still have preferred somebody to come in and say, "Look, we're going to do an amnesty for you," and this has happened to some extent, "and we're going to take everything and we're going to restructure this debt over 50 years or 30 years or whatever it is, ten years moratorium. We do this." I mean, the banks are provisioned. They might as well [both speaking at once]

LEWIS: But you wouldn't write down the principal.

HOPE: Oh, I wouldn't have, no, I wouldn't have. If they're going to do it, fine, but, I mean, if you're a banker and you've just had this asset written down, do you want to lend money to this country? [both speaking at once]

WEBB: It's very much the Japanese line, isn't it?

HOPE: Yes, it's pretty consistent.

WEBB: You don't touch the principal [all speaking at once] as long as . . .

HOPE: I mean, it might well be that this also is just living day to day. In this case it's decade to decade. I mean, you try and make it possible for them to service the interest in a reasonably comfortable way out of their existing exports and leave them enough so that they can invest and try to get their economies going again. I mean, that's the only option. No, the other option, of course, is write off the debt and make them uncreditworthy, put them outside the market for who knows how long, and see what happens. But people aren't that generous. If you did it this other way, no principal for ten years, and then you've got bonds or whatever you've got out there, and the banks can hold those assets and pretend they're okay so they don't get crucified by their own regulators and they've already written off, provisioned against the bulk of this anyway, so that they're pretty well protected: I mean, that's the way to do it and you can have some hope that it would work. I mean, the Indonesia case, of course, all these debts that they've pushed off for years, they're inconsequential.

KAPUR: Why wouldn't the Indonesia sort of example not be used as a model?

HOPE: I think because of lack of will. I mean, people . .

KAPUR: You don't think the World Bank is part of . .

HOPE: No, no, no. Not the Bank. It's the G-5. I mean, it's--the solutions always come from the governments. We can suggest things to them. I mean, we--against that, Treasury, no one suggested anything. But I mean when you think about it, we're talking massive amounts of money. I just criticized some of the other proposals because they were very careless with other people's money. The World Bank was in a pretty difficult situation. I mean, we talked about this quite a bit. I mean, who's the biggest creditor? We're close to the biggest creditor. We've got $45 billion. We can reschedule that. No. Are we going to refinance? No, no, because our Triple A rating's at risk. So we're going to be serviced; we're preferred. All these other guys have got to do it. Well, how can we tell bilaterals and the commercial banks what they're going to do when we say, "We're not coming to this party. We're outside of

this." So to some extent we were pretty much hamstrung by the requirements of the Bank, and it was pretty much, I think—it was clear to see on the whole that the Bank's position is a reasonably viable one. But, I mean, people wanting to write off: terrific.

I mean, I remember saying or writing somewhere that when these bank committees first got put together and you had 1300 banks to deal with, and then all of a sudden the secondary market emerged, and I suggested that if the governments of Brazil and Mexico are rational, they've got agents running around Montana and Albuquerque and places, buying out all these little banks at 30 cents on the dollar--anything! I mean, for these guys, they were just embarrassed. They wanted to get the debtor countries out of their portfolios. But every time you get one of these fringe banks out, you make the negotiating position easier and you're actually, de facto--I mean, doing what they've been trying to do with the debt reduction exercise: you're buying these guys out at a very attractive rate. If you've got reserves, you're better off, if there's anything in the way of excess, to go around and buy up some of this stuff--if you can do it, because it contravenes the provisions of the major loan documents. But that would have been rational behavior for governments with the smaller banks, just to get them out of the process, uncomplicate this.

Now, there's no doubt that write-offs now have to be part of the process. We've progressed to a stage where, you know, I can believe that Brazil could have serviced 100 billion from the mid-'80s, '82, '83. I have no problem with the notion that Brazil could have serviced that amount. Whether they can now, I've got--I'm not part of the process anymore; I don't know whether they can. But I suspect to get their economy moving adequately, kick-start the process, you may even have to have write-offs. I would still rather see the notion that the banks come in and they say, "Look, you're not going to pay us. Pay us the interest, but ten years on, you'll owe us 50 billion dollars, and we're going to restructure that money way out there and then we'll worry about what happens when it happens." But that's the sort of solution I would want to see.

LEWIS: You were really—you're pro Baker and anti-*[Nicholas F.]* Brady, then, right?

HOPE: Yeah, because Brady's not a solution. Brady is a recognition of a fact that had to happen. I mean, all that Brady said is, "We're being driven to the point where we have to have write-offs. Let's accept it. But let's not delude ourselves that we're winning." I mean, this is a war of attrition. Things were being written off. The secondary market was writing off for certain people for a long period. It may have been writing off for the governments who were clever enough to sneak in and buy back some of this debt very cheaply. This fellow, Colin Moynihan in Britain, was running around for Bolivia, trying to say, "They owe so much. We can buy all this back at ten cents on the dollar. Why don't we do them a favor and take our aid money and buy all the commercial bank debt at ten cents on the dollar and relieve Bolivia of the obligations." A wonderful suggestion; go to it. And he did get some of that done.

Now, that guy knew what he needed to do because when you talk write-off, there have even been some people in the Bank, they say, "This is all being written off." That's rubbish! That's accounting. That's for the bank regulators. Even in Zaire where it was written off ten years ago, Citibank's still got all those loans in a file

cabinet in the back there, and as soon as that country looks as if it's being managed reasonably well, all those things come out, and they're going to be renegotiated. Richard knows this better than me. But I mean they're all going to be renegotiated. You can expect that that's going to happen to a lot of these countries when they do start to improve--well, at some point, maybe. I mean, there will be long memories. People will trot some of this stuff out and try and collect.

WEBB: Well, look at nineteenth century bonds.

HOPE: Absolutely! They held them for years. And, I mean, remember when the Brits just recently came to agreement with Russia on the pre-World War I bonds. They were holding--people were holding those, and they got some settlement.

WEBB: Now, Nick, but . .

HOPE: I'm talking too much!

LEWIS: No! That's what you're here for!

WEBB: It's absolutely marvelous, listening. But Shahid thought something else *[inaudible]* I mean, I talked with him, and he came up with this, that he had directed this study on the Latin American area and he still would say that. I was surprised at how blunt he was that the Bank failed, the Bank was a follower rather than a leader. Do you really think the Bank had an option besides . . .

KAPUR: At least intellectually.

HOPE: Both are true. I mean, if you look at the quality of analysis on the Shahid study—I mean, I agree with what Shahid said, by the way--but if you look at the quality of analysis in that study and you see how much guess work is involved: we worked on a RIMSIM *[RIMS II]* model; we've done this, we've done that, and we've done something else. And if you went to Ernie or somebody else and said, “Look, you've got to buck the U.S., buck the G-5, buck the Fund on the basis of their analysis, and here's what we've got,” I think Ernie did in fact laugh at it, say, “It's crazy! Jesus, anyone can generate a little model like this. We're talking about real economies here, guys.”

KAPUR: But surely, I mean, if Ernie—I mean the models being run by the U.S. Treasury were hardly far more . . .

HOPE: No, no, no, of course not, but I mean you're dealing with perception, and you're not going to change perception by producing this model. But I mean I think there were two failures of leadership, and one is on the intellectual side, a lot of which was just common sense. I mean, if we could have—if I could have written more coherently at the time things I knew, if I could have got Helen—because Helen was very frustrated because she had no influence because she antagonized people so much--but if she, given her writing skills, if she’d been able to do it, if Shahid himself had been able to make the arguments in a way that weren't immediately associated: “Oh, that's Mahbub ul-Haq; he’s pushing the UNCTAD line.” But if you could have done it in a way that said, as Jeff and others have tried to argue, this write-off is in the

interests of the banks, the commercial banks, you improve your overall asset structure by writing off some of the assets, terribly difficult thing and terribly difficult to understand, but models can be constructed that show that.

Now, if you'd have come forward and said, “Listen, guys, how can you possibly solve this problem by requiring the finance ministers of all these countries to spend every day of their working lives negotiating with some guy who runs a bank in Podunk or the AID *[U.S. Agency for International Development]* or whatever it is, I mean, how can that be a solution?” Now, I mean, articulate argument might have worked. So in that sense I think there is a reason to say that we were deficient in intellectual leadership. And we were deficient in leadership because--and I think Ernie here probably does have something to carry--but when the Paris Club said, “Don't you squeak,” we shut up. I mean, when the Fund suggested--I mean, when these things emerged from the Bank, I mean it wasn't just the Shahids and the others, I mean there were people that worked in those countries who said, “What are we doing in these countries? They can't do this. This program doesn’t have a prayer.” They said, “Don’t you go for—keep quiet. We've got to get this standby in place.” So there were a lot, I think, of areas where the Bank, where we could have said, stepped forward and said, “Look, to hell with this. We're not going to be a part of this because this doesn’t have a prayer of working.”

LEWIS: On a country by country basis.

HOPE: Yeah, I mean, not the global leadership, but by country. But we could have said, “Look, guys, we're out of this. I mean, there's no way this is going to work.”

WEBB: It's one thing when one talks now about what could have been done. I think it’s easy to forget the psychological atmosphere at the time . .

HOPE: Yes.

WEBB: . . that--and that I experienced in a very personal *[inaudible]* way because at one point in '84 I said something that was sort of unorthodox without being *[inaudible]*--I was at the central bank--and the roof fell in on me. And everyone in the establishment--including the Bank, but it was more the Fund and the steering committee and--just dumped on *[inaudible]* dumped through them on me. It was forbidden to say something that, as you say, is just common sense from the numbers, you know. All I said was that the projections don’t match, I said. That’s basically what I said, but my minister of finance, who considered that I had pulled the rug out from under his feet, he was content with the idea of annual refinancing. He said, “That’s just the way it is; there’s nothing else we can do. We just have to keep up.” What I’m saying is that a lot of this was a sort of a theater people just took as necessary. And I'm not sure anywhere, you know, you can say, “Well, that was—you should have punctured that right from the beginning,” because that’s really how financial systems function. When you say yourself that once you're out, you're out, that this was a cost people didn't realize, that once you've written off you can never come back, and . .

KAPUR: Default.

WEBB: Yeah, or written down, you know, you're rescheduled, this huge difference. As soon as you're rescheduled, you're not . .

HOPE: You're a pariah.

WEBB: You're a pariah. I mean, when you say that you're really talking about psychology, perception, because banks—well, it isn't really [all speaking at once] there's profit and loss involved there, is the difference between--as long as you're refinancing voluntarily, you're still charging interest. Your books are still showing interest incoming and . .

HOPE: So you keep the banks on your side, and they're willing to do a lot for you if you can preserve that facade for them. [all speaking at once]

WEBB: And it's more than—it's a facade but it's also, it's real. It's money.

HOPE: That's right. Money's coming in. No, I agree [all speaking at once]

WEBB: Sorry, but just to finish this. What I—I'm trying to be sympathetic to Ernie, in other words, that I can see being in his shoes and saying, "Well, look, you just can't play with this, with these ideas, the perceptions." Maybe, you know, maybe you're beginning to see through the--you begin to see that the emperor has no clothes, okay, but you just have to go along with this.

LEWIS: Let me just add a footnote sort of on perception to add in here. This is—I've known Ernie a hell of a long time—I've known him since he was a boy, practically--and I think he's tremendously gifted, but if he had any insecurity, I would bet you it is with respect to sort of downtown New York finance.

HOPE: Not any more, though, John.

LEWIS: Not any more?

HOPE: No, no, no. I think that was right at the time.

LEWIS: Well, I mean at the time.

HOPE: Yeah, *[Eugene H.]* Rotberg and others ran rings around him. But don't get me wrong. I'm not critical of Ernie because I don't think he had an option. He had Tom *[Alden W.]* Clausen, for God's sake, as the president of the institution. What was Clausen going to do? He wasn't going to tell Bank of America that their assets had to be restructured over 50 years. And Ernie was too busy trying to do other stuff. He was helping with structural adjustment. His focus was on the real economy, and at the time I think that was a blind spot. Ernie went over now. He's as gifted in finance. And in the end, of course, he negotiated all of these deals with Mexico. He knows the bankers better than anybody. He worked with the steering committee. I mean, he is the most gifted guy we've got. There was no way, if I'd have been in Ernie's job or if other people had been in Ernie's job, you would have done anything different because you're too damned busy!

Now, the question is how might he have been better helped? What would we have done anyway? I mean, I don't know what we would have done, beyond say to the Fund, I mean—it's perhaps what Ernie could have done. It was *[William B.]* Dale, then, wasn't it? They got rid of him in part, I guess, because he wasn't sufficiently doctrinaire. But he could have gone across the road to the deputy managing director and said, "Listen, we've got to seriously talk about this because we're doing things that don't make any damned sense. If we believe a solution, it's to make these, to reintegrate these countries into the global financial markets."

WEBB: McNamara might have taken that . . .

HOPE: Yeah, he might have done.

LEWIS: Although he was very locked into liquidity view of things. After he left . .

HOPE: Well, McNamara--McNamara's--McNamara's view--I mean, I saw this because when they pulled me into the *WDR,* it was the second oil shock, and although I was the lowest one on the totem pole, *[inaudible]* me--he was ranting and raving about more money, more money, more money. I mean, his view of this was we fix it by giving them more money. I mean, Bob's idea was that because capital's scarce in developing countries, it must always be a better solution to put more financing into the countries. And that was always what he wanted to do.

I mean, I remember being in a meeting where he asked the question, "The Fund has created these SDRs. Why don't they come and spend the SDRs? Why don't they use that money? They can invest it and get stuff from it."

Now, I suggested to him in that meeting that maybe because these countries feel that they need some reserve levels and that those SDRs are in fact their reserves and they've pared down what they're holding in foreign exchange because they have those things.

And he said, "Oh, well, that may make some sense." But at the time his view was more financing, and that really wasn't necessarily the solution for a lot of countries.

We know that—I mean, with hindsight the one thing I would change if I could change, I mean, it wouldn't be that Volcker said real interest rates were minus three to plus six or whatever it was, although that was a pretty significant factor. I mean, Jean Baneth would probably argue that was the main factor. A lot of people would. I mean, all of a sudden interest rates were there. But the thing I would change if I could, I'd go back to the Mexican government, and I would say, "Please don't let the pork barrel roll so fast. You don't have to have a deficit of 18 percent of GDP. You may be able to placate some of these guys with a three or four or five percent of GDP. Don't start all these big projects in every province because the oil price collapse is just down the track." Now, if that could have been done, it's quite likely that the major borrowing countries would have weathered the storm.

LEWIS: Was the oil price collapse anticipated?

HOPE: No, no, no. In fact, it was a purely transient problem. I mean, Mexico was the one country in all of this, I think, where you could have said, "This is a standard Fund solution, a 1965-type solution. Sure, the economy's not growing. The global economy's not growing, so that it's going to be a more painful adjustment." But if you looked at the situation, you said, "Look what's happening: capital flight, massive fiscal deficit. So you spend less, you devalue your currency, you tighten up your costs." Classic Fund model. Mexico probably could have got out of that problem in a less hostile environment with more financial support. And they didn't do a bad job of it. By '85 Mexico looked great. And then, of course, election time and downturn and stuff again and they didn't do so well again for a while.

But I don't think the other countries necessarily would have had a major external crisis then in that period. The odds were good because the domestic management was still pretty dreadful. I mean, Brazil's domestic management is still terrible; it was bad then. Argentina, for the reasons that Aliber and others—I mean, for other reasons, they also were very poorly managed in those days.

WEBB: I think a big part of the reason for that is free money. In other words, it's [all speaking at once]

HOPE: That's absolutely correct.

WEBB: I don't know. Are there governments--how many governments will not take free money?

HOPE: Well, I asked the question, I remember, on one . .

LEWIS: What do you mean, "free money"?

WEBB: Well, money that's just practically given to them.

LEWIS: Oh, you mean from outside, external money.

HOPE: But they don't think of repayment. I mean, our people in the debt division *[inaudible]* this office, and here are people saying, "Well, we went to Africa. We talked to senior officials in the finance ministry who couldn't understand why they were repaying more than they borrowed on loans. 'We borrowed 100, and look at all this money you're collecting!'" The concept of interest was unknown. Now, a lot of those people could [all speaking at once] I mean . .

WEBB: It was negative, then.

HOPE: In real terms, but even then in a nominal sense they didn't understand why it was that they had to budget to pay back more than they actually borrowed.

And we--I remember asking the question rhetorically in a meeting on African countries, and said, "One of the difficulties of my job in working with developing country governments and advising them on debt is explaining how when dollar interest rates are 15 percent, if you get offered an export credit at 8 percent, that may not be a good deal. Now, you know, why might that not be a good deal? Well, you

may not be able to use the damn thing productively. You may not be able to do that. Your macro economy may be such that you cannot generate the repayment funds." And I gave a couple of other reasons I had.

And Paul Isenman came out, when I said this in this meeting, and he said, "And of course, when you get this good deal, the price of the bloody product is 50 percent above what it would be if you'd procured it under international competitive bidding." So I mean what you're doing is paying for the soft financial terms in the higher price of the product to begin with. So, I mean, there's lots of reasons why you wouldn't want to borrow, but a lot of governments don't see that. All they see is the opportunity to do the big prestigious project or whatever it is that's going to help them to get re-elected.

WEBB: Well, they're thinking five years, ten years, three.

HOPE: That's right.

KAPUR: At that time—I mean later on, after you left, the Bank went into debt restructuring loans. The Bank itself has—although it doesn't say this in public--but it has done debt restructuring of its own in its portfolio in two or three cases, three, I think, India, Haiti. At that time were any of these things being—you know, were there any bubbles, I mean, were there people writing inside the Bank these memos as to what there might be, options for a—at least to lay them out?

HOPE: No, I don't think so. I mean, we had no option. I mean, we had to be part of this restructuring process because the U.S. and the G-5 mandated it, and that was—and the Brady plan was the new game in town. I mean, I remember when Joe was there and I was in the debt division, and I said to Joe, you know, "What plans have we made"—I said this in an elevator which wasn't particularly tactful but I've never been that tactful--but I said to Joe, "What plans are we making about the need to restructure or to reschedule our debt?"

He said, "We aren't going to reschedule."

And I said when I got down to the office, "Yeah, what about when we have to restructure?" Within a year from there we introduced provisions. We started provisions against the portfolios.

WEBB: What year was that?

HOPE: Oh, it was the early '80s. I mean, Mike *[Michael J.]* Gillette was then over as the accounting director, so perhaps it was '83 or '84. But I mean Joe was a tremendous policy vice president, but I mean in that sense--and the smartest guy that you'll ever see--but I mean Gene's story was consistently, "We don't restructure because in our undisbursed top line we've got more money than the government owes us, and they'd be crazy to restructure us. I mean, once I cut back, once I stop disbursement, my liquidity position improves." This is the story he told the creditors. "This is why, you know, there's no risk to lend us money because these countries can't afford to default on us." But I mean it got to a point where it was plainly evident to anybody that wanted to look that the Bank was going to have to be—I mean, when

everybody's preferred, nobody's preferred. And that's evident. We were in that situation in a lot of countries.

KAPUR: Increasingly, not just in Africa.

HOPE: Yeah, and I think--well, that's right. In Africa, IDA *[International Development Association]* and the IMF--I mean, John Underwood started to do this work when I was still in the debt division and Ram *[Ramgopal]* Agarwala. But looking at this debt in Africa issue as it emerged, it was pretty clear. You only have to look at the debt service obligations and see what the problems were. There was a bit of commercial money, short term money that had been consolidated into long term. Countries like Zambia had owed a bit of trade credit and they didn't pay it back and then they thought that the banks had forgotten it, but then at some point all of a sudden there's 800 million in long-term debt on commercial terms. How the hell can they possibly service that? And the answer is they can't.

I mean, this is where some of these rules that, you know, I've developed over there would come from. The approach in the early '80s was to service the long term, keep the syndicated credits rolling over and let the arrears build up in short-term debt. That's absolutely insane! If you can't service the short-term debt, then in the end it's going to bring you down anyway. You're better off to keep your short-term credit line serviced, go into arrears on your longer-term lines, and if you can't buy yourself that, at least when you get to the Paris Club they won't cut your trade financing.

Brazil, for all their trouble, they never got cut in their short-term trade financing because they serviced the short-term debt consistently. I think all countries did better who maintained servicing on their short-term debt than those that allowed the arrears to build on short-term debt.

WEBB: You know, even Peru.

HOPE: Yeah, absolutely.

WEBB: Even under Alain Garcia.

HOPE: Yeah, very sensible.

WEBB: We were paying on short term debt, and we were getting a lot of credit.

HOPE: It's interesting, Richard, because I've got a friend who runs a small bank in the area, and he said, "I'm not rescheduling anything. I'm getting paid on everything." A part of it was the importance of being unimportant.

WEBB: Yeah.

HOPE: I mean, he was too small to really do anything, but he was still extending credit. He couldn't take the money out, but he was essentially getting his interest, and he was revolving and providing short-term trade financing and the countries were servicing it. And it was evident you had to do that. Africa didn't know that. They

didn't know that to be self-liquidating credits had to be liquidated because if they didn't they ate you alive.

WEBB: Yeah.

KAPUR: And at that time two other things that happened: one was that the Bank's own currency disbursements began to shift there. Now, people have raised the issue that the Bank really passed on the risk of its own lending because of the mismatch between its borrowers and its disbursements. So in the very countries which had least capabilities, the Bank had to take the risk.

HOPE: Unarguable; absolutely what happened. I mean, Joe Wood and others in the finance complex were arguing that in the '70s, I mean, "Why are we doing this? Why are we hopping around buying so-called cheap currencies when presumably the market is efficient and the expectation is that interest rates reflect expectations about exchange rate movements?"

I remember Joe asking this question about Gene Rotberg's policies and saying, "Why is Gene hopping around trying to borrow at low interest rates when in fact if there's any sort of information flow, these interest rates accurately reflect the expected differentials in exchange rate over the period at which we borrow?" He was saying, "Shouldn't Gene be paying more attention to longer-term access to markets, and if we have to be in the U.S. market longer term, we've got to be there now, even if it's the high interest rate area," as it was at the time. So, I mean, he was asking these questions. Gene was running around borrowing cheap currencies, disbursing them, holding dollars at high interest rates, and showing this large book profit on the cash position with the result that the countries were hammered by this huge currency translation loss. Now, it's not altogether clear that that was the wrong policy anyway, but the countries had no way to protect themselves against it, and once the pool came in, even less because they didn't know what the hell was going on.

Now, that helped in some respects. It helped that they didn't get lumbered at 8 percent with Deutsche marks, Swiss francs, or whatever happened to be the currency of the hour when the disbursement requests came in, but it did mean that they had no way to project which currency would be called at any point.

So, I mean, the Bank did manage this. And the argument that Gene would use--which was reasonably cogent when you get right down to it--was, "In the end we're a cooperative. I mean, the countries are getting the benefits of this policy, and if we're hammering them in some senses on the outstanding loans, we're benefiting them as well because these monies are used for administrative costs. They're holding down the interest charges we'd have to put to the countries." But of course it affects you differentially depending on how much of a currency hit you took.

KAPUR: But also it affects you in the case—in fact, one of the *World Debt Tables* had a section on the East Asian countries, which obviously had more capabilities of managing these things, actually did much better, you know, in this sort of a cooperative arrangement, whereas the African countries much worse.

HOPE: I haven't seen that.

KAPUR: This was '80 *[inaudible]* based on the Bank's own. I was quite surprised that they published it.

HOPE: Well, we'd done that work. I mean, we were tracking what the Bank's currency breakdown was. I remember we did one on currency. It was very interesting because we found the Fund criticized us. It was an egregious howler that some economist in the Fund made. We made the point that what was happening--see if I can get it right—I mean, we had official debt and we had private debt, and the dollar share was rising, but it was actually falling in both. And we made some pronouncement about this, and the Fund came back and said, "Oh, it's the interest rate effectively moving away from the dollar." It was rubbish. It was moving in private borrowing, and what you had was this sort of semi-paradox that you get in the *[Wolfgang]* Stolper-*[Paul]* Samuelson theorem: when the real wage falls, then the labor to capital ratio has to increase in both industries which means an absolute decline in output from capital-intensive industries so you can free up labor. So what we were seeing in this case was an exact analogy with this where you actually had the share of dollars in private borrowing falling, the share of dollars--because the interest rates were pegged--the share of dollars in official was falling because the U.S. was no longer so important and the Bank was funding massive amounts of the Swiss franc and yen and Deutsche mark, but the overall effect was that the share of the dollar was increasing, and that was because of the shift away from public towards private financing. We did do some analysis of this towards the end of the '70s to see what was happening.

WEBB: What I see, when I think of this whole debt story or when I read anything about it, it seems that it's—*[inaudible]* mostly in terms of the debt itself and maybe something--but it's not seen enough, I think, in terms of the economy, the real economy, and the evolution of the real economy parallel to the evolution of the debt business. And I think to me the really big event was the general failure by economists to see how much production losses were going to be, also how much more of an inflationary effect and how difficult it would be to get rid of that. The ultimate losses that have accompanied all these financial coming and goings, down there the ultimate losses are far more--they totally surpassed anything that anyone ever expected.

HOPE: I agree with you. I was totally culpable. I was an international finance guy, I focused on international finance, balance of payments issues, and I had no appreciation for things like the fiscal effects of the debt. I mean, even now, in Indonesia, 48 percent of the current budget just goes to debt service, external debt service. They don't borrow anything domestically. But when you looked at the Brazils and the Argentinas and you saw how much of the budget had to be devoted to internal and external debt service on public borrowing, and you thought, "God Almighty! I mean, the structural impacts of this--if I devalue the currency by 100 percent, look at what this does to my budget! It blows me out of the water. How can I do it?"

WEBB: There's another component of this failure or perception failure, which has a happier ending, which is that no one has really seen the size of private capital, mostly in Latin America, probably everywhere but most visibly in Latin America, because an awful lot of the damage that has occurred probably has been the result of the outflow

of money that was generated by this chaos time, this financial chaos and the political chaos that was associated with it. No one really saw the volume of that and much less people see how to *[inaudible]* what huge amount of money that has become.

HOPE: To come back once things stabilize. Actually . . .

WEBB: And it gives a lot more importance to the psychological aspects of the whole financial management.

HOPE: Yeah, I was a little critical of the *[John T.]* Cuddington-*[J. Michael]* Finger's stuff when they started off to do this thing on capital flight, and then the Fund picked it up subsequently. I mean, it seemed to me that--Al *[Arnold C.]* Harberger persuaded me—that in the case of an Argentina, for example, you use the tablita, and you create a situation in which people can earn 6 percent a month in dollars. As long as you think the situation is credible . .

[End Tape 1, Side B]
[Begin Tape 2, Side A]

HOPE: . . again they created a distortion which pulled money in, even if it was domestic assets that were already earned by Argentinians. These were people who traditionally would have put their money offshore. They brought the money in because the earnings were so high. But as soon as that distortion was removed and the tablita was gone, that money was gone, and there's no presumption that that money could come back. And I think in a lot of the countries you can say that what we see as capital flight is in fact a response to changes in arbitrage opportunity or changes in relative yield that come about as the countries move. So this is a dynamic thing, and it's not something where you take a snapshot and say, "Look at this massive capital flight." But nonetheless you're right. I mean, a lot of money went out because of instability, and then that money can come back in. There's no question about it. That can really transform a situation once confidence is restored.

KAPUR: But also it means that it's almost sort of equivalent to what happened in Europe a few weeks back: the sheer strength of one currency means that the others generally have much less control *[inaudible]* If Volcker agrees to high interest rates, then it doesn't matter as much what India does.

HOPE: No, if you're . .

KAPUR: That is much more attractive.

HOPE: Yes, I mean, what you say is quite right. If what the Argentinians are doing is to try and counteract what--this vacuum cleaner that Volcker's established, I mean, the same argument works in reverse, that once the U.S. removes this huge incentive or the Germans cut the interest rates and the huge incentive's not there, the money should come back. Indonesia's experiencing now an inflow that the governor of the central bank attributes to the interest rate differential. With a reasonably stable rate of depreciation, there's a couple of points of uncovered arbitrage yield, so the money comes in.

But I remember writing a little piece--well, it was a speech. I was on a panel with Bob *[H. Robert]* Heller and a couple of other guys in one of the Goldwater monetary conferences out at Arizona State and talking about this perception of the market as something that was really dominated by private capital flows. And at that point, as I indicated, we had about 600 billion of debt that we tracked, 500 billion was borrowed by public or publicly-guaranteed entities and the other 100 billion wasn't. But of that 100 billion, my best guess was that 90 percent of it was guaranteed by export credit agencies or other agencies in the creditor countries. So the actual debt flows that were really risk-oriented flows where firms or people had done it were almost minimal. It was predominantly sovereign to sovereign. The actual markets were very much less atomistic and competitive than you might have thought in any way.

Now, what I argued in that was that my concern was that there was very little risk in foreign lending. There was massive uncertainty, but risk in the technical sense of the standard deviation above the reasonable expected return was zero. You were going to get paid because it was all sovereign risk. If you didn't get paid, you're in terrible trouble because there was no precedent.

LEWIS: *[inaudible]*

HOPE: You know, there's no precedent, though, to determine how this thing was going to work itself out. And we still don't know! Ten years after we still don't know how much these people are going to get, but the point was it was a bang-bang situation, and I was arguing then that what we needed was more atomism in the decision-making process. I mean, banks in developed countries had to get to know the firms that they were lending to in developing countries. I mean, there had to be a credit risk aspect of it. And, sure, that would raise the cost of financing to the countries, but it could to some extent move you away from this bang-bang problem that existed with sovereign risk.

WEBB: By the way, on that, what position does the Bank take on this socialization of private debt *[inaudible]*

HOPE: I'm not sure that that many-- I mean, because you've made this point before about the private borrowing became important--over in the debt division when we had discussions with people, with countries, we kept emphasizing, “You're not just managing public debt.” I mean, here we, I think, we were prescient. We said, “You're managing the economy.” We used Yugoslavia as an example. I mean, a year ago you’d tell us these workers cooperatives were private. That's rubbish! And we saw at Paris Club, I mean, when you went to the creditors' side you'd talk to the Berne Union people and the export credit agencies, they don't make a distinction between what is to private interests in the developing country and which is to the parastatal agency. They come to negotiate all their exposure, and if the developing country didn't know what lines were which, they simply paid. So they automatically took over the private debt.

In some cases they had to. I mean, in a Sudan or probably most of Latin America--certainly Mexico--if the borrower walks into the central bank and said, “Here's a package of pesetas. Transfer my dollar obligation to Citibank,” and the teller says, “We haven't got any dollars,” the guy says, “Well, I've paid you the local currency

equivalent," you've just become the borrower. Now, that happened and had to happen because they couldn't transfer legitimately to the private sector. You see, there are plenty of cases where the private borrower had gone broke, no longer existed as a commercial entity, had vanished, and the country was on the hook to pay because these guys, the export credit agencies, came in and said, "We get paid. This is all up for negotiation."

So we were saying to countries, "Look, whatever you think about private unguaranteed debt, we agree you should stress that this is not an obligation. But if you've got a foreign exchange control regime and you get into an embarrassing situation with respect to your liquidity, you are going to become the guarantor of that debt, and you have to manage all of your debt as if it was public, so that when you make the decisions related to the external sector and overall expenditure decisions, do it with the whole of the debt in view because, you know, there's no separation in the mind of creditors and there's no organic separation in the economy itself."

KAPUR: How much *[inaudible]* debt? I mean, is commercial, you know, industrial *[inaudible]* from a private borrower in Mexico or wherever--and they couldn't repay, why should--I mean, and then the country says, "Look, it's between this external bank and you. I mean, that's fine. You took the risk, you do that and . ."

HOPE: That's exactly what has to happen, exactly what has to happen! That's the point about this atomistic thing. If you lend to my--even if it's my damned airline--and I'd say, "My interest in my airline, I own the stock. If it goes bankrupt, it's bankrupt. I'm not going to pay the debtors." But that has to happen. But two or three things would happen. If the guy goes bankrupt and the fellow on the other side has cashed in his obligation--I mean, he was the creditor for the three Airbuses the guy bought, and so he goes along to COFACE and he says, "This guy's a deadbeat, and he hasn't paid me for the Airbuses," and they say, "Okay, we'll pay you." And then the export credit agency becomes the guy.

So then the export credit agency's got it on his books, and then when the government--still doesn't have to pay, still doesn't have to worry--but once you then get into a balance of payments crisis and you've got to restructure the rest of the stuff, all the publicly guaranteed debt that COFACE has insured, then you're in a situation where in comes the finance manager from COFACE, and he says, "Well, here's our exposure to your country." Unless you're very much on your toes and you know a hell of a lot more about individual loan transactions than most managers in developing countries, you won't pick up the fact that you've got lumbered with debts of companies that have vanished. And all that gets restructured; you pay.

And, of course, as I said, the other thing is that when you've got this foreign exchange constrained environment--I mean, you've got a--what do I call it? A Brazil run, where you've got to apply for foreign exchange . . .

LEWIS: A licensing system?

HOPE: Yes, that's right. Basically a licensing system, if you can't fulfill your side of the bargain, then you become the borrower if you're a central bank.

LEWIS: You can hopefully pay in local currency.

HOPE: And typically that's the case. I mean, when you have a debt problem, often, particularly of the Mexican variety, you've pumped up the local economy, and the local firms are making local currency profits like gangbusters. It's a high inflationary situation. They can pay the central bank with whatever they want. In fact, in Sudan it got to the point where the Sudanese government, the central bank, refused to take the money. They bankrupted their commercial banks by having these payments that were due, and they were saying, "Oh, please, no, you can't give us that. We're not taking that. We're not going to take on the obligation." But ultimately, then, as they devalue and devalue and devalue, the commercial banks are stuck with these ever-escalating liabilities in local currency and they go down the tubes.

WEBB: What's you're saying, that it's a situation where it's a fact of life is basically the leverage, the external leverage, has on a country, so that the country is really forced into honoring or the government is forced into honoring. It's a fact of life. It's a bargaining situation is what you're saying. [both speaking at once]

HOPE: What we don't know . .

WEBB: My question's really what, given that, if the Bank had come out to back up governments against the commercial banks, shouldn't it have done that? Couldn't it have helped?

HOPE: Yeah, yeah. No, I think we should have done it. [both speaking at once] This is what I said before about the lack of leadership. I mean there were situations when we, in the Paris Club or elsewhere, "We're not going to put any money in this because this can't work." And the Fund should have helped more. When you go back to the original Mexican agreement, 7 billion of new money and the Fund signs off, and when you look at it, now--I don't know. At the time I thought it was very cheap for the banks.

But, I mean, suppose the Fund had taken a different view. The Fund always asks the question, "Here's the available financing. This is what you have to do. This is what you've got to do on the fiscal side, monetary side and the exchange rate because this is all the financing you can get, including rescheduling—or whatever." And that's what they used to do. What if you'd asked the question the other way around? This is all we can do on the fiscal policy, monetary policy, exchange rate adjustment because of political and social and humanitarian constraints, and say, "What does that imply for financing?" And if the Fund had taken a pro-adjustment as opposed to pro-stabilization approach from the beginning, they might have gone back and said, "Look, you're talking 7 billion. You've been lending fifteen, and in fact if they don't get the fifteen we're not going to put any money in because we don't think this has got a prayer."

Now, the Fund is not well designed to do that. The Bank was much better designed because we had a much better organic feel for the countries. The Fund had a model. It's a good model, and it means all countries can be treated the same way. They bring the Fund model, they apply it, they fit the things in, they have a look and they say, "This is all the financing you've got; you've got to make these adjustments." But

increasingly, with a Camdessus--who, of course, came from the other side--I mean, I think the Fund of course is beginning to take a very different view, but in those days my perception was that they were asking the wrong question, or at least they were asking the question the wrong way round some of the time.

In many instances, a lot of countries that were very poorly managed economically, there was no option but for the Fund to come in with the tough medicine and then say, “This is all the creditors are willing to do for you. You've got to do the rest.” But in some cases where there are external things, where these are large economies, they owe a lot, they impinge on others, they affect the financial system, it wouldn't have been an unreasonable thing for the Fund to say, “Look, let's try and take the view of what is feasible domestically and then what's the bill, how much.” And if the two figures are hugely different, then at least we could have recognized the problem and said, “We've got to be aware here that if we're going to put them in that straitjacket, there’s a very real prospect that they're not going to make it. All right, we can't find that much financing. The creditors are not going to tolerate that. But then we better make clear to people that we’re in a very uncertain situation in terms of the outcome.” And if I’d been the Fund, I would have said, “Look, there's a hell of a good chance that my standby is going to break down.”

And, of course, this happened with our structural adjustment loans as well. I mean, we went in there and we had conditions on these loans, largely, of course, coming from the Board and their insistence on what they wanted. But we asked countries to do things. There are examples, I think--I can't remember one—I’ve got one *[inaudible]* so I may be wrong. I think I can remember adjustment loans where the first tranche required the moon and the earth and the sun, and the second tranche required some small part of what was in the first tranche as people got a more realistic view of what could actually be achieved. And they said, “Jeez, they can’t afford this. Listen, let's see what they can do.”

Now, again, hindsight is wonderful, but I think the Fund more than the Bank in some sense has missed the boat with the major borrowers in this area, that they were the creatures of the creditors, the creatures of the financial markets, and they probably tried to do with less than the countries needed at the time.

WEBB: A lot of this had to do with the underestimation of the adjustment loans.

HOPE: Yes. In that circumstance, in that situation. It wasn't the ‘60s anymore. It wasn't the case that six months--in fact, there was a woman I knew in the Treasury at the time, Hara Lipman, who did some of the work. She used to come and see us because she prepared briefs for the State Department on the Paris Club. And she came over and said to me one day, she said, “Look, this is cloud cuckoo land. I mean, there are people over here and they really think that if such and such a country simply cuts expenditure for six months and devalues the currency by 15 percent--they're laughing. They've got no perception of the export response capacity in the country. I mean, these are countries that produce, I mean, peanuts and sisal.”

WEBB: What’s her name?

HOPE: Hara Lipman. She's no longer in the Treasury. She's actually out in Denver somewhere. You know, I think she runs a--she works for the central bank for cooperatives or something on farm credit overseas. But Hara was extremely . .

LEWIS: How do you spell her name?

HOPE: H-A-R-A. But I mean she was a smart woman. I mean, she said, "This is weird! These people think they're in the '60s and that what worked then is going to work now." And, I mean, yes, it could have for a small country. I mean, you can think of countries--if you can think of one--which had a fairly diversified export base, that was spending too much, that had over-borrowed, there you can say, "Okay, they cut fiscal. They tighten monetary. They devalue the exchange rate, and they sit back and everything's fine." But how many countries are in that situation? Brazil had a chance because for years, no matter how mismanaged Brazil was, they didn't have a foreign exchange problem. They just devalued and became competitive.

WEBB: In '86 there was, a front page *Time* magazine cover was "Brazil Bouncing Back." And why Brazil is the exception? Because it was, it's used its money from the '70s wisely; all that debt money was invested in things that are now generating exports or reducing imports.

HOPE: But they could always export, and the domestic distortions never went away.

WEBB: And they've always had a good foreign exchange.

HOPE: Yes, always managed well on the external sector. That's why they shouldn't have had a debt problem, in a sense, why their creditors should have stuck to them. Brazil always paid--and generously.

WEBB: Well, when we chose--we were looking for an author for the chapter on Brazil in the second volume, which we decided would be a case of a highly indebted country *[inaudible]* and asked him for suggestions for authors on highly-indebted countries *[inaudible]* And he said, "No," he said, "Brazil doesn't have a debt problem," which is a different . . .

HOPE: I agree with Dave. I mean, they had a liquidity--they really had a liquidity problem with their creditors but they've got this appalling domestic mismanagement. But it's interesting.

Look, I know you've given—we've taken a lot of time, but I've got another meeting I'm meant to be at.

WEBB: You've been terrific.

[End Tape 2, Side A]
[End of Interview]