Institute of International Finance
Tribute Dinner in Celebration of the Honorable Nicholas F. Brady
on the 20th Anniversary of the "Brady Plan"
Washington DC, April 25, 2009.

Address by the Honorable Nicholas F. Brady
Former United States Secretary of the Treasury

Good evening. I'd like to thank Charles Dallara and the IIF for organizing this gathering of old and new friends to celebrate the 20th anniversary of the Brady Plan. Although I've been given the honor of speaking, I'd like to note that a great many of you here tonight share the credit for making the Brady Plan a success. And I want to thank you all of you who have spoken so generously.

Let's start with why the Brady Plan was called the Brady Plan. We had been negotiating with Mexico since March 1989 under the rubric of what we called "the new debt strategy." In July, while we were in Paris for the Group of Seven Summit, we had a major breakthrough with Mexico. When President Bush, No. 41, held the traditional end-of-summit press conference before 1,000 reporters, one journalist asked the president if he was going to call the new strategy the Bush Plan. He didn't miss a beat before answering, "No, we're going to call it the Brady Plan. Then if it works, we'll call it the Bush Plan." The audience erupted into laughter, and the president, with his marvelous sense of humor, repeated the line so many times in the following days that the name stuck.

There are uncanny parallels between the situation we find ourselves in today and the one the Bush administration confronted a generation ago. We faced a three-pronged crisis, including the credit markets, the real-estate market, and the budget just as the Obama administration does now. So it may be useful to recall the issues and challenges of the late '80s and early '90s as we try to resolve current problems and move into the future.

First of all there was a serious LDC debt crisis. It's easy to forget that in 1988 our banking system was in dire straits because the commercial banks held billions of dollars of loans in countries whose economic prospects had ground to a halt. Three weeks into my job as Treasury secretary, the late Gustavo Petricioli, then Mexico's ambassador to the United States, called for an urgent meeting at the Treasury department to tell me that Mexico was threatening to default on its international bank loans. Talk about reality. It didn't take much imagination to grasp that if Mexico took that route then a string of Latin American economies likely would follow and that a volatile region would move from chaos to danger.

Clearly a new approach was needed. For several years before I got to the Treasury, people had come in with various papers and solutions, all aimed at alleviating the debt overhang, but none really accomplished that. In a huge stroke of good fortune, I inherited two brilliant people at Treasury—David Mulford and Charles Dallara—and the first thing we did was to write a paper that came to be known as the "Truth Serum Paper." We worked days, nights, and weekends to establish a detailed description of the problems we faced, of what the fundamental realities were. No troublesome obstacle was passed over. Among the indisputable points we laid out were that new money commitments had dried up in the past 12 months and that many banks were negotiating private sales of LDC paper at steep discounts while maintaining their claim on the countries that the loans were still worth 100 cents on the dollar. There were more, and they were equally sobering.

We used these irrefutable facts as a starting point in all subsequent meetings. Our rule was that no suggestions were permitted to be discussed if they didn't accept the Truth Serum. They were off the table. Goodbye. Don't waste time.

I felt that the solution to too much debt was not more debt but less. From there, you know the rest: we persuaded the international commercial banks—at first with great difficulty—to write down the stated value of the loans on their books to something close to market value in exchange for that lesser amount of host-country bonds backed by U.S. zero-coupon Treasuries. The Brady Plan was achieved at a negligible cost to the U.S. government. Yet it led to the restructuring, for example, of more than $100 billion of foreign bank debt for Mexico, Brazil, and Argentina alone. The plan broke the debt gridlock and opened the door for economic growth and social development in Latin America after the lost decade of the 1980s. And it created a new asset class: publicly traded sovereign debt—Brady Bonds—that grew to exceed half a trillion dollars. The process bought time, and the bonds helped to provide funds to developing nations in exchange for long-lasting reforms by the participating countries.

A second initiative the Bush 41 administration had to undertake was to reconstitute the savings and loan industry and the real-estate market it financed—a problem not of President Bush's making. We created the Resolution Trust Corporation to take over some 750 insolvent savings banks, which reintroduced vibrancy into the real-estate market. In order to do this, we had no choice but to seek funding from Congress and undergo the intense political criticism that came with it. So we took the heat and moved on to solve the problem. Leadership can be painful. The final tab for cleaning up the S&L mess was $165 billion, including what was spent before we arrived. While this is not trivial, it didn't come close to estimates by businesses, politicians, and the media, which estimated that it would cost us $500 billion. I've been asked a number of times what reversed that era's negative thinking—and when. My firm conclusion is that it subsided in direct proportion to the weekly successful results recorded by the RTC to close the bankrupt S&Ls, gather up the real estate they held, and sell it promptly into the market.

Third, in a major contrast to today, we set about to reign in escalating spending by the U.S. government, which was, for that day and age, clearly out of control. The Budget Act of 1990 established binding caps on the amount that Congress could spend on discretionary items. It was easy to see—and it was easy for me to recommend—that that's what the country needed. But President Bush, who had uttered the famous words, "No new taxes," in his 1988 election campaign, said to me more than once, "The trouble with you, Brady, is that you never ran for sheriff." The record should be clear that George Bush fully grasped the political ramifications of designing this legislation, but he decided it was the right thing to do for the country. And while the Budget Act probably contributed to his reelection defeat in 1992, it was an essential building block for the decade of economic growth that followed.

People constantly tell me that the problems we're dealing with today are much more complex than those we faced 20 years ago. Maybe. Maybe not. The issues didn't feel simple to us back then, just as I'm sure they don't feel simple to Secretary Tim Geithner and his associates at the Treasury now.

I won't spend a lot of time tonight trying to assign blame for the current crisis; I've been gone from Wall Street too long. In broad strokes I would say that when I came to Wall Street in 1954, it was a profession, one that financed the building of this country's industrial capacity and infrastructure. Year by year, however, the industry's emphasis has moved away from that purpose and toward financial innovation for financial profit's sake. Of course, many banks have served their clients well and their hard work has been a positive factor. Nevertheless, the U.S. Department of Commerce figures show that from 1980 to 1982, the financial sector accounted for an average of 9.1 percent of U.S. total corporate profits. By 2005 to 2007 that three-year average had more than tripled, to 28.6 percent.

The particulars of today's collapse in judgment and common sense have been laid out in chapter and verse, so just I'll say briefly, first, that the whole notion that risk can be measured by a mathematical formula is based on the illusion of reality. Second, the desire for the improved returns generated by high leverage led the purveyors of this risk to push it beyond any reasonable boundaries.

But while assigning villainy to CEOs of banks and other institutions may be high theater, playing to our country's justifiable anger is counterproductive. There are many good people in the industry, people who inevitably will—and should—be called on to work through the malfunctions in the system. The political process should concentrate now on how to fix the financial system and let the country's legal arm ferret out and deal with the wrong doers.

A core issue today is that the government has yet to adequately describe the roots of the financial crisis to its citizens and therefore to fully pinpoint its size. It's been my experience that you can't fix what you can't explain. This leads one to think that the solution lies in providing ringing clarity on how the housing market burst, how the market excesses spread beyond housing, how these forces were fueled and then accelerated by our outsized external imbalances, and, with this knowledge, decide how markets can now be stabilized.

At the same time, it's hard to see how our national leaders have helped the country dig out of its very real problems when they devalue each public pronouncement with the caveat: "Remember, it's not over yet."

Their caution reminds me of a story that was told to me by a friend, Bob Kleberg, who was the head of the King Ranch, the largest ranch in the United States, about a college commencement ceremony in his hometown of Kingsville, Texas, during the worst of the Great Depression. Bob had invited two speakers. One was an earnest Ivy League economist and the other was this country's most famous cowboy-philosopher, Will Rogers. The economist, who spoke first, read a long and languorous speech about how bad things were, leaving the roomful of 21-year-olds wondering if there was any hope to be had about their prospects. The conclusion of his speech was met with nervous and polite applause, after which Will Rogers, who was sitting in the front row, literally vaulted up onto the stage. Facing the audience squarely he looked out and said just six words: "Live through it if you can." Then he jumped off the stage and returned to his seat. Terse, maybe. But they did live through it.

And we will, too. So what should we do as the crisis abates? Here, there is real work to be done. First we should just come out and say it: the financial system that led us to the brink of disaster is broken.

How do we proceed?

The first step would be to reduce the number of and simplify the U.S. regulatory authorities, which include the Federal Reserve, the OCC, the FDIC, the OTS, the CFTC, the SEC, and state regulators too numerous to list. The easiest part of this process is naming them! Nowhere else in the world is the implementation of banking authority so diffuse, and the choices they present to the governed result in regulatory shopping for the softest touch. Be forewarned: each one of these organizations has a protector in Congress, and it will take a thunderbolt from the White House and Congress to reorganize and streamline them. Tough as it will be, the necessity is apparent to all, both here and abroad.

The next step after marshaling the regulatory authorities is to move on to the banking institutions themselves. Of course we must be attendant to the fact that markets are international and by definition interrelated and interdependent. Yet a sense of order would dictate that we tend to our own back yard before trying to gain consensus with 19 other countries.

As I see it, we have two choices. The first is to repair the current system, which is made of deposit-taking institutions on the one hand and what's known as the shadow banking system, or non-bank financial institutions, on the other. Under this approach, we would subject the entire group to one large, all-seeing regulatory system. Doing so would be enormously complicated, and the more complicated the regulatory system the less effective the regulation. In my opinion it is a bridge too far.

We need a stronger identity of purpose between the regulators and the businesses subject to regulation beyond mere adherence to the law. My own view is that in addition to too many regulators, there is the further problem that the regulators did not use their existing powers. They could have halted the growth of the excessive leverage but did little. A culture of systemic risk awareness has to be developed, with clear guidelines to be followed regularly.

Equally important, we need a financial system that has untouchable safety and survivability as its main stem. This would remove debate over whether any of its parts is too big to fail. After all, we're talking about the people's money. Is it operationally possible to combine the mechanics of the shadow banking system, which has emphasized gigantic leverage under-girded by stratospherically complex mathematical formulae, with the principle of securing the people's money? And as tempting as it is to tinker with the present system instead of building a new one, is it the best we can do to prevent another crisis?

I believe that we need a simpler system centered on deposit-based banks. Under this approach, individual accounts in the depository banks would continue to be protected up to $250,000 and these banks would have access to the country's central bank. These institutions would not be allowed to participate in markets involving inordinate leverage or equity transactions that would risk their deposit-protecting charter. In contrast to the current mode, when asked what their primary purpose is, the banks' chief executives wouldn't talk first about shareholder return. Instead they would stand up and say: "Our institution's primary purpose is to repay the depositors' money." Of course this is not the institutions' only purpose, and innovation within them as it relates to the asset side of the balance sheet should be encouraged as long as they keep a weather eye on leverage and equity risks.

The highly innovative shadow banking system with its mantra of lower transaction costs, which would continue to introduce new concepts, would fund itself from the money markets and other sources but without federal guarantees and access to America's central bank. Institutions that currently straddle the two funding markets would have to choose which type of business to pursue. I know this would provoke the immediate cry that the financial system would be further pinched and credit would further shrink. My answer is that any deposit-gathering system with a $250,000 guarantee from the U.S. government and access to the central monetary authorities would get all the deposits it needed to provide a vibrant credit system.

Admittedly, ironing out the details of such a vastly complicated system is a task of the highest order, but I believe it is attainable. You may have noticed that the Senate voted this week to create an independent commission to examine the root causes of the economic collapse and provide a blueprint for the future, and the Speaker of the House called for an inquiry similar to the Pecora Commission held in the early 1930s that gave rise to that generation's new securities laws. It takes me back. My first assignment as a new hire at Dillon Read in 1954, where I stayed for the next 35 years, was to read the volume on securities from the Pecora findings as an explanation for why we did things the way we did.

This country has had a long and important history of independent commissions aimed at laying the groundwork for solutions to national problems of huge moment. Independent is the key word. Such commissions, which call on people with deep knowledge of the underlying problem, have had as their precept exposing fundamental realities. It's unfathomable why such a suggestion has been so long in coming, except to note that commissions terrify the powers that be, both inside and outside the government. If properly constituted, however, they bring together the best of the country's thinkers and thinking, and they're often the only force that unifies the nation. I've been dismayed to read that a number of lawmakers who say they're for a commission nonetheless don't want it to get in the way of acting now. That's exactly backwards. In my view what we need is a rigorous debate and that takes time. As the American writer and philosopher Ralph Waldo Emerson once said, "Counsel to which time hath not been called, time will not ratify."

The composition of the commission is critically important: it can shape the whole outcome. It should have the word "independent" in its title. I believe its chair or chairs should be appointed by the president and that its expert membership should be appointed in equal numbers by the Democratic and Republican leadership of both houses of Congress. It is vital not just that far-reaching, complex reform of the financial system be pursued prudently but in a bipartisan manner in order to gain national support. After all, the purpose is to revive public confidence in the system itself.

In conclusion, let me thank all of you for the great warmth of your reception. We can all agree that thanks to so many of you in this room tonight, including Charles and David, Bill and Pedro and Angel, that the Brady Plan worked and that it indeed set the base for significant prosperity over the past 20 years. I believe that if we can muster similar boldness, clarity, and determination today, we can build prosperity from this crisis and I look forward to working with you in this endeavor.

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