DEBT BONDAGE OR SELF-RELIANCE

A Popular Perspective on the Global Debt Crisis

by GATT-Fly

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Preface

A Biblical Account of Emancipation from Debt Bondage

The ordinary people and their wives began complaining loudly against their brother Jews. Some said, "We are having to barter our sons and daughters to get enough corn to eat and keep us alive." Others said, "We are having to mortgage our fields, our vineyards, our houses to get corn during the famine." Still others said, "We have had to borrow money on our fields and our vineyards to pay the king's tax; and though we are of the same flesh as our brothers, and our children as good as theirs, we are having to sell our sons and our daughters into slavery; some of our daughters have even been raped! We can do nothing about it, since our fields and our vineyards are now the property of others."

When I heard their complaints and these words I was very angry. Having turned the matter over in my mind, I reprimanded the authorities and officials. "What a burden you impose," I said "everyone of you on his brother!" Summoning a great assembly to deal with them, I said to them, "To the best of our power, we have redeemed our brother Jews who had been sold to foreigners, and now you in turn are selling our brothers for us to redeem them!" They were silent and could find nothing to say. "What you are doing" I went on "is wrong. Do you not want to walk in the fear of our God and escape the sneers of the nations, our enemies? I too, my kinsmen, and my servants have lent them money and corn. Let us cancel this debt. Return them their fields, their vineyards, their olive groves and their houses forthwith, and remit the debt on the money, corn, wine and oil which you have lent them." "We will make restitution," they replied "we will claim nothing more from them; we will do as you say." At once I summoned the priests and made them swear to do as they had promised. Then I shook out the lap of my gown with the words, "May God do this, and shake out of his house and property any man who does not keep this promise; may he be shaken out like this and left empty!" And the whole assembly answered, "Amen" and gave praise to Yahweh. And the people kept this promise.

Nehemiah 5:1-13

(The Jerusalem Bible)

Chapter 1
Introduction

"You load sixteen tons and what do you get? Another day older and deeper in debt. St. Peter don't you call me 'Cause I can't go, I owe my soul to the company store."

Most of us remember this popular song. It describes a situation of debt bondage. When workers or tenant farmers owe their employers or landowners debts they cannot repay, they are effectively enslaved. They often have to make all their purchases at the company store where prices always exceed their earnings. Indebtedness binds them to serve their masters endlessly. . .or until they rebel and refuse to serve any more.

Such slavery still exists today in several forms. Recently the Brazilian Bishops' Pastoral Commission on Land denounced this practice at the Cristalino River Valley Agribusiness Company in Para state.[1] This company, owned by Volkswagen Corp., is accused of turning 43 peasants, including children, into slaves. Jobless rural workers are promised contracts by middlemen who deliver them to the plantation far from their homes. The company then pays a fee to the middlemen which the workers are obliged to pay back through deductions from their wages. Since their earnings are so low and costs at the company store are so high the workers never get out of debt.

Similarly, thousands of Canadian farmers have mortgaged their land to banks in return for loans which, under the present system of marketing for most farm products and under the prevailing high interest rates, cannot be paid off. Instead, farmers find themselves working very hard just to pay the interest on their loans without touching the principal. Elbert van Donkersgoed, Research and Policy Director of the Christian Farmers Federation of Ontario, says that "[many farmers] have to decide if they are going to work for nothing for the rest of the decade."[2]

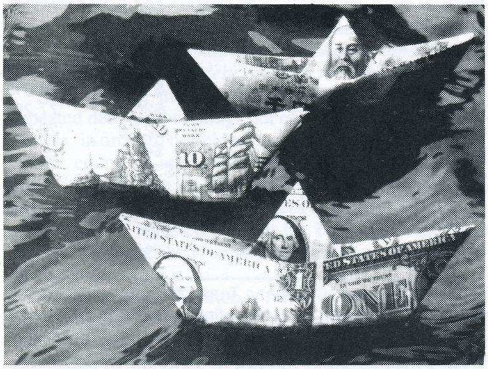
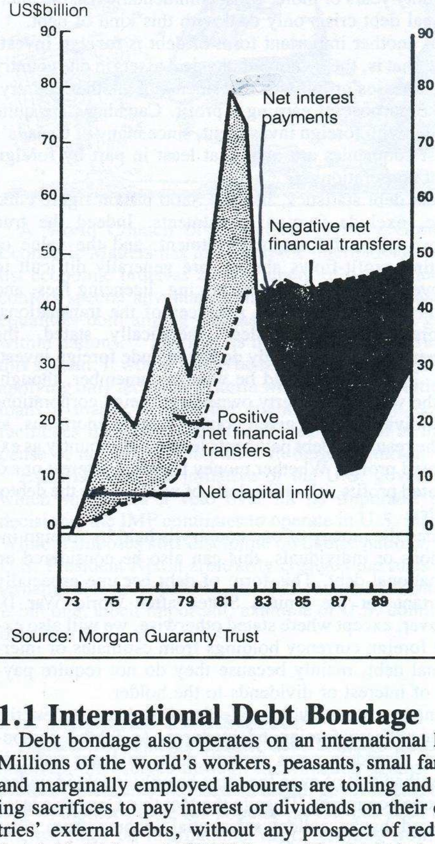


Figure 1: Negative Transfer of Wealth from the Third World



Source: Morgan Guaranty Trust

1.1 International Debt Bondage

Debt bondage also operates on an international level. Millions of the world's workers, peasants, small farmers and marginally employed labourers are toiling and making sacrifices to pay interest or dividends on their countries' external debts, without any prospect of reducing that debt. At the end of 1983 the combined debt in loans to all underdeveloped countries was $800 billion.*[3] That year these countries paid back to their creditors $21 billion more than they received in new loans.[4] As illustrated in Figure 1, Morgan Guaranty Trust Company of New York, one of the major banks involved in international finance, forecasts that this negative transfer of wealth from the impoverished to wealthy creditors will continue throughout the 1980s.[5]

*All dollar amounts in this study are in U.S. currency unless otherwise stated.

What exactly do we mean by international debt? Essentially two things. First, there are the **loans** received by governments, businesses, or individual residents of one country from governments, other institutions, or individual residents of another country or from multilateral institutions such as the International Monetary Fund (IMF). These loans can be short-term, that is for one year or less, or they may be medium or long-term, for as many as twenty years or more. Most commentaries on the international debt crisis only deal with this kind of debt.

But another important form of debt is **foreign investment,** that is, the owning of physical assets in one country by businesses or individual residents of another country, for the purpose of earning a profit. Canadians are quite familiar with foreign investment, since many of Canada's largest companies are owned at least in part by foreign parent corporations.

Most debt statistics, like the $800 billion figure cited above, exclude foreign investments. Indeed the true money value of foreign investment, and the value of resulting profit-flows abroad, are generally difficult to discover because of transfer pricing, licencing fees, and other creative accounting practices of the transnational corporations. Thus, unless specifically stated, the numbers used in this study do not include foreign investment. The reader would be wise to remember, though, that the value of property owned by foreign corporations and individuals in a given country can be enormous, as can the resulting debt payments leaving the country as expatriated profits. Whether money leaves as interest or expatriated profits, it's still a drain of wealth from the debtor country.

When the money of one country is held by foreign institutions or individuals, this can also be considered an international debt. This form of debt became especially important for the United States after World War II. However, except where stated otherwise, we will also exclude foreign currency holdings from estimates of international debt, mainly because they do not require payment of interest or dividends to the holder.

Canada shares with underdeveloped countries the burden of heavy foreign indebtedness. As Table 1 demonstrates, Canada's gross foreign debt, in loans only, is higher than that of even the most heavily indebted underdeveloped countries. Despite the fact that Canada's large chartered banks collect substantial income from their overseas operations, Canadians taken together have to make on a per capita basis even larger net payments abroad than do Brazilians, Mexicans, or South Koreans.

The overall dimensions of international debt are truly astonishing. The combined debts of 81 countries, developed and underdeveloped, surveyed by Morgan Guaranty Trust exceeded two trillion U.S. dollars in 1983. Some significant examples are presented in Table 1. While the large debtors, especially in Latin America, have received most of the attention, international debt bondage is no less serious for the populations of smaller states. African countries, for instance, have been severely affected. Since 1971 at least 16 African countries have experienced negative net financial flows for various periods of time. Thus some of the world's poorest countries have been paying out more to creditors than they have received in new loans and grants.[6]

This system of global debt is now in crisis. In 1983 alone, at least 38 nations were in arrears on their debt payments.[7] That same year a record 63 states had to draw on credits from the IMF, a measure which is reserved for exceptional circumstances only.[8] *Time* magazine ran a January 1983, cover story on "The Debt Bomb: The Worldwide Peril of Go-Go Lending", in which they stated:

Never in history have so many nations owed so much money with so little promise of repayment.[9]

Tragically, this international financial system operates to increase disparities of wealth not only between countries, but also within them. This system permits and even encourages wealthy elites to invest abroad, draining capital from indebted countries and leaving the poorer classes to face the consequences. For example, while the peasants and workers of the four most heavily indebted

Table 1:
Gross Foreign Debt at end of 1983
(U.S.$ billions)

Selected Countries	Total Foreign Debt	Foreign Debt As % of Gross National Product (GNP)
Argentina	$45.3	70.6%
Brazil	$93.1	41.1%
Canada	$105.7	33.5%
Costa Rica	$3.8	124.2%
France	$94.5	18.3%
Ivory Coast	$9.4	116.9%
Japan	$119.1	10.3%
Mexico	$89.8	60.5%
Nigeria	$17.0	24.0%
Philippines	$26.4	77.2%
Poland	$27.0	29.3%
South Korea	$40.1	53.5%
U.S.A.	$325.0	9.8%
U.S.S.R.	$29.0	2.1%
Venezuela	$34.9	52.6%
West Germany	$121.0	18.5%
Zaire	$5.4	154.6%

Source: Morgan Guaranty Trust, *Morgan International Data*. Total external debt as defined by Morgan Guaranty includes *all loans*, from both the public and private sectors. It does not include foreign investment.

Latin American countries — Brazil, Mexico, Argentina, and Venezuela — struggle to produce exports sufficient to make payments on $263 billion in foreign debt, the elites from these same countries collect interest and dividends on some $100 billion they invested abroad between 1973 and 1983.[10]

International debt bondage also penalizes the poorer social groups in that they derive little or no benefit from most of the loans contracted between banks, governments and international financial institutions. Many of these loans have been used to finance large, capital-intensive, mega-projects, such as hydro-electric dams or nuclear power plants. These projects create few jobs and often displace people from their land. Some loans have been for the purchase of armaments. Others were invested in projects that have failed. Were the rules of domestic banking applied, these would have been written off as bad debts.

But international lending has operated under a different set of rules. Most of the loans in question were either made directly to governments or to agencies whose debts are guaranteed by governments. These loans are generally treated as binding upon the governments in question, regardless of the performance delivered by the resulting investment. Moreover, an increasing proportion of new international debt is being directed not at development projects (good or bad), but simply at financing payments on existing debts.

Private bankers acknowledge that they no longer expect governments to repay these debts. They are now ready to accept payment of interest only, with little or no net payment of principal. This could of course continue indefinitely as a flow of net income to the lending banks. A vice-president of the Royal Bank of Canada explains:

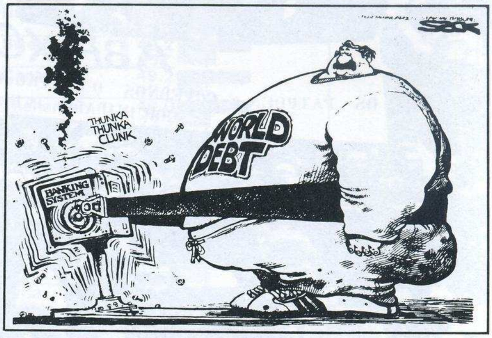
I think that there is a realization in the banking industry that the expectation that a sovereign government is ever going to repay its debt is just not realistic. . .The key is the ability to service the debt.[11]

Similarly, a senior vice-president of Citibank, one of the U.S. banks most heavily involved in international lending, says:

Let's be clear. Nobody's debts are going to be repaid. . . Paying it back isn't really the issue. The issue is the borrower's remaining creditworthy and able to service and carry the debt, but not to re-pay it.[12]

The principal may be rolled over into new loans as repeated debt reschedulings put off its repayment. Nevertheless, in order to be able to continue paying interest due, debtor countries are told to reduce their domestic consumption and increase their exports. There is no pretense that the purpose of these sacrifices is to produce savings which can be invested to meet the basic needs of those who are malnourished, unemployed, ill-housed and poorly clothed.

Yet the greatest sacrifice is from the poorest sectors of the population. Wealthy elites are generally able to avoid the costs that are explicit in the adjustment programs demanded by the IMF. In fact one of the explicit aims of the IMF is to eliminate the use of foreign exchange controls to stop capital flight. Instead the IMF prefers to open up a country to penetration by foreign capital and to ensure that the outflow of profits and interest to foreign investors is not impeded. Under IMF direction debtor nations are frequently compelled to hold down wages and cut subsidies for basic items needed by the poor.



A World Council of Churches Advisory Group on Economic Matters has identified the international capitalist economic order as an instrument of domination that confers special advantages on the rich and increases inequalities both among nations and among social groups within nations.[13] The IMF is the enforcer of the rules of this system. It would like to be seen as a multilateral body applying only technical criteria when setting conditions to loans it makes to indebted countries. In fact the IMF facilitates the private accumulation of capital at the expense of national development in these countries.

Established at the initiative of the U.S. government, which still holds a veto over all its important policy decisions, the IMF continues to operate in U.S. interests. While it imposes stiff discipline on debtor nations, when U.S. President Nixon arbitrarily changed the rules of international finance in 1971, the IMF remained silent. This is but one, albeit important, example of U.S. domination over the IMF.

1.2 Popular Resistance

Popular movements against debt bondage frequently manifest themselves through mobilization against harsh austerity measures imposed on debtor governments by the IMF. Another cause for popular protest has been rising interest rates on international debt, resulting from U.S. monetary policy and massive U.S government spending on armaments. This resistance has been in some cases organized, in others spontaneous.

Public demonstrations against food price increases and unemployment springing from IMF demands have erupted into rioting and looting in Brazil. Popular labour leader Luis Inacio da Silva (Lula) explains that "the

Catholic mass against IMF-imposed austerity, Sao Paulo, September 1983

people's patience has run out."[14] In September of 1983 Sao Paulo's Cardinal Arns led 50,000 people in prayers for "jobs and just wages for all". He denounced "the agreements made with the IMF which have caused so much sorrow and which rob us of the right to decide for ourselves."[15]

On May 1st, 1984, more than a million and a half Mexican workers marched in the annual May Day parade. Normally a tame affair, in which workers march "to give thanks to the President", this year's parade turned into a general protest of the government's Austerity Plan negotiated with the IMF. Government leaders were reportedly unnerved by the display of popular outrage against the unemployment and hunger caused by the Plan.[16]

In June, 1984, more than 80,000 Argentinians led by members of Congress from all the major political parties marched in support of the Alfonsin government's firm line in negotiations with the IMF and multinational banks. A banner in front of the parliament buildings read *National Unity Against International Usury*.[17]

The wave of illegal strikes that swept Poland in the summer of 1980 was sparked by consumer price increases demanded by Western banks as a condition for additional loans to Poland.[18]

In July of 1984 thousands of Filipinos demonstrated in the streets of Manila demanding an end to IMF and World Bank dictatorship of their economy. The protests were sparked by price increases for basic necessities.

Popular repudiation of austerity measures demanded by creditors has also swept a number of nations with smaller debts but whose consequences are no less painful. For example, the widespread protests of April, 1984, in the Dominican Republic followed huge price increases demanded by the country's creditors for basic foods and medicines. More than 200 people were killed and some 5,000 injured as the military repressed the demonstrations.[19] Canadians have also protested against the hardships endured by workers, the unemployed and family farmers that result from Canada's dependence on international capital markets and Bank of Canada policies that mirror the U.S. In November of 1981 over 100,000 people demonstrated on Parliament Hill against high interest rates. This was the largest protest ever held in

Anti-PRI demonstration, May 1, 1984, Mexico City

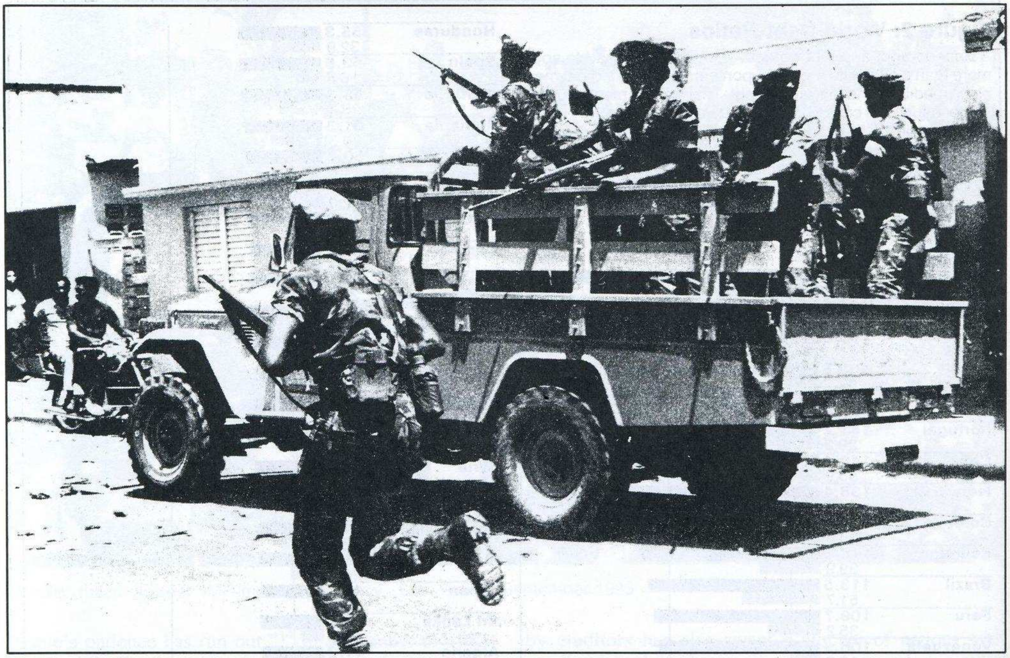
Figure 2: World Debt Ratios

A decade ago, analysts worried when a country had to spend more than a fifth of its annual export earnings making payments on its medium- and long-term debt. That was no magic number; some countries could afford more, some less. But it was a general rule of thumb. Today more than 40 countries of 81 regularly surveyed by Morgan Guaranty Trust Co. have debt-service ratios (gray bar) higher than 20%. And the ratios are higher still if short-term obligations are included in the debt-service payments, as more conservative analysts prefer (black bar).

20% 100% 200%

Argentina	199.5	58.1
Philippines	173.5	31.6
Uruguay	159.6	25.3
Israel	156.8	32.7
Mexico	146.5	56.7
Portugal	141.2	29.2
Chile	140.4	55.9
Ivory Coast	138.4	44.5
Colombia	118.9	38.8
Ecuador	118.6	39.9
Brazil	113.5	51.7
Peru	109.7	35.2
Venezuela	106.9	18.8
Costa Rica	106.4	51.4
Sudan	96.7	25.5
Zimbabwe	95.4	37.2
Morocco	88.8	54.4
Ireland	85.0	48.3
Poland	84.6	80.8
Zaire	84.4	53.3
Turkey	82.5	31.8
Egypt	77.9	31.9
Finland	76.8	18.2
Bolivia	72.3	52.7
Denmark	65.1	32.7
Korea	64.7	19.1
Ghana	62.1	13.1
South Africa	61.4	8.8
Czechoslovakia	60.5	25.7
Hungary	59.4	31.0
Dominican Rep.	58.8	29.4
Nigeria	56.9	21.7
E. Germany	55.6	38.0
Honduras	55.3	32.9
Spain	53.5	16.8
Australia	53.3	28.4
Romania	51.3	34.3
United States	50.7	21.6
Bulgaria	50.1	22.0
Sweden	49.2	25.7
Canada	49.2	17.1
Thailand	49.0	22.3
Jamaica	49.0	43.5
Soviet Union	47.7	17.7
Germany	46.6	14.2
France	46.6	9.6
Greece	46.1	22.7
Syria	46.1	27.7
Norway	45.1	21.6
Yugoslavia	44.3	28.0
Iceland	44.0	22.1
Japan	42.7	7.6
Sri Lanka	42.1	15.9
Algeria	41.2	36.3
Jordan	41.1	25.8
Iraq	40.8	18.4
United Kingdom	40.1	8.8
Austria	38.0	13.4
Italy	36.7	15.9
Kuwait	36.4	4.4
Indonesia	35.4	17.3
New Zealand	35.4	22.7
Pakistan	34.7	14.2
Belgium	32.7	6.0
Switzerland	30.6	5.4
Tunisia	30.3	18.9
Guatemala	29.1	16.2
Iran	23.6	5.6
Trinidad/Tob.	20.5	12.4
China	19.5	10.6
Gabon	19.4	14.3
Malaysia	19.2	8.9

Source: Wall Street Journal, June 22, 1984.



Supression of riots against IMF-ordered "adjustments" in the Dominican Republic, April 1984

Ottawa. It was organized by a coalition of trade unions, farmers organizations, mortgage payers, pensioners, women's groups and other popular organizations. The demonstrators heard National Farmers' Union president Wayne Easter denounce the "vicious economic violence" of an interest rate policy that was ruining family farmers and causing massive unemployment.[20] Protestors demanded lower, made-in-Canada interest rates and many carried signs calling for the nationalization of Canada's chartered banks.

In Africa as well popular movements have reacted to austerity measures. "During the past four years cuts in food subsidies and public services required under IMF stabilization programs have sparked demonstrations in Tanzania, Ghana and Zambia, and food riots in Morocco, Egypt, Tunisia and Sudan. The demonstrators were protesting policies [that] shifted the burden of repaying African debt onto the backs of those least blameworthy and most vulnerable."[21] Coming on top of widespread drought these policies have increased hunger on a massive scale.

In November of 1984 Tanzania's president Julius Nyerere, just elected as chairman of the Organization of African Unity, said that African countries should refuse to pay their foreign debts and force creditor nations to negotiate a more just world economic order. Nyerere declared:

Third World countries have the power of debt. They should simply refuse to pay. If Africa did that and said we are not paying until we sit down and discuss how we are going to pay, then Europe would sit up and take note.[22]

President Nyerere's evident frustration is well-founded. It grows out of decades of failed attempts to persuade the industrial capitalist countries to initiate reforms of the present trade and payments system, a system that keeps many millions of people in poverty.

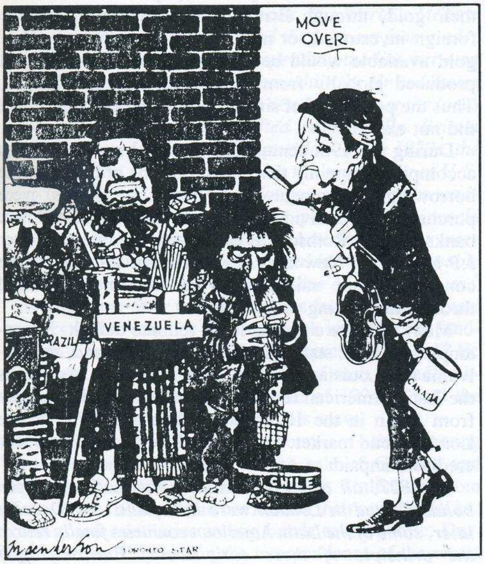
Nyerere was not the first to suggest that debtor nations use the threat of withholding payments to extract concessions from their creditors. The potential power that debtors wield is often expressed by paraphrasing a famous saying of John Maynard Keynes:

If I owe the bank $1000 then I have a problem; but if we owe several billions then the banks have a problem.

But no debtors cartel has yet emerged. For the time being the divide and rule strategy of the major creditors is working. Debtor countries remain divided. One fundamental reason why this division persists is that the elites who rule in most debtor nations find it to their advantage to obey existing rules rather than attempt to forge a new order in the interests of the majority of their population. Despite their rhetorical denunciations of the policies of creditor institutions and of U.S. interest rates, these elites resort to violent repression of their own people rather than accede to popular demands for fundamental change.

1.3 Perspective of This Study

Most studies concerning international finance reflect the view of private banks, national governments or international financial institutions such as the IMF and the World Bank. With the exception of some governments, all of these are trying to ride out a genuine crisis in the global capitalist financial system without making basic



changes in that system. Studies with this perspective assume the legitimacy of existing institutions such as the IMF and, when not standing pat, espouse reforms designed to repair the faltering system leaving it more or less intact.

GATT-Fly takes a different view. We consider the current crisis as seen by its victims — workers, peasants, small producers and the urban and rural unemployed. They make up the majority of people in even the most developed of nations. Many of them belong to popular organizations, such as trade unions, farmers groups and opposition political movements, which question the legitimacy of the present system. They are organizing to seek their own emancipation from debt bondage. We identify with the aspirations of these people to control their own destinies, by creating alternative, self-reliant paths to national development independent of the constraints imposed by debt bondage.

Most studies of world finance also assume that Canada fits neatly into a category of creditor nations. Perhaps this is because Canada's six large chartered banks are among the leaders in world lending. In fact Canada is deeply in debt and heavily dependent upon foreign capital. While we have not yet suffered a debt crisis involving the formal intervention of the IMF, our federal and provincial governments have been feeding us the IMF's medicine. Like the people of other indebted nations, we need a strong popular movement in Canada to overcome our own debt bondage. Only through such a movement can we hope for policies to restructure our economy along more self-reliant lines, which serve the needs of the majority of Canadians. This, too, is part of GATT-Fly's perspective.

Inevitably, given the nature of the topic, we shall also have to explain the positions taken by wealthy and conservative interests. These include not only those listed at the beginning of this section, but also the corporate and individual holders of finance capital who, through their speculative quest for profits, have played their part in destabilizing the present system.

Notes to Chapter 1

1. See "Slave Labour in Volkswagen Farm," *Brazil Information*, No. 14, Aug./Sept. 1984, IBASE/FASE/CPT, Rio de Janeiro, pp.10-11.
2. *Globe and Mail*, Toronto, Oct. 3, 1984, M3.
3. Harold Lever, et al. *The Debt Crisis and the World Economy*, Report by a Commonwealth Group of Experts, Commonwealth Secretariat, London, 1984, p.15.
4. "Debt Crisis Act II", *South*, May, 1984, p.87.
5. *Ibid.*
6. Lever, et al. *op. cit.*. p.41.
7. *ICCR Brief*, Vol. 13, No. 5, 1984, p.3B.
8. UNCTAD, *Trade and Development Report, 1984*, United Nations, Geneva, 1984, Vol. 1, p.76.
9. *Time*, January 10, 1983, pp.32-41.
10. *Fortune*, Nov. 26, 1984, p.195.
11. *Globe and Mail*, Toronto, Oct. 5, 1981, B3.
12. *Wall Street Journal*, June 22, 1984, p.29.
13. Marcos Arruda, ed., *Ecumencism and a New World Order: The Failure of the 1980's and the Challenges of the 1980's*, World Council of Churches, Geneva, 1980, p.31.
14. *Globe and Mail*, Toronto, April 11, 1983, p.12.
15. *Latin America Weekly Report*, 21 October, 1983, p.4.
16. *Resena de Economia y Politica*, Ano XVI, No. 14, Mayo de 1984, CENCOS, Mexico D.F.
17. *Latin America Newsletters — Southern Region*, 29 June, 1984, p.1; and *Globe and Mail*, June 28, 1984, p.11.
18. See Juan Cameron, "What the Bankers did to Poland", *Fortune*, Sept. 22, 1980, pp.125-128.
19. International Commission for the Co-ordination of Solidarity Among Sugar Workers (ICCSASW), *Sugar World*, Vol. VII, No. 3, Sept., 1984, p.5.
20. *Globe and Mail*, Toronto, Nov. 21, 1981, p.2.
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22. *Globe and Mail*, Toronto, Nov. 17, 1984, B15.

Chapter 2
The Origins of the Debt Crisis

It is true. . .that the [post World War II] international institutions, largely fashioned in Washington, were designed to serve the international interests of the United States. The charge that they could in many respects be considered as the creatures of American "capitalist imperialism" can in a sense be accepted. It does not follow, however, that their establishment and operation were contrary to Canadian interests as perceived at the time or subsequently by Canadian governments.[1]

Wynn Plumptre Canadian delegate to the Bretton Woods Conference.

2.1 The 19th Century: British Rule and the Gold Standard

During the 19th century international debts were settled through the transfer of gold bullion from one country to another. Reflecting Britain's superiority in industry, shipping, and naval power, the Bank of England became the world's leading banker. It accepted deposits, in gold, from all over the world. Its own lending was relatively modest, consisting mostly of short-term credits to finance trade. The Bank of England's pound notes became the closest thing to an international currency, trusted because they could be exchanged for gold upon demand.

Other countries also fixed the values of their currencies in relation to gold. Under this system if a country, like Canada, had a trade deficit with Britain this would be balanced by a net transfer of gold to England. The resulting decrease in Canada's gold reserve would lead to a contraction in Canada's money supply. This would in turn reduce the demand in Canada for goods and services at current prices, leading to an increase in unemployment and downward pressure on prices in Canada. Generally speaking, Canadian imports from Britain would fall and Canadian exports to Britain rise, because British goods would now be relatively more expensive for Canadians, and Canadian goods cheaper for the British.

In principle, the Canadian trade deficit would disappear, and the flow of gold out of Canada stop. The system would once again be in international balance. In practice other factors might intervene to produce different results. One of the most important of these was a net flow of British foreign investment into Canada, which could itself offset a trade deficit. In any event, such an international gold standard clearly worked to Britain's advantage as long as it remained the dominant centre of global trade, finance, and of military power.

The gold standard did impose a certain discipline upon the international finance system and upon Britain in particular, a discipline not present today. The supply of any widely accepted currency, including the British pound, could not be expanded unless additional gold were acquired by the issuing country to back the new money. Even if Great Britain were to drain other countries of all their gold, through British trade surpluses, profitable foreign investment, or military victories, the amount of gold available would be clearly limited. The new gold produced globally from gold mines was also limited. Thus the possibility of simply printing new money at will did not exist.

During the 19th century international investment was accomplished mainly through the issuing of bonds by the borrowing government. These bonds (or IOU's) were purchased by individual investors through investment banks like the Rothschilds or Barings in London or later J.P Morgan of New York. Large enterprises, such as the construction of railroads, were frequently financed through the issuing of such bonds.

Many of these overseas loans fell into default. For example, the U.S. states of Mississippi, Maryland, Pennsylvania and Louisiana all repudiated their debts. As soon as the Latin American republics gained their independence from Spain in the 1820s they began borrowing on the London bond market. Frequently they left their European creditors unpaid:

By 1827, all of the £20 million plus Latin American bonds floated in London were in default. . . . Decades later, some of the Latin American countries finally retired the principle of these early loans. But only after successive write-downs, decades of lost interest, and considerable losses by the original investors.[2]

These defaults did not cause bankruptcies for European banks because the bonds were largely sold to individual investors. The scale of these early loans was also still modest.

The international indebtedness which developed in the 19th century was characterized by instability. Charles P. Kindleberger has shown that such lending went through a series of booms and busts over the years 1808-10, 1823-25, 1856-61, 1885-90, 1910-13 and 1924-28.[3] All of these ended with borrowers forced to suspend debt payments and to go into default. These debts were sometimes resumed during the next upswing. Often loans had to be written off as losses by the investors.

Sometimes the creditor nations used military force to collect on these debts:

[At] the turn of the century German and English gunboats bombarded Venezuela to collect on debts.

[President] Theodore Roosevelt sent U.S. tax collectors into the Dominican Republic in 1904 to collect customs revenues for European banks. Later, the United States landed Marines in the Dominican Republic to quell civil strife and keep the tax revenues flowing. Marines stormed Haiti in 1915 to secure the island's gold when the government failed to pay its debts.[4]

The outbreak of World War I marked the end of one such lending boom. New loans were suspended and many countries declared a moratorium on debt payments during the war. A number implemented exchange controls on dealings in foreign currency and shipments of gold were halted. The war also marked the end of British hegemony over the trade and payments system. Michael Moffitt explains what happended in his book *The World's Money:*

During the war Britain pulled the legs out from under the old system by effectively suspending the link between the pound sterling and gold. Meanwhile the United States became a leading creditor. As a result of the war the locus of world economic power shifted dramatically. Britain never recovered its preeminent position. In the 1920s, the strength of the U.S. recovery plus the emergence of U.S. corporations and banks as major foreign investors made the United States the dominant power in the world economy. Yet the new realities of American power were not translated into new international institutions capable of filling the vacuum left by the decline of British power.[5]

Writing just after the war Keynes foresaw that private bankers would attempt to re-establish international lending "on a far vaster and definitely oppressive scale."[6] He expressed doubts about the viability of such an undertaking. The subsequent lending boom of 1924-28 and the crash of 1929 tended to confirm his view.

The international lending boom of the Roaring Twenties consisted largely of the sale of German and Latin American bonds to U.S. investors. Unlike the boom of the 1970s the banks did not lend on their own behalf but acted as intermediaries selling bonds to the public. During the Great Depression the interpendence of the world economy led to defaults and bank failures in country after country. The 1931 failure of Austria's largest bank, Kredit Anstalt, led to a chain of bankruptcies in a number of countries and a suspension of debt payments. By 1935, 85% of Latin American bonds denominated in U.S. dollars were in default.[7]

2.2 The Great Depression: Keynes Questions Free Trade and Capital Flows

Post-World War I efforts to restore the gold standard and expand global trade and capital movements ended with the Great Depression. Many analysts in Europe and North America observed that the interdependence of the world economy had served to transmit unemployment and economic contraction from one country to another after 1929, and had acted as an obstacle to economic recovery in the 1930s.[8] Meanwhile, in Brazil, the relative isolation from the world economy brought on by the Depression set the stage for a "bourgeois revolution" and an "unparalleled growth in national industry" based on the re-investment of domestic savings rather than upon foreign capital.[9]

One of those Depression-era critics of the orthodox idea that great benefits could be expected from expanding world trade and unrestricted movements of capital across international borders was Keynes. In a 1933 essay entitled "National Self-Sufficiency"[10] he strongly questioned the idea that greater world trade, i.e. 'free' trade, would lead to an ideal international division of labour. He was particularly determined in his attack on the "flight of capital" abroad which made national economic planning so difficult. He questioned whether international peace was not endangered by "the penetration of a country's economic structure by the resources and influence of foreign capitalists."

"We're celebrating 100 years since Keynes was born."
"I'm not celebrating. I'm missing him."
Source: Hoy July 1, 1981

As an alternative to what he called "the decadent international but individualistic capitalism. . .which. . .is not a success, not intelligent, not beautiful, not just, not virtuous. . .and doesn't deliver the goods," Keynes suggested a different model of development:

I sympathize. . .with those who would minimize, rather than those who would maximize, economic entanglement among nations. Ideas, knowledge, science, hospitality, travel — these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national.[11]

Keynes was also a vigorous critic of the gold standard which he called "part of the apparatus of conservatism."[12] He saw dependence on that "barbarous relic" as contributing to unemployment and depression because it limited the growth of the supply of money. Were they not so limited, governments could use an increase in the money supply to stimulate spending during downturns in the economic cycle. Under conditions of free trade and unrestricted capital flows, Keynes argued that domestic programs of stimulative fiscal and monetary policies become more difficult, if not impossible, to apply.

Implicit in his argument for national self-reliance is the notion that domestic gains in employment more than offset any possible inefficiencies that might result from restricting imports. Keynes' vision of national self-sufficient economies still allowed for some international trade, but only of goods that could not reasonably be produced at home. Fred Block comments:

This kind of foreign trade could be organized through a series of bilateral trading arrangements that would assure other countries a stable market for certain of their commodity exports or through some type of state trading monopoly. Either of these arrangements for the organization of trade would eliminate the need for extensive financing of trade through short-term lending. This would make it possible to eliminate most international capital flows. . . Underlying this vision was the simple argument that, over the long term, whatever diseconomies might result from the failure to pursue international specialization would be more than outweighed by the gains that resulted from continuous, uninterrupted full employment and full capacity utilization.[13]

Keynes' support of national self-reliance is particularly striking because it seems so at variance with the Bretton Woods system with which his name is so closely associated. Had he changed his views so radically by the end of World War II, when the Bretton Woods system was created? In fact his views may not have changed, but the political context within which he found himself had. Britain's own World War II debts and its need for war-related assistance from the United States became crucial.

During World War II Keynes was sent to the U.S. to negotiate on behalf of Britain for the supply of war materials under a Lend-Lease Agreement. The U.S. State Department was aware of Keynes preference for a post-war world of bilateral trade agreements and controls on foreign capital. They therefore seized the opportunity presented by the Lend-Lease negotiations to insert an article into the agreement which required that the British not discriminate against U.S. exports after the war through the use of controls on trade or capital movements.[14] "Furthermore, the U.S. made it clear that if Britain followed a policy after the war of extending bilateral trade agreements, this would mean a trade war with the U.S."[15]

Although Keynes at first objected strongly, he knew that Britain could not afford a trade war with its major creditor. Also, the Lend-Lease Agreement was essential to England's war effort. The British had little choice but to accept the U.S.'s conditions.

Having received a clear message from the United States that they would not allow Britain to use bilateral trade agreements and exchange controls as the basis for its post-war economic strategy, Keynes set to work to devise a multilateral financial system which he felt would minimize the risks of disorder and put the burden of adjustment on creditor as well as debtor nations. His plan for an "International Clearing Union" underwent several drafts, one of which he sub-titled "a plan for financial disarmament."[16]

In his maiden speech in the House of Lords Keynes explained that the principal object of the Clearing Union was "to provide that money earned by selling goods to one country can be spent on purchasing the goods of any other country."[17] It would establish an international currency, the bancor, which would supplement gold without requiring gold reserves to be held against it. Countries with trade deficits would automatically receive financing from the Clearing Union. Countries with trade surpluses would be under pressure to adjust by importing more goods because they would be required to pay interest on their accounts at the Clearing Union above a certain amount. The plan was intended to allow countries to control their domestic economic affairs despite any balance of payments deficits that might occur.

2.3 The Bretton Woods System

Despite several modifications made to accomodate domestic and international political interests, Keynes' plan did not become the basis for negotiations at the 1944 Bretton Woods Conference convened to establish a post-war international monetary system. Instead the plan for what became the International Monetary Fund was based essentially on the United States' proposal as drafted by Assistant Secretary of the Treasury, Harry Dexter White.

This plan was modified during the Bretton Woods negotiations, in part through the mediation of the Canadian delegation. Nevertheless, "at Bretton Woods the decisive factor was not the intellectual merits of the White plan versus the Keynes plan but the reality of American power."[18]

Wynn Plumptre, who was part of the Canadian delegation to Bretton Woods, recounts that "the Canadians were at first attracted by the intellectual elegence of the Keynes plan. . .but reluctantly concluded that it would not be acceptable to the Americans."[19] Thus the Canadian delegation sought accomodation with the U.S. plan. The Canadian proposals were jokingly called "off-White". Plumptre's judgement of what happened at Bretton Woods is summarized in the quotastion at the beginning of this chapter.

A crucial issue at Bretton Woods concerned whether nations would have automatic access to the new Fund, as Keynes wanted; or whether conditions would be attached to access, as White wanted. A compromise left the issue unclear in the final draft of the accord, but an unspecified conditionality was at least implied. Keynes and White subsequently gave diametrically opposed interpretations of the agreement:

As a result, Keynes could go home and tell Parliament that use of Fund credit would not bring foreign intervention into domestic economic policy-making in Britain. He

IMF/World Bank meetings, September 1984

said it was the exact opposite of the gold standard. White, for his part, wrote in Foreign Affairs *six months after the meeting that the IMF would not simply dole out money to debtor countries. The Fund, he asserted, would force countries to take measures that under the gold standard would have happened automatically.*[20]

It was the interpretation of White and of the U.S. which subsequently prevailed. Even though many of the features of the Bretton Woods monetary system have by now broken down — e.g. fixed exchange rates and U.S. dollar backing by gold — the ability of the IMF to impose stiff policy conditions on countries applying for credits has been strengthened over the years.

The most important feature of the Bretton Woods system was the enshrinement of the U.S. dollar as the world's most important reserve currency, convertible into gold by the central banks of other countries. This had been Harry White's intention from the beginning. The way this key item was inserted into the Bretton Woods agreement is one of the ironies of history. While Keynes was busy chairing the committee that worked on the establishment of the International Bank for Reconstruction and Development (the IBRD, which is more usually called the World Bank), White chaired the committee that was drawing up the rules for the IMF. At the July 6th meeting of that committee a Professor Robertson, acting *against Keynes' instructions, but as the responsible British delegate, suggested that the words 'gold and gold-convertible currency' be replaced by 'net official holdings of gold and U.S. dollars', and remarked that this would involve several changes elsewhere. This was White's opportunity. Using his authority as chairman, he referred the matter to a special committee, which took it out of any further discussion. . . . The special committee was [a] group of technicians headed by White. It prepared for inclusion in the Final Act a number of provisions that were never discussed. . . .*

The change from 'gold' to 'gold and U.S. dollars' was lost in the ninety-six page document the chairmen of the delegations would sign a few days later. Whether or not any of them noticed it, or understood its implications, it seems that none of them expressed any reservations about it. Keynes would not find out until later, when he studied the Final Act. . . . Henry Ford [commenting on Bretton Woods shortly afterward] said he had always favoured a universal currency. "That currency," he added, "should be our own dollar."[21]

Whether most of the delegates realized it or not, the accord they signed gave the United States, and its industrialists like Henry Ford, an enormous privilege. By accepting the U.S. dollar as the principal international reserve currency, convertible into gold at $35 an ounce, the system gave the United States the unique privilege of paying its foreign debts and of buying foreign assets simply by printing more U.S. dollars. The U.S. became in effect banker to the Western world, disciplined only by the limits of its own gold reserves. This single constraint had indeed little practical consequence in the years immediately following World War II, when the U.S. held a large gold surplus.

During these years dollars flowed out of the United States to finance foreign military bases, aid programs such as the Marshall Plan for the reconstruction of Europe, overseas investment by U.S. corporations, and foreign bank loans. Over the decade of the 1950s the resulting total U.S. balance of payments deficit (the net amount of dollars flowing out of the U.S.) amounted to some $7 billion.

However, the system's one constraint eventually came into effect. The U.S. could not indefinitely run balance of payments deficits while at the same time maintaining the dollar's gold convertibility. By 1960 the amount of gold held by the U.S. Treasury was already smaller than the amount of dollars held abroad. As the 1960s wore on the U.S. supply of gold continued to dwindle while foreign dollar holdings soared.

In addition to the factors already listed, two others swelled U.S. dollar exports in the 1960s. First, Japan and Europe (especially West Germany) emerged as strong competitors on world markets, causing U.S. goods exports to decline and imports to rise. This worsening U.S. trade balance meant that fewer imports could be financed with foreign exchange earned from goods exports, and more were paid for with U.S. dollars.

Second, the U.S. government financed its expanding war in Vietnam by printing more dollars, rather than raising domestic taxes. Many of these dollars were spent abroad, in Vietnam and elsewhere. At the same time, the surplus dollars dumped into the U.S. economy by deficit financing of the war raised inflation rates within its borders, bringing into question the ability of the dollar to sustain its value in relation to gold and to other currencies. Speculators chose increasingly to exchange U.S. dollars for West German marks, Swiss francs, or Japanese yen. These speculators often included the currency trading departments of the world's largest banks and corporations.

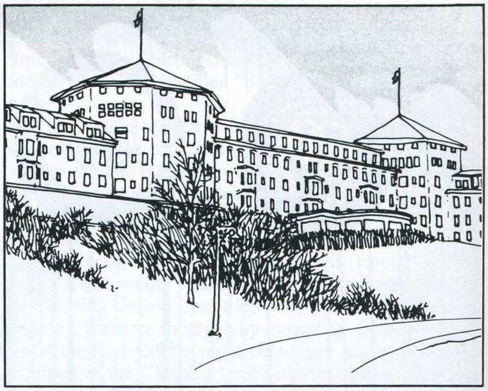
One result was the accelerated growth in the number of U.S. dollars held by foreign central banks. Rather than hoarding these dollars in their vaults, most of these banks chose to purchase interest earning assets, especially U.S. government Treasury Bills. By loaning these dollars back to the U.S. government, European, Canadian, and Japanese central banks were in effect financing U.S. budget deficits and in particular the war in Vietnam.

Why did they not convert their dollars into gold, which under the Bretton Woods agreement they had every right to do? It could not have been to earn, in interest payments, more U.S. dollars of which they had more than enough already. Cy Gonick offers the following explanation:

The European powers recognized the U.S.A. as the bastion of world capitalism around which their economies revolved, and it made no sense to weaken it. Moreover, European and Japanese corporations benefited handsomely from the arrangement. The American war machine kept the Third World safe for capitalist trade and investment. . . .[22]

The same could be said of the Canadian government's attitude at the time.

The exception to this rule was President Charles de Gaulle of France who condemned the "exorbitant privilege" that Bretton Woods conferred on the United States.[23] De Gaulle preferred to convert dollars into gold.



The Mt. Washington Hotel in New Hampshire, site of the Bretton Woods conference.

For a time the central banks of most other Bretton Woods countries joined with the United States to protect the dollar against the French gold drain. As well as purchasing U.S. Treasury Bills, an international gold pool was established by these banks to defend the price of gold at the official $35/ounce level. Arrangements were also made to "swap" currencies with the Federal Reserve Board (the U.S. central bank).

2.4 Nixon Changes the Rules

What finally broke the back of the Bretton Woods system was the wave of speculation against the U.S. dollar which peaked in 1971. With its gold reserves seriously eroded, and fearful that it would be unable to honour impending demands for additional gold from central banks swimming in U.S. dollars, the U.S. imposed its own solution. And instead of acting against the speculators who included many of its wealthiest corporate citizens, it moved against its trading partners abroad and its own workers.

On August 15, 1971, President Nixon went on national television to announce what he called his New Economic Policy. According to one account not one of Nixon's advisors bothered, or dared, mention to him that he was about to contravene the rules of the IMF. "To mention this to a determined President Nixon would only have lowered his opinion of them, relegating the offender to the dreaded category of 'technician'."[24] Almost as an afterthought the Managing Director of the IMF was invited to the offices of Treasury Secretary Connally to watch the speech on T.V.

Three of the measures Nixon announced are most significant. First, he declared that the U.S. dollar would no longer be convertible into gold, unilaterally breaking the Bretton Woods agreement. By denying U.S. creditors the option of holding gold rather than dollars, the terms of the $61 billion debt that the U.S.A. then owed to foreigners were radically changed, and at the debtor's initiative alone. It is worth remembering that the U.S. is forcefully opposed to any other debtor nation following its example, and acting independently to relieve its own debt burden. Clearly the rules insisted upon by the U.S. at Bretton Woods do not apply when, and only when, they inconvenience their author.

Second, Nixon announced a temporary 10% surcharge on all imports, violating the spirit if not the letter of Bretton Woods. There was no rhetoric about the virtues of free trade. Instead Nixon said, "There is no longer any need for the United States to compete with one hand tied behind her back."[25]

Third, Nixon imposed wage "and price" controls as a domestic anti-inflationary measure and as a means of improving the competitiveness of U.S. products abroad. Predictably these controls had a greater effect on wages than on prices or profits. After a year and a half of controls, wages were growing at a rate of 5.5% a year, while prices rose by 10% and profits by 30%.

Nixon's Treasury Secretary, John Connally, ingenuously explained the rationale for what the Japanese call the "Nixon Shocks" by saying:

We had a problem and we are sharing it with the world just like we shared our prosperity. . . .That's what friends are for.[26]

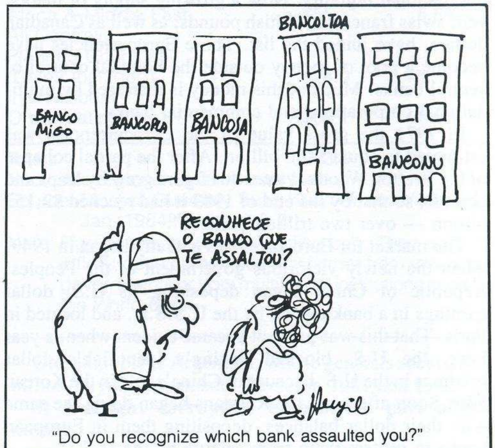
The rest of the world did not see it as a friendly gesture. The underdeveloped countries complained about the drop in the real purchasing power of their dollar-denominated commodity exports, when the U.S. dollar was subsequently devalued against European and Japanese currencies. Despite Nixon's rhetoric that he was acting against "international speculators", a massive stampede from the U.S. dollar continued and the dollar was twice devalued, in December, 1971 and February, 1973. These devaluations contributed to a short-term restoration of a positive U.S. trade balance, but they did not end speculation against the dollar.

In the wake of the Nixon Shocks, Canada dispatched both its Minister of Finance and Minister of Industry, Trade and Commerce to Washington. Their message was that Canada was not the source of the U.S.A.'s trade and payments problems and that Canada, as the U.S.A.'s largest trading partner, should be exempt from the 10% surcharge. Far from being sympathetic to Canada's plea for special treatment, Treasury Secretary Connally wanted Canada to revalue its currency upward, above parity with the U.S. dollar. It was finally agreed that the Canadian dollar would be allowed to float freely in relation to the U.S. dollar, effectively devaluing the Canadian currency in relation to the Europeans and the Japanese but maintaining Canada's close integration with the U.S. market.

After the 1973 devaluation of the U.S. dollar, central banks began limiting their intervention in world currency markets to smoothing the upward and downward movements of currencies. The Bretton Woods system of fixed exchange rates gave way to floating rates with currency speculation playing a central role in setting short term values.

On January 19, 1972, Nixon made another policy announcement, further undermining what was left of the Bretton Woods agreement. After the Allende government in Chile nationalized the U.S. owned Kennecott and Anaconda copper mines, Nixon announced that:

When a country expropriates a significant U.S. interest without making reasonable provision for compensation to U.S. citizens, we will presume that the U.S. will not extend new bilateral economic benefits to the expropriating country. . .[and] we will presume that the United States government will withhold its support from loans under



"Do you recognize which bank assaulted you?"

consideration in multilateral development banks.[27]

Nixon kept his word. The resulting financial squeeze of Chile was one of the precipitating factors leading to the bloody coup d'etat by General Pinochet on September 11, 1973.[28] The World Bank and the IMF in particular were supposed to apply only 'technical considerations' to the loans they made. Instead a clear political bias was demonstrated in the case of Chile. The World Bank completely suspended loans to Chile during the Allende years, and resumed them immediately under the military dictatorship that followed.[28]

The political use of the IMF and World Bank by the United States, which enjoys a veto over most loan applications, has continued long after Nixon's exit via Watergate. This theme is discussed more extensively in the next chapter. Here it is sufficient to note that the Reagan administration currently maintains a "hit list" of countries with leftist governments which former Secretary of State Alexander Haig says should not "get a penny of indirect aid" from the World Bank and other multilateral institutions.[29]

2.5 The Eurocurrency Market and Private Bank Lending

After the Bretton Woods system had broken down under the weight of accumulated U.S. dollar outflows and global currency speculation, the central banks of Europe, Japan, and North America chose to exercise little control over international money supplies. Thus the 1970s and early 1980s saw the phenomenal growth of what has become known as the 'Eurocurrency' market.

Eurocurrencies are currencies deposited outside the issuing country, for example U.S. dollars deposited in Swiss banks and German marks held in Great Britain. Until recently this meant mostly Eurodollars, since the United States was supplying the world with most of its international liquidity. Now a growing supply of marks, yen, swiss francs and British pounds, as well as Canadian dollars, have joined the list. These Eurocurrencies have become a pool of money outside the nominal control of central banks. Much of this money is managed by multinational corporations and commercial banks.

In 1971 the gross value of the Eurocurrencies was estimated to equal $150 billion. After the partial collapse of the Bretton Woods system this figure grew by leaps and bounds, so that by the end of 1983 it had reached $2,153 billion — over two trillion dollars![30]

The market for Eurocurrencies actually began in 1949, when the newly victorious government of the Peoples' Republic of China began depositing its U.S. dollar earnings in a bank owned by the U.S.S.R. and located in Paris. That this was prudent became evident when, a year later, the U.S. blocked Peking's identifiable dollar holdings in the U.S. because of China's role in the Korean War. Soon afterward the Russians began doing the same with their dollar balances, depositing them in European banks to protect them from seizure by the U.S.[31]

Eurocurrencies' growth accelerated after President Johnson tried to persuade U.S. businesses to voluntarily curb capital movements out of the U.S. This attempt apparently failed, and mandatory rules were then introduced.[32] U.S. banks and corporations thwarted this effort as well, turning to Eurocurrency markets as holding grounds for their dollar receipts.

At the same time two new kinds of international banks emerged. First, multinational banking consortia combined the financial muscle of European, U.S., Japanese, Canadian and Australian banks into international super-banks. Among these are the Midland and International Bank Ltd., and the Orion Banking Group now controlled by the Royal Bank of Canada.

Second, overseas shell banks were incorporated in such tax havens as the Bahamas and the Grand Cayman Islands in the Caribbean, or Panama, Hong Kong, and Singapore. These banks were actually managed from New York, London, or Toronto, as Eurocurrency 'safe houses'. Such offshore banking havens were already well established prior to the 1973/74 escalation in the price of petroleum engineered by OPEC and the largest multinational energy companies.[33] Subsequent deposits by oil exporters helped to further swell the size of Eurocurrency markets, but their importance has often been overestimated. OPEC money never accounted for more than 15% of the total value of Eurocurrencies held at any one time.[34]

Most Eurocurrency deposits in the 1970s came not from OPEC countries, but from North American and European investors who had discovered the profitability of Eurocurrency markets. Funds also came from nervous elites of Third World countries and from the world-wide multi-billion dollar traffic in drugs and arms.[35]

New Eurocurrency deposits brought into any international bank, from whatever source, could then serve as reserves against which new Eurocurrency bank loans could be made. The banks were careless about whom or for what they lent money. A 1976 edition of *Business Week* offers the following account:

In fact, the stalled recovery in the U.S. and overseas has delayed the return of quality borrowers — forcing the banks, awash in liquidity and desperately eager for higher earnings, to continue relying on the profitable, but risky, business of lending to less developed countries. "The earlier talk of caution is still there," says a vice-president at Chase Manhattan Bank, "but it's only talk. There's no indication of banks pulling in their horns."[36]

There was a herd instinct behind the banks behavior, as smaller banks joined their bigger cousins in multi-bank lending consortia, assuming that the bigger banks knew what they were doing. A former Latin American finance minister recounted to Anthony Sampson how aggressive the banks were:

I remember how the bankers tried to corner me at conferences, to offer me loans. They wouldn't leave me alone. If you're trying to balance your budget it's terribly tempting to borrow money instead of raising taxes.[37]

2.6 Where Did All the Money Go?

To whom did the private loans go? Table 2 shows the destination of new international borrowing for the years 1976-1983. Included are both international bond issues which went primarily to industrial capitalist countries, and Eurocurrency bank credits which were more widely distributed. Had the United States not borrowed the extraordinary amount of $54.8 billion from Euromarkets in 1981, Canada would have been the largest international borrower over the period surveyed. The huge capital outflow back into the United States after 1980 was an effect of the high interest rates prevailing there, shown in Chart I.

How was this money spent? Despite everything that has been written about the international financial crisis, it is difficult to identify spending on a country by country basis. Some generalizations are nevertheless possible:

1) Much of the borrowed money was used to finance imports or cover debt service payments on previous loans.

Although a good deal has been made of the effects

Zaire's Mobutu

petroleum price increases have had on underdeveloped countries' balance of payments, this factor has been overblown as a cause of the debt crisis. Payments for imports other than petroleum and petroleum products gobbled up significant amounts of foreign exchange, as world prices of industrial goods escalated. Rising interest rates on new and outstanding loans also became a major drain on foreign exchange receipts.

2) Many of the loans were tied to specific projects for the development of mining, forestry, or electric power.

For instance, billions of dollars were borrowed abroad by Hydro Quebec, Ontario Hydro, and other Canadian public utilities to finance electric power projects. Similarly, 15% of South Korea's external debt is held by the Korean Electric Power Company, most of this borrowed to fund Korea's nuclear power program.

Some of the projects for which enormous amounts were borrowed have wound up producing little or no value for the borrowing country. One example is the Chingaza hydroelectric project in Columbia, which was shut down after only four months of operation when the main tunnel collapsed.[38]

3) A substantial portion of the borrowed money was spent on military goods.

Table 2.
Gross New International Borrowing 1976-1983
(U.S.$ billions)

Country	New Bond Issues and Eurocurrency Loans	Percentage of Total
All Industrial Countries	$591.2	60.1%
All Underdeveloped Countries — Of Which:	$304.2	30.9%
Latin America	$180.5	18.4%
Asia	$68.7	7.0%
Africa & Middle East	$55.1	5.6%
All Centrally Planned Countries (China Included)	$24.0	2.4%
International Organizations*	$64.1	6.5%
Totals	$983.5	99.9%

*Includes regional development banks.

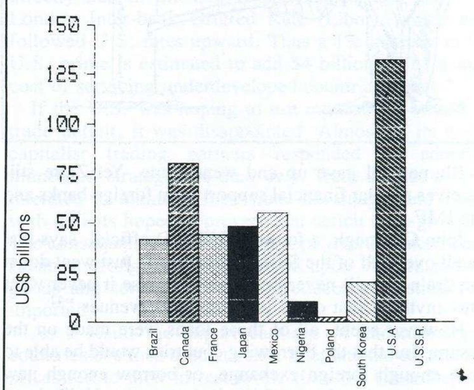
Source: Morgan Guaranty Trust, *World Financial Markets*, Jan. 1984, Tables 6 & 7.

Note: Figures are for private lending only. They exclude official development loans whether from individual governments or from multilateral institutions such as the World Bank.

One example is Argentina, whose generals spent $13.9 billion buying armaments abroad in 1981 and 1982.[39]

4) Outright corruption absorbed a part of the money.

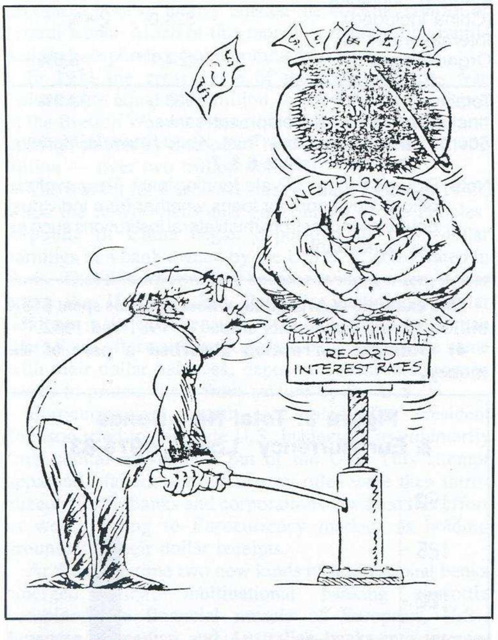
Figure 3: Total New Bonds & Eurocurrency Loans, 1976-83



The Alfonsin government discovered vast amounts of money unaccounted for when it took over from the Argentine generals. Some of this appears to have been spent on contraband luxury imports, some went to offshore bank accounts, and some was used to purchase real estate in Uruguay. Roughly $20 million "vanished" from Haiti's official accounts in 1981.[40]

The most famous case of corruption is that of Zaire and its dictator, Mobutu Sese Seko. In 1978 Zaire was virtually put into receivership by the IMF. Erwin Blumenthal, a former official of West Germany's Bundesbank, was sent to take over Zaire's central bank. Blumenthal reported

refusing high officials' requests for bundles of cash of up to $50,000, finding a government payment of $4 million to a Belgian professor who was the guardian of Mobutu's son, and discovering a discrepancy of $32.6 million . . .in the government's bank accounts abroad.[41]



Blumenthal gave up and went home. Yet Zaire still receives regular financial support from foreign banks and the IMF.

John Cavanagh, a former UNCTAD official, says that "well over half of the $810 billion clearly just went down the drain. It will never be repaid, because it never went into anything that could generate any revenues."[42]

However spent, all of those loans were made on the assumption that the borrowing countries would be able to earn enough foreign exchange, or borrow enough new money, to meet the resulting loan payents. Unlikely as this may have been, it became impossible for many debtor nations after the dramatic turn around in the world economy between 1980 and 1982. This change for the worse can again be traced largely to a policy initiative of the United States government.

2.7 Monetarism and the Great Recession

Of all the factors precipitating the present debt crisis, the single most important cause has been the adoption of monetarism as the economic strategy of the major capitalist countries. Nominally monetarism is a strategy for fighting inflation, which is as monetarists see it the single greatest threat to captalist prosperity. Monetarists fight inflation, they tell us, by lowering the rate of growth in the money supply, and *this* is accomplished by raising interest rates. Since interest rates are the price one pays for money, higher rates mean that money costs more (to borrow) and so less of it will be 'bought' (i.e. borrowed) and less of it will be held by individuals and intitutions.

Of course higher interest rates also slow down spending, both consumer spending and business investment. This in turn means less production, leading to layoffs and growing unemployment. Higher unemployment in turn dampens the wage demands of workers, and makes it easier for corporations to win lower wages in labour contracts. Many of those who support monetarism in fact argue that escalating wage demands are the most imortant cause of excessive money supply growth and thus of inflation. By this reasoning higher unemployment and a sharp downturn in economic activity become basic tools of economic policy.

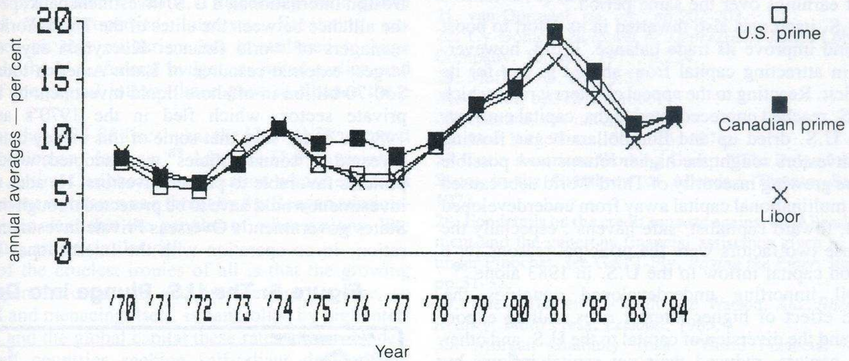
The opposite side of this coin is a strategy for assisting corporations and banks to accumulate more capital and boost profits. By lowering wages, at least relative to prices, the proportion of income going to owners of capital increases. Profits rise, which particularly pleases one set of monetarist allies, the supply-siders. They contend that only higher profits lead to new investment, with new growth and declining unemployment to follow.[43]

They are not particularly concerned that this must be built upon depressed consumer income and depressed sales in domestic markets. Successful competition in foreign markets will substitute for any lack of sales at home. They recognize that there will be many losers in this global competition. Supply-siders do not expect to be among these losers.

Were monetarism to be adopted only by those countries which are running trade deficits, it would have an effect similar in some respects to that of the old gold standard. Under that standard, a contraction of the money supply and of spending in trade deficit countries is one consequence of the net gold outflows required to pay for the trade deficits. As noted earlier, this contraction should result in fewer imports and greater exports, thus ending the trade deficits.

It was also noted that this effect might be offset by in-

Figure 4: U.S., Canadian and International Interest Rates



creased foreign invesment in the country in question. Such investment would replace the money (or gold) flowing out of the country because of the trade deficit. Under these latter conditions the trade deficit could continue as long as it was paid for by the net **inflow** of foreign investment.

The U.S. at the end of the 1970s was a trade deficit nation. It was also a nation with a net **outflow** of foreign investment. If one disregarded the interests of workers, and of other U.S. consumers, then monetarism may have seemed an attractive policy alternative. Apparently it did, since in October of 1979 the U.S. Federal Reserve Board embraced monetarism and initiated a meteoric rise in domestic interest rates.

Although monetarist policies were adopted earlier by other countries, including Great Britain and to a limited extent Canada, the monetarist impact globally waited upon the Americans. After October, 1979, and even more clearly after Ronald Reagan's election to the Presidency in 1980, the enormous economic power of the U.S.A. was committed to a monetarist and a supply-sider's world.

As Figure 4 demonstrates, U.S. interest rates peaked in 1981 at a prime rate of almost 20%, with other rates above 20%. In Michael Moffitt's words, "Usury was institutionalized."[44] Canadian rates were actually well above those in the U.S. from 1975 to 1977, when the Bank of Canada attempted to implement what it called "monetary gradualism."[45] From 1979 onward, faced with a much more determined monetarist assault by the U.S., the Bank of Canada ended its efforts at an independent monetarist approach and reverted to the more traditional relation between Canadian and U.S. rates. This was simply to keep Canadian rates marginally higher than those in the U.S. in order to prevent an outflow of capital to an otherwise more attractive U.S. market.

When the U.S. interest rate roller-coaster took off Canadians and Americans were taken for a dizzying ride. Economic activity in both the U.S. and Canada plunged into the deepest downturn since the Great Depression. Millions of workers were laid off as borrowing costs became prohibitive and thousands of small businesses and family farmers went bankrupt. During this period the rate of inflation did fall dramatically, pleasing government policy makers, but at the cost of tremendous human suffering.

Pleasing to supply-siders was the boom in major corporate profits which set in after 1981. It became apparent that the very rich were truly enjoying the ride, just as the policy makers intended.

The impact on underdeveloped debtor nations was also devastating. By 1983 40% of all underdeveloped country debts were tied to floating interest rates, compared to only 5% a decade before.[46] The cost of servicing these loans is directly tied to the U.S. prime interest rate or to the London Inter-bank Offered Rate (Libor), which also followed U.S. rates upward. Thus a 1% increase in the U.S. prime is estimated to add $4 billion to the annual cost of servicing underdeveloped countries' loans.[47]

If the U.S. was hoping to use monetarism to end its trade deficit, it was disappointed. Almost all its major capitalist trading partners responded by adopting monetarist strategies of their own. Trade surplus nations intended to maintain their trade advantage, and others with deficits hoped to prevent that deficit from growing. The consequence was that in Europe, North America and Japan a strong brake was placed upon the demand for goods and services, whether produced domestically or imported.

As a result the export earnings of underdeveloped countries declined dramatically. International commodity prices fell to their lowest levels since the Great Depression.[48] Seventy oil **importing** underdeveloped countries saw their export earnings fall by $24 billion between 1980 and 1982. Oil **exporting** underdeveloped countries — which include such highly indebted nations as Mexico, Venezuela and Nigeria — experienced a $85 billion drop in export earnings over the same period.[49]

The U.S. itself was also thwarted in its effort to boost exports and improve its trade balance. It did, however, succeed in attracting capital from abroad to pay for its trade deficit. Reacting to the appeal of interest rates which in the U.S. reached unprecedented highs, capital outflows from the U.S. dried up and Eurodollars began flowing back as investors sought the higher returns now possible there. The growing insecurity of Third World debt caused a shift in multinational capital away from underdeveloped countries, toward capitalist 'safe havens', especially the U.S. These two factors were the principal reasons for a $60 billion capital inflow to the U.S. in 1983 alone.[50]

For oil importing underdeveloped countries the combined effect of higher interest rates, falling export earnings and the diversion of capital to the U.S. and other capitalist centers, reduced their net capital inflows by over $100 billion between 1980 and 1982.[51] During 1983 and 1984 these countries became net capital exporters to the rest of the world.

Tom Naylor sums up the consequences of this drain of funds from the underdeveloped world to the centres of international finance:

Since there was no way that institutions like the IMF could make up the shortfall, both by indisposition and lack of resources, developing [sic] country debtors were forced to put the process of economic development into reverse, squeezing government spending, slashing industrial production, destroying living standards and courting future economic, political and social disaster.[52]

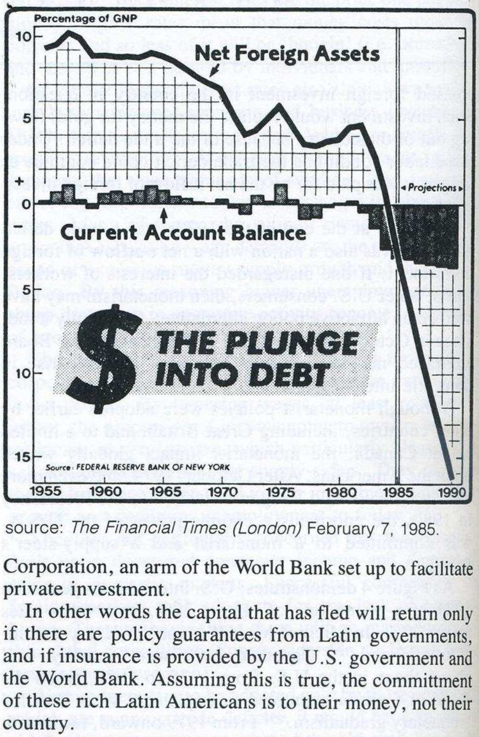
2.8 The Rich Abandon Ship

Another less well recognized cause of the immediate crisis has been capital flight from impoverished debtor countries as the wealthy in their populations seek safer and more profitable locations for their money. It is conservatively estimated that rich Latin Americans and Latin American corporations deposited abroad at least $100 billion in 1981 and 1982.[53] At least $20 billion seems to have been taken out of Argentina alone in 1981.[54] Wealthy Mexicans are estimated to have deposited $14 billion in Eurocurrencies and invested another $25-30 billion in U.S. real estate.[55] Some $6 billion flowed out of Venezuela during the last quarter of 1981 and the first three months of 1982.[56]

One of the bitter ironies of the debt crisis is that most of this capital fleeing the Third World has been deposited in the U.S. where it can earn the highest return. While the peasants and workers of these countries are left slaving to make payments on their governments' debts, their wealthy compatriots seek to enrich themselves further through foreign real estate speculation or through the purchase of short-term investment certificates from U.S. banks.

Pedro-Pablo Kuczynski, who was once Peru's Minister of Energy and Mines and is now co-chairman of First Boston International, a U.S. investment bank, personifies the alliance between the elites of the Third World and the managers of world finance. Kuczynski says that "the largest external resource of Latin America today is the $60-70 billion in offshore liquid investment by the Latin private sector, which fled in the 1970's and early 1980's."[57] He says that some of this money could be reinvested if "sound policies" were adopted, which means policies favorable to private investors. He adds that such investment would have to be protected through the United States government's Overseas Private Investment Corporation, in co-operation with the International Financial Corporation, an arm of the World Bank set up to facilitate private investment.

Figure 5: The U.S. Plunge into Debt



source: *The Financial Times (London)* February 7, 1985.

In other words the capital that has fled will return only if there are policy guarantees from Latin governments, and if insurance is provided by the U.S. government and the World Bank. Assuming this is true, the committment of these rich Latin Americans is to their money, not their country.

A further irony of the world debt crisis is the fact that in 1985 the United States itself has become a net debtor. Figure 5 shows graphically the U.S. plunge into debt.

We have already described the causes of this reversal - a large inflow to the U.S. of capital owned abroad, and the rapid decline in loans abroad by U.S. banks. There has also been a weakening in new U.S. foreign investment. All of this has been precipitated by the policies of monetarists and supply-siders, although more fundamental factors are at play as well. One of these factors is U.S. militarism, and the determination of U.S. elites to maintain with force of arms if necessary their global financial and propertied interests. Escalating expenditures on this militarism has contributed to huge deficits in the U.S. federal budget, as noted earlier, and much of the capital inflows have gone to finance these deficits.

During the 1985-86 fiscal year the U.S. plans to spend $312.3 billion on 'defense.'[58] After the U.S. invasion of Grenada, a tiny Caribbean island nation whose efforts at development were seen as a threat by the Reagan administration, it is clear that the peoples of other nations, like Nicaragua, are at similar risk.

One of the cruelest ironies of all is that the growing U.S. expenditure on war and preparations for war, so wasteful and menacing itself, is bankrolled by high interest rates and the global capital these rates attract. Underdeveloped countries seeking self-reliant development face not only the greater debt payments resulting from these same high interest rates, but the threat of a military invasion financed by these rates as well.

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Chapter 3
The Logic of the IMF

In Brazil alone 1000 children each day are starving. And the logic of this starvation is that you must pay the debt and to pay this debt you must work more, eat less, in order to export the resources, tons of meat. We must export to have money, not to pay the debt but only interest on the debt.[1]

Jose Alamiro Andrade
Franciscan priest in Brazil

Despite the breakdown of most elements of the Bretton Woods system, the significance of the International Monetary Fund as a global police officer dictating policy terms to indebted countries has increased. The power that the IMF wields is not proportionate to the quantity of funds it actually controls. For example, in 1980 net lending by private banks internationally amounted to $165 billion, while the IMF lent only $8 billion or less than 5% as much.[2]

Under the Bretton Woods agreement the IMF was to be the institution which countries in balance of payments difficulties would turn to for short-term financing. In this chapter we shall examine why the Fund has become so central to the debt crisis and so despised by peoples held in debt bondage.

3.1 Private Banks and the IMF — the Peruvian Experience

In 1976, just as the private international lending boom was gaining steam, a consortium of six U.S. banks embarked on an adventurous attempt to deal with a debtor government without the mediation of the IMF.[3] At the time Peru owed private banks about $1.5 billion as part of a total external debt of $3 billion. The six U.S. banks offered to make a $200 million loan to Peru, a country which was having difficulty making payments on its debt in the wake of falling copper prices and disappearing anchovy schools off its coast.

There were strings attached to the banks' offer. In return for the new loan, the government of Peru would have to agree to the following conditions:

— reduce state participation in the economy by selling off government-owned companies, including the fishing fleet.

— give more favourable treatment to foreign investors, including compensation for an iron mine that had been nationalized and re-open Peru for exploration by multinational oil companies.

— accept an austerity program involving cuts in government spending, a devaluation of the currency, and increases in food prices.

As the result of this deal food prices rose by 25-30% and workers' real wages fell to their 1968 level. Protests

"But they told me the solution was to borrow more."
Hoy, 22 July 1981.

by dwellers in shanty-towns around Lima were repressed by the military government, which then abolished the right to strike and sanctioned the dismissal of workers who violated any "national emergency" decree. The private banks made the disbursement of the second half of their loan absolutely dependent upon the successful implementation of the austerity program, which the banks themselves were monitoring.

By the beginning of 1977 the banks had become concerned that their loan to Peru might not be repaid, believing that the austerity program was still too lenient to sqeeze the necessary wealth out of the Peruvian people. Furthermore, the banks were becoming increasingly aware of the public relations disaster they had created for themselves, as their direct involvement in monitoring Peru's economy was interpreted as "Wall Street Imperialism."[4]

Morgan Guaranty Trust (a member of the six-bank consortium) became the most vocal bank in arguing that they *should retire to their traditional seats in the wings and let the IMF get on with the job of doing the dirty work for them. The unsatisfactory experience of 'going it alone' in Peru did more than anything else to persuade the banks of the pivotal role of the IMF as the institution best suited to impose on debtor countries . . .those harsh economic conditions needed to ensure the profitability of the international banks.*[5]

Canadian bankers have come to echo this view. Consider, for example, the words of the vice-president for international operations of the Royal Bank:

There certainly is a need for (the IMF) to be in there as a lender and as a disciplinarian *and that's the thing all of us like about the IMF.*

They, perhaps like no one else, can make conditions on loans, which ensures some tightening of the belt.[6]

Similarly, the deputy chairman of the Bank of Nova Scotia asserts that the banks need the IMF as a back-up because:

. . .the use of 'conditionality' — seeking agreement with countries on programs to bring their financial houses into order — has proven virtually impossible for privately owned banks acting on their own.[7]

The chairman of the Bank of Montreal says

The more strings they [the IMF] have on their bow, the better.[8]

In the case of Peru a team from the IMF arrived in March of 1977 and quickly diagnosed Peru's problem as "a misallocation of resources caused by excessive state intervention."[9] The medicine it prescribed is a classic example of the conditions that the IMF attaches to most of its loans:

— harsh spending cuts in all public enterprises.

— an increase in petroleum prices.

— a sharp cut in purchases of machinery for public sector investment.

— elimination of all import quotas.

— a 30% devaluation of the currency.

— wage controls that would keep wage increases below the rate of inflation.

Popular resistance to the program of the banks and the IMF took the form of a general strike in June of 1977. Police and army units moved to crush the strike, killing ten workers. Hundreds were arrested and factory owners were allowed to dismiss some 6,000 strikers from their jobs.

Despite the popular protest, a "letter of intent" was submitted to the IMF by Peru's Finance Minister and the IMF agreed to a $100 million stand-by loan. The loan was to be released in bimonthly installments contingent on Peru meeting its targets for slashing its budget deficit and inflation. When Peru failed to meet these targets the IMF suspended payments, and private banks halted consideration of a $260 million loan which depended on the IMF giving its "seal of approval."

Negotiations with the IMF continued and in May of 1978 the government agreed to an even more drastic austerity package. The resulting doubling of prices for fuel, public transport, and basic food items such as milk and cooking oil led to street demonstrations in Lima where more than a dozen people were killed. Martial law was declared and hundreds of leaders from trade unions, slumdwellers and political parties were arrested and where possible deported. Nevertheless a successful two-day general strike shut down the country.

In the face of the riots and general strike the banks agreed to roll-over the principal on $200 million in loan repayments into new credits. Interest payments still had to be met and the deal was subject to yet another agreement with the IMF that brought further government cutbacks and another devaluation. At this point the governments of Western capitalist countries, acting through the Paris Club of government creditors, agreed to postpone 90% of Peru's official government-to-government debt.

The rescheduling and postponement did not solve Peru's debt problem. They only delayed the day of reckoning. The effects of austerity on working people are dramatically illustrated by the following account:

From 1975 to 1979, wage earners in Lima lost up to half of their purchasing power . . .unemployment stood at 10% and under-employment at 50% of the labour force. . .resulting in a reduction of calorie intake, a rise in infant mortality and a growth in reported cases of tuberculosis. . . .By 1979, Nicovita, a chicken feed containing a number of toxic substances but costing less than 9 pesos a kilo, was being eaten by [urban] squatters and peasants alike.[10]

In the 1980s Peru's debt crisis continues despite efforts by the Peruvian government to stimulate production for export and the inability of the majority of people to buy imported goods. Peru was hit hard by the Great Recession of the early 1980s brought on by monetarist policies in the principal capitalist countries. In 1981 high international interest rates meant that debt service payments consumed 62% of Peru's export earnings. The recession again reduced copper prices and Peru had to return to the IMF for yet more funding to keep up payments to its private creditors.

3.2 The Ideology of the IMF

Why do the conditions imposed upon debtor nations by the IMF always include policies of domestic austerity, such as cutbacks in government spending and restraints on wages? Why does the Fund insist on the elimination of import restrictions? Would it not be more logical for a country needing to conserve foreign exchange to halt non-essential, luxury imports?

Why does the IMF insist that prices be free to rise while wages are constrained? Why does it insist that foreign exchange controls be dismantled, allowing capital flight to continue, when indebted countries need desperately to stem this haemorrhage of wealth? Why does the Fund demand that state enterprises be dismantled while countries open themselves to private foreign investors, investors whose repatriation of profits will lead to a further net drain of wealth from the indebted nation?

The fundamental answer to all these questions has already been given, in Chapter 2. The IMF has always been the tool of its creators and masters, the ruling elites in the United States and their allies in Canada, Europe, Japan, and in the Third World. Their objectives, from the beginning, have been:

1) to control global production and trade;

2) to keep international capital flows free from government constraints.

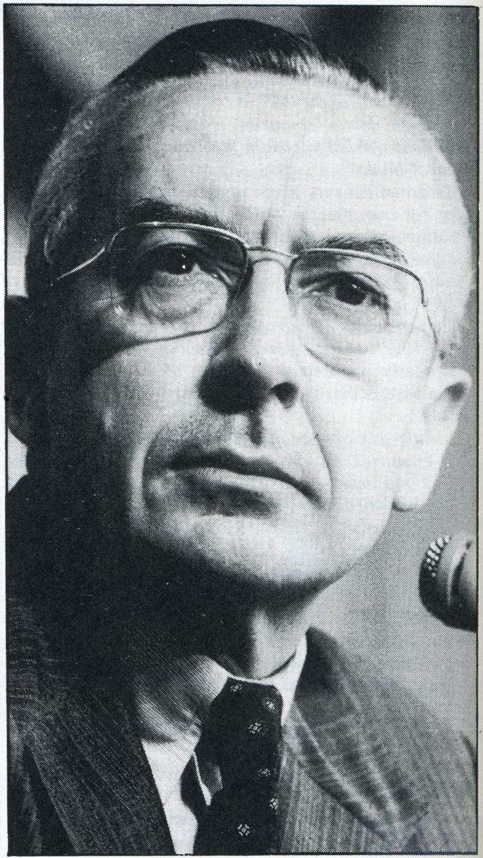
The first promises to deliver the world's wealth into their hands; the second gives them the power to move that wealth when and where they will.

The official ideology of the IMF has reflected most especially the ideology of those who rule in the U.S. It has continued to promote "laissez faire", an idealized freedom of the marketplace, as the golden rule, with profits and prosperity the just rewards for those who use their freedom well. Article One of the IMF Agreement states that the purpose of the Fund is "to facilitate the expansion and balanced growth of world trade" and asserts that unrestricted trade is the best route to the "maintenance of high levels of employment and real income." This Article also declares that the Fund's purpose is "to assist in the . . .elimination of foreign exchange restrictions which hamper the growth of world trade."

Negotiating teams of the IMF are bound by the terms of its Articles of Agreement. Although some IMF programs have during periods of emergency allowed foreign exchange and import controls, the direction of IMF policies is always towards their removal. There is a clear bias in these policies since the accompanying austerity of real wage cutbacks means that only the wealthy can buy most imports; and only the wealthy have capital to send abroad.

Instead of allowing direct controls on imports, the IMF requires that imports be reduced indirectly through the market-dependent mechanisms of currency devaluation — which makes imports more expensive — and programs of domestic austerity to reduce total demand. However, for underdeveloped countries which often have at best inadequate domestic substitutes for basic imports such as food, textiles, and industrial inputs, devaluation in the short run usually means higher, not lower, import bills. The consequence is greater inflation, and further downward pressure on real wages. The longer-term development of domestic substitutes for imports is at the same time frustrated by the IMF assault on local public investment. Foreign investors, the darlings of the IMF, have little interest in production for the home market.

The IMF also contends that devaluation promotes exports by making them cheaper in terms of other currencies, that is currencies used by foreign importers. One difficulty in this case is that raw materials exporters typically sell their goods at world prices, usually denominated in U.S. dollars, not at prices stated in the local currency. Local currency prices, and exchange rates, are therefore irrelevant to this type of export. Devaluation, and falling real wages, may enhance the competitiveness



IMF chief de Larosière

in world markets of domestic low-wage manufacturing industries, but not for long when similar policies are pursued in competitor nations.

Lowering real wages is an essential part of the Fund's formula for reducing "excessive demand", which it identifies as a principal problem in debtor countries. Not only is demand for imports said to be too high, but so is demand for domestic goods as well. Both high import bills and domestic inflation are said to be results of excessive demand.

The IMF's most recent device for lowering wages is to impose the monetarist solution of raising domestic interest rates. The resulting unemployment and underemployment is the precise opposite of the "high levels of employment and real incomes" promised in Article One of the IMF Agreement. While lowering real wages may result in a reduced overall import bill, it can do so only at terrible cost to the majority of the people and — if profits go up in response to lower wages — may actually raise luxury imports. Moreover, when accompanied by devaluation, domestic inflation may increase at the same time that real wages are falling.

The Fund's conditions are the opposite of the full-employment policies which were advocated by Keynes. The latter include the use of government spending and expansionary monetary policies to stimulate demand at home for domestically produced goods. These policies require nation states to plan their foreign trade and to control outflows of foreign exchange.

In contrast to any such notion of national self-reliance, the IMF insists upon keeping down real wages everywhere so that "everyone must become more competitive with everyone else."[11] The contradiction embodied in this game of 'competitive impoverishment' is that low-paid workers cannot afford to purchase most of the products either they or others produce. A cartoonist has captured this contradiction very well:

The competition for shrinking world markets is fierce. For example, sugar-exporting countries find themselves exporting their sugar at prices less than half their costs of production. Debtor governments end up subsidizing these exports at the expense of the rest of the domestic economy. For instance, in 1984 the Brazilian government spent over $100 million on subsidies for the sugar industry to bridge the gap between the 6¢/lb. world price and the 12¢/lb. domestic cost of production.[12]

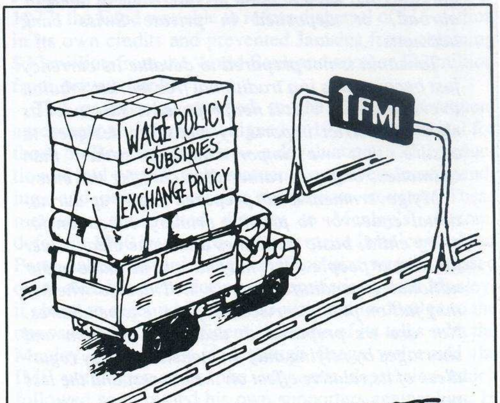
The logic of the IMF makes little sense when taken at its word. Greater indebtedness and economic ruin are the usual products of its policies for most people in borrowing nations, and not the opposite claimed by the Fund.

Its logic does *hold* together if we consider whom it serves. In countries where IMF conditionality rules, profits for both local ruling elites and for foreign investors often do rise, mainly in response to lower wages.

Furthermore, as Cheryl Payer points out,

It is an explicit and basic aim of the IMF programmes to discourage local consumption to free resources for export.[13]

The preference which foreign investors, and their domestic allies, have for exports to markets in developed capitalist centres is thus matched by an IMF depression of local markets. In addition, by encouraging foreign investment the IMF promotes greater foreign control over domestic production, over exports and imports, and over domestic surpluses. Removing foreign exchange controls increases the ease with which the resulting wealth can be safely, and irrevocably, funnelled abroad.



From the *Gazeta Mercantil.*

All of this could help a country meet its debt payments in the short term, were enough new capital to arrive in the form of added foreign investment and were exports actually to gain over imports. However, the prospects for an improved trade balance under an IMF regime is at best uncertain, as we have seen. As regards new foreign investment, the present erosion in world markets, and the global recession, makes a major influx of capital into any debtor nation unlikely. Even were this to happen, the recipient nation would merely exchange loan debt for the debt of foreign ownership. In either case, **maintaining** debt bondage, not ending it, are part of the IMF program.

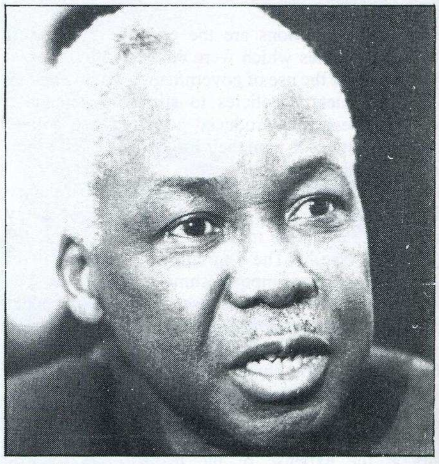
Tanzania President Julius Nyerere Says "No to IMF Meddling"

We expected [the IMF's] conditions to be non-ideological, and related to ensuring that money lent to us is not wasted, pocketed by political leaders or bureaucrats, used to build private villas at home or abroad, or deposited in private Swiss bank accounts. . .

Tanzania is not prepared to devalue its currency just because this is a traditional free market solution to everything. . . .It is not prepared to surrender its right to restrict imports by measures designed to ensure that we import quinine rather than cosmetics, or buses rather than cars for the elite.

My government is not prepared to give up our national endeavor to provide primary education for every child, basic medicines and some clean water for all our people. Cuts may have to be made in our national expenditure, but we will decide whether they fall on public services or private expenditures. Nor are we prepared to deal with inflation and shortages by relying only on monetary policy regardless of its relative effect on the poorest and the less poor. . . .

[The IMF] has an ideology of political and social development which it is trying to impose on poor countries irrespective of their own clearly stated policies. And when we reject IMF conditions we hear the threatening whisper: "Without accepting our conditions you will not get any money, and you will get no other money."[14]



Julius Nyerere

I believe that these institutions, originally meant as institutions of co-operation among the developed countries, are now being used as instruments of control over the developing countries. They have become instruments for a new kind of empire.[15]

3.3 The U.S. Veto and Political Dominance

The U.S. holds dominion over the IMF through a system of weighted voting, in which votes are assigned according to the relative economic size of member countries. The U.S. has always had the biggest single block of votes. It is true that the voting shares of other capitalist and major oil exporting countries have increased relative to the U.S. with recent reviews of country quotas; but the shares of all other nations have decreased.

A related advantage enjoyed by the U.S. and a select circle of friends is their position as permament members of the IMF's Executive Board. The Board has six permanent members — the U.S., Britain, West Germany, France, Japan, and Saudi Arabia.

At the beginning of 1984 the voting shares of various country groupings were as follows:

1) industrial capitalist countries, 60.4%, of which the U.S. held 19.2%;

2) major oil exporters, 11.4%;

3) all other countries, 28.1%.[16]

Because major decisions require either 70% or 85% of the total votes, the United States together with a few of its western allies, e.g. Canada, can veto any attempt to change the basic rules and procedures of the IMF.

The degree of severity with which IMF conditions are applied, as well as decisions about who receives IMF credits, and when they are granted, are frequently determined by the political priorities of the capitalist powers who control the Fund. One study of the political use of IMF credits notes:

In practice there are considerable inequalities of treatment, affecting perhaps a quarter to a third of all agreements. The stringency of policy conditions will in practice often depend upon whether the government which has applied for the credit has powerful allies within the Executive Board. . . .Vietnam has been prevented from obtaining a credit altogether because of a **de facto** *US veto. Among countries widely regarded as having benefited from influential patronage are Pakistan, Yugoslavia, Turkey, Liberia and Zaire.*[17]

Among the more blatant examples of the political use of the IMF have been loans to El Salvador and to the Somoza regime in Nicaragua. In 1981 the U.S., with support from Canada, pushed a loan for its allies in El Salvador through the Executive Board of the IMF. European members objected that the Fund's own staff had recommended against the loan because conditions in El Salvador were so unstable that it was impossible to make a realistic projection of future export earnings.[18] Similarly, in the spring of 1979, just as the dictatorship was tottering in Nicaragua, the IMF approved a $60 million loan which Somoza promptly deposited in his overseas bank accounts.

The Sandinistas had implored the IMF not to make the loan, but to no avail. When they took power nine weeks later they inherited this debt, which they pledged to honour despite the fact that the money had been stolen by Somoza. This incident strengthened the resolve of the Sandinistas to exclude the IMF from the re-negotiations of all the debts left by Somoza.

(The successful re-negotiation of $582 million of Nicaraguan debts with private creditors in 1980 took place without acceptance of IMF conditions. The banks concerned, of course, treated Nicaragua as a special case, knowing that the U.S.'s inept effort to prop up Somoza with IMF credits weakened their own negotiating position. By 1984 most of these creditors had begun writing off their Nicaragua loans as the result of the U.S. campaign to ruin the Nicaraguan economy.)

The IMF helps poor countries. . .to become poorer.

In Chapter 2 we referred to a Reagan hit list, countries which the U.S. is determined will get no assistance from the IMF or other multilateral financial institutions. The existence of this list was first revealed in 1983. Grenada was on the list, despite glowing reports from the staff of the World Bank on the successful economic policies of the New Jewel Movement under Prime Minister Maurice Bishop. These policies, based upon a form of national self-reliance, were anathema to the U.S. government. This was apparent from a variety of U.S. moves to undermine the Grenada economy under Bishop. The U.S. fear of Grenada's success was a principal motivation behind its later invasion of the island.

On occasion the U.S. has used its power to keep countries under the wing of the IMF. For example, in March of 1984 Nigeria's Foreign Minister told the *Financial Times of London* that the U.S. government had withheld from Nigeria some $70 million in credits for wheat purchases "specifically until the new government had reached agreement with the IMF."[19]

Another case of political interference through the IMF is its role in the defeat of the social democratic government of Michael Manley in Jamaica. By failing the Jamaican government on a technicality[20] in December of 1977, the Fund was able to refuse dispersal of $15 million in its own credits and prevented Jamaica from obtaining $30 million from the World Bank and another $32 million from private banks.[21]

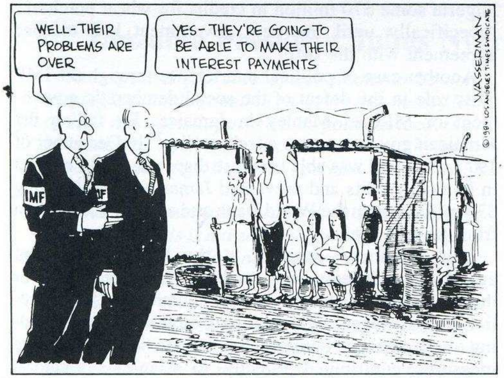
The conditions attached to the IMF's subsequent agreement with Jamaica, signed in 1978, were typical for those on Reagan's hit list — a devaluation, a 25% reduction in real wages, tight restraints on government spending, and policies favoring the private investor. These measures contributed directly to Manley's electoral defeat in 1980 by the pro-free enterprise Jamaican Labour Party under Edward Seaga. IMF politics were expressed quite clearly when, during its negotiations with Manley, it chose to meet with Seaga as well and to divulge to the opposition leader confidential details of its talks with the Manley government.[22] Although Seaga welcomed the IMF with open arms, the economic depression which followed soon turned his own supporters against him. In June of 1985 a one week general strike was called by six unions, including Bustamante Industrial Trade Union, an affiliate of Seaga's Jamaica Labour Party.

3.4 The IMF Fails Its Own Tests

The experience of the Seaga government in Jamaica is instructive because it shows how IMF policies fail the Fund's public criteria for success, even with maximum cooperation from the borrower. After the 1980 election Seaga moved quickly to apply the "Puerto Rican" strategy of export-led growth and openness to foreign capital. He immediately set out to reduce state spending by laying off hundreds of public employees and privatizing nationalized industries. He removed restrictions on foreign trade and took down tariff barriers, prompting the Jamaican Manufacturers' Association to complain that the free flow of imports "meant the death knell for local industry" as many of its members faced bankruptcy.[23]

Seaga's voluntary surrender of the Jamaican economy to foreign interests earned him $698 million in new credits from the IMF on what appeared to be very lenient terms. In fact Seaga had already complied with the IMF's wishes and the only new conditions seem to have been the implementation of public sector wage controls and the removal of half the items from the government's price control list.

By 1983 it had become clear that the voluntary swallowing of the IMF's standard medicine had not put the Jamaican economy on the road to recovery. Only 3,000 of the 90,000 new jobs that were supposed to be created by private investment had materialized. Average incomes had fallen further, but then this was intended. Not in-



tended, at least officially, was the increase in Jamaica's trade deficit, up 47.6% in 1982 following the dismantling of import controls. New foreign loans were spent on imported consumer goods. Jamaica's foreign debt rose from $1.6 billion at the end of 1980 to $2.3 billion in 1983, and to $3.2 billion at the beginning of 1985. On a per capita basis the debt in 1983 was as large as Mexico's.

In April of 1983 the IMF again suspended disbursements to Jamaica and demanded another round of austerity measures involving more cuts in government spending and more price increases. Despite the public failure of earlier doses of this same medicine, the IMF did not alter its prescription.

In June of 1985 the Jamaican trade unions launched a general strike to protest the failure of Seaga's strategy. He had put his faith in luring foreign private investment with the promise of preferential access to the U.S. market under President Reagan's Caribbean Basin Initiative. Instead there had been a net outflow of capital from Jamaica, both to pay for imports into Jamaica's unprotected market and capital flight into high interest U.S. government bonds.[24]

Do IMF programs regularly fail to produce balance of trade surpluses, or at least produce net influxes of capital through new foreign investment? Do they usually fail to bring the "high levels of employment and real income" promised in Article One of the IMF Agreement?

John Loxley has surveyed several studies on the effectiveness of IMF programs as well as conducting his own enquiry into the effects of IMF conditionality on the least developed countries. He reports that:

Most studies conclude that IMF programs have at best only a modest positive short-run impact on a country's balance of payments, are associated with deteriorating inflation records and in general are as likely to reduce growth rates as to raise them.[25]

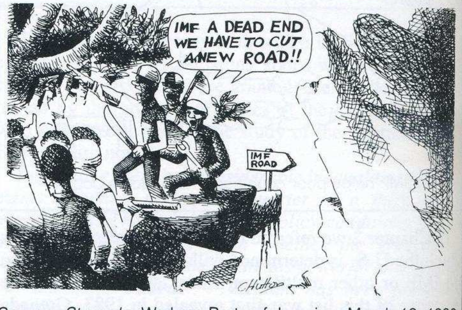
Loxley argues that a recent study being used by the IMF to defend the success of its programs[26] contains a high degree of bias because it examined only a narrow range of countries and covered a period of expansion in the world economy which is no longer relevant.[27] Expanding exports under present global conditions is a great deal more difficult, no matter how low the asking price of exports from a particular country. For all 63 countries which had to borrow from the IMF in 1983 to succeed at the game of competitive impoverishment is impossible.

3.5 The IMF Action in Brazil

A brief review of the IMF's history in Brazil will help illustrate the point that the logic of the IMF is, in the final analysis, "the logic of world capital."[28]

Among the people of that country the awareness of the debt issue is very high. Journalist Penny Lernoux reports that labourers there can cite exact figures of Brazil's debt to each U.S. bank.[29] Hostility toward the IMF is deeply ingrained in the popular consciousness. In the late 1950s President Kubitschek won wide popular acclaim by breaking off negotiations with the IMF. One of the factors precipitating the military coup d'etat of April 1964, was President Goulart's inability to come to terms with a mission from the IMF.

Goulart had incurred the wrath of U.S. investors by signing a Profit Remittance Law, limiting the amount of profit they could take out of Brazil, and by nationalizing all private oil refineries in the country. His plans for land reform, in response to the growing mobilization of peasants, enraged the landed oligarchy who grow coffee and sugar for export. These foreign and domestic opponents became supporters of the military coup.



Source: *Struggle,* Workers Party of Jamaica, March 13, 1980.

The U.S. had cut off aid to Goulart after his government's negotiations with the IMF broke down. The main obstacle seems to have been his concession of wage increases demanded by workers in the public sector. Four days after the coup the *New York Times* dismissed Goulart as "an obstacle to the negotiation and extension of Brazil's towering debt."[30] U.S. aid resumed and within months the new military rulers had signed an agreement with the IMF. The result was an economic depression which lasted until 1967.

After that Brazil experienced several years of rapid growth, the so-called "economic miracle," engineered by

Table 3
Brazil's External Debt 1970-1983

Year	Gross External Debt (U.S.$ billions)	Debt Service Ratio (Interest + Principal as a % of Exports)
1970	$5.3	54%
1971	$6.6	58%
1972	$9.5	58%
1973	$12.6	42%
1974	$17.2	33%
1975	$21.2	42%
1976	$26.0	48%
1977	$32.0	51%
1978	$43.5	64%
1979	$49.9	70%
1980	$53.8	65%
1981	$61.4	67%
1982	$86.9	88%
1983	$93.1	52%

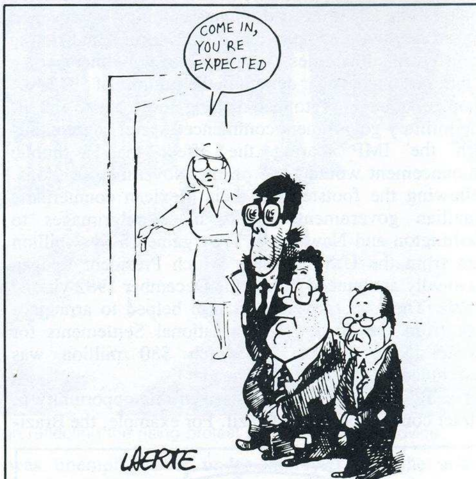
Sources: 1970-1981, Banco Central do Brasil;
1982-1983, Morgan Guaranty Trust.

Planning Minister Delfim Netto. Netto opened the country to multinational investment and proclaimed his intention "to make foreign debt an integral component of our development strategy."[31] Netto's strategy was to integrate Brazil with the rest of the capitalist world.

For the workers and peasants of Brazil Netto's strategy led to an extremely unequal polarization of wealth within the country. From the point of view of multinational corporations and banks, Brazil became a very profitable place to invest. Over the years 1968 to 1974 Brazil's Gross Domestic Product grew by an average of 10% per year. Over the same period the external debt grew by an average of 29% per year. The inevitable strain inherent in trying to make payments on such a rapidly expanding debt soon caught up with Brazil.

As Table 3 shows, by 1982 Brazil was having to spend 88% of its export earnings just to pay the interest and principal on its long-term debts. If short-term debts are included, this figure rises to 141.5% of export earnings in 1982.[32] The payments due could be met only through new borrowing.

In an attempt to cope with this growing debt storm,



Former Central Bank president Carlos Langoni, planning minister Antonio Delfim Netto and finance minister Ernave Galveas are back in the bankers' offices, asking for more.

Table 4: Income Levels in Brazil

Figures released by the official Brazilian Institute of Geography and Statistics show how desperate the economic situation is becoming for Brazilian workers — and a big reason more than 600 U.S. and Canadian multinationals now operate in Brazil:

Income Brackets (Minimum Wages*)	US$ Equivalent (Monthly#)	Percentage of Population 1980	1981	1982
Up to 1 Min. Wage	under $59	34.2%	32.1%	40.8%
1-2 Min. Wages	$59 - 118	30.4	28.5	27.4
2-5 Min. Wages	118 - 295	23.6	26.2	21.3
5-10 Min. Wages	295 - 590	7.0	8.1	6.6
Over 10 Min. Wages	over $590	4.6	4.9	3.5

Share of National Income

	1960	1970	1980
Poorest 50%	17.4%	14.9%	12.6%
Richest 10%	39.6	46.7	50.9

*Brazilians measure wage levels with reference to the government-set minimum wage, rather than to money amounts.
#Wages are set at a monthly rate. The standard work week in Brazil is 48 hours, not 40.
Source: Brazil Labour and Information Resource Centre

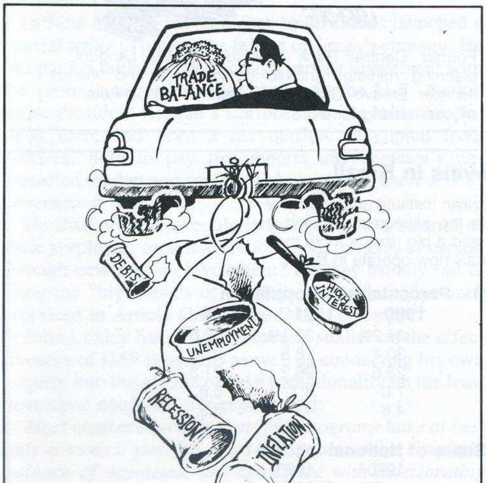
Brazil instituted its own austerity program in 1979. It included a 30% devaluation, cuts in government spending, and reduced subsidies to domestic industries. The conservative British journal, *The Economist*, commented that "Brazil has swallowed most of the IMF medicine without calling in the doctor."[33] A year earlier *The Economist* had warned:

The international banking system should start girding its loins for the possibility that it may never see some of the money it has splashed out to Brazil.[34]

The self-imposed austerity impressed the international bankers enough to keep the loans coming. However, it caused massive unemployment inside Brazil and rioting occurred in some cities in response to price increases.

After Mexico's near default in the summer of 1982 (see Chapter 4), bankers stopped making new loans to Brazil. The military government commenced secret negotiations with the IMF fearing the effect that a public announcement would have on the November elections. Following the footsteps of their Mexican counterparts Brazilian government leaders made pilgrimages to Washington and New York. They gained a $1.2 billion loan from the U.S. Treasury which President Reagan personally announced during his December 1982 visit to Brazil. The U.S. government also helped to arrange a loan from the Bank for International Settlements for another $1.2 billion, of which $80 million was guaranteed by the Bank of Canada.

The Reagan administration seized this opportunity to extract concessions from Brazil. For example, the Brazilians were forced to open their domestic computer market to U.S. companies. The Reaganites also demanded that Brazil support their policies in Central America.[35]



A humorist's view of the consequences for the Brazilian economy of economic policies devoted to satisfying the IMF and international bankers.

The visits to New York included meetings with representatives of 125 of Brazil's leading commercial bank creditors. At the time Brazil owed commercial banks about $60 billion, of which one-third was owed to U.S. banks and about $4.5 billion to Canadians. The IMF surprised the bankers, telling them that their co-operation was essential for the rescheduling of Brazil's debt. They were told that "Brazil is too big for the IMF."[36]

By the end of 1982 Brazil had in fact rescheduled $4 billion in bank loans and there were hints that a full moratorium on interest and principal payments might follow. Finally, in early 1983, the complete package was in place including the rescheduling of $4.7 billion in old loans, new credits worth $4.4 billion from the banks, and $5.4 billion from the IMF.

All of this, of course, was contingent on Brazil adhering to the conditions set down in a letter of intent signed with the IMF. This proved to be the first of seven such letters signed over the next two years. Although these letters are not made public, their contents soon became known.

According to the monetarist version of IMF conditionality, they set out targets for:

— reducing the government deficit through spending cuts.

— lowering the rate of inflation by reducing the rate of growth in the money supply.

— increasing the trade surplus to $6 billion in 1983.

— eliminating controls on foreign exchange (in this case it meant ending restrictions on the ability of multinational corporations to remit royalty and dividend payments abroad[37].

Whenever Brazil failed to meet the targets set out in the letters of intent the IMF would suspend disbursements and send another mission to negotiate a new agreement. When it became apparent in 1983 that Brazil was not going to meet its targets, the government took more drastic action. It devalued its cruzeiro by a further 30% on top of its regular "mini-devaluations" and introduced a draconian program of wage restraint. Decree Law 2045 would have limited all wage increases to 80% of increases in the Consumer Price Index (which had already been manipulated to reflect less than the true rate of inflation).

The IMF program depended on the passing of this law. Workers across the country mobilized against it. A 24-hour general strike was organized in Sao Paulo. Sugar workers in the Northeast successfully won a full cost of living adjustment despite the resolve of the landowners, the government and the IMF to roll back their wages.[38] In the face of unprecedented opposition in Congress the government had to withdraw the law. Eventually another, somewhat less harsh, law was pushed through. Nevertheless the popular mobilization against the government and the IMF had demonstrated to both the military and the civilian politicians the growing strength of the trade unions, opposition parties and allies in the churches.

Massive popular protests against the IMF occur because people know the consequences of the austerity demanded by the IMF. Crowds of demonstrators shouted the Portugese initials for the Fund — FMI — which they say also means Fome, Miseria, Inflaçao, that is, Hunger, Misery, Inflation.

Between the beginning of the self-administered IMF medicine in 1979, and early 1985, the prices of basic foods in Brazil skyrocketed:

— rice rose by 21,552%.
— beans (the staple food) rose by 15,809%.
— cooking oil rose by 21,975%.
— milk rose by 21,507%.

Over the same period the minimum wage, on which almost half of Brazil's population subsists, rose by 10,577%, an enormous increase in money terms but roughly half the increase of the basic foods listed above.[39] One Brazilian journalist observed that "Even when there was slavery in Brazil, the value of work in terms of goods was not so low."[40]

Over the years 1977 to 1984 food production in Brazil declined by 15%. Part of this decline was a direct result of the use of scarce government funds to subsidize export crops at the expense of production for the domestic market (for instance the sugar subsidy mentioned earlier).

In a July, 1984, report on IMF policies in Brazil, Morgan Guaranty Trust applauds the fall in real wages:

Wage policy has undergone ***a significant change for the better, and now that real wages have declined****, the rise in labour costs is no longer a contributing factor to inflation. . . .The change in wage policy has been instrumental in reducing current government spending. . . .Wages paid by industry in Greater Sao Paulo (where 28% of production is for export) lagged the local cost of living by 8% in 1983 and may have fallen an additional 15% since December [1983].*[41]

During 1983 Brazil did manage to increase exports and restrain imports, recording an unprecedented trade surplus of $6.5 billion. This was $500 million above the target set by the IMF. But the domestic consequences of this effort were devastating. Industrial investment fell by 40% and unused capacity exceeded 50% in some industries.[42] This was accompanied by large-scale unemployment. In December of 1983 it was estimated that more than a quarter of Brazil's work force of 49 million was unemployed or under-employed. For the under-employed, family income was below the equivalent of one full-time minimum wage, then about $66/month.[43]

"Out with the IMF! Support National Sovereignty" A Sao Paulo sign reflecting the rising protest against outsiders' advice

Despite the huge trade surplus, and the suffering entailed in getting it, this was not enough. The value of interest and principal due on the external debt was greater. Interest alone in 1983 was $9.6 billion, $3.1 billion more than the trade surplus.

An even greater surplus was sought by the Brazilian government in 1984, and it was acheived — some $12 billion. The target for 1985 has also been set at $12 billion. However, even if realized, this surplus is expected to cover in 1985 the interest due only.

The Brazilian Institute for Economic and Social Analysis sums up the logic of the IMF in Brazil with these observations:

The recessive policy imposed by the IMF. . .is only recessive for the sectors that produce predominantly for the internal market. Therefore it's called a 'policy of austerity'. Workers and consumers, small and medium businesspeople, are called on to tighten their belts. . . .In truth only 20% of the population even have belts to tighten.

The export sectors, on the contrary, receive stimulus and incentives of every type. . . .The dollars they earn are first of all intended for paying interest to the creditor banks. Only secondly can they be used for the import of *essential products for the survival of an economy becoming so dependent on the outside.*

This combination of ***reduction of the internal market and expansion of the external market*** *is only possible through a transfer of resources from one sector to the other. This means that Brazilians have to cut back on necessities so that Brazil can feed. . .the fortunes of the great banks.*[44]

Chapter 7 gives details of the alternatives to IMF policies being developed and supported by popular groups in Brazil. One element in these alternatives is usually a moratorium on debt payments, accompanied by political negotiations — i.e. government to government — to deal with the unacceptable burden of present indebtedness. This is supported by Celso Furtado, who was Minister of Planning in the last civilian government before the 1964 coup. In an influential book *No To Recession and Unemployment*, Furtado states why he feels this is necessary:

In the first place we must break away from the guardianship of the International Monetary Fund, and, secondly, decide to what extent Brazil will honour its foreign [debts]. . . . The IMF in itself is not important, as the resources it provides are modest. . . .It has turned into an instrument through which. . . countries are forced to deepen the internationalization of their economies so that they cease to be controlled domestically and become mere extensions of the international market. It is for this reason that Brazil is being asked to dismantle part of its industrial sector, particularly in the capital goods area, which is considered 'disproportionately large'. Now, with world trade declining or stagnating and with the present situation of excessive indebtedness, to demand that Brazil open up its economy is to condemn the country to a recession of indeterminate length.[45]

Notes to Chapter 3

1. American Friends Service Committee, "Hunger and Debt in Brazil," Philadephia, July, 1984.
2. Duncan Cameron, "Order and Disorder in the World Economy," *Studies in Political Economy*, No. 11, Summer 1983.
3. See GATT-Fly, "Reflections on UNCTAD IV," September, 1976.
4. R. Andrew Nickson, "Peru: The Bankers Go It Alone," in M. Honeywell, et al., *The Poverty Brokers: The IMF and Latin America*, Latin American Bureau, London, p.78.
5. *Ibid.*, p.78.
6. *Globe and Mail*, Toronto, Jan. 16, 1982, p.B1. Emphasis added.
7. *Ibid.*, Dec. 15, 1982, p.B2.
8. *Ibid.*, Jan. 16, 1982, p.B1.
9. Nickson, *op. cit.*, p.78.
10. *Ibid.*, p.82.
11. Teresa Hayter and Catharine Watson, *Aid: Rhetoric and Reality*, Pluto Press, London, 1985, p.56. Citing a British government official.
12. *Latin America Weekly Report*, 1 Feb., 1985, p.11.
13. Cheryl Payer, *The Debt Trap*, Penguin, Markham, 1974, p.32.
14. Hayter and Watson, *op. cit.*.
15. *Ibid.*.
16. Deborah M. R. Coyne, *Monetary and Financial Reform*, The North-South Institute, Ottawa, 1984, Table 3.1, p.22.
17. Hayter and Watson, *op. cit.*, pp.47-48.
18. Martin Honeywell, et al., *The Poverty Brokers: The IMF and Latin America*, Latin American Bureau, London, 1983, pp. 45-47.
19. Celso Furtado, *No To Recession and Unemployment*, Third World Foundation for Social and Economic Studies, London, 1984, p.xv.
20. The Bank of Jamaica was said to have failed the IMF's target for restraining domestic credit when its net domestic assets exceeded the IMF-imposed ceiling by just 2.6%.
21. Hayter and Watson, *op. cit.*, pp.48-49.
22. Winston James, "The IMF and Democratic Socialism in Jamaica," in Honeywell, et al., *op. cit.*, p.102.
23. *Ibid.*, p.107.
24. *Toronto Star*, June 9, 1985, p.H6.
25. John Loxley, "Saving the World Economy," *Monthly Review*, September, 1984, p.31.
26. Donal J. Donovan, "Macroeconomic Performance and Adjustment Under Fund Supported Programs: The Experience of the Seventies," *IMF Staff Papers*, Vol. 29, No. 2, June, 1982.
27. John Loxley, *The IMF and the Poorest Countries*, The North-South Institute, Ottawa, 1984.
28. Marco Antonio de Souza Aguiar, et al., *Ditadura Economica versus Democracia*, Instituto Brasileiro de Analises Sociais E Economicas (IBASE), Rio de Janeiro, 1983, p.129ff.
29. Penny Lernoux, *The Banks We Trust.*, Anchor Press/Doubleday, New York, 1984, p.225.
30. Payer, *op. cit.*, p.155.
31. *Ibid.*, p.164.
32. Morgan Guaranty Trust, *Morgan International Data*, June, 1984, Table A-10.
33. *The Economist*, Sept. 19, 1981.
34. *Ibid*, May 17, 1980.
35. *Manchester Guardian Weekly*, Dec. 12, 1982; and *Wall Street Journal*, June 17, 1983, p.2.
36. *Latin America Weekly Report*, 27 Feb. 1981, p.8.
37. *Ibid.*.
38. See "300,000 Brazilian Sugar Workers Seek International Solidarity," International Commission For the Coordination of Solidarity Among Sugar Workers (ICCSASW), Toronto, September, 1983; and *Sugar World*, Vol. VI, No. 3, ICCSASW, Toronto, October, 1983.
39. *Latin America Weekly Report*, 22 March, 1985, p.12.
40. Bernardo Kucinski, Interview on *Sunday Morning*, CBC Radio, Oct. 2, 1983.
41. Morgan Guaranty Trust, *World Financial Markets*, July, 1984, pp.1 & 7. Emphasis added.
42. Marco Antonio de Souza Aguiar, et al., *op. cit.*, p.113.
43. Edward Boyer, "Why lenders should still be scared," *Fortune*, Dec. 12, 1983, p.128.
44. Marco Antonio de Souza Aguiar, et al., *op. cit.*, p.131. Emphasis in original.
45. Furtado, *op. cit.*, pp.3-4.

Chapter 4
The Banks' Agenda

Latin America is an interesting exercise, and don't try to pin me down too closely. We in the Royal Bank have been operating in Latin America for 70 or 80 years and I can tell you that we've gone through numerous overthrows, changes of government, some quite radical.

And most governments, whatever their political colour, extreme left or right, tend to be reasonably good managers and recognize their international obligations.... not only past, but future [obligations] and will, for lack of a better term, play the game.[1]

a vice-president of the Royal Bank of Canada

4.1 Loans Recycled, Not Repaid

The private banks like to give the impression that they are unperturbed by the debt crisis. They behave this way because the entire banking system ultimately rests upon an intangible commodity called "confidence". The last thing the banks want is to scare people into thinking that their money is not safe. Thus most statements from bankers exude confidence.

Even though many countries cannot make their debt payments, bankers these days are very reluctant to declare any sovereign loan in default. In fact, as Cheryl Payer explains, "the very last thing international bankers want is to admit that their multi-billion dollar loans to Brazil, Mexico or Poland are down the drain. By declaring a default they would relinquish their chances of recovering all but a small fraction of their investment, and the default of a really large debtor country might well bring down a major bank or two with it, setting off a chain reaction of default — as in 1931."[2]

If any one bank declares a loan in default it then triggers the "cross-default" clauses written into most international loan agreements, forcing a scramble among creditors to seize whatever assets the debtor country might have outside its borders. However, most nations have few assets abroad.

One exception was the Iranian default which occurred in the midst of the "hostage crisis" at the U.S. Embassy in Tehran. This default was initiated not by the Ayatollah Khomaini's regime, nor by the Carter Administration, but by the Chase Manhattan Bank. Chase wanted to seize the $400 million which the Shah had deposited in its London

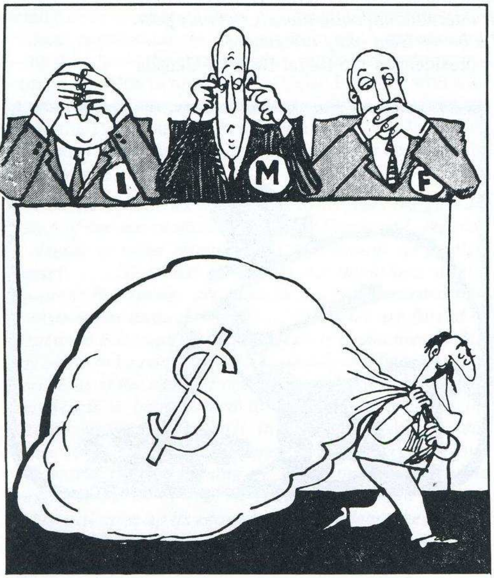
Table 5
Outstanding Loans by Canadian Banks to Latin America
($ million Canadian)

	Mexico	Brazil	Venezuela	Argentina	All Latin America
Royal Bank	$1,328	$1,075	$650	$400	$4,203
Canadian Imperial Bank of Commerce	$940	$934	$250	$270	$2,754
Bank of Montreal	$1,495	$1,598	$552	$296	$4,167
Bank of Nova Scotia	$941	$726	$506	$275	$3,087
Toronto-Dominion	$822	$712	$288	$150	$2,146
National	$543	$545	$145	$159	$1,733
Totals	$6,069	$5,590	$2,391	$1,550	$18,090

Sources: 1983 Bank Annual Reports; and Economic Council of Canada, Twenty-First Annual Review, 1984, Tables 4-6, p.61.

branch before the new Iranian government could withdraw it.[3] This amount nicely covered the $366 million that Chase had on loan to Iran. Once Chase moved then other banks followed, setting off an endless round of courtroom battles over the control of Iran's foreign assets.

When the Carter Administration froze Iran's assets on Nov. 14, 1979, U.S. banks held $6.2 billion in Iranian deposits, of which $4 billion were in their overseas branches. Total bank loans outstanding to Iran were worth $3.7 billion, considerably less.



Even most oil exporters today do not have the kind of bank balances piled up by the late Shah. Now, when a country falls behind on its debt payments, the banks almost always agree to renegotiate its loans. And they must do so quickly. Under U.S. law, after 90 days a loan that is not receiving interest has to be classified as "non-performing" and losses must be recorded on the banks' books.

A senior vice-president of Citibank explains:

If someone runs out of money and one knows he's run out of money, then there is going to be a ***de facto*** *moratorium for a while. And up to now, all the parties have sat around the table and tried to work out where you go from there. . .*

I think a lot depends on the spirit in which all of this is done. . .

If you're meaning a more aggressive thing. . .where the parties involved don't really seem to be looking for a solution, then it becomes more difficult to picture what will happen. I'm not sure that the sequence of events after that would be very rational.[5]

Vocabulary of the Debt Crisis

Sovereign Loans — Loans to national governments, or loans whose repayment is likely to be protected by national governments.

Default — Loosely defined, means any failure to meet debt service payments. More strictly, a default only occurs when a creditor takes legal action over arrears in payments. This seldom happens on international loans because *cross default* clauses in debt contracts mean that once one creditor declares a loan in default then other loans are automatically also declared in default.

Repudiation — A declaration by a debtor country that it won't pay its debts. A repudiation would force creditors to declare loans in default and would prompt retaliation in the form of refusal of any new credits or seizure of any assets the country held abroad. These might be foreign bank accounts, cargos of export products, or airplanes from its national airline. However, as Cheryl Payer explains, "these days it is not necessary to take the drastic step of repudiation to obtain many of its benefits. Why risk retaliation with 'we won't pay' when a polite telex saying 'we can't pay' will achieve the same results without incurring severe retaliation?"[4]

Moratorium — A temporary suspension of debt payments by a debtor who does not repudiate but promises payment at a later date. A country may formally declare a moratorium, or, more commonly these days, drift into an unofficial moratorium by missing payments, but, when creditors make urgent enquiries, promise them for some future date.

Renegotiation, Restructuring, Rescheduling, Refinancing, Roll-overs — These words are often used interchangeably to describe any new agreement reached by creditors and debtors which changes the original terms for loan repayment. Used properly, refinancing does have a somewhat different meaning, implying that new loans are part of the new repayment package.

Grace periods — When only interest is paid, but not principal.

Maturities — The period over which repayment is to be completed.

Spreads — The amount of interest to be paid above the going base rate, which base may be either:

a) the *U.S. prime interest rate*, the rate at which U.S. banks lend to their "best" customers (in fact many corporations obtain loans at rates below prime); or

b) *Libor*, the London Interbank Offered Rate, the rate at which banks lend money to each other on the international market.

The terms of these renegotiations have recently been changing as part of a wider divide and rule strategy, designed to prevent joint action by the debtor countries. Ultimately the goal of this strategy is to allow the banks to continue collecting interest payments over the longest term possible, in effect making the debt bondage permanent.

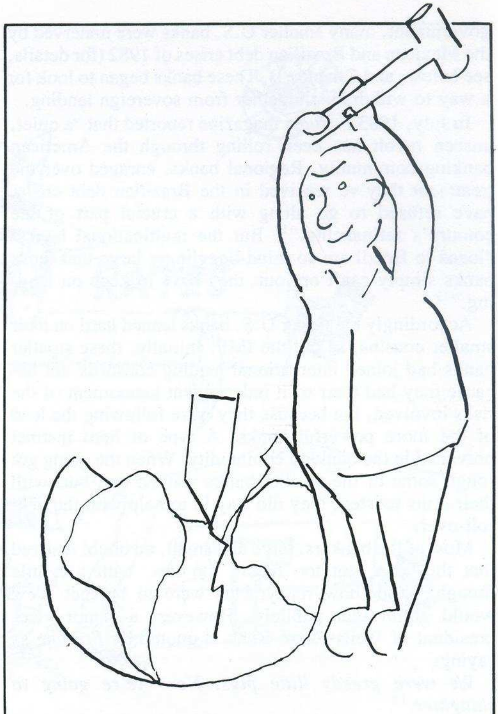
As long as the bankers can collect the interest due, they don't mind rolling over the principal on sovereign loans. As one U.S. banker told the *International Herald Tribune:*

No one [in the banking community] wants their money back. It would only have to be relent. And at least we're earning a sensible margin on it. Why should I take a loss? My bank is not squeezed for liquidity. Yes, we've lost the flexibility about where we might have directed the repayments, had they been made, but we're earning more money.[6]

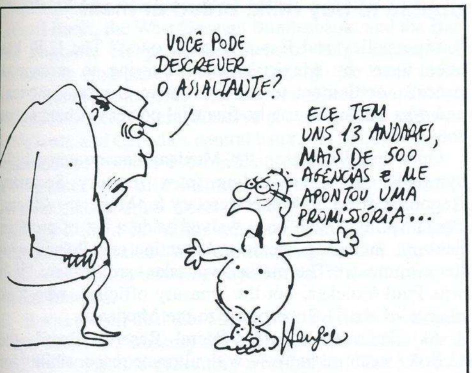
However, as we have already noted, sovereign debtors are having increasing difficulty paying even the interest on outstanding loans.

Debt renegotiation has never been a pleasant experience for the debtor. Lenders have traditionally used this process to drive hard bargains and increase their profits. Until very recently renegotiations usually involved higher 'spreads' (see *Vocabulary of the Debt Crisis)* than the original loans, with relatively short maturities of 5 to 8 years, and special fees which "made it attractive" for bankers to embrace the new deal. One bank stock analyst explained that these fees were necessary to impose some "discipline" on borrowers.[7]

For example, when Mexico rescheduled $19.7 billion worth of loans at the end of 1982 the bankers collected a 1% rescheduling fee worth $197 million.[8] In addition, Mexico had to pay interest rates set a 1&7/8% above Libor or 1&3/4% over U.S. prime. These spreads were about three times as great as those Mexico was paying on the Euromarket at the end of 1981.



Divide and rule



"Can you describe your assailant?"
"It had 13 stories, more than 500 branches and it hit me with a promisary note."

Brazil was forced to pay a fee of 1&1/2% on its rescheduling of $4.7 billion in 1983, plus a spread of 2&1/2% over Libor or 1&7/8% over U.S. prime. The combination of higher spreads, added fees, and a full rebate on a withholding tax meant that banks could earn a full 3% more on renegotiated loans to Brazil than they could on other credits. This situation prompted a Brazilian finance ministry official to comment:

The banks have tasted human flesh and will not give up the habit readily.[9]

More important still is the fact that each of these renegotiations is dependent on the debtor nation signing a letter of intent with the IMF. The United Nations Economic Commission for Latin America has examined closely the letters of intent signed with the IMF by thirteen Latin American countries during 1982 and the first half of 1983.[10] In every case these programs set out explicit targets for reducing government spending and limiting the expansion of domestic credit, just as we would expect from the IMF. More interesting here is the fact that in six cases the IMF explicitly demanded that countries resume delinquent debt service payments to commercial creditors.

Despite the intervention of the IMF and even the U.S.

government, many smaller U.S. banks were unnerved by the Mexican and Brazilian debt crises of 1982 (for details, see below, and Chapter 3). These banks began to look for a way to withdraw altogether from sovereign lending.

In July, 1983 *Fortune* magazine reported that "a quiet, unseen revolt has been rolling through the American banking community. Regional banks, enraged over the treatment they've received in the Brazilian debt crisis, have refused to go along with a crucial part of the country's refinancing."[11] But the multinational banks' "loans to Brazil are so mind-bogglingly large that those banks simply can't opt out; they have to keep on lending."[12]

Accordingly the larger U.S. banks leaned hard on their smaller cousins, as did the IMF. Initially, these smaller banks had joined international lending consortia not because they had their own independent assessment of the risks involved, but because they were following the lead of the more powerful banks. A type of herd instinct prevailed in the banking community. When the going got rough some of the smaller banks wanted out; but, with their arms twisted, they did stay in to help with the debt roll-over.

Most of the bankers, large and small, no doubt realized that they had lent too much, too fast, with too little thought about how repayments were to be met. Few would admit that publicly. However, a senior vice-president of Wells Fargo Bank is quoted by *Fortune* as saying:

We were greedy little pigs. Now we're going to slaughter.[13]

One product of the debt crisis is a closer sense of mutual dependence among the commercial banks, the IMF, and government officials of the major capitalist nations. Within this group, one actor is key. It is, not surprisingly, the U.S. government, and in particular Paul Volcker, Chairman of the U.S. Federal Reserve Board. It was Volcker who arranged the original emergency financing for Mexico in 1982. It is Volcker who plays a key role in the next stage of the U.S. plan to divide and rule the indebted nations by striking special deals, first with Mexico, and then one by one with other major debtors.

4.2 The Mexican Crisis of 1982

In August of 1982 the government of Mexico realized that it could not make payments on its $80 billion external debt. The manner in which the ensuing crisis was handled reveals a great deal about the actual pecking order in world finance.

On August 13, 1982, Mexico's Finance Secretary Jesus Silva Herzog flew to Washington for a series of emergency meetings. He went first to the offices of the U.S. Secretary of the Treasury, Donald Regan. Then he met with the Managing Director of the IMF, Jacques de Larosière. Lastly, he called on Paul Volcker. It was not until five days later that Silva Herzog went on national television in Mexico to inform his people about their country's financial crisis.

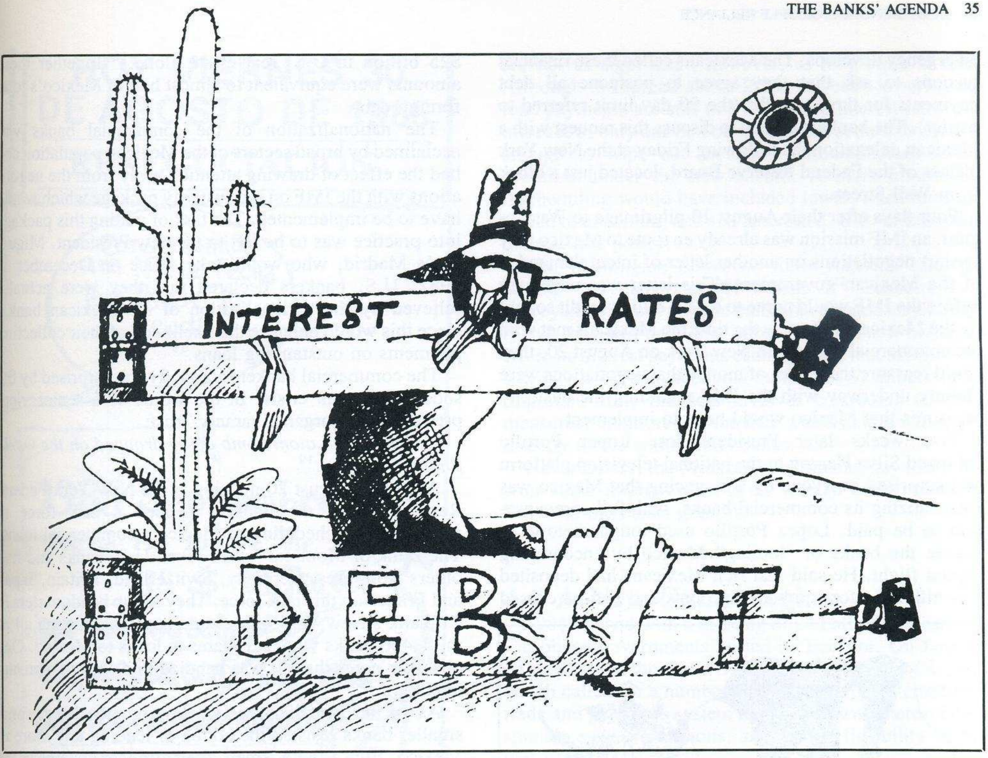
The Mexican government officials accompanying Silva Herzog knew that they were in for a rough ride in Washington. Earlier that summer they had seen a briefing paper from the U.S. State Department which suggested that Mexico's crisis might lead it "to sell more oil and gas to us at better prices."[14] The memo speculated that a Mexico "with the wind out of its sails" would be more willing to ease restrictions on foreign investment, negotiate a trade agreement, co-operate in the control of illegal migration and "be less adventuresome in its

Unable to buy milk, bread or meat

foreign policy and less critical of ours." The U.S. has been upset by Mexico's role in trying to arrange a peaceful settlement to the conflict in Central America, and was hoping to use its financial power to change that role.

Once in Washington the Mexicans encountered little sympathy or understanding from Treasury Secretary Regan, or from his Undersecretary for Monetary Affairs, Beryl Sprinkel who once waived aside a list of problem debtors, including Mexico, Argentina and Poland with the comment, "The market will take care of them."[15] It was Paul Volcker, not the Treasury officials, who took charge of the U.S. response to the Mexicans.

As Chairman of the Federal Reserve Board, the U.S.A.'s central bank — with ultimate responsibility for the health of the U.S. banking system — Volcker is keenly aware that a default by a major debtor like Mexico could cause the failure of even the largest U.S. banks. As



"lender of last resort" to U.S. banks, it is the Federal Reserve Board that would have to try to rescue them should a failure by Mexico to pay its debts precipitate a default.

His response was therefore to begin personally arranging emergency credits for Mexico. He telephoned the heads of other major central banks, e.g. the Swiss National Bank, the West German Bundesbank, and the Bank of England. He persuaded them to help secure $1.85 billion in emergency financing through the Bank for International Settlements, the central bankers' own association. The U.S. Federal Reserve provided $750 million of this loan, and Canada's central bank, the Bank of Canada, guaranteed another $150 million of the total.

Volcker was also instrumental in getting credits for Mexico from other arms of the U.S. government. He arranged for a $1 billion advance from the Commodity Credit Corporation, $300 million from the U.S. Treasury, and a $1 billion advance payment for future oil imports from Mexico.

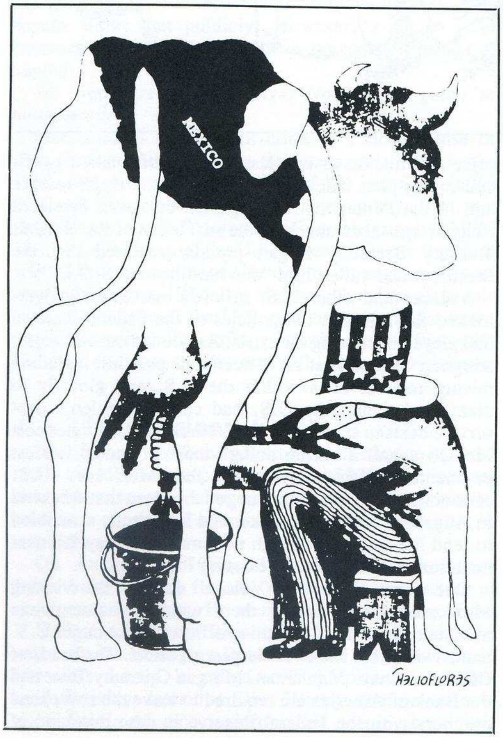
It was the oil deal that almost scuttled the whole operation. The U.S. Treasury offered to pay $28 a barrel for the oil, $4 below the prevailing world price. The Mexicans resisted at first, but eventually caved in by agreeing to pay additional fees and interest on the loan, effectively lowering the price for a sale of oil that contravened both the price and market diversification goals of Mexico's official energy plan. The oil went to the U.S. strategic reserve and to the Pentagon. It is reported that even President Reagan was taken aback by the stiff terms of the oil deal. Treasury Secretary Regan proudly reported that the President had called him "one hard-hearted S.O.B."[16]

Volcker and other U.S. officials conveniently overlooked the role that the policies of the Federal Reserve had played in causing the crisis. As pointed out earlier, by adopting a monetarist set of economic policies, including raising interest rates within the U.S. and globally to dizzying heights, the U.S. had caused Mexico's debt service costs to skyrocket. Each 1% rise in U.S. rates cost Mexico a half a billion dollars more in annual interest payments. Unfortunately for the Mexicans, U.S. economic policy was not a negotiable item that weekend in August of 1982, as Volcker and his cohorts scrambled to lend Mexico just enough new money to pay the next installments owing on its existing loans.

One other thing that Volcker did for the visiting Mexicans was to supply them with the home phone numbers of the chief executive officers of the major U.S. banks who were Mexico's largest creditors. The heads of Citibank, Chase Manhattan, Morgan Guaranty Trust and the Bank of America are required to leave their weekend numbers with the Federal Reserve in case this kind of emergency develops. The Mexicans called these financial tycoons to ask that they agree to postpone all debt payments for three months (the 90 day limit referred to earlier). The bankers agreed to discuss this request with a Mexican delegation the following Friday at the New York offices of the Federal Reserve Board, located just a block from Wall Street.

Four days after their August 13 pilgrimage to Washington, an IMF mission was already en route to Mexico City to start negotiations on another letter of intent demanded of the Mexican government. This letter was necessary before the IMF would agree to a $3.9 billion credit sought by the Mexicans. Thus by the time the Mexicans met with the commercial bankers in New York on August 20, they could reassure these men of money that negotiations were already underway with the IMF regarding the austerity measures that Mexico would have to implement.

Two weeks later President Jose Lopez Portillo followed Silva Herzog to the national television platform and surprised everyone by announcing that Mexico was nationalizing its commercial banks, with full compensation to be paid. Lopez Portillo used tough rhetoric to accuse the banks of "looting" Mexico by encouraging capital flight. He said that rich Mexicans had deposited $14 billion in foreign bank accounts and had purchased



$25 billion in U.S. real estate alone.[17] Together these amounts were equivalent to almost half of Mexico's total foreign debt.

The nationalization of the commercial banks was acclaimed by broad sectors of the Mexican population and had the effect of drawing attention away from the negotiations with the IMF on the austerity package which would have to be implemented. The task of putting this package into practice was to be left to the new President, Miguel de la Madrid, who would take office on December 1, 1982. U.S. bankers declared that they were actually relieved by the nationalization of the Mexican banks, since this would enhance the likelihood of their collecting payments on outstanding loans.[18]

The commercial bankers claimed to be surprised by the sudden Mexican crisis. In the words of a senior vice-president of Morgan Guaranty Trust:

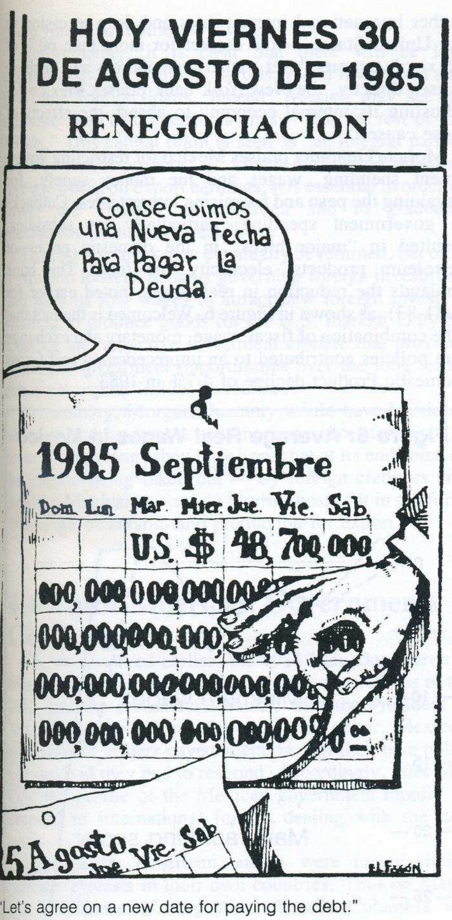
It was like an atom bomb being dropped on the world financial system.[19]

After the August 20 meeting at the New York Federal Reserve Board the bankers formed a task force to negotiate a rescheduling of Mexico's commercial loans. The Bank of Montreal joined seven U.S. banks and five others from West Germany, Switzerland, Britain, Japan and France on this task force. They set up headquarters in Citibank's New York offices and began contacting all of the 1,400 banks who had shares in loans to Mexico. One observer notes that "It was handled like a money-raising telethon."[20]

As in the Brazilian crisis a few months later, some smaller banks resisted the notion of lending any more to Mexico. But, as with Brazil, their stronger cousins in the banking community prevailed. There was also strong pressure from Jacques de Larosière, the IMF Managing Director, who realized that the total resources of the IMF (then $65 billion) were not enough to rescue Mexico let alone all the other troubled debtors.

On November 9 the Mexican letter of intent was ready to be countersigned by de Larosière and by December 15 the commercial banks had come up with all but $400 million of the $6.5 billion promised in the Mexican refinancing package.

While the nationalization of the banks temporarily demobilized the opposition in Mexico, by May of 1984 it had regrouped to protest strongly against the effects of the austerity plan agreed upon with the IMF at the end of 1982. By the latter date these measures were severely punishing the majority of the population. In 1983 Gross Domestic Product fell by 4.7%. Real minimum wages fell by 16% during 1983, to a level 26% below that of 1981. Unemployment reached 14 million, out of a total population of 75 million, while underemployment was 50 % of the labour force. Morgan Guaranty calculated that an outward flow of domestic savings equivalent to 3% of the Gross Domestic Product would continue for the rest of the 1980s. It is little wonder that Mexican workers hurled insults instead of the traditional thanks to their President during their May Day march in 1984.



"Let's agree on a new date for paying the debt."

4.3 A Special Deal for Mexico

In the middle of 1984 Mexico received what seemed to be an especially favourable deal from its foreign bank creditors. It involved all of Mexico's commercial debts due between 1984 and 1990, instead of covering the usual one or two years — $48.5 billion in all, or more than half of Mexico's $96 billion total in foreign debt. Repayment was extended over 14 years. Interest rates on $22.7 billion had their base shifted from U.S. prime to Libor, and the spread above Libor was lowered from 1&7/8% to 1&1/8%. What's more, the banks did not charge their usual 1% rescheduling fee. It is estimated that these new terms will save Mexico an average of $350 million a year in debt payments through 1998.[21]

The concessions to Mexico in this latest arrangement are not as significant, however, as they seem at first. Although the spread above Libor has been lowered, the loan payments are still tied to floating interest rates. An increase of only one half of one percent in the Libor rate is enough to wipe out the $350 million annual saving promised under the new accord. A more meaningful rescheduling would have included lower, fixed rates not linked to uncertain, and self-interested, U.S. or European interest rate policy.

The *Washington Letter on Latin America* calls the accord "an elaborate PR scheme."[22] Economists it surveyed point out that the banks have stated emphatically that they will only lend Mexico enough new money to cover its interest payments each year and that Mexico will still face a net annual capital outflow of $7 billion. More important still, the deal involves continuing austerity measures, monitored by the IMF which in turn will report directly to the commercial banks.

Nevertheless, the Mexican government may feel it has won some improvement in its foreign credit relations. Why did the banks grant it?

4.4 A New Game Begins

1984 opened with a meeting of 24 Latin American and Caribbean governments hosted by Ecuador. On January 13 they issued the *Quito Declaration and Plan of Action*, which called for a number of reforms of the international trade and payments system including lower interest rates, spreads and commissions, and greater flexibility on the part of the IMF.[23]

In February Morgan Guaranty Trust published an analysis restating its conviction that the only long-term solution to the debt crisis is for debtor countries to increase their exports. It advised the debtors to abandon policies of import substitution and concentrate on exports. It also recommended reducing the role of government in the economy so that resources could be freed up for the private sector, a sector apparently more inclined to exports. This is part of the standard IMF prescription, designed to ensure a continual flow of wealth out of the indebted countries and into the banks' coffers.

Arguing that this export-led strategy would have to be pursued over an extended period of time if it is to succeed, Morgan Guaranty went on to say that in the meantime some way had to be found to reduce the burden of debt service payments. This could be done "ideally through lower U.S. interest rates, but also through lower bank fees and spreads *for countries that successfully implement IMF programs.*"[24] One of the most influential banks in the world was stating that payment terms should be eased, but only for nations strictly adhering to IMF conditionality.

Despite appearances, Morgan Guaranty was not seeking a way out for nations in the debt trap. The increasing militancy of Latin American demands as signaled by the *Quito Declaration* had the banks worried. The concessions to Mexico may be interpreted as a tactical retreat by the banks who, like generals finding their troops in disarray, elect to withdraw to build a new line of defence.

4.5 The Mexican Showcase

Three months later, in May of 1984, Morgan Guaranty published a glowing report on Mexico's "progress" since its near bankruptcy in 1982. The New York bank called Mexico a "showcase for programs supported by the International Monetary Fund."[25]

A remarkable feature of this Morgan Guaranty report is the candour with which it describes the causes of Mexico's debt crisis. It observes that "the seeds of the problem were planted in 1978 when the government embarked on. . .full-speed exploitation of newly found. . .petroleum reserves. Oil production *and exports* were the key ingredients in a high-growth strategy that was spearheaded by heavy public sector spending. . .which far outstripped oil revenues."[26]

While Morgan Guaranty acknowledged overspending in the petroleum sector as a chief cause of Mexico's difficulties, it was silent regarding the fact that the banks encouraged Mexico to adopt this strategy, and it was they who eagerly lent Pemex (Mexico's state-owned oil company) billions of dollars for that purpose. The *Wall Street Journal* is more candid than Morgan Guaranty on this point. In an article entitled "Bank Responsibility for Mexico's Woes," the *Journal*'s Mexico City correspondent cites one banker who says defensively that "blaming the banks is like blaming the candy store for your cavities."[27] Another banker says:

the candy store analogy is correct, but it is more appropriate to say the bankers were like pushers supplying a drug addict.

The *Journal* correspondent leaves no doubt that Mexican government officials blame the commercial banks for leading Mexico into its predicament. As another banker put it:

In retrospect, maybe we were too greedy. We didn't push them over the cliff, but we led them to the edge.

Morgan Guaranty does acknowledge the role of capital flight as a cause of Mexico's crisis:

Capital flight, already significant for several years, increased sharply with the fear of further devaluations and exchange controls. Capital outflows exceeded $9 billion in 1982, for a cumulative total of more than $25 billion for 1978-82.

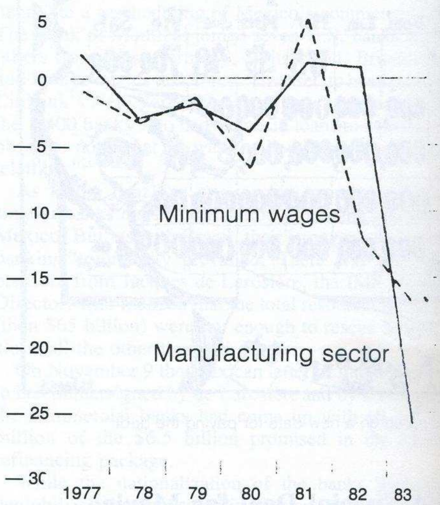
Again, what Morgan Guaranty doesn't say is also revealing. It doesn't mention that much of this capital was deposited in the U.S. and overseas branches of commercial banks, including their own. These deposits raised their liquidity — and so their protection against defaults — as well as their capacity to make additional profitable loans. Mexico's loss was their gain, so long as it didn't go too far and force a Mexican default!

Other causes of Mexico's debt crisis recognized by Morgan Guaranty included "lower world oil prices, higher international interest rates and deep recession in the United States — the market for more than 60% of Mexico's exports." Yet, rather than address any of these causes directly, the New York bank praises Mexico for adjusting its internal economy to absorb the effects of these causes.

Morgan Guaranty praises Mexico for restricting government spending, wages and the money supply, for devaluing the peso and for raising interest rates. Cutbacks in government spending, particularly for subsidies, resulted in "major hikes" in the domestic prices of petroleum products, electricity and food. The bank applauds the reduction in real wages (noted earlier for 1981-83), as shown in Figure 6. Welcomed is the fact that "the combination of fiscal, wage, monetary and exchange rate policies contributed to an unprecedented real Gross Domestic Product decline of 4.7% in 1983."

Figure 6: Average Real Wages in Mexico

(annual percent change)



Source: *Globe and Mail (Toronto)*

Morgan Guaranty is not totally oblivious to the social costs of this economic program. It notes that "labour unions can be expected to resist additional losses [in real wages]." Therefore salary adjustments are to be kept in line with inflation and the living standards of the poorest-paid workers are to be somewhat protected by concentrating the remaining subsidies on basic consumer goods. But no recovery of real wages is contemplated. As for the 12% of the work force officially counted as unemployed, and the 50% "partially employed", and the 800,000 new entrants to the labour market every year, they will have to find jobs through "more labour-intensive [investment] more reliant on domestic savings."

Unfortunately, it is clear that there will be less domestic savings available for this type of investment and few new foreign loans. Indeed "Mexico may see an outward flow of domestic savings. . .for the rest of the 1980s." This capital drain is seen as "an integral part of the adjustment process. . . .Given the limited prospective growth in oil export earnings, it is essential in order to lower the external debt burden and to gradually reestablish creditworthiness."

The lost resources may eventually be returned, but only if Mexico loosens its laws governing foreign investment and uses its low wages to attract new foreign investors wishing to produce goods for the U.S. market. Only by creating an "attractive investment climate that provides profitable investment opportunities over the long term" can a net capital inflow be realized.

In summary, Morgan Guaranty would have Mexico's peasants and workers accept more sacrifices for years to come. In exchange they may hope that at its end some of the capital being taken out — by foreign creditors and wealthy Mexicans — might return, most of it in the form of foreign ownership and production for export.

4.6 Latin American Governments Get Tougher

As we observed earlier, the 1984 May Day march in Mexico saw workers angrily repudiate the policies of the IMF and the commercial banks, with the President of Mexico the immediate object of their anger. Mexico's government leaders payed attention. For their own political survival they had to respond. Accordingly, after May Day the profile of the Mexican government rapidly increased in international forums dealing with the debt crisis.

Other Latin American leaders were facing similar popular protests in their own countries. Thus on May 9 the presidents of Argentina, Brazil, Columbia and Mexico issued a common declaration (later reluctantly endorsed by the President of Venezuela) objecting to the fact that U.S. interest rates had again risen above 12%. This statement demands "adequate repayment and grace periods, reduction of interest rates, of margins [i.e. spreads], and of commissions and other financial charges."[28] That same day five trade union confederations staged another 24 hour general strike in the Dominican Republic demanding that the government break off negotiations with the IMF and revoke price increases for basic foods and medicines.

At the same time there was heightened speculation in the international news media about the formation of a "debtors' cartel" which would carry out joint negotiations with creditors. Latin American governments scheduled another inter-governmental meeting to discuss debt issues. This meeting was to be held at Cartagena, Columbia, at the end of June.

On May 30th Bolivia announced that it had decided to suspend payments on its $3.9 billion debt because it anticipated inadequate export earnings. This move was deemed necessary by Bolivian leaders in light of the pressures being brought upon them by the Bolivian Workers Federation. Argentina's Economy Minister defended the Bolivian action and said that other nations might be obliged to follow Bolivia's example. The Argentine minister's statement was unnerving for Argentina's creditors who faced a June 30th deadline for the repayment of $750 million in overdue principal.[29]

Meanwhile Venezuela was falling behind $1.1 billion on interest payments and entering its fifth 90 day moratorium on principal payments.

4.7 Bankers in Philadelphia, Government Heads in London

It was against this background that many of the world's leading commercial bankers and heads of central banks assembled for a conference in Philadelphia on June 4. At this conference Paul Volcker reportedly took a leading role in pressing reluctant bankers to offer a special deal to Mexico when negotiations resumed with that country later in the month.

As we have seen, that deal offered essentially what was called for in the February report of Morgan Guaranty Trust. In Philadephia the bankers admitted candidly that they took the threat of joint action by debtor nations seriously. They agreed that it was necessary to drive a wedge between these debtor countries.[30] It was rumored that if an accord could be struck with Mexico then a similar package would be offered Brazil.

One week later, the heads of government of the seven leading capitalist countries held their annual Summit Conference in London, England. The government leaders confirmed the divide and rule strategy and agreed to

— handling debt problems on a "case-by- case" basis.

— "encouraging the IMF in its central role in this process."

— "in cases where debtor countries are themselves making successful efforts to improve their position, encouraging more extended multi-year rescheduling of commercial debts and standing ready, where appropriate, to negotiate similarly in respect to debts of governments and government agencies."[31] A U.S. Treasury official attending the London Summit Conference made it clear that "[multi-year rescheduling] will not be across the board but only for successful countries. It will be an important reward and incentive for successful conduct [implementing IMF austerity programs]."[32]

4.8 Canada's Bankers Endorse the Strategy

Canadian bankers have, for their part, signalled their agreement with the divide and rule strategy adopted at the Philadelphia and London conferences. At the end of June, 1984, interviews with Canadian bankers indicated that they believed the debt problem could in this way be "contained".[31] Thus while they are willing to go along with the kind of deal given to Mexico, they resist any more substantial concessions. In the words of the chief economist for the Royal Bank:

Anything in the nature of negative spreads or big write-offs is simply not in the cards.[34]

A study conducted by Dominion Securities Pitfield Ltd. has shown that such negative spreads would cut heavily into Canadian bank profits. Specifically, the study demonstrates that if the six largest Canadian banks were to reduce the interest rates on their loans to Latin America by 5% — taking these rates below U.S. prime — they would see cuts in their overall profit for 1984 of:

— 20% for the Royal Bank.
— 32% for the Canadian Imperial Bank of Commerce.
— 34% for the Bank of Montreal.
— 25% for the Bank of Nova Scotia.
— 17% for the Toronto-Dominion Bank.
— 50% for the National Bank.[35]

By the end of June the banks and Western governments had consolidated their new strategy and delivered to Mexico their first special offer. Meanwhile the government leaders of Latin American and Caribbean countries were preparing to meet at Cartagena and African finance ministers were meeting at Addis Ababa, Ethiopia, to discuss the debt issue. It remained to be seen whether debtor countries would agree to joint negotiation or whether the divide and rule strategy would prevail.

Notes to Chapter 4

1. *Globe and Mail*, Toronto, Oct. 5, 1981, p.B3.
2. Cheryl Payer, "How to win time and influence creditors," *South*, September, 1983, p.69.
3. Herman Nickel, "Battling for Iran's Frozen Billions," *Fortune*, Dec. 15, 1980; and "The Iran Deal Doesn't Look Bad," *Fortune*, Feb. 23, 1981.
4. Payer, *op. cit*.
5. *Wall Street Journal*, June 22, 1984, p.29.
6. Honeywell, et al., *op. cit*., p.111.
7. *New York Times*, Jan. 10, 1983.
8. *Ibid*.
9. *Latin America Weekly Report*, 2 October, 1981, p.11.
10. *Economic Survey of Latin America and the Caribbean 1982*. United Nations, 1983, Vol I, Table 49., p.83.
11. David B. Tinnin, "The War Among Brazil's Bankers," *Fortune*, July 11, 1983, pp.50-55.
12. *Ibid*.
13. *Ibid*.
14. "U.S. and Mexico: Major Rift Emerges," *New York Times*, Aug. 14, 1982, p.2.
15. Penny Lernoux, "Rescue Missions Impossible," *The Nation*, Oct. 6, 1984, p.31.
16. *Ibid*.
17. Alan Riding, "Mexico Seizing Banks to Curtail Flight of Capital," *New York Times*, Sept. 2, 1982, pp.1 & 32.
18. "Takeover Pleases U.S. Banks," *New York Times*, Sept. 2, 1982, p.32.
19. *Time*, Jan. 10, 1983, p.38.
20. *Ibid*.
21. *Latin America Weekly Report*, 14 September, 1984, p.8.
22. *Ibid*., 5 October, 1984, p.9.
23. *Globe and Mail*, Toronto, Jan. 17, 1984.
24. Morgan Guaranty Trust, *World Financial Markets*, February, 1984, p.11.
25. Morgan Guaranty Trust, *World Financial Markets*, May, 1984. This is the source for the remaining references to Morgan Guaranty in this chapter.
26. See also GATT-Fly, "Lessons from Mexico's Crisis," *GATT-Fly Report*, Toronto, November, 1982.
27. Lawrence Rout, "Bank Responsibility for Mexico's Woes," *Wall Street Journal*, Oct. 22, 1982, p.20.
28. *Latin America Weekly Report*, 25 May, 1984.
29. The only reason Argentina was able to make its March payments was that the U.S. government arranged for it to receive an unprecedented loan of $300 million from Mexico, Brazil, Columbia and Venezuela. This loan put countries with huge debts into the curious position of joining Argentina's creditors. Morgan Guaranty Trust applauded Mexico's willingness to cooperate with this manoeuvre, saying that it "affirms its commitment to seeking constructive ways to cope with the worst economic crisis to hit L.A. in 5 decades."
30. *Globe and Mail*, Toronto, June 18, 1984.
31. *Official Communique*, The London Economic Summit, London, England, June, 1984.
32. *Ibid*., Toronto, June 11, 1984, p.10.
33. *Ibid*., Toronto, June 25, 1984, p.IB1.
34. *Ibid*.
35. *Ibid*.

Chapter 5

Debtor Governments Respond

We have information that Mexico is achieving a multi-year repayment plan. . . It's like a Formula One race. We're letting Mexico take the lead, and we're going to ride in its slipstream, later overtaking to achieve even better repayment conditions.

Celso Pastore
former President, Bank of Brazil[1]

5.1 Cartagena

Given all of the expectations that had been built up in the news media about the imminent formation of a debtors' cartel, the June, 1984, meeting of Latin American and Caribbean government leaders at Cartagena proved anti-climactic. There was a clear disavowal of any intention to set up a "cartel". Only a "consultative mechanism" emerged whereby governments would compare notes on the progress of their individual debt negotiations.

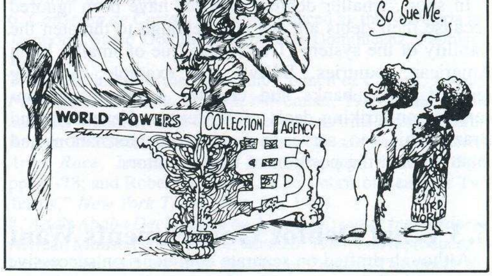
According to the *Financial Times of London* and the *Wall Street Journal*, Mexico and Brazil opposed any radical measures and met privately with the Argentinians to encourage them to come to terms with the IMF.[2] Meanwhile Argentina, Bolivia, the Dominican Republic and Ecuador are reported to have advocated "some unilateral action to reduce debt payments". Bolivia in particular pushed for a debt negotiating commission and an attempt to limit debt service payments to some proportion, perhaps 25 %, of export earnings.

The Latin American Weekly Report says that Venezuela also pressed for a conciliatory attitude and it cites the Argentinian delegation as saying that the idea of a debtors' cartel was never on the agenda. The Argentinians felt it would be impossible to negotiate jointly debts that differ so much from one country to another.[3] It was later reported that the Brazilians under the direction of Planning Minister Delfim Netto had forged an alliance with the Mexicans "to impose a 'moderate' tone among the Latin American debtors' meeting at Cartagena."[4]

Whatever the actual diplomatic manoeuvres at Cartagena, what happened afterward is clear. Mexico, even then in negotiations with its creditors, went on to sign the 'special deal' described in Chapter 4. Later Venezuela, which had been holding back debt payments despite having substantial oil revenues, followed with an agreement very similar to that of Mexico's. By the end of 1984 Brazil had not yet signed a new deal but it was clearly seeking one. What has surfaced then is not a united front but a game of follow-the-leader, each country seeking its own rescheduling based upon whatever precedent its neighbour has achieved. The divide and rule strategy appears to have succeeded.

Given the social composition of most Third World governments, this victory should not surprise us. The political and economic interests of most government elites are more strongly integrated with the international capitalist system, dominated by the U.S., than they are with regional interests or with the majority of their own populations.

Still, it is essential for their domestic political survival that these elites appear strongly opposed to the policies of their foreign creditors. When the United States raised its prime interest rate by one-half a percentage point on June 25th, the day after the conclusion of the Cartagena meeting, Mexico was quick to denounce this affront as "a reprisal for having held the Cartagena meeting."[5] The *Cartagena Consensus* released at the end of the meeting noted that each 1% increase in interest rates means an additional \$2.5 billion in debt payments flowing out of Latin America annually. It urged that interest rates be held down.[6]



Earlier that same month the Reagan administration had adamantly refused pleas from France, West Germany and Canada at the London Summit Conference to take action to lower its interest rates. The Reaganites refused to acknowledge that their budget deficits, and particularly their huge military budget, had anything to do with the prevailing high rates. This despite a growing consensus among economists that there is a close relationship between U.S. deficits and interest rates.[7]

Ignoring the havoc caused for the rest of the capitalist world economy, the U.S. continues to insist upon setting its fiscal, monetary and military policies so as to strengthen its own position. Neither the protests of its Western allies nor the Cartagena countries to the south are about to deter it.

5.2 The Addis Ababa Declaration

During the three days prior to the Cartagena meeting, Africa's finance ministers also met in the capital of Ethiopia where they issued the *Addis Ababa Declaration on Africa's External Indebtedness.*[8] Since it was not accompanied by media speculation about the formation of a debtors' cartel, this meeting received much less attention in North America. In their declaration the African ministers observed that while Africa's external debt of $150 billion might seem small when compared to the rest of the world, it nevertheless constitutes a heavy burden for the countries involved. In 1983 alone, fifteen African countries were forced to accept harsh terms in order to restructure their debts.

The declaration sums up in one paragraph why Africa is being ignored and what the consequences of inaction are for their people:

Although at the international level, particular attention has been focused on the major debtor developing [sic] countries which, although more prosperous, could if they defaulted, place the financial institutions of some industrialized countries in jeopardy, no particular attention has been paid to the case of many African countries whose poverty has prevented them from obtaining more loans. The latter's liquidity problems have not always been presented as major debt problems but as arrears in payment. . . .Drastic cutbacks in imports of essential commodities [have] caused a slowdown in national output and a scarcity of essential commodities, especially foodstuffs.

In short, smaller debtor countries have been ignored because their debts are not large enough to threaten the stability of the system. This is also true of smaller Latin American countries. Bolivia, for example, is being ignored while banks and creditor governments concentrate on striking deals with Mexico, Venezuela and Brazil. This, too, serves to divide the debtor nations and to strengthen the position of their creditors.

5.3 What Debtor Governments Want

Although drafted on separate continents on successive days, with little opportunity for mutual consultation or reflection, the *Cartagena Consensus* and the *Addis Ababa Declaration* are remarkably similar. They represent compromises forged between countries as politically diverse as Chile and Bolivia or the Ivory Coast and Tanzania, yet with a common problem.

Both documents leave it up to individual countries to renegotiate their debts on their own behalf, without proposing any inter-governmental collaboration beyond the sharing of information. Any notion of joint negotiations with creditors is absent from both agreements. Both also assume the legitimacy of the IMF as the arbitrator of world finance, although they both specifically demand greater flexibility in the conditions that the IMF attaches to its loans.

Each calls for limiting debt service payments to a "reasonable percentage of export earnings" without specifying what this percentage might be. The government leaders of Africa and Latin America also ask that developed capitalist countries lower interest rates by changing their monetary policies. They demand better terms for rescheduled loans, with the Africans specifying that loans due over a minimum period of five years should be consolidated to be repaid over a fifteen year period.

Both documents call for an increase in new financing for development, with an emphasis on increased official development assistance from Western governments, the World Bank and the regional development banks. They each accept a role for private capital investment by multinational corporations.

Only in the African declaration is there a specific demand for a *moratorium* of at least three to five years on debt service payments for public and private debts. The Africans also demand the "conversion of a substantial part of the debt service obligations. . .into grants." Only the Africans take up the offer made at the London Summit Conference to implement multi-year reschedulings of government-to-government debts.

A specific plea for action to stabilize commodity prices is found in each document.

How do they expect these goals to be achieved? In essence both groups place their hopes in the convening of conferences between debtor and creditor countries. The *Addis Ababa Declaration* recommends that

. . .an International Conference to deal with the External Indebtedness of African countries, where all African countries, all developed creditor countries and multilateral financial institutions would take part should take place as soon as possible.

Similarly, at a meeting held at Mar del Plata, Argentina, in September, 1984, the same eleven Latin states who met at Cartagena called for "a direct political dialogue" with the governments of the industrialized countries to take place early in 1985, as the best means of resolving their demands.[9] The industrialized countries have never consented to such a direct dialogue. As a result, at the third meeting of the Cartagena countries, in Santo Domingo, February, 1985, their position was watered down. They agreed merely to take their concerns to the regular meetings of the Interim Committee of the IMF, and to the Development Committee of the World Bank, which were scheduled to meet April 17 and 18 in Washington. They also decided to write the leaders of the seven Western countries before their next summit in Bonn, May, 1985.[10] These decisions meant the acceptance of forums in which the United States and its conservative allies hold firmly the levers of power.

5.4 Futile Negotiations

Industrialized capitalist countries have a long history of resisting the demands of underdeveloped countries in these forums, and they show every intention of continuing to do so. We in GATT-Fly have monitored for more than ten years the exchanges taking place within the United Nations Conference on Trade and Development (UNCTAD), specialized U.N. Conferences, and annual meetings of the IMF and the World Bank. We have yet to see any signs of significant movement on the part of the developed capitalist countries in the direction of justice for Third World nations.[11] Moreover, it has become apparent to us that one of the most enduring elements in the strategy of industrial capitalist countries is simply to "keep 'em talking".

Even when a few less powerful developed countries have shown some sympathy for the plight of their underdeveloped counterparts, the United States and its strongest allies have crushed any reforms they have proposed at international conferences. A good example of the way this works took place at the September, 1984, meetings of the World Bank and the IMF.

At those meetings, even Margaret Thatcher's Conservative government was prepared to back the demand by Commonwealth finance ministers that there be a firm plan to start negotiations on a reform of the international economic system. This proposal was apparently too threatening for both the United States and the entrenched bureaucracy of the IMF. The U.S. Secretary of the Treasury and the Managing Director of the IMF conspired to execute what has been called "a skillful pre-emptive strike", by announcing their backing for a special three-day conference on debt, trade and monetary affairs to be held in April, 1985.[12]

The Secretary of the Treasury spelled out the limitations that would be placed on the conference. It would be "a time for discussion. . .not negotiations or attempts at generalized solutions to the debt problem."[13]

Finance Minister Bernard Chidzero of Zimbabwe, a member of the Commonwealth, interpreted the U.S.-IMF ploy this way:

They took over our idea and changed it around. . . .The whole exercise has been emasculated.[14]

An Asian delegate was even more scathing in his interpretation:

It's a U.S. strategy to get the Third World to agree to a new round of trade negotiations. They want us to open our markets to their services and hi-tech goods, but they will not negotiate on anything else.[15]

For real progress the peoples of underdeveloped countries have had to look elsewhere than these multilateral gatherings ruled by the U.S. and its closest allies. They have had to look first to themselves. The truly successful struggles for social and economic justice have been and will continue to be found within nations.

Even were reforms of present multilateral institutions to be accepted by the U.S., so as to relieve the debt burden of indebted nations, they would not by themselves bring economic justice to the majority of the world's population. Indeed many might be worse off if their dictatorial rulers were strengthened by such changes at the international level.

This is why we have relegated to the Appendix an examination of some of the reforms now being proposed for the international finance system. More important than any of these proposals is the perspective expressed by Javier Iguiniz, a leading Peruvian economist — a perspective increasingly shared by the world's oppressed:

For the majority of the continent's poor, the problem isn't the debt; it is their countries' overall political and social structures. Schemes designed to allow more gradual payment of the debt won't really affect them. The question is not whether to pay the debt; it is how non-payment might influence political and economic structures. What the people of Latin America really need is concrete alternative economic programs and policies. The debt debate is, in the final analysis, a debate among elitist groups who have always tried to dominate the continent's history. Of course, the poor have a keen interest in the debate, because it is they who, in the end, pay the debt. But it would be absurd to hope that paying more slowly will substantially improve their situation.[16]

Notes to Chapter 5

1. *New York Times*, Sept. 23, 1984, p.9.
2. *Financial Times of London*, June 23, 1984, p.1; and *Wall Street Journal*, June 25, 1984, p.26.
3. *Latin America Weekly Report*, 29 June, 1984, p.1.
4. *Ibid.*, 25 Jan., 1985, p.6.
5. *Globe and Mail*, Toronto, June 26, 1984, p.2.
6. *Consenso de Cartagena*, as reproduced by the Secretaria pro Tempore, Santo Domingo, Republica Dominicana, February, 1985.
7. See for instance the Economic Council of Canada, *Twenty-First Annual Review*, Ottawa, November, 1984; Ernie Regehr and Mel Watkins, "The Economics of the Arms Race," in Ernie Regehr and Simon Rosenblum, eds., *Canada and the Nuclear Arms Race*, James Lorimer and Company, Toronto, 1983, pp.77-78; and Robert B. Reich, "The Debris of Reagan's Two Terms," *New York Times*, Oct. 29, 1984.
8. *Addis Ababa Declaration on Africa's External Indebtedness*, African Ministers of Finance, June 20, 1984, and reproduced as United Nations Economic and Social Council, Document No. E/1984/110/Add.1.
9. *Comunicado de Mar del Plata*, Argentina, 14 Sept., 1984.
10. *Comunicado de Santo Domingo*, Dominican Republic, 8 Feb., 1985.
11. See for instance GATT-Fly, *Reflections on UNCTAD IV*, September, 1976; and GATT-Fly, *Reflections on the Seventh Special Session of the U.N. General Assembly*, November, 1975. Both are available from GATT-Fly, Toronto.
12. Melvyn Westlake and Robert Manning, "Regan's three-day April fool summit," *South*, November, 1984, p.44.
13. *Ibid.*
14. *Ibid.*
15. *Ibid.*
16. Javier Iguiniz, "For the Poor, the Problem is Economic, Political Structures," interview in *Latinamerica Press*, 29 March, 1984, p.5.

Chapter 6
Canada's Indebtedness

Like the addict, every time we attempt to reduce our dependence on foreign capital, we suffer withdrawal symptoms in the form of capital flight, reduced investment by foreign firms, more unemployment and an hysterical media campaign admonishing us to stop discriminating against foreign firms. We are told that the 'solution' to the economic havoc created by foreign owners whose interests are threatened, is to have another fix of foreign capital. This will make us feel better — at least temporarily. But it will only strengthen our addiction further.

John Calvert, Canadian Union of Public Employees[1]

When discussion turns to Canada's debt problems there is an understandable confusion. Most of the public debate centres around what is known as the "national debt", that is the money owed by the federal government. Most of this debt, about 90%, was loaned within Canada. We literally do owe it to ourselves. Less well known, and less frequently discussed, is Canada's "international indebtedness", that is the amount owed abroad by all Canadian businesses, governments and individuals. In this chapter we shall explore the differences between these two kinds of debt. We hope to demonstrate that while the national debt is a cause for concern, our international indebtedness is a far more serious problem.

6.1 The National Debt

Business interests, the news media and conservative politicians (from whatever party) relentlessly campaign for government spending cuts, mostly in social programs such as unemployment insurance, as their preferred solution to what they identify as Canada's debt problem. These groups usually refer to the figures for the federal government's debt as shown in Table 6. As of March 31, 1984, Canada's national debt amounted to CDN$157 billion*.

*Unless otherwise stated, all dollar amounts given in this chapter *only* are in Canadian dollars.

This is a net figure — assets valued at $40 billion have been subtracted from gross liabilities amounting to $197 billion. The size of the national debt grows each year through the addition of the Canadian government's annual budget deficit. In the fiscal year 1983-84 the federal government had a deficit of $37.5 billion, raising the national debt by this same amount, from $119.5 billion as of March 31, 1983, to $157 billion a year later.

Much attention has been given to recent budget deficits and the resulting growth in the federal debt. For example, the powerful Business Council on National Issues has placed the federal deficit at the heart of Canada's economic woes. Its members have campaigned constantly for spending cuts to reduce the deficit.[2] The Mulroney government apparently agrees and has made deficit reduction a top priority.

Table 6
Federal Government Debt
(Public Accounts Basis, Selected Years, $ Canadian Millions)

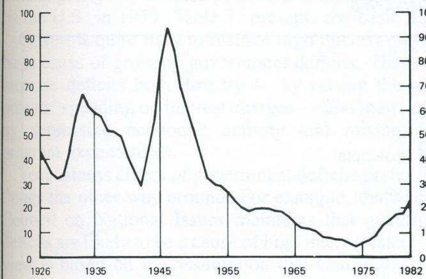
Year	Net Debt*	% of GNP**
1952	$11,185	51.7%
1957	$11,009	34.3%
1962	$14,767	37.2%
1967	$17,013	27.5%
1972	$18,811	19.9%
1975	$22,927	15.5%
1976	$28,390	17.2%
1977	$34,600	18.0%
1978	$44,889	21.4%
1979	$57,115	24.6%
1980	$68,595	26.9%
1981	$81,263	27.4%
1982	$94,869	28.0%
1983	$119,522	33.5%
#1984	$157,000	40.2%

*Net Debt = Gross Liabilities — Assets, as of March 31 each year.
**Calculated using GNP (Gross National Product) of the preceding calendar year.
#Estimate.
Sources: Department of Finance Economic Review, April, 1984, Table 52; and *Globe and Mail*, Toronto, May 17, 1985, p.4.

In order to see beyond the simplistic notion that too much government spending is the basic problem with government finances, if not with the economy as a whole, we need to look more carefully at three dimensions of government finance. First, we need a historical perspective. Second, we need an understanding of the workings of government finances. Third, we need to understand the causes of recent increases in government deficits.

Although these recent increases appear large when measured with today's inflated dollars, a more historical view of Canada's national debt in relation to GNP gives us a different picture. During the Great Depression of the 1930s and World War II our national debt was a much greater drain upon our yearly national product

Figure 7: Net Federal Debt as a Percentage of GNP



Source: Hon. Marc Lalonde, Minister of Finance, *Deficit in Perspective*, April 1983

(represented by the GNP) than in the 1980s.

Second, to understand the impact of government finances on the economy we require a broader measure than the "public accounts" figures given in Table 6. Accordingly we shall use the more comprehensive figures recorded in the "national accounts" as shown in Table 7. These accounts cover the revenue and spending of *all* levels of government, federal, provincial and local. They include not only annual taxation but also important extra-budget revenues received by governments. In the latter category are the substantial pools of savings held by the Canada and Quebec Pension Plans, and the money held in the accounts of other social programs such as the Unemployment Insurance Commission. The national accounts also cover government revenues from the profits of crown corporations, and interest collected from other government accounts, including the substantial part of the national debt that one government agency owes to another.

Table 7 uses the national accounts to show government deficits and surpluses in Canada over the years 1974 to 1983. Figure 8 gives federal and provincial debt as a percentage of Gross National Expenditure (a measure of annual national output similar to GNP). This graph makes it clear that provincial government debt is quite important, rivaling that of the federal government in recent years.

There are important differences between the federal and provincial debt. We noted earlier that ninety percent of the federal debt is financed within Canada. In part this reflects the fact that the federal government owns the Bank of Canada. This is the only bank in Canada which by law can order Canadian dollars to be printed (or Canadian dollar bank accounts created) in order to finance its owner's debts, regardless of any deposits or reserves which it may, or may not hold. The unique borrowing privileges which this gives the federal government are not enjoyed by the provinces.

Hence provincial governments and in particular the provincially-owned crown corporations, are much more prone to raising money abroad. As shown in Table 13, just about half of the money borrowed on the international bond markets by Canada is owed by the provincial governments and their utilities.

6.2 Causes of Growing Government Deficits

Third, in order to deal with the misguided notion that excessive government spending is the essential problem to be attacked, we must answer the question, "Why have government deficits grown in recent years?" John Calvert, researcher for the Canadian Union of Public Employees, has provided the answer in his recent book, *Government Limited*.[3] In summary:

1. There has been an underlying crisis in the private sector of Canada's economy, resulting in the biggest economic downturn since the 1930s.[4] Greater unemployment, less business investment, and a greater number of business and family farm bankruptcies have all reduced tax revenues. At the same time these factors have meant greater government spending on social programs such as unemployment insurance and welfare (even though government spending on social programs *as a percentage of Gross Domestic Product* actually fell between 1975-76 and 1982-83).

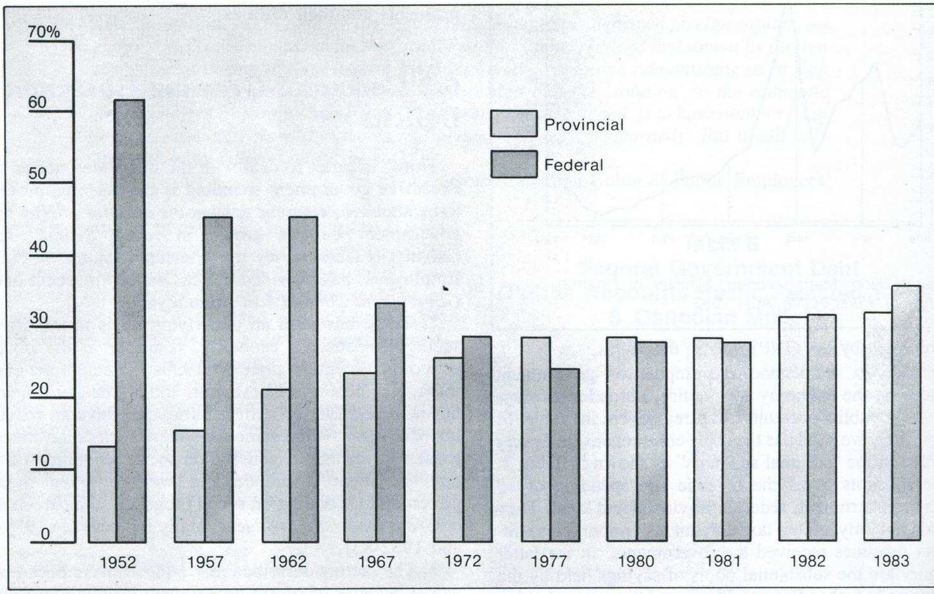
2. The factors described in 1., above, have been made worse because of recent government economic policies, especially the adoption of monetarism and government

Table 7.
Government Deficits in Canada, 1974-1983 (National Accounts Basis, $ Canadian millions)*

Year	Federal Government	Provincial Governments	#Total Government
1974	$1,109		
$652	$2,795)		
1975	($3,805)	($1,756)	($4,049)
1976	($3,991)	($1,543)	($3,222)
1977	($7,303)	($734)	($5,005)
1978	($10,626)	$749	($7,294)
1979	($9,131)	($131)	($4,630)
1980	($9,880)	($429)	($7,304)
1981	($6,984	($204)	($3,845)
1982	($20,502)	($1,950)	($18,928)
1983	($24,457)	($2,225)	($22,749)

*Deficits are given in brackets, ( ).
#Total Government includes *all* levels of government, federal, provincial and local, as well as hospitals and Canada and Quebec Pension Plans. Thus the values in this column are *not* the sum of the preceding columns.
Source: Statistics Canada, National Income and Expenditure Accounts, as reported in Department of Finance, Economic Review 1984, Reference Tables 48, 50 and 55.

Figure 8: Federal and Provincial Debt as a Proportion of GNE, Canada, Selected Years, 1952-83



Source: based on data from Statistics Canada and from Bank of Canada.

spending restraints. These policies throttle economic output and promote additional unemployment.

3. Government revenues have been lowered further through generous tax concessions to large businesses and to wealthy individuals. For example, Canada's Auditor-General estimates that in 1984 federal "tax expenditures" (that is taxes foregone through exemptions) amounted to between $30 and $50 billion.[5] If collected, these taxes would have been enough to cover the total government deficit for that year.

4. The tax base for governments in Canada is restricted because the Canadian economy is too dependent upon the production of unprocessed raw materials for export. If Canada had a healthier and more diversified manufacturing sector, governments could raise more revenue from these industries and from the workers whom they would employ.

5. The policy of high interest rates, especially in the United States, has led to a major increase in the costs of government borrowing.

Reducing government spending, particularly spending on social programs, is hardly an adequate response to the above causes. Indeed, since cuts in government spending tend in general to weaken the economy, they are the opposite of what is needed.

A comprehensive program for economic recovery in Canada that includes tax reform, economic stimulation, lower made-in-Canada interest rates, and a revision in government spending priorities, is urgently required. Expanded government payments to the unemployed and to the working poor can play an essential role in economic recovery, by increasing effective demand for basic goods and services such as food, clothing and shelter. Similarly, government investment in Canada's underdeveloped manufacturing sector could lead a return to full employment. Not despite, but rather because of this greater government spending tax revenues would grow and the need for spending in subsequent years decline. Recovering tax expenditures from wealthy businesses and individuals would be more than sufficient to eliminate any remaining deficit in government budgets.[6]

6.3 High Interest Rates

Despite the fact that Canada's national debt, as a percentage of GNP, was much higher in the 1950s than it is today, the cost of paying interest on the debt is much higher now. The reason is the very high rates of interests which have prevailed since the adoption of monetarism as official policy, by Canada in 1975 and more importantly by the U.S. in 1979. Table 7. presents the basic data.

Calvert is quite right to include high interest rates as a basic cause of growing government deficits. These rates increase deficits both directly — by raising the governments' spending on interest charges — and indirectly — by depressing economic activity and raising social program expenditures.

Yet business critics of government deficits prefer to see things the other way around. For example, the Business Council on National Issues maintains that government deficits are likely to be a cause of high interest rates.[7] This view is based on the assumption that Canadian interest rates are the result of competition for loanable funds *within Canada* between business and governments. Were this true, more government borrowing to finance deficits could drive interest rates up and deny funds to business investors.

The Economic Council of Canada has conducted a special study of this question. The Council found that "Canadian [government] deficits and total government debt do not appear to have a significant influence on the level of long-term [interest] rates."[8] It does point to a different situation in the U.S., where federal government deficits, deficits which are in large part the result of military spending, have a significant impact on U.S. interest rates (a point made earlier in this study).

As with interest rates facing indebted nations on international money markets, Canadian rates are largely a product of U.S. rates. They are not determined by the availability of or demand for loanable funds in Canada. This is because it is the policy of the Bank of Canada to set Canadian rates marginally above those in the U.S., and so to override any distinctively Canadian expression of either borrowers or lenders.

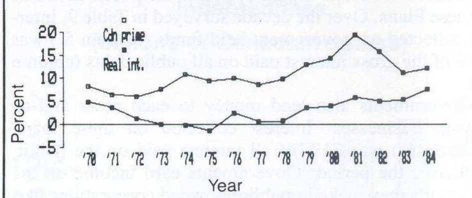
Why does the Bank of Canada do it? Because govern-

Table 8.
Interest on Total Government Debt As a % of Gross National Expenditure

Year	% of GNE
1950	2.9%
1955	2.3%
1959	2.8%
1975	4.0%
1976	4.2%
1977	4.4%
1978	5.0%
1979	5.2%
1980	5.6%
1981	6.3%
1982	7.2%
1983	7.1%

Source: Calculated from Department of Finance, Economic Review, April, 1984, Tables 3 & 48.

Figure 9: Real Canadian Interest Rates



ment economic policy makers fear the flight of capital out of Canada which might follow any lowering of Canadian rates below those of the U.S. This fear has become more important than any government concern about the depressing effect of high interest rates upon the Canadian economy.

The real problem with Canadian interest rates is not government spending, or government deficits. It is the failure of the Canadian government to use its sovereign authority and implement a made-in-Canada interest rate policy. And neither Canada nor any other indebted nation can look for help from the U.S. Although interest rates in the U.S. have appeared to fall substantially since 1981, they have actually risen in real terms. This is shown clearly in Figure 9, as reflected by the real interest rate in Canada, which is the nominal rate less the rate of consumer price inflation. The real rate of 7.7% in 1984 is the highest reached for any year since monetarism was embraced as economic policy. These high real rates are certainly profitable for the banks and other major lenders in Canada; but they are a disaster for the Canadian economy.

6.4 Financing Government Deficits

Despite all the publicity given to the national debt and to the question of annual government budgets, there is surprisingly little analysis of how governments actually finance their debts. What does reach the public eye can be very misleading. For example, when the federal government tabled its 1985-86 spending estimates in Parliament, a headline in the Toronto *Globe and Mail* proclaimed "Cost to carry national debt $999 for every Canadian."[9]

The implication that most readers would draw from this headline is that they must pay almost $1,000 in taxes to cover the cost of interest on the government's debt. What this and most other commentaries on government debt refer to are the *gross* interest costs. The *net* costs to governments in Canada from their loans and investments is a more meaningful value, since it is only the net costs which Canadians must cover with taxes. The relevant figures are given in Table 9.

The facts are that Canadian governments pay much of the interest on the national debt back to themselves. For example, the provinces annually borrow substantial amounts from the Canada and Quebec Pension Plans. Interest on these loans is paid back into the public accounts in these Plans. Over the decade surveyed in Table 9, interest collected on government held funds (column 5.) was 29% of the gross interest paid on all public debts (column 2.).

Governments also lend money to each other and to private businesses. Interest collected on these loans (column 6.) was 31% of all interest paid on the public debt over the period. Governments earn income on investments they make in publicly-owned corporations like CN Railways or Petro-Canada, or the provinces' electric utilities and liquor stores. Earnings on these investments covered another 10 % of gross interest costs for the decade. Finally, governments, especially provincial governments, collect royalties on natural resources they own, royalties which amounted to 26% of the ten-year gross interest charges.

Added together (column 9.) the income from these loans and investments covered all but 4% (column 10.) of the interest charges on the national debt from 1974-1983. The net deficit on government loans and investments income was substantially higher for 1983 alone, at 12%, but this is a reflection of both unnecessarily high interest rates and a depressed economy, not of excessive government spending.

There is another important element to this question of financing government deficits. Economist Ruben Bellan calculates that Ottawa borrows its money by selling bonds in the following proportions:

— 13% to the Bank of Canada;
— 80% to Canadian businesses and individuals; and
— 7% to non-residents.

Bellan points out that:

The federal government owns the Bank of Canada; at the end of each year, the Bank turns over all its revenues to the government, deducting only its operating costs. Thus in 1982 when the Bank received $1,986 million as interest on bonds it held, it gave back $1,878 million.[10]

Table 9.
***Government Net Loans and Investments Income ($ million Canadian)**

Year	1.	2.	3.	4.= 2.-3	5.	6.	7.	8.	9.= 5.+6. +7.+8.	*10.= 9.-2.
1974	n.a.	5425	713	4712	1688	2019	664	1545	5916	419
1975	7.2%	6538	946	5592	2047	2414	734	1917	7122	584
1976	7.8%	8101	1570	6531	2483	2837	754	2283	8357	256
1977	7.5%	9268	2065	7203	2910	3247	1110	2660	9927	659
1978	7.9%	11538	2620	8918	3465	2927	1483	2645	10520	-1018
1979	9.0%	13748	3030	10718	4077	4554	1618	4538	14787	1039
1980	10.5%	16655	3293	13362	4866	5408	1857	5300	17431	776
1981	11.7%	21813	3958	17855	6063	6786	1850	5253	19952	-1861
1982	14.0%	26067	5681	20386	7363	7777	2225	5744	23109	-2958
1983	n.a.	28116	6583	21533	8434	8127	2132	6044	24737	-3379
Totals:		147269	30459	116810	43396	46096	14427	37929	141858	-5483
% of Gross Interest (col. 2.)										
1983	—	00%	23%	77%	30%	29%	8%	21%	88%	-12%
Totals, 1974-1983	—	100%	21%	79%	29%	31%	10%	26%	96%	-4%

Column References:
1. Average Interest Rate on the Federal Debt.
2. Gross Interest on All Public Debt.
3. Interest Paid to Non-Residents.
4. Interest Payments Remaining in Canada.
5. Interest Collected on Government Held Public Funds.
6. Interest Collected on Loans, Advances, and Investments.
7. Remitted Profits of Government Businesses.
8. Royalties Collected.
9. Government *Gross* Loans and Investment Income.

*10. Government *Net* Loans and Investment Income.

Sources: Statistics Canada, *National Income and Expenditure Accounts 1969-1983*, Tables 16, 17 and 48; and *Public Accounts of Canada, 1981 and 1982*, Table 11.7.

In effect, when the federal government borrows from the Bank of Canada, it borrows from itself. It could finance much more of its debt in this way. Critics of such a solution to the costs of government debt argue that it would be inflationary, since — *were no other action taken* — borrowing money from the Bank of Canada increases the money supply. However, as the Economic Council of Canada rightly observes, "an increase in the money supply is not automatic as the Bank may neutralize the impact of government actions through various operations. . . ."[11]

Bellan also reminds us that interest payments made to Canadians holding government bonds are not lost to the Canadian economy. He estimates that these bondholders "pay Ottawa in tax probably 40% of the money they receive as interest on their bonds"[12] The rest is essentially a transfer of income by government, from other sources of government revenue (including those detailed in Table 9.) to government bondholders.

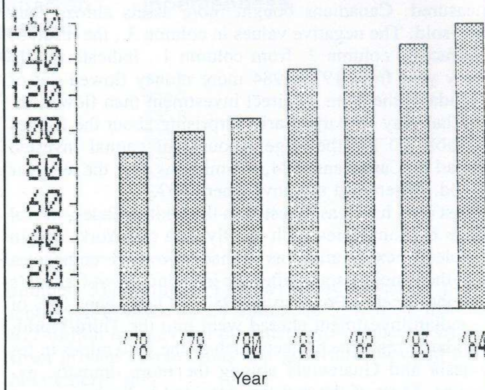
It is the 21% (23% for 1983 alone — see Table 9, column 3.) paid to non-residents that is lost to the Canadian economy, and it is these interest payments about which there should be the greatest concern. They are part of Canada's growing international indebtedness.

Among the biggest Canadian customers for international loans are the provinces' electric utilities. This kind of government financing — using foreign loans to pay for mega-projects (any project costing more than $100 million) such as Ontario Hydro's nuclear power program or Hydro Quebec's James Bay project — has needlessly mortgaged Canada's future to money-lenders who have at best only a secondary interest in this country. This borrowing is doubly foolish because much of it is for the production of electricity which may never be needed in Canada. It is planned instead for export to uncertain markets in the U.S., at uncertain prices which may be well below costs of production. Such additional electricity as may in future be needed domestically could be produced from smaller-scaled energy projects, complemented by aggressive energy conservation programs, and financed by borrowing within Canada.[13]

6.5 Canada's International Indebtedness

As we know from Chapter 1, most figures commonly cited for external debt exclude foreign investment (or, using the terminology of international finance, foreign "equity" investment). Thus comprehensive debt figures for most countries are not readily available. Statistics Canada, however, has just revised its estimates of Canada's "international investment position", intended to be a complete accounting of Canada's indebtedness. As defined by Statistics Canada, it includes all international money transactions, both loans and "direct" investment — another term for foreign investment — whether held by corporations, individuals or governments.[14]

Figure 10: Canada's Net International Indebtedness (billions of Canadian dollars)



Source: Statistics Canada

Statistics Canada (Statscan) reports that at the end of 1984 Canadians owed non-residents a total of $275.6 billion, in the form of money borrowed abroad and foreign investments in Canada. At the same time $117.4 billion were owed to Canadians in loans and investments placed outside Canada. The difference between these liabilities ($275.6 billion) and assets ($117.4 billion) constitutes Canada's net international indebtedness of $158.2 billion, as of December 31, 1984.

Figure 10 shows the growth in our net indebtedness between 1978 and 1984. In order to get a clearer view of the consequences of Canada's rising international debt, we must examine its parts. First we will look at recent trends in foreign investment into and out of Canada and the efforts being made by various levels of government to lure foreign investors. Later we will examine Canada's borrowing abroad, what Stascan calls "portfolio investment".

6.6 Capital Flight and Growing Foreign Ownership

One of the paradoxes of Canada's present international indebtedness is that we suffer from both a flight of investment capital out of Canada and a growing foreign ownership of our economy. A brief look at recent data concerning direct investment flows will help us to understand this paradox.

Table 10 gives the annual flow of direct investment (i.e. foreign investment)[15] into and out of Canada over the years 1975 to 1984.

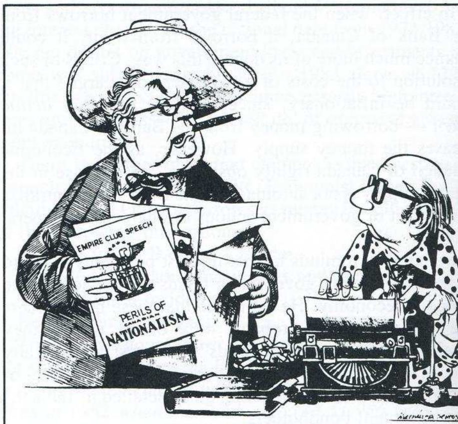
In column 1. of this table a negative value indicates that in the given year foreign residents sold more domestic assets to Canadians — taking the proceeds out of the country — than they bought from Canadians (the sale by its former Belgian owners of Petrofina, to Canadian-owned PetroCan, is an important example). The positive values in column 2. mean that in each of the years measured, Canadians bought more assets abroad than they sold. The negative values in column 3., the result of subtracting column 2. from column 1., indicate that in every year from 1975-1984 more money flowed out of Canada in the form of direct investment than flowed in.

What may be particularly surprising about the figures in Table 10 are the huge amounts of capital invested abroad by Canadians, $24,845 millions over the ten-year period. Where did this investment go?

Just over half was invested in the United States, in real estate by companies such as Olympia and York, and in petroleum exploration as Canadian-owned companies took their money south after the introduction of Canada's National Energy Program in 1980.[16] Only about 16% of Canadian investment abroad went into the Third World, with large resource projects such as the Inco mines in Indonesia and Guatemala among the more dramatic examples. Most of the rest was invested in Europe.

The total in column 1. of Table 10 indicates that on balance, for the last ten years foreigners have taken a net $135 million *out of Canada* in direct investment capital. One might expect this to mean that the total value of foreign investment in Canada is declining. However, as Table 11 demonstrates, the cumulative value of foreign investment in Canada has continued to increase yearly.

This apparent paradox is explained by the fact that foreign companies in Canada grow mainly through



'Next time cut out the guff about independence and sovereignty . . . just tell 'em, Uncle Sam owns the joint!'

reinvesting earnings made in Canada, rather than by bringing in new capital. Thus between the years 1978 and 1984 the cumulative book value of productive assets in Canada controlled by foreign residents (Table 11., Column 2.) grew by almost $35 billion, while the net value of new direct investment into Canada (Table 10., Column 1.) was minus $1.035 billion.

Generally speaking, foreign corporations have been increasing their control over the Canadian economy, not by bringing in new capital but by reinvesting the surplus

Table 10.
Annual Flow of Direct Investment*
($ million Canadian)

Year	1. Direct Investment Into Canada By Foreign Residents	2. Direct Investment Abroad By Canadians	3.=1.-2. Net Direct Investment Into Canada By Foreign Residents
1975	$725	$915	($190)
1976	($300)	$590	($890)
1977	$475	$740	($265)
1978	$135	$2,325	($2,190)
1979	$750	$2,550	($1,800)
1980	$800	$3,150	($2,350)
1981	($4,400)	$6,900	($11,300)
1982	($900)	$950	($1,850)
1983	$200	$2,700	($2,500)
1984	$2,380	$4,025	($1,645)
Totals:	($135)	$24,845	($24,980)

*Brackets ( ) indicate flow in opposite direction, and thus a negative number.
Source: Statistics Canada, *Quarterly Estimates of the Canadian Balance of International Payments, Fourth Quarter, 1984*, Table 40.

Table 11.
Cumulative Value of Direct Investment ($ billions Canadian)

Year	1. Total Value of Foreign Investment in Canada	2. Total Value of Canadian Investment Abroad	3. = 1.-2. Net Direct Indebtedness
1978	$48.3	$16.4	$31.9
1979	$54.3	$20.0	$34.3
1980	$61.6	$25.8	$35.8
1981	$66.5	$32.8	$33.7
1982	$69.2	$33.9	$35.3
1983	$74.6	$35.9	$38.7
1984	$83.1	$41.4	$41.7

Source: Statistics Canada.

from their Canadian operations, and by borrowing in Canada. In addition, these same corporations have been taking out handsome sums in the form of dividends paid to their head offices. Lastly, although Canadian direct investment abroad has been growing rapidly in recent years — making Canada the base for an expanding list of multinational companies — foreign investment in Canada has grown even more. The result is that Canada's net indebtedness to foreign investors has increased more than 30% over the past seven years.

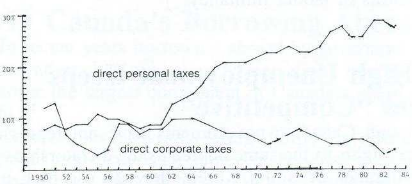
6.7 Luring Foreign Investment

The accelerating pace of international investment flows has been accompanied by a growing competition among governments to create a "more attractive climate for private investment" within their jurisdictions. Rather than use direct controls over capital movements, governments in Canada, both federal and provincial, have resorted to a host of measures designed to lure investors. Figures 11 and 12 illustrate the fact that federal and provincial governments have been steadily reducing the proportion of their revenues raised from direct corporate taxes while raising the share from direct personal taxes. For example, in 1950 the federal government raised 28% of its revenues from direct corporate taxes and 27% from direct personal taxes. By 1983 the proportions were 13% from corporate taxes and 50% from personal taxes. What's more, indirect taxes such as excise taxes on gasoline, alcoholic beverages, and cigarettes accounted for another 23% of federal revenues in 1983. These taxes are passed on by corporations to the consumer, and weigh more heavily on persons with low to middle incomes than they do upon the wealthy.

In addition to lowering taxes, governments attempt to lure private investment by offering direct grants and subsidies. It is estimated that in 1984 federal direct grants and subsidies to corporations amounted to some $7.4 billion.[17] Moreover, federal tax expenditures (see *Causes of Growing Government Deficits*) saved corporations another $11 billion. Together these financial plums amounted to some $18.4 billion, or 53% more than the $12 billion in taxes that the federal government collected from private corporations and government-owned business enterprises.

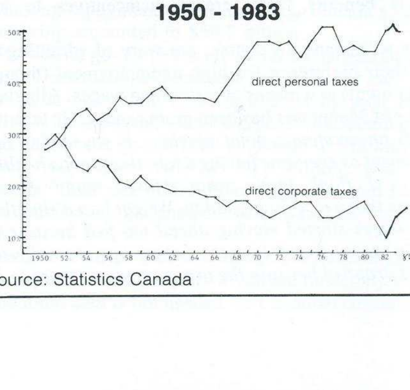
Besides these government revenue transfers, Ottawa and the provinces have other strategies for luring investors into Canada. The Mulroney government recently

Figure 11: Percentage Shares of Provincial Government Revenues: All provinces 1950 - 1983



Source: Statistics Canada

Figure 12: Percentage Shares of Federal Government Revenues 1950 - 1983



Source: Statistics Canada

dismantled the Foreign Investment Review Agency (FIRA) and replaced it with a new body called Investment Canada to welcome most, if not all, foreign investments. Despite vigorous protests against FIRA from the U.S., FIRA was very much a paper tiger. As Table 12 shows, between 1974 and 1981 only a small percentage of the foreign investment applications considered by FIRA were disallowed.[18]

The creation of Investment Canada, however, signals a much more aggressive search for foreign investment capital on the part of the Mulroney government. Nevertheless, surveys of U.S. investors by Canadian journalists have revealed no rush to undertake new investment in Canada, despite an appreciation for Mulroney's open door policy.[19] *Globe and Mail* reporter Thomas Walkom documents how foreign investors are not interested in investing in manufacturing in Canada. One U.S. businessman told him, "Canada should continue to do the things that it does well. And that's resources." But markets for minerals and timber, etc. are glutted with cheap products because indebted countries are exporting everything they can trying to earn foreign exchange to meet their debt payments.[20]

One reason why foreign investors have been in no hurry to rush into Canada is simply that they have so many other options. For example, manufacturers of computer components and other high technology products often find it more profitable to locate production in very low wage areas in the Third World, particularly in Asia. There not only are wages much lower but repressive governments guarantee investors immunity from strikes and other forms of labour militancy.

6.8 High Unemployment Keeps Wages "Competitive"

Although Canadian governments have not repressed workers' rights to the same degree as the dictatorships in the Philippines or South Korea, they do use high unemployment as a deliberate policy to keep wages down and so enhance Canada's ability to attract foreign investment. One expression of this policy is the move by the Mulroney government to tighten the regulations governing unemployment insurance, saying they fear that too generous benefits "may create disincentives to job search."[21]

Most politicians, of course, are wary of admitting in public their preference for high unemployment (though not their own!) as a means of restraining wages. Alberta's Minister of Manpower has been more candid. He tells us:

From an economic point of view, if you define full employment as everyone having a job, that's not a healthy thing. . . .I think that's what caused many of the problems that we're facing today. We got into a situation where wages started moving ahead too fast because of virtually zero unemployment where productivity of workers dropped because the pressure wasn't there to do a good job.[22]

Table 12: FIRA Decisions 1974 - 1981

Industrial sector	Investments disallowed
Agriculture	14.7%
Mining	3.7%
Oil and gas	16.2%
Plastics	2.4%
Printing/publishing	23.3%
Machinery	1.2%
Metal fabricating	4.5%
Transportation	17.8%
Communications	28.6%
Wholesalers	9.7%
Retailers	12.4%
Finance	13.1%
Services	11.4%

Source: Jack Layton, *Capital and the Canadian State*

Other Canadian politicians prefer to speak of the job creation which will follow provision of an attractive climate for private investment.

Spokespersons for business groups can also be revealing. The president of the Canadian Federation of Independent Businesses has said the following:

In Canada we have workers who are not willing to make a downward adjustment in their incomes in order to get a job. To a large extent that is the fault of the unemployment insurance system. . . .Many unemployed workers who live comfortably on [unemployment insurance] for up to a year simply do not beat the pavement looking for jobs that pay less.[21]

In framing policies to attract foreign investment, governments do not lack for advice from big business either. Canada's bankers have been among the strongest advocates for opening our doors to foreign investment. The president of the Bank of Montreal gives the following advice:

The answer is simple — make it more profitable and increase the number of investors. . .make it easier and more profitable for foreigners to invest here.[24]

6.9 Cutting the Social Wage

Business groups have also been putting pressure on governments to improve the investment climate in Canada by cutting social expenditures and rolling back many of the hard-won gains of working people in protective legislation. In October of 1984 the Canadian Manufacturers Association (CMA) recommended that the federal government weaken laws dealing with minimum wages, statutory holidays, child labour and health and safety concerns.[25]

Furthermore, the CMA advises replacing all existing social assistance programs including old-age pensions, unemployment insurance, child tax credits and veterans' allowances with a guaranteed annual income of $7,000 a year for a single person. Such an income would be well below the 1984 poverty line of $9,900 a year set by the National Council of Welfare for a single person living in a large metropolitan area.[26]

The CMA believe that their proposals would cut federal spending by almost $30 billion. They were soon followed to Ottawa by a delegation from the Canadian Chamber of Commerce (CCC) who also urged the government to cut spending, particularly on unemployment insurance. The CCC argued that these cuts should be combined with offers of "fiscal encouragement" to investors, including foreign corporations.[27]

While business lobbyists command the attention of the government and news media with their pleas for special favours to investors and punishment for workers and lower income Canadians, the over 4.3 million Canadians living in poverty (23% more than in 1981) are largely unheard.[28] Also receiving little attention are the demands from anti-poverty groups, churches, and the trade union movement for more socially just solutions to the economic crisis. Absent from the public debate is any serious consideration of alternatives being put forward by these groups. As we shall see in the next chapter, most of these alternate programs would stop the outflow of investment from Canada and use it here to meet the employment needs of Canadians. They would not rely upon multinational corporations to decide our future for us.

6.10 Special Enterprise Zones

The Social Credit government of British Columbia has already adopted severe measures designed to lower wages and support profits in that province. It has also proposed to take us yet another step along the road to becoming what it believes is "internationally competitive". This government is planning to establish "special enterprise zones" where, in addition to further tax breaks, corporations would be offered cheap energy, low rent land and buildings, and special tariff exemptions to produce for export. If Ottawa will cooperate, companies investing in these zones would also be offered special exemptions from federal labour laws.[29] Comparing British Columbia's plans to the export processing zones of South East Asian countries, a B.C. Cabinet Minister has said that the aim is to make B.C. into a "more educated Philippines."

Trade unionists in the Philippines, however, have thoroughly rejected any model of development based upon:

— cheap labour.
— repression.
— tax exemptions and freedom to repatriate profits for foreign corporations.
— high unemployment.
— concentration of land ownership.
— underdevelopment of the domestic market.
— growing international indebtedness.[30]

President Marcos himself has explained the basis of the Philippines strategy:

Our country now has one of the lowest average wage levels in this part of the world. . .We intend to see to it that our export program is not placed in jeopardy by a rapid rise in the wage level.[31]

In response to the B.C. government's initiatives the B.C. Federation of Labour has condemned the special enterprise zones as

havens for footloose capital, companies travelling abroad in search of a better climate for exploitation. . . .[Such zones] involve the exploitation of the work force, typically female, through lower wages, longer hours and often mandatory overtime. They would be the final step in the B.C. government's efforts to downgrade people's rights to a level usually associated with the Philippines or Taiwan.[32]

Similarly other trade union leaders in Canada have recognized that there is no future for Canadian workers if they have to play the game of competitive impoverishment against their sisters and brothers abroad. One of these is Gerard Docquier, the Canadian Director of the United Steelworkers, who has said:

We have no future in following a [South] Korean model of low-wage, export-led growth. It won't work because someone, somewhere in the world, with enough starvation and enough repression can always underbid you.[33]

6.11 Canada's Borrowing Abroad

In recent years borrowing abroad by governments and corporations has overtaken foreign direct investment to become the largest component of Canada's international debt.[34]

Canada does most of its foreign borrowing on the international bond markets, either in New York or on the Eurocurrency markets located in other financial centres.

Table 13 presents the distribution of new international bond issues among governments and corporations based in Canada over the years 1975-1984. Over this most recent decade Canadians borrowed $85.1 billion from international lenders in the form of new bond issues. After deducting repayment of earlier loans, Canada's net new borrowing amounted to $59.2 billion.

Provincial governments are by far the largest Canadian users of international bond markets. Just over half of this provincial borrowing is accounted for by their electric utilities. To illustrate, Ontario Hydro's outstanding long-term debt at the end of 1983 amounted to $18 billion, of which just under half, or $8.8 billion, was raised abroad.[35] This one utility alone thus accounted for 11% of all outstanding Canadian bond issues at the end of 1983.

As noted earlier (see *Financing Government Deficits*) the output of mega-projects which are funded by such international debt is not needed for Canadian consumption.

Table 13.
Canada's New International Bond Issues 1975-1984*
($ billions Canadian)

	1. Gross Value	2. % of Total	3. Net Value	4. % of Total
Federal Government	$17.7	21%	$11.3	19%
Provinces and Their Utilities	$40.5	48%	$30.7	52%
Municipal Governments	$4.5	5%	$2.1	4%
Private Corporations	$22.4	26%	$15.0	25%
#Totals:	$85.1	100%	$59.2	100%

*Excludes Trade in Outstanding Bonds.
#Column 3. does not add due to rounding.
Source: Statistics Canada, *Quarterly Estimates of the Canadian Balance of International Payments, Fourth Quarter, 1984.*

When this output is exported foreign exchange is then earned to pay the debt service due on past borrowing. These enormously expensive projects, of little or no value domestically, creating relatively few jobs, damaging our environment, and undermining the aboriginal rights of native peoples, are then part of our international debt burden. Their exports are becoming a key element in our governments' strategy for coping with Canada's foreign indebtedness.

6.12 The Costs of Indebtedness

One measure of the overall money costs of Canada's international debt is the yearly outflow of interest and dividend payments. Column 1. of Table 14 shows a net outflow of interest and dividends paid to foreign residents, in every year measured. It also shows, in column 3., the negative balance we have consistently run on trade in manufactured goods. This excess of manufactured goods imported over those exported is due largely to the dependent nature of industry in Canada. Not only are many of our basic consumer goods imported, including food and clothing, but our industries often require imported inputs as well in order to produce at all. Notable in the latter category is the dearth of machine tools produced in Canada.

The numbers in these two columns represent two of the principal causes of our negative current account balances registered in all but the last three years of the period. Unfortunately, the positive current account balances for 1982-84 are a sign not of greater health, but of the opposite. Consumption in general, and imports in particular, fell off dramatically during these years of the current "great recession".

To pay for the outflow of money in interest and dividends, and to purchase manufactured imports, policy makers in Canada have encouraged Canada's continued dependence upon the export of crude, unprocessed raw materials. Notable among these are food grains, especially wheat, and energy resources, e.g. oil, gas, electricity and uranium. The latter are recorded in column 4.[36]

Despite recent successes in marketing our minerals, forestry products, wheat and petroleum abroad, our overall merchandise trade surplus has not during most years been large enough to offsett our deficits in columns 1. & 3. As a result governments have had to encourage more foreign borrowing, indicated in column 6., in order to avoid a drastic devaluation of the Canadian dollar.

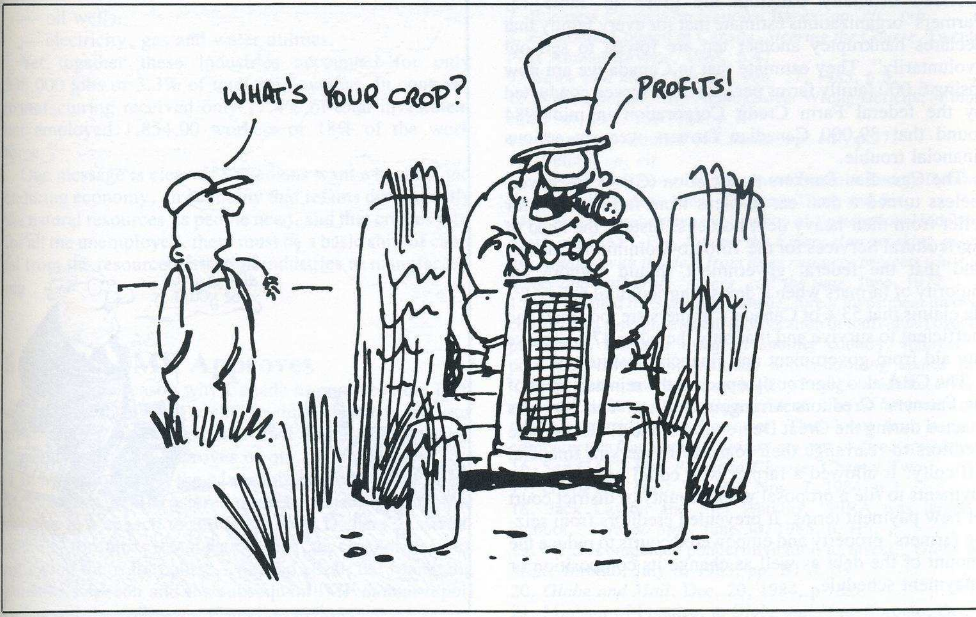
Predictably, this new foreign debt calls forth greater outflows in interest, in effect mortgaging our future. Such a mortgage is not subject to Canadian law or to Canadian economic policy. The interest payments sent abroad are lost resources, with uncertain prospects of any returning.

At the same time, the foreign investment which our governments seek comes not so much in the form of added foreign money, with which to import and pay existing debts, as additional ownership paid for through reinvested earnings in Canada. This leads of course to greater dividends flowing abroad in concert with the swelling interest payments.

Little wonder, then, that Canadian interest rates are tied to, and marginally above, U.S. rates (as pointed out earlier). Lower rates would — *without exchange controls* — mean more massive money outflows as major corporations and wealthy individuals, foreign and Canadian, sought higher returns elsewhere. Although policy makers in government don't always admit it, concern over Canada's external accounts has determined interest rate policy in Canada.[37]

6.13 Farmers Driven Off the Land

We have already observed that these high interest rates have seriously damaged the Canadian economy. They were directly responsible for the steep economic decline and soaring unemployment of the early 1980's. In addition to causing layoffs through a reduction in demand for



new housing, durable appliances, automobiles, and other consumer goods, many thousands of small businesses and family farms were forced into bankruptcy.

Record interest rates have combined with declining real prices for farm produce to severely threaten our farm economy in particular. The number of family farms

Table 14.
Covering Our Debts: Relevant International Payments*
($ billions Canadian)

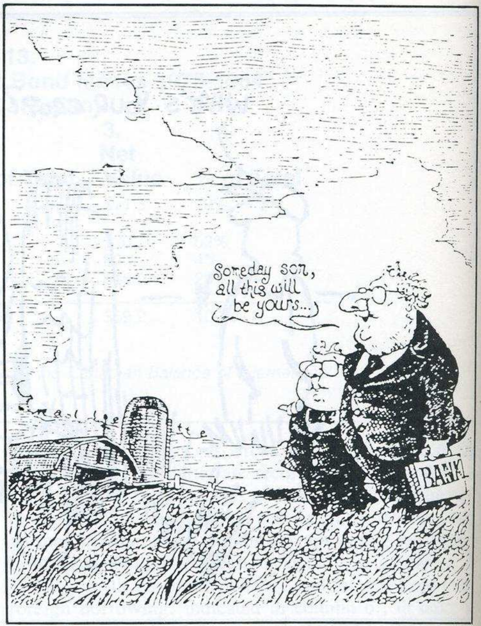
Year	1. Net Interest & Dividends	2. Merchandise Trade Balance	3. Trade Balance in Manufactured Goods	4. Trade Balance in Energy	5. Current Account Balance	6. Net New Borrowing
1975	($2.0)	($.5)	($9.6)	$1.3	($4.8)	$4.4
1976	($2.8)	$1.6	($9.5)	$1.3	($4.1)	$8.6
1977	($3.8)	$3.0	($10.4)	$1.4	($4.3)	$5.3
1978	($4.9)	$4.3	($12.4)	$1.9	($4.9)	$5.3
1979	($5.4)	$4.4	($17.1)	$3.5	($4.8)	$3.5
1980	($5.6)	$8.8	($16.4)	$2.8	($1.1)	$3.6
1981	($6.7)	$7.3	($18.8)	$2.5	($6.1)	$11.6
1982	($9.1)	$17.8	($11.0)	$6.0	$2.7	$11.7
1983	($9.0)	$17.7	($12.8)	$7.7	$1.7	$5.0
1984	($11.3)	$20.8	($15.5)	$9.1	$2.0	$8.0

*Brackets ( ) indicate a net flow of money out of Canada.
Numbers without brackets indicate a net flow of money into Canada.
Source: Statistics Canada, *Quarterly Estimates of the Canadian Balance of International Payments*, various issues; and Canadian Petroleum Association, *Statistical Handbook*.

declared officially bankrupt are given in Table 15. Farmers' organizations estimate that for every family that declares bankruptcy another ten are forced to sell out "voluntarily". They estimate that in Canada we are now losing 6,000 family farms per year.[38] A survey conducted by the federal Farm Credit Corporation in mid-1984 found that 39,000 Canadian farmers were in serious financial trouble.

The Canadian Bankers Association (CBA) has nevertheless turned a deaf ear to pleas from farm groups for relief from their heavy debt burdens. Instead the head of Agricultural Services for the Toronto-Dominion Bank has said that the federal government should "ignore the majority of farmers when it devises agricultural policy."[39] He claims that 53% of Canada's farmers are too small and inefficient to survive and that only the other 47% deserve any aid from government and financial institutions.

The CBA also vigorously opposed the reinstatement of the Farmers' Creditors Arrangements Act. This law was enacted during the Great Depression of the 1930s to force creditors to rearrange their loans to farmers in financial difficulty. It allowed a farmer who could not meet debt payments to file a proposal with a county or district court for new payment terms. It prevented creditors from seizing farmers' property and empowered courts to reduce the amount of the debt as well as change its composition or repayment schedule.



6.14 Two Million Unemployed

So far Canada has been relatively successful in finding foreign exchange to pay for our international indebtedness. At least the IMF has not yet required a letter of intent from this country. The costs, outlined in the sections above, have been enormous. Before proceeding to the alternatives, a few more comments about two of these costs is appropriate. They are the exhaustion of our natural resources, and unemployment.

In one resource sector, crude oil, we are once again net exporters.[40] We are selling off the cheaper, more accessible sources of oil found in southwestern Canada. As they are being depleted, oil companies, including the government-owned PetroCan, have begun turning to offshore areas and to the oil sands for more costly sources of oil. Provincial and federal governments have taken steps to accelerate the export of natural gas to the U.S., even though it too is an exhaustible energy source. Hardly anything is planned toward the development of renewable energy sources. Our forests are still being cut down faster than they are replanted. The complete list of natural resources being pumped out, dug out, damned up, and cut down for export is much longer. Yet still our foreign debt grows.

What we are witnessing, for the sake of our foreign creditors and their domestic allies, and in the name of international competition, is a model of underdevelopment applied to Canada. Among those most penalized by this model are the more than two million unemployed workers in Canada, including "discouraged workers" who have given up looking for non-existent jobs.

One of the less apparent causes of unemployment in Canada is the concentration of investment in capital intensive industries exporting unprocessed raw materials. In January of 1984, 43.7% of all the capital invested in Canada was placed in the following industries:

— forestry.
— mining.
— quarrying.

Table 15.
Number of Official Farm Bankruptcies in Canada

Year	1979	1980	1981	1982	1983	1984
Total No. of Bankruptcies	125	222	261	410	488	551

Source: Department of Consumer and Corporate Affairs, Ottawa.

— oil wells.
— electricity, gas and water utilities.

Yet together these industries accounted for only 338,000 jobs or 3.3% of total employment. In contrast, manufacturing received only 17.4% of total investment but employed 1,854,00 workers or 18% of the work force.[41]

One message is clear. If Canadians want a healthy and enduring economy, an economy that retains domestically the natural resources its people need, and that creates jobs for all the unemployed, there must be a basic shift of capital from the resource extraction industries to manufacturing .

6.15 The IMF Approves

Perhaps one reason why Canada has not seen the IMF called in to set things "right" in this country is that our governments are taking the IMF medicine already. Certainly, the IMF approves of our current policies.

In March of 1982, the Managing Director of the IMF, Mr. Jacques de Larosière, praised Canada's economic policies in a speech to the Investment Dealers' Association in Toronto. "Unquestionably, the authorities are following the right course," he said. Both the Managing Director's speech and the subsequent IMF annual report welcomed the following Canadian actions:

— keeping interest rates high.
— restraining public sector wages.
— cutting spending on social programs.
— facilitating the free flow of goods and money internationally.[42]

Mel Watkins exposes the double standard of the IMF's position when he writes:

In Mr. de Larosière's world it is perfectly natural for lenders, like banks, to raise interest rates to compensate, and more than compensate, for inflation; otherwise, they just wouldn't have the incentive to lend. But workers, well, they're supposed to keep right on working, and working harder (or starve if they can't find a job) while getting paid not more, or even the same, but less.

Watkins then concludes:

It is in the interest of the Canadian people, just as it is in the interest of the Third World, not to play by the IMF rules.[43]

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15. As defined by Statistics Canada, direct investment involves *control* by a foreign resident (corporation or individual) over the productive assets it owns in another country. Indirect, or portfolio, investment includes non-controlling shares in a Canadian company which are held by foreign residents, or loans made to Canadians by foreign residents who do not have a controlling interest in the borrower. Thus loans from a parent company to a Canadian subsidiary are part of *direct* investment.
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27. *Globe and Mail*, Toronto, Oct. 19, 1984, p.9.
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30. "The Unemployment Question in the Philippines," *GATT-Fly Report*, May, 1983.
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Chapter 7
Popular Responses to the Debt Crisis

There is no doubt that under the policies of the IMF and of the actual government the quality of life of workers and their families has fallen dramatically. Therefore, none of us can be accused of being subversive when we take to the streets to shout at the top of our voices, "Out of our country, cursed IMF!"[1]

Julio de Peña
General Secretary,
General Workers Confederation, Dominican Republic

In contrast to the compliance of most governments, occasionally obscured by their rhetorical denunciations of international creditors, popular groups throughout the world have been determined in their insistence on radical alternatives to their present debt bondage. It is their demands, and not the behaviour of present government elites, that contain the seeds of meaningful solutions to this crisis.

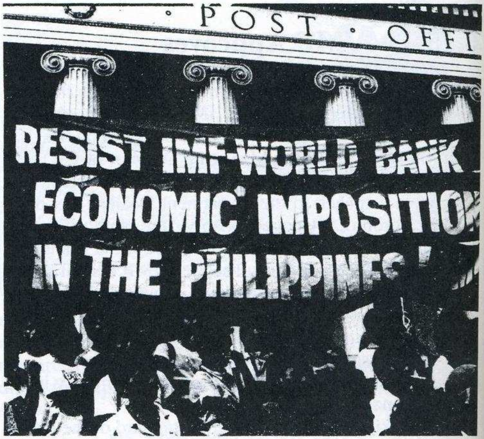
For example in September of 1984 representatives of sugar workers from eight Caribbean countries met to assess "The Impact of International Monetary Fund Programs on Sugar Workers."[2] The meeting was sponsored by the International Commission for the Coordination of Solidarity Among Sugar Workers. The trade union leaders in attendance firmly rejected the harsh and unjust programs that the IMF had imposed on their indebted nations.

As an alternative to IMF prescriptions they proposed:
— a moratorium of 15 — 20 years on debt repayments
— repatriation of national capital which has fled abroad
— reactivation of the traditional sectors of the domestic economy to reduce dependency in food and other basic necessities.

Numerous popular groups — trade unions, peasant and farmer federations, organizations of slum dwellers and opposition political parties — throughout the world are proposing alternate programs of national development that often contain very similar elements, including frequent calls for moratoria on debt payments. In the final chapter of this study, we shall sum up the common elements that run through these programs. Here we shall present some examples of the positions that popular organizations have adopted.

7.1 Dominican Republic

A leading popular group among those opposing IMF policies in the Dominican Republic has been the General Workers Confederation (Central General de Trabajadores — CGT). The CGT participated in the coalition of five trade union federations that sponsored several marches against hunger, as well as general strikes to protest austerity programs demanded by the Dominican Republic's creditors. It has also helped organize a broad front including students, peasant organizations, the urban unemployed and several women's groups to protest the Dominican government's acceptance of IMF austerity measures. These measures have resulted in food price increases of 300% while the minimum wage rose by only 84%; cutbacks in government spending on education and social assistance; 30% unemployment and 40% underemployment; and 80% of the population without adequate nutrition.[3]



As an alternative economic program the CGT has demanded:

1) a definitive break with the IMF and its policies;

2) a 10 to 20 year moratorium on debt payments (the Dominican Republic finds itself paying interest but no principal on its debt and yet has no foreign exchange left for productive investments);

3) government control over foreign currency and foreign trade (to end the flight of capital out of the country);

4) a reorientation of the domestic economy, including land reform, to develop local industry and agriculture for the domestic market (in a country where one percent of the landowners hold almost 50% of the cultivable land and food imports are running at $200 million a year);

5) effective price controls on items of popular consumption;

6) diversification of the sugar industry to produce other products than sugar for export.[4]

7.2 Philippines

In the Philippines the country's largest labour alliance, the National Coalition of Labour Against Poverty (PKMK), which includes the country's largest militant union central, the May First Movement (Kilusang Mayo Uno, KMU), accuses the IMF of "quack-doctoring" the economy and of having "ruined the lives of most of our people."[5] As real wages are falling farther and farther behind price increases the labour movement is staging more massive protests. The May First Movement has proposed the following alternative program to the policies of the IMF:

1) Economic production based on the domestic needs rather than export-oriented production;

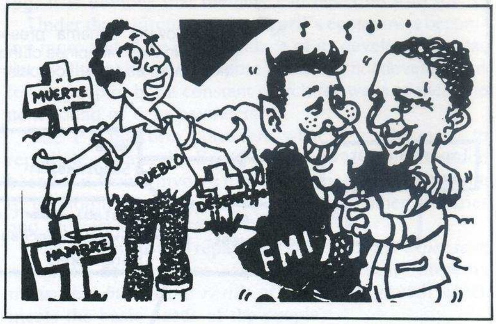
2) Nationalization of our industries rather than foreign-investment industrialization;

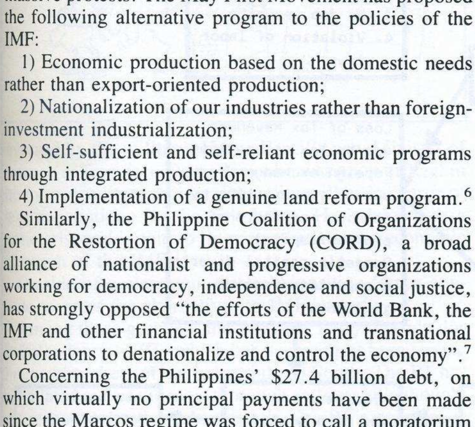
3) Self-sufficient and self-reliant economic programs through integrated production;

4) Implementation of a genuine land reform program.[6]

Similarly, the Philippine Coalition of Organizations for the Restortion of Democracy (CORD), a broad alliance of nationalist and progressive organizations working for democracy, independence and social justice, has strongly opposed "the efforts of the World Bank, the IMF and other financial institutions and transnational corporations to denationalize and control the economy".[7]

Concerning the Philippines' $27.4 billion debt, on which virtually no principal payments have been made since the Marcos regime was forced to call a moratorium in October of 1983, CORD demands that it be "renegotiated on terms that will not increase the poverty and misery of our workers and farmers, nor impair our national sovereignty and independence." Instead CORD says "The development of the national economy must be self— directed, self-reliant and self-governed."





7.3 Brazil

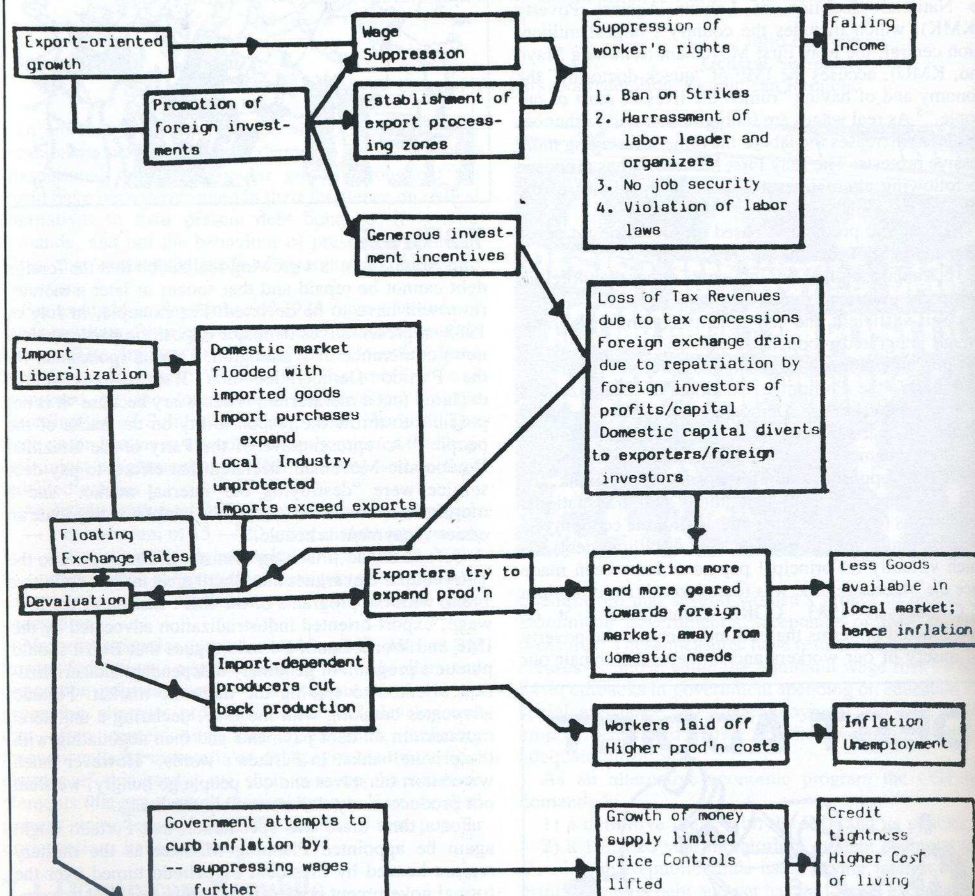
In Brazil there is a growing realization that the foreign debt cannot be repaid and that sooner or later a moratorium will have to be declared. For example, in July of 1983, representatives of major opposition parties held a news conference in Washington. There a spokesman for the Partido Democratico dos Trabalhadores (PDT) declared that a moratorium is necessary because "it is not possible to throw the responsibility on the backs of the people"[8] A representative of the Party of the Brazilian Democratic Movement declared that efforts to pay debt service were "destroying our internal market" and a moratorium is needed "to force the bankers to negotiate an easier repayment schedule."[9]

Celso Furtado, Planning Minister in Brazil prior to the 1964 coup d'etat argues that Brazil must make a definitive break with the programs of the IMF. Instead of the low-wage, export-oriented industrialization advocated by the IMF and World Bank, Furtado argues that Brazil should pursue a program of genuinely independent industrialization oriented to serving the domestic market. Furtado advocates breaking with the IMF, declaring a unilateral moratorium on debt payments and then negotiating with the private banks. In Furtado's words, "However much we contort ourselves and our people go hungry, we shall not produce many dollars to help the banks."[10]

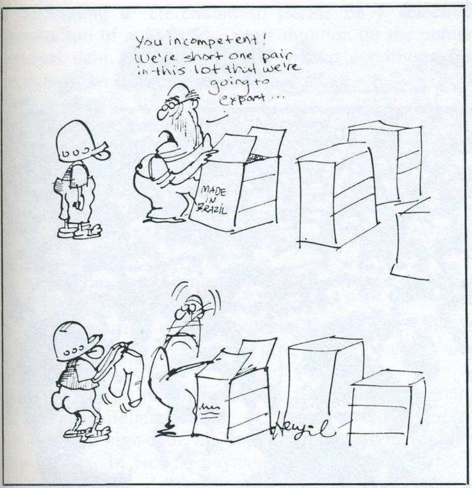
For a time there was speculation that Furtado might again be appointed Planning Minister as the military regime headed by President Figueiredo turned over the formal government powers to a civilian coalition government. However the delicate politics of transition to civilian rule; the dramatic turn of events occasioned by the illness and death of President-elect Tancredo Neves; and the succession to the presidency of Jose Sarney, member of the newly created Liberal Front Party and formerly president of the Democratic Social Party set up by the military, has resulted in a much more cautious approach to economic reform. The great fear is that the whole process of "abertura" (political opening) might be

Figure 13: The IMF and How it Affects the Filipino People

The following schema presents an analysis by opposition groups in the Philippines of the effects on the Filipino people of IMF strategies to reduce balance of payments deficits.



Source: Ma. Theresa Diokno, "The IMF and How it Affects the Filipino People", Third World Studies Centre, University of the Philippines, Manila, September 1983, Appendix "B".



reversed by the military. Hence Brazil's new Minister of Finance is Francisco Dornelles, who was a top official in the former military regime. Dornelles will be in charge of debt negotiations for the time being. He is known as a monetarist and is said to be sympathetic to the economic approach of the IMF.[11]

Outside of government circles opposition forces continue to press for alternatives to IMF austerity.

Among these groups is the Workers' Party (Partido dos Trabalhadores — PT) which has its strongest base among the metalworkers of the industrialized South. The PT has articulated one of the most thorough and carefully thought out responses to the debt crisis.[12] The PT's program is significant because it goes beyond a call for a moratorium on debt payments and articulates a program of measures that would have to be undertaken while a moratorium were in effect.

The PT program starts with a recognition of the futility of Brazil's present efforts to borrow its way out of debt. When new loans are contracted not for investment in production, but only to pay the interest on past borrowing, it is obvious that the debt can never be paid off.

Under these circumstances Brazil's economy is becoming more and more an appendage of its developed capitalist creditors. Its chief purpose becomes, not development for its people, but a constant search for ways to meet the next round of debt payments.

The PT platform considers what it would mean to repudiate unilaterally Brazil's debt and rejects this option because it would involve too high a price: the interruption of economic and financial relations with other countries and the seizure of Brazil's assets abroad.

The PT insists that repayment be, *not at the expense of* national development as under present austerity measures, *but as the result* of economic growth which meets the basic needs of the people.

The PT explains that debt service can be maintained in one of two ways:

a) by reducing internal consumption and increasing exportable surplus while lowering imports; or

b) by increasing production enough to cover internal consumption needs, substitute for imports, and still allow for exports to earn foreign exchange.

The imposition of the first model has meant enormous suffering for the Brazilian people through rising unemployment and prices, and falling real wages and social services.

To implement the second option the PT calls for a pattern of self-reliant development that would radically alter Brazil's present development plans. It would involve land reform and increasing investment in the production of basic goods (food, clothing and shelter) and of capital goods, curtailing through import and foreign exchange controls the imports of luxury items and reducing Brazil's dependency on capital goods from abroad. It would involve basic changes in the pattern of demand within the Brazilian economy. For example "the production of passenger automobiles would be replaced in the short term by collectivized transportation with a corresponding saving in fuels, raw materials and urban space."[13]

LATIN AMERICAN WORKING GROUP

PT rally in Sao Paulo, September 1982. The second banner reads "Land, Work and Liberty", one of the party's main campaign demands during the 1982 elections.

Fernando Ochoa--NACLA

Sao Bernardo metalworkers at union meeting during 1980 strike.

Recognizing that the banks will not readily accept loan extensions and interest rates sufficiently low to allow the implementation of this kind of program the PT calls for comprehensive negotiations at the political level with governments of creditor countries.

The history of actions by the U.S. Federal Reserve Board in dealing with the Mexican and Brazilian 1982 debt crises confirms the importance of creditor government involvement. Only governments have the authority to negotiate comprehensive solutions. They are already deeply involved both as creditors in their own right and through their central banks hold ultimate responsibility for their domestic banking systems.

The PT maintains that its strategy is not dependent on the formation of a "cartel" of indebted countries, arguing that if a country the size of Brazil takes the lead then it is certain that other countries will follow. As we saw in Chapter 4, international creditors have taken this prospect very seriously, and are attempting to prevent it from becoming a reality. Obviously, an effective alliance of debtor countries cannot fail to invoke a response from the governments of creditor countries who hold ultimate responsibility for the health of the financial system. While the PT does not want to provoke the collapse of the financial system it pledges to press these demands on behalf of the workers and peasants of Brazil, leaving it up to the creditor countries to decide if they want to force a default.

Another voice in the debate within Brazil concerning what to do about the debt burden is the Brazilian Institute for Social and Economic Analysis (IBASE) which has put together a five-point plan:

1) refuse to accept any IMF conditions;

2) declare a 2 to 5 year moratorium on debt payments;

3) demand an end to floating interest rates and agree to pay only fixed rates in the range of 4-5%;

4) demand that debt payments be no more than 10% of export earnings;

5) stimulate investment in production of goods for the domestic market.[14]

As this study is being written the transition to civilian government in Brazil is just getting under way. It is impossible to predict the exact course of future events. Nevertheless it is certain that the debt issue will retain a central place in Brazilian politics. The voices of the popular sectors calling for relief from the austerity measures dictated by the IMF can be expected to grow louder and more persistent as events unfold.

7.4 Peru

Prior to the April 1985 presidential elections political parties began to define their positions with respect to Peru's $14 billion external debt. One of the clearest platforms was that of the United Left coalition (Izquierda Unida, IU) which identifies itself as "the political expression of the dispossessed, the forgotten, the oppressed and the rural and urban poor." The IU called for:

1) holding a referendum to decide on a selective moratorium of at least five years duration on the public external debt, during which terms and conditions for repayment would be renegotiated;

2) assuming state control of foreign trade and all foreign currency transactions;

3) making some debt payments in kind, (that is through exports of goods) rather than in cash;

4) reducing the government deficit by lowering the portion that goes to debt service abroad;

5) offering incentives for the return of Peruvian capital that has fled abroad;

6) providing tariff protection and selective import controls for local manufacturing industry;

7) restructuring of government finances to eliminate tax evasion and to decentralize government revenues and spending.[15]

In the months preceding the elections the government of President Belaunde Terry all but suspended payments on Peru's foreign debt, making only token payments on a few credits. In fact no payments of principal had been made on Peru's debts since March, 1983 and interest payments had started to dry up after June, 1984.[16] There were reports that some of Peru's private creditors wanted to declare their loans in default and seize Peruvian property abroad, but this did not happen.

Instead the U.S. government intervened, preventing Peruvian loans from being declared "value-impaired" in the U.S. after a token interest payment of $25 million was made. A U.S. banker admitted that "political considerations" had been involved, giving the Belaunde government some breathing space prior to the elections.[17] No doubt the U.S. strategy was to avoid making the debt issue a central element in the election campaign in order to defuse the threat that the United Left coalition might gain power through a democratic election.

The elections were actually won by the Social Democratic APRA party (American Popular Revolutionary Alliance) with the United Left (IU) coming in second and the former President Belaunde Terry's party third. The APRA party had played down the debt issue during the campaign. Then in his July inaugural address the new President, Alan Garcia, announced his policy on Peru's foreign debt:

1) Peru would dedicate no more than 10% of its export revenues to debt service over the next 12 months;

2) and Peru would refuse to negotiate with the IMF, talking instead with its private bank creditors.[18]

Garcia declared that his government would "not negotiate Peru's sovereignty because we're about to begin a revolution and we won't sacrifice our children to pay the foreign banks."[19]

Other measures announced by the APRA government included:

3) an unspecified cut in arms purchases;

4) an austerity program labelled a "war economy" involving a one-time wage increase averaging 18%, followed by price controls, a lowering of domestic interest rates, and a devaluation of the local currency;

5) some import restrictions and foreign exchange controls;

6) a redistribution of income, promised as the key to strengthening the internal market;

7) an increase in local food production to replace costly imports;

8) steps to halt tax evasion.[20]

Garcia's apparently bold initiative won headlines throughout the America's and much international attention as a possible "third way" between declaring a moratorium on all debt payments and accepting full IMF austerity. One analyst told the *New York Times* that "everyone is watching Peru to see what space exists for negotiations."[21]

The first reaction of the Reagan Administration was to cut off all U.S. aid to Peru until it resumes payment on its $11 million debt to the U.S. government.[22] At last report the U.S. is considering rescinding this move pending further negotiations with the Peruvians.[23]

The private banks, for their part, have taken the Peruvian declaration in stride. One New York banker said:

If we look at this from a cynical point of view, this ten per cent is more than Peru has paid this year.[24]

This same banker characterized Garcia's speech as "very political, saying what the people wanted to hear." The banker stated his expectation that Peru would be flexible in negotiations.

Another New York banker treated the speech as the declaration of a young inexperienced government. He pointed out that there were within the government others with more experience in international banking and that only in four or five months would the real story be known.[25]

Within Peru commentators have also expressed skepticism about the ability of the APRA to stick to its promises.[26] They point out that should Peru spend 10% of its export-earnings on debt service, amounting to about $350 million in 1985, Peru would be almost doubling the rate at which debt payments had been made during the first six months of 1985. Many commentators point out that the Alfonsin government had pursued a very similar strategy after taking over from the Generals in Argentina. At first Alfonsin took a very firm position against the IMF but in June of 1985 his government submitted a letter of intent to the IMF involving an austerity package not unlike the one introduced in Peru.[27]

It should be recalled that once before a Peruvian government negotiated a rescheduling of its debt with a consortium of private banks without involving the IMF. This ended in failure as explained in Chapter 4.

The United Left coalition has maintained its pre-election position by introducing a bill in Congress calling on Peru to declare a five year moratorium on interest and principal payments and to convene a Latin American front of debtor countries.[28]

As this study is being completed the negotiations between the APRA government and its creditors have not yet commenced and it is too early to predict the outcome. What is certain, however, is that the pressure from the workers and peasants of Peru for liberation from debt bondage will increase.

7.5 Bolivia

In July of 1984 the powerful Bolivian Workers Central (Central Obrera Boliviana, COB) pressured the centre-left coalition government of President Hernan Siles Suazo into declaring an indefinite moratorium on payments to Bolivia's private bank creditors.[29] The declaration came as part of a settlement package ending a general strike called by COB to protest government austerity measures. Bolivia had already missed several payments on its $720 million private debt. The government also pledged to continue meeting interest payments on some $4 billion in loans owed to governments and to the World Bank, as long as these payments did not exceed 25% of the value of Bolivia's export earnings.[30]

The COB had objected strongly to an austerity package that Siles Suazo attempted to introduce in April, 1984. This package would have resulted in a 400% increase in the consumer price index, following upon four years of falling real incomes that had seen the average minimum wage fall below $30 a month. Through a series of 24-hour strikes and general work stoppages, Bolivian workers won back government subsidies on seven crucial consumer items, and a 130% retroactive wage increase to compensate for the loss of purchasing power caused by the April 1984 austerity package.

With these victories the Bolivian workers were able at least in part to protect their standard of living and to set a precedent for workers' movements in other indebted countries. The COB also incurred the wrath of the private bank creditors who did not want such a precedent to be set even though the amount of money involved was much smaller than the many billions at stake in Brazil or Mexico. Accordingly the bankers threatened to seize Bolivia's civilian air fleet. Then in January, 1985 one U.S. creditor, a firm called Practical Concepts Inc., won an unprecedented court order freezing $1.7 million from the accounts of the Bolivian state mining corporation, Comibol, held by the National Bank of Washington.[31] This action is of particular significance because the Bolivian miners' federation (FSTMB) has been in effective control of Comibol since April of 1983 under a system of worker co-management negotiated with the government.

Despite gains in worker control and the substantial influence the COB and the Peasants' Confederation of Bolivia (CSUTCB) have demonstrated, the tragedy of the Bolivian situation is that the peasants and workers of Bolivia have inherited from centuries of colonialism and neo-colonialism, and decades of military rule, a mishapen economy highly dependent on the export of just a few commodities — tin and natural gas. (A third export commodity, cocaine, is even more important in terms of earnings but its revenues enter the underground economy.)

While the soldiers who were responsible for building up much of Bolivia's external debt have retired to barracks, the civilian government is faced with an economic crisis made worse by external events. For example, in October, 1984 the price of tin on the London metal market fell to an all-time low of $5.21 per lb. while the cost of producing a pound of refined tin from Bolivia's depleted mines is close to $22.[32]

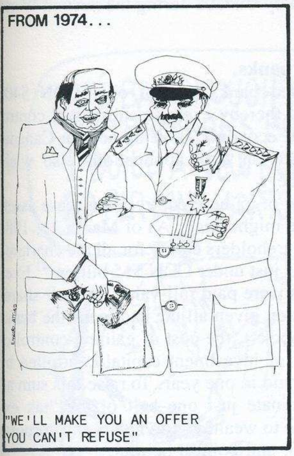
Similarly much of the capital borrowed during the years of military government was wasted on expenditures that have not benefited the majority of the population. It is estimated that at least $400 million was squandered on luxury imports, unspecified "military expenditures" and outright corruption.[33] Other monies were spent on a fruitless search for petroleum. Natural gas was found instead, which is now shipped by pipeline to Argentina. Unfortunately, given their own financial crisis the Argentines have been making payments to Bolivia on an irregular basis.

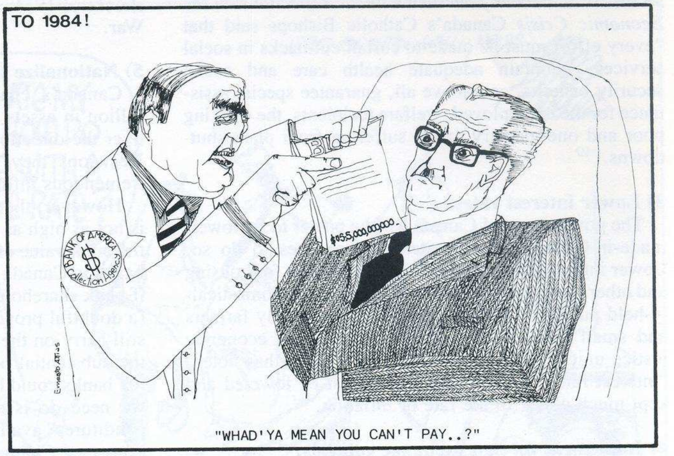
As a result of these factors, Bolivia's official debt service obligations for 1984 were larger than all of its export earnings. The Bolivian Finance Ministry estimates that in 1985 it would cost Bolivia 158% of all its export earnings if it were to attempt to make up the arrears on its debt payments.[34] In other words it is impossible for Bolivia to pay its debts.

Nevertheless, creditors are taking a hard line against Bolivia's moratorium lest it be imitated by other countries. Bolivia's former vice-president, Jaime Paz Zamora (at one time a partner in the coalition government with Siles Suazo) has denounced the international bankers for imposing an undeclared blockade on Bolivia forcing it to pay cash in advance for all of its imports. Mr. Paz Zamora says that the international financial community "wants to punish our poor country." He traces the origins of Bolivia's 8,200 percent a year inflation to the vain efforts that were being made to make debt service payments prior to the declaration of the moratorium.[35]

Despite the dark future Bolivia faces, with rumors of another military coup , the genius of its workers and peasant organizations shows through in the novel form of protest they organized in February, 1985 when the government introduced another package of austerity measures designed to placate Bolivia's creditors. While the government expected the COB to call another general strike, the labour federation along with other popular organizations effectively took over for a time the distribution of key basic commodities.

The government had shown itself powerless to stop middlemen from selling sugar at double or triple the official price. The COB's response was to distribute 1,500 quintals of sugar at the official price, by mobilizing workers at the Bolivian development corporation (CBF) to supply the sugar, while workers at the central bank federation procured credit and handed out tokens. It also





managed to mobilize the state oil workers' union (YPFB) to sell domestic gas bottles, directly to consumers, at half the speculator's price.[36]

An example of the Bolivian workers' attitude toward their country's international debt burden and the IMF management of that burden can be found in the position of the Bolivian Cane Cutters Trade Union (FSTZB). At an International Seminar of Sugar Workers in Peru, August, 1985 the FSTZB declared the following:[37]

1. The IMF is distorting Bolivia's economic growth in the interests of imperialism.

2. The economic recession accompanied by misery, unemployment, and declining Gross National Product, is caused by policies adoped by the central capitalist countries.

3. A trade union campaign is necessary at the continental level to resist the policies of the IMF, which are contrary to Latin American development and sovereignty.

4. The IMF insistence on repayment of the external debt is the rope which is strangling the economies and people of Latin America. This should be the subject of a continent-wide conscientization of workers, to generate political pressure against repaying the debt.

The outcome of the July 1985 elections in Bolivia is still uncertain as this study is being completed. Another military coup is an ever-present danger. Bolivian trade unions and peasant organizations have been able to resist austerity measures to some degree and to search for alternatives. They are also struggling to gain greater democratic control over the Bolivian state, so that these alternatives can be made a reality.

7.6 Canada

Within Canada many popular groups have adopted alternative economic programs designed to overcome Canada's economic crisis. One of the most comprehensive programs for economic recovery in Canada is the "Ten-Point Plan" put forward by the Canadian Union of Public Employees (CUPE), Canada's largest trade union.[38] Other Canadian unions and a number of the major Canadian churches have adopted similar positions. In discussing economic alternatives to the IMF-style austerity preferred by recent Canadian governments, we shall use CUPE's ten points as a convenient outline, referring to complementary positions adopted by other groups.

Together the ten points discussed below address both the causes of growing government deficits and some of the dangers posed by Canada's huge international indebtedness (see Chapter 6).

1) Stimulate the Economy.

Direct government spending is needed to create permanent jobs for the more than one and a half million Canadians who remain unemployed. In the words of the National Working Group on the Economy and Poverty of the United Church of Canada: "There is no shortage of work to be done, in reforestation, urban renewal, care of the young and the elderly, culture, recreation, community services. . .affordable non-profit housing and the development of alternative energy sources."[39] Government spending in these areas and on other social needs, such as adequate pensions for retirees, would not only increase employment. It would also stimulate demand for basic goods and services, since the newly employed would have additional income with which to purchase necessities formerly denied them. This stimulation will in turn widen the base for government taxation revenues.

2) Stop cuts in public spending.

These cutbacks not only cost the jobs of people working in the health, education and social welfare fields, but they also cause hardships for the more disadvantaged sectors of our society. In their *Ethical Reflections on the Economic Crisis* Canada's Catholic Bishops said that "every effort must be made to curtail cut-backs in social services, maintain adequate health care and social security benefits, and above all, guarantee special assistance for the unemployed, welfare recipients, the working poor and one-industry towns suffering from plant shutdowns."[40]

3) Lower interest rates.

The government of Canada has the power to set lower, made-in-Canada interest rates if it chooses to do so. Lower interest rates would stimulate demand for housing and other items, lower the cost of carrying the domestically-held public debt, save jobs, and keep family farmers and small businesses in production. As the economic justice unit of the United Church of Canada has noted, "interest rates in Canada can and must be lowered and kept much closer to the rate of inflation."[41]

4) Implement foreign exchange controls.

This policy is an essential complement to any program for lower interest rates because as we have already observed, large investors (whether Canadian or foreign) who were dissatisfied with lower interest rates in Canada would try to take capital out of Canada in search of higher returns elsewhere. In the words of a vice-president of the Royal Bank of Canada, "Capital lacks loyalty; capital goes where the returns are most attractive."[42] Although frowned upon by the IMF, exchange controls are a policy measure that have been used by Britain in the 1960's and 1970's, by the United States at the time of the Nixon shocks of 1971, and by Canada during the Second World War.

5) Nationalize the banks.

Canada's chartered banks control over CDN $400 billion in assets and thereby exercise substantial control over the direction of economic development in Canada. Decisions they make on loan applications also wield tremendous influence.

However, the cost of gaining control over these assets is not as high as one might think. As of March 31, 1984 the book value of shareholders equity for all the chartered banks in Canada was just under CDN $15 billion.[43] Even if bank shareholders were paid full-value for their shares (a doubtful proposition given all the bad loans the banks still carry on their books), the cost of gaining control of the substantial pool of investment capital controlled by the banks could be paid in one year. To raise this sum all we need do is eliminate just one half of the "tax expenditures" available to wealthy individuals and corporations (see Chapter 6, and point 8 below).

Indeed one reason why the banks in Canada have grown so rich and powerful is the favourable tax treatment they are granted. For example, in 1982 the Royal Bank of Canada made CDN $358 million without paying a penny of income tax.[44] Instead it received a tax credit to set against future taxes. As Table 16 indicates Canada's chartered banks have recorded enormous profits in recent years even though other sectors of the economy, such as family farms and small businesses, have faced unprecedented numbers of bankruptcies.

In discussing nationalization of the Chartered banks it

Table 16: Profit Increase of Canada's Banks, 1970 - 1981

Bank	Pre-Tax Profits 1970 ($ millions)	Pre-Tax Profits 1981 ($ millions)	Per Cent Increase
Royal	144.3	656.5	355.0
Commerce	137.0	419.8	206.4
Montreal	93.3	457.6	390.5
Nova Scotia	61.9	266.8	331.0
Toronto Dominion	55.6	308.3	454.7
TOTAL FIVE BANKS	492.1	2109.0	328.5

Source: Walter Stewart, *Towers of Gold: Feet of Clay*. Toronto Shrug Ltd., 1982, p. 280.

is important to stress that a publicly-owned banking sector does not necessarily mean a single, centralized, state-controlled banking structure. Rather, banking can be decentralized to facilitate more local control over banking decisions through provincial, regional and local boards representing depositors, borrowers, trade unions, farmers, fishers, bank employees and the public.

Nationalization of the banks is important to prevent the speculative flight of capital abroad and to ensure that capital is re-invested in socially useful development.

6) Shift defense spending into socially useful production.

In 1983 Canada spent CDN $7 billion on its armed forces. The Canadian churches, along with the trade union movement, have been strong advocates of reduced arms spending by Canada as a concrete step towards reducing world tensions and promoting peace. Converting arms and defense industries into civilian production also makes economic sense. Studies show that $1 billion (US) spent on defence creates only 76,000 direct and indirect jobs, while the same amount would create 139,000 jobs if spent on health services or 187,000 jobs if spent on education.[45]

7) Introduce price controls.

Inflation is really just a fancy name for rising prices. The most direct way of controlling inflation is through price controls. Canada had effective price controls during the Second World War, as did most other countries. Whereas monetarist programs of high interest rates and wage controls put the burden of fighting inflation on ordinary people, price controls place the burden on those most able to bear it, the largest corporations.

8) Restructure government finances.

Canada's taxation structure is grossly unequal. Minor tinkering with tax rates will not be enough to restore equity nor to ensure that governments have adequate revenues for much needed social programs and for public investments. A major overhaul of the whole structure of government finance is needed.

For example, we have seen that a central feature of Canada's tax system is the existence of special "tax expenditures" that allow wealthy investors and companies to avoid paying billions of dollars annually in taxes. This money is needed by government to fund essential programs.

The United Church of Canada Working Group on the

Economy has joined the call for tax reform demanding that "the tax system must be made more fair, with fewer exemptions, with progressively higher rates, and with corporations bearing a larger share of the tax load."[46]

9) Expand Public Ownership.

In order to create jobs and to give the public an effective voice in the overall planning of Canada's economy the various levels of government should expand their involvement in direct investments. Too much investment is now directed to capital intensive energy mega-projects that create few jobs, abuse the environment and threaten native rights. Public ownership is vital for redirecting investment into the processing of raw materials and the manufacturing of such goods as farm machinery, public transit equipment and housing. This expanded public participation also demands the restructuring of present crown corporations to allow for greater public input into decision making. Such input is especially important from groups most affected by the development plans of these corporations, as for instance farmers whose land might be crossed by Ontario Hydro transmission lines, or native peoples whose fishing grounds would be endangered by Petro-Canada offshore drilling.

10) Extend public services.

Many vital needs of Canadians, especially those of children, women, native peoples, and the elderly, are not yet being adequately addressed. These include day care, health care, education, cultural activities, adequate pensions and other services for the elderly. Rather than cutting back on the already inadequate levels of public services, it is necessary to extend these basic services.

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Chapter 8
Towards Self-Reliance

"Power never concedes anything without a struggle; it never has and never will."[1]

Frederick Douglas

leader of the fight for emancipation from slavery in the United States

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The struggle against debt bondage is like the earlier struggles against slavery. The rich and powerful will not readily concede their power without a struggle on the part of those who are enslaved by debt. The primary agents of liberation from slavery are the enslaved themselves.

If we ask, "Who holds power in the world of finance?", the answer at first seems obvious — the banks, the International Monetary Fund and the governments of creditor nations. However, if we look more deeply we see that power relations are shifting. To paraphrase again the familiar saying of John Maynard Keynes, "If I owe the bank $1,000 then I have a problem, but if we owe several billion then the banks have a problem."

And so it is that the banks, the international financial institutions and the creditor governments are genuinely worried. As Henry Kissinger, no stranger to the realities of power politics, has said:

It seems only a question of time until some major government, or more likely a group of them, will seek to impose their terms on the creditors.[2]

The objective conditions for such debtor power are growing; what is lacking is the political will on the part of most governments. At present there is little likelihood of the formation of a "debtors' cartel". For the time being the "divide and rule" strategy of the creditors seems to be working. Moreover, as Javier Iguiniz explains with regard to Latin America:

Individual Latin American countries' political and economic dependency on the United States is much stronger than the ties among the Latin American countries.[3]

However, as we have seen in Chapter 7, among opposition groups within most highly indebted countries there is a rising tide of resistance to perpetual debt bondage [and a] growing demand for alternative self-reliant paths to development. Present governments are conscious of these demands. It has therefore become more urgent than ever for them to appear to be resisting their creditors. Hence the flurry of diplomatic activity symbolized by the Cartagena Consensus and the Addis Ababa Declaration described in Chapter 5. As Javier Iguiniz explains, when these "nationalist" governments declare that they cannot pay their debts, they are not really saying they won't pay. They are trying to threaten the banking system with "political instability" and "revolution" in order to pressure the banks to ease up on their terms. And these groups do need easier terms in order to survive.[4]

8.1 Keeping the Elites in Power, Sustaining Dependence

There is evidence that some bankers do recognize keeping present governments in power (or substituting others of similar inclinations) is in the banks' best interests. Thus the "Western Hemisphere Commission on Public Policy Implications for Foreign Debt", chaired by David Rockefeller of Chase Manhattan Bank with representatives from Morgan Guaranty Trust, Citibank, First National Bank of Chicago and Bank of America, recommended that:

The cost of rescheduling should not be excessive, and all parties should seek to maintian an orderly negotiating process, in an effort not to tempt unilateral action on the part of debtors.[5]

The Commission, which can be considered the voice of big U.S. finance and industry, was keenly aware of the threat to stability posed by the debt crisis. It recognized that rising unemployment and inflation and declining real incomes are producing widespread popular opposition:

with a pronounced tendency to blame foreign bankers for encouraging borrowing which countries could not afford, and the IMF for imposing austerity. . .There are limits to austerity beyond which governments dare not venture.[6]

Similarly the chairman of the Canadian Imperial Bank of Commerce told the bank's 1984 annual meeting that it is

timely. . .that the commercial banks review their terms, especially the rates of interest we have been demanding (that are) well beyond what we historically have been charging. . . From a strict credit point of view there may be some rationale for that. But I have to ask whether. . .we are not risking more long-term pain for some short-term gain. . . It may be good boxing tactics to hit hard when your opponent is on the ropes. I wonder whether it is good banking.[7]

Thus one possible scenario is that banks and other creditors will pursue "enlightened self-interest" and relax the terms and conditions attached to refinancing debts. We have already seen that the "special deal" offered to Mexico constituted a tactical retreat on the part of the banks at the urging of the U.S. Federal Reserve Board. If Celso Pastore's image of a Formula One auto race proves true we may very well see a country like Brazil, following in the slipstream of Mexico, negotiate a slightly better deal.

However, even if Brazil or another major debtor does achieve a better deal than Mexico, that would not necessarily mean popular resistance to IMF-style austerity would be lessened. Even where a moratorium on debt payments occurs, as in the Philippines, governments may continue to adhere to austerity programs designed to increase exports at the expense of domestic consumption so that debt payments could eventually be resumed. Negotiating softer terms or declaring a moratorium are by themselves no guarantee of an escape from debt bondage. They may just mean that the debt is paid more slowly with the majority making sacrifices over a longer term. The crucial question is whether policies are implemented during a moratorium that would guarantee a country a less dependent, more self-reliant path to development.

The only way that dependent countries can escape the debt trap, in our view, as well as that of a growing number of groups representing workers, farmers and unemployed slum-dwellers, is to "de-link" their economies from the world capitalist system and pursue independent, self-reliant models of development. In our *Reflections on UNCTAD IV*, published in September of 1976, we examined in detail the case of Peru whose debt crisis had caused it to accept the dictates of a consortium of private banks. We concluded that study by predicting that the world would see more situations "where financial leverage is used to dictate policies to debtor nations."[8]

A basic restructuring of the trade and payments system will not occur through inter-governmental conferences such as the United Nations Conference on Trade and Development. UNCTAD has grown weaker still as the problems it is supposed to treat have become much more acute.[9] A basic restructuring of the international trade and payments system can be forged only by those countries that have disengaged themselves from the dominant capitalist system. If we are to give meaning to international solidarity then our first commitment must be with those who are struggling for national liberation. Like Frederick Douglas, we see hope for liberation in the struggles of oppressed peoples themselves, and not in the expectation of concessions from the powerful.

We should be clear that the reforms of the international trade and payments system discussed in the Appendix are, for the most part, desirable. Recent history demonstrates that they are not being seriously considered by the corporate and government powers who rule in the Western capitalist countries. Recent U.S. Administrations, and indeed Canadian governments, albeit in a less ostentatious manner, have consistently opposed any real reform of the trade and payments system.

The United States continues to oppose any progressive reforms within the existing international financial institutions. The evidence we have presented in this paper argues strongly that the International Monetary Fund is fundamentally flawed and should be replaced. If a progressive reform of the IMF were to be attempted then it would have to be as outlined in the Arusha Initiative cited at length in the Appendix. In the words of the signers of this document, the rules of the IMF would have to be changed

. . .to reflect the sovereign right of states to choose their own social and economic models and development paths. In particular there must be no penalization of countries which opt for strategies which emphasize national planning, systems of administrative budgeting (of foreign exchange, imports, investment and credit), the reform of traditional institutions and an active role for the public sector.[10]

No such proposal for the reform of the IMF has yet been put forward by any group of countries. In fact such changes would be so contrary to the actual practice of the Fund that they would necessitate the amendment of its fundamental Articles of Agreement. In effect they would demand the creation of a whole new international monetary system. In the Appendix we examine some of the proposals that have been put forward for such a system.

Here we must stress that there exists no consensus for negotiations among debtor governments beyond the demands contained in the Addis Ababa Declaration and the Cartagena Consensus. As we point out in Chapter 5, these agreements have not challenged the legitimacy of the IMF, nor do they offer any program for comprehensive reform of the monetary system.

The governments of most indebted countries have not yet publicly acknowledged what is central to the programs of the popular movements just examined in Chapter 7: that is, the necessity of by-passing the IMF and negotiating directly with creditor governments. As long as the IMF promotes low-priced exports and the free flight abroad of capital from indebted countries, it will remain a major barrier to the kind of self-reliant economic development that is advocated by the popular groups cited in the previous chapter.

8.2 Self-Reliant Alternatives

Self-Reliance is the central theme echoed by popular movements in many countries who are struggling for an alternative to debt bondage. What precisely do we mean when we speak of self-reliant alternative models of development? By self-reliance we refer to a development strategy that consists of three basic elements:

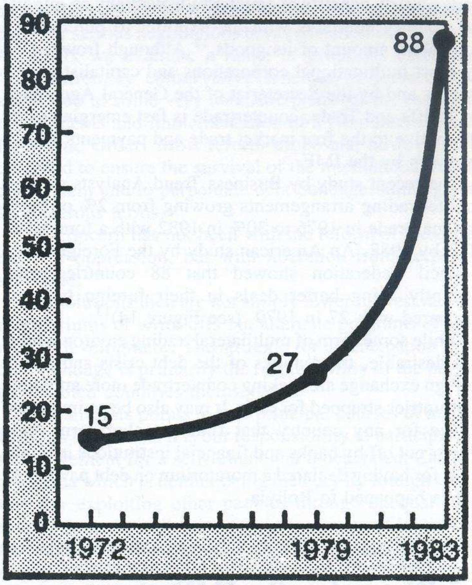
1) Domestic production of the essential goods and services a society needs for its own people, using when possible locally available resources.

2) Sufficient income for all members of society to procure the goods and services they need. This requires a progressive redistribution of income which shifts effective demand away from luxury items toward basic needs.

3) International trade as a planned extension of production for the domestic market, not the central motor of the economy.

Achieving self-reliance requires considerable development of democratic, socially controlled enterprise and economic planning at every level. The abandonment of monetarism and the assertion of democratic control over capital movements are essential for any self-reliant

Figure 14: Number of Countries Engaged in Barter Trade



Source: U.S. Foreign Trade Council

development program. The demand for this kind of economic planning and democratic control over capital movements is reflected in the programs of the popular movements cited in Chapter 7. The ten-point program for economic recovery in Canada proposed by the Canadian Union of Public Employees also embodies a desire for a self-reliant Canadian economy. Self-reliance, as we have defined it, is very similar to Keynes' notion of "National Self-Sufficiency" which warrants repeating here:

Ideas, knowledge, science, hospitality, travel — these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible and , above all, let finance be primarily national. We do not wish, therefore, to be at the mercy of world forces working out or trying to work out, some uniform equilibrium according to the ideal principles, if they can be called such, of laissez faire capitalism. We wish. . .to be our own masters and to be as free as we can make ourselves from the interferences of the outside world."[11]

When we talk about self-reliance we do not mean autarky, or absolute self-sufficiency. We do mean an economy in which meeting the basic needs of the population comes first. Whatever loss in efficiency might be entailed in pursuing self-reliance is more than made up through increased national output and social wealth resulting from full employment and reduced capital flight.

One step along the road to self-reliance could be the signing of bilateral trade agreements between countries producing complementary products. Some 30% of world trade already consists of countertrade whereby an importing country contracts with the exporter to purchase an equivalent amount of its goods.[12] Although frowned on by most multinational corporations and capitalist governments and by the Secretariat of the General Agreement on Tariffs and Trade, countertrade is fast emerging as an alternative to the free market trade and payments system overseen by the IMF.

One recent study by Business Trend Analysts showed countertrading arrangements growing from 2% of international trade in 1976 to 30% in 1982 with a forecast of 40% by 1988. An American study by the Foreign Trade Council Federation showed that 88 countries were currently using barter deals in their foreign trade as compared with 27 in 1979. (see Figure 14)[13]

While some form of multilateral trading environment is still desirable, the realities of the debt crisis and scarce foreign exchange are making countertrade more attractive to countries strapped for cash. It may also be an important device for any country that finds its short-term trade credits cut off by banks and financial institutions in retaliation for having declared a moratorium on debt payments, as has happened to Bolivia.

8.3 Disarming the IMF

Another implication of the self-reliant strategy is the progressive "disarming" of the International Monetary Fund which, as we have seen, is supplying a smaller proportion of new credits for indebted countries even as its role as global police officer is being enhanced. The strategy proposed by the Workers' Party (PT) in Brazil is worthy of emulation: refuse to negotiate with the IMF and instead demand negotiations with the governments of creditor nations. Here we note that the proposal is not for intergovernmental conferences as called for by the Cartagena Consensus and the Addis Ababa Declaration; nor is it a unilateral repudiation of debt with the risk of retaliation. It is an offer to negotiate, not with the IMF under its restrictive terms of reference, but with the governments of creditor nations who ultimately hold responsibility for their domestic and international financial health.

For such negotiations there are no precedents. There are not yet any ground rules. The proposal does involve some risks. But what it offers is an opportunity to break out of the straitjacket imposed by the IMF. For example, it could involve agreement on terms for a moratorium, for writing off "bad debts" (such as the debts for many nuclear power programs); for resuming payments only after substantial economic recovery has been achieved and the debtor country has a surplus available for export; for payments in-kind rather than in convertible foreign exchange, etc. There are no rules yet, only possibilities for any government willing to break new ground.

8.4 Orderly Write-Offs. . . Or A Financial Collapse?

One inescapable implication is that much of the burden of international debt still carried on the books of the private banks and the international financial institutions will have to be written down or written off. This debt reduction can be achieved in an orderly fashion, without threatening the jobs and security of workers in creditor countries, only through the intervention of national governments in their domestic financial markets. Specifically, this requires the nationalization of endangered private banks and the orderly renegotiation of outstanding credits.

If the private banks hold out against such an orderly solution to the debt problem, they risk precipitating a collapse of the international financial system and chaos in their own national economies. One measure of how close even the largest banks are to calamity is the ratio between their own capital, that is the money invested by their shareholders, and their loans to some of the most heavily indebted countries. The nine largest U.S. banks have lent the four most indebted countries of Latin America — Brail, Mexico, Argentina and Venezuela — amounts equal to 135% of their combined capital. Canada's chartered banks have lent these same countries amounts equivalent to 119% of their shareholders' capital.[14]

It is not possible to predict every consequence of a sudden and precipitous collapse of the international financial system. One result would certainly be a sharp contraction in the availability of consumer and investment credit within the U.S., Canada and Western Europe as leading banks either fail or totter on the brink of failure. Since the expansion of credit within these countries has been the key to such economic recovery as has occurred since 1982, a tumble into the depths of economic depression would almost certainly result in North America and Europe.

Many commentators writing in some of the most conservative financial journals are predicting that it could happen. In our *Reflections on UNCTAD IV* GATT-Fly cited Emma Rothschild's perceptive observation: "The question for the financial system is not whether these debts will be dishonoured. Rather it is an issue of when and how and where."[15]

Since then the headlines have become even more alarming:

"A Nightmare of Debt", *The Economist*, March 20, 1982

"The Debt Bomb: The Worldwide Peril of Go-Go Lending", *Time*, January 10, 1983

"Postponement of Third World Debts Threatens Upheaval, Financial Collapse", *The Wall Street Journal*, June 22, 1984

More recently the Group of Experts Report to the Commonwealth Nations warned: "The world's financial safety is balanced on a knife-edge. . .The erosion of the living standards of developing (sic) countries has pushed their people to the margin of tolerance."[16]

If no negotiated solution to the problem of the existing debt load can be achieved and major debtors are declared in default by their creditors, then central banks — the Bank of Canada and the U.S. Federal Reserve Board, for example — would have to step in immediately to try to save the banking system from a chain reaction of bank failures as happened in 1931. In theory Canadian depositors would have up to CDN $60,000 protected by the Canada Deposit Insurance Corporation and U.S. depositors up to $100,000 by the Federal Deposit Insurance Corporation.

However the Canada Deposit Insurance Corporation has limited resources. In fact during 1984 it went from a surplus of CDN $250 million to a deficit of at least CDN $332 million and probably higher by the end of its fiscal year.[17] The deficit was caused by financial losses at a number of trust companies. In an emergency the government would probably try to shore up the CDIC by printing money.

In the United States the government's response to the recent failure of Continental Illinois Corporation, a Chicago banking firm heavily involved in bad loans to the petroleum industry, indicates how it would deal with a major bankruptcy. The U.S. government stepped in to "rescue" Continental Illinois but even it was unable to stop a run on the bank as nervous depositors sought to withdraw their funds despite government assurances.[18]

It is also significant that the U.S. Federal Reserve Board leaned on the Federal Deposit Insurance Corporation and persuaded it to exceed its legal obligations by rescuing not only depositors but also protecting the owners of Continental Illinois bonds, notes and preferred shares. It is especially significant that the U.S. government did not permit any resolution of the Continental Illinois bank failure that would have involved writing down the value of its loans to Latin American governments. The U.S. authorities feared any precedent that would have shown those loans were worth much less than their face value, perhaps only 60 cents on the dollar in the estimation of *Fortune* magazine.[19]

The Wall Street Journal argues that any major loan default would result in even greater unemployment in North America as there would be massive cutbacks in domestic lending.[20] Deposits placed in the overseas branches of multinational banks, and ironically this includes much of the capital that has been deposited outside of indebted countries by their wealthy elites, would probably be the first to disappear during a major banking crisis. Although a major international financial crisis must certainly haunt the world's bankers, it is naive to think that these same bankers will, of their own accord, initiate an orderly write-down of bad debts. In the words of one Canadian banker: "Anything in the nature of. . .big write-offs is simply not in the cards."[21] Therefore the role of governments in negotiating an orderly write-down of bad debts is all important. In the Appendix we review several of the proposals that have been made to enable this to happen.

8.5 Political Action

While various "solutions" for the reform or reconstitution of the international financial system have been proposed, none of these plans has yet been accepted as a basis for serious negotiations between nation states. In the Appendix we examine a range of proposals extending from extremely conservative schemes to preserve the status quo to some very idealistic plans for the cancellation of debts and implementation of a New International Economic Order. Most reform proposals, however, are designed to ensure the survival of the international financial system and to perpetuate debt bondage, although on less onerous terms.

Our concern has not been with the reform of the structures of oppression, but with liberation from perpetual servitude.

The solutions then are not simply lower interest rates or moratoriums or write-offs but alternate programs of self-reliant development. The struggle for emancipation from debt bondage is primarily the responsibility of the people of indebted countries themselves.

This analysis points to two principal courses of action: First, as Canadians it is our responsibility to participate in the movement for a self-reliant and independent Canada, a Canada which is neither being bled dry by foreign creditors nor exploiting other peoples through unequal trade relations, or the collection of usurious rates of interest on foreign loans. We must strive for a self-reliant Canada that engages in international relations on the basis of mutual advantage. Second, we must find ways to act in solidarity with the workers, farmers, peasants, the unemployed and all who participate in popular movements for emancipation from debt bondage in other countries.

Far from being a denial of international solidarity, our efforts to achieve a more just, independent and self-reliant Canada are a necessary part of the struggle to be able to stand in solidarity with other peoples. At present Canada's over-dependence on foreign capital and particularly on capital from the United States, constrains our ability to take an independent course in international affairs.

8.6 Putting Canada on the Road to Self-Reliance

Some of the specific changes we should work for have already been outlined in Chapter 7. As we point out there, some of these demands, e.g. less spending on arms, tax reform, and improved social services are already established policies of the Canadian churches. We must pursue these goals along with our allies in the labour movement and other social groups.

Other demands are clearly more controversial. For example there is not yet the same consensus on the need to nationalize Canada's chartered banks. Nevertheless the analysis presented in this study forces us to conclude that this is necessary. To achieve such a goal would require a very strong, broad-based political coalition that has yet to be built. The base for such a coalition exists among the labour movement, farmers and other small producers and especially the unemployed who are coming to realize the key role that finance capital plays.

While many of the demands could be the subject of immediate action, the achievement of other goals is a longer term proposition. Though it is not a complete platform for social change in Canada, we do submit that the ten-point plan put forward by the Canadian Union of Public Employees is worth discussing as a basis for building a broad-based coalition for social justice and economic independence.

For church groups an essential first step may involve more dialogue with popular organizations around these points, rather than immediate approaches to the government. As the martyred Archbishop of San Salvador Oscar Romero said, "The principal interlocutor of the church is not the state but the people."

8.7 Solidarity with Popular Movements Throughout the World

One of the findings of our analysis is that there is no ready-made package of international reforms that would solve the debt crisis. Instead the history of emancipation from debt bondage is likely to be much more uneven, as different peoples make independent progress towards self-reliance. Our task is to join them, bringing to the process a uniquely Canadian contribution.

One implication is that Canada's aid and trade policies vis-a-vis the Third World must be fundamentally reoriented. In their study *Perpetuating Poverty: the Political Economy of Canadian Foreign Aid*, Virginia Smith and Robert Carty advocate an aid policy based on

political and economic liberation. If these were the goals of Canadian (policy). . . aid would be reserved for popularly supported governments that seriously want to eradicate poverty at its roots in a self-reliant way.[22]

A complementary trade policy would offer bilateral trade to countries genuinely struggling for self-reliance with a surplus of goods complementary to what can be produced in Canada. For peoples struggling under repressive dictatorships to whom governmental aid would be inappropriate, Non-Governmental Organizations such as the churches, trade unions, and farmers' movements can offer important people-to-people aid and solidarity, assisting popular groups in those countries.

Finally, our analysis leads us to predict that many more countries will soon be following the programs outlined by popular groups examined in the last chapter, declaring unilateral moratoria on their debt payments and refusing to submit to the austerity measures demanded by the IMF and their private creditors.

It is certain that the IMF, the Reagan Administration and the private banks will attempt to contain and punish any country that refuses to demand sacrifices from its population so that debt payments continue to be made. And the financial and military power available to these interests is certainly great.

Nevertheless, our prime political task is not a vain effort to achieve reforms of the IMF which they would find acceptable. It is instead to join with peoples in Canada and globally who are struggling for emancipation from debt bondage and pursuing self-reliant development. Many leaders of popular groups throughout the world have declared that debts must not be paid through the hunger of the people. It is our duty, and our gain, to stand with those peoples who demand food for the hungry before profits for their creditors.

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Appendix

Proposals for Reforming World Finance

> *Another idea floated recently by the CIA. . .is that the central banks of the debtor countries would issue a new kind of security. . .(that) would be given to the commercial bank creditors in exchange for the existing loans. (This) would constitute a mortgage on the export revenues of the debtor countries. . .It bears an uncomfortable similarity to situations that emerged 100 years ago as country after country — Egypt, Turkey, Tunisia, Morocco — fell under the sway of the bankers who, after sending in troops and battleships to reorder the political priorities of the countries concerned, then took over control of customs receipts, tax administration, canal and railway revenues, and assigned these revenues first and foremost to servicing debt.*[1]
>
> Tom Naylor
> Professor of Economics McGill University

While the positions adopted by popular groups are mostly ignored in the public debate on the world debt crisis, there is an abundance of other proposals for reform. A large number of plans have been developed by bankers, academicians, central bank officials and politicians. As yet there is no consensus among the banks and the creditor country governments about which route to pursue. The debate goes on both in public and in private. In this Appendix we shall examine a number of proposals ranging from very conservative plans to extract the banks from the hole they have dug to blueprints for the reform of the world trade and payments system.

Most of the proposals surveyed in this Appendix have one thing in common: they assume that the system of so-called free trade and free capital flows is in the interests of both the creditor and debtor nations. Most of these propositions also assume the legitimacy of the IMF. In fact many of the proposals would strengthen and expand its role as global police officer enforcing austerity measures for debtor countries. Some of the more liberal proposals call for reform of the IMF and changes in the kind of conditions it imposes. But only a very few suggest that the IMF be dissolved and replaced with a more representative institution. Almost none of these proposals differentiate between debtor countries politically. Thus they would assist General Pinochet, President Marcos and President Mobutu as readily as they would aid the people of Nicaragua or Tanzania.

A.1 Free Enterprise Solutions

At one end of the political spectrum we find the hard-line, free-enterprise point of view whose proponents argue that there should be no bailout either for the banks or the debtor nations. For example Professor Karl Brunner of the University of Rochester argues that "improvised, piecemeal rescue packages to protect debtor nations from financial collapse could lead to renewed world inflation and are a waste of resources."[2] Instead he argues that the debt crisis will be resolved by the operation of market forces even if this means that the banks have to accept some losses. He does, however, allow for a "temporary" increase in IMF resources to meet what he sees as a short term liquidity crisis.

Most observers are not as confident that market forces will provide an easy resolution. Many very conservative voices admit that the banks will have to pay a price for having overlent to so many risky debtors. For example, a former chairman of the Chase Manhattan Bank, George Champion, argues that lending to foreign governments should not have been the business of the banks in the first place.[3] He proposes that U.S. banks not be allowed to make any further loans to underdeveloped or Eastern European countries and that 50% of the banks' pre-tax earnings be dedicated to writing-down non-performing loans to no more than 50% of their face value. He also says that dividends to bank shareholders should not be increased and that the U.S. banks sould have to increase their reserves against loan losses.

Mr. Champion does not have any advice for the underdeveloped countries involved. Needless to say his proposals for taking losses are not very popular with his fellow bankers. Nevertheless he does receive support from William Simon, a former U.S. Secretary of the Treasury. Simon takes a hard line on the IMF, accusing it of propping up "every socialist government in the Third World."[4] Therefore Simon opposes increases in IMF funding "to prop up old loans with new ones" at the taxpayers expense. Instead he favours a bilateral approach so that the United States can use its foreign aid directly to advance its interests abroad. Another former Secretary of the Treasury and now White House Chief of Staff, Donald Regan talked of a solution to the debt crisis through "a return to sound market-oriented economics" and urged other nations "to shift their own political gears" along the lines of the "Reagan revolution."[5]

Another voice from the right is that of Martin Feldstein, chairman of President Reagan's Council of Economic Advisors. Feldstein advises debtor countries to adjust by implementing much deeper devaluations of their currencies in order to stimulate exports. He adds that "It is crucial, moreover, to maintain this real devaluation by preventing wages, and therefore prices, from rising to offset the devaluation."[6]

A.2 Write-Downs and Bail Outs

Some voices in the business community perceive the problem in terms of a weakening bargaining position on the part of the creditors and a growing strength for the debtors. For example, Albert Friedberg, a director of a Toronto commodity brokerage firm, accuses the banking community of having exhibited "lemming-like tendencies" as it "teeters on the precipice." He says that current reschedulings are only making the problem worse and he observes that:

The positions at the bargaining table have reversed. The creditors are weak and don't know it yet, and the debtors are strong and haven't mustered enough courage to force their terms.[7]

Before the debtors do force their own terms, Friedberg advises the banks to accept responsibility for making bad loans and take some write-offs in an orderly manner. Then the banks could offer Third World debtors incentives, such as lower interest rates, for those countries willing to make the sacrifices demanded by the IMF. He recognizes that "the nation that submits becomes a vassal to the creditors of the world." Thus, in the last analysis, his plan is aimed at the perpetuation of debt bondage. Its costs, however, would be borne by the bank's shareholders and their depositors and not by the taxpayers if his plan were ever adopted.

Other businessmen advocate that the cost of writing down bad debts should be "socialized" with both the banks and the taxpayers sharing part of the costs. Thus New York investment dealer George Soros proposes that central banks either guarantee private debts or take them off the hands of the private banks at a discounted value so that the banks take partial losses. Some commentators say that the private banks expect such a bail out to occur sooner or later and therefore have adopted a cynical attitude which may be summed up as follows:

Wring all you can from the Third World now and if a new crisis comes the Government will at least bail you out.[8]

In fact most of the serious proposals for dealing with the debt crisis involve some form of government bail out.

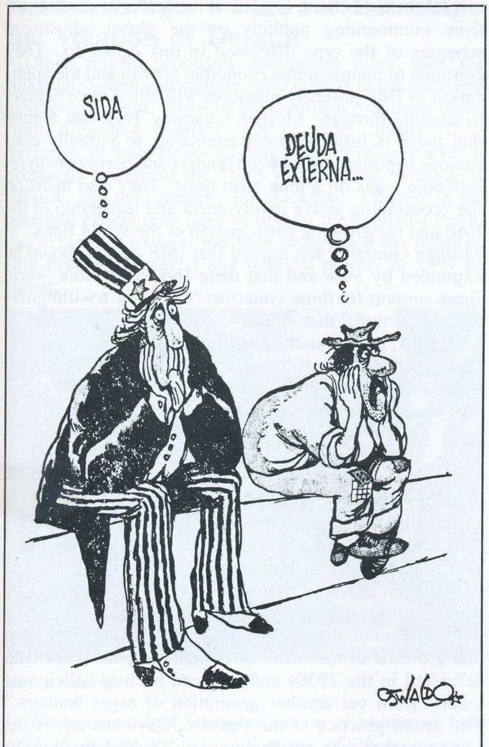
A.3 Exchanging Loans for Bonds

A number of plans have been proposed for converting existing loans to long-term, lower interest bonds which would then be held by central banks or some kind of international agency. Many of these proposals foresee an enhanced role for either the IMF or the World Bank which would create a new branch to hold the bonds. In most cases the banks would sell their loans to the new agency at a discounted value, taking some losses but freeing themselves from the burden of bad debts (Presumably they would be able to write off these losses against their domestic taxes, though this element is seldom mentioned).

The report by the Commonwealth Group of Experts on the debt crisis lists at least seven plans which fit into this category.[9] It is significant to note that all seven of these propositions imply a strengthened role for either the World Bank or the International Monetary Fund and none of them are accompanied by recommendations for the reform of these institutions or even a loosening of the terms of IMF conditionality.

To illustrate this category of proposals let us look at the plan put forward by Felix G. Rohatyn, a partner in the investment firm of Lazard Freres and chairman of the Municipal Assistance Corporation (MAC), the government body set up to bail out New York City from its debts in 1975.[10] Essentially what Rohatyn proposes is "a worldwide MAC" to convert short-term debt into long-term debt. An international agency, such as the IMF, would assume debts from the banks in exchange for long-term, low interest bonds of its own. The banks would have to take some losses but the exact allocation of costs among the banks, taxpayers and debtor countries would be the subject of "difficult negotiations".

The new agency would then become the creditor for the Third World. It would, in Rohatyn's words, "help the debtor countries establish a revenue stream tied to sales of their commodities or other kinds of income. . .Such a new agency would undoubtedly have to carry some form of guarantee by Western governments." Repayment would be at 6% interest over 15 to 30 years and repayment schedules for debtors would be tailored country by country to reduce debt service costs to 25%-30% of ex-



AIDS External Debt

port earnings. The IMF would continue in its role of "oversight", although Rohatyn advocates that it become more "practical", without explaining what this means.

A.4 Exchanging Loans for Equity

Another set of proposals involve arrangements under which the loans would be exchanged for equity ownership in the raw materials and the state corporations of debtor countries. For example, a share in the ownership of an iron ore mine would be exchanged for the cancellation of part of a loan. One advocate of this proposition is Nigel Lawson, the United Kingdom's Chancellor of the Exchequer. Another proponent is Fritz Leutwiler, head of the Bank for International Settlements. But most bankers reject this option pointing out that many Third World companies are unprofitable and that it would be politically impossible to touch the profitable ones like the state petroleum companies in Mexico or Brazil. A vice-chairman of the Morgan Guaranty Trust dismisses the proposal out of hand saying it's "nonsense. . .Banks cannot hold equity. Our business is money business."[11]

Another version of this idea has been developed by the Georgetown University Institute for Strategic Studies, which Tom Naylor identifies as a "think tank" for the CIA. It would involve the central banks of debtor countries issuing a new kind of security called an "exchange participation note".[12] The banks would then swap existing loans for these notes which would constitute a mortgage on the export earnings of particular industries in the debtor country. As noted at the beginning of this Appendix, Tom Naylor compares this scheme to the nineteenth century practice of seizing taxes, canal and railway revenues from indebted countries.

The President of Mexico has recently put out feelers concerning the conversion of a portion of Mexico's public debt into minority shares in 40 state-owned companies. The list sent to some of Mexico's large creditor banks reportedly includes steel mills, a hotel chain, and mining, metal and chemical companies, all of which are currently losing money.[14]

A.5 Capping Interest Rates

Anthony Solomon, President of the Federal Reserve Bank of New York, has proposed that the debt problem be contained by putting a "cap" on the interest rates paid by debtor countries. Under such a scheme the debtor would pay interest up to a certain limit after which any higher portion of interest payments would automatically be added onto the principal, extending the loan by that amount.[15] One Mexican writer, Pablo Alvarez Icaza has replied that such a scheme does not really solve the fundamental problem because it only postpones payments. Alvarez Icaza points out that it does reveal the intentions of creditors who know that the debt can never be repaid in full but want to set up a permanent mechanism for making profits through the collection of interest payments.[16]

One example of an interest-capping loan is a co-financing program that the World Bank has initiated in co-operation with a number of private banks lending to Brazil. Under this plan there's a ceiling on how much interest is paid each year. (The cap was set at 12% under a similar loan made to Paraguay.) Any amounts of interest due above this level are automatically converted into a fresh loan owed to the World Bank. The private banks involved enjoy a guarantee from the World Bank.[17]

A.6 U.S. Task Force on International Private Enterprise

Various officials of the United States government have made proposals for dealing with the debt crisis. But the Reagan Administration has no coherent plan of action. Decisions are made on an ad hoc basis with Paul Volker, Chairman of the Federal Reserve Board, playing a key role.

In October, 1984 a 21-member Task Force on International Private Enterprise appointed by President Reagan submitted a draft report containing a number of policy options. It recommended that the U.S. government set up a special crisis management team to co-ordinate U.S. efforts to cope with the debt crisis, indicating that the members of the task force, mostly presidents and chief executive officers of major corporations, view the crisis as very serious.

The Task Force invited the Reagan Administration to consider what it called "a cafeteria of potential solutions" which included: long-term stretching out of the debt; a moratorium on interest payments; increases in loan loss reserves for U.S. banks; continued adjustments by the debtor nations backed by the IMF; emergency infusions of capital; and significant economic growth to provide export markets for debtor nations.[18] The fact that this Task Force could not settle on any one set of recommendations indicates that there is no consensus among the ruling circles in the United States on what to do about the debt crisis.

A.7 Rockefeller Commission

Another group of U.S. business leaders have put forward a more comprehensive list of recommendations. Convened by David Rockefeller and several other leading U.S. bankers, the Western Hemisphere Commission on Public Policy Implications of Foreign Debt recommended:

— increased contributions to the IMF and the World Bank;
— allowing the IMF to borrow in private markets;
— increased contributions to the IMF and the World Bank;
— expanded co-financing for banks in co-operation with the World Bank and the InterAmerican Development Bank;
— IMF and World Bank guarantees for private financing;
— expanded direct government to government credits and guarantees through the U.S. Ex-Im Bank (the U.S. Equivalent of Canada's Export Development Corporation);
— liberalized trade through the General Agreement on Tariffs and Trade;
— encouragement of private investment in debtor countries;
— an expanded role for the Overseas Private Investment Corporation, a U.S. government body that insures foreign investments;
— converting a portion of the debt into equity.[19]

A.8 Banks Prefer Muddling Through

In Chapter 4 we examined the private banks' attitude toward the debt crisis. In general the banks have refrained from commenting publicly on the global adjustment schemes of the type discussed in this Appendix. They continue to maintain that economic growth and the application of IMF austerity measures will allow most debtors to muddle through. Morgan Guaranty Trust has argued that there is little practical alternative to virtually continuous negotiations between lenders and borrowers to reschedule loans on a long-term basis. They also insist on the "continuing active involvement and leadership of the IMF and the growing participation of the World Bank."[20] Morgan Guaranty has argued that IMF quotas should be expanded by 50% and that there should be more World Bank support for those countries "that show a willingness to take actions that promote exports."[21] As noted in Chapter 4, deals like the one offered to Mexico for multiyear reschedulings at lower spreads and without rescheduling fees will only be offered to countries that "successfully implement IMF programs."

A.9 Debt Repudiation

Some have discussed debt repudiation as an option for certain hard pressed countries. Writing in *Canadian Business*, Charles Davies notes that

Pentagon planners ponder nuclear war — it would be messy but there would be survivors.[22]

Davies notes that the same Latin American countries that are now at the brink of default were the ones who defaulted in the 1930s and bounced back to "elicit vast credits from yet another generation of eager bankers." The actual practice of the bankers, Davies notes, is the same whether they are dealing with Dome Petroleum or Brazil, that is, "simply to ignore default, to let payment dates slip by in the knowledge that, sooner or later, all parties (including governments) will agree on a rescheduling agreement."

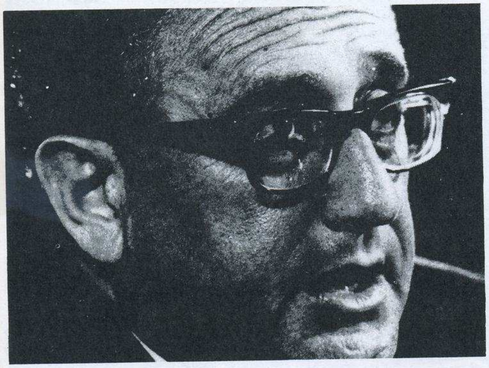
But would a country take the bold step of actually repudiating its debts? *The Wall Street Journal* echoes what we say in Chapter 4 when it reports that

countries don't have to stop making interest payments **and** *antagonize creditors; rather they can stop payments without incurring the wrath of the banks. They simply say. . .they have run out of money. . .Bankers themselves admit countries can avoid drastic consequences if the nations simply slide into a moratorium on interest payments.*[23]

The Wall Street Journal goes on to report that a study conducted by the Brookings Institute concluded Brazil would be better off after repudiating its debt if the result were only a 5% drop in export earnings and a 5% increase in import costs. The same study concludes that Argentina could endure a 10% loss on its external trade because it is already self-sufficient in food and energy. It also notes that when Cuba was forced to repudiate its debts to the United States in 1961 it managed to sustain its standing with other creditors including Canada.

A.10 Kissinger's Plan for Defusing the Weapon of Default

Other reform proposals encompass more than the financial system and include other aspects of the trade and payments system. Some of these reform proposals come from surprising quarters. For example, former U.S. Secretary of State Henry Kissinger has developed a set of proposals to deprive the Third World of the "weapon of default" and the "capacity for blackmail" inherent in the potential power they have to disrupt the capitalist financial system. Kissinger has long understood the relationship between financial and political power. In 1974 he stated:



Henry Kissinger

Those who wield financial power. . .sooner or later seek to dictate the political terms of (their) relationships.[24]

Kissinger's way of defusing the debt bomb is to have governments, international financial institutions, and banks cooperate to create an early-warning system and clarify who would act as lender of last resort in the event of a major default. He would like to see the IMF and the World Bank strengthened and become more active in shaping the policies of debtor countries.

The governments of Western countries would have to co-operate in encouraging economic growth, promoting Third World exports, and resisting protectionism. The U.S. would have to bring down interest rates chiefly by curbing its government deficit. Western banks would also have to create "new mechanisms. . .to bring the interest burden in line with the ability to pay and reschedule debts over a realistic period of time."[25] The Western governments are also called upon to expand their bilateral foreign aid programs as well as increase the resources of the IMF and other international financial institutions. Kissinger concedes that both the banks, ("those who took unwise risks") and the taxpayers ("the public interest in maintaining a vital banking system") would have to share the costs of a bail-out operation, but the old negotiator does not suggest how costs should be borne by each party.

Kissinger is not the only retired government leader to propose a master plan for revamping the world economy and defusing the debt bomb. Former West German Chancellor Helmut Schmidt has proposed a similar plan.[26] Former Austrian Chancellor Bruno Kreisky has said that the banks will have to write off billions of dollars worth of debt and urged Western countries to implement a "new Marshall plan" to build up the infrastructure in the underdeveloped world.[27]

A.11 Brandt Commission

While the Kissinger and Schmidt initiatives are clearly conservative in nature, the "reformist" label can be more properly applied to the proposals contained in the 1983 report from the Brandt Commission entitled *Common Crisis, North-South: Co-operation for World Recovery.*[28] This Commission chaired by Willy Brandt, former Chancellor of West Germany, reflects a more social democratic point of view and has substantial input from Third World representatives, unlike the other reform proposals considered above. Nevertheless it is important to understand that the Brandt Report also starts with the assumption that a trading system based on the principles of free trade is in the best interests of both the South and the North. The Brandt Commission also assumes the legitimacy of the IMF, though it proposes reforms to reduce its "ogrish reputation".

The Brandt Commission recommends that the IMF make available more low-conditionality credits and it proposes that "the IMF in framing its programs give greater weight to output, growth, employment and income-distribution considerations, relative to its past emphasis on the control of inflation and payments deficits." It also advocates reform of the IMF and the World Bank toward greater power sharing, and a review of these institutions to lead to a new Bretton Woods-type Conference on international financial institutions.

Among the other recommendations made by the Brandt Commission are proposals:

— to expand the Compensatory Finance Facility of the IMF by 300%;

— to make Special Drawing Rights (a type of reserve asset created by the IMF commonly refered to as SDRs) the principal international reserve asset, replacing the U.S. dollar;

— for a new allocation of SDRs favouring underdeveloped countries.[29]

As discussed in Chapter 5, a basic problem with the Brandt Commission's recommendations for greater Third World input into decision-making bodies such as the IMF and the World Bank, is the unwillingness of the United States and its staunchest allies to concede any independent power to these institutions. As John Loxley puts it "The realities of imperialism and political power, which seem lost on the Brandt Commission, leave no room for such altruism."[30] Loxley concludes that Brandt

is therefore arguing essentially for greater equity

Willy Brandt

within a globally managed capitalism in which Third World countries participate through export-oriented growth strategies.[31]

A.12 The Arusha Initiative

In his review of the reform proposals put forward by the Brandt Commission and others, Martin Honeywell distinguishes between those proposals which would provide underdeveloped countries with more finance to continue in their present dependency, and those reforms which would allow less developed countries more scope to pursue independent, self-reliant modes of development.

An example of the latter is the demand made by the signers of the *Arusha Initiative: A Call for a United Nations Conference on Money and Finance.*[32] The Arusha Initiative correctly identifies the IMF as "a basically political institution (that) tends to reproduce colonial relationships by constraining national efforts which promote basic structural transformations in favour of the majorities. Its orientation is fundamentally incompatible with. . .self-reliance." In addition to calling for a United Nations Conference to create a new and more democratic international monetary system, the signatories of the Arusha Initiative urgently demand that IMF conditionality be changed

. . .to reflect the sovereign right of states to choose their own social and economic models and development paths. In particular there must be no penalization of countries which opt for strategies which emphasize national planning, systems of administrative budgeting (of foreign exchange, imports, investment and credit), the reform of traditional institutions and an active role for the public sector.

As we saw in Chapter 3, it is precisely these measures which the IMF is bound to oppose. Our review of popular groups' programs in Chapter 7 also showed that these are the kinds of initiatives that popular groups propose as solutions to their countries' economic crises. As desirable as a reform of the type described by the Arusha Initiative might be, it is naive to think that it would ever be conceded by the powers who control the IMF. In Martin Honeywell's words:

If the IMF is viewed as one of the instruments that the elites [who control the Western powers] use to maintain control over the less developed countries, there [is] no reason why those who control the IMF should agree to changes that would be clearly against their own interests. Without the power necessary to force Western nations to accept such radical reforms, they will fall as nothing more than pious supplications on deaf ears.[33]

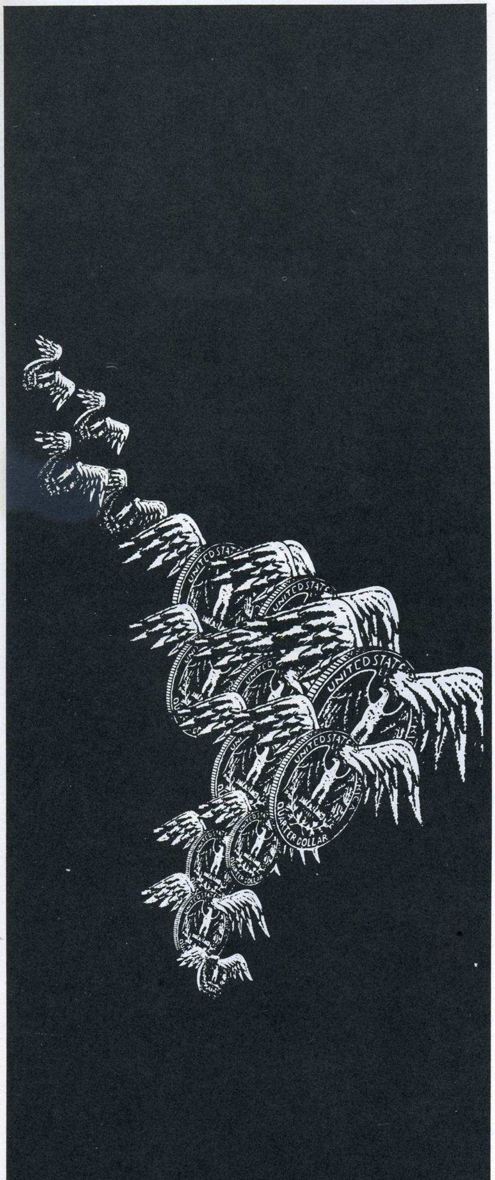
Honeywell is also correct in his assessment of the likely impact of less radical reforms that might be conceded by the Western nations in the interests of preserving the system:

Those reforms that recommend massive new lending to the deficit less developed countries, but only minimal changes in the conditions attached to that lending, could lead to some growth in the less developed countries in the context of a growing world economy. However, such growth would be brought about at the cost of further maladministration of the countries' resources in the hands of a small elite. . .Further that source of growth reinforces a model of development that cannot lead to the integral development of an economy geared to meet the needs of the local population, but rather those of the international market.

Besides. . .such reforms could not bring about sustained growth. More lending may generate net inflows of capital into deficit less developed countries in the short run, but they inevitably mean net outflows of capital in the long run.[34]

A.13 A New International Monetary System?

In addition to the Arusha Initiative cited above, there have been many other calls for the convening of a new international conference to rewrite the rules for the trade and payments system. Among the voices calling for such a conference are French President François Mitterand, former New Zealand Prime Minister Robert Muldoon, the Non-Aligned Movement and a Commonwealth study group whose report entitled *Towards a New Bretton Woods: Challenges for the World Financial and Trading*



System was issued in July of 1983.

So far both the Liberal and Conservative governments in Canada have ignored these calls. Finance Minister Michael Wilson accepts the IMF as the central agent of the international monetary system and has expressed no interest in its substantial reform.

According to reports appearing in the *Washington Post* and the *New York Times* a U.S. Treasury official, thought to be Donald Regan himself, has indicated that the United States is willing to consider such a conference some time this decade.[35] If this is the case, and if the history of the preparations for the Bretton Woods Conference is any indication, then the United States must have some kind of plan under internal discussion. No doubt, as in 1944 at Bretton Woods the U.S. will insist on writing the first draft of any new proposal.

While the Arusha Initiative does not present a complete draft of a new international monetary system it does lay out certain principles that the signers would want incorporated in any new institution:

1) democratic control to reflect the interests of the majority of the world's population;

2) universality — having the participation of all countries, East and West, South and North;

3) incorporating an international currency unit as the primary asset;

4) incorporating a degree of automaticity in resource transfers through a link between reserve asset creation and the needs of less developed countries.

Harvard University professors Schor and Epstein have put forward a draft proposal for a reformed international monetary system based on some of the features of Keynes' plan for an International Clearing Union. It did not become the basis for the post-war monetary system because of United States domination of the Bretton Woods process.[36] The main features of Keynes Plan included the establishment of an international currency, the "bancor", as the major unit of account and the automatic granting of credit from the Clearing Union to countries in deficit positions. It also included a means of encouraging countries with balance of payments surpluses to adjust because of the interest they would have to pay on the credit balances they had accumulated with the Clearing Union.

Keynes' plan also envisaged state control over international goods movements and the ability of sovereign nations to stop capital flight from within their borders.

Taking into account changes in the world monetary system since the 1940s Schor and Epstein propose a new monetary order based on Keynesian principals that would involve:

1) the convertability of all currencies into SDRs;

2) "crawling peg" exchange rates;

3) national controls on capital movements through the use of exchange controls;

4) a "substitution account" to allow governments holding Eurodollars to exchange them for SDRs;

5) a more democratic voting procedure where one third of the votes would be allocated according to each of three

factors — GNP, population and by country;

6) the use of "progressive conditionality" under which deficit countries would be encouraged to impose exchange controls to curb capital flight, to use import restrictions against luxury imports and to agree to an international code of labour relations that would put an end to the process of what they call "competitive impoverishment" where countries compete for foreign investment by offering lower wages than their competitors.

Schor and Epstein also call for the establishment of an international Bank Regulatory Office to regulate the Eurocurrency markets and international banking activities.

Howard Wachtel, a professor of economics at American University in Washington, has put forward another proposal for a comprehensive reform of the world monetary system.[37] Wachtel starts from an analysis that emphasizes the "transnationalization" of the global economy, by which he means that private capital has extended its reach beyond the borders of the traditional nationstate to such an extent that it can no longer be controlled by the system of public regulation and the international rules that once prevailed under the Bretton Woods agreement.

Wachtel's reform plan aims at restoring managed international exchange rates in order to permit individual countries to resume economic growth "by shutting off the potentially devastating spillover effects that now exist in a wide-open, anarchic transnational economy." Secondly, Wachtel would like to see an international currency unit (like the bancor advocated by Keynes) established, which would be controlled internationally.

Wachtel argues that it must be recognized that the $800 billion international debt "can never be repaid. These are bad debts and the normal business way of dealing with bad debts is to write them off the books." But these debts cannot be wiped out all of a sudden without precipitating a global financial collapse. Therefore he recommends that they be phased out gradually through a comprehensive agreement among banks, international financial institutions and the governments of both creditor and debtor countries.

Wachtel says that it should not appear that the debtor countries are being totally absolved of responsibilities. Accordingly he advocates that they give up token collateral such as Embassy buildings and air landing rights. The private banks, for their part, would receive a once-for-all bail out from their bad debts and in return would have to submit to the regulation of their international lending activities. They would no longer be free to wheel and deal on the unregulated Euromarket. Instead they would have to accept international regulation that would involve reserve requirements on their Eurodollar deposits that would be higher than the reserve requirements they face in domestic money markets. The banks would also have to provide more public disclosure of their international operations and accept regulated interest rates on international loans.

A.14 Fidel Castro

As this appendix is being written the news media are giving more than normal attention to the opinions of President Fidel Castro of Cuba. He is cited as advising Caribbean and Latin American countries to join in a "general strike" against their creditors by refusing to pay their $360 billion worth of external debts.[38] Although the North American news media have attempted to sensationalize, and thereby discount, President Castro's position, it should be noted that his actual proposals for "political dialogue and negotiations" between debtors and creditors are the product of a deeper examination of the whole debt crisis, which was first revealed in a long interview that Castro gave to the Mexican newspaper, *Excelsior*.[39]

In that interview Castro first reviews the data on the debt crisis, pointing out the sacrifices that Mexico, Brazil, Argentina and other countries have made to increase their exports with the resulting surplus being used exclusively to pay interest on their debts. He then offers an estimate of the net outflow of capital from Latin Ameirca to the industrialized countries for the years 1983 and 1984 amounting to $56.7 billion.

After a country by country survey of the state of the debt crisis in several Latin American republics, Castro then comments:

The paradox of all this is that the United States, the most industrialized country in the world, uses all kinds of tariff and other formulas to jealously protect not only its industries, which are far from competitive in many branches, but also its agricultural products, such as beet sugar and even corn syrup for sweetening soft drinks. Yet its professors come to teach us how to tear down our tariff barriers and make our industries competitive.

He then proceeds to analyze the factors that have contributed to the negative flows of wealth from the Caribbean and Latin America into the U.S.:

— high interest rates which contributed to the unprecedented inflow of $40 billion into the U.S. in 1983;

— the deterioration in the terms of trade of Third World countries, which saw the purchasing power of the products exported by underdeveloped countries (including oil) fall by 21.9% between 1980 and 1984;

— the real increase in the cost of servicing the debt due to the over-valuation of the U.S. dollar.

— the flight of capital.

Castro sums up this analysis by saying:

. . . the Latin American countries' economies were illegitimately stripped of more than $45 billion in 1984: $20 billion for the deterioration in trade relations, $10 billion for excessive interest, $10 billion for the flight of capital and $5 billion (a conservative estimate) for the overvaluation of the dollar. Adding it all up, including what can be considered normal interest on the debt, in just one year the Latin American countries have turned values equal to around $70 billion over to the rich, developed world. And $50 billion of that was in cash.

Next Castro discusses the situation inherited by the new civilian leaders of Latin America who have just been elected, most of them taking over from a series of right-wing military regimes. Castro absolves them of responsibility for the debt crisis they have inherited. He suggests that the debt crisis of each of these countries cannot be solved through the "mere palliatives" that are being offered in current debt negotiations.

Castro then goes on to suggest that these countries unite to demand a New International Economic Order that would give them the same advantages that Cuba now enjoys in its trade and financial dealings with the Soviet Union and other countries belonging to Comecon, with whom Cuba conducts 85% of its trade:

— fair prices for exports (for example Cuba receives the equivalent of $0.25 a pound for sugar it exports to the Soviet Union while exporters on the international market receive less than $0.03 a pound, far below the costs of production);

— postponement of debt payments for 10, 15 and even 20 years at a time without interest.

Castro says that "the cancellation of Latin America's foreign debt in itself won't solve our problems; it would only offer a few years respite." He goes on to argue that "mathematically it can be shown that the debt can never be paid off." He explores four sets of assumptions and finds that even under the most favourable set of assumptions — an interest rate of only 6%, a ten-year grace period on both principal and interest, and payment spread over ten more years — even then after 20 years the current debt would grow to $857 billion from $360 billion at present.

President Castro then suggests how the forgiveness of the Latin American and Caribbean debts could be handled domestically within the United States. He recognizes that there would have to be a bail out for the U.S. banking system adding to the U.S.'s national debt; but he suggests that carrying this additional national debt would be bearable for the people of the U.S. if only 10% or at most 12% of the U.S.'s military budget were diverted for this purpose.

To bring this about President Castro advises the formation of a strong debtors' club to counter the joint power of the creditor countries already manifest in the IMF and other institutions. Having estimated that the cost of attempting to meet debt service over the next ten years under current terms will cost Latin American countries some $400 billion, Castro concludes:

Now the decision-making power has passed to us. We have the power to simply declare that we won't accept this plunder and won't hand over the $400 billion. They couldn't even threaten us with suspending future loans. Well used, that $400 billion that they are demanding we produce from the sweat and sacrifices of the Latin American peoples could finance Latin America's development in the next ten years. Every country can lend itself what it's paying in interest.

Recognizing that the cancellation of Latin America's $360 billion debt is, by itself, not sufficient, President

Castro also advocates the establishment of the New International Economic Order[40] and the eventual economic integration of all Latin American and Caribbean countries. He does not consider the option of greater economic self-reliance for each country nor does he spell out what constitutes the New International Economic Order other than to cite the decade-old United Nations resolutions on the establishment of a New International Economic Order and a Charter of Economic Rights and Duties of States. These resolutions have been systematically ignored by the United States and other industrialized capitalist countries ever since their passage through the General Assembly.

Another weakness in the position outlined by President Castro is his failure to explain how industrialized, capitalist countries could be persuaded to open up their domestic markets, increase the prices paid for commodity imports, and implement the other reforms contained in the N.I.E.O. resolutions, especially in the wake of a refusal to make debt payments by the underdeveloped debtor states.

The greatest oversight in President Castro's reported analysis is his acceptance of most current Latin American governments as legitimate and independent representatives of their own majorities. Popular groups in many of these countries, as we have seen, are strongly opposed to the present debt policies of their governments. They are demanding alternatives which are in turn clearly opposed, sometimes violently, by their governments. (In Latin America the two most notable exceptions are Nicaragua and Cuba itself.) It is evident that new governments are needed which identify much more closely with the expressed interests of workers and peasants, and much less with the interests of the wealthy.

Specifically, popular groups are increasingly demanding governments which are prepared, whether singly or together, to initiate a moratorium on debt payments and to use the savings on debt service to build self-reliant domestic economies. Only then can they truly break the chains of international debt.

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DEBT BONDAGE OR SELF-RELIANCE

ERRATA

p. iii - Table 16 is on page 66, not page 62.

p. 1 - Figure 1: The dotted line indicates Net interest payments, and the solid line indicates net capital inflow.

p. 14 - Reference to "Chart 1" near the bottom of the second column should refer to Figure 4, p.17.

p. 38 - The source for Figure 6 is Morgan Guaranty Trust, not the Globe and Mail.

p. 40 - The last four notes, 32-35, are all references to the Globe and Mail, not to the Official Communiqué of the London Economic Summit.

p. 45 - The first line of Table 7 should read

1974 $1,109 $652 $2,795

All values for 1974 are positive.

p. 47 - Reference to Table 7 in the first paragraph should instead be to Table 8.

p. 48 - Table 9: % of Gross Interest, 1983, should read 100% in column 2.

p. 54 - The first complete paragraph of column two, beginning "Despite recent successes..." should be struck and replaced by the following:

> " The brake on imports together with recent successes in marketing our minerals, forestry products, wheat, and oil and natural gas abroad boosted dramatically Canada's overall trade surplus for the years 1982-84, as seen in column 2. While these trade surpluses were greater than the corresponding deficits of column 1, the same cannot be said of trade surpluses in the later half of the 1970's.
>
> The new monetary policies of the 1980's were fashioned partly in response to the uncovered interest and dividend deficits of the 1970's. While the higher trade surpluses of the 1980's were linked to the new policies, so were the higher interest rates which led Canadian borrowers to seek - and find - lower rates outside the country. The new policies have therefore promoted even greater foreign borrowing, shown in column 6, in the presence of trade surpluses which ought to have reduced the need for such borrowing."

p. 56 - The last sentence in column 2 should commence with the "During 1982..." and not "In January of 1984..."

p. 77 - The cartoon should bear the heading "Incurable Diseases".

p. 78 - The complete quotation from Charles Davies at the beginning of Section A.9 should read:

> *"major defaults are now discussed the same way the Pentagon planners ponder nuclear war - it would be messy but there would be survivors."*

Debt bondage: this is a term which most aptly describes the situation of millions of the world's workers, peasants and unemployed. They did not seek their country's international debt, nor have they benefited from it. Yet they are forced to bear the burden of austerity measures imposed by the IMF and private banks to pay for that debt.

Self-reliance: this is the demand of a growing number of peoples' movements in Third World countries and in Canada who are struggling against the IMF "cures" of the debt crisis. It means putting the basic needs of people ahead of multinational profits. This book examines the global debt crisis from the perspective of the people who are most severly affected by the crisis. The preoccupation of so many of the studies on the debt crisis to date has been how the faltering international financial system can be patched up. This book highlights the alternative programes of popular organizations in the Third World and in Canada who are struggling for their own emanicipation from debt bondage.

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