Forever in our Debt? An Analysis of Developing Country Borrowing: Simon Mouatt

Introduction

The total external debt of developing countries is a global tragedy of immense proportions. The crux of the crisis is the amount owed to the financial institutions of the North. Figures published in 1995 calculate that the external debt of developing countries had reached $1,945 billion and its annual debt service a staggering $199 billion (Brown et al, 1995).[1] In 2000 the total figure stands at $2.2 trillion (World Bank, 1998). It is this continual increase, since the Mexican default in 1982 that alarms many. In sub-Saharan Africa, for example, the debt is three times the 1980 total, 10% higher than the annual output of goods and services, and debt service is four times the regional expenditure on health and education (Brown et al, 1995). According to OECD statistics, resource flows to the North between 1982 and 199O exceeded flows in the opposite direction by $418 billion (George, 1992). Whilst the North has become relatively richer, the borrowings exact immeasurable human suffering in the South.

How Europe progressed from enlightenment to industrial revolution and subsequent economic growth is unclear. Yet, many development theorists and practitioners have sought to emulate a similar pattern of industrial development for the South. This has not always been appropriate. In practice, inequalities have continued to widen in the global economy. Some critics claim that the North dominates international institutions, and other political structures, ensuring that the interests of northern finance capital are protected. Inequality is compounded by the recent liberalisation of the global financial system, the growth of transnational corporations, and pervasive free-market ideology, which are all hindrances to effective development in the South (Thomas, 1996).[2]

It is within this context that we must consider the debt issue. Whilst it is true to say that debt is only one of the problems facing developing countries, it is arguably the most significant. Debt >per se= is not necessarily the problem, since industrialisation (if this is the objective) often depends upon credit, but the ability to service the debt is. Therefore, a sustainable income is an essential prerequisite for sensible borrowing. It is also part of the solution.

Indebtedness provides powerful political leverage for creditors. A bank, with authority to grant or decline credit to prospective entrepreneurs, can determine their future success. Similarly, international debt provision can be a key factor in the patterns of future economic activity, employment, and prosperity. This lead Strange to identify finance, inter alia, as a primary source of global power (Strange, 1988). Furthermore, the ability of creditor nations to enforce macro-economic adjustment upon developing countries is enhanced. These measures, as Ould-Mey suggests, can serve to advance the geo-political interests of creditor nations (Ould-May, 1994).

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[1] Debt service is the interest and principal payments due in a given year on long-term debt.

[2] Several thinkers have expressed similar sentiments. For a discussion of the political interests of finance capital see Capitalism in an Age of Globalisation (Amin, 1997).

So, who are the lenders and borrowers of the external debt? The lenders are first categorised into official and private groupings. Official creditors include multilateral lenders such as the International Monetary Fund (IMF) and the International Bank of Reconstruction and Development (World Bank) but also include the regional development banks such as the African Development Bank. These institutions are multilateral and act with the authority of states who provide contributions, personnel, and legitimacy. The second type of official lending is known as bilateral debt which exists between two states. This could form part of an overall aid programme or other negotiated agreement. Private (or non-official) lending takes the form of money provided by commercial banks, bond issues, or non-government organisations (NGO's) such as charities.

The borrowers could be governments (or their agencies) and entities, such as private or state corporations, that the authorities guarantee to underwrite. There is also some lending which is private and non-guaranteed. The total debt stock consists of both short and long term borrowings and the use of IMF credits, which are related to structural adjustment programmes.

The Origins of the Crisis

The threat of Mexican default was termed the debt crisis in 1982 but, for some, the crisis is over. During the eighties, the threat to the stability of the global financial system, creditor governments, international institutions, and commercial banks was ever present. Now, however, it is theoretically possible for widespread default to occur without bank insolvency and minimal disruption to the international institutions or global finance.[3] Notwithstanding, it is still appropriate to speak of a debt crisis for two main reasons. First, the debt problem continues to present tremendous difficulties for many developing countries. Second, debt continues to rise, there is (arguably) unlikely to be a sustainable stability in the world economy. Therefore, a suitable solution needs to be found. So, what were the origins of the debt build-up?

First, there was a switch from public to private lending. In many ways this was a product of the emerging neo-liberal ideology of the period. The state was viewed as wasteful and bureaucratic whilst the private sector was seen as a more efficient allocator of financial resources. By the mid-seventies the commercial banks had replaced the IMF as the main lender for balance of payments problems and their lending to non-oil exporting countries had expanded by 600% (Reed, 1996). The effect was riskier and larger borrowings. The banks access to capital markets was on less preferential terms than multilateral institutions (like the IMF) and, subsequently, their rates were relatively high. Also, their necessity to return a profit for investors, led to more expensive credit. This was unproblematic whilst economic conditions were buoyant. At the time, growth rates in the third world were consistently higher than the North and commodity prices were high. Subsequently, commercial banks were able to realise substantial short term profits. The banks were eager to lend and even sent representatives overseas to persuade potential borrowers. However, it soon became apparent that their criteria for credit worthiness were less rigorous (than the public bodies) leading to an over extended risk portfolio and the threat of future default (Reed, 1996). It was this type of 'agressive lending' that has led some critics to suggest that the banks should bear a larger part of the responsibility for the debt

[3] The government backing of special reserves has enabled the commercial banks to make provisions against default. Even the worst possible scenario would merely reduce profits since the risk of bank collapse has been removed (Bird, 1989).

overhang (Adams, 1992, Payer, 1992). Yet, the switch from public to private lending had also been a deliberate policy of the emerging political forces, rather than the mere actions of economic agents (Helleiner, 1996). Governments were also at fault and, therefore, responsible.

Another factor was OPEC. Most academics agree upon the significance of the seventies oil price rises, which flooded international capital markets with 'petrodollars' as oil-rich states sought to invest their new wealth in western banks.[4] Payer rightly points out that much lending was already underway prior to these events but, the excess funds provided resources for substantial lending increases (Payer, 1991). Much OPEC money was deposited in the emerging 'Eurodollar' markets since the dollar was (and is) the main reserve currency and, also, the 'offshore' markets offered trading that would be unhindered by restrictive US banking legislation.[5] Also the OPEC preference for the financial institutions of the North might also have been enhanced by their attempt to circumnavigate islamic law where usury is forbidden.[6] Subsequently, banks, with larger capital ratios, extended their global search for debtors. Unfortunately, this was combined with an erroneous belief that that it was impossible for individual nations to go bankrupt.

A third cause was the breakdown of the Bretton Woods economic system in 1973. The system had consisted of fixed exchange rates, with dollar gold convertibility. During Vietnam, the dollar came under increasing pressure and Nixon decided to close the 'gold window' and float the exchange rate (Gill and Law, 1988). One consequence was a rise in long run interest rates and the emergence of currency speculation. Subsequently, the commerical banks provided loans on variable interest rates to compensate for future fluctuating macroeconomic conditions.This was unproblematic as long as rates remained relatively low (albeit higher than before) but in the eighties the circumstances were different. As interest rates rose, the debt became unserviceable.

Another factor of the debt build-up was the hegemonic power of the US. Since the dollar is the global reserve currency the US is able to experience 'seignorage' - the ability to profit from being the issuing currency - eg the service of external debt in dollars. Conversely, developing nations with debt denominated in dollars, are subject to fluctuating exchange rates and hence the vagaries of the US economy. In the early eighties Reagan, with his preference for external borrowing rather than taxation, expanded military expenditure.[7] As the Pentagon drained liquidity from the capital markets, the dollar appreciated resulting in more expensive debt servicing for debtors (George, 1988). Also, monetarist policies served to raise rates further and restrict the growth of the money supply. The result was an unserviceable external debt for many developing states. Furthermore, the existence of global markets and pervasive 'free-market' ideology have sometimes reduced commodity prices, hindering debt repayment (Ould-Mey, 1994). This is because some states are dependent upon key exports and, are victims of clever marketing by northern economic actors. In Uganda, for example, coffee constitutes 94.8% of total exports and

[4] For a discussion of the origins of the debt crisis see George (1988).

[5] The eurodollar markets were outside the jurisdiction of the United States. These financial intermediaries were attractive to OPEC depositors since they feared US domestic policy constraints (Helleiner, 1996).

[6] For an analysis of Islamic financial practices see the Financial Times survey (FT, 1995).

[7] At the time the Pentagon was engaged in an expensive Strategic Defence Initiative (stars wars) research project.

is likely to remain vulnerable to market forces.[8] So, various factors have led to the present level of external debt, but what impact has the debt had?

The Impact

The threat of Mexican default in 1982 brought anxiety to the global financial system. There were two main reasons for this. Firstly, there was the possibility that trade, investment, and financial flows would be brought to a halt.[9] Second, the debts were so huge that if the banks were forced to write them off they would be declared insolvent (Kapstein, 1991). The crisis threatened to affect everyone. Initially, the key decision makers responded well. The Federal Reserve (US) and the Bank for International Settlements (BIS) provided an inflow of capital in order to avoid default.[10] The global economy is now more interdependent and, therefore, susceptible to asymmetric shocks. However by the late eighties, as mentioned previously, banks had made adequate provisions against possible default and, at least for the North (and the decision makers), the crisis is over (Bird, 1989). In the developing world, the situation is different.

Where has the money has gone? Payer suggests that funds was frequently used as a facade for 'export financing schemes' which provided lucrative contracts for businesses in the North (Payer, 1986). This rather cynical view of loans exposes a contradiction between the objectives of commercial creditors and the necessities of effective development. The building of the Mexican Sicartsa steel plant provides a good case in point. The plant was constructed, using loans from foreign commercial creditors, yet its economic value to Mexico was unclear. A recent Harvard Business school book concluded that few northern countries considered the economic benefits to Mexico and loans were provided to maximise the benefit to business in the North (Adams, 1991). The commercial financial institutions were not alone in supporting inappropriate schemes. The World Bank created and supported agencies within the South which it preferred to deal with when providing funds. These agencies have been the subject of much criticism.[11] Funded schemes were easily coordinated and involved technologies that could only have been imported from the north (Rich, 1994). Furthermore, much of the borrowed funds have been directed towards ill conceived projects that have caused considerable problems for local people (Adams, 1991).

Some borrowed monies have been subject to corruption or have returned to the north in the form of capital flight. A BIS report noted that $55 billion had drifted north from Latin America between 1977 and 1983 and this is a conservative estimate (George, 1988). Capital flight is a feature of the global economy, since financial liberalisation, and it persists in evading effective

[8] Export promotion under structural adjustment polices have contributed towards a glut (and lower prices) in many commodity markets.

[9] Much had been learned from the instability of the thirties when German default on war reparations sparked a spiral of events that culminated in the Wall St crash and world trade collapsing to a fifth of its former value in 1931.

[10] The sums involved were too huge for the IMF and IBRD to handle (Nitsch, 1991).

[11] The IBRD, was seen to be biased in its lending policies (during the Cold War), and lacked accountability, and it also engaged with inapproriate lending projects (Rich, 1994).

regulation. The process, which Kindleberger calls a 'middle-class rebellion,' directly affects state economic sovereignty (Kindleberger, 1987). Capital movements, often for speculative purposes, can adversely affect the balance of payments and, subsequently, induce exchange rate volatility.[12] The developing world is particularly vulnerable. This, in turn, can seriously hinder debt service capability and trade. The problem has been exacerbated by the activities of the northern financial institutions who have assisted illicit capital movements through the provision of offshore trusts, fake investment companies, parallel foreign exchange swaps (that avoid national banks) and back to back loans (lending clients their own money). Susan George notes that the American Citibank has been a key culprit of this in their search for profits (George, 1988). It is also interesting that countries practising capital controls, have managed to avoid substantial capital flight yet, they have been persuaded to remove these constraints under structural adjustment policies.

Adjustment programmes originate from the IMF (and the World Bank) and include macroeconomic policy measures designed to bring financial discipline. A typical adjustment programme would involve the reduction of government spending, the elimination of price and exchange controls, the privatisation of state industries, the encouragement of export growth (and import limits), and the general facilitation of market forces. The stated aim is economic development with countries being better placed to service their external debt. In practice, however, adjustment policies have been heavily criticised for inflicting harsh conditions on developing countries. In Venezuela, in 1989, riots left 250 dead and many injured as people protested against the austerity programmes which brought lower wages and higher food prices. Similar violence was experienced elsewhere (Jackson, 1990). UNICEF calculate that at least half a million children die each year as a result of the programmes and the average person in Latin America or Sub -Saharan Africa has seen their standard of living fall (Jackson, 1990). These results are very different to the intentions of the founders of the IMF. The original mandate for the organisation was to maintain balance of payments stability and favourable growth conditions in the global economy. One of the IMF Articles of Agreement, for example, expresses an intention to 'promote and maintain high levels of employment and real income. Yet, the IMF response to the debt crisis has caused 'cutbacks in incomes, imports, massive unemployment, social deprivation, deterioration of capital stocks, and productive capacity cuts' (Adams, 1993).

The World Bank is also hypocritical. The fourth Article of Agreement forbids the institution from political and economic interference in sovereign states yet IMF/IBRD 'conditionality' ignores their sovereignty (Rich, 1994). Mexico was forced to abandon its agricultural reforms (to improve local consumption) to switch resources to export production and gain dollars to service their debt (Stubbs and Underhill, 1994). Economic restructuring is a prerequisite for further loans from the IMF (and commercial banks) and, unless the country adopts autarky, they are forced to accept them. Recently the World Bank, with other international agencies, has created schemes to mitigate the social costs of adjustment although they are critisised for minimal effects in Ghana (Khor, 1995).

One fallacy concerning developing country debt, is that the crisis is mainly suffered in the South yet, the tragedy is truly global (George, 1992). Firstly, the environmental effect. Here George has identified a correlation between deforestation and an increasing debt, as a result of

[12] The capital account greatly exceeds the current account (international trade in goods and services) and, therefore, is a greater determining factor in exchange rate movements.

increasing agricultural production for export growth. This has implications for global warming and air quality. Also, disappearing bio-diversity threatens our future food sources and medicines. Another problem , the cocaine trade, is exacerbated by the high level of Latin American debt. Bolivia, has falling tin and gas exports to Argentina, as a result of their debt. Subsequently, cocaine has become a major source of foreign currency (especially dollars). Furthermore, the Bolivian government has condoned the incorporation of 'drug money' into the national economy by deregulating the foreign exchange markets.[13] It is ironic that the IMF has praised Bolivian austerity programmes and balance of payments stability.[14] In public, the IMF has failed to recognise the significance of the Bolivian drug trade to external debt service. Clearly, drugs have many associate problems and constitute huge expense and social distress in creditor nations.

Another repercussion of the crisis for the north is the tax bill. In most creditor countries the tax authorities have set up mechanisms to allow banks to offset third world debt against tax. When the banks create special reserves, in order to protect themselves against default, the monies can be offset against tax. In addition, northern goverments have lent large sums to the third world in order that they might meet their obligations to private banks. Finally, the secondary market in debt (whereby the debt is sold at a discount to a third party) enables financial institutions to offset losses against tax. The cost, in lost revenue, is enormous (George, 1992). Should states grant tax relief to creditors when debtors receive nothing? It appears to be morally indefensible. It is possible, however, that the leniency with which the banks are handled by states stems from the fact that governments feel partially responsible for the initial debt build-up.

The North has also lost jobs due to smaller export markets. The rationale of US Senator Bradley's proposals in the US (for debt solutions) was that several American jobs had been lost as a result of Latin American debt (Nitsch, 1991). With deflationary conditions in the developing countries (from adjustment that discourages technical imports) future prospects are not encouraging (George, 1992). This is pertinent since export growth from North to South (of technical capital) is probably a prerequisite for effective development. Finally, George also attributes immigration problems and military conflicts, affecting the North, on the continuing level of external debt. In 2000 the huge external debt continues to exert a detrimental impact on the world. If effective development in the South is to be the objective, a solution needs to be found.

Historical Solutions

At the outset of the crisis, when loans to the south sharply declined, it became apparent that, without liquidity, mass default could threaten the stability of the financial system. The response was the provision of bridging loans to the countries threatening default and these were dutifully supplied by the BIS and the Federal reserve. Next, came the arrangement of IMF adjustment programmes. Once agreed, further financial support and rescheduling of debt was provided by the IMF and commercial banks. This key role for the IMF has continued to the present day, whereby the banks have made all further lending dependent upon debtor acceptance of these austerity programmes. However, this process only served to increase the level of debt whilst, the adjustment increased suffering. The rescheduling process, as Milivojevic noted, was costly.Banks made large fees from the process, increased their spread, and hence profits

[13] This means in practice that US dollars can be laundered through official channels.

[14] Imports purchased in dollars are not part of Bolivian official figures.

(Milivojevic, 1985). The banks were slow to increase lending and only did so after pressure from the IMF (Cline, 1984). There was also the incentive for the banks to 'free-ride'. A general increase in lending reduces the risk of default. If banks decided to keep their own debtor exposure constant they could achieve the benefit of the reduced default risk for free (Cline, 1984). The IMF overcame these problems by threatening to withdraw from the process (Gibson, 1996). Once IMF conditions were agreed the process was then (and is) handled by the so-called Paris Club, consisting of representatives from the various creditor governments and the commercial banks, who work the finer details on a case by case basis (Altaver et al, 1991).

The Baker Plan (1985-1989), also sought to alleviate the crisis through providing more loans in combination with adjustment. In fact, the plan was the same but for two differences. Firstly, the emphasis was upon >adjustment with growth (to enhance ability to pay) and, second, there was an enhanced role for the World Bank in crisis management.[15] However, despite the political rhetoric, the policy makers were really trying to manipulate the costs and benefits of default. Default is only a serious option when new (and expected) lending starts to fall below the levels of debt service (Kaletsky, 1985). In the late eighties, net financial flows from South to North actually exceeded flows in the opposite direction for the first time in post-war history.[16] Development finance, essential for growth, diminished. The Baker plan had successes yet, the economic growth failed to materialise, debt increased, and the banks reneged on their commitment to provide the necessary finance even after IMF pressure (Jackson, 1990).

It became apparent that the debt was becoming unsustainable. Debt reduction was now seen as essential by many experts. Furthermore, it was realised that as debt grows its market value on the secondary market falls and, therefore, it was more viable to reduce it (Economist, 1991).[17] This, led to the Brady plan which utilised this growing secondary market that had emerged. If debt could be purchased at a discount, debt relief would be easier and cheaper. Many banks and debtors had negotiated *ad hoc* settlements on this basis for some time. However, the Brady plan had the benefit of US government approval and, therefore, would have a greater chance of success. It was also supported by funds from the IMF, World Bank, and the Japanese government. Also, any legislative obstacles to debt relief were also removed (Griffith-Jones, 1993). Under the scheme four types of debt conversion were facilitated.

Firstly, debt for equity swaps where debt is exchanged for corporate investments in the debtor country. Yet, the method is subject to the availability of suitable investment and, therefore, must be seen as a limited solution. In Chile, there is little available for investment, since the state has privatised most of the public enterprises.[18] In addition, various intermediaries make large sums of money in fees. (Larrain and Valesco, 1990).

Another option within the Brady plan involved the transfer of external debt into tradable government bonds, after a portion of debt had been purchased from the secondary market. One weakness, however, has been finding buyers in the North. Notwithstanding, the conversions have contributed to debt reduction in several debtor countries.

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[15] Ironically, the US had been holding back its payments to the World Bank (Payer, 1986).

[16] Banks used these monies to make reserves as provision against default (Jackson, 1990).

[17] This phenomena is illustrated by the debt-relief laffer curve (Economist, 1991).

[18] The private sector could be open to foreign portfolio investment if the stock market regulations permitted this.

Another strand of the Brady initiative was the conversion of external debt, via the secondary market, into schemes that protect the environment or facilitate development. These occur where non-government organisations (NG0's), such as charities, purchase portions of debt on the secondary market. These NGO's can then utilise the debt for bargaining with debtor governments in order to achieve environmental or development objectives. Six commercial banks, for example, donated their Sudanese debt to UNICEF who were then able to initialise some high-priority social spending in the region (Griffith-Jones, 1993). However the impact of these type of swaps in terms of reducing debt service obligations is limited. In Costa Rica, where the most debt-for-nature swaps have occurred, the debt burden has been reduced by a mere 5% (Thapa, 1990).

Also, debtor countries can purchase their own debt on the secondary market. Bolivia and Chile have both taken advantage of this yet, potential recipient countries are limited by their availability of funds. Most countries simply do not have the resources (Jackson, 1990). The other problem is that if debtor countries are able to purchase a portion of their debt, this can increase the value of the remaining debt, since the threat of default has been diminished. Bolivia purchased about half of its $670 million debt, which traded on the secondary market at approximately $40.2 million (6 cents per dollar). After Bolivian expended huge sums of money the remaining debt rose to 11 cents in the dollar with a total market value of $39.8 million, almost the same (Bulow and Rogoff, 1995). Unless the total debt can be purchased it is necessary to proceed with caution.

When evaluating the efficacy of the Brady initiative it is helpful to distinguish the detrimental effects of the debt overhang in the South. An excessive debt can be a disincentive for governments to take painful or politically unpopular measures, since any gains made would go mostly to the creditors (Griffith-Jones, 1993). Taxes will also be high leading to a discouragement of investment and capital flight. Debt service will also add to budget deficits serving to raise money supply growth and inflation (Gibson, 1996). Debt relief, then, can be seen to benefit both creditors and debtors in economic terms. The costs and benefits of default can be manipulated in order to make sustainable debt service an attractive proposition. Furthermore the relief can engender an environment which is more conducive to economic growth. The 1990-94 period in Mexico, following debt relief, was marked by higher levels of economic growth and positive capital flows (Griffith-Jones, 1993). Venezuela and Uruguay had similar experiences.

The Brady scheme has been helpful but, the amount of debt relief has been too small, averaging 32% of eligible debt (Gibson, 1996). It also does not apply to official bilateral and multilateral debt, which has been growing throughout the period.[19] Also, the implementation of negotiations has been time consuming and has relied on the voluntary compliance of banks.[20]

The Heavily Indebted Countries Initiative: 1996

The main aim of the HIPC is 'debt sustainability' for the 41 countries designated as heavily

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[19] Some states have reduced official bilateral debt with write-offs and conversions, to improve balance sheets of export credit agencies or for ethics (Griffith-Jones, 1993, DFID, 1998).

[20] Banks default provisions, offset against tax. Griffith-Jones suggests that if banks fail to make any debt reductions then they could be forced to repay authorities (Jackson, 1990).

indebted. According to the IMF, this means the ability to meet current debt service in full without recourse to debt relief, rescheduling, arrears accumulation, or restricted growth (IMF, 1999).

The scheme, proposed by the IMF and World Bank in 1996, aims to achieve this over a six year period for each country concerned. The first three years is marked by adjustment, and is based upon current debt relief mechanisms. After this, the country reaches its 'decision point' where the IMF and World Bank jointly consider their eligibility for the initiative. This decision is based upon a comprehensive Debt Sustainability Analysis (DSA) involving a calculation of the debt/export ratio and debt service/export ratios. To be manageable the debt/export ratio is expected to be within 200-250% (reduced to 150% at 1999 G8 summit) and the debt service/export ratio within the 20-25% (IMF, 1999). The threshholds have now been decreased at the Cologne G8 summit in 1999. The DSA also takes into account the various country-specific 'vulnerability factors' such as types of exports, fiscal burden, GDP, resources, reserves, and internal debt (IMF, 1999). At this stage, a state may be deemed to have a sustainable debt, declared a borderline case, or granted eligibility status. During the second stage (the next three years) bilateral and commercial debt relief is granted, up to 80%, and the World Bank can deliver IDA grants if necessary. At the completion point the country will receive 80% relief. If this is still insufficient (for long term debt service) then the multilateral creditors will provide relief until the sustainable level is found.

The HIPC initiative is the first time (in the history of the crisis) that debt reduction covering the total debt stock, of a particular debtor nation, has been considered. The multilateral institutions that had previously avoided any debt reductions were now included. The IMF and the World Bank have prepared preliminary DSA's for a number of countries which are eligible for early consideration under the HIPC inititative. Six countries have been designated as having completed the first three year period, Benin, Bolivia, Burkina Fasa, Guyana, Mali, and Uganda. Of these Uganda and Bolivia are considered as the most eligible (due to compliant structural reforms and a huge debt overhang) and, Uganda has received debt relief amounting to 20% of total debt stock (IMF, 1999). Yet, despite progress, there are weaknesses with the HIPC scheme.

To begin with, several creditors (notably Germany, Japan, and Italy), lacked the political will to make the HIPC intitiative a success, using their power on the IMF and World Bank to enforce the strictest implementation.[21] These difficulties are compounded by the lack of contributions to the trust fund. The World Bank has committed resources to the fund yet, the IMF has not. Recently, however there are plans to sell some of the gold reserves with a view to future replenishment. Another potential problem is the principle of proportionate burden sharing, which may result in a relief deadlock if some creditors delay their response.

Next, there is the danger that several creditor governments may use the initiative as an excuse to reduce overseas aid to developing countries. Even with a total debt relief scheme (100%) the problems of many developing countries can only be solved with the provision of substantial development finance for the future (IMF, 1999). The debt crisis is only one of the problems for the South. Most of the 41 countries spend over one fifth of their revenues on debt service and all but six are in the lowest category of the UNDP's Human Development ranking.

[21] Germany has recently expressed commitment under the new administration.

Also, the actual quantity of debt relief is overexaggerated by the rhetoric of the scheme. Despite the claims of the IMF and World Bank, only 6.4% of the total debt stock of the 41 poorest countries will be tackled, whilst at the same time debt service is due to rise and commodity prices to fall (Jubilee 2000, 1998). Mozambique, for example, will only pay 1% less than their current debt service payments. This is because some of the debt is not considered as eligible. Debt related to aid and recent borrowings (including reschedules) are all excluded from the figures (Eurodadd, 1998). Finally, the process of HIPC implementation is too time consuming. Few countries will receive any benefit before 2000 and, meanwhile, poverty continues. What is the present condition of the scheme and what is the likely outcome?

In 1997, Gordon Brown outlined UK policy towards external debt, stating that debt relief was an integral part of the United Nations target to reduce global poverty 50% by 2015 (DFID, 1998). The main proposal was that every 'eligible' country should, at least, have started the process of securing an exit from their debt problems by 2000. The eligible countries referred to were those whose debt burden is too high, after Paris Club rescheduling (up to 67% relief on eligible debt). These proposals were accepted at the Mauritius (Commonwealth) summit and were later endorsed by the Birmingham G8 meeting in May 1998. However, overall, it is unlikely that the HIPC initiative will achieve the level of debt relief necessary to reduce global poverty to an acceptable level to satisfy the demands of justice. In Mozambique the reduced debt payments (will amount to 50 pence (per year) for each member of the population (Jubilee 2000, 1999). In the North, the UK government is prepared to go further than other creditors to facilitate real relief for debtors, and have written off a substantial amount of bilateral debt and trade credit (DFID, 1998).[22] However, more needs to be done.

If there are future problems with the debt overhang, more relief may become essential. If stunted economic growth, and human suffering, continues on the scale of the last seventeen years, it will benefit both creditor and debtor nations to take more effective action. Yet, will this relief be minimal or of sufficient magnitude to effect real development? Even the IMF, who normally underestimate the needs of the South have recognised that without substantial aid flows, the HIPC will fail in its objectives (IMF, 1999).

Future Solutions

The most radical proposal is to eliminate the debt altogether. There are two main arguments made against this. Firstly, the practicalities. The majority of the debt is held by private banks and, they will need to be compensated for their losses. This would be expensive and, at present, the political will is lacking. Increased public spending would entail sacrifices made elsewhere which, creditor governments are not prepared to make. Secondly, from an ethical perspective, the cancellation of the debt would mean irresponsible borrowing being rewarded, and the countries with a minimal debt burden (through fiscal prudence) being penalised. This may send out the wrong signals to creditors and debtors and discourage the working of capital markets in the future. In addition, many of the world's highly indebted countries have a relatively high GDP. A substantial transfer of monies to those countries, would be unfair on the poorer countries without debt burdens, and probably restrict aid flows.

[22] About 1.2 billion pounds of aid loans to 30 of the poorest countries have been written off since 1978 and 185 million pounds of export credit was written off last year (DFID, 1998).

Notwithstanding, debt cancellation is a proposal that attracts much support. Jubilee 2000 is a coalition of different groups that campaign for total elimination of debt, for the worlds poorest states (Jubilee 2000, 1999). Dr Rene Padilla, a Latin American theologian, has recommended total debt cancellation as a necessary act of 'justice' inspired by the 'fear of God'. In Old testament times, the God of Israel gave instructions to the Israelites to cancel their debts every fifty years in what was termed the "Jubilee" (Lev25, NIV). Christian and Jewish theologians are not alone in their radical proposals for debt solutions. Within the Islamic conception of financial propriety, interest (usury) is forbidden, in the economic system (FT Survey, 1995) Under such circumstances, a debt crisis would not have initially arisen. Also, in the North, the levels of individual, corporate, and government debt are high and, arguable, unsustainable in the long term.

In many ways the debt crisis is really a crisis of capitalism itself. Historically, it could be argued, credit creation has provided a (capitalist) solution to the relentless search for new markets. Inequalities of income (and wealth) are an inevitable consequence of the functioning of a capitalist economic system. Yet, without redistribution, these can restrict its efficient operation and cause class conflict. Marx had identified the tensions that existed between capital and labour and suggested that these would eventually lead to social, economic, and political transformation. In the event, capitalism survived, proving to be more resilient and adaptable than expected. However, without income redistribution, spending would have been limited and capitalism may have collapsed. This is because capitalism relies upon constant purchase for its survival. Credit, then, serves a similar function to redistribution by providing spending power to individuals, businesses, and governments. The concept of 'spending ability' forms the basis of Keynesian economic policy, that serves to correct 'demand deficiencies'. In fact, Keynes identified the failure to redistribute income as one of the two main "economic ills" of any society (Keynes, 1936).[23]

Many of these proposals are currently politically unacceptable and, other more practical suggestions have better prospects. One proposal involves the sale of IMF gold, currently valued at $35 billion. Cheryl Payer has suggested that the World Bank change its constitution in order to increase its capital/asset ratio, and provide more substantial resource flows (Payer, 1986). However, most people involved in debt management seem to be agreed on the necessity of debt relief . This has been helped by a strong intellectual case for relief made by Krugman, Williamson, and Sachs (Krugman, 1989, Williamson, 1988, Sachs, 1990). Sachs, in his research, has identified weaknesses with voluntary schemes of debt relief, used by policy-makers since the onset of the crisis. The schemes result in small debt service reductions, banks are tempted to 'free-ride', and banks do not want to set precedents that undermine the credibility of future capital markets (Sachs, 1995). Instead, Sachs proposes an 'international debt facility', at the IMF and World Bank, which coordinates a comprehensive strategy that encompassses all creditors. He suggests the best form of relief is reducing interest rates, to a fixed amount, on the total debt of a country (Sachs, 1995).[24] Repayment could then be guaranteed by the 'facility', and the banks would be coerced into accepting the losses.

Also, as Kenen notes, the general consensus between policy makers favours strategies that,

[23] The other was the failure to provide for full employment (Keynes, 1936).

[24] Under the scheme, each country could receive a different level of debt relief according to their particular circumstances (Sachs, 1995).

reduce the incentives to default (Kenen, 1990). He subsequently proposes that the secondary market should be utilised, to enable debtor governments to purchase their debt (with discount) with new loans. A process which he calls ‘defeasance’(Kenen, 1990). The problem with this is that it is unlikely to gain much political support and, therefore, the funds to implement the strategy.

There are some who advocate debt repudiation. When capital flight, corruption, and military expenditure are considered, should present governments be responsible for the debts of others? Adams argues that they should not and cites the United States annexation of Cuba to defend her case. At the time, the US declared the old Cuban government debts ‘odious’ and refused to pay them. Adams argues that a precedent has been set in international law, and many debts in the South can be renounced (Adams, 1991). When we consider that 20% of the debt has been spent on arms the argument is more convincing. Fidel Castro has long advocated a reduction in military expenditure in order to finance debt relief (Suter, 1991). In short, there are many proposals that offer solutions to the debt crisis, and the ideal solution would probably entail a synthesis of many.

Suter, in a study of external debt spanning 200 years, noticed that high levels of debt, have marked out fifty year periods since 1820. These correspond to the 1820's, 1870's, 1930's, and the 1980's. He has also noticed that these high levels are associated with declining profits and market saturation in the North (Suter, 1992). However, each time debt elimination has been essential. Yet, the history of the recent crisis management involves, the manipulation of default incentives, and minimal debt relief. The total debt stock continues to grow (Suter, 1992).

A Global Panacea?

Perhaps the best solution to the debt crisis is a radical one, with the redistribution of income and wealth between North and South. A common fallacy, regarding redistribution, is that it is a zero-sum activity. That is, in order to increase the income of one country you need to decrease that of another. However, although initially true, the net effect will expand total global GDP. This is because more liquidity, trade, and the Keynesian accelerator and multiplier would reverse demand deficiencies and expand economic activity. However, the relative gains may contain inequalities.

Yet, it is unlikely that this kind of redistribution could be implemented without a level of multilateral cooperation, since the modern state has been subjected to sovereignty erosion (Mouatt, 1996). Sovereignty loss has been partly due to the increased role of transnational corporations. Substantial rivalry exists between governments who, compete to provide the most de-regulated business environment for foreign direct investment (Stopford and Strange, 1991). Also, sovereignty is affected by the liberalisation of finance. Without exchange controls capital flight can destabilise trade patterns, and force states to alter fiscal and monetary policies (Griffith-Jones, 1998). Potts, in his study of the European Union, discovered that the removal of capital controls in 1987, forced member states to converge macro-economic policy. This, in effect, removed their economic sovereignty (Potts, 1997). States that carried out redistributive resource flows, unilaterally, would experience capital flight and reduced direct investment. This would not be politically attractive.

Redistribution would, however, stimulate development in the South and, subsequently, facilitate debt service. But, what are the main arguments against such a strategy? It is argued that the public sector is the wrong vehicle to implement redistribution since, state structures are often subject to financial abuse and inefficiencies. Also, demand-side policies in the South have been traditionally associated with increased lending, which will lead to more debt. Furthermore, demand-side policies are inflationary, due to difficulties in determining the trade cycle and time lags. Stimulated aggregate demand is thought to increase imports, threatening exchange rate stability. This is significant for debt service. Also growth has environmental implications.

Firstly, the argument against the state in the South. A solution might be found in a form of ‘private-sector Keynesianism’, where redistributed resources are diverted to the private sector. This could utilise existing microcredit organisations or monitored agencies for larger firms[25] Secondly, in order to avert debt increase, grants, could be given, in addition to credit. Redistribution that targets the South, will bring reciprocal benefits to the North, that is currently facing saturated markets. Third, demand stimulation can cause inflation, but only where resources are fully employed. When unemployed human and physical resources are considered, it seems unlikely that inflation will occur. Fourth, it is possible that increasing disposable income will expand import levels, particularly since many people in the South are denied access to the goods available in the North. Yet, there are various measures that states can take to overcome this. One solution would be in forms of ‘import substitution’ policies. Finally, the issue of resource depletion and environmental damage. Here, a range of ‘conditionality measures’could be included with the provision of grant resources. But what about the debt itself? For this, a comprehensive debt relief package (to sustainable levels) with repayments guaranteed by the multilateral institutions could be agreed. Interest rates could also be frozen at an lower level.

Conclusion

It is clear the above measures are politically unacceptable to the global policymakers. Yet, as Walters notes, in the absence of a crisis, little is likely to change. In a crisis, however, radical proposals are often considered (Walters,1993). In the current climate, then, I would recommend a concerted G7 effort to facilitate the success of the HIPC initiative and, a consideration of the Kenen and Sachs schemes. Time will reveal whether the South remains, “Forever in our Debt”.

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[25] For a good analysis of microcredit organisations, see Hulme and Mosley (1996).

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