Reply to a question on debt

3 August 2000

Dear Nick Beams,

What I don't quite understand is how all of these countries got so heavily in debt in the first place. What collateral did they put up to get the loans? I do understand clearly that getting somebody, or a country, in debt is a time-honored way of controlling them. But what was the mechanism at work in so many countries?

And it does seem a bit odd that every single one of these countries agrees to sell off for a song their nationalized industries, strip the aged of their pensions, gut the medical system, agree to dis-develop in order to start an export platform and condemn the people to misery.

It seems that some little country would say enough, the medicine is worse than the disease, we don't want your investments, we can starve very well by ourselves. Yet none of them even offer a whimper of resistance.

Again, my question is: what mechanism did the banks use to get all these countries in debt and what collateral was put up for the loans?

Thank you,

CA

Dear CA,

Much of the debt of the poorest nations was initially incurred in the latter half of the 1970s in the aftermath of the oil price increases earlier in the decade. The poorest countries had a need for loans, while the banks and financial institutions were flush with recycled petro-dollars, which they were looking to invest.

Under conditions of rising inflation and a falling US dollar, taking out an international loan was an attractive prospect. The combination of a falling dollar and rising inflation meant that real interest rates were low, in some cases even negative.

The "collateral" used for the loans was the "sovereign power" of the respective governments—their ability to finance repayments through their taxing powers and other revenue raising measures.

The relatively favourable position for debtors changed fundamentally after the high-interest rate regime initiated by US Federal Reserve Board chief Paul Volcker on behalf of the banks in 1979. By the early 1980s, debtor nations were now facing rising interest rates, coupled with an increase in the value of the US dollar in which the debts were usually denominated. An additional factor that tightened the debt stranglehold was the fall in the prices for the commodities upon which many of the indebted countries were dependent after the world recession of 1981-82—a factor which continues to operate to this day.

Hence, as the figures in my article made clear, much of the increase in indebtedness over the past two decades has been due to the capitalisation of interest payments, rather than simply the taking out of new loans.

The turning point in relations between indebted countries and the banks changed dramatically after the Mexican debt crisis of 1982. In the words of Jerome I Levinson, a former official of the Inter-American Development Bank, the debt crisis "afforded an unparalleled opportunity to achieve, in the debtor countries, the structural reform favoured by the Reagan administration" the core of which was a "commitment on the part of the debtor countries to reduce the role of the public sector as a vehicle for economic and social development and rely more on market forces and private enterprise, domestic and foreign."

You ask why every one of these countries went along with these means and raised no opposition to the demands of the banks.

The answer is to be found in the fact that the "restructuring" program was beneficial to sections of the ruling classes in the indebted nations. They had a direct interest in maintaining access to international financial markets, which would have been jeopardised by any policy of debt repudiation.

Furthermore, no section of the ruling classes in the indebted nations could mount a struggle against the international banks because to do so would mean mobilising the working class and the impoverished rural masses. Such an initiative would go well beyond repudiation of international debt and would immediately challenge the grip of local banks and financial interests. In short, any serious struggle to break the grip of the international banks immediately calls into question the continued existence of capitalist property relations in the indebted countries themselves. That is why no section of the national bourgeoisie in these countries has seriously advanced it.

Yours sincerely,

Nick Beams