The Debt Crisis: Obstacle to Development or Path to Democracy?

Susan George

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The debt of Third World nations exceeds $1.3 trillion. This paper analyses the factors which combined to bring about this situation and reveals the devastating effects that the debt crisis and 'stabilisation' policies are having on the Third World's poor and on the world's environment. The author suggests some imaginative solutions, which address the debt crisis in ways designed to contribute both to democratisation and environmental rehabilitation.


Dr George is a Fellow and Associate Director of the Transnational Institute, Amsterdam; she works with non-government organisations and the media to popularise the struggle against world hunger and the consequences of debt; and she has served on the boards of national and multilateral organisations concerned with development. In January 1989, she joined the International Advisory Board of the United Nations Economic Commission for Africa.

The views expressed are hers.

Introduction

Fallen bodies, pillaged shops, massive police retaliation: the scenes of violence in Venezuela are still fresh in our memories. The hundreds who died were overwhelmingly poor Venezuelans protesting sudden and unendurable increases in their cost of living. They fell victim to a continuing crisis which had already claimed over three thousand lives in riots in 23 countries as different as Brazil, Jamaica, Egypt and Zambia. The same crisis, according to UNICEF, is responsible for the deaths of 500,000 children every year. It is the Third World debt crisis.

In 1986, the debt owed by Third World nations first passed the trillion dollar mark, and as of 1989 stood at $1.3 million million. This unprecedented financial burden has not only disastrous economic consequences but profound implications for relations between rich and
poor countries, for citizens of both the North and the South and for the prospects of a peaceful world. To understand these implications we must try to answer three basic questions:

- How were such huge debts accumulated?
- How is this debt being administered and which social groups bear the burden of reimbursement?
- What solutions could bring an equitable end to the crisis?

**How was the debt accumulated?**

It takes two - borrowers and lenders - to build a debt mountain, and until the bubble burst in 1982, both behaved irresponsibly. They share blame for the current crisis. National debt is a normal phenomenon: when borrowed money is invested productively it helps a country develop and reimbursement does not cause serious problems. Most of the money borrowed during the 1970s was not, however, invested productively. Instead, it was devoted to:

**Paying for petroleum.** Many conventional explanations of the debt crisis place all the blame on the price increases imposed by the oil producing countries. OPEC countries raised prices twice, in 1973 and in 1979, and their incomes escalated accordingly. They could not absorb the sudden surge in revenues and deposited the money in Western banks which, in turn, had to find an outlet in order to pay interest to their depositors. OPEC deposits were thus 'recycled' in Third World countries, with bankers aggressively placing loans. Although this explanation is true as far as it goes, higher oil prices account for less than a third of the present debt burden.

**Weapons purchases.** Armaments are pure consumption, never productive and, unlike investment in agriculture or industry, do not generate wealth. Borrowing to strengthen armed forces and for purchases of military hardware accounts for about 20% of Third World debt.

**Capital flight.** Wealthy individuals, government officials and companies frequently sent borrowed money straight back to the banks as deposits. Although it is impossible to measure precisely, Mexican capital flight alone is reliably estimated to be equivalent to Mexico’s entire debt - over $100 billion. And although Africa is the poorest of all continents, rich Africans exported at least $22 billion in flight capital between 1979 and 1986. The borrowing country no longer has part of the money, yet must still pay interest on the full face value of the loan. The banks are paid back twice - once in flight capital deposits, again in interest on the debt as shown on their books.

**'Pharaonic' projects,** as Latin Americans call them. These unproductive investments, 20th century 'pyramids', are huge, environmentally destructive dams, underused 'turnkey' factories, stadia, nuclear power plants, etc. Brazil spent about forty billion borrowed dollars on nonfunctioning nuclear plants; while the Philippines must pay interest of $500,000 per day on money loaned for a nuclear reactor which will soon be dismantled. (It was built in a volcanic zone...)
Current consumption. Some countries, particularly in Latin America, borrowed money to import foreign goods consumed by the upper and middle classes, basically living beyond their means. These massive imports not only added to the debt mountain, but undermined local enterprise unable to compete with imported goods sold at artificially low prices. In countries like Chile, national firms and factories failed by the hundreds, leaving a legacy of massive unemployment.

Interest payments. Interest is simply the cost of using someone else’s money. Third World countries borrowed most of their money at variable rather than fixed interest rates, thus placing themselves at the mercy of market fluctuations. In the 1970s, interest rates were low or even negative (lower than the rate of inflation). In the 1980s, however, inflation fell dramatically and real interest rates rose, so borrowers were suddenly obliged to pay far more on their loans. These rates have continued to rise throughout the 1980s.

Even when borrowed money was not spirited northwards in flight capital, spent on military hardware, current consumption, unproductive projects or absorbed by higher oil prices or interest rates, still loans were all too often invested in production for export. Both public and private creditors encouraged debtor countries to participate fully in world markets, even if this meant denying the basic needs of their people. Exports were supposed to raise the standard of living for everyone in the long run - and were also vital to earn the hard currency needed to pay back the loans. Meanwhile, in the poor countries, agriculture and industries geared to satisfying internal demand foundered for want of investment and unemployment became chronic.

As the debt crisis clearly shows, these factors add up to a costly and unsustainable development model. When ‘development’ is based on excessive military and police establishments, prestige projects, outward-looking economies and the enrichment of a small elite to the detriment of everyone else - the logical consequences are continuing hunger, disease and poverty for the majority.

How is the debt being administered and which social groups are making sacrifices to reimburse it?

When a country is living beyond its means and cannot cover imports or interest payments from reserves or from new commercial loans, it must bridge the gap by borrowing from the International Monetary Fund (IMF). The Fund was set up to make loans to countries with balance of payments deficits (which occur when imports exceed exports). The IMF never gives credit, however, without conditions - and the worse the finances of the country, the tougher the conditions. Governments have no choice but to accept IMF ‘adjustment’ or ‘stabilisation’ programs (often called ‘austerity’ programs) and to comply with its advice. Without the IMF seal of approval, the country will get no further loans from any public or private financial source in the world.

The IMF’s adjustment plans seek to force the debtor to earn more than it spends or, in Fund language, to restore a positive balance of payments. Deficits can only be wiped by exporting more and spending less. Such advice would be wise if only a few countries were receiving it. Unfortunately, dozens of countries are now under IMF tutelage and all of them at once...
are trying to earn hard cash by exporting goods which fall into a narrow range - agricultural and mineral raw materials or, in slightly more sophisticated economies, textiles, apparel, microprocessors, etc.

Too many goods competing on saturated world markets lead to gluts and rapidly falling prices. In 1987, Third World raw material export prices hit their lowest levels in sixty years. To make matters worse, Northern countries try to protect their ailing industries through tariffs and other barriers. If the rich creditor countries want interest paid on their loans, they must open their markets and import from the debtors. Logically, they cannot expect payback of loans while refusing to purchase the debtors' goods - and yet they do!

The IMF also obliges countries undergoing structural adjustment to slash public spending. Budgets for health, education and welfare are invariably the first to suffer. Prices for essential services like electricity, water and public transport increase dramatically. Food subsidies are always an early target - with the result that prices for staple foods on which the poor most depend - bread, rice, tortillas or cooking oil - may double overnight. The IMF claims that it does not itself choose the budgets that must be cut - it leaves that up to governments. Still, not a single IMF program has demanded cuts in military or police expenditures, possibly because 'IMF riots' like those in Venezuela over escalating prices are frequent occurrences.

Just at the time when the cost of life's basic necessities inexorably rises, caps are placed on wages and credit becomes much more expensive, so local firms contract or fail. Governments sack thousands of their own employees - civil servants, teachers, health workers, etc. and close down or sell-off public enterprises. The IMF calls this 'reducing demand', and it is commonplace to find cuts in real wages of 30 to 70 percent. These sacrifices are imposed on people already living close to the brink of survival.

Sharp devaluation of the local currency is another standard feature of IMF programs. True, many Third World currencies are grossly overvalued, but drastic devaluation means that people's savings in their own countries' currencies are wiped out. Their purchasing power is thus further reduced. Imported goods automatically cost more after devaluation. For oil importing countries, any item requiring transportation - virtually everything - will naturally cost more. Most poor countries do not produce their own medicines, fertilisers, spare parts for vehicles, etc. which they must also import at far higher prices - or do without. For want of such basic items, whole industries decline, buses stop running, patients cannot be transported to hospital - where they would find little medicine and equipment in any case.

These measures are presented as technical, yet clearly none of them is neutral. People who derived no benefit from debt-financed projects are expected to make sacrifices so that debts can be paid. Malnutrition, illness and death rates increase among the poor. To give just one example, a worker who received the minimum wage in Peru in 1980 (who was therefore already a member of a privileged 'aristocracy' of labour) had to work seventeen minutes to earn a kilo of rice or a tin of powdered milk. Five years later, the same worker with a minimum wage (even more a privileged person five years later) had to work 2 hours, 5 minutes to earn a kilo of rice and 1 hour, 15 minutes to earn a tin of powdered milk. In other words, seven times more to earn the rice, nearly five times more to earn the milk.

The middle class slides into poverty. Elites, however, are little affected when public transport, schools and hospitals deteriorate or are closed, because they can afford private
ones. Upper classes continue to eat well and to educate their children while the number of hungry children, low birthweight babies and school dropouts grows.

Emphasis on export production also has harmful consequences for ordinary people. Food crops for local consumption tend to be supplanted by saleable cash-crops, although these fetch very low prices. When less food is produced internally, it too becomes more expensive. Peasants are encouraged to produce more coffee or cotton; they have less time and space for corn and beans. The environment suffers and natural resources are squandered in the desperate effort to cash-in anything saleable. Heavily indebted countries like Brazil, Indonesia and the Philippines will, at present rates, have almost no tropical forests left in the year 2000.

The debt crisis is not merely a problem for the Third World: its effects are also deeply felt in the rich industrialised countries of the North. The South used to be a good customer for Europe, purchasing about a third of European exports. Now debtors must serve the banks first - and banks have indeed made record profits. But no funds are left for other purchases, so people in the North lose their jobs in industries that once manufactured goods for export. Farms fail massively, particularly in the United States, where one acre in three was devoted to crops sold abroad.

The debt drain means that the poor are financing the rich on an unprecedented scale. Between 1982 and 1987, the Third World remitted to the rich countries $287 billion more than it received in new loans or aid. This figure does not count capital flight or low commodity prices.

What solutions could bring an equitable end to the crisis?

Over a hundred technical/financial solutions have been proposed, but most would simply tend to pile new debt on old. Several countries considered important to Northern interests have had their debts 'rescheduled' - or pushed into the future - at slightly more favourable rates; they remain in debt bondage nonetheless.

Repudiation. Many people wonder why Third World countries don't simply stop paying and let the North worry about the problem (as Fidel Castro has proposed). Northern banks would no longer be threatened if this happened - today the banks have reduced their exposure to the extent that only 6 percent of their loan portfolios are placed in the Third World. Although economic chaos and riots may one day push indebted governments to default, as of mid-May 1989, while some debtor governments had tried to limit payments, all had refused the default option. They fear that outright refusal to pay would make them financial lepers for years to come. They want to remain in the world trading system and above all, they want to maintain access to fresh funds.

Between debt bondage and default, is there a third way? Yes, if imaginative management were applied - but a just solution to the debt crisis will not happen without plenty of political pressure from citizens in North and South. If 'creative reimbursement’ or the '3-D solution' - standing for Debt, Development, Democracy - were tried, however, debt could become a tool for authentic peoples’ participation in their own development.
The '3-D solution'. Public debt (owed to governments, the World Bank or the IMF) could be paid back in local currency, not in hard-earned dollars, and placed in a national development fund, with certain conditions. It would be managed not just by the State but also by democratically chosen popular representatives of the civil society (with special provisions made for fair representation of women, rural people and ethnic minorities). These funds could finance development projects proposed by local NGOs and associations, feed revolving credit pools in which small farmers and particularly women could get credit at normal and non-usurious rates (sometimes called 'peoples' banking', of which the Grameen Bank of Bangladesh is a well-known example) and provide salaries for ecological preservation and renewal.

Countries might also elect to reimburse part of the debt in kind, on the principle that their natural heritage is presently being destroyed. Governments would be rewarded for preserving their forests and soils. Each project could be assigned a monetary value and the debt would be written off by that amount as it was completed. For example, the creditor country could offer to write down the debt by a set amount for every million trees planted; similarly, a monetary value could be placed on the provision of small irrigation works on a given number of hectares. Other examples could include collection and conservation of plant and animal genetic species, anti-erosion and water conservation measures, planting of ‘green belts’, improvement of building techniques with local materials, etc. This would contribute to preserving the common heritage of the planet, which has become an increasingly central element of the political agendas of the countries of the North.

Governments could limit their debt payments to a certain percentage of export earnings (as President Alan Garcia of Peru attempted to do) or refuse to pay in today’s commodity dollars. For example, copper sold for twice as much a decade ago as in 1987. A copper producer should sell only as many tonnes of copper as would have been necessary in, say, 1979 to pay back each $1 million worth of debt incurred in 1979. Debtors could also go on an interest-paying strike until banks returned some of the flight capital that debtor country citizens have illegally stashed away. All these tactics, and others which could be imagined, would be far more feasible if Southern countries united around a common program. To date, they have remained divided and have submitted to the ‘case-by-case’ strategy employed by their creditors.

Mutual interest. We in the North have a commercial interest in encouraging creative reimbursement and ‘3-D’ solutions. Only healthier economies in the Third World can reduce unemployment and keep our own economies humming. For example, Third World debtor countries cannot afford to buy Australian exports, thereby contributing to Australian employment, if they have no money left over after paying their debts. ‘3-D’ solutions would also help to save our environment, as debt is the driving force towards environmental destruction.

Finally, we have a political interest. If we encourage decentralised, democratic, sustainable development, our world becomes safer. If, on the other hand, we allow the debt crisis to fester and despair to grow, we must expect a much higher level of social conflict and terrorism, over-spilling inevitably into creditor societies. All of us are passengers on the Titanic, though some of us are travelling first class.
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The Editor
Development Bulletin
Australian Development Studies Network
Australian National University
GPO Box 4
Canberra, ACT, 2601
Tel: (062) 49 2466
Fax: (062) 57 2886