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DEBT WHERE CREDIT IS DUE

"The discovery of America, and that of the passage to the East Indies by the Cape of Good Hope, are the two greatest events recorded in the history of mankind ... To the natives, however, both of the East and West Indies, all the commercial benefits which can have resulted from those events have been sunk and lost in the dreadful misfortunes which they have occasioned... It is impossible that the whole extent of their consequences can have been seen ... What benefits, or what misfortunes to mankind may hereafter result from those great events, no human wisdom can forsee ...

All European nations have given such extraordinary privileges to bills of exchange, that money is more readily advanced upon them, than upon any other species of obligation ... Many vast and extensive projects, however, were undertaken, and for several years carried on without any other fund to support them besides what was raised at this enormous expense. The projectors, no doubt, had in their golden dreams the most distinct vision of this great profit. Upon their awakening however ... they very seldom, I believe, had the good fortune to find it ... Each endorser becomes in turn liable to the owner of the bill for those contents, and, if he fails to pay, he becomes too from that moment bankrupt." (Adam Smith, The Wealth of Nations, 1776)

The real Adam Smith, like his contemporary copy, wrote during a period of long economic crisis. He made the two above cited observations, which afford us important historical perspective on the contemporary debt crisis.

One of Smith's observations reflects the drain of resources from poor peripheral countries to rich metropolitan ones, which is generated during periods of economic crisis. The "Rape of Bengal" and the drain from the Caribbean slave colonies during the economic crisis of the 1760s and 1770s observed by Smith is an example. Another is "The Drain" from India and other newer colonies during the period of imperialism and colonialism in the crisis after 1873. The exploitation of Central Europe by Germany and the "Greater East Asian Co-Prosperity Sphere" of Japan in the 1930s are other examples. The contemporary "perverse" flow of capital from poor Third World debtor countries to rich creditor ones is therefore not exceptional but normal for periods of economic crisis.

Smith's other observation reflects on a normal crisis response, which has also become a mechanism to effect this "perverse" resource transfer: the excessive creation of credit by drawing and re-drawing bills of exchange, "to which the unfortunate traders have sometimes recourse when they are on the brink of bankruptcy". Smith observed how the Banks of England and Scotland issued "too great a quantity of paper" in the preceding years. In the centuries before Smith as well as in those after him, speculative credit creation and use has characterized each culminating boom and led to the subsequent bust, like those of 1520, 1720, 1873 and 1880s, 1907, 1929, and the one likely to come.

In the present crisis, this speculative financial mechanism is an important instrument to effect the neo-colonial drain of resources and capital from poor to rich, which is analogous to the colonial drains during past economic crises. However, today's drain is a veritable hemorrhage, which is proportionately greater than some of the recent past. The reparations transfer out of Germany after its First World War defeat was about 2 per cent of annual GDP in the late 1920s and reached a maximum of perhaps 3.5 per cent in the darkest years 1929 – 31. Reparations payments amounted to about 15 per cent of export earnings. In his *The Economic Consequences of the Peace,* John Maynard Keynes has warned that this drain would be unsustainable for Germany and counterproductive for the world. He was proven right by the resultant rise of Hitler. Yet many Third World countries are today being drained of 5 and 6 per cent of their GNP and 30 to 50 per cent and more of their export earnings annually through the resource transfer of their debt service. Since the beginning of the Third World debt crisis in 1982, the Third World has suffered a net transfer of about US $ 200 billion through debt service per se (of which $ 135 B from Latin America, and $ 50 B from Africa), another $ 100 billion through capital flight (which increases proportionately to incoming loans), an additional $ 100 billion through lower export prices and terms of trade, plus the usual $ 100 billion of remittances of profits and royalties on foreign investment and technology. That totals up to roughly $ 500 billion remitted in five years, compared to a total accumulated debt of $ 1,000 billion.

Despite this enormous hemorrhage of the Third World, most proposals to deal with the Third World debt crisis propose to increase the debt now and debt service later even more. This is notably true of the (U.S. Treasury Secretary) Baker plan to increase loans to 15 Third World countries and the proposals to cap the interest rate and to add this interest to the principal. Instead, the obvious emergency remedy against this hemorrhage is to reduce the massive outflow of resources and money from these countries. Only a minority of political proposals advocates this. They range from Fidel Castro's suggestions for unilateral Third World debt moratoria or even default to U.S. Senator Bradley's proposal to write down principal by 3 per cent each year and President Garcia's unilateral decision to limit Peruvian debt service to 10 per cent of export earnings. Only the last of these has received even limited support by the powers that be.

Ironically, while such diverse figures as Henry Kissinger, Fidel Castro and Raul Alfonsin propose a yet unacceptable political solutions to what they see as a political problem, the market has begun to offer de facto modifications. The magic of the market discounts the face values of these debts to the estimated real values that new purchasers are willing to pay for them in secondary markets. At the same time, however, it maintains the nominal face value of this paper on which the debtors are supposed to pay debt service to the new owners. This procedure only reduces the debt service if the debtor buy his own paper at a discount or if he defaults on it. Banks have also increased their bad debt reserves to hedge against such possible debtor defaults. However, there are also a number of as yet unused

normal legal practices available to reduce the hemorrhage and complement the realistic market write down of these debts. We review some of these below under contract law, privatization, international charters, and bankruptcy.

The onset of the debt crisis itself and much of the accumulated registered debt is by now due to the sudden spectacular rise in the rate of interest after 1979. (First the American Federal Reserve raised the interest rate for domestic reasons and then the Reagan Administration bid it up even further by borrowing to finance its growing domestic budget and foreign trade deficits generated by the huge increase in its arms expenditures). The monetary interest rate reached 20 per cent, and discounting inflation the real interest rate was over 10 per cent for several years. Yet when the money was borrowed in the 1970s the real interest rate had been negative (and banks earned their money through fees), and historically the real interest rate never averaged more than 2 or 3 per cent. So the interest rate has been over three times its historic norm, which is much higher than anyone had imagined possible. Debtors have been charged this new high rate of interest on previously existing old loans and on new ones taken out to pay this elevated interest on the old loans. The creditors had inserted "floating" rates of interest into the fine print of the original loan contracts, whose subsequent meaning creditors and much less debtors had not understood or imagined at the time of signature. Normal contract law provides that contracts are invalid or can be invalidated by a court if they were signed without full cognisance by both contracting parties. Applying this legal norm to the floating interest rate small print of these 1970s debt contracts would substantially reduce the amounts nominally owed. That is, this interest accrued at rates that were unilaterally increased by the creditors should have to be neither paid nor defaulted by the debtors, since under normal contract law it never became a legally binding part of their debt. Why has the nominally high interest component of Third World debts, which accrued without the knowledge or knowing agreement of the damaged contracting parties, not been declared legally null and void? Legal provisions to do so can and should be made.

Instead, so far interest has been piled on top of the debt, and some of both have been "privatized" through debt-equity swaps. Debts that can never be repaid are sold, often at a discount, and then converted into local currency, which is used to buy up equity ownership of local enterprises and resources. Thus, debt is converted into, or swapped for, equity. This procedure has achieved popularity in some circles as a solution to the debt problem. It has several limitations and drawbacks, however. First, only a few billion worth of debt have been so converted. The hill of equity in existence in Third World debtor countries is insufficient to be swapped for more than a small part of the $ 1,000 billion mountain of Third World debt, or even for any significant portion of it owed to private banks. Second, potential foreign investors are more interested in some countries in East Asia rather than in the most indebted countries of Latin America and Africa. Third, this procedure contributes no new capital for the development of new production, but only transfers old enterprises and resources to new owners. Fourth, this exercise mostly transfers national public enterprises and natural resources to foreign ownership. Fifth, debt-equity swaps alienate these enterprises and resources at forced sale bargain prices. However, much of the present nominal debt was not properly contracted and certainly was never received by the debtor as an equivalent flow of real capital or resources from abroad. Therefore, now swapping this nominal foreign debt for real national equity amounts to giving away the family jewels for a mess of porridge. Sixth, therefore any possible extension of such debt-equity swaps to the most valuable national treasures, such as Petrobras and Pemex, will arouse justifiably fierce nationalist opposition.

On the other hand, many loans were originally taken out, not by governments, but by private enterprises; and they have subsequently been socialized. Yet current political wisdom and market logic speak for the reverse. When the private debtors were threatened by bankruptcy and were no longer able to service their debts, they called on earlier government guarantees or asked for new ones. Their loans were guaranteed or taken over outright by national governments or their central banks. If these private and public parties in the Third World did not so agree on their own, creditor banks or governments as well as the International Monetary Fund (IMF) blackmailed the Third World debtors into government guarantees or takeovers of these private loans on threat of withholding further credits. The reason for all this was simple: private losses threatened with bankruptcy (as Smith supposed) were socialized for payment by the public at large through taxes and/or inflation as well as reduced government services.

There is no political or economic justification for the all too common socialization of private losses. On the contrary, if privatization and the magic of the market offer such surefire solutions to contemporary ills as President Reagan, Prime Minister Thatcher, Prime Minister Chirac and others claim, why not privatize public loans or at least re-privatize those that were socialized? Indeed, the magic of the market has itself begun effectively to privatize some loans by selling and buying them at a discount from their face value in the secondary market. However, when Brazil proposed to convert part of its debt into securities at current market discount prices, creditor banks and governments balked. The U.S. Secretary of the Treasury declared the Brazilian proposal a non-starter, and Brazil withdrew it. If the magic of the market is good for all and privatization is good for the goose, then why should they not be good for the gander?

Unequal treatment of the formally equal but actually unequal is also rampant elsewhere. The IMF (Institute for Misery and Famine) obliges Third World debtor countries to swallow its "stabilization" (read contractive) medicine supposedly to reduce their domestic fiscal and foreign payments deficits. Large parts of these deficits, of course, are generated by the governments' debt service in the first place; and they are further aggravated by swallowing the IMF medicine. Yet the IMF does not even recommend the same medicine to the United States with the world's largest foreign debt (by now more than all of Latin American foreign debt combined and still growing soon to top the entire Third World debt) fed by a massive $ 200 billion annual domestic budget deficit and nearly as large a trade deficit. Nor does the IMF treat the balance of payments surplus countries, like Germany and Japan. Yet, the IMFCharter provides for surveillance of all these

countries alike; and the Group of 24 (developing countries) has long since asked the IMF for equal treatment of all deficit countries.

All pleas for equal treatment have been to no avail. The IMF Director has always been a European, but he only dances to the American tune. In fact, European Governors of the IMF invariably also vote the American line. Yet these same European governments finance, trade, agricultural and other ministers sustain far reaching and deep going economic disputes, also about American deficits, with their American colleagues. Why are these never reflected in European votes at the IMF? If war is too important to be left to generals, money is too important to be left to bankers, including central bankers. Perhaps finance ministers or treasuries rather than central bankers should exercise greater prerogatives at the IMF. Finance ministries and Treasuries may be more sensitive to public demands and more sensible about real world conditions than the isolated bankers' bankers.

One real world fact of life (as Adam Smith observed) is bankruptcy. Of course, it is anathema to bankers, except when they wish to exercise this privilege for themselves, as a growing number have done in the United States, for instance. There, as in all other capitalist countries, in the name of the public good and capitalist efficiency, bankruptcy laws provide for the insolvency of private enterprises, private individuals, public institutions, regional and local governments (New York City nearly went bankrupt), and even banks themselves. Both debtors and creditors are afforded the protection of their most essential interests by law and court, which (as under Chapter 11 of the United States bankruptcy code) also seek to enable the enterprises, institutions and individuals to make structural adjustments to reestablish themselves as going entities by freeing them from unbearable burdens (New York City, the Chrysler Corporation, Rolls Royce, AEG Telefunken,etc. and the Continental Illinois Bank and Trust Company among many others were all enabled again to set their houses in order). Why should this same legal practice in the public interest be denied to effectively insolvent "sovereign" debtors? Instead, the banks encourage them first to socialize the bankrupt private debt. Then the IMF obliges them to increase the payment of unbearable burdens and take them out of the hides of their poorest citizens who are least able to bear these burdens. And the World Bank calls for simultaneous structural adjustments and economic growth to boot. These demands from the Third World, of course, contradict all economic logic and legal procedure elsewhere. The United Nations Commission for Trade and Development (UNCTAD) in 1985 and Mr. Kunibert Raffer from Austria more recently have proposed the much more logical extension of normal bankruptcy laws and the establishment of bankruptcy courts or commission to cover sovereign country borrowers as well. There has been no visible or audible response, but there should be.

Moreover, sovereign bankruptcy proceedings need only be a last resort after the debt burden has already been reduced by declaring the elevated interest charges as the contractually invalid fine print that they are and by (re)privatizing some of the socialized debts, which would thereby make them automatically subject to the bankruptcy laws and proceedings already available to the private sector. These are some of the practical logic and legal practices to stem the hemorrhage of Third

World debtors on an emergency basis now. Later we can turn to the task of reforming the old economic order, before it results in benefits accompanied by further dreadful misfortunes that no human wisdom can forsee.

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UNCTAD VII – EINE PLATTFORM FÜR DIE ZUKUNFT

Arbeitsbeschaffung für Diplomaten – das beste Ergebnis, das eine Welthandelskonferenz je hervorbrachte: Dies sind die beiden Extreme, zwischen denen die Beurteilung der UNCTAD VII schwankt, die im Juli dieses Jahres in Genf stattfand. Hier soll versucht werden, eine Beurteilung der Konferenz und eine Einschätzung ihrer Ergebnisse darzulegen, nüchtern und realistisch, aber sicherlich nicht frei von subjektiven Einflüssen, wie sie einem Teilnehmer auch nicht verdacht werden können.

Die Vorzeichen, unter denen die UNCTAD VII stand, waren denkbar ungünstig. Einerseits war die Haltung der Gruppe B, also der westlichen Industriestaaten, vom Trauma der bisherigen Konferenzen gezeichnet, die eine Fülle individueller Resolutionen und Entscheidungen brachten, deren Durchführung den Keim weiterer Auseinandersetzungen in sich barg; auch brachten die Bemühungen um eine institutionelle Reform und um eine Erhöhung der Effizienz der UNCTAD in den letzten Jahren nur bescheidene Erfolge. Andererseits ließ auch die von den Entwicklungsländern (der „Gruppe 77") in Havanna erarbeitete Ausgangsbasis nichts Gutes erhoffen, da in der Havanna-Deklaration und in den einzelnen Positionspapieren im wesentlichen nur eine Fortschreibung traditioneller Maximalforderungen enthalten war. Einen Hoffnungsschimmer brachten die vom UNCTAD-Sekretariat ausgearbeiteten Unterlagen, die verhältnismäßig ausgewogen und realistisch waren. Den sichtbarsten Niederschlag fand die zurückhaltende Einstellung der Gruppe B darin, daß die USA ihre Delegationsleitung auf relativ niedrigem Niveau hielt und als einer der wenigen Teilnehmer nicht auf Ministerebene vertreten war.

Die endgültige Fixierung der Tagesordnung der Konferenz kann als erster Erfolg einer realistischen Einschätzung der Lage gesehen werden. Anstelle einer langen Auflistung zahlreicher Problempunkte gelang es, eine Konzentration auf vier wesentliche Sachbereiche durchzusetzen: Ressourcen für die Entwicklung, einschließlich finanzieller und verwandter monetärer Fragen; Rohstoffe; internationaler Handel; und Probleme der am wenigsten entwickelten Länder. In der Tat lassen sich unter diese Themata die wesentlichen Probleme im Nord/Süd-Verhältnis subsumieren, vor allem wenn man bedenkt, daß die Konferenz unter dem meritorischen Generalthema „Revitalizing development, growth and international trade" stand. Dazu kam noch, daß die Gruppe B von Anfang an darauf bestand, daß der Festschreibung politischer Konklusionen eine gemeinsam erarbeitete Beurteilung („assessment") der Weltwirtschaftslage vorangehen müsse. Dieses Konzept wurde von der Gruppe 77 nur widerwillig akzeptiert, erwies sich aber dank seiner logischen Überzeugungskraft als letzten Endes erfolgreich.

Schließlich muß auch bedacht werden, daß das weltwirtschaftliche Szenario zu keinem großen Optimismus Anlaß bot. Die Volkswirtschaften der Industriestaaten