14 Debt and Development

CHAPTER SUMMARY

Lending and borrowing, and regulations to control loans and loan collections, go back some 4,000 years. International borrowing goes back at least 700 years, but it remains controversial. Charles Kindleberger proposed that the economy runs in cycles of growth, mania, and crisis and that during the mania phase, a surplus of capital leads to increasingly risky and speculative lending, particularly loan pushing to developing countries. During the crisis period, borrowers often cannot repay and therefore default.

Lending in the 1970s, both commercial loan pushing and lending to Cold War allies, precipitated a loan crisis in the early 1980s when interest rates were suddenly driven up. During the 1970s, lending did provide new money for developing countries, but since then there has been a net transfer of wealth from poor countries to rich ones through debt servicing. Developing-country debt has increased dramatically, but with no discernible benefit to borrowing countries. Further, many of the initial loans were made to political leaders who were known to be corrupt and unlikely to use the funds to improve their country's economic or social development, such as President Mobutu of Zaire, or to regimes, such as that in South Africa during apartheid, that used the funds to further the disempowerment of their own people. Meanwhile, the United States and other industrialized countries have been net borrowers, with developing countries. Thus, the period since 1982 has seen a huge transfer of wealth from poor countries to rich ones, and developing countries, de facto, have become major lenders to the rich industrialized countries.

VIDEO RESOURCES

Money As Debt
https://www.youtube.com/watch?v=jqvKjsIxT_8
Time 46:56

Essential viewing on money and the banking system. *Money As Debt* is a fast-paced and highly entertaining animated feature by artist and videographer, Paul Grignon. It explains today's magically perverse debt–money system in terms that are easy to understand.

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Why should we worry about poor countries' debt?
https://vimeo.com/23204815
Time 5:33

Susan George explains what's wrong with third world debt. Rich nations, the IMF, and multinationals keep poor countries handicapped by structural adjustment programs and debt, which she calls a form of colonialism. Creditor nations drag out the debt crisis. Debt relief campaigns have made some headway in cancelling debt, but more debt relief is needed.

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The Wealth and Poverty of Nations: Financial Crises, Debt, Economic Success (1998)
https://www.youtube.com/watch?v=W5EgK9lxcjk
Time 1:01

The Wealth and Poverty of Nations: Why Some are So Rich and Some So Poor, published in 1998, is a book by the late David Landes, formerly Emeritus Professor of Economics and former Coolidge Professor of History at Harvard University. In it, Landes elucidates the reasons why some countries and regions of the world experienced near-miraculous periods of explosive growth while the rest of the world stagnated. He does this by comparing the long-term economic histories of different regions of the world, giving priority to Europe and the United States, as well as Japan, China, the Arab world, and Latin America. In addition to analyzing economic and cliometric figures, he gives substantial credit to such intangible assets as culture and enterprise in the different societies he examines in order to explain economic success or failure.

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BBC investigation into debt "vultures"
http://news.bbc.co.uk/2/hi/programmes/newsnight/8610062.stm
Time 9:27

Vulture funds buy up a poor nation's debt at knockdown prices, before going to court to recover the full amount. In one of its last acts before the election, Britain's parliament has voted to ban so-called "vulture funds," which profiteer from third world debts.

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Doing Business in Less Developed Countries: Financial Opportunities and Risks
https://www.youtube.com/watch?v=TnDij2TsJb8
Time 2:26

There are substantial opportunities and risks in establishing a successful business in developing countries. Financial and economic risks of doing business with developing countries, manifested in World Debt Crisis, require careful examination before a business venture is attempted.

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Martin Khor: Debt in the Developing World—Part One
https://www.youtube.com/watch?v=nNN06z7a_IE
Time 2:21

In this two-part series, Martin Khor addresses issues relating to debt and international trade. Since the debt crisis began in the 1970s, many developing countries have had to agree to new loan conditions imposed on them by the International Monetary Fund (IMF). These conditions, of benefit to many western commercial interests, often prevent national governments from implementing their own key economic, development and environmental policies. Trade liberalization is one such condition. Dr Khor describes the adverse effects a liberal trade agenda can have on these countries, particularly on their farmers and small industries. He argues that developing countries must be given the freedom to adopt policies of their own. Finally, he welcomes the G8's decision to cancel the debt of some 18 countries, but warns that the terms and scope will need careful study.

REVIEW QUESTIONS

1. What is the Heavily Indebted Poor Countries Initiative (HIPC)?

2. Explain the origins of the 1980s debt crisis in the developing world.

3. Describe Charles Kindleberger's view of economic cycles and international lending.

4. Briefly describe the Jubilee 2000 campaign.

5. Discuss the concept of lender liability as it relates to developing countries by drawing on the example of South Africa.

6. Charles Kindleberger proposed that the global economy runs in cycles of growth, mania, and panic. What does he mean by this statement?

7. What are the main difference between the 1930s and the 1980s making the condition of life of the developing countries worse than before? Explain by a reference to the terms and condition of debts.

ANSWER KEY: REVIEW QUESTIONS

1. Launched in 1996, the HIPC initiative accepted for the first time that some poor countries would not be able to repay their loans made by the World Bank and the IMF, and that some loans would have to be cancelled. This debt cancellation was to be done in parallel proportion with debt cancellation of bilateral loans with governments and by private creditors. Debt cancellation was negotiated with strict neoliberal structural adjustment policy conditions, and involved three creditor groups: the Paris Club, the London Club and the IMF, World Bank and other development banks. The initiative ultimately failed, and was replaced by the Multilateral Debt Relief Initiative, which did substantially reduce debt service payments. (pp. 268–269)
2. The 1970s were a time of "mania," which resulted in excess surplus capital. As a result, there was a sharp increase in "loan pushing" at very low interest rates. In the 1970s, the amount of developing country debt increased sevenfold, which included a real transfer of money from South to North. In 1984, when real interest rates peaked at 12 per cent, Mexico became the first country to default on its debt obligations, setting off the debt crisis. In order to save the international banking system, debts were renegotiated, and some new loans were made just to pay interest rates. By 1990, developing country debt had reached over one trillion dollars, but now with no new benefits to recipient countries. Private lenders wanted to sell debt and debt was traded, which included debt-for-nature and debt-for-development swaps, but debt still rose inexorably and have persisted into the twenty-first century. (pp. 266–267)
3. According to Kindleberger, a cycle begins with a period of real growth and rising profits through the development of new technologies, transportation, or communications systems. When growth eventually outstrips productive investments, speculation begins, which is often linked to fraud and swindles. Kindleberger calls these bubble periods "mania." These periods involve heavy international lending as banks exhaust domestic borrowing potential and desperation to lend leads to high-risk foreign loans. Eventually the bubble bursts, prices fall, and a period of "panic" ensures when investors try to sell or collect loans, which ultimately leads to a "crash." (p. 264)
4. In 1997, Jubilee 2000, an international campaign for debt cancellation of "unpayable debt," was launched. The campaign had as its goal the cancellation of the unpayable debt of the world's poorest countries through a "fair and transparent process" by the year 2000. The campaign was successful in three main ways: (1) it made a technical issue into something the layperson could easily understand; (2) it linked local debt campaigns in both North and South; and (3) it attracted an unexpectedly large number of supporters (24 million from 166 countries) and put pressure on Northern governments to increase debt cancellation under the HIPC initiative. (pp. 267–268)
5. When Nelson Mandela was released from prison in 1985, he was saddled with the responsibility for debt incurred under the racist Apartheid regime. South Africa paid the $6.5 billion in debt service in 1997, which totalled four times the amount demanded of the Apartheid state. However, there are questions as to whether the South African nation should be held accountable to the debt incurred by the apartheid state, a discredited regime. The UN had described Apartheid as a crime against humanity, and imposed an arms embargo on the country in 1977. Chicago economists questioned whether loans to the regime were in the interest of the nation and its people, and whether repayment could be ensured with the imminence of a change in regime. The fact that banks didn't listen to warnings and that the country had to repay the debt after the fall of apartheid, both demonstrate that it was not a successful case of illegitimate debt, despite the fact that lenders could have been legitimately argued to bear responsibility and that the regimes incurrence of debt might be classified as odious. (p. 274)

6. He means that the mania includes loan pushing that turns to economic bust and panic. This was the case in the 1930s and in the 1980s, which led to two "lost decades of development" across much of the Global South. For two decades, the developing world gave $48 million to the rich world each day—yet every day the debt burden increased by $204 million. Similarly, the global financial crisis in 2008 was rooted in excessive lending, followed by a sudden bust. And the pattern was repeated. The North printed money through quantitative easing, and some of this surplus money was lent to the South, promoting what will become a new debt crisis. Meanwhile, within the rich countries, wealth has been transferred from rich to poor while poorer people have been encouraged to borrow to maintain minimal levels of consumption. And the US has built up a huge foreign debt by forcing developing countries to keep US dollars as reserves, making developing countries net lenders to the US and other industrialized countries. (p. 280)
7. The major difference between the 1930s and the 1980s was the existence of the Bretton Woods institutions (BWIs). Poor countries became increasingly dependent on "aid," and the "donors" made their aid conditional on recipient countries having World Bank and IMF programs, which in turn imposed two sets of conditions. One was continued debt repayment. Little concession was made for economic problems such as bad crops, and debt bondage lasted indefinitely. Indeed, with respect to the Bretton Woods institutions, developing countries have fewer rights than the citizens of Hammurabi's Babylon did nearly 4,000 years ago. The second highly controversial condition was that poor countries adopt neoliberal economic policies and what were known as "structural adjustment programs" (also discussed in Chapters 3 and 9). Import-substituting industrialization was the model followed earlier by the now-industrialized countries and was the model being followed by the developing world (Chang, 2002), but the BWIs forced poor countries to open their borders to manufactured goods from the industrialized countries, and instead to adopt a model of export-led growth. This resulted in many countries rapidly expanding the production of agricultural and mineral exports, which in turn meant increased competition and a drop in the prices paid by the rich countries to the poor countries. Cocoa sold for $2,604 a tonne in 1980, less than half that ($1,267) in 1990, and even less in 2000 ($906). Commodity prices began rising again from 2004. But for two decades, the industrialized countries forced the developing world to sell industrial inputs for ever-lower prices while also forcing them to buy imported manufactured goods instead of producing them locally. Debt had become a major weapon of economic power used by the industrialized countries. (p. 273)