

# 4.

## CONDEMNED TO DEBT?: THE TRADE TRAP AND THE DANGERS OF DEFAULT

Just as a debtor country, in order to make a foreign debt payment, must sell to foreigners more goods and services than it buys from foreigners, so a creditor nation, in order to receive a completed debt payment, must be prepared to buy from foreigners more goods and services than it sells to them . . . The degree to which such a creditor country accepts an import surplus measures its willingness to receive debt payments . . . One thing is certain – a country which is unwilling to receive payments cannot be paid.

*Harold G. Moulton and Leo Pasvolsky, War Debts and World Prosperity,  
The Brookings Institution, Washington, DC, 1932, pp. 16 and 402*

These [indebted] countries must be able to sell their goods abroad to service their debts. If their access to industrialized countries' markets is impaired through protectionism, the developed world will be condemning the indebted nations to perpetual financial crisis.

*William E. Brock, US Trade Representative, Chairman of the Cabinet-level Trade Policy Committee,  
'Trade and Debt: the Vital Linkage', Foreign Affairs, Vol. 62, No. 5, Summer 1984*

The creditor countries, the IMF and the banks pretend to want their money back, with interest, from the Third World – but do they really? If

so, it is strange and contradictory that together they should practically ensure the debtors' inability to pay. Unless there is a secret document, stashed somewhere in the vaults of subterranean Washington, ordaining that the debtors must be bled dry, recolonized, reduced to bondage and virtual penal servitude, we need to explain the contradictions exhibited by the major actors in the North.

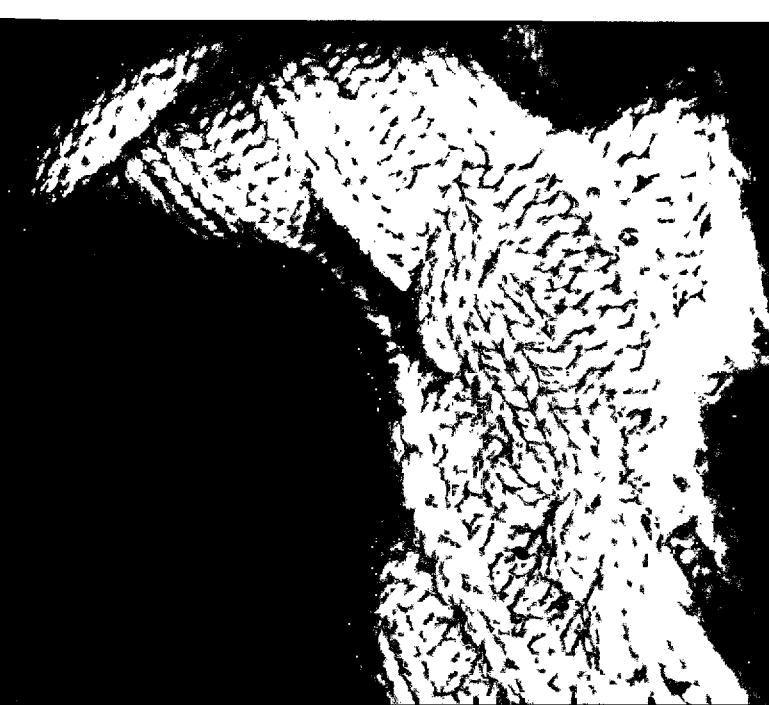
As need hardly be pointed out, it is hard to pay back money when one hasn't any. Chapter 1 explained why many debt-financed projects aren't bringing in revenues – the money has been squandered on current consumption or spent on sterile pursuits or has ended up in Northern banks. The money must none the less be repaid. This leaves trade. As Moulton and Pasvolsky knew in 1932, if creditors want their loans paid off, debtor nations must be allowed to earn their international keep. Now, as then, countries must not be prevented from exporting and from earning a fair price for their goods.

Without earnings from trade, one can continue to borrow new money only in order to service old loans. 'Rescheduling' is the polite name for this process. It is widespread in spite of the banks' reluctance to keep on lending: there were 144 reschedulings of official debt alone between 1975 and 1985. A strategy that serves only to push debt further and further into the future is unlikely to succeed for ever.

Debtor nations are *not* earning a fair price for their goods, and they *are* being prevented from exporting. The world economy is enfeebled as a result: the debtors' only recourse is to cut imports drastically in a desperate attempt to create a trade surplus that will allow them to pay back the banks. Once they've cut the fat, they start depleting muscle and bone. Agriculture and industry must forgo vital needs like fertilizer, spare parts and machinery. Debtor nations must also deprive their people: they can no longer afford basic drugs or foodstuffs, much less books. The policy – for it does seem to be a policy – of *preventing* countries from repaying their debts or purchasing basic necessities has pernicious consequences for the North as well as for the South.

### OF GLUTS AND GLUTTONS

Whenever the hit squads of the IMF arrive to bring an erring member back into line, they scarcely disembark from the plane before insisting that the country increase its exports. As we saw in the preceding chapter, this policy is an article of faith at the Fund. Such prescriptions might theoretically be good medicine for country *x* or *y*, taken



separately, if they alone could supply cocoa or cotton or computer circuits. The IMF now, however, has over forty countries under surveillance (those that have accepted adjustment packages), and there are other large debtor countries, like Brazil and Nigeria, practising Fund doctrine while refusing formal Fund guidance. For some forty indebted countries, then, the word from Washington is export or perish.

This is all very well except for a few minor points. One is that plenty of other countries, indebted or not, First World or Third, are also trying to get rid of their merchandise on world markets. As the debtors boost exports and slash imports they can't help becoming poor customers, necessarily depressing Northern export industries. As the entire indebted South virtually drops off the map as far as imports go, the concept of 'world' markets begins to translate as 'solvent, Northern-hemisphere, capitalist-economy-country markets'. The Soviet bloc is of little help, accounting for less than 10 per cent of world trade outside its own borders. Northern markets may be rich, but there are limits.

Compounding the problem is the limited range of goods that the debtors can offer, which pits one against another. African coffee producers compete not only against other Africans but against Latin Americans as well. The least developed economies are dependent on one, two or three agricultural or mineral raw materials, and it is folly to tell them to diversify in their present capital-starved condition. Slightly more sophisticated debtor economies compete in textiles, garments, small electronics and the like, but they too are increasing in number. Some agricultural exports from heavily indebted countries face cut-throat, usually subsidized, competition from well-organized OECD nations—for example, Brazilian soybeans compete with American ones; Argentine wheat faces the US, Canada, Australia and the EEC.

Third World commodities are further undermined by substitution. Every time the industrial countries think that the price of some raw material is out of line, they introduce a substitute that they can produce without recourse to outside suppliers. Sugar is a flagrant case: ever since the one-off boom in sugar prices in 1974, the heavy-user industries (such as soft drinks) have been diversifying into high-fructose corn syrup or sweeteners engineered with bio-technology. Many other agricultural products are threatened by substitutes as well—rubber, jute, cotton, timber, even coffee or cocoa.<sup>1</sup> As for non-agricultural raw materials, more efficient Western industries are using fewer mined metals, employing more synthetics and wasting less of the metals that they do use. Glass fibre as a substitute for copper wire in the telecommunications industry is one example.

When Third World countries struggle to sell a limited range of goods in the face of shrinking demand, over-supply and plunging prices are the predictable results. 'Glut' is possibly the ugliest word in the English language. If you look it up, you'll find its root means 'to swallow', but when applied to markets it means just the opposite. Markets, unlike gluttons, simply cannot swallow unlimited quantities of foods or textiles or transistors.

Is the IMF's insistence on the same export-led strategy for all as mindless as it appears? The Fund defends itself by proclaiming its opposition to protectionism as well. If trade were really free, says the IMF, all would be well. No doubt. If we had some ham, we could have some ham and eggs if we had some eggs. Being 'against' trade restrictions is certainly a principled moral and intellectual stance. However, the Fund does not apply the kind of pressure on the restricters that it routinely applies to its indebted pupils.

The relevant issue is not what the Fund is for or against but who benefits and who loses from present Fund doctrine *as applied*, not as it appears in sacred neo-classical economic writ. IMF policy is not mindless when one considers that (1) the banks *are*, on the whole, being paid back (although it is not clear how much longer this repayment can continue), and (2) the countries that run the IMF and the rest of the international financial system have, so far, reaped a bonanza from the glut.

The size of the bonanza is estimated by the *Economist* at \$65 billion for the year 1985. Sixty-five billion dollars is the size of the 'poor man's gift' to the rich as measured in disastrously low commodity prices—an estimate arrived at *before* the precipitous drop in oil prices. Corporations that process Third World raw materials benefited from a 10 per cent drop in the cost of agricultural raw materials and a 15 per cent drop in metals prices between 1984 and 1985.\*<sup>2</sup> Thailand, for instance, followed the IMF's advice and increased its rubber exports by 31 per cent in the first half of 1985 as compared with the same period in 1984. What did it receive for its pains? An 8 per cent *drop* in rubber revenues (from \$262 to \$242 million).

International commodity agreements, the great white hope of the 1970s, are dead as dinosaurs. Intended to stabilize the prices of raw materials, the few that were actually signed fell victim to the pressures of market forces to which IMF policies have prodigiously contributed. The

\* These percentages are calculated in Special Drawing Rights, the IMF five-currency basket that avoids the built-in mistakes of valuing commodities in sharply fluctuating dollars alone.

United Nations Conference on Trade and Development (UNCTAD) vainly hoped that the Integrated Programme for Commodities (IPC) would stabilize prices for eighteen key raw materials from which roughly 60 per cent of Third World export income derives.

After the IPC launch at the UNCTAD Nairobi meeting in 1976 there ensued dozens of international meetings and thousands of hours of negotiations. The very fact that the rich consumer countries even participated initially in what has been called 'the sorry history of the IPC' partly 'reflected fears about the possible economic and political consequences of not doing so . . . two years after the OPEC oil shock . . . [when] other raw-material producers might consider launching their own cartels, perhaps with OPEC's assistance', explains Alan Spence, writing in the *Banker*. Such fears are now outdated. The West has thus 'not needed to accommodate Third World demands for commodity agreements,' concludes Spence (my emphasis).<sup>3</sup>

Instead of giving their all to the fruitless IPC process, Third World countries would have been better off banking what they spent on it with, say, Citicorp at 10 or 12 per cent. They could have saved the money committed to travel, hotels, vehicles and sundries, devoted the people-hours put into preparing position papers and haggling in negotiations to less spurious projects; and simply waited until the North put some serious proposals on the table. Had the South shown this kind of healthy scepticism, it would certainly have smaller debts and, arguably, higher commodity prices today. In a convoluted way, its own borrowings, followed by its own desperate attempts to export and the resulting gluts, have given the West such a strong hand that it need no longer 'accommodate Third World demands'. The IMF strategy contributed to the windfall showered on Western industries in the form of rock-bottom prices for basic supplies and to the consequent weakening of the South's hand. This is not a conspiracy (it may not even have been wilful), but it has been mightily beneficial to some.

Today commodity prices are going, going, gone. The IMF, which does keep good track of these matters, measures the purchasing power of a basket of thirty primary commodities, excluding gold and oil, in terms of the manufactured goods that they can buy. Starting from 100 in 1957, the IMF index has risen above that index only twice, in 1973 and 1974. Ever since, though there have been peaks and valleys, the trend has been downwards. By 1985 the index had plummeted to the lowest level ever recorded – a dismal 66.<sup>4</sup>

In spite of the Fund's best efforts to make everybody trade, the General Agreement on Tariffs and Trade (GATT) headquarters

reported that after a small surge in 1984 world trade in 1985 slowed dramatically. GATT says that the decline 'signals that the world economy is in danger of slipping back into the anaemic performance of the post-1973 period'.<sup>5</sup>

Experts have a ready answer for the LDCs' commodity problems – for example: 'The implication for producers and exporters is that they will have to rely on cost-cutting and better management to widen their thin profit margins, rather than on more lucrative prices or sustained increases in Western demand.'<sup>6</sup> That may sound like good advice, but what exactly does 'cost-cutting and better management' imply in the context of poor exporting countries, if not *reducing the cost of labour*? Work itself – which is to say workers – is virtually the only element the exporters control, precisely because it is mostly raw materials that are at stake. If countries are to try to pay debts through commodity sales at present prices, the only option is that human labour be pushed harder and paid less.

### BETTING ON BLOODLETING: THE PROTECTIONIST TEMPTATION

It's clear that the Third World can't pay – and yet it does! For Latin America alone, new capital inflow (both aid and investment) came to under \$38 billion between 1982 and 1985, while it paid back \$144 billion in debt service. Net transfer from poor to rich: \$106 billion.<sup>7</sup> In 1985 Latin America's per capita product was 9 per cent lower than in 1980 and no better than in 1977. Unemployment and poverty spread inexorably, overtaking large segments of the middle class. Huge cuts in imports mean that productive capacity is eroded, impairing tomorrow's exports. Commodity prices show no signs of improvement.

The pertinent questions are, then, how can this remittance process possibly continue, and why doesn't it stop? The trade surpluses that allow countries to keep on paying have been achieved at tremendous cost. Imports have been slashed and government spending has been severely curtailed. Pounds of flesh have been exacted and blood shed. My own suggestions for 'creative reimbursement' will be found in the final chapter. They are very different in spirit from present practice, and I hope that future political pressure may promote their adoption. Realistically, however, we must examine carefully the system that obtains today and that will dominate tomorrow unless a shift in the present balance of forces takes place. This is why the issue of *protectionism* is so important.

Never would I have expected to come down on the side of Reagan Republicans\* or of Jacques de Larosière, former managing director of the IMF. None the less, on the trade question I believe they're right – *always assuming* that political alternatives to trade earnings cannot be pushed through as a means of solving the debt crisis. Without even using the justice argument – massive transfers from South to North are simply *wrong* – the North has to recognize that trade surpluses eked out by the South under present conditions cannot go on for ever.

Every recession in this century has provoked a ritual demand: 'Save us from foreign competition.' It finds supporters among broad segments of the population in industrialized countries, especially those dependent on weak and declining industries. Politicians in democratic societies have to be sensitive to such special pleading. The situation today is beginning to approach that of the 1930s, when 'beggar-thy-neighbour' policies reigned and each country tried to undercut every other one. These desperate trade wars eventually led to disaster, including real war and Fascism; the lessons of history have not, however, prevented the adoption today of a great many *ad hoc* protectionist measures by a great many countries.

What with quotas, 'voluntary' restraints, tougher non-tariff barriers and subsidies to ailing industries, Larosière estimated that 'in 1983, products subject to restriction accounted for about 30 per cent of total consumption of manufactured goods in the United States and the European Community – up from 20 per cent in 1980.'<sup>8</sup> If industrialized countries do not act to dismantle barriers, the debtors cannot possibly earn a big enough surplus to pay back the banks, much less buy anything from the North.

Refusing protectionism is in the interest of the creditors as well, whatever the short-term effects on some industries may be. As William Brock points out, developed-country exports to the Third World were 23 per cent of their total exports in 1973, rising to 28 per cent in 1980. By 1983 the US depended on developing countries to buy fully 40 per cent of its exports – more than Europe or Japan. Export industries in the US are growing fastest and account for four out of every five *new* jobs created in manufacturing.

When the debt crisis hit Mexico in 1982, Brock explains, the effect on the *United States* was immediate and devastating: between the end of

\* Reagan administration behaviour, however, speaks louder than its anti-protectionist rhetoric. See its actions with regard to Brazilian computers and to the Generalized System of Preferences below.

1981 and the end of 1982 US exports to Mexico dropped by \$10 billion. Every billion dollars in exports sustains 24,000 jobs, so the Mexican crisis alone cost the US 240,000 jobs in just one year.<sup>9</sup> In 1980 the United States had a manufacturing trade *surplus* of \$12 billion, by 1984 a *deficit* of \$88 billion. Applying Brock's figures to this '\$100 billion gap, it represents a loss of close to 2.5 million jobs.

Spectacular growth in US farm exports resulted from opening up Third World markets. But compression of agricultural exports, down from a peak of nearly \$44 billion in 1980–81 to \$28 billion in 1985–6, has hit US farmers hard and has contributed to the epidemic of farm foreclosures. True, lower prices were responsible for part of the drop, but export *volume* also fell by 25 per cent in the first five years of the 1980s.<sup>10</sup> Even if prices for US food exports had remained at the relatively high levels of 1980–81, the volume sold in 1985–6 would still have brought in \$10 billion less than in the peak year. As it was, farmers lost nearly \$16 billion compared with 1980. That's a lot of missed farm revenue. What proportion of this can we attribute to the Third World's debt burden?

Latin America as a whole was buying \$6 billion worth of US farm products in 1980 and 1981. The best customers were Mexico, Brazil and Venezuela, with Peru and Chile as important runners-up. The year of reckoning came in 1982, when US agricultural sales to South America declined by 31 per cent. Mexico's purchases fell by fully 52 per cent, Brazil's and Venezuela's by 25 per cent, Peru's by 40 per cent, all in a single year.

Was this just a fluke, explained by exceptionally good harvests in the region? Unfortunately for US farmers, no. Although farm sales to Latin America did improve slightly in 1983 and 1984, the downward slide continued. The decline one can measure between 1981 (the bonanza year before the debt crisis) and 1985 looks just as grim as the one between 1981 and 1982. In 1985 Latin American imports of US farm products as a whole were still 31 per cent below the record levels of 1981. Using 1981 as a base, Mexico's were down 38 per cent, Brazil's were down 26 per cent, while Chile's and Peru's dropped by fully 77 per cent and 79 per cent in a five-year period!<sup>11</sup> Without growth in Latin American economies – impossible so long as they must cope with debt service – slashes in farm imports from the US must be seen as a permanent feature.

If asked which were more important to American farmers, sales to the Soviet Union or to Latin America, most people would reply, offhand, those to the USSR. They would be dead wrong. In 1981 South America

imported over three and a half times as many farm products as the USSR (\$6.2 billion v. \$1.7 billion). Even in 1985, when belt-tightening had already reduced southern-hemisphere imports and the Soviets had a poor harvest, the USSR bought 'only' \$2.5 billion worth of food compared to Latin America's \$4.2 billion.

Indebted countries besides those in Latin America have felt the pinch and had an impact on American farmers too. Since 1981 US farm exports to the Philippines have dropped 12 per cent, those to North Africa by a quarter and to Nigeria by a third. Debt-enforced cutbacks by all these customers is bad news in the corn and wheat belts.

As a study for the Joint Economic Committee of the US Congress shows, American farmers are made to suffer from the foreign-debt crisis in still another way. Debtors like Argentina and Brazil – large agricultural producers in their own right – must export or perish. Consequently, they increase their plantings, and 'this additional production and competition cuts into US sales to non-debtor nations and places downward pressure on virtually all major commodity prices. Falling commodity prices, in turn, make it more difficult for US farmers to continue servicing their debt and push many of them into bankruptcy.'<sup>12</sup>

In spite of all the evidence that protectionism is deeply harmful to creditor nations, some 400 trade Bills were introduced in the US Congress in 1985 alone. All were aimed at preventing imports from specific countries and at protecting specific industries. Congress seems to believe that other people's export subsidies and barriers to US goods are the main reason for the soaring US trade deficit. It's more complex than that.

A too strong dollar makes US goods more expensive abroad and contributes heavily to trade deficits. But so does Third World debt itself. 'The Latin American debt crisis has all but shut down a market for US exports that was once almost as large as Europe's,' says Silvia Nasar, writing in *Fortune*. The US is also addicted to imports. In 1980 fewer than 15 per cent of manufactured goods sold in the US were imported; in 1985 more than 20 per cent were. When people have grown accustomed to foreign products, Nasar says, tariffs levied against specific countries don't eliminate imports – they just shuffle them around.<sup>13</sup>

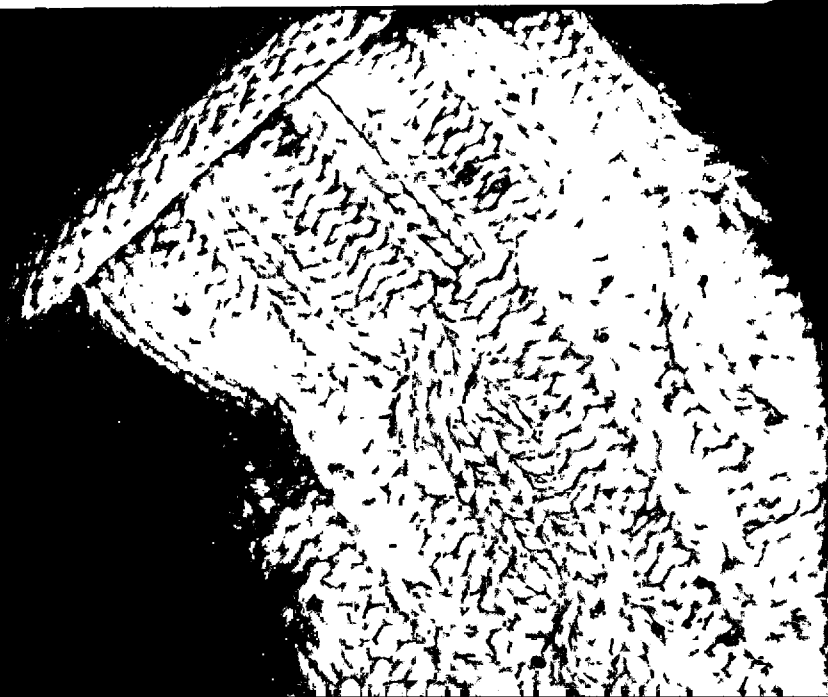
What happens when the US tries to shut other countries out of its market by abruptly slapping tariffs on their exports? Since the foreign exporters can't compensate for the new barrier with, say, a 25 per cent cut in their margins, they raise prices. If US consumers still need or want these foreign goods, they have to pay that much extra. Protectionism

also gives domestic industries a *licence to raise prices* – the normal response when competition is eliminated. *Protectionism is therefore inflationary* because people must pay more for protected goods produced in their own countries as well as for imported ones. The *Fortune* article, citing a study by the Federal Reserve Bank of Cleveland, claims that that 90 per cent of any revenues raised by the US through protectionist policies would come straight out of US pockets.

### GO TO BLAZES? WHY NOT DEFAULT?

Given all the obstacles set in their paths, why don't Third World countries simply refuse to pay – tell the banks and the creditor governments where to get off, so to speak? Such behaviour has been a constant of international relations for about five hundred years, so why not today? Some leaders, like Peru's President Alan García, have announced they will limit their payments to a specific proportion of export revenues – 10 per cent in the case of Peru. But this is not the same thing as refusing to pay altogether. In the 1840s the United States itself defaulted on loans owed to European creditors, and the world did not come to an end. All the indebted Latin American countries defaulted in the 1920s and 1930s. As one scholar has noted, 'Borrowing and default follow each other with almost perfect regularity. When payment is resumed, the past is easily forgotten and a new borrowing orgy ensues. This process started at the beginning of the past century and has continued down to the present day. It has taught us nothing.'<sup>14</sup> This was written in . . . 1933. Today, however, the screws are being tightened on the Third World, and some officials do not hesitate to paint a picture of the grim consequences a default would have for countries that repudiate their debts. Consider the words of R. T. MacNamar, then Deputy Secretary of the Treasury, in a speech before the International Forum of the US Chamber of Commerce:

*A repudiation takes place when a borrower unilaterally renounces responsibility for some or all of his debt obligations. Under such circumstances, the foreign assets of a country that repudiated its debt would be attached by creditors throughout the world; its exports seized by creditors at each dock where they landed; its national airlines unable to operate; and its sources of desperately needed capital goods and spare parts virtually eliminated. In many countries, even food imports would be curtailed. Hardly a pleasant scenario.'<sup>15</sup>*



Indeed not, as Paul Fabra, chief economic columnist of *Le Monde*, confirms. He reports on a conversation with an American banker, described as a 'sensitive and intelligent man', who told him, 'If any Latin American country repudiates its debts with us, we have the legal machinery all ready to go. It would be lightning-fast: we would seize all the country's assets on land, on sea and in the air. We would block all the bank accounts of its citizens; not a single one of its ships could dock or a single plane land anywhere outside that country's borders without being immediately sequestered.'<sup>16</sup>

Argentina was a test case for the bankers, the one they most feared after Mexico. Here was a nation owing \$50 billion, more likely than others to default because it is self-sufficient in food and energy. Argentina nearly refused to swallow the IMF's medicine in 1984 until, as *Fortune* puts it, '[The bankers] showed how much pressure can be brought to keep a country from becoming an outcast of the international financial community.' When Argentina tried to stop paying interest, 'it found itself virtually isolated.' It was not only the US bankers who applied coercion: 'Latin American finance ministers, economists from the IMF and commercial banks, and officials from major industrialized countries dropped by to remind the government of the consequences of defying the lenders.'<sup>17</sup>

Mr McNamar again assumed the role of US ogre-in-chief. *Fortune* reports that the US Treasury was 'persuasive': it compiled a list of items that would become 'scarce' in the debtor countries should they default. McNamar 'emphasizes that the list did not single out Argentina. But he says it raised such interesting questions as: "Have you ever contemplated what would happen to the president of a country if the government couldn't get insulin for its diabetics?"'

How, then, could these same Latin American countries repudiate debt with such apparent nonchalance in the 1920s and 1930s? In those days most of their debts were in the form of government bonds, held by private individual investors. In the Thirties the debtor governments defaulted (i.e. declared their bonds worthless), then haggled with a committee representing the bondholders. The latter never came out on top. Today, as a Citibank vice-president explains, 'They don't have a weak committee of individuals across the table, but a powerful group made up of the biggest banks in the world. Any default and the whole banking system would be against them. They would get no credit at all, not even short-term.'<sup>18</sup> A sobering prospect. Mr McNamar, on the other hand, told his US Chamber of Commerce audience that a moratorium, as opposed to a repudiation, is OK in so far as the borrower announces

his willingness to repay as soon as he can. Such standstills harm the credit rating of borrowers but do not bring down on their heads the dire consequences described above.

Anatole Kaletsky has undertaken the most thorough examination to date of the costs of default in his booklet of that title.<sup>19</sup> Kaletsky, a correspondent for the *Financial Times*, looks at the problem from the legal, economic and political standpoints: he is worried. He labels today's apparent orderly repayment of debts as a 'deceptive calm', encouraged by the (temporary) boom of the US economy and 'the willingness of debtor governments to cut their nations' living standards farther and faster than even the most sanguine creditor had dared to hope'.

At least this makes clear what is hoped! But can such cuts continue? Countries have been reimbursing only by dint of enormous sacrifices and cannot maintain trade surpluses for ever without renouncing growth in their economies for the next century or two. Kaletsky thinks a solution to the debt crisis is neither black nor white – repayment in full or repudiation. Either would place unacceptable strains on the world economy. He opts for a conciliatory shade of grey and hopes that both debtors and creditors can be lured towards an in-between terrain where realism will prevail and some losses be accepted in order to safeguard the financial system as a whole.

His analysis is perceptive and persuasive: if creditors have the sense to listen – and there are signs that they may – they at least will be making a good bargain. Kaletsky does not dwell on basic injustices in the present system, nor is he interested in encouraging the alternative development models and greater popular control that an imaginative handling of the debt crisis might bring about. In fact, he recommends a *higher* degree of management of debtors' economies by the IMF and the World Bank as the price to pay for relief on the debt front. But because the Kaletsky scenario may be the best we can hope for in the present political context, it is worth looking at carefully. He has a strategist's grasp of the issues involved.

Outright, defiant, confrontational defaults are in no one's interest, he contends. A creditor whose policies provoked them would be cutting off his nose to spite his face. None the less, something will soon have to give or the debtors' temptation to default, singly or collectively, may become irresistible. He sees a place for what he calls 'conciliatory defaults' and, since he believes this is the way the world is moving, begs the creditor community to prepare contingency plans for them.

Whatever happens, the illusion that all is going smoothly must be



preserved. Banks of all sizes, and especially governments, must be prepared to orchestrate the necessary transitions that conciliatory (that is, masked) default will necessarily entail. The US government, through its Comptroller of the Currency, has already declared that it will not allow the top eleven US banks to fail, and the federal rescue of Continental Illinois bears this out.<sup>20</sup>

However, even if the mega-banks did collapse in the unlikely event of collective Third World default, Kaletsky says, the rest of the banking system could survive if everyone co-operated. The top eleven, contrary to popular belief, represent only 18 per cent of the whole US banking system (comprising nearly 15,000 commercial banks) in terms of deposits and even less in terms of capital. Everything would hang on the way that a possible crisis was handled. If ordinary American depositors got the idea that banks over-exposed in the Third World were teetering on the brink of insolvency because of a major default, and feared that their demise would endanger the other 14,989 banks (with far less Third World exposure), we would have a 1930s-style panic.

So long as depositors remain confident, not to worry. We live in a world of public relations, and their confidence will depend entirely on the way in which default is presented:

*The banks are no worse off, in terms of cash flow, if a debtor stops paying interest altogether than if the debtor pays his interest with one hand, only to borrow it back with the other. This is precisely what happened in the five years between 1978 and 1983. The banks received about \$125 billion in interest from developing countries and then advanced the very same countries \$140 billion in 'new money'.<sup>21</sup>*

Outright default by one or several major borrowers could trigger hysteria. 'By contrast, conciliatory default might appear far less disastrous.' Conciliatory default means that you don't pay, but you declare that you have every intention of doing so as soon as you can manage it, or you pay only certain selected creditors, or you make a unilateral decision about lowering your interest rates – all with a pleasant smile and courteous manners.

*[A] conciliatory default would be like a slow leak in the banks' balance sheets . . . A repudiation, by contrast, would be like an explosion below decks; it would blow a hole right through the center of the banks' capital structure, which could sink some of the banks before there was even a chance to begin emergency measures.<sup>22</sup>*

The creditors' club, particularly the US government and the money-centre banks, would have no interest in unleashing fierce retaliatory measures against defaulters if they too agree to play the conciliation game – this would be small-boy petulance. Kaletsky, however, fears such petulance:

*It is at least arguable that the behaviour of the Reagan administration over the first two years of the debt crisis provides evidence that an amicable response to default cannot be taken for granted. At each stage of the debt crisis, the administration's instinctive reaction has been hostility towards the debtors, tempered by pragmatism only after the dangers of adhering to the ideological hard line became overwhelmingly plain.*

These lines were written before the Baker Plan, more fully described in Chapter 12, was revealed at the end of 1985. While it means little or nothing in terms of real relief and is now largely dead, it signalled a less emotional, more realistic attitude on the part of the US government. The government has probably realized that provoking default or applying heavy sanctions against a debtor would be a signal to the public that something was horribly amiss and could set off a run on the banks. Retaliation would also further impair the capacity of the errant debtor ever to pay. Creditors must tread a fine line between keeping the debtors at the bargaining table and pushing them out into the cold.

*If it were done gradually, the banks – even the most exposed ones – could easily afford to write down or write off a good deal of Third World debt. There are innumerable ways to do this, which we will not detail here except to say that the more farsighted bankers are the ones suggesting them (e.g. Anthony Solomon, former-president of the New York Federal Reserve Bank). The Bank of England has reportedly prepared, for internal use, a list of about a hundred schemes for overcoming the debt crisis that have been proposed over the past few years.<sup>23</sup>*

The US government does not necessarily have the political backing for a tough stance against a potential defaulter either. Sanctions would not be favoured by transnational corporations with equity investments in a defaulting country – they would be liable to have their property seized by the defaulter as a counter-counter-measure. Trade unions would recognize that no more American products could be sold to a defaulting debtor, causing further erosion of jobs.

If the debtor were smart enough to announce that money saved on interest would be used to import American products, there would be

scant likelihood of solidarity between the transnational corporations or their workers with the banks. And who knows if the American public at large could even be counted on, in a crunch, to side with the mega-banks against an impoverished debtor country in economic shambles? There could be a big political constituency for speaking loudly perhaps but carrying a very small stick.

Kaletsky rests his case there. Unfortunately for the creditors, their own protectionist actions can only force the debtors closer and closer to a radical stance. The successful Brazilian computer industry is a case in point. It has grown at 30 per cent a year and managed to outsell the transnational competition for the first time in 1985. The United States claims that it has lost \$1.5 billion dollars in sales since 1980, and American Secretary of State George Shultz took the trouble to warn his Brazilian counterpart that this could have 'serious consequences' for US-Brazilian relations. As a follow-up to Shultz's message, the US sent an Under-Secretary of State to Brazil in May 1986 to explain that President Reagan was studying 'trade reprisals' if Brazil insisted on supplying a large segment of its own internal demand for computers instead of letting IBM do it. (IBM used to have half the market.) Brazilian steel, shoes and agricultural products are reportedly on the Americans' hit list.<sup>24</sup> Brazil is therefore expected to find enough dollars both to pay its debt and to buy IBM computers. Heads I win, tails you lose. What should Brazil do? Use its foreign exchange to buy computers that it could perfectly well supply itself? Or make its own computers and lose foreign exchange because it can't sell its steel, shoes and orange juice to the US? This is no choice at all.

Latin American countries have recently made a quite spectacular swing towards democracy even though Chile and Paraguay still blight the southern-hemisphere map. Democratic governments have one great disadvantage: they must try to satisfy their people. If they can't, they are likely to crack down and revert to authoritarian rule. Meanwhile, the United States makes the demented claim that tiny Nicaragua, with 3 million people and an economy in shreds because of the protracted Contra war and other hostile US actions, is a threat to national security. How would the US like it if Mexico, under intolerable pressure from its citizens, became a far more left-wing, or right-wing, anti-American country? Eighty million angry people and a common frontier from California to Texas sounds like a rather more credible threat.

Is this inconceivable? Mexico itself must feel that its northern neighbour has little concern for its problems: It has recently been put on the 'graduates' list of countries to which the US will not extend the General

System of Preferences (GSP) for part of its export production. The GSP, established in 1976, was supposed to help Third World countries export as an aid to their development process. In spite of Reagan's rhetorical attacks on protectionism and his promise to veto Bills that promote it, he has adopted his own brand of protectionism by throttling the GSP. Certain items from certain countries, previously admitted duty-free, will now have to pay tariffs to get into US markets. Copper from Chile, Peru and Zambia – all heavily indebted – is on the list of products no longer eligible for GSP treatment.

US trade representative Clayton K. Yeutter explains, 'As the advanced beneficiary countries become competitive enough in particular products to compete in the US market without GSP benefits, we are graduating their products from the program. These changes reflect the dynamic nature of the US GSP program.'<sup>25</sup> One doubts that these 'advanced beneficiaries' will feel honoured at being thus graduated. Mr Yeutter, and his boss, might do well to remember that other countries, and other peoples, have their own tolerance thresholds and that they can be 'dynamic' too.

#### POST SCRIPTUM

In April 1987 GATT released provisional figures showing how much the Third World has lost out during these debt-crisis years. While less developed countries held 28 per cent of world trade in 1980, by 1986 their share had dropped to 19 per cent. The developed countries increased their trade share from 63 to 70 per cent during the same period. In 1980 the rich countries bought 29 per cent of their imports from poor ones and 66 per cent from each other. In 1986 they bought only 19 per cent of their imports from Third World countries and 77 per cent from each other. (The Eastern bloc represented 9 per cent of world trade in 1980, 11 per cent in 1986.) World trade volume increased by 18 per cent between 1980 and 1986 but only by 6 per cent in dollar terms. Volume of trade in manufactured goods increased the most: agricultural trade is flat and mining exports well below their 1980 volume. It's still a rich man's world.