35. David Kotz, "S&L Hell: Loan Wolves Howl All the Way to the Bank," *In These Times*, 8 August 1989.
36. Kotz, "S&L Hell."
37. Lawrence J. White, *The S&L Debacle: Public Policy Lessons for Bank and Thrift Regulation* (New York: Oxford University Press, 1991), 63.
38. White, *The S&L Debacle*, 62, 64.
39. White, *The S&L Debacle*, 68.
40. Kotz, "S&L Hell."
41. White, *The S&L Debacle*, 111.
42. White, *The S&L Debacle*, 88–89.
43. White, *The S&L Debacle*, 92.
44. David E. Rosenbaum, "How Capital Ignored Alarms on Savings," *New York Times*, 6 June 1990.
45. Rosenbaum, "How Capital Ignored Alarms."
46. Leslie Wayne, "The Great American Land Sale," *New York Times*, 30 November 1992.
47. Kotz, "S&L Hell."
48. Greider, *Secrets of the Temple*, 654.
49. Richard W. Stevenson, "The Gospel according to Greenspan: Rising Home Prices," *New York Times*, 3 November 1999.
50. Ann Mariano, "Fewer Can Buy Homes, Study Finds: Poor Seen Trapped in Rent Cost Squeeze," *Washington Post*, 24 June 1989.
51. Kevin Phillips, *The Politics of Rich and Poor: Wealth and the American Electorate in the Reagan Aftermath* (New York: Random House, 1990), Appendix 1.1; Richard Sweeney, *Out of Place: Homelessness in America* (New York: HarperCollins, 1993),).
52. E. J. Dionne Jr., "Poor Paying More for Their Shelter," *New York Times*, 18 April 1989.
53. Michael Janofsky, "Home Prices Are out of Reach for Many," *New York Times*, 12 June 2000.
54. Michael Levitas, "Homelessness in America," *New York Times Magazine*, 10 June 1990.
55. William Clairborne, "Big Increase in Homeless Families," *San Francisco Chronicle*, 22 December 1993.
56. Lawrence Mishel and David M. Frankel, *The State of Working America, 1990–91* (Armonk, N.Y.: Sharpe, 1991), 104.
57. Nina Bernstein, "Shelter Population Reaches Highest Level since 1980s," *New York Times*, 8 February 2001.

4

Debt Crisis and Globalization

On March 27, 1981, Polish government officials in London told representatives of five hundred Western banks that Poland could not repay the $27 billion it had borrowed from them. In July, the Romanian government followed suit, suspending payments on its more modest $7 billion debt to Western banks.[1] The financial problems created by these defaults were dwarfed a year later, in August 1982, when Mexico's finance secretary, Jesús Silva Herzog, announced that Mexico could no longer make payments on its $90 billion foreign debt. During the next year, more than forty other countries, most of them in Latin America, ran out of money and announced they could no longer repay the interest or principal on huge debts owed to private banks and government lending agencies in first world countries. Collectively, countries in Latin America, Africa, and Eastern Europe owed $810 billion in 1983, a twelvefold increase from the $64 billion they owed in 1970.[2] "Never in history have so many nations owed so much money with so little promise of repayment," *Time* magazine observed.[3]

The sudden inability of so many countries to repay their debts created a "debt crisis" that threatened first and third world countries alike. If countries like Poland, Mexico, and Brazil could not repay loans made by banks in Western Europe and North America, then major banks could fail, creating widespread bankruptcy, financial chaos, and possibly, global economic depression. Moreover, if borrowing countries in Latin America, Africa, and Eastern Europe defaulted on their loans and declared bankruptcy, they could no longer obtain the money they needed to pay for essential food and oil imports, or develop the industry they needed to provide jobs for growing populations.

Although the debt crisis, which became acute in the early 1980s, threatened rich and poor countries alike, measures taken to address the crisis had different consequences for northern creditors and southern debtors. The threat of bankruptcy for lenders in the North has receded. In 1994, the *New York Times* even announced that the debt crisis was officially over. But while the crisis may have ended for lenders, it continues for debtors, who found themselves even deeper in debt in 2000, despite having made every effort to repay debts accumulated in the 1970s.

But how did a collective crisis produce such different outcomes? As we will see, debts in Latin America, Africa, and Eastern Europe increased rapidly during the 1970s, both because rich countries wanted to lend and because poorer countries wanted to borrow large sums of money. Although the transfer of money from northern lenders to southern borrowers was beneficial to both in the 1970s, it proved troublesome in the early 1980s as a result of two developments. First, rising interest rates, which were designed to fight inflation in the United States, increased the amount that borrowers were expected to pay northern lenders. Second, falling commodity prices for the goods southern countries exported to the North decreased the incomes of countries in the South, making it more difficult for them to repay northern lenders. Increasing costs and falling incomes made it difficult for borrowers to repay their debts, and a debt crisis ensued. To solve this crisis, northern creditors and the global monetary institutions that represented them (the International Monetary Fund [IMF] and the World Bank) demanded that southern borrowers adopt strenuous economic measures to repay their debts. These global institutions took the opportunity presented by the debt crisis to remake the economies of debtor countries along neoliberal market lines. So the debt crisis indirectly became a force for globalization. Although the creditors were able to avert a financial crisis, the debt crisis caused enormous economic hardship for borrower countries and left them, for decades, even deeper in debt. Debt doubled from $639 billion in 1980 to $1,341 billion in 1990.[4] In Latin America, the region with the largest share of debt, "total indebtedness . . . now equals about $1,000 for every man, woman and child" on the continent—this in a region where $1,000 is more than most families earn in a year.[5]

Although countries around the world experienced a debt crisis, Latin America will be the focus of the discussion here because the countries with the largest outstanding foreign debts (Mexico and Brazil, with $90 billion each) are in Latin America and because the continent owes more than half of the total outstanding debt.[6] By contrast, for example, Eastern European countries collectively owed $92.8 billion in 1981, equal to Mexico's debt,[7] and African countries together owed $82 billion in 1985, less than either Mexico or Brazil.[8]

GETTING INTO DEBT

In the 1970s, the amount of money loaned to countries in Latin America, Africa, and Eastern Europe increased dramatically. Between 1970 and 1973, banks in Western Europe and the United States lent $23.4 billion to Latin America, more money than had been loaned in the previous thirty years.[9] During the next decade, Latin America multiplied its debts more than twelve times. Debt expanded rapidly in the 1970s because lenders had large supplies of money that they were eager to lend and because countries around the world had great demand for borrowed money. "Indebtedness is a two-sided relationship," New York investment banker Richard Weinert observed. "It depends not only on a willing borrower, but equally on a willing lender. Indebtedness results as much from the need of lenders to lend as from the need of borrowers to borrow."[10] But conditions that in the 1970s encouraged rich countries to lend, and poorer countries to borrow, changed dramatically in the 1980s.

THE LENDERS

After World War II, government agencies and institutions like the IMF and the World Bank made the majority of the loans to poor countries. They did not lend large amounts (about $20 billion to Latin America between 1950 and 1970), they attached strict conditions to the loans, and they loaned money primarily to promote financial stability or to finance large-scale development projects like dams and ports. During the 1970s, private banks in Western Europe and North America began lending increasing amounts of money, increasing their share of total lending from about one-third to more than one-half of all loans by the end of the decade.[11] Private banks lent large sums of money to Latin American countries because they saw it as a way to invest profitably the growing pool of money available to them in "Eurodollar" or European currency markets.

During the 1970s, governments and private investors from around the world deposited U.S. dollars and other hard currencies they had earned in trade with the United States in Western European banks and in U.S. banks with subsidiaries in Europe. Some of the first dollar deposits were made by the Soviet Union. They were joined by investors in Latin America, Japan, and other countries around the world who deposited dollars in these accounts because they regarded them as safe and because they were not subject to the same kind of government regulations that applied to currencies deposited in the accounts of domestic banks.[12]

The money available in this Eurodollar banking pool grew from about $10 billion in 1960 to $110 billion in 1970.[13] Then, in the 1970s, money from another source began to deepen and ~~expand this~~ monetary pool. After the 1973 OPEC oil embargo sent oil prices soaring, OPEC countries received huge amounts of dollars from industrialized countries in payment for their oil, as much as $100 billion a year. "Since $100 billion a year is hard to spend," one writer ~~observed, "even on Cadillacs~~, private 747s, and sophisticated missiles," the OPEC countries deposited much of their money in Western European and U.S. banks, and this money found its way into the Eurodollar market.[14] OPEC countries did this because they wanted to earn interest on their newfound wealth and because they regarded Western European banks as safe havens for their money. With the influx of dollars from oil-producing countries, often called petrodollars because they were dollars used to pay for OPEC oil, the pool ~~of money in~~ the Eurodollar market grew to $1,525 billion by the 1980s.[15] (Precise estimates vary enormously because government regulatory agencies have a difficult time monitoring or tracking this money. Still, the rate of increase during the 1970s is the same regardless of the figures used.[16])

As the money available to Western banks grew, bank officials searched for profitable ways to invest or loan it. Large U.S. banks became particularly active in Latin America, where banks had numerous subsidiaries and a fairly long history of involvement in local economies. "The nine largest U.S. banks, whose total capital is $27 billion, have lent over $30 billion (or more than their net worth) to private and government borrowers in just three countries: Mexico, Brazil and Argentina," the *Wall Street Journal* wrote in 1984.[17] The banks loaned money from Eurodollar pools, from U.S. depositors in their branch banks, and from smaller banks that joined loan syndicates.

Public and private lenders in the North lent money to countries in the South for a variety of reasons. Banks made loans so that poor countries could purchase goods made in Western Europe and North America. In the 1970s, for example, "42 percent of [Britain's] construction equipment, 33 percent of new aircraft and 32 percent of British textile machinery went to third world markets. In the United States, by 1980, the third world market accounted for . . . 20 percent of U.S. industrial product and about one-quarter of gross farm income."[18]

The U.S. government's Export-Import Bank, for example, loaned money to Latin American governments so they could purchase U.S. airplanes. As Boeing Aircraft president Malcolm Stamper explained, "The Ex-Im Bank . . . was created to help promote exports . . . to help foreign firms and their nations to buy big-ticket goods that would be of social and economic benefit. Airplanes certainly meet this description. . . . Airplane exports are also very good business for this country's own economy, by the way."[19]

Private lenders also discovered that they could make more money loaning money to foreign borrowers than to domestic borrowers.

> While the ten largest U.S. banks had a phenomenal expansion of international earnings [from Latin American loans] in 1970 to 1976, profitability in the domestic market ran generally flat. By the mid-1970s, most of the large banks had 50 percent or more of their earnings from abroad. In the case of Citicorp . . . by 1970 over 80 percent of their earnings came from their international operations.[20]

U.S. bankers in the 1970s did not worry greatly about the risks associated with foreign loans for several reasons. First, ~~most of their money was~~ loaned to Latin American dictatorships, ~~which maintained close and friendly ties to the~~ United States and seemed unlikely to renege on their debts (see chapter 6).[21] Second, they observed that the prices of many southern ~~commodities, particularly~~ oil, were rising in the 1970s, which helped their economies grow. This suggested that as their incomes grew, borrower countries would be able to repay old debts and shoulder new ones without difficulty. And third, because governments had the authority to raise money by ~~taxing their~~ citizens, they could still repay loans should economic problems develop. Explaining why his bank was bullish on foreign loans, Citicorp chairman Walter Wriston told the *New York Times* in 1982, "A country does not go bankrupt."[22]

Not everyone was so optimistic. *Euromoney* observed in 1975 that

> a purely technical analysis of the current financial position [of many borrowing countries] would suggest that defaults are inevitable; yet many experts feel this is not likely to happen [because] the World Bank, the IMF and the governments of major industrialized nations . . . would step in rather than watch any default seriously disrupt the entire Euromarket apparatus.[23]

Despite their enthusiasm for foreign loans, northern banks worried about the risks associated with mounting debt. So they hedged their bets, insisting in the late 1970s that borrowers agree to readjust interest rates ~~on new and old loans every six months and bring interest rates into line with current market rates.~~[24] ~~And~~ by 1983, nearly 70 percent of all loans in Latin ~~America were~~ subject to floating interest rates, which would rise or fall depending on the interest rates set in the United States.[25] Although interest rates were then stable, which meant that borrowers did not worry greatly about accepting this new condition, the bankers' insistence that floating interest rates be adopted by borrowers would have important consequences for both lenders and borrowers in the early 1980s.

THE BORROWERS

Not only were bankers willing to lend, governments and corporations in Latin America were eager to borrow money in the 1970s. Public and private borrowers had substantial and diverse needs for northern loans. Much of the money they borrowed was simply used to repay lenders. "Between 1976 and 1981," Sue Branford and Bernardo Kucinski wrote,

> Latin America borrowed an enormous $272.9 billion. But over 60 percent of this, $170.5 billion, was immediately paid back to the banks as debt repayments or interest. Another $22.9 billion remained with [northern] banks as reserves [against potential losses], which were a kind of additional guarantee for the debt itself. And an estimated $56.6 billion was quickly sent abroad as capital flight. Only $22.9 billion effectively entered the continent to be used (or not) in productive investment.[26]

Of the $88 billion Mexicans borrowed between 1977 and 1979, only $14.3 billion was actually available for use in the country.[27]

Although estimates of the amount of borrowed money actually available for use in any given country vary considerably, the money that remained was put to different uses by public and private borrowers.

In their effort to promote economic growth, governments borrowed money to pay for essential imported goods like oil, food, and machinery. Rising oil prices in the 1970s forced countries without oil to pay more for imported oil. U.S. economist William Cline estimated that oil price increases cost southern countries an extra $260 billion in the years between 1974 and 1982, a figure comparable to the $299 billion acquired by these same countries during this period.[28]

Some Latin American countries, like Mexico, had large oil supplies of their own. But while Mexico did not pay more for imported oil, it borrowed heavily to develop its oil fields and become a major producer, expecting that increasing oil prices would enable it to pay off mounting debts. As we will see, this expectation did not materialize, and falling oil prices after 1980 helped trigger Mexico's debt crisis.[29]

The cost of imported food also rose in the 1970s. Rising oil prices increased the cost of growing food because farmers rely heavily on gasoline-powered tractors and petroleum-based fertilizers and pesticides. Moreover, poor harvests in the Soviet Union during the mid-1970s increased the demand and therefore the price of food on world markets (see chapter 13). "For low-income countries, the increased cost in these years . . . of food imports from [first world] countries far exceeded the increased cost of oil imports," argued Shahid Burki.[30]

As we have seen, with money provided by northern lenders, southern governments also purchased tractors and textile machines to expand commodity production in fields and factories and built roads, ports, and airports—and the aircraft to use them—to facilitate the transport of commodities, business managers, and bankers. Many of these activities provided jobs to northern manufacturers of imported goods and employment for domestic users of these products in the South. By building huge mining, hydroelectric, irrigation, and industrial projects, governments could put people to work and increase their income from project revenues and worker taxes.

In addition to paying for essential imports, governments used borrowed money to build up hard currency reserves and stabilize their currencies, to subsidize or lower the cost of fuel, food, and transportation so that domestic consumers would not be adversely affected by rising oil and food prices, and sometimes to balance their budgets.[31] As one Latin American finance minister recalled, "I remember how the bankers tried to corner me at conferences to offer me loans. If you are trying to balance your budget, it's terribly tempting to borrow money instead of raising taxes."[32]

Not all the money was used for essential or legitimate government purposes. Some of it was used to increase military expenditures, wasted on boondoggle development projects, or siphoned off for personal gain. Military spending by Latin American countries doubled during the 1970s, despite the fact that they faced no external threats. Military spending in Africa increased by one-third.[33] Many development projects proved to be boondoggles. A huge development project providing electricity from the Inga Dam on the Zaire River to a copper-cobalt mining complex in Shaba province cost nearly $1 billion, but when it was finished, the electricity it delivered was no longer needed at the mines.[34] And in some countries, government corruption was widespread. In Zaire, a country described by some writers as an "absolutist kleptocracy," President Mobutu Sese Seko stashed away about $5 billion in personal Swiss bank accounts, a sum equal to his country's total foreign debt.[35] In Brazil, President Fernando Collor de Mello was impeached for corruption in 1992.

Governments were not the only borrowers. Private borrowers acquired a substantial portion of Latin American debt. In Latin America, "private debt rose from $15 billion in 1972 to $58 billion in 1981," accounting for about 20 percent of the total ($272.9 billion in 1981).[36] During the 1970s, domestic owners of Latin American farms and factories, often "the principal national monopolistic groups of the country," borrowed heavily to finance the expansion of their businesses.[37] In Mexico, these groups acquired one-quarter of the country's total debt.

Alongside private domestic borrowers, subsidiaries of businesses in Western Europe and North America also borrowed money, and when they did, they increased the debt of southern countries. So, for example, General Motors, Ford, Union Carbide, Pepsico, and Volkswagen were all important borrowers in Mexico, adding $750 million of debt to Mexico's total.[38]

Like northern lenders, southern borrowers were confident they could repay mounting debts. Inflation in northern countries meant that real interest rates were fairly low and stable in the 1970s, commodity prices for the raw materials and goods they produced were rising, and their economies were growing. But these favorable conditions, which encouraged both lenders and borrowers in the 1970s, did not last. When conditions changed—when interest rates rose and commodity prices fell—in the 1980s, they triggered a crisis that proved earlier assumptions wrong.

THE CRISIS: RISING INTEREST RATES, FALLING COMMODITY PRICES

When Paul Volcker, head of the Federal Reserve, raised U.S. interest rates in 1979 to fight inflation in the United States, he did not intend to create a global debt crisis. But rising U.S. interest rates and the rising London Interbank Offered Rate (LIBOR), which set interest rates for Eurodollar lending, greatly increased the cost of southern loans, most of them now tied to floating rates set by the United States or LIBOR.[39]

Rising interest rates had two important consequences. First, they increased interest payments on accumulated debt. "Mexico's interest bill tripled from $2.3 billion in 1979 to $6.1 billion in 1982. . . . For the region as a whole, interest payments more than doubled, from $14.4 billion in 1979 to $36.1 billion in 1982."[40] High interest rates made it harder for borrowers to pay back their debts. U.S. economist William Cline estimated that high interest rates in the 1980s cost indebted countries $41 billion more than they would have paid had interest rates remained at the average level between 1961 and 1980.[41] Other economists have estimated that Latin American countries paid out more than $100 billion in "excessive" interest between 1976 and 1985.[42]

A second problem was that high U.S. interest rates acted like a magnet, attracting money from around the world. U.S. officials understood that capital flight from other countries would reduce investment abroad and undermine the competitiveness of other countries. As we have seen, it did not greatly weaken Western Europe and Japan because they had higher savings rates, which meant they had more capital available to them and because the U.S. government returned some of this capital to them in the form of U.S. military spending. Unfortunately, countries in Latin America, Africa, and Eastern Europe did not have these advantages, because they had low savings rates and a huge demand for capital (which is why they

had been borrowing money from abroad). And, except for Panama, where the United States stationed a large military force, the United States returned little of the money it acquired from Latin American investors in the form of military spending. As Volcker observed, "In many [indebted countries], their excessive debt burdens can be traced in large part to a flight of capital by their own citizens discouraged from investing at home."[43] He might have added that U.S. policies, which were under his control, also encouraged them to invest their capital in the United States.

High interest rates attracted $150 billion in capital from Latin America between 1973 and 1987, the bulk of it after 1979, when as much as $25 billion annually "flew" to the United States to purchase Treasury bonds.[44] Massive capital flight created several problems for Latin American countries: it deprived them of money they might have used to invest in their own countries, pay for imports, or repay debt, and it eroded their country's tax base as investors withdrew taxable savings from Latin American banks and placed them in tax-free deposits in U.S. banks.[45] During the height of Mexico's debt crisis, "a Mexico City newspaper published the names of 537 Mexicans each with over a million dollars on deposit with foreign banks."[46] Thus, capital flight deprived indebted countries of money at a time when they needed it most.

Just as interest rates increased, commodity prices began to fall. During the 1970s, the price of commodities typically exported by third world countries—metals, raw materials, and foodstuffs—generally rose. They could then use the hard currencies they earned by selling these goods to northern countries to repay their loans, which had to be repaid in hard currencies. Lenders insisted on repayment in dollars or other hard currencies (deutsche marks, pounds, yen), not in pesos or astrals, because they worried that indebted governments would simply print more money and use inflation to repay loans in worthless, depreciated currency.

Generally speaking, the prices Latin American countries could get for their commodities fell slowly between 1950 and the mid-1970s, when the OPEC embargo and weather-related food shortages began to increase commodity prices, particularly of oil and food. Commodities then began to fall dramatically in the 1980s.[47] Between 1980 and 1982, world commodity prices fell by more than one-third, "to their lowest level in 30 years, a disastrous development for countries that expected commodity exports to pay their way," noted sociologist John Walton.[48] "The beef that Argentina [exported] fell from $2.25 a kilogram . . . in 1980 to $1.60 by the end of 1981. Sugar from Brazil and the Caribbean fell from 79 cents a kilo to 27 cents by 1982. And copper, a big-ticket item for the likes of Chile and Zaire, fell from $2.61 a kilo to $1.66," one writer observed.[49]

Falling prices reduced the ability of borrower countries to repay debts, which were being pushed up by higher interest rates. Prices continued to fall during the rest of the 1980s. A World Bank index of raw material prices, which started at 168.2 in 1980, fell to 100 by 1990, and 86.1 in 1992, the lowest prices in real terms since 1948.[50]

The price of oil also fell, slowly after 1980 and then sharply after 1985. Mexico, which borrowed heavily to become a major oil producer because it believed oil prices would continue to climb, found itself with mounting debt and declining revenues.[51] "Given the deterioration in the terms of trade, Latin Americans sell more and get less," observed Mexico's finance minister, Jesús Silva Herzog.[52]

Why did commodity prices fall so dramatically in the 1980s, crippling the ability of borrowers to repay their debts? They did so because high U.S. interest rates triggered a global recession that reduced demand for their goods. They also fell because northern countries had begun to develop new supplies or to substitute materials for southern commodities (we will examine these developments in greater detail in the next chapter). In the case of oil, the discovery of new oil fields in the North Sea increased the supply and helped lower global prices, while energy conservation measures reduced demand. Commodity prices also fell because southern countries collectively produced more of these goods in the 1980s. Remember that in the 1970s borrowers used northern money to expand their production of oil (Mexico), coffee (Colombia), frozen orange juice (Brazil), beef (Argentina), copper (Chile, Zaire), and tin (Bolivia). With money and hard work, they succeeded in producing more of these goods. But as production expanded, supplies increased and prices fell. The irony is that the harder they worked and the more they did what they set out to do, the less they earned and the more deeply they fell into debt.

CRISIS MANAGEMENT: THE IMF TAKES OVER

Mounting debt and a growing inability to repay loans threatened to bankrupt the major U.S. and Western European banks. If that occurred, financial chaos and a global economic crisis would have ensued. To avert such a catastrophe, lenders acted quickly to manage the crisis. The IMF and the World Bank quickly took the lead, assuming responsibility for managing the debt crisis and ensuring that borrower countries repay all of their debts, both public and private. As Princeton economist Robert Gilpin observed, "Interest payments on the debt would not be decreased across the board nor world commodity prices received by debtors be increased. The burden of solving the problem would continue to rest squarely on the debtors."[53]

For much of the postwar period, the World Bank and IMF were fairly obscure institutions. The World Bank made modest loans to promote economic development in poor countries, the IMF helped manage the occasional crisis that emerged when poor countries ran out of the hard currencies they needed to purchase foreign goods. But the debt crisis thrust these Bretton Woods institutions into the forefront of efforts to manage the debt crisis. The IMF, in particular, was asked to assume a new, expanded, global role. Not only was it asked to manage crisis in dozens of countries simultaneously, it was also expected to reshape the government policies and economic structures of those countries. The IMF required governments to abandon decades-old development policies and adopt new, neoliberal market policies in their place. These new policies and practices contributed to the globalization of these economies.

If the IMF had not taken the lead, if individual banks had tried to collect debts or seize assets on their own, chaos would have ensued and debtors might have been able to play lenders against each other. Instead, by forming what Gilpin calls a "creditor's cartel," which was led by the IMF and World Bank, northern lenders could practice a "divide and conquer strategy" and "impose their will on the debtors."[54] They were able to do this because private lenders could speak with one voice, through the IMF, in negotiations with foreign borrowers. The lenders also possessed two important advantages: they alone could lend borrowers the money they needed to make ends meet and they alone possessed accurate information on the debts and economic conditions of borrowing countries (most debtor governments lacked key financial information on private debt in their own country).[55] The existence of powerful global institutions, unity of purpose, and control of economic data enabled the lenders to bargain with debtors from a position of strength.

While IMF officials managed the debt crisis in dozens of countries, private lenders moved to protect themselves from the consequences of the crisis by reducing credit and shifting the burden of financing new loans to public agencies and making taxpayers assume some losses.

During previous Latin American debt crises, lenders simply stopped lending to borrowers, sometimes for decades. During the 1980s, private banks greatly reduced their lending, though they did not cut off credit entirely. Capital flows to Latin America fell by one-third between 1980 and 1984 as private lenders began to cut and run.[56] The problem was that borrowers desperately needed new loans, at least in the short term, so they could get their finances in order and take steps that would eventually enable them to repay debts. Public lending agencies urged private bankers to continue lending money. U.S. treasury secretary James Baker, whose 1985 Baker Plan attempted to advance a comprehensive settlement of the debt crisis, argued that "increased lending by the private banks in support of comprehensive economic adjustment programs" was essential in order to make it possible for borrowers to repay their debts. As Baker told bankers, "I would like to see the banking community make a pledge to provide these amounts" ($20 billion over the next three years) on a "voluntary basis."[57]

Because private banks did not respond to Baker's invitation, the Baker Plan failed.[58] So the U.S. government and international lending agencies had to pick up the slack, which meant that taxpayers in Western Europe and the United States had to shoulder increasing responsibilities for debt crisis management.

Private lenders also protected themselves by declaring losses on foreign loans, which enabled them to reduce their taxes. But while they claimed losses, they could still demand full repayment from borrowers, so they could declare losses, receive tax breaks, and recover their original investment.[59] Although the tax laws that allow banks to take "provisions," or make "loan-loss reserves" as they are called, differ from country to country, the savings to banks can be substantial. One economist estimated that between 1987 and 1990, "over $20 billion of U.S. bank debt on the third world was charged off and provisioned under federal mandate. Since the corporate tax rate on U.S. banks is 34 percent, this sum would give rise to tax credits of at least $6.8 billion."[60] British banks received about $7 billion, German banks $10 billion, and French banks $10.9 billion as a result of similar laws.[61] Altogether, private banks probably received between $44 billion and $50.8 billion in tax credits in this period, all at taxpayer expense.[62]

Taxpayers not only assumed responsibility for revenues lost in this fashion, they also had to foot the bill when their governments agreed to provide debt relief to some borrowers, as the U.S. government did when it discharged $7 billion of Egypt's debt for agreeing to participate as a U.S. ally in the 1990–1991 Persian Gulf War.[63]

Although the stockholders of some banks experienced losses when it became apparent that their banks had lent heavily to debtors and the value of their bank stocks declined, private banks emerged from a potentially devastating crisis relatively unscathed. No major Western bank failed as a result of the debt crisis. But while lenders averted serious problems, borrowers did not.

DEBTORS FALL APART

When borrowers in Latin America, Africa, and Eastern Europe ran out of money to repay their debts, they faced serious problems. Without foreign currency, they could not pay for imported fuel or food, and owners of domestic capital began to send it abroad. Without imported or domestic capital, agricultural and industrial businesses would grind to a halt and lay

off workers, and the economy would collapse. To avert these economic disasters, borrower governments, under IMF direction, took steps to get the hard currency they needed to purchase imported goods and repay lenders.

As a condition for receiving a continued influx of money, borrower governments were asked to assume responsibility for repaying private debts that they did not themselves incur. In Venezuela and Argentina, nearly 60 percent of the total debt had been acquired by private businesses, domestic and foreign.[64] Although private borrowing in Latin America as a whole accounted for 20 percent of the outstanding debt, about $58 billion, governments and taxpayers were asked to repay this debt as if it were their own. According to Harvard economist Jeffrey Sachs, "In country after country, governments took over the private debt on favorable terms for the private sector firms, or subsidized the private debt service payments, in order to bail out the private firms. This 'socialization' of the private debt resulted in a significant increase in the fiscal burden of the nation's foreign debt."[65]

This was unfair because it imposed on the people of these countries debts not of their making. Not only did governments bail out private sector firms in their own country, many of them subsidiaries of northern corporations, they effectively bailed out private northern banks because these banks would not otherwise have been able to recover private debts in foreign countries. Once they knew potential losses were averted and private debt responsibilities assumed by southern governments, private lenders agreed to continue making loans during the debt crisis, though, as we have seen, they reduced their share of new loans.

With the money they needed to avert the immediate crisis, southern governments were then forced to adopt painful economic policies, which the IMF insisted would allow them to repay debts in the long term. Although the specific IMF policies varied, most governments adopted similar "structural adjustment programs" (SAPs), or "austerity programs," as they were called, trying to create trade surpluses and government budget surpluses to raise the money they needed to repay their debts.

Indebted governments were first required to increase their trade surpluses. If they could export more goods than they imported, they could acquire a larger amount of hard currency, which they could then use to repay old debts and reduce their need to borrow money to pay for imported goods. To create trade surpluses, they tried simultaneously to increase exports and reduce imports. To increase exports, governments urged agricultural and industrial businesses to expand production and export more of their goods. They assisted in this process by devaluing their currencies. When the United States devalued the dollar, government officials hoped that this would make U.S. exports cheaper abroad and make Japanese goods more expensive in America (see chapter 2). They expected the devaluation to increase U.S. exports and discourage U.S. consumers from buying imported Japanese goods, thereby reducing the U.S. trade deficit. Latin American governments hoped their own currency devaluations would have the same effect, helping them create a trade surplus that would provide them with much-needed currency.

Latin American countries did export more goods, though falling prices for those commodities, global recession, which reduced demand, and northern restrictions or tariffs on many southern goods meant they had a difficult time keeping exports at 1980 levels. From 1980 to 1985, Latin American countries increased the volume of goods they exported by 23 percent, but the value of these exports remained about the same.[66] Latin American countries exported between $90 billion and $100 billion worth of goods between 1980 and 1984. Exports then fell to about $78 billion from 1984 to 1986, mostly as a result of falling oil prices, before recovering to the $100 billion level by 1988.[67]

With exports holding steady (despite increased efforts), the only way Latin American governments managed to create trade surpluses in the 1980s was by cutting back on imported goods. Whereas Latin American countries imported between $90 billion and $100 billion worth of goods in 1980, they imported only $60 billion by 1982, staying at this level throughout much of the mid-1980s.[68] By slashing imports, they created a trade surplus that gave them between $30 billion and $40 billion, which they used to repay lenders. As Mexican finance minister Silva Herzog observed, "The much heralded improvement in Latin America's current accounts therefore is attributable mostly to import reduction, rather than to export increase."[69]

Because indebted governments were responsible for repaying public and private debts, they also had to find ways of raising money to repay lenders. The IMF instructed them to raise money by selling off state assets to foreign or domestic buyers and by creating budget surpluses.

During the 1960s and 1970s, many southern governments created state-run business to promote economic development. Governments could borrow money and derive revenue from their operations. These businesses—government-owned phone, airline, bank, oil, cement company, or state coffee board—often enjoyed monopoly status, either because they offered services that private businesses could not profitably provide or because monopoly eliminated "wasteful" domestic competition and allowed these firms to compete with large transnational corporations (TNCs). In debt crisis negotiations, the IMF insisted that indebted governments sell off or "privatize" state-owned businesses, both to increase "competition" and to raise money to pay off debts. They also insisted that governments change their laws so that TNCs could purchase these assets when they

were offered for sale. Many southern governments had long restricted foreign investment because they worried that key sectors of the economy would fall under the control of foreign owners.

At IMF insistence, Latin American governments began selling off state-owned businesses. By 1990, for example, the Mexican government sold off 875 of the 1,155 enterprises that it had owned all or part of in 1982.[70] And this pattern was repeated around the continent, with governments selling off airlines, port facilities, phone companies, and chemical plants. Currency devaluations played an important role in this process.

As in the United States, where the 1985 dollar devaluation made U.S. assets available for sale to Japanese investors at one-half their previous price, currency devaluations in Latin America enabled foreign investors to purchase important economic assets at bargain-basement prices. Privatization and currency devaluations worked more to the advantage of foreign investors, though Latin American investors who had placed their money in the dollar accounts of Western banks during the great capital flights of the early 1980s could also acquire state assets at advantageous prices. So, for example, Mexico sold Teléfonos de México, the government's telephone company, for $1.76 billion to a French, American, and Mexican communications consortium.[71] Because the Mexican government had devalued the peso, foreign investors got a real bargain.

Although governments could raise money to repay debts by selling public assets, this was a one-time way to raise money. To raise the money they needed, governments had to create continuing budget surpluses. They did this by increasing taxes and cutting public spending. The burden of tax increases and spending cuts typically fell on poor and middle-income taxpayers.

During the 1970s, many third world governments used borrowed money to keep oil and food prices low so that transportation, cooking fuel (kerosene), and basic foodstuffs would remain affordable for poor and working people at a time when world oil and grain prices were climbing. But to create budget surpluses, they were forced in the 1970s to eliminate these subsidies, which accounted for a considerable proportion of government spending, and to increase taxes. Generally speaking, taxes on corporations and the rich were reduced (as they were in the United States in this same period), while excise and sales taxes, which fell most heavily on the poor, and income taxes on middle-income groups increased. "A 1986 study of 94 [IMF]-supported adjustment programs implemented between 1980 and 1984 found [that] 63 percent . . . contained wage and salary restraints; 61 percent included transfer payment [for Social Security and unemployment programs] and subsidy [for food and fuel] restraints; . . . and 46 percent included personal income tax measures," writes economist Howard Lehman.[72]

The SAPs administered by the IMF provided important benefits for the North. First, they ensured that lenders would be repaid by southern borrowers, which averted a financial crisis in the North. Second, they increased the flow of goods from South to North. Because the increased supplies helped lower the price of these goods, producers and consumers in the North paid less, reaping a substantial benefit. Third, the sale of industries in the South, at cheap, devalued prices, meant that northern investors could snatch up some real bargains and increase their control of economies in the South. SAPs contributed to the globalization of the South, a development that provided important benefits for the North.

THE CONSEQUENCES

The steps taken by lenders and borrowers had important economic, social, and political consequences for indebted countries. It undermined economic development, setting them back decades, accelerated environmental destruction, and adversely affected women and female children. The silver lining in this otherwise black cloud was that debt crisis also contributed to the fall of dictatorships and the rise of democracy in many countries (a development we will examine in chapter 6). Let us review some of the important social consequences of the debt crisis.

Deeper in Debt

In economic terms, indebted countries managed to repay their debts, but found themselves deeper in debt. Moreover, their strenuous efforts to repay debt exhausted their economies, prompting some economists to describe the 1980s as a "lost decade." As Volcker said, "Even a decade later, the wounds in Latin America itself have not fully healed. For some of those countries (and for those similarly affected in Africa), the 1980s was a lost decade in terms of growth and price stability."[73]

How could borrower countries repay their debts, yet end up deeper in debt? Between 1982 and 1990, lenders sent $927 billion to southern borrowers. In the same period, borrowers repaid lenders $1,345 billion in principal and interest. As a result, indebted countries paid $418 billion more than they received. British economist Susan George argues that this sum is six times greater in real terms than the amount of money the U.S. transferred to postwar Europe through the Marshall Plan.[74] Yet despite these massive repayments, borrowers found themselves "61 percent more in debt than they were in 1982."[75]

Mexico, for example, paid lenders $100 billion in debt service between 1982 and 1988, $10 billion more than it owed when the crisis struck in 1982. But while it repaid vast sums to first world lenders, it owed even more: $112

billion in 1988. How could this happen? It is similar to what happens when people buy a house. Home buyers understand that if they borrow $100,000 at 10 percent interest for a thirty-year period, they will actually pay $300,000 in all, two-thirds of it as interest and one-third as the principal (the amount of the original loan). The bank, of course, insists that the borrower repay the interest first. After ten years, the borrower has repaid $100,000, but still owes $200,000, which is larger than the original loan. In the same way, Mexico had made substantial payments, but still had a lot left to repay.

Latin American debt increased from about $280 billion in 1982 to $435 billion in 1993, and total third world debt climbed from $639 billion in 1980 to $1,341 billion in 1990. Most borrowers will continue to repay debt into the foreseeable future.

In Argentina, debt grew from $40 billion in 1982, when the debt crisis began, to $132 billion in 2001. At IMF request, the government introduced repeated austerity programs. But its debts grew anyway, despite its two-decade effort to repay them. The most recent austerity program, announced in 2001, required the government to cut salaries and pensions for government workers. Teachers were not paid for months, schools could no longer afford to boil water to make powdered milk for malnourished children, and public health officials no longer vaccinated dogs for rabies, leading to a widespread outbreak of the disease.[76] "Argentina is a country without credit," President Fernando de la Rua admitted.[77]

Although indebted governments successfully repaid lenders in the 1980s, they drained their economies. Instead of growing, most Latin American economies actually shrank by about 10 percent while their populations continued to grow.[78] In Mexico, the real incomes of average workers fell 40 percent between 1981 and 1988, while the incomes of government employees fell even more, nearly 50 percent.[79] In most Latin American countries, wages fell, while unemployment rose, prices and taxes increased, and hunger grew. In 1986, twenty million more people in Latin America were living below the poverty line than in 1981, 150 million people in all.[80] Not surprisingly, declining incomes and rising unemployment persuaded many Latin Americans to emigrate to the United States in search of jobs. According to Sachs, "As for the debtor countries, many have fallen into the deepest economic crisis in their histories. . . . Many countries' living standards have fallen to levels of the 1950s and 1960s. A decade of development has been wiped out throughout the debtor world."[81]

Gender and Debt Crisis

The debt crisis adversely affected men and women across the South. But, for a variety of reasons, SAPs were particularly hard on women and female children.[82]

First, the IMF encouraged governments to expand the production of export crops so they could earn hard currency to repay debt. But the expansion of land devoted to export crops often reduced the amount of land devoted to subsistence agriculture and in-common uses: forests for firewood, land for gardens, water for domestic consumption (see chapter 13). Women in many countries grow food for their families, forage for firewood to cook their meals, and draw water to bathe their children and wash their clothes. The conversion of agricultural land and forests from subsistence production to export agriculture, and the use of water from rivers to grow water-intensive crops, has made it harder for women to provide these goods and resources for their families.[83] Women and female children have had to walk farther, forage longer, and pay more for resources they need. So SAPs have increased female work burdens substantially.

Second, governments eliminated subsidies for food, fuel, and transport, forcing people to pay more for these goods. Higher costs meant that many families must do with less of each. But when families cut back, men cut back less and women more. Women cut back more because in most patriarchial families, men command a greater proportion of household income and resources than women. Women typically work longer hours (twelve to fourteen hours a day compared to eight to twelve hours for men), and devote a greater share of their earnings to the household. Economists have found that women in Mexico contributed 100 percent of their earnings to the family budget, but men contributed only 75 percent of theirs. As the World Bank reported, "It is not uncommon for children's nutrition to deteriorate while wrist watches, radios and bicycles are acquired by the adult male household members."[84] Throughout the South, the adverse impact of rising prices, a product of SAPs, was disproportionately felt by women.

Third, governments cut back on public services, particularly education and health care. Again, these cuts adversely affected men, but hurt women more because in patriarchial households, families more often send male children to school or send males to seek medical treatment, neglecting the needs of women and girls. In hard times, women and girls do without. The result is that fewer girls attend school and illiteracy among women has increased. As public health care services have declined, government-sponsored campaigns against AIDS or female genital mutilation (in Africa) have languished, and infant mortality rates, particularly for girls, have increased.[85] The IMF-directed decline of public services has been particularly detrimental for women and female children.

Environmental Destruction and Debt

Governments also increased the rate of deforestation so they could export hardwood timber or beef raised on cleared rainforests. Brazil and Mexico,

the two largest debtors, are also major deforesters. Brazil is ranked number one and Mexico number six in the world. In Mexico, much of this deforestation has occurred in Chiapas, the southern state where Zapatista peasants revolted in 1994. Both have increased deforestation rates dramatically in the past two decades: Brazil up 245 percent, Mexico up 15 percent.[86]

Debt and Protest

These social and environmental problems frequently led to social conflict, what some scholars have called "IMF riots," when people protested government SAPs. University of California sociologist John Walton recorded fifty major "protest events" in thirteen countries between 1976 and 1986. He found that when governments cut subsidies for food and basic necessities, increased fares on public transportation, or eliminated government jobs, riots sometimes resulted. In September 1985, for example, "hundreds of Panamanian workers invaded their legislature chanting: 'I won't pay the debt! Let the ones who stole the money pay!'"[87]

Debt and Democracy

Although the debt crisis had disastrous economic and social consequences for indebted countries, it had some positive political consequences. The debt crisis and SAPs imposed by the IMF discredited the dictators who had borrowed and ruled most Latin American countries. When debt crises struck, civilian democrats demanded and received political power in return for their support for arduous debt crisis management programs. As we will see (chapter 6), debt crises contributed to the democratization of much of Latin America in the 1980s. So while the debt crisis was an economic disaster, it was also a political opportunity.

Impact on the North

Although indebted countries experienced great difficulties as a result of debt crises, people in northern countries also experienced debt-related problems. As we have seen, Latin American borrowers increased trade surpluses, which provided them with much-needed cash, by reducing their imports. Because many of these imports were goods made or grown in northern countries, import reductions contributed to unemployment in Western Europe and the United States.

Between 1980 and 1986, U.S. exports to Latin America fell by $10 billion. One economist estimated that this resulted in the loss of 930,000 jobs in the United States.[88] U.S. trade representative William Brock calculated that 240,000 U.S. jobs were lost as a result of the Mexican debt crisis alone.[89] Senator Bill Bradley observed that Latin American debtors had made a "Herculean effort" to service their debts. But he noted, "The price the United States has paid for Latin America's ability to meet its new debt schedules has been the collapse of Latin American markets for U.S. products . . . and the loss of more than one million [U.S.] jobs."[90] So while private lenders managed to cover their assets, workers and taxpayers have had to foot some of the bill.

Debt Relief?

Although lenders averted a global economic crisis, borrowers continue to wrestle with the consequences of the debt crisis. From the lenders' perspective, borrowers still owe them a great deal. But from the borrowers' perspective, they have already repaid their debts. Some economists have suggested that remaining debts could be forgiven or reduced without great harm to lenders. They also note that continued indebtedness undermines the ability of indebted countries to purchase imports, which is essential for the health of economies in Western Europe and the United States. Former World Bank president Robert McNamara argued, "The evidence that growth and progress in the developing countries now has a measurable impact on the economy of the United States reflects the importance of the developing countries to the United States as export markets and as customers of U.S. commercial banks."[91]

The continued insistence on full repayment of debt, the objective of bankers, conflicts in the long run with the sale of northern goods in southern markets, which is the objective of farmers and manufacturers in the North. The problem in coming years will be how to resolve the conflicting objectives and needs of different groups, North and South.

One proposal, advanced by the IMF in the late 1990s, would be to provide debt relief to some of the poorest countries. The money would come in part from the sale of gold reserves held by the IMF.[92] For extremely poor countries like Uganda, which "spends $3 per inhabitant on health annually, and about $17 a person on debt repayment," debt relief would be extremely welcome.[93] But German, Japanese, and other officials in the G-7 have objected to the plan, arguing that the IMF should not sell off even a small part of its $40 billion in gold.[94] Countries in Africa, the poorest of the debtor countries, would receive most of the relief outlined in recent IMF plans. But they would receive only a partial reduction of their debt, and then only if their governments adopted new SAPs.

The debt crisis was not anticipated either by lenders in the North or borrowers in the South. But when it occurred, institutions in the North

seized the opportunity to reshape the South along neoliberal lines, a process that contributed to contemporary globalization.

NOTES

1. Iliana Zloch-Christy, *Debt Problems of Eastern Europe* (Cambridge: Cambridge University Press, 1987), 29, 34; Christopher A. Kojm, *The Problem of International Debt: The Reference Shelf*, vol. 56, no. 1 (New York: Wilson, 1984), 8.
2. John Walton, "Debt, Protest and the State in Latin America," in *Power and Popular Protest: Latin American Social Movements*, ed. Susan Eckstein (Berkeley: University of California Press, 1989), 301.
3. Robert Gilpin, *The Political Economy of International Relations* (Princeton, N.J.: Princeton University Press, 1987), 317.
4. Steven Greenhouse, "Third World Markets Gain Favor," *New York Times*, 17 December 1993.
5. Paul Kennedy, *Preparing for the 21st Century* (New York: Random House, 1987), 204.
6. Kojm, *The Problem of International Debt*, 10.
7. Zloch-Christy, *Debt Problems*, xiii.
8. Trevor W. Parfitt and Stephen P. Riley, *The African Debt Crisis* (London: Routledge, 1989), 16–17.
9. Sue Branford and Bernardo Kucinski, *The Debt Squads: The US, the Banks and Latin America* (London: Zed Books, 1988), 47.
10. Michael Moffitt, *The World's Money: International Banking from Bretton Woods to the Brink of Insolvency* (New York: Simon & Schuster, 1983), 98.
11. Branford and Kucinski, *The Debt Squads*, 47; Jacobo Schatan, *World Debt: Who Is to Pay?* (London: Zed Books, 1987), 9.
12. Branford and Kucinski, *The Debt Squads*, 58.
13. Branford and Kucinski, *The Debt Squads*, 58. See Stephany Griffith-Jones and Osvaldo Sunkel, *Debt and Development Crises in Latin America: The End of an Illusion* (Oxford: Clarendon Press, 1986), 72.
14. Kojm, *The Problem of International Debt*, 36.
15. Branford and Kucinski, *The Debt Squads*, 58.
16. Robert Cherry, *The Imperiled Economy*, vol. 1, *Macroeconomics from a Left Perspective* (New York: Union for Radical Political Economics, 1987), 202; Gilpin, *The Political Economy*, 315.
17. Kojm, *The Problem of International Debt*, 18.
18. Richard W. Lombardi, *Debt Trap: Rethinking the Logic of Development* (New York: Praeger, 1985), 91.
19. Lombardi, *Debt Trap*, 90.
20. Robert Devlin, *Debt and Crisis in Latin America: The Supply Side of the Story* (Princeton, N.J.: Princeton University Press, 1989), 36, 38.
21. Lombardi, *Debt Trap*, 76–77.
22. Lombardi, *Debt Trap*, 74.
23. Cherry, *The Imperiled Economy*, 201.