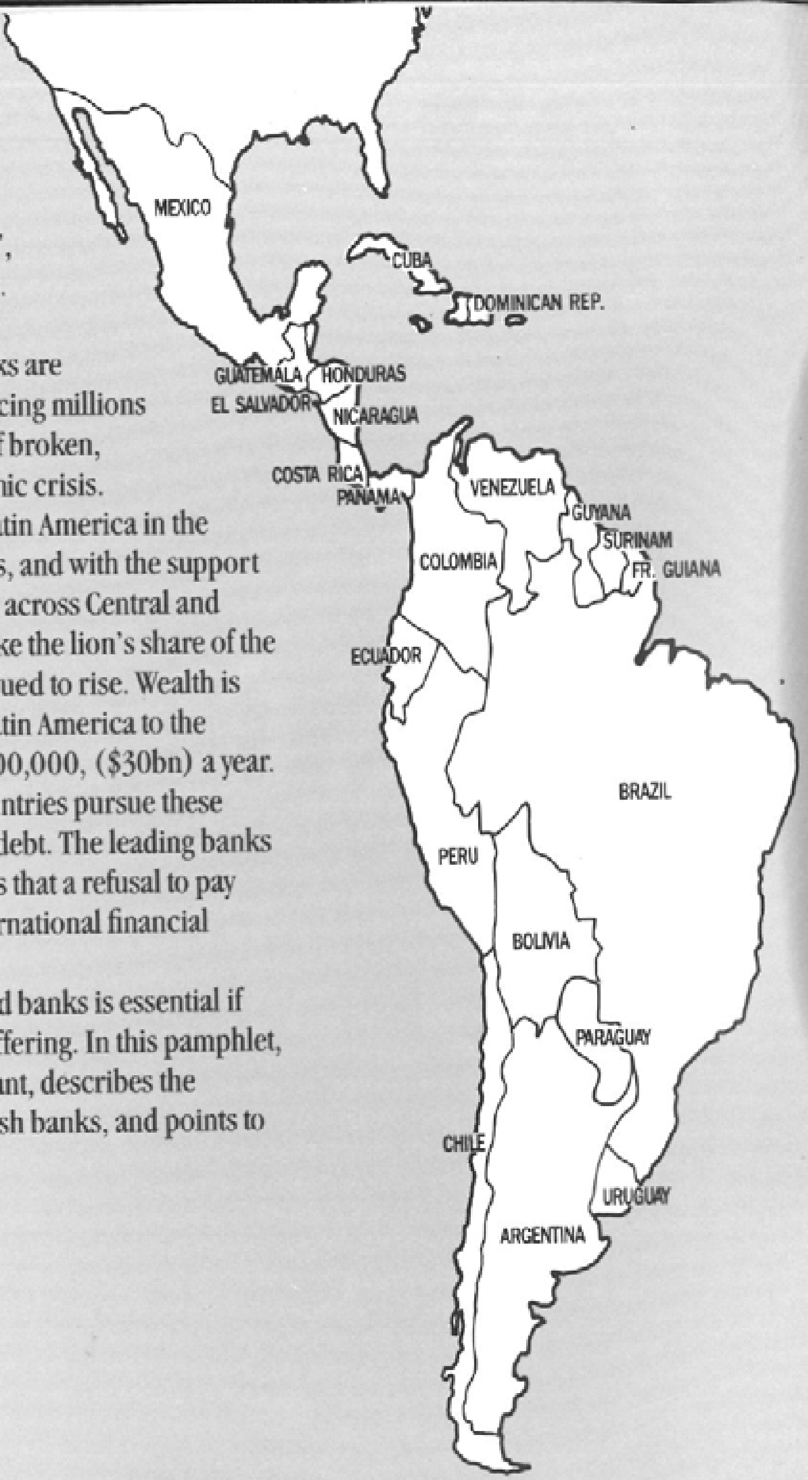
PROFITS OUT OF POVERTY?

British banks and Latin America's debt crisis



The slums of Latin America's great cities may seem a long way from the familiar signs of the 'Black Horse', the 'Listening Bank' and the other high street banks. But there is a very direct link.

Unknown to most of their customers, the main British banks are heavily involved in a chain of lending and debt which is forcing millions of women, men and children into poverty. A chain which, if broken, could plunge the western world into new depths of economic crisis.

Massive, uncontrolled and imprudent lending to Latin America in the 1970s has now been stopped. At the insistence of the banks, and with the support of the IMF, harsh austerity measures have been introduced across Central and South America. The poorest people have been forced to take the lion's share of the burden of repaying the debt while bank profits have continued to rise. Wealth is now being transferred from the developing countries of Latin America to the industrial countries of the North, at the rate of $30,000,000,000, ($30bn) a year.

While the banks in Britain and other advanced countries pursue these policies vigorously, they are themselves threatened by the debt. The leading banks have lent so much to a small number of indebted countries that a refusal to pay could bankrupt them and cause severe damage to the international financial system.

Action by the British Government and British-based banks is essential if Britain is to avoid being implicated in immense human suffering. In this pamphlet, WoW Campaigns, the campaigning associate of War on Want, describes the background to the debt crisis, the involvement of the British banks, and points to the action we in Britain must take.

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Getting into debt

In the early 1970s Latin American countries faced a severe need for finance. The flows of money which had come, in the 1940s and 1950s from private investment and in the 1960s from aid and government lending, were no longer adequate to maintain economic growth. When the OPEC countries doubled and then redoubled the price of oil in 1973 most countries anticipated increased oil import bills but had no funds to meet them.

The solution came from a surprising source. The OPEC states received huge increases in oil revenues. Large sums were deposited with commercial banks in the United States, Britain, Western Europe and Japan. The banks in turn began to lend heavily, with the encouragement of their governments, to selected developing countries.

The share of lending to all developing countries taken by banks rose from 15% in 1970 to 36% in 1983, but it was particularly heavily concentrated in a relatively small number of 'credit-worthy' countries, mainly in Latin America and South East Asia. By 1984, the total Latin American debt was $360bn, of which $242bn was owed to the banks. Just four countries, Brazil, Argentina, Mexico and Venezuela held $210bn, 87% of the debt.

Faced with the need to pay for oil, to maintain investment and development projects and to pay the interest on existing debts, most countries had little choice but to borrow.

And the banks' offer was attractive. Virtually unlimited sums of money appeared to be available without having to adopt the stringent conditions which tended to accompany loans from the IMF and the World Bank. Interest rates were low making borrowing cheap *(see graph below)*. Other commodity prices initially rose in the wake of the oil price increase and it seemed there would be little problem in repaying the debt.

Neither the lending banks nor the borrowing countries ever thought that the debts would be repaid in full. As repayments of capital became due, new loans would replace them. All the borrowers needed to do was to continue to make the interest payments from which the banks made most of their profits.

The gathering crisis

The frantic bout of borrowing began to run into difficulties at the end of the 1970s. In 1979, oil prices again rose sharply, throwing the world economy into recession and creating new balance of payments problems for oil importing countries. Even in oil producing countries the additional income generated expectations of increased wealth, particularly where there were large and rapidly growing poor populations, which could not be fulfilled without further borrowing. Initially, the developing countries were able to continue to borrow to cover their new liabilities, but in the industrialised countries governments began to attach increasing

Lending to Latin America

In the 1950s most of Latin America's external finance came through private companies, which were often part of US multi-nationals. Extensive industrialisation took place behind restrictive import barriers, and the US companies were able to repatriate large profits. In the 1960s, lending and direct aid from western governments and the 'multi-lateral' bodies – mainly the Inter-American Development Bank and the World Bank – played a more important role as part of the US' attempt to secure Latin America within its sphere of influence.

Even before the bank lending took off, Latin America faced problems servicing its debts. In 1969, the Pearson Commission reported to the World Bank that 87% of new lending to Latin America was being eaten up by payments on existing debts. The current debt crisis is the latest, and most severe sign of the continuing problem of financing Third World development on terms that are realistic and affordable.

Rural women in Bahia, Brazil, make rush mats for a living.

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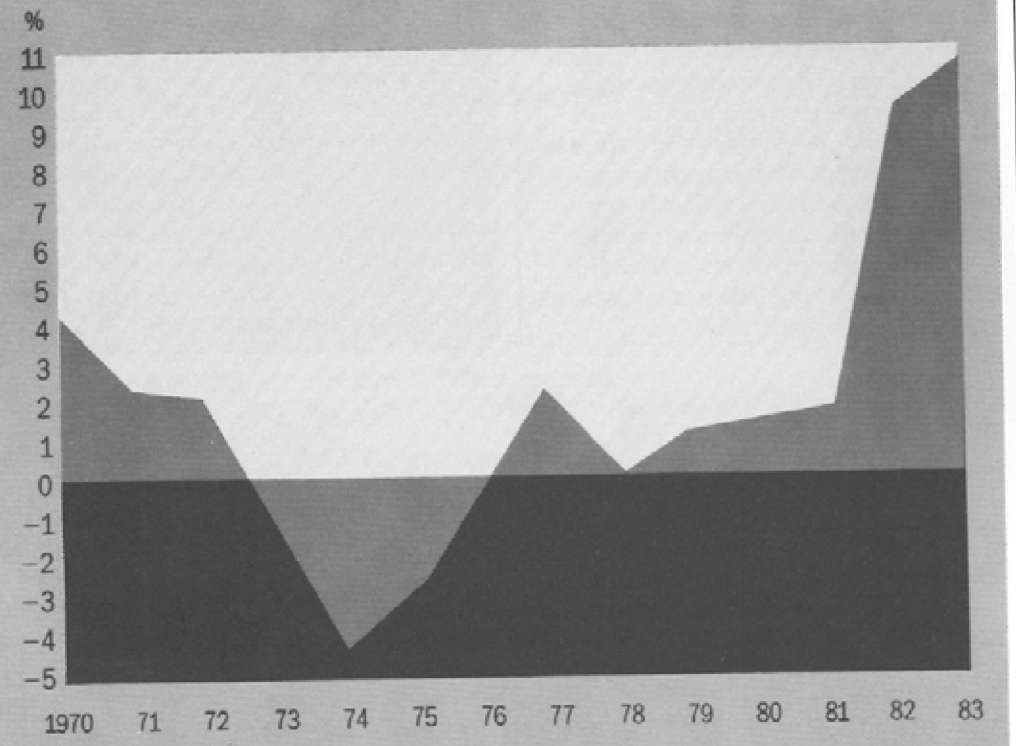
importance to reducing inflation. They pursued policies which deflated their economies and pushed up interest rates. The indebted world saw its commodity prices fall and its markets for raw materials and manufactured goods shrink. While earning power was reduced, spiralling interest rates dramatically increased the cost of borrowing *(see graph below)*.

For a short time, indebted countries tried to bridge the gap between earnings and debt payments by borrowing increased sums for short periods.

Short-term borrowing could not do anything but temporarily stave off the crisis.

How interest rates spiralled

Real dollar interest rates: 1970-1983



The sudden rise in interest rates in 1981-1983 was, in fact, even worse for most Latin American countries than is shown here. The dollar rose in value against most other currencies at the same time as the dollar value of Latin American export commodities fell. Seen from the debtors' viewpoint, the real interest rate on their debt appeared more like 15–25%

Mexico's default

In 1982, Mexico owed over $80bn in medium- and long-term loans and had borrowed extensively on short-term loans. On August 20th it announced that it was suspending all payments of principal for 90 days, pending negotiations with their bankers. The announcement caused cataclysmic shock in the financial institutions.

Many of the world's leading banks had lent so heavily to Mexico and the other major Latin American debtors that a default threatened to bankrupt them and to precipitate the collapse of the world banking system.

The banks which had rushed to lend to Latin America during the 1970s now turned on their collective heels. Faced with a group of countries whose earnings could not possibly match their commitments on debt servicing, imports and government expenditure, the banks began to cut off the flow of funds. At the time when debtors countries most needed external support, the supply of finance dropped sharply.

However, the banks could not simply write off their bad debts without facing bankruptcy. The impression had to be maintained that the loans were being serviced and would eventually be repaid. Paradoxically, this meant that Mexico and, later, other debtor countries had to be lent *more* money so that they could return it to the banks as interest. But, even when faced with possible financial collapse, the banks were unwilling to extend new loans until they had some guarantee of repayment.

The International Monetary Fund had only played a limited part in Latin American affairs in the previous decade as most countries preferred to borrow from the banks. After August 1982, however, the IMF became embroiled in the crisis, assuming a role as lender and financial policeman.

In November 1982 the Mexican Government agreed to cut the gap between its income and expenditure by increasing the prices of goods and services, putting up taxes and cutting public spending and devaluing the currency. In return, the IMF agreed to allow Mexico to borrow up to $3.9bn over the next three years. These measures would still not allow Mexico to pay all its debt charges in 1983 but, armed with the IMF agreement, the banks were persuaded to make additional loans with which Mexico could pay its interest. (Such 'involuntary loans' make up almost all the new lending the banks have made to Latin America in the past four years). Mexico stuck rigidly to the IMF agreement during 1983 and, with adjustments, in 1984. In addition, in both 1983 and 1984, Mexico was able to 'reschedule' a major part of its debt – to renegotiate payments over a longer period of time.

Mexico's agreement formed the pattern followed by most debtor countries over the following years. The austerity policies introduced by the debtor countries at the insistence of the IMF and the commercial banks transformed the position of the Latin American debtors. After many years in which there had been steady flows of finance into Latin America, the countries of Central and South America began to export their wealth to the financial institutions of the advanced industrial countries. After importing a net $9bn in 1981, a net $20.2bn flowed out of the country in 1982 followed by $29.5bn in 1983.

In the process the burden was thrown firmly onto the poorest people in Latin America.

'Suspend the payment of the external debt': mass demonstration in Mexico City.

Why the debt falls on the poor

- In parts of north-east Brazil, every fifth child dies before the age of one
- The Mexican National Consumer Institute reports that 70% of low income families have largely stopped eating rice, eggs, fruit, vegetables and milk
- Six out of ten Bolivians live beneath the poverty line and half of all Bolivian children are malnourished
- Preventable diseases such as influenza, diarrohea, TB and heart disease cause 40% of the deaths of women aged between 25 and 40 in South America.

Across Latin America there are at least 100 million, and probably 150 million women, men and children living in absolute poverty. According to UNICEF, there are 40 million children living 'on the streets'.

The rapid economic growth achieved by many Latin American countries in the forty years after the second world war, brought only limited benefits to many of the poorest people. While Latin America as a whole became considerably richer, as industry, agriculture and raw material workings boomed, the distribution of wealth was chronically squewed. The share of wealth held by the poorest fifth of the population stayed as low as a fiftieth, while the wealthiest tenth took between a third and a half *(see table below)*.

Between 1960 and 1975, the share of income of the poorest 40% actually *fell*. With a rapidly rising population the number of people unable to meet even basic needs rose by over 11 million between 1974 and 1982 – the hectic years of borrowing from the banks.

In many countries, the already powerful and wealthy extended their influence. When the newly democratic government of Brazil announced a land reform programme in 1985 it revealed that 1% of landowners held over 45% of the land. Over twenty years of military rule, land acquired by cattle barons, large companies and speculators had created 342 properties totalling 118 million acres, equal to the land owned by 2½ million peasants.

All the indications are that the share of wealth going to the richest people has increased since 1982, while the other major beneficiaries have been the multi-national companies which have been able to extend their control over the economy. After the banks effectively stopped all but 'involuntary' lending in 1982, the poor bore the brunt of the 'austerity measures' demanded by the banks and the International Monetary Fund.

Wealth in Latin America

Country	Wealth owned by the poorest 20%	Wealth owned by the top 10%
Peru (1972)	1.9	42.9
Chile (1968)	4.4	34.8
Brazil (1972)	2.0	50.6
Argentina (1970)	4.4	35.2
Mexico (1977)	2.9	40.6
Venezuela (1970)	3.0	35.7

(Figures in brackets indicate date of last survey)

The intention of the IMF measures was to 'adjust' the debtor countries' economies. Adjust, that is, to the sudden and catastrophic fall in the flows of new money into the countries and to the equally sudden requirements to begin transferring wealth to the advanced industrial countries. Some people had to do more 'adjusting' than others.

Indebted countries are urged to restore economic health by exporting more and importing less, creating the trade surplus and foreign earnings from which debt payments can be made. Government spending has to be cut, local interest rates are raised and the currency devalued. The economy is opened up to foreign investment.

For the bankers, IMF measures provide immediate action and the prospect of continuing repayment, at least in the short-term, of their debts. The impact was dramatic. In 1983 Latin America as a whole achieved a trade surplus of \$31.2bn, after a deficit of \$1.6bn in 1981. But the price of this apparent success was high.

The public spending cuts demanded by the IMF include reductions or the abolition of subsidies on staple foods, utilities, transport and other services. Health, education and development programmes have to be suspended. The huge reductions in imports are achieved by deflating the demand in the economy – put bluntly, this means reducing real wages drastically to cut the demand for imported goods and restricting capital investment in industry. The abolition of subsidies, raising of interest rates and devaluation of the currency all fuel inflation *(see graph opposite)*.

Most debtor countries had little option but to agree a 'letter of intent' with the IMF setting out the austerity policies they would follow. Almost immediately, Latin America's economic growth was halted and reversed. The wealth produced fell by 3.3% in 1982 and 5.3% in 1983. By the end of 1984, wealth produced per person was nearly 10% below the 1980 level.

For those living on or below the poverty line, any recession or fall in living standards is disastrous. But these bald figures hardly indicate the way in which the burden of the debt crisis has been thrown on the poorest.

The unequal distribution of wealth is mirrored in an uneven share of falling living standards. While wealth produced per capita fell by 9% between 1980 and 1983, real living standards on average dropped by 13%. But, according to UNICEF, *'It is not uncommon that a 2-3% decline in national incomes in the developing countries results in at least a 10-15% decline in the incomes of the poorest classes.'*

On top of this, the poorest suffer most from the sharp price rises in the basic foods and goods which consume most of their income. In Brazil in 1983 prices went up by 769% for beans and 188% for rice, whilst the minimum wage for those in work, rose by only 142%. (Up to 40% of Brazilians depend on the minimum wage while 25% of the economically active receive less).

The working hours needed to buy each month's food rose from 127 to 242, in the Brazilian city of Recife, between 1982 and 1984. Mexican wages fell by 40% in real terms in the three years after 1982, reaching less than three-quarters of their mid-1970's value. The Food and Agriculture Organisation estimates that 63% of Peruvian households do not earn enough for an adequate diet.

Members of larger than average families also suffer disproportionately. In Candelaria, Colombia, children in four child families were found to be receiving 500 calories a day less food than children in two child families.

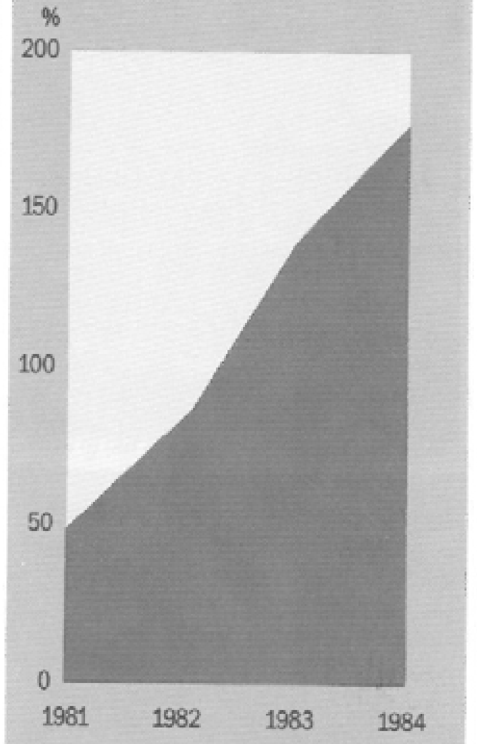
Welfare benefits or safety nets are either absent or minimal in most Latin American countries. The recession has thrown more and more people out of work into chronic unemployment, or under-employment in casual or marginal activities. In Sao Paulo, Brazil, in a country where a million new jobs are needed every year just to prevent unemployment rising, industrial employment fell by a quarter between 1980-4, to 1973 levels. Slum dwellers in the same city scour the rubbish tips for anything which may be re-used or sold.

Four out of ten Mexicans are permanently unemployed or underemployed; in Peru it's between 50 and 70% of the population. Across Latin America, growing numbers of people, particularly women, are being forced into the 'informal' economy – domestic work, street vending, cleaning car windows.

The changes forced by the austerity programmes have had serious wider social effects. Key development programmes have been jeopardised, and clear indications are emerging that progress made previously in health and education is being lost '... *'the initial signs of deterioration now appearing (in child welfare) should be seen as important* warning signals *of much more serious problems that can perhaps be avoided only if concerted action is taken immediately.'* (UNICEF) These early indications include:

- an increase in the number of babies born below normal weight in Sao Paulo, a gradual increase in the number of baby deaths linked to malnutrition, and an increase in the number of children in Brazil given up by their parents because of poverty.
- infant mortality in Mexico increased by 10% between 1981 and 1983.
- in Chile the number of cases of malnutrition dealt with at recuperation centres of 'last resort' have risen significantly, while the pressure on women to take waged labour means that more and more young children are abandoned to themselves or left in the care of siblings.

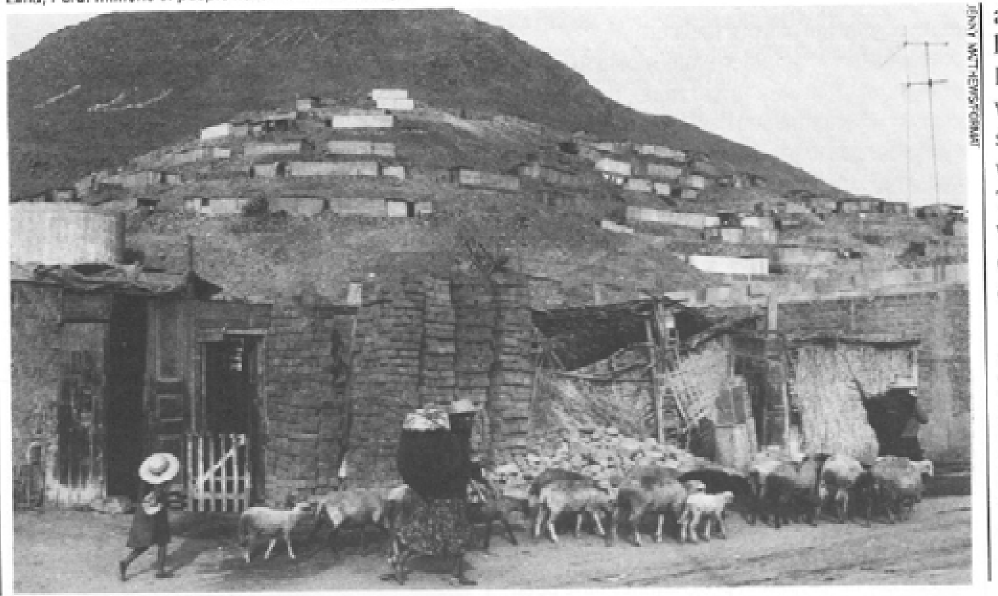
Inflation in Latin America (consumer prices)



One impact of austerity measures has been to force up inflation, hitting the living standards of the poorest hardest.

The austerity policies have had a particular impact on poor women, who are generally responsible for child care and domestic duties in addition to any work outside the home. Women account for 60-80% of illiteracy in Latin America and women's education is held back through the lack of resources, with wider social consequences. (One recent study suggested that infant mortality

Lima, Peru. Millions of people have flocked to shanty towns outside Latin America's cities in the search for work.



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amongst educated women is up to five times lower than amongst illiterate women.) In the Rocinta slum of Rio de Janeiro, nearly half the women aged 17-50 have not completed primary school. Education is held back by the pressure of work, domestic responsibilities and ill-health. The Asociacion Peru Mujer, which provides women's education classes in the poorest areas of Peru, found that in one shanty town two-thirds of their pupils suffered from TB.

The austerity measures are forcing economic changes which, again, hit the poor. The emphasis of agriculture has moved more strongly to cash crops for export. The acreage of land devoted to orange growing in Brazil increased by 6% in two years, while the areas used for growing maize and rice have decreased by 6% and 16% respectively since 1981. The pressure for exports has helped large

The IMF and debt-management

The International Monetary Fund was established after the Second World War, primarily as an international body which could provide short-term financial support for countries with balance of payments problems. It was hoped that this support would help prevent the sort of world recession seen in the 1930s. Over recent years the IMF has been drawn more and more into the longer-term financial supervision of troubled Third World economies.

The main role of the IMF is to lend money to its member countries. It is the conditions which the IMF applies to its loans – and the significance which they are given by other potential lenders – which give the IMF its power.

The IMF's policies are effectively determined by the United States, which wields enough votes to give it an effective veto over any initiatives it dislikes. IMF policies are characterised by a hostility to public sector industry and investment and to social spending; to measures which restrict foreign imports and the penetration of local industry by multi-national companies, and to interference with the 'free-market' through, for example, the indexing of wages or the subsidy of basic commodities.

The banks, which share a similar economic outlook to the IMF, have regarded IMF conditions as the only guarantee of repayment of their loans and due service. As country after country needed to borrow more just to pay its interest and avoid default, IMF conditions became largely inescapable.

IMF approval has also been required for countries wishing to reschedule their debts. In return for agreeing IMF terms, new money is made available to the debtor country. Typically, there is a contribution from the IMF and from the banks: part of the due debt is rescheduled and there may be a grace period in which payments are suspended. Brazil's 1983 'adjustment' programme, for example, involved an additional $5.9bn from the IMF, new loans of $4.4bn from the banks and the rescheduling of $4.4bn of bank debt. The IMF terms included the abolition of wage indexing at a time when Brazil's inflation rate was 180% (this demand was partially resisted by the Brazilian Congress). While the IMF sees fit to intervene directly in the wages policy of a borrowing country it does not apply conditions to other areas of policy. In February, 1985 Labour MP Eric Deakins asked Treasury Minister Ian Stewart MP 'whether the IMF imposes any conditions relating to purchase of arms or level of military expenditure when making loans to or rescheduling the debt of developing countries . . .?' Mr Stewart replied 'No, the IMF does not impose any such conditions in its loans . . . United Kingdom support for applications for IMF loans depends on their technical merits.'

landowners resist land reform even though there are said to be 10.5 million peasants looking for work in Brazil.

At the same time, the enforced reduction in capital imports is undermining the economic base on which Latin American recovery will depend. Industry is being left without vital equipment. The Argentine Government calculates that a 1% growth in GDP requires a 1.4% increase in imports of equipment, machinery and raw materials (and Argentina is more self-sufficient than most Latin American economies), but imports of these goods have actually fallen dramatically across the whole of Latin America.

While the poorest have been hit hardest, the salaried middle classes and sections of the business community have also suffered. In Brazil, several savings institutions have collapsed after middle class depositors withdrew savings to maintain living standards. To a considerable extent, however, the very wealthiest sections of Latin American society have escaped the impact of the austerity measures. The same techniques of speculation and the export of capital abroad which served them well during the years of borrowing have enabled them to survive the IMF's austerity measures.

Inevitably, the desperate position of the poor has led to rising social tensions throughout Latin America, with increasing trade union militancy, clashes over land, and sharp rises in crimes committed to obtain food and basic goods.

In Brazil, there have been many instances of violent clashes between landowners and landless peasants. 180 people were killed in the Sao Luis state in land disputes in 1984 alone while, in one incident in the neighbouring state of Para, 13 peasant squatters were killed by gunmen hired by local landowners.

Bolivia has seen six general strikes in

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A starving child, used to beg in Sao Paulo, Brazil.

two years against austerity measures and the impact of hyper-inflation. In March 1985 the strike action led by miners was backed by a hunger strike by over 100 women in the capital La Paz demanding the setting up of 'popular stores' to provide the poorest people with basic necessities such as milk, rice, kerosene and soap.

In the rural areas of Peru a bitter conflict is being fought with the Sendero Luminoso guerilla group.

In the first two months of 1986 alone, British newspapers reported:

- the seizure of the city hall in the Brazilian town of Jala by 200 unemployed migrant labourers
- armed clashes in the Colombian city of Cila killed 15 and a curfew was imposed on working class districts
- 100,000 people demonstrated in Mexico City calling for non-payment of the foreign debt
- a general strike in Argentina against austerity measures, led by right wing Peronist unions, paralysed the country for two days, and a visit by US banker David Rockefeller sparked off riots
- a further general strike in Bolivia lasted for two days and the Bolivian army took control of the state-owned Palma Sola oil refinery where union unrest over redundancies and benefit cuts had virtually halted production.

The growing conflicts have brought increasingly strident warnings even from conservative voices in Latin Ameria. Sr Antonio Ortiz Mena, the President of the Inter-American Development Bank, told an audience of western bankers in London in January 1986 '*. . . the very survival of our elected governments may be at stake. For unless our representative governments can rekindle the flame of hope in the hearts of our populations – the hope of a better, more dignified and economically more secure future – the task of coping with today's burden may well be taken away from them. And in all too short a time, the painfully achieved gains of a generation can once more be wiped away. It seems to me that the older democracies have a responsibility in seeing that this does not happen.*'

Sr Ortiz Mena chose his audience well. The application of IMF conditions has become such an integral part of the debt crisis that it is easy to paint the IMF as the sole villian in the development of the human tragedy. But the IMF does not act alone. The western banks which made the loans are still involved, arguing vigorously for the same austerity policies which force the poor to pay back a debt from which they saw little benefit. In the next section we look at how the banks became involved and their role today.

Profits out of poverty? The role of the banks

Mexican shanty town dwellers collecting water.

While the poorest people in Latin America have seen their living standards plummet, most of the banks involved in the debt crisis have remained highly profitable. Britain's big four high street banks – Lloyds, Midlands, NatWest and Barclays made combined profits before tax of over £2.5bn in 1985.

The banks have suffered to some extent. They have been forced to write off some debts and to make allowances for others, which has reduced the profits they can declare on their Latin American loans. Rescheduling has allowed debtors to defer payments the banks would otherwise have already received. But it is remarkable how little harm has been done to the banks (or the bankers) compared with the suffering inflicted on the debtor countries.

Bank earnings on Third World lending come more from the scale of business involved than from particularly high profits on individual loans. During the 1970s the competition between banks to lend was fierce and profit margins were forced down. But, with billions of dollars being lent, even small margins brought large returns – a loan of $100M would earn between $1.25m-$2m a year profit and the commission for organising the loan might well bring another $1m-$1.25m immediate profit.

Between 1975 and 1982, debt payments from Latin America totalled $276bn. The proportion of payments on government guaranteed debts going to commercial banks, rather than government or multi-lateral lenders virtually doubled to over 80%, bringing billions of dollars in profits to the banks.

By 1977 the 12 largest US banks took almost half their earnings from international lending, most coming from developing country loans; it is hardly surprising that so many banks wanted at least a part of this lucrative business.

Banks are notoriously secretive about the details of their profit-making, and it is impossible to estimate with any accuracy what the total earnings of the banks were during the 1970s and early 1980s. But until 1982 at least the profit-making continued smoothly.

The initial effect of the Mexican crisis in August 1982 was to boost bank earnings.

At the same time as austerity measures were being imposed on Mexico's poor, Lloyds Bank International announced quadrupled profits for the six months beginning September 1982. They noted a major boost from countries which were being forced to reschedule their loans. For many banks the fees involved in the Mexico rescheduling almost doubled the return on their lending.

In 1983, Brazil alone was responsible for 20% of the profits of the leading US bank Citicorp, while, in the following year, a third of same bank's profits came from just four countries – Brazil, Mexico, Venezuela and Argentina.

As the intractable nature of the debt crisis was absorbed by the banks, the limits to punitive charges were recognised and profit margins have been reduced and fees reduced or dropped altogether. While the banks have continued to make profits, they still remain vulnerable to default.

The threat to the banks

A relatively small number of banks have made the bulk of the loans; most syndicates were arranged by 25–50 of the largest commercial banks. In the US just 9 banks (of the 15,000 or more banks in the country) hold 63% of US loans to the Third World. British lending is dominated by the main clearing banks. However, as many as 3,000 banks around the world participated from time to time. Both the concentration of lenders and the interlinking of so many banks are causes of concern for the banking system.

Mexico's threatened default caused shock waves to run through the world's financial establishment. The fears ran far wider than the potential damage to the individual banks involved.

Before Mexico's crisis it was not realised how heavily involved many of the major banks had become in Latin American lending. In fact, leading international banks in the USA and Britain had lent considerably more than the value of their capital *(see table below)*.

The failure of a major debtor to pay (and the distinct possibility that others could follow) would have several serious consequences. Most obviously, individual banks would be crippled or actually bankrupted if the bad debts were sufficiently large. But such damage could not happen in isolation from the rest of the banking system.

Banks are heavily involved in lending to and borrowing from each other. As one is threatened by bad debts, each of the banks from which it has borrowed come under threat. The reaction of depositors to the possible (even rumoured) collapse of a bank is to remove their money to somewhere safer, thus increasing the bank's problems. The possible default of Latin American countries could trigger a financial collapse of banking across the world.

When the smoke had cleared, the banking system would be severely reduced in size. Confidence in the whole business of international lending would be severely shaken, and depositors highly reluctant to trust their money to any but the most prudent banks. Major banks would have had a large part or even all of their capital value wiped out and, as the ability of a bank to lend is linked to the value of its shareholders' funds, they would only be able to lend a fraction of previous volumes.

The overall effect would be to reduce dramatically the money available to investment and trade finance throughout the world, plunging both the industrialised and developing worlds into recession.

The big banks' exposure to the big debtors

*US and British banks' loans to Mexico, Brazil, Argentina and Venezuela as a proportion of * capital ** at the end of 1984*

	%
British Banks*	
NatWest	84
Barclays	89
Lloyds	202
Midland	274
American Banks**	
Citicorp	140
Bank America	122
Chase Manhattan	142
Manufacturers Hanover	173
J.P. Morgan	103
Chemical	134
Bankers Trust	114
First Chicago	103

*loans as percentage of shareholders funds and reserves
** quoted in *Debt and Danger* (Lever and Huhne)

How the lending developed

Initially it appeared to be in everyone's interests for the oil earnings of the OPEC countries to be 'recycled' by the banks to developing countries. The borrowers were able to meet oil bills and sustain economic growth; their growth helped take the edge off the recession hitting the industrialised countries; and, by using the flexible and rapid channel provided by the banks, the western countries avoided having to negotiate directly with developing countries and get drawn into wider discussion about the transfer of wealth from 'North' to 'South'.

The banks turned out to be an unsuitable means of transferring such vast sums of money. They appear to have become mesmerised by the opportunities which were opening up. Bank 'salesmen' were despatched to different parts of the world with instructions to make as many loans as possible. The commercial measures which they took and the assumptions they made to protect their loans turned out to be fatally flawed.

There was little scrutiny of the final uses of loans, for whatever particular purpose they were formally made. The bankers argued that, with government backed loans, it was the national economy as a whole which would repay, rather than the particular project involved. While this may be a reasonable assumption for one lender to make, when all lenders are making the same assumption it becomes a dangerous strategy.

The bankers attempted to make loans more secure by including linking clauses which in effect said that a default on one loan would be held as a default on all loans. Protection was also sought by making virtually all loans at floating interest rates, which places the burden of changes in world economic conditions on the borrowers. When the crisis came, both these measures actually threatened to make the impact of a default more catastrophic.

The eagerness to lend was backed by the misplaced belief that lending to sovereign nations is a particularly safe form of lending – a country, after all could not go bankrupt; its land, people and assets could not simply disappear and so loans must be repayable. It was not until the early 1980s that it became apparent that most of the measures available to penalise a defaulting company – bankruptcy, seizure of assets, etc – could not be applied to sovereign governments.

Finally, the banks avoided making loans to the very poorest countries which ensured that the recycling of the oil surplus was not directed to the regions of greatest need.

Currencies and exchange rates

Over 90% of commercial bank loans to Latin America were denominated in \$US. For this reason, \$ have been used in this pamphlet, except in the section on British bank involvement. It should be noted that British banks convert their \$ loans into £ sterling for the purposes of their accounts. This has the effect of making the extent of bank lending and earnings vary in sterling terms with fluctuations in the £-\$ exchange rate.

The \$-£ exchange rate in 1985 averaged approximately \$1.29 = £1.

N.B. 1bn = 1,000,000,000.

International lending

In the wake of the banking collapse and recession in the 1930s, most countries imposed strict regulations on their banks. But, with strong economic growth after the Second World War, these were gradually relaxed and new banking practices developed which enabled the banks to operate increasingly freely throughout the world.

The most significant development was the 'euro-dollar market', in which currencies are bought and sold outside the country of origin. (Most business is conducted in dollars, but there are also euro-sterling, euro-mark, euro-yen and other euro markets.) The euro-dollar market enables transactions to take place well beyond the control of the country and government issuing the currency. With increasingly rapid communication systems the euro-dollar market provided the ideal means by which the banks could lend to Third World countries with minimum involvement or control by western governments.

International lending in the 1970s was on a vast scale. Banks began to spread the risks by joining together in syndicates to make loans. Syndicated loans were intended to allow individual banks to have relatively small involvement in a large number of different loans in different countries and regions.

The great majority of Latin American loans were made at floating interest rates, tied to the current price of borrowing on the money markets (set by LIBOR – the London Interbank Offered Rate – or the US Prime Rate). The profit was determined by the addition of a percentage or 'spread' above LIBOR or US Prime. The growth of syndicated loans was accompanied by the charging of a fee or commission by the banks involved in putting the syndicate together.

Many strong and legitimate criticisms can be made of individual banks and the international banking system, but it is unlikely that such a chaotic and cataclysmic collapse would bring many benefits to the majority of people. In the recession and instability that would follow the conditions would be created for the return to power of authoritarian and anti-democratic regimes.

The recognition that British banks were as heavily embroiled in the debt crisis as their US counterparts came very late. In April 1984, Chancellor of the Exchequer, Nigel Lawson was asked *'Is it not a fact that the British banks have behaved completely responsibly in this matter and in accordance with the best banking practice to reach agreement (on rescheduling) on the basis on which they have done?'*

Nigel Lawson replied, *'My hon. friend is right. If there is scope for criticism of banks throughout the world – this applies more to American banks than to British banks – it is that they have allowed themselves to become overextended in these countries. Having had to face such a situation they have behaved with considerable responsibility.'*

In fact, two of the leading British banks are as exposed as their American counterparts, and their response to the crisis has been dominated by the narrowest of interests *(see table above)*.

At the end of 1984, UK banks claimed at least 12% (\$28.6bn) of the debt owed by major Latin American debtors, a figure which does not include subsidiaries of British banks registered outside the UK.

The leading lender by some distance is Midland. Its own lending had reached £5.3bn by the end of 1984. In addition, it had made an ill-fated attempt to buy a 'ready-made' international division in 1981 by acquiring the Californian-based Crocker Bank. Crocker turned out to be plagued with bad debts, including heavy exposure in Latin America. In early 1986, Midland announced plans to sell Crocker – without its debts – to another US bank. It appears that Crockers' Latin American lending – of \$2.4bn at the end of 1984 – either has been or will be transferred to Midland.

At the end of 1984, Midland's own lending was 3.1 times greater than the value of its shareholders' funds, with 14% of all its lending

British bank lending to Latin America

The figures below are drawn from annual accounts and other published material for the end of 1984

Country	Lloyds £m	Barclays £m	NatWest £m	Midland £m	Crocker \$m
Brazil	1,857	571	700	1,871	804
Mexico	1,181	1,010	795	1,590	558
Argentina	556	450	475	757	452
Venezuela	554	278	250	400	231
Others	1,133	706	492	681	353
Total:	5,281	3,015	2,712	5,300	2,428
% of all lending	17	6.2	6.1	14.1	15.3
% of shareholders funds and reserves	257	116	102	310	212
Profits (pre-tax): 1984	468	623	671	135	—
Profits (pre-tax): 1985	561	854	804	351	38

Note: in February 1986, Midland announced the intended sale of its Crocker subsidiary. It is believed that Midland will retain Crocker's loans to Latin America on its own books.

Figures drawn from published reports and brokers' estimates.

What would the government do?

Treasury Minister Ian Stewart MP told the House of Commons in June 1984 that 'the possibility that British banks might experience liquidity difficulties for this or any other reason is entirely hypothetical. However, the Bank of England has on occasion in the past acted to prevent general damage to confidence in the banking system and would do so again if the circumstances made this necessary.'

It is by no means clear that his confidence is justified. The Bank of England has never faced a massive default threatening all the British banks; nor have the other central banks in Europe and North America. A particular problem for the European banks is that most loans have been made in dollars. It is unlikely that the Bank of England could easily find sufficient dollars to cover the potential losses of British banks.

Even if the banks could be rescued, would the government look simply at the stability of the financial system or would there be concern for the interests of the poor?

in Latin America. The Crocker deal will add significantly to both figures.

Midland's sale of Crocker will leave Lloyds as the second largest British lender with loans totalling £5.2bn (including over £400m lent by its Brazilian subsidiary), 2.57 times the value of its shareholders' funds. The London stockbroker analysts, Savory-Milln, recommended against buying Lloyds shares in June 1985, commenting *'On balance we are cautious of Lloyds simply because, if the worst did happen, Lloyds will be a major English casualty'.*

Barclays and NatWest have lent considerably less to Latin America, both in absolute terms and in proportion to their other activities. This does not mean that they are protected from the impact of a general banking crisis, however, which would undoubtedly affect both seriously. Barclays in particular has very heavy commitments in South Africa which, currently in political turmoil, is also facing serious problems servicing debts.

All the banks have been forced to make increasing allowance for the bad loans they have made. Bad and doubtful debt provision by the four main British banks has grown rapidly from £1.2bn in 1980 to £3.9bn in 1985. Although this includes domestic and other international problem debts the Latin American loans have been a major cause of concern. Despite increased provision, analysts Savory Milln commented, *'both (Lloyds and Midlands) look horrendously underprovided, not only in absolute terms, but also in relation to their rivals (Barclays and NatWest)'.*

The financial markets have their own way of estimating the value of the debts when they are sold between different institutions. Without exception Latin American debts are sold at well below face value, reflecting the market's 'confidence' in their eventual repayment.

On strike against mine closures, miners collect for food in Lima, Peru.

The case against the banks

Lloyds is the only British bank to have identified publically the profits made from lending to Central and South America. Between 1982 and 1985, they fluctuated wildly, rising from £62m in 1982 to £86m in 1983, before falling to only £14m in 1984 and rising again to £32m in 1985. These variations, however, reflect the bank's decisions to make greater allowance for bad debts, and changes in exchange rates rather than variations in payments received from the debtor countries.

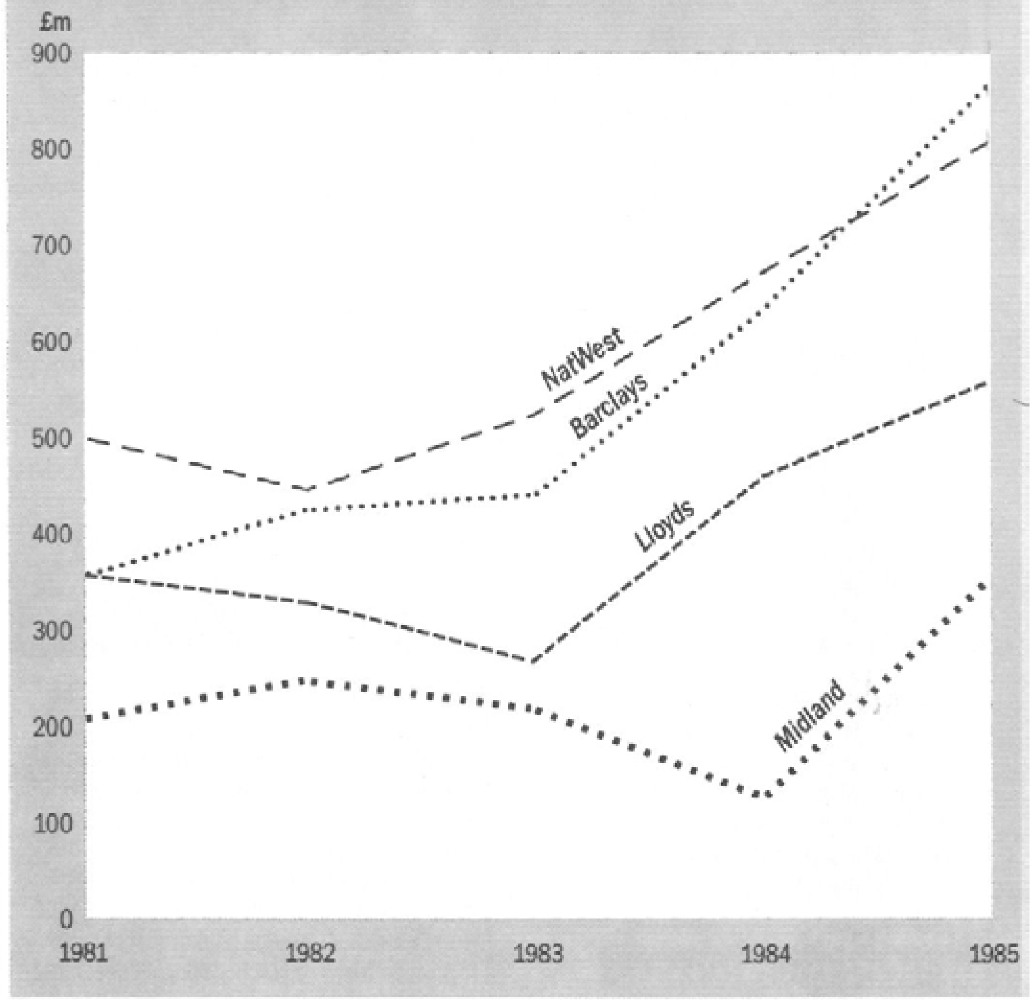
The actual *payments* made to Lloyds on their total lending of over £5bn, which include interest and some repayment of the original capital loans as well as Lloyds' profit margins would have been far higher – probably well over £400m in 1985. From the point of view of the debtor country, it is the total payments to the banks, rather than just the profit element, which present the problems.

For most banks involved, interest payments form a very significant part of their income. In 1983 the interest received by major US banks on Latin American lending was equivalent to more than 40% of their profits. In early 1984, a threatened default on Argentinian debt would have reduced the income of some leading US banks by as much as 20% in the first quarter of the year. (Presumably British banks were affected to a similar extent, although less stringent banking legislation meant that they did not publish comparable data.)

There is, clearly, a contradictory position. As long as payments are made, the banks are able to declare at least some significant profits (43% of all Lloyds international pre-tax profits since 1982 came from Latin America). If the payments stop, the banks will not only lose their profits in the Latin American loans, but a substantial and possibly catastrophic loss of income which could well wipe out all their profits and more.

Bank profits on their Latin American loans may be relatively low given the vast sums lent, but it is the vast transfer of wealth from Latin America's poor to the banks which keep them profitable at all. The 1985 pre-tax results of the British banks mark another year of steadily increasing profits *(see above)* which have only been maintained at the expense of the poor.

Bank profits 1981-85 (pre-tax)



'Favelados' – shanty-town dwellers in Sao Paulo – invade land to build homes.

JENNY MATTHEWS/FORMAT

During the 1970s the banks lent recklessly. Yet, although banking is meant to be a 'risk' business, they have weathered the debt crisis almost unscathed. They have successfully passed the burden onto other people and have avoided taking any real responsibility for the bad loans they have made.

Negotiating poverty

The most neglected aspect of the British banks' involvement in the debt crisis is the role they have played in imposing austerity policies. In the wake of Mexico's crisis, Advisory Committees of banks were established for each major debtor, usually involving the most highly exposed banks.

It is these Advisory Committees, coordinating negotiations on behalf of all the lending banks, which have insisted on IMF conditionality as a pre-condition for making any new loans. Through the Advisory Committees, and their regional consultations with perhaps thousands of smaller banks, are reflected the banks' reluctance to make new lending. (From the onset of the crisis it has been a basic principle that all lending banks must participate in any new loans or rescheduling, in order to prevent smaller banks dropping out and leaving the large banks even more vulnerable.) The overall influence of the Committees seems to have been to make IMF conditions more rather than less restrictive.

British banks or their subsidiaries are represented on each of the Latin American advisory committees, which are usually chaired by a major US bank. In January 1986, before Midland announced the sale of Crocker, the representation was:

Colombia:	Barclays
Ecuador:	Lloyds
Mexico:	Lloyds
Argentina:	Lloyds
Bolivia:	Midland (Crocker)
Brazil:	Lloyds
Chile:	Midland (Crocker)
Peru:	Midland (Crocker)
Uruguay:	Lloyds
Venezuela:	Lloyds (Joint Chair)

The network of lending banks established through these Advisory Committees has played an important role in shaping western responses to the crisis. In late 1985 the Argentine Committee, with the addition of four banks including Barclays, was heavily involved in discussing the banks' response to the Baker Plan *(see page 20)*. In January 1986, Sir Jeremy Morse, Chairman of Lloyds, joined bankers from other European countries in discussions of the same initiative in New York. Between December 1985 and February 1986 there were a series of statements in support of the Baker Plan from national groups of banks.

The detailed work of the Advisory Committees is shrouded in secrecy and few members of the British public will be aware of this role of the British banks. At most meetings of UK lenders, bankers are urged not to reveal what was presented or discussed. After several press leaks, NatWest stopped hosting information meetings on Peru. During 1986 and over the following years, as major negotiations take place with Mexico, Brazil, Argentina and many of the smaller debtors, far more detailed scrutiny must be placed on the positions taken and demands made by the British banks.

The borrowers

By 1983 the Latin American debt was \$360bn; interest payments were averaging \$35bn a year. For most countries the cost of servicing the debt was taking the equivalent of at least 35% of export earnings and in many cases far more *(see table below)*.

The cost of the debt was forced so high by the sharp changes in interest rates, falls in commodity prices and the downturn in the world economy which precipitated the 1982 crisis. None of these factors was within the control of the debtors. For this reason alone the debtors' plea against bearing all the costs of the debt is legitimate.

But the record of the debtors cannot go without criticism. Too little of the borrowing ever benefited the poorest people who are now expected to repay it.

Much of the most hectic borrowing took place under military dictatorships. Between 1975 and 1982 Brazil's debt increased by \$60bn, and Chile's by \$13bn, The Peruvian military saw an additional \$5bn borrowed between 1975 and 1980, while the six years of Argentinian dictatorship after 1976 increased Argentina's debt by \$30bn. The people of these countries had no sanction against their rulers' policies.

Vast sums of money were misappropriated, wasted, or consumed by payments on existing debts. The World Bank estimates that of the \$35bn borrowed by Argentina between 1976 and 1982 little if any was used to finance net additional investment.

The transfer of money overseas to purchase property or other investments, or even to place with western banks, is known as 'capital flight'. It has been estimated that, between 1974 and 1978, the equivalent of a third of all the increase in debt of Argentina, Brazil, Mexico, Venezuela and Chile went into overseas assets and bank accounts.

Mexican government statistics suggest that Mexicans own some \$25bn of property in the United States and have around \$20bn in US banks: Argentinians are believed to hold over \$10bn in deposits overseas.

Borrowed money fuelled consumer and property booms. Santiago is littered with unfinished office blocks, half completed during Chile's borrowing boom in the late 1970s.

Even 'real' investment was too often misplaced and inefficiently carried out. Jose Carrilo Penna, Brazil's Minister of Industry and Commerce admitted in 1984 'we have \$50bn worth of incomplete projects with zero degree of usefulness'. The \$18bn Itaipu dam and hydro-electric scheme on the Brazil-Paraguay border had produced little electricity by 1984. Colombia's Chinguza hydro-scheme, which cost three times the budgeted \$300m was shut down after four months' operation with major engineering problems.

The ready availability of finance enabled countries to avoid problems of the distribution of wealth and the conflicting claims of different sections of the community. The public sector and publicly-owned companies became overstaffed by any judgement and corruption flourished. The former head of Pemex, the Mexican state oil company is now in jail on charges of embezzlement.

The debt burden

The Latin American debtors have to commit a high proportion of export earnings to debt payments:

Country	Total debt (\$bn) 1985†	Debt payments as % of exports
Argentina	50	80*
Bolivia	4	22*
Brazil	102	41*
Chile	21	53*
Colombia	13	38*
Costa Rica	3.5	32*
Dominican Republic	2.5	23.5**
Ecuador	6.9	41*
El Salvador	2	15**
Guatemala	2	4**
Honduras	2.3	19**
Mexico	97	59*
Nicaragua	4.5	18.5**
Panama	3.8	
Paraguay	1.8	19**
Peru	14	33*
Uruguay	5	45*
Venezuela	44	34*

†Recent official sources (some are for end-1984).
*Manufacturers Hanover (quoted in the Economist, January 1986)
** CEPAL (Sources * and ** not directly comparable)

Corruption and inefficiency were by no means the only uses of borrowed money. A massive proportion was consumed simply in paying the interest on previous loans with governments, multi-lateral institutions and private banks. Between 1977 and 1983 Latin America's foreign debt rose by $220bn; over the same period $154bn, equivalent to 76% of the increase, was paid out in interest.

In practice, it is impossible to identify precisely what the borrowed money, or even individual loans were used for. In a banking expression, money is 'fungible'; money made available for one purpose frees other money for other uses. Latin American borrowing allowed corruption and productive investment, capital flight and payments for oil imports, development and speculation to continue for several years in a way which would otherwise not have been possible.

The tragedy is that so little was used to benefit the majority; while the 'trickle-down' effects increased employment in urban areas and some social programmes were expanded, by the end of the decade of borrowing the position of most women, men and children had barely changed.

Corruption and capital flight did not come to an end in 1982. The wealthiest sections of Latin American society continue to gamble against the health of their own economies by exporting money abroad. The Bank of England calculate that $80bn left Latin America in the four years 1981-4. Virtually all the money borrowed – whether voluntary lending or as rescheduling agreements, has directly or indirectly left the borrowing countries whilst the poor have suffered huge reductions in their living standards.

The problem of the debt crisis is a problem within the debtor countries as well as a problem between debtors and creditors.

Women vote in Argentinian elections. Fragile democracies are threatened by the debt crisis.

ASSOCIATED PRESS

Public and private debt

Not all debts were incurred directly by governments. Borrowers also included state-owned companies, private banks and private companies. Loans to the private sector were sometimes government guaranteed, effectively making the private debt a national debt. The significance of private borrowing varies considerably from country to country. In Venezuela, half the country's debt was incurred by the private sector whilst in Mexico private debt is only 16% of the total.

Over recent years, banks have become increasingly concerned about the vulnerability of loans made to private banks and companies without government guarantees. It has become increasingly common for banks to insist that debtor governments take responsibility for all debts as part of rescheduling and new loan agreements, or at least to make sure currency is available at favourable exchange rates to enable the private sector to repay debts.

The end of the debt crisis?

When bankers talk about the 'end of the debt crisis' they don't mean the end of indebtedness or the end of transfers of wealth from the indebted countries, let alone the prospect of reducing poverty. Their hope is simply that the worst danger to the financial system posed by the big debtors has passed, and that serious damage to their profits and operations has been avoided. Even with this narrow and limited aim, each apparent end to the crisis has been followed swiftly by a renewed set of problems.

By the end of 1985 a major default had been avoided by a combination of financial and political diplomacy, and above all, by the burden taken by Latin America's poor. The fundamental problems were no nearer solution.

In January and February 1986 the immediate cause for concern was the collapse in oil prices. Mexico was particularly hard hit. Dependent on oil for 70% of export income the Mexican Government saw its projected income fall 40%. On 21st February the Mexican President de la Madrid declared that Mexico would not be able to meet its full debt payments of over $10bn in 1986 and the government began to negotiate openly a reduction in interest payments on its existing debts.

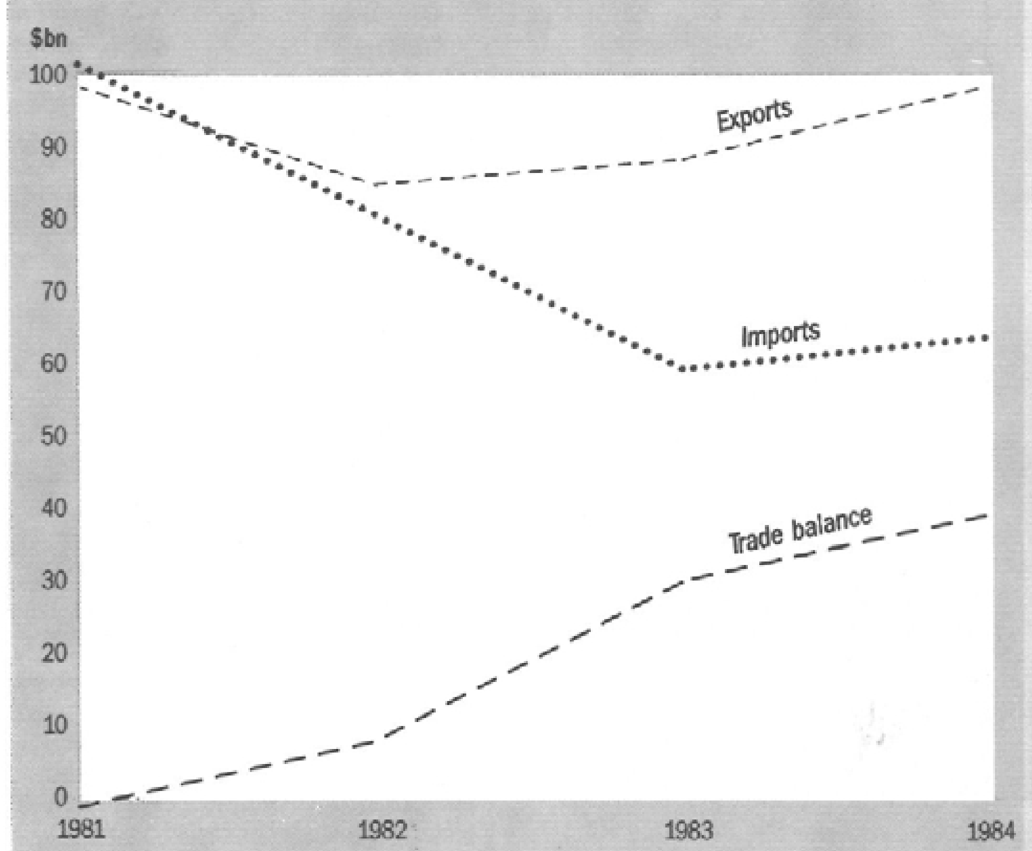
Even without the collapse in oil prices the debt crisis remained all too real. Almost every influence on the situation suggested that the chances of Latin American countries continuing to make full payments of debt service up to and past the end of the decade were slim.

The domestic social pressures against austerity policies were beginning to tell. In 1985 the Mexican elections encouraged the government to relax restrictions on public and consumer spending. As a result, the IMF threatened to suspend lending – a threat only partially lifted because of the Mexican earthquake. Even before the oil price fall, Mexico had entered 1986 without a new agreement with the IMF and the banks on economic strategy and on the $4bn of new lending, later revised to $6bn, the country would need to survive the year.

The longer term economic damage caused by austerity measures was also beginning to become apparent. The apparent initial success of the IMF 'adjustment' policies was based on the large trade surpluses generated in 1983 and 1984. But these were achieved almost entirely by cuts in imports to the region *(see graph above)*. It seemed unlikely that countries would continue indefinitely to maintain policies which prevented their own economic growth but transferred vast sums to the industrialised countries.

The debtor countries face another

Latin America's trade surplus



The main impact of IMF measures on Latin America's trade has been to force down imports, undermining future economic growth.

Austerity measures cut development programmes. (Shipibo education class, Amazonia, Peru).

fundamental problem from the shrinking markets for their exports. High levels of exports were maintained by the boom in the US economy. As the US Government takes action to reduce its deficit, and with little sign of a compensating expansion in Europe, world markets will shrink. More direct problems are caused by rising protectionism. The cut in Latin American imports cost as many as 400,000 US jobs and cut imports from the EEC by $6bn a year. Reciprocal demands for action against Latin American exports have grown.

There is little sign, either, of concerted action to bring down interest rates which are the immediate cause of Latin America's problems.

At the beginning of 1986, Latin American debtors faced a future in which they were expected to maintain transfers of wealth to the advanced industrial countries while the markets for their goods shrank, income from commodities fell, and the price of any new borrowing was austerity conditions which hit living standards, created social tensions and prevented economic growth.

Despite these gloomy portents, the bankers' fundamental assumption is that, at the end of the day, no country will be prepared to take the consequences of defaulting on their loans. The cost of isolation from the international community is said to be too severe: no new lending for many years; no credit to finance trade; diplomatic and political isolation.

As the crisis became more and more entrenched, this orthodox view has been challenged increasingly.

The consequences of default

It is by no means clear that the consequences of default will always be worse than the costs of continuing to pay the debt.

A defaulting country would be cut off from new lending. But, unless the new lending is at least sufficient to cover interest payments, the debtor will continue to export wealth. A defaulting country could retain more of its exports earnings. (There are numerous historical precedents also to suggest that, after a number of years, bad debts are effectively forgotten and lending resumes.) A country which has built up substantial reserves of foreign exchange as Brazil or Venezuela have done, or has a marketable asset in oil or minerals, might find it advantageous to default.

The penalties of default depend to a considerable extent on the ability of creditors to impose some form of effective sanctions. Refusal to lend is one. Action against trade finance is another. But if a debtor continued to pay its trade creditors, though not its commercial bank creditors, trade finance might well continue. Increased trade could also be achieved through the use – already apparent – of barter trade. More direct trade sanctions are again possible in principle, but much trade is conducted by multi-national companies which are unlikely to want their interests to suffer for the sake of the banks. Seizure of foreign assets is often mooted, but in many cases these would be privately owned and there would be considerable legal difficulty in taking these to pay off government debt.

Few analyses of the consequences of default suggest it would always be against the debtors' interests. A decision to default would not, however, be a simple economic calculation but a resolution of conflicting political pressures and judgement.

Is there a solution?

Several approaches to the crisis are in contention in both creditor and debtor countries. They range from radical strategies advocating default, associated with the Cuban President Fidel Castro, to the dominant western plan put forward by US Treasury Secretary James Baker. The debtors have met collectively in the Cartegena Group although little concerted action has followed. Only Peru has yet been prepared to take unilateral action.

The 'case by case' approach and the Cartegena group

The western governments and financial institutions have been particularly concerned to stifle collective action by the debtors. IMF/bank negotiations have been conducted on a strict country-by-country basis.

Different countries do have significantly different interests, of course. Their economies vary, and so does their power to threaten the banks. It is unlikely that Brazil or Argentina, for example, will risk their own interests in support of Peru or Bolivia. The major borrowers are to some extent guaranteed a serious consideration denied to smaller countries.

The inducements to individual debtors to negotiate succesfully are significant. The most compliant have been rewarded with MYRAs – Multi-Year Rescheduling Agreements – which reschedule all a country's debts, rather than just those falling immediately due. Western countries, including Britain, have shown willingness to make favourable trade credit arrangements open to 'responsible' debtors.

For these reasons, the debtors' organisation known as the Cartegena group has had only a limited impact. At their meeting in Cartegena, Colombia, the eleven members – Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru, Uruguay, Venezuela and the Dominican Republic – called for radical measures to resolve the crisis, including action to cut interest rates, extended grace periods on repayments, limits to the proportion of export earnings to be spent on debt services, and the transformation of interest due into new loans. The Cartegena Group has met regularly since June 1984 and has reiterated similar demands. It has become recognised, albeit informally, as the representative debtor organisation. To date, however, it has never sought to make the transition from lobby group to an initiator of coordinated action. The major debtors have often been accused of using Cartegena meetings as a tool in their own individual negotiations.

'Can't pay; won't pay'

A more radical attempt to promote concerted international action has been made by the Cuban leader Fidel Castro. Taking the simple proposition that the debt is unpayable and hence won't be paid, the Cuban Government has tried to bring together a wide range of political, cultural and labour movement leaders from across Latin America, culminating in a major conference in Havana in July 1985. Castro's strategy is not a simple call for default. He argues that international and collective negotiations between debtors and creditors are the best and necessary means of resolving the crisis. Default is an unavoidable option if such negotiations fail – or fail even to take place.

The supporters of the Cuban initiative include few people who currently hold political power in Latin America. Nonetheless, it is likely that the initiative and the views expressed by it will gather support in the absence of any other successful approach to the crisis.

Unilateral action: Peru's example

In the absence of any coordinated debtor strategy, few countries have pursued radical challenges to the orthodox policies advocated by the banks and the IMF. Brazil, the most powerful Latin American economy promoted strong economic growth during 1985 and was able to meet all its debt payments. On the strength of this performance Brazil was able to agree the rescheduling of $31bn of bank debt in March

The debt – Castro's view

'I suggest the following: that Latin America needs a grace period of approximately ten to 20 years as a minimum in terms of its foreign debt obligations . . . on the principal and the interest according to the country and its circumstances . . . This is not to solve the problems; it's only a start in order to have some relief, a breather. The problems of unequal exchange and the protectionist measures will have to be solved for the development of trade. In other words it would only be a breather for a new international economic order, just a respite. . .

Since the creditors are primarily private banks, the solution will be for the industrialised countries to take over the debts owed to the private banks if the bankruptcy of the financial system is to be prevented. The United States has a (huge) public debt and this would only increase it slightly. The aggregate Third World debt is less than what is spent every year in military expenditures and will have to be cancelled in the long run . . .

My opinion is that no other alternative exists. To try to collect this debt, at least in Latin America, would be socially explosive.'

(Interview with EFE news agency, Feb. 1985)

President Garcia has limited Peru's debt payments. Will others follow?

JENNY MATTHEWS/FORMAT

1986. The agreement was announced almost simultaneously with a wage and price freeze and other economic measures aimed at tackling the 225% inflation rate, which gained wide initial public support. Few other Latin American countries, however, have the ability to follow such an independent growth policy and still maintain full debt payments.

Only Peru has acted directly to limit the cost of servicing its debts. After his election in June 1985, President Alan Garcia announced that Peru would devote 10% of its export earnings to servicing its long-term debts and no more. Trade finance and multi-lateral creditors, including the World Bank, would take precedence over the commercial banks. (In practice, the commerical banks would get little or nothing.) Later in the year, Peru also suspended IMF repayment because the IMF had refused to give further loans. By the end of 1985 Peru's debt service arrears were about $400m. The strategy was coming under increasing pressure as continued World Bank lending was threatened with suspension.

Peru's debt of around $14bn is too small to threaten the banks directly. But for the first time a theoretical proposal had been translated into action. Peru has not yet had imitators within Latin America but, at the beginning of January 1986, Nigeria unilaterally limited debt repayments to 30% of export earnings.

The Baker Plan, the West's response

By the summer of 1985, a combination of the deteriorating world economic situation and the growth of concern that Peruvian-style debtor action might spread finally convinced the US Government that a new initiative was required. The Baker Plan was launched by the US Treasury Secretary James Baker at the annual meeting of the IMF and the World Bank in Seoul, South Korea, in October.

The Plan proposes that between 1986 and 1988 $40bn of new lending will be made available to the world's 15 largest debtors, 10 of which are in Latin America. Half will come from the banks, and half from the World Bank.

In some respects the Baker Plan is a radical change in policy; in others it represents the same conservative approach in a new package.

For the first time, the western governments and financial institutions appear to accept the need for rapid economic growth if Latin America is to have any chance of servicing its debts. New lending is vital and only a concerted new approach could produce it. The World Bank is seen by many Latin American governments as a more acceptable lending institution than the IMF.

But, at the core of the Baker Plan, the transfers of wealth will continue. The new lending is only a third of debt service payments Latin America must make over the next few years, and Latin America will continue to become ever more heavily indebted. The money available, and the terms on which it will be lent are far less than is needed.

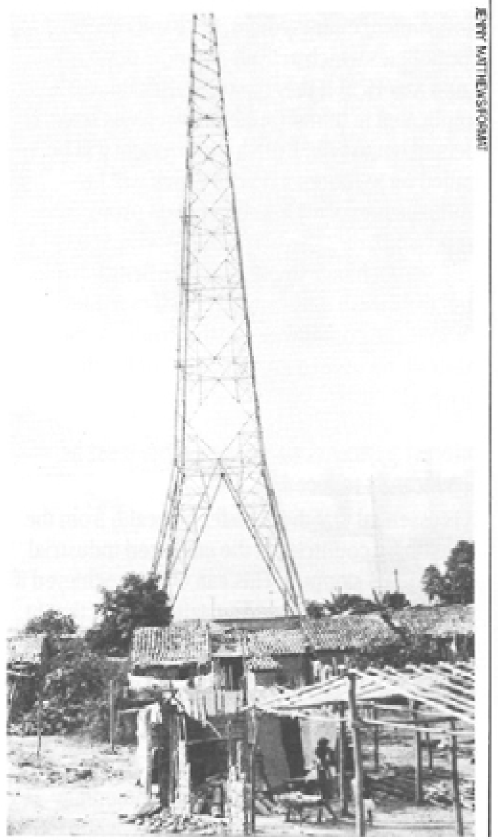
The money will come with strings that many debtors are reluctant to accept. 'Internal adjustment' policies will be required involving the wholesale promotion of free-market policies and the penetration of Latin American economies by multi-national companies. Protection of local industries will have to be dropped, price controls and wage indexation abandoned and public industries and assets put into the private sector.

The Cartegena Group, while cautiously welcoming the Baker Plan as a step in the right direction, have stressed its failure to provide sufficient resources and to allow for adequate economic growth.

The banks have also generally accepted the Plan, although many are seeking stronger guarantees from their own governments for the new lending they are being asked to make.

At the end of the day, the commercial banks have little option but to accept the Baker Plan. It is hard to resist the conclusion that the lending proposed by Baker has been calculated more to prevent major debtors defaulting than to produce any fundamental solution to the crisis.

Huge loans brought little benefit to the poor. These homes in Bahia, Brazil, have no electricity.



JENNY MATTHEWS/FORMAT

The Baker Plan – the Cartegena Group response

Meeting in Montevideo in December 1985 the Cartegena Group made nine proposals in response to the Baker Plan; in outline:

1 there must be a return to historically low rates of interest and bank profit margins must be reduced;

2 there must be an increase in the flow of funds to Latin America, and the issuing of new loans must be treated separately from the question of repayment of existing loans;

3 new lending must be at levels which keep pace with inflation;

4 there must be a limit to the transfer of resources from Latin America;

5 more resources must be made available from the multi-lateral organisations such as the IMF, World Bank and Inter-American Development Bank;

6 governments in the industrialised countries with outstanding loans to Latin America should be prepared to accept the multi-lateral restructuring of the principal and capitalisation of interest;

7 there must be an increase in the capacity of the IMF to make special provision for the economic problems faced by Latin American countries caused by balance of trade problems, high rates of interest, falling prices for commodities and natural disasters;

8 conditions imposed by lenders must be appropriate to the problems of each country and must allow sufficient economic growth and job creation to meet the needs of their population;

9 all actions to solve the debt crisis depend, in the medium to long term, on ensuring that protectionist measures which limit the market for Latin American exports are curtailed.

Solving the crisis – who benefits?

From the experience of the last four years, there is little immediate chance of a rational and internationally agreed solution to the debt crisis. The main debtors and creditors have never met together on even one occasion.

As the crisis develops the banks and the western governments will push for action which maximises repayments and limits new lending to the minimum which is economically and politically feasible. The debtor governments will continue to press for new finance, longer periods of payments, lower interest rates and freedom from austerity conditions. Within the debtor countries conflicts over the distribution of wealth and resources will grow.

The dominant hope in the western financial community is that the system will muddle through. If the Baker Plan can provide just sufficient new funds to persuade major debtors that cooperation is better than default the banks can live with the possibility of smaller debtors taking unilateral action. With luck, debtors may continue to meet and press for action but will exert little collective power.

If the situation holds some will benefit. The new adjustment policies which come with the Baker Plan will create more opportunities for multi-national companies to expand their strength within the debtor countries and to transfer public companies and resources to the private sector. As long as the banks are able to present their accounts in a profitable way they may feel they have more to lose by facing up to the problems of the crisis than by continuing to hope for the best.

Despite these hopes, the system remains unstable. Certainly, bankers do not panic at the word default as they did in 1982. They've learnt to live with Peru, Nigeria and South Africa limiting payments, and they might even be able to agree special reductions in interest payments for Mexico – although there would be real problems if all major debtors demanded equal treatment.

But even if the financial system was secure, the real debt crisis would remain. The possible collapse of the banks will be the issue that first attracts the attention of people in Britain, but the perpetuation of poverty in the interests of the banks is equally unacceptable.

Solutions to the debt crisis cannot simply be ways of keeping the banks in business. They must also open the way to a serious assault on the problems of poverty.

British banks and the British government will have a central role to play in the next few years. At present, with apparent government endorsement, the banks are pushing for policies which actively promote poverty in Latin America. If they continue, Britain will be implicated in human suffering on a vast scale. If default occurs the British Government will be called on to mount a rescue which will be immensely expensive and may well prove to be impossible.

A change in policy by the British banks and the British government is well overdue. Despite the complexities of the problem, the basic elements of a fairer way out of the debt crisis are clear:

Interest payments on existing debts must be significantly reduced

It is essential that the transfer of wealth from the developing countries to the advanced industrial countries is stopped. This can only be achieved if there is a substantial and sustained reduction in the interest burden on the debtor countries. Ideally, this would be achieved by a permanent fall in world interest rates – a 3% fall would reduce the debt burden by about $40bn, the same amount as the proposed lending under the Baker Plan. But there seems little immediate prospect of coordinated government action to reduce interest rates. In its absence interest payments must be cut by agreement to reduce the effective interest rates on existing debts.

Such action would inevitably hit the profits of the banks. But the banks have done well enough from Latin American debt and it is right that they should begin to bear some of the burden which has until now been placed on the poor.

New lending must continue, with the lead taken by governments and multi-lateral institutions

Banks can fairly be expected to take a loss on their existing loans, but new bank lending would have to be made on commercial terms. For this reason, banks are an inappropriate mechanism for providing the large inflows of money Latin America will need over the next few years. Reliance on banks will only recreate the same debt problems.

Most countries will be unable to pay commercial interest rates for many years, and many of the most important development projects which are needed by the poorest people are unlikely to offer a commercial rate of return. New bank lending should be left to 'traditional' investment in clearly commercial projects. New capital for more general lending should come from the western governments and institutions like the World Bank.

The needs of the poorest should be put first in any new lending

New lending is essential. At the same time, there is no point in recreating the conditions in which Latin America's wealthy are able to enrich themselves on borrowed money. It is inevitable that conditions will be attached to any new lending from the World Bank or other sources. These conditions should encourage social and development programmes and link lending to the redistribution of wealth and the fair sharing of the benefits of economic recovery.

New initiatives must be taken to promote world economic growth

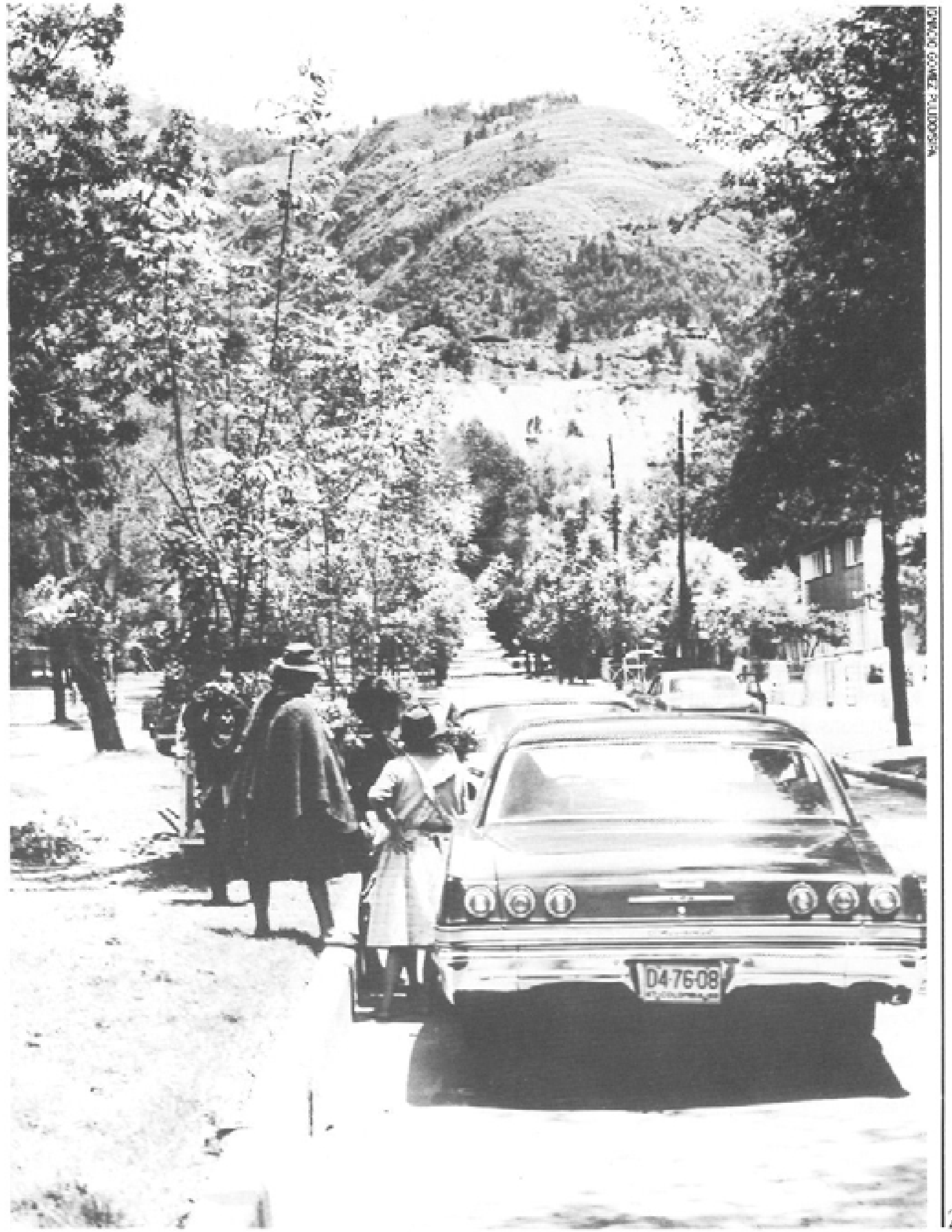
None of the measures proposed above *depend* on improved world economic conditions but their implementation will be eased considerably if both the developing nations and the industrialised world are achieving faster economic growth. The common interests of both advanced and developing countries must be recognised and action taken to reduce interest rates, promote concerted economic expansion in the industrialised world and to resist 'beggar-my-neighbour' protectionism.

Proposals for growth

Global Challenge, *published in 1985 under the leadership of Willy Brandt, the former West German Prime Minister and Michael Manley, the former Prime Minister of Jamaica, stressed the mutual interests of developed and developing countries in promoting economic growth. Their broad proposals include:*

- *an international commitment to sustaining an annual reflation of the world economy by an extra $100bn spending (equivalent to about 10% of the world's arms expenditure). This could produce increases in wealth produced of 20-25% in developing countries over 5 years;*
- *reconstructing multi-lateral financial institutions to ensure that, in contrast to the current role of the IMF, an international body exists in which developing countries are properly represented and which is able to provide the financial and stable conditions for economic growth;*
- *recognising the power which the United States wields to block such 'global' solutions, the potential contribution of individual governments and groups of governments is stressed. European governments, or groups of them, acting together and in coopertion with developing countries could make an important start towards global reflation.*

Rich and poor in Bogata, Colombia. New finance must reach the poorest people.



JENNY MATTHEWS/FORMAT

Will bank 'solutions' to the debt crisis benefit Brazil's landless sharecroppers?

In summary; a transition is needed that takes the burden of funding Latin American development from the commerical banks towards governments and multi-lateral institutions. As part of this transition, banks must take a major drop in profits in recognition of the irresponsible lending they have made in the past and of the large profits already received. New lending must be organised which favours the poorest sections of Latin American society.

The campaign in Britain

There are obvious limits to the unilateral action that can be taken by British banks and the British Government. No single bank could simply reduce its own demands for payment, for example, without inviting commerical suicide.

But these limits do not prevent the banks or the government from advocating and campaigning for the policies outlined above. The government's voice should be clearly heard at meetings of the IMF, the World Bank and of leading industrial nations; the banks should be arguing the same cause within the Advisory Committees and other banking bodies.

Strong public pressure will be needed. The secrecy which surrounds the banks' operations and their relations with the Bank of England and the government must be removed, and their activities opened up to public debate. Shareholders and customers, large and small, must ensure that their bank's involvement in the debt crisis is given close scrutiny.

Over the next few months and years, the banks and the government will be drawn ever more closely together by the debt crisis and the search for a long-term solution.
Will the government and the banks choose a solution which favours the poor of Latin America, or one which merely protects the banks?

The *Profits out of Poverty?* campaign aims to ensure that it is widely recognised that:

- the banks' lending in the 1970s was irresponsible, governed by the search for profits, and did little to benefit the poorest
- the austerity measures imposed by the banks with the IMF hit the poorest women, men and children hardest
- the banks are continuing to press for measures which create poverty while the contributions from the people of Latin America keep bank profits high
- the debt crisis not only threatens the people of Latin America but could cause a disastrous economic recession in Britain and the rest of the advanced industrialised countries.

By taking these 'causes for concern' to bank users, the development groups, local authorities, religious organisations, unions, women's groups, MPs, councillors, political parties and other influential individuals and organisations, *Profits out of Poverty?* intends to make sure that the banks and the British government place the poorest people in Latin America at the centre of measures taken to resolve the debt crisis.

For further information, contact WoW Campaigns Ltd, 37-39 Great Guildford Street, London SE1 0ES.

I enclose a donation* of £50 ☐ £30 ☐ £10 ☐ £______ to support War on Want's work in Latin America.

Please send details of covenants ☐ Please send details of the campaign *Profits out of Poverty?* ☐

*Donations returned with this form will be used exclusively to support development projects in Latin America.

Name ____

Address ____

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Please return to: War on Want, Freepost, Room 53C, 37-39 Great Guildford Street, London SE1 0YU.

The *Profits out of Poverty?* campaign is run by WoW Campaigns, the campaigning associate of War on Want. War on Want supports development projects in 5 Latin American countries, working with local people to develop education, health services, employment and agriculture. Your donation can't pay off Latin America's debt but it can bring immediate help to some of the poor today.

WHAT YOU CAN DO:

- Write to the Chairs of the 'big four' banks, expressing your concern about their bank's role in the debt crisis:
  Lord Boardman, NatWest Bank plc, 41 Lothbury, London EC2P 2BP
  Sir Kit McMahon, Midland Bank plc, Poultry, London EC2P 2BX
  Mr John Quinton, Barclays Bank plc, 54 Lombard Street, London EC3P 3AH
  Sir Jeremy Morse, Lloyds Bank plc, 71 Lombard Street, London EC3P 3BS.
- Form a *Profits out of Poverty?* campaign group.
- Contact local organisations and individuals, drawing their attention to the banks' role in the debt crisis, and asking them to voice their concern.
- Organise leafletting of bank customers and other publicity events.

Campaign materials including a local activity guide are available from WoW Campaigns Ltd, 37-39 Great Guildford Street, London SE1 0ES.

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Bolivian women – who have a tradition of protest action – demonstrate against austerity measures, La Paz, March 1985.

WAR ON WANT

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