On Debt and War

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It brings no satisfaction to be able to say 'I told you so' when one has correctly predicted economic or political disaster. Ten years have passed since Dan Smith, writing in *The Debt Boomerang*, edited by Susan George, warned of the dire results which the mounting burden of foreign debt would have in generating war and brutality in the Third World. In the book which I wrote at the same time with Pauline Tiffen, entitled *Short Changed*, we went further and demonstrated the direct connection between foreign debt and the threat of growing violence and war in sub-Saharan Africa, through the structural adjustment measures required by the International Monetary Fund and the World Bank to deal with the debt, especially the requirement of increased commodity exports and their consequent declining prices. We were even able to quote a high-ranking World Bank official, Mr Kim Jaycox, concluding his report in 1990 on 17 African countries: 'The financial crisis is so deep, the debt burden so heavy that they will not make it. [In these countries the structural adjustment programmes] will not, in fact, work unless there is an increase in the flow of resources from outside.'

Mr Jaycox estimated conservatively that the short-fall would be at least one billion dollars. If, as we wrote, 'agricultural commodity prices were to recover to the average levels of 1980-84, it is possible that this gap could be met'. We did not expect it to be, and it wasn't.

Our predictions were only too horribly fulfilled. To genocide in Rwanda, civil war in Sierra Leone and communal violence in Nigeria were added the breakdown of law and order in Algeria and renewed war between Eritrea and Ethiopia. In all cases the association with high levels of foreign debt and the requirements of structural adjustment was evident. But the association of debt and war was no longer confined to Africa. Conflict in the Balkans and the break up of Yugoslavia, according to the best placed commentator, Susan Woodward of the Brookings Institution and senior UN adviser in Bosnia in 1994, should be attributed to the impact of foreign debt and the economic reforms required by the IMF to obtain finance to meet debt repayments.

'The conflict,' Ms Woodward wrote in her book *Balkan Tragedy* 'is not a result of historical animosities or the pre-communist past; it is the result of the politics of transforming a socialist society to a market economy and democracy. A critical element of this failure was economic decline, caused largely by a programme intended *to resolve a foreign debt crisis* (emphasis added). More than a decade of austerity and declining living standards corroded the social fabric and the rights and securities that individuals and families had come to rely on.'

It is often argued (by Misha Glenny for example in his *The Third Balkan War*, Penguin 1993) that only a strong central power had kept the separate ethnic groups in Yugoslavia from killing each other. Tito certainly united all Yugoslavs against the German and Italian invaders and their Axis allies, and, it is said, that when he went, internecine war was inevitable. But all previous strong central power, coming from outside – Turkish, Hungarian, Austrian, German, Italian – had been established by dividing, not uniting, the South Slavs. American power can now be added to the list. Between invasions these various Slavs of different religions and nationalities had, for hundreds of years, lived side by side in peace in their towns and villages. Left alone, and given time to recover from a worse destruction than had ever been visited on them before, they will settle back together again. But they need help that is not divisive.

Accumulating foreign debts had equally disastrous results in Latin America. But here, instead of increasing exports of commodities, whose value in world markets was steadily declining, peasants in Peru and Bolivia switched to growing better-priced coca for the American drug barons. Strong armed action by the United States and by dependent local governments to suppress this illegal traffic at source led to peasant resistance, most notably in Peru by the Shining Path Guerrillas. Another revolutionary armed group representing the socially excluded suffering from economic decline established a famous siege of the Japanese Embassy in Lima, holding hundreds of distinguished guests as hostages, some for several weeks. Once again, the story in the media was of ancient ethnic struggles – this time between indigenous Indians and European settlers – without a word about the burden of debt to be paid to European and American banks and the demands of the international financial institutions to cut back public spending so that debts could be repaid.

Debt and development

Nearly all countries which have achieved advanced levels of economic development have relied on foreign loans in the initial stages of that development. The exception is Britain, which defeated the other European powers for the lion's share of colonial plunder as the main source for industrialisation. How is it that the developing economies of today have (with exceptions in East Asia) failed to use their foreign borrowing to advance their development? The answer is complex. It is generally averred by creditors in the North that the borrowings were dissipated in the purchase of arms, and in the private salting away of funds by corrupt and tyrannical dictators. There is some truth in this: Marcos in the Philippines, Suharto in Indonesia and Mobutu in the Congo are cited as outstanding examples. But who created and for long sustained Marcos, Suharto and Mobutu? In fact, the big build up of arms exports to the developing countries took place in the 1970s. Sales declined in the 1980s, but it was in the late 1980s and 90s that the worst violence and civil wars erupted.

It is necessary to go back to the period of colonial rule to explain the emergence of these dictators and to understand the failures of the presently 'developing economies'. For these lands all once came under the rule of Britain and other colonial powers. The essence of colonial rule was that the colonies should supply the raw materials for the industrialisation of the metropolitan country. They therefore started from an unequal division of labour, from which it was not easy to extricate themselves. Only in South-East Asia was the Japanese empire based on some development of refining and manufacturing in the colonies. When, elsewhere, the colonial peoples achieved their independence, the new nationalist leaders were drawn from those landed and merchant classes which had been involved in the colonial trade or saw great advantage from continuing it, at best to finance their development programmes, at worst to build up personal fortunes and finance their clienteles. Revolutionary leaders like Sukarno in Indonesia and Patrice Lumumba in the Congo were disposed of together with their followers by intervention from the imperial powers.

For some years after independence the division of labour between manufacturing in the North and raw material production in the South was not too harmful to the South. World prices of commodities, apart from oil, were high, and the rate of economic growth of the developing countries actually exceeded that of the developed. This did not last, and for several reasons.

The first was that non-oil producing countries were hit by the oil price hike in the 1970s, and began to borrow heavily to sustain their imports and development programmes.

The second was that interest rates on this borrowing were raised sharply so that loan charges grew, and debts accumulated.

The third was that non-oil commodity prices began to fall. This was not only the result of a temporary recession in the developed countries, but of a more permanent switch from natural materials to artificial substitutes, as in the case of textiles, and in food products like sugar and palm oil from tropical supplies to subsidised temperate sources. Moreover, as standards of living rise the demand for physical goods rises more slowly than the demand for services; and modern micro-technology uses less and less material per unit of output.

Why then, one may well ask, did the developing countries (other than those in South-East Asia) not switch from primary commodity production to manufacturing? Some tried, especially in Latin America and in India, but two obstacles stood in the way. First, many of the ruling groups in these countries were, as already noted, tied in to the old colonial trade, and it paid the imperial powers to keep it that way. So it was that, secondly, the already industrialised countries of the North maintained protective devices – tariffs escalating with the value added to the primary product, non-tariff barriers and quotas, control over new technology – which made it difficult for infant industries to establish themselves in the South. Only the Japanese operated a somewhat different system of sub-contracting in East Asia, which permitted an independent manufacturing base to be established in South Korea, Taiwan, Singapore, China and Hong Kong.

These obstacles would have been serious enough, but such uneven development was exacerbated by the policies of the IMF and the World Bank, which required debtors to pay off their debts through expanding commodity exports *and* to open up their markets to goods from the North, with which their new industries could not hope to compete. A major reason for the success of the East Asian countries' industrialisation was that they rejected the advice of the international financial institutions and protected their infant industries until they could compete in world markets with Japanese assistance. Producers of primary commodities were, moreover, increasingly brought by the requirements of these institutions under the market control of giant mining and trading companies. These trans-national companies were not only able to divide and conquer the many millions of small primary producers, thus reducing the world market prices of their products, but to operate transfer pricing policies which concealed from the original producers the actual market value of their produce, and also the actual price of the inputs of materials – chemicals and equipment – that they supplied. It has been estimated that the African countries with mining operations would now have no foreign debts had they been paid in full the world market price for their minerals in the 25 years from 1975; and this is taking into account even the steady decline in world mineral prices compared with manufactured goods' prices over the period.

Debt and disorder

It still has to be explained why rising foreign debt and falling commodity prices should lead to such disastrous disorder, and even to genocide and civil war. We shall try to trace the steps which lead from debt to disorder. Debt carries with it the demand for annual service payments of interest, and possibly some part of the principal. These payments have to be found from the export earnings of the country concerned in the required currency or in one that can be converted. If these earnings cannot be increased, or some other foreign expenditure reduced, it soon becomes clear in the foreign exchange markets that there is a payments deficit. The value of the debtor country's currency relative to the convertible currency – dollars, sterling, francs, deutschmarks, yen – will go down. The government may try to borrow from the international financial institutions to defend its currency, but this, of course, only adds to the debt.

The results of a declining exchange rate for any country's currency are twofold: imports become more expensive for home buyers; exports become cheaper for foreign buyers. The balance of advantage for the country and for any of its individual citizens will depend on whether they can sell more goods for export at the lower price without losing too much from the higher price of imports. Given the general decline in demand for commodities, which we have noted, with all countries trying to increase their exports to pay off their debts, the result for commodity producers will be like running faster and faster just to stay in the same place. The nice equilibrium that economists expect to result in rising demand from falling prices simply does not come about in a world of surpluses.

The remedy that is recommended by the international financial institutions, the IMF and the World Bank, is that governments with indebted economies should cut back their spending to release goods and services for export. But this does not work. Spending on health and education is essential for an effective local labour force. Spending on roads, the electricity network, sewerage and water supplies and communications is necessary to maintain the basic infrastructure of the country. If this is allowed to decline, not only are local businesses affected and the quality and reliability of their products brought into question, but foreign investment is discouraged. There arises a vicious downward spiral of falling confidence. The results are cumulative. While prosperity attracts, poverty repels. Many examples were given in our book on Africa and world trade, entitled *Short Changed*.

The result of these imbalances will affect different groups of people in quite different ways. There will be a great difference between the situation of those who control an export business and may be able to earn more from increased exports, and of those who simply get the lower price and have to pay more for imported goods, especially for food and kerosene and other essentials. Economists talk about a 'trickle down effect' from the rich to the poor in a prospering economy. This does nothing to reduce the inequalities, but in the case of foreign debt the result is much worse. There is a 'flood down effect', but it is a flood of losses and not of benefits. Governments and businesses alike pass on the debt by cutting their expenditure, being encouraged to do so by the international financial agencies. What this means is sacking their workers or reducing their pay. While the rich may survive, the poor face unemployment, starvation wages and their own burden of debt.

Rising prices of imports will not only lead to reduced purchasing power and unemployment in businesses that depend on imports, but also to higher local interest rates for borrowing. This is because those with money will want to see a real yield for their money during the year, and that is over and above the rise in prices. The higher the rate of inflation, the higher the local interest rates will be, and they will generally be well above the inflation rate. Bank rates will be high enough where borrowers have some assets as collateral. For those without assets, rates will be much higher, as high as 100%, and with a fixed pay-back time. Some people in an indebted country will have access to foreign currency, either through tourist services, remittances from abroad or other export earnings. They will be able to remain immune from the country's troubles and may benefit from operating a black market, especially where the government tries to keep its currency above the level set on world markets. It is a common experience of foreign visitors to indebted countries to find themselves approached by money dealers with offers to change their money at well above the official rate.

It is not difficult to see what a witches' brew is here being concocted from the national debt – rising prices and interest rates, mass unemployment, reduced government services, lower wages and incomes for farmers and growing inequality, especially between those with access to foreign currency and those suffering from the declining value of the local money. As more and more of the country's resources have to be devoted to servicing the debt and less and less goods are imported, the money that peasants and workers receive, little as it is, finds nothing to buy in the stores. Those who have money push up the prices. The rate of inflation accelerates. The government is forced to print money to pay its armed forces, police and officials. The local money becomes worthless. Hyper inflation reigns at rates of 1000% and more. The government has either to abdicate and allow chaos to reign and the black market to take over, or they can issue a new currency tied to some strong foreign currency, and take in all the old money at its current almost worthless value. Anyone who does not own property or have access to foreign currency, and has savings in local money, loses everything. Only a government which has strong force at its command and/or strong popular support can survive such a disaster.

The breakdown of law and order

All governments, even the most authoritarian, need to maintain a certain cohesion in their populations and win a degree of legitimacy for their actions. For this, four essentials are required by the people: protection from outside attack, maintenance of internal law and order, the opportunity to earn a living, and a money that can be relied on. It is now obvious how far these will be threatened by a large burden of foreign debt. A high rate of unemployment, especially when combined with a high rate of inflation, can always be found to lead to increased crime – theft and personal violence. In England and Wales, the Catholic Bishops Conference of 1996 made a particularly strong point of this association. But the actual breakdown of law and order, leading to violence in the streets, to civil war and even to genocide, does seem to require a wider explanation. It is clear that the situation must have reached an extreme point, of mass unemployment or collapse of earnings or galloping inflation, but very great hardship may still be borne where everyone in a society appears to be suffering equally. To trigger violence and disorder, there has to be, in at least one part of the population, a profound sense of injustice at the inequalities of suffering.

Of course, inequalities are normally found in capitalist societies, and such inequalities have been widening in recent years in both developed and developing societies. This seems to be largely the result of the reduced share of the national income devoted to state spending on health, education and other social provision which acted in effect as a redistribution through the tax system of income from the rich to the poor. This reduced spending was aggravated in most countries by a switch from direct taxes falling most heavily on the rich, to indirect taxes which fall most heavily on the poor. In many indebted developing countries, as we have seen, cuts in spending were actually required by the IMF and the World Bank as a condition of aid for debt repayment. The poor suffered most, but this is not an unusual situation. Unemployment and inflation, whenever and however they arise, tend to strike hardest at the poorest groups in society.

What seems to have been the cause of violence breaking out in highly indebted countries has been the injustice experienced by one or more groups in society. Obvious examples are the Catholics in Northern Ireland, non-Russians in many parts of the one-time Soviet Union, the Hutus in Rwanda-Burundi, the rural population in Algeria, indigenous American Indians in Peru. The case of Yugoslavia is particularly indicative of the direct effect on inequalities of the burden of foreign debt. The debt had been incurred by the Federal Government, which was also responsible for the welfare system based on a redistributive tax, taking most from the richer industrialised republics in the North – Slovenia and Croatia – and benefiting most the poorer raw material producing lands in the South, Bosnia, Macedonia and Kosovo. As the burden of debt repayments increased, the Federal Government, under directions from the IMF, reduced its redistributive payments, but still seemed to the rich northern republics to be making unreasonable demands on them to aid, as they saw it, their less hard-working brothers in the South. Nationalist demands for independence from federal power grew steadily more insistent in the North.

One particularly divisive result of a heavy foreign debt burden is that the collapse of the local currency does not affect all groups in an indebted country equally. As we have seen, some have access to foreign currency through tourism, remittances from abroad or from work in foreign enterprises. In Peru, some had access to 'coca dollars' from the drug trade. In Yugoslavia the divisive effect of access to deutschmarks or lira was closely connected with the division between the rich north and the poor south. Workers from all over Yugoslavia went to Germany as *gastarbeiter* and brought back their earnings while the German boom lasted. The main advantage, however, lay with those who worked in tourism and in enterprises jointly owned with German and Italian capital, where they could keep the foreign currency they earned. These were mainly to be found in the rich northern republics of Slovenia and Croatia.

There had to be historic cultural and religious divisions already existing which led to the animosity between a mainly Catholic north and Moslem south with the Orthodox Serbs in between. But for centuries the different groups had lived together in their towns and villages generally at peace. This was true wherever there were mixed populations throughout Bosnia, in southern Serbia, in large parts of Croatia and in Kosovo and Macedonia. It had only been the divide and conquer policies of occupying imperial powers that led to periods of conflict and ethnic antagonism. German recognition of the independence of Slovenia and of

Croatia, with no guarantees for the Serb and Moslem minorities, and American actions in Kosovo can be seen as a continuation of what the Turks, the Hungarians, the Austrians, the Germans and the Italians had done before. Ethnic 'cleansing' so-called today, as is becoming increasingly clear, has been the result, not the cause, of foreign intervention.

Is there an alternative?

It has been argued here that the economic and political effects of heavy foreign indebtedness have been exacerbated by the structural adjustment programmes of the international financial institutions. By contrast, the argument of the economists from the IMF and the World Bank has been that there was no alternative other than the further opening up of the indebted countries' economies to the world market, and the reduction in these countries of government spending. This rule was applied equally to all countries, whatever their previous regime and culture. There was one fish that escaped the net – the Republic of Cuba. Her economy was based heavily on trade and aid agreements with the Soviet Union and other countries of East Europe. When this was withdrawn in 1989 the country faced disaster. Since the missile crisis in 1962, the United States had enforced a virtual economic blockade of the country. This was not relaxed, rather reinforced with the aim of bringing down the Castro regime. Between 1989 and 1993, as Robin Blackburn has described it (*New Left Review*, July-Aug, 2000), Cuba lost 70% of its exports, 75% of its imports. National income fell by a third. The currency became worthless. Food and essential medicines were scarce. Power cuts were frequent. Today, after a slow and gradual recovery, foreign debt still amounts to $13 billion, ten times the value of goods' exports; and the payments deficit remains, although the tourist industry is beginning to fill the trade gap.

How is it that Cuba has not collapsed into violence and inter-ethnic struggle? The population is extremely mixed – of European, African and Indian origin. A part of the population has access to dollars from tourism and the remittances of relatives in the United States. There are, in effect, two economies, as Blackburn describes the situation, because of the circulation through the tourist trade of the dollar as a second currency. It looks like the witches' brew we identified in Africa, Yugoslavia and most of Latin America. Yet, there was no serious disorder or inter-ethnic violence. It can be said that many of the richer Cubans had escaped to Florida. It can be said that the beauty of the beaches and the proximity to North American tourism saved the country. It can be said that a ruthless military and police regime kept the cap on any smouldering revolt. But all these things can be said of other indebted countries – Algeria for example – and they did not stop the eruption of violent conflict bordering on civil war.

The answer must be that Cuba did *not* follow the IMF prescriptions. In a recent interview with a former Director General of UNESCO, quoted by Blackburn, Fidel Castro claimed that 'We did not close down a single health-care centre, a single school or day care centre, a single university, or a single sports facility . . .

What little was available was distributed as equitably as possible'. And Castro went on, recovery was possible because Cuba had not been forced to follow IMF prescriptions:

> 'During those critical years, the number of doctors doubled and the quality of education improved. The value of the Cuban peso increased sevenfold between 1994 and 1998, and has remained consistently stable. Not a single dollar fled the country. We acquired experience and efficiency on a par with the immense challenge facing us. Although we still have not reached the production and consumption levels we had before the demise of socialism in Europe, we have gradually recovered at a steady and visible pace. The great hero in this feat has been the people, who have contributed tremendous sacrifices and immense trust. It was the fruit of justice and of the ideas sowed over 30 years of revolution. This genuine miracle would have been impossible without unity and without socialism'.

Of course, it is not being pretended that Cuban society is perfect. There should be alternative candidates in the Popular Assemblies. Political prisoners should be released. Many of those who left should be allowed to return. But the prospect of a flood of rich refugees from Florida with North American capital is a frightening prospect. It is sometimes argued that the blockade is all that keeps Castro in power, but this is not how his government sees it. They would like to see a relaxation of the blockade. They do not favour the total de-linking that some commentators from the North would wish upon the developing countries. They need the technology of the North, and trade with the North, but on fair terms. What they do not want is the full IMF package, and we know how wise they are. But under the North America Free Trade Agreement (NAFTA) they would have to accept the free movement of American goods and American capital throughout the Cuban economy. What has happened in Africa and Latin America and recently in Eastern Europe must convince them that this would be an invitation to disaster.

There is an alternative then, but democracy must not be tied to so-called 'free' markets, which are free only to the most powerful traders. The debts of the poorer developing countries must be fully and unequivocally cancelled. The lenders have already had more than their pound of flesh. Moreover, the present practice of making debt remission conditional on so-called 'economic reforms' – the very policies which have proved so disastrous, and which Cuba eschewed – must be ended. If the creditors cannot be persuaded to remit without some guarantees from the debtors, let these be discussed with them, not, as at present, dictated. But the framework for new agreements cannot any longer be the now hopelessly discredited structural adjustment programmes or the requirement of opening to global capital without the right for the developing countries to control this process so as to pursue internal policies that are best suited to their particular circumstances and the stage of their economic development.

The alternative must thus comprise firm limits to the opening up of developing countries to the capital of the developed countries in the ways that were proposed in the Multilateral Agreement on Investment (MAI) and introduced by the revised World Trade Organisation (WTO). It was the resistance of the developing countries' delegates at the WTO conference in Seattle in 1999, as much as the protests on the streets, that halted the steam-rollering of American measures for bringing the whole world under the rule of American capital. Such resistance shows that the power of capital is not unlimited. Resistance everywhere is to be encouraged, but resistance on its own is negative. It needs a complementary positive programme. An alternative way of bringing the new technology of the North to meet the needs of the South still has to be found. But the seeds of a new way are being sown by the Fair Trade movement in bringing commodity producers in the South into direct contact and joint partnerships with consumers in the North. Already, this movement is radically altering the coffee market, and the chocolate and tea markets are under siege from alternative traders. The movement will grow to embrace many other commodities, because it has the growing support equally of the millions of commodity producers in the South and the millions of concerned consumers in the North.

Footnote: The potential of the Fair Trade Movement has been fully explored in a two-volume report commissioned by the British Department for International Development (DfID), edited by Michael Barratt Brown, Robin Murray and Pauline Tiffen of Twin Trading, entitled *Understanding and Expanding Fair Trade*. The report includes case studies of coffee, tea, cocoa, bananas, brazil nuts and ground nuts. TWIN and Twin Trading have also prepared a *Summary of the Fairtrade Movement in Europe*, which includes recent (April 2000) estimates of values of sales of different products.