THE 1980s CREDIT CRISIS

By Dan Armstrong

Capitalization through loans and credit is the universally accepted method of Third World development. It has been going on in one form or another since the end of the Second World War. Early on, as Europe and Asia recovered from the war, almost all Third World development loans originated from the World Bank, which operated out of Washington, D.C. under the oversight of the U.S. Congress. Because of this, a large portion of the Third World development was directly tied to U.S. foreign policy and the U.S. monetary system. Through the early portions of the Cold War, with the United States wearing the white hat and riding a tremendous economic surge, this process appeared to be working. Links between the United States and Third World development were, at least superficially, still politically correct. The world held a brighter future.

This began to change in the early 1970s. An increasing Vietnam War debt forced the United States to take the dollar off the gold standard, effectively floating it against the other currencies of the world and causing the dollar to inflate radically. During this same period of time, the Organization of Petroleum Exporting Countries (OPEC) raised the price of oil, which was set in American dollars, seventy percent, partly to keep pace with U.S. inflation, partly for political reasons associated with the Yon Kippur War, and partly because oil reserves in the continental U.S. had surpassed peak production. After a period of turmoil that included a U.S. embargo of OPEC oil and long lines at U.S. gas stations, the United States accepted the new oil prices with one critical condition; the profits OPEC made from American buyers would be invested in American banks through special high yield twenty and thirty-year certificates of deposit. This dark and tenuous wedding of OPEC and the American banking system was the starting point of a credit crisis that would rip through the Third World in the 1980s.

With the resultant surge in profits connected to the increased prices, OPEC infused huge quantities of cash into the American banking industry beginning in the 1974. Significant portions

of this oil money, multiplied by the methods of fractional reserve banking (a one billion dollar reserve expands to more than $30 billion in loans), were then loaned to developing countries all around the world. This so-called "petro-dollar recycling" would allow developing countries to afford oil at the new price.

In many cases, because the money was there to be loaned, eager American bankers offered sums well beyond the reasonable carrying capacities of the borrowing countries. Ten years down the line, as sliding interest rates rose with an inflating American economy, the most indebted of these nations were in danger of defaulting on their loans. Such was the size of these loans (in excess of $800 billion then), the extent of their diversification into other banks and holding companies, and their financial expectations, the world financial community in its desperately complex interdependence could not allow these Third World loans to fail for fear of bringing down the entire banking system.

Noted journalist William Greider tells the story in vivid clarity in his book on the Federal Reserve Bank, *The Secrets of the Temple* (winner of the *Los Angeles Times* book prize in 1988):

> "In a formal sense, this (Mexico's loan default) was the starting point for what became known as the international debt crisis—actually, a continuing series of crisis points, as one country after another approached the brink of insolvency, then appealed for relief from the Fed, the international lending agencies and private banks. Within the next year, fourteen other nations would undergo the same trauma that Mexico experienced in August of 1982—accepting new conditions of domestic austerity in exchange for new credit from the International Monetary Fund and the international banks. Each time a nation approached default, the international banking system was threatened anew, and each time, Paul Volcker (then Fed Chairman) and his aides from New York and Washington would play the crisis managers.
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> In a more fundamental sense, the debt crisis had its origins in the collision of purposes with the Federal Reserve itself. In the late seventies and early eighties, the Fed and other regulators had failed to impose prudent limits on the money-center banks and their zealous lending to the Third World. They had issued mild warnings occasionally, but they had not tried to stop the risky lending. Then, starting in 1979, Volcker launched his aggressive campaign to break inflation, rationing money tightly and imposing stern discipline on the world economy. The global liquidation collided with the mountain of LDC (Lesser Developed Countries) debt."

What began as big banks making excessive and imprudent loans initiated dynamics (much like the recent sub-prime mortgage fiasco) that would ripple through the world economy.

As the LDCs lined up one after another at the loan windows of the IMF or World Bank, the bankers took over management of each country's economy as part of the new refinancing program. That is, in the complex web of international finance, new loans were procured so that interest payments on old loans could be maintained, so as not to bring down some of America's biggest banks (Citibank, Chase Manhattan, Chemical Bank, Morgan Guaranty, Bank of America, to name a few) and the rest of the international banking community with them. Stipulated in these new loans was that the IMF would send its own financial managers, as economic supervisors, to the LDC in question to make sure this second loan was applied properly. Unfortunately, in many cases a third and fourth such "austerity" loan was necessitated to keep the system afloat. This method of maintaining these generations of loans became a horrid strike against the people, the environment, and the resources of the LDCs. The United Nations *World Food Summit Technical Papers* from 1996 describe the situation:

> "During the mid and late 1980s, the conditionality required by the IMF and the World Bank on stabilization and sectoral adjustment loans was perceived as stringent, rigid, and unbending. The resultant belt-tightening and austerity were often associated with wrenching drops in real incomes and levels of living, primarily hurting those least able to adjust. Some countries rebelled at the severity of the adjustment measures imposed by the IMF and the World Bank, often in the face of civil unrest in opposition to imposed austerity."

In an effort to revitalize the LDCs economies and to accelerate the loan payments, the IMF managers instituted programs that borrowed heavily from the futures of these Third World countries. In the name of loan re-servicing currencies were devaluated, forests were sold off to transnational lumber companies to be clear cut, mineral rights were sold off to be strip mined, social programs were laid to waste, and critical imports, food and medical supplies, were cut for lack of funds. Though employment temporarily climbed as companies came in to reap the harvest, it was at reduced wages and with eventual lay-offs. Generally, all fiscal sources were squeezed to service these debts that were generated out of "synthetic" money created by making loans that were foolhardy in the first place! In some cases half a country's export earnings would go simply to paying interest on these re-serviced debts, with results further described in *The World Food Summit Technical Papers*:

> "Most people in highly indebted African and Latin American countries suffered a severe drop in living standards during the eighties. In Mexico, for example, real wages declined by more than 40 percent in 1982-88. In 1983, a basket of basic goods for an average family of five cost 46 percent of the minimum wage; by 1992 it cost the equivalent of 161 percent. Deepening disparities have widened political riffs; one result was the uprising of impoverished peasants in the southern state of Chiapas in early 1994."

Subcommandante Marcos, resurrection leader in Chiapas, addressed this ignored reality of financial chain reaction in vivid language to the rest of the world via the internet from the La Lacandona Jungles in August of 1992:

> "In Chiapas, Pemex (the national oil company) has 86 teeth clenched in the townships of Estacio'n Jua'rez, Reforma, Ostuaca'n, Pichucalco, and Ocosingo. Every day they suck 92,000 barrels of petroleum and 517,000,000,000 cubic feet of gas. They take away the petroleum and gas, and in exchange leave behind the mark of capitalism: ecological destruction, agricultural plunder, hyperinflation, alcoholism, prostitution, and poverty."

Loans made in the name of development and economic independence had become financial chains. And these over zealous "petro-dollar recycling" loans of the 1970s were unwarranted, at least in size, from the beginning. They placed undo pressure on LDCs to industrialize more quickly than their situation allowed. Sadly, corrupt Third World leadership eagerly took the money for immediate gain, mansion homes and Swiss bank accounts, while mortgaging away their country's hopes for the future.

Incredibly, this same system of loan apparatus and structural adjustment is still maintained by the largest international banks today. Changes have been made, but, for the most part, the debts and the imposition of trade conditions and neo-liberal philosophy remain. That is why a Bank of the South could be so important for South America.