1985: The prelude to a global financial breakdown

by David Goldman

Major commercial banks finally endorsed U.S. Treasury Secretary James Baker III's program to contain the debt crisis, two months after he had unveiled it at the October annual meeting of the International Monetary Fund in Seoul, South Korea. Baker's scheme, the first official American admission that the debt crisis is *global* in nature, will probably shatter upon the debtors' objections to the most brutal of its terms: that they auction off major national assets, e.g., their petroleum companies, for a fraction of their underlying value, in return for additional loans.

What guarantees the failure of the Baker Plan, however, is the relentless spread of depression in international trade. World exports, running this year at a flat $1.7 trillion annual rate, remain 10% below their 1980 level. The industrial nations' imports of raw materials are even more depressed, at 12% below the 1980 level. For the largest Ibero-American debtors, the situation is much worse: An *Executive Intelligence Review* study included in our most recent *Quarterly Economic Report* showed that exports to the United States of a basket of 18 agricultural and industrial commodities fell by 34.9%, in terms of physical tonnage, during 1980-83. The Ibero-Americans, meanwhile, increased their exports of energy-intensive intermediate goods by a staggering 153.2%.

Although the overall decline in trade is somewhat exaggerated by the much higher value of the American dollar, in which these figures are expressed, the financial results are what matter here: They reflect a 31.2% fall (according to the International Monetary Fund index) of the price of all commodities since 1980, including a 10% fall in the 12 months through 1984.

The 12% decline over 1979-84 in OECD nations' absorption of commodity imports, mainly from the developing sector, compares to a 58% rise between 1975 and 1979, the last period of industrial growth in both the developing and developed nations. This 70% swing in commodity export growth rates between the two periods explains the devastating fall of commodity prices, and makes the present situation parallel the 1929-34 period, when commodity prices fell by approximately 50% overall.

OPEC's decision in December to raise rather than restrict exports, provoked by Anglo-Norwegian-Soviet dumping of crude oil, has already pushed crude oil prices down by more than 10%, and threatens to bring oil prices down by an additional 25%. The situation is even bleaker in some other markets. After the bankruptcy of the Tin Producers Council last October, it is expected that the re-opening of tin trading will occur at roughly half the previous price level for the widely traded metal. In this context, a further 20% decline in raw materials prices during the next two quarters would be no surprise.

Leaving aside the disastrous results in the agricultural and energy-producing sectors in the United States, which are chiefly responsible for the 113 bank failures during the year to date, the situation of the developing nations has become insupportable. The London *Economist* described the effects of the price collapse as a $65 billion "poor man's gift" to the industrial nations, and warned bluntly that a financial crisis would ensue unless something were done about it. The situation is even worse than the commodity indices show. An *Executive Intelligence Review* study demonstrated that the biggest Ibero-American debtors lost 35% of their export prices between 1980 and 1983 alone, i.e., an amount even larger than the decline in the prices they obtained for those exports traded on global commodity markets. That reflects the devaluation of their currencies under International Monetary Fund programs during the period.

Since the devaluation-bred decline of export prices is mirrored in higher import prices as well, the Ibero-American debtors' terms of trade fell, overall, by roughly 60% during the same period. That is, the major debtors must export 60% more, as well as import 60% less, in order to earn the same volume of dollars for debt payments. The resulting squeeze on their economies has cut domestic consumption in the range of 30%—exact numbers are incalculable from available data—and wreaked even more damage upon those countries' future, through the suspension of all infrastructural improvements.

Using estimates prepared by Morgan Guaranty Trust, American Express International, as well as our in-house studies, the following picture of the debtor nations' finances emerges for this year.

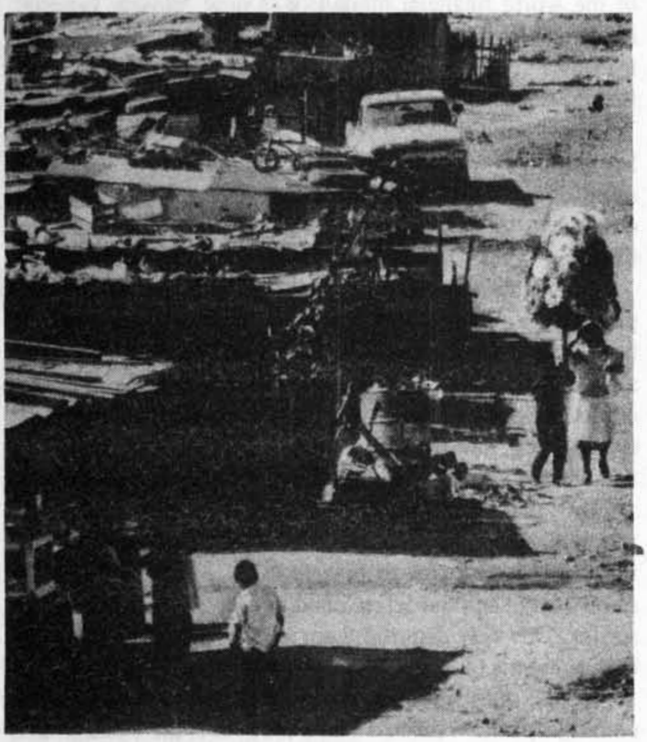
For the 21 major debtors surveyed by American Express (*Amex Bank Review*, Nov. 4, 1985), total debt-service requirements are running at $132 billion per year.

Of the $132 billion, $37 billion represents interest, $20 billion represents principal on outstanding debt, and $75 billion short-term debt payable immediately.

The 21 major debtor countries are, in fact, paying slightly more than their interest payments to creditor banks. In other words, they are paying down a fraction of the principal, albeit at crushing economic cost.

Of the 21, the 15 worst-off paid $32.4 billion in interest during the year ended in June 1985. Amex Bank, however, calculates an additional $2.6 billion in repayment of principal—after all World Bank loans, private capital investment, and other inflows are taken into account. During those 12 months, the developing nations shipped, net, $35 billion to their creditors.

It is impossible to judge the size of flight capital still leaving the developing nations, although Federal Reserve officials believe that the $50 billion "errors and omissions" inflow into the U.S. economy projected for 1985 reflects continuing flight capital from the developing nations. A recent *Wall Street Journal* estimate warned of $5 billion in flight capital from Mexico alone, and the total for 1985 will probably exceed $25 billion.



An impoverished slum in Mexico: A continuation of IMF policies, and these people will not be poor, but dead.

Adding the flight capital to the net capital export figure, we see that the debtor nations are paying out $60 billion annually in hard cash to their creditors.

The collapse of terms of trade

By the London *Economist*'s judgement, the developing nations coughed up an additional $65 billion, the "poor man's gift" in the form of a 10% decline in commodity prices during 1985. But, as indicated above, the overall decline in terms of trade since 1980 is 60%—60% of the non-oil developing nations annual exports of about $725 billion adds up to $435 billion.

The *Economist* survey, published last Nov. 30, observed that the $65 billion cut out of developing nations' export earnings this year amounted to 0.7% of the industrial nations' Gross National Product. "Since real GDP growth in the OECD countries is running at an annual rate of about 3%, a quarter of it comes courtesy of cheaper commodities. The full bonus is probably even bigger, because anything that cuts prices directly will produce such second-round benefits as smaller wage increases and lower interest rates," the *Economist* concluded.

Taking 1980 as a base, and using *EIR*'s more comprehensive measure of terms of trade, we find that the price-reduction of non-oil developing nations' exports since then, at $435 billion, amounts to a full 4.8% of total sales (GNP) in the industrial world—or considerably more than their total reported "real growth." Leaving aside the fact that the real growth numbers, as reported in GNP terms, are at best misleading and at worst completely fraudulent, the broad result is entirely correct. Without the collapse of developing nations' export earnings, the charade of economic recovery could not be maintained anywhere in the industrial world, with the possible exception of Japan.

The developing nations are politically, economically exhausted after five years of looting at an accelerating pace. Their economies, deprived of spare parts, let alone infrastructure investments, cannot maintain the same rate of exports, and their social structures cannot withstand the concomitant spread of mass starvation and epidemic disease.

Treasury Secretary Baker's attempt to hold the financial system together with mirrors, appears in its proper light. According to the Amex Bank, full-fledged implementation of the Baker Plan would capital outflow from the developing nations to a mere $20 billion per year, rather than the $35 billion registered over the past 12 months. That leaves out, of course, the continuing problem of flight capital, which remains almost as large as the total interest burden to these economies. Most of all, it ignores the devastating damage done to the economies of the developing nation through the huge shift in their terms of