View from Manila

How the debt crisis was created

In late 1986, a small pamphlet on the international debt crisis was circulated in Manila, entitled: "Third World's War: The Debt Fall-out." Its author, economist and business leader Antonio Valdez, is now a leader of the Nacionalista Party of the Philippines, whose chairman is former Defense Minister Juan Ponce Enrile.

The pamphlet fueled a growing debate in the Philippines and its government over how the country's debt crisis would be handled. Various members of the government, grouping around Solita Monsod, head of the National Economic Development Authority, have called for a "Peruvian solution" to the $26 billion debt—the limiting of the Philippines' annual debt service to 10% of its export earnings, and the use of the funds thereby saved for projects that will raise agricultural productivity and revitalize industry. On the other side, Finance Minister Jaime Ongpin and Central Bank chairman José Fernández are holding the line for the International Monetary Fund and bankers' austerity program for the Philippines—a non-solution that will deliver the country into the hands of the Theology of Liberation New People's Army.

"Third World's War: The Debt Fall-out" examines the way in which the debt crisis of the developing countries was the end result of a staged conspiracy by the World Bank and IMF. We print here sections of the pamphlet analyzing the source of the debt crisis and its rebounding back into the U.S. economy:

The U.S. breakaway from the Bretton Woods System [in 1971] accomplished two compelling necessities for the conspiracy that otherwise would have been impossibilities under the Bretton Woods System—instant availability of international liquidity for the planned international lending explosion to Third World nations and the devaluation of the dollar. Hence, the onslaught on the Third World was launched. . . .

The scenario, in an overview, envisaged the inducement of a calculated and calibrated lending to the Third World countries, in which U.S. banks would play a dominant and major role. By advocating the policy of deficit spending and compensatory financing as fiscal tools of development, foreign borrowing would be aggressively promoted to the point when Third World debtor nations would become far too dependent on foreign borrowing. In the course of the lending explosion, influence on debtor countries' economic policy-making would be exerted through forceful intervention, utilizing financing as leverage for adjustments and policy reform.

Target 'countries of concentration'

The political and economic significance of Third World countries in relation to the U.S. economic, political, and security interest varied widely, and the funds available for international lending were not limitless. The conspirators, therefore, had to concentrate their assault on Third World nations of strategic political and economic importance to the U.S. The criteria for choosing the "countries of concentration" were obvious: the relative size of the economy, primary export products, geographical location in relation to the U.S. and communist states, the presence and threat of communist insurgency, U.S business presence and U.S. investment potentials, and U.S. security considerations such as the presence of U.S. military bases and installations.

These explain the heavy indebtedness of certain specific Third World nations. They had been targeted as "countries of concentration." Brazil, Mexico, Argentina, Venezuela, and Colombia are the five largest economies of Latin America in descending order, with Mexico sharing thousands of miles of common border with the U.S. . . .

The strategic, political and economic importance of the Philippines is obvious. In the early 1970s, it was the third largest economy in East Asia and the Pacific, behind Indonesia and South Korea, and it had the largest U.S. business presence in the whole of Southeast Asia. It had been among the primary product exporters. More importantly, it hosts the two largest U.S. military bases outside the U.S. . . .

International lending explosion in 1970s

The debt bomb that exploded in 1982 signaling the onset of the debt crisis in the Third World was the inevitable outcome of the international lending explosion to developing nations during the immediately preceding decade. From 1970 to 1981, long-term lending to 107 DRS (Debt Reporting System of the World Bank)—reporting developing countries rose from $66.45 billion to $489.99 billion, or at an average annual rate of increase of 19.9%. Borrowing from the financial markets exhibited the highest annual growth rate (31.9%) during the period, rising more than 21 times over from $9.21 billion in 1970 to $194.58 billion in 1981.

While the developing countries turned more and more to the financial markets as borrowing source, their use of IMF credit had also been increasing during this period. IMF credit rose more than 18 times over from $177.9 million in 1970 to $14.3 billion in 1981, or an average of 30.3% increase annually. This meant that commercial bank borrowings were

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made easily available even to developing countries with balance of payments problems.

Stages of assault

The domination, subjugation, and integration of the Third World economies was expected to be a slow process, with the conspiracy having to constantly contend with obstacles and opposition posed by the nationalists of the Third World. The conspiracy, therefore, planned a long-drawn staged assault on these economies and, in retrospect, this phased assault is more clearly seen now than it was during the 1970s. Four stages of assault are clearly discernible, though applied under varied time-frames in the Third World nations, except the final stage which applied simultaneously to all. . . .

The beachhead stage: The entry or "beachhead" stage pertained to the period from the World Bank Group's dramatic entry, or more pronounced presence, in the target countries up to the setting in place of beachheads for accelerated lending. The establishment of a beachhead meant basically the successful advocacy of the policy of deficit spending in development finance along the World Bank prescribed path of development. It also called for the significant entry or increased presence by U.S. banks in the Third World economies primarily to ensure U.S. banks' dominant position during the lending explosion.

The international lending explosion to the Philippines coincided with the martial law years from 1972 to 1980. It was during this period when the government launched a policy of deficit spending, embarking on a series of five-year development plans anchored on foreign borrowing. Total public debt rose dramatically from P8.3 billion in 1972 to P67.7 billion in 1980, or an average annual rate of increase of 29.9%. During the same period, public foreign debt soared from P1.7 billion (or 20.9% of total public debt) in 1972, to P50.8 billion (or 60% of total public debt) in 1980, or an average annual increase of 52.5%. Total external debt rose from $1.1 billion in 1972 to $8.3 billion in 1980, or at an average annual rate of increase of 27.8%.

Accelerated lending by private foreign banks occurred during periods 1972-76, and 1978-80. The significant increase in U.S. banks' presence in the country, which occurred in 1972 following the World Bank-IMF financial reform that led to the accommodation of foreign banks into Philippine commercial banks constituted part of the beachhead for this accelerated international lending.

Saturation stage: The "blitz" or saturation stage corresponded to the marked acceleration of international lending from all sources, though at a more rapid pace on the part of the private banks. The underlying medium-term objective of accelerated lending was to encourage and directly support deficit-spending by debtor governments to unsustainable levels, thereby creating an irresistible momentum for, and dependence upon, foreign borrowing. This situation would place the IMF and the World Bank in commanding positions to effectively utilize financing as leverage to orchestrate the adjustment and policy reforms in the Third World economies.

The global patterns of phased assault on target Third World "countries of concentration" are clear. The rate of growth of foreign borrowing by debtor countries during the period 1975-1978 was higher (23%) than during the previous five-year period. With private banks accelerating their lending at an average growth rate of 36.6% in 1975-78, comparied with 34.9% in 1970-75. The heavy concentration of lending to target Third World countries occurred earlier (1972-75), as reflected by the high 1973-74 average debt service ratios of Western Hemisphere nations (21.5%, or past the solvency threshold of 20%) and the 15 heavily indebted countries (18.2%) and high ratios of external debt to exports of 139.8% and 123.8% respectively.

Accelerated borrowing in 1975-78 led to the rapid deterioration of these target debtor countries' average debt service ratio to 33.3% for Western Hemisphere countries and 28.6% for the 15 heavily indebted countries, crossing the solvency danger threshold. . . .

The consolidation stage: The trends towards the period of instabilities and the devastating impact on the Third World economies did not escape the attention of and appraisal by the conspiracy. But, as the instabilities spelled troubles for the debtor countries, the conspiracy saw them as an opportunity to precipitate the debt crisis under a "suitable" general economic condition that would provide the smokescreen for their ulterior motives.

The shift into the consolidation stage was compelled by developments in the Third World that threatened the conspiracy as well as adverse developments in the U.S. Towards the end of the 1970s, the political climate in many Third World nations became increasingly unstable causing many governments to vacillate in dismantling their protectionist systems—the real acid test for the conspiracy. What appeared to them as a bleaker development, however, was the reemergence of nationalist sentiments that took the form of strong insistence for encouraging import substitution in intermediate and capital goods, as exemplified by the Philippines' unveiling of its industrial projects—a direct contradiction to the conspiracy's underlying objective. The conspirators' fears heightened when in the summer of 1980 a wave of bombing incidents turned out to be the work of the nationalist industrialist class that was most adversely affected by the World Bank and IMF-promoted liberalization measures and was then starting to lean toward leftist-oriented opposition to the Marcos regime.

On the homefront, the conspirators were not blind to the adverse developments taking place in U.S. trade and industry, mainly representing the worsening of the trends since the 1950s. The international competitive strength of U.S. indus-

try and trade continued to be weakened by increasing flow of imports. Since 1978, the once-great productive sectors of the economy such as the steel and automobile had throttled to a virtual halt. The agriculture sector was on the verge of collapse, with about one-third of the nation's farmers facing debt crisis. The U.S. urgently needed to expand its exports but the remaining protectionist systems in the Third World had proved still formidable obstacles, thus, the need to speed up "liberalization" in these economies.

The conspirators, moreover, were anticipating a Republican victory in the U.S. 1980 presidential elections. The implications of a U.S. foreign policy based on "Reaganomics" should lay the basic framework of their action. The ultimate dismantling of protectionism in the Third World economies should recreate the opportunities for U.S. export industries, the international competitiveness of which would be boosted by the tax relief under "Reaganomics." Furthermore, the prospects of increased federal deficits and borrowings would mean lesser funding available from U.S. banks for international lending. These considerations favored forcing through a debt crisis.

Thus explained the conspiracy's preparations to precipitate the debt crisis. The consolidation was set in place. The World Bank's Structural Adjustment Loan was unveiled in December 1979 to reinforce the IMF's program loans and gain added leverage in the planned armtwisting and screws-tightening. Ultimatums were raised against vacillating governments, the Philippines included, and calls for stronger protectionist measures were exhorted in the developed nations. The IMF quota of the U.S. was raised in 1980 to $12.61 billion from $8.41 billion in 1978 and still another increase was envisioned when the debt bomb would have exploded.

The conspiracy successfully launched and sustained an era of deficit spending based and foreign borrowing dependent development in the Third World through 1981. For a while, as their traditional exports enjoyed relatively stable prices in the world markets and as some of them gained varying measures of success with non-traditional exports, the developing nations' export earnings were generally sufficient to pay for their essential imports and fully meet debt servicing. The IMF was always ready with compensatory financing facility to take care of any BOP disturbances. Encouraged by the open access to financial markets the developing nations increasingly resorted to foreign borrowing. . . .

Serious troubles for the developing nations started shaping up in 1978 when instabilities gripped the developed economies, most notably the U.S. inflation, though relatively mild, set the tone that year for other economic instabilities ahead. Interest rates jumped dramatically in 1978 through 1980; the discount rate soared from 6% in 1977 to 9.5% in 1978 and through 13% in 1980. . . . By the end of 1982, the level of industrial production was lower than in 1979.

The instabilities in the U.S. and the rest of the industrial nations exacted a heavy toll on the developing economies, largely contributing to the debt crisis. While initially the developing nations benefited from the inflation in the developed nations in terms of increased prices of their commodity exports, the subsequent recession dampened import demand and caused commodity prices to plummet even as internal pressures of protectionist policies intensified in the developed countries. . . . The steep rise in interest rates jacked up interest on the developing nations' external debt and drew capital outflows from their economies.

During this period, the debtor countries' debt servicing capabilities rapidly deteriorated as the combined result of increasing debt service burden, mounting deficits, widening trade gaps due to decelerating or negative export growth, and worsening BOP and international reserve positions. The cutback in new lending in 1982 disabled the debtor countries to roll over their maturing loans. Against a 37.3% increase in 1981, the 25% ($20.7 billion) reduction in net long-term lending from all sources in 1982 was a shocker and of sufficient force to detonate the debt bomb.

The kill stage: The cutback in new lendings by all sources in 1982 was both a concerted effort influenced by the conspiracy as well as forced action on the part of U.S. credit—the unprecedented U.S. federal deficit in 1982 of $125.7 billion, representing a 60% increase from the previous year's level, necessitated heavy government borrowing from U.S. financial markets. U.S. banks increased their net lending to the federal government by $20.0 billion in 1982 and an additional $57.4 billion in 1983.

The tight credit situation in 1982 and 1983 delayed the approval of the additional increase in the U.S. quota in IMF, undermining the financial institution's role at the most crucial moment of need. . . .

How debt crisis affects U.S. economy

As the debtor countries have pinned their hopes for shaking their economic slumps on significant improvements in the performance of their exports to developed countries, fast emerging adverse trends in the U.S. have been generating a high level of anxiety and uncertainty. In the face of the dollar sinking, the U.S. trade gap has continued to widen, in baffling contradiction of accepted modern economic tenets. At the current pace the trade deficit is swelling and is expected to hit a record $175 billion, up 18% from last year's level. Meanwhile, the dollar has already dropped by about 30% against an average of major foreign currencies during the past 18 months, is still plunging to further depths.

The growing trade deficit has placed the U.S. economy in increasingly difficult and dangerous circumstances. The escalating fears that its effects can push the U.S. into a critical situation now appears well founded, particularly if one reflects on certain unfavorable developments currently taking place, namely: the steep fall of U.S. farm exports, with the

U.S turning into a net importer of agricultural products during May and June for the first time since 1971; the reduction in corporate investment expected this year; the still growing number of American industries that have been all but destroyed by low-cost foreign competition; and the recent marked slowdown in GNP growth. . . .

Meanwhile, the rising costs of U.S. imports brought about by the declining value of the dollar have elicited pressure for a possible resurgence of inflation. U.S. economists have cautioned against the further sinking of the dollar and called for forceful measures to rein in the bloating federal budget deficit, which is to hit a record $207 billion in 1985 up 16.3% from previous year's $178 billion. Government borrowing from both domestic and foreign sources, which has been increasing at an average annual rate of 16% during the past 15 years, has siphoned off a large portion of available savings and forced interest rates higher than they otherwise would have been. But the fear of recession that a reduction in government spending may trigger has apparently exerted the more forceful influence on current U.S. fiscal policy, expectations of legislation by U.S. Congress calling for a ceiling on budget deficit in 1987 notwithstanding.

The continuing deterioration in the U.S. trade position and its adverse impact on U.S. industry is showcased by the collapsing U.S. steel industry. The inroads into the U.S. market made by raw steel imports from the other major industrial nations as well as from the newly industrializing developing countries like Brazil and Venezuela have forced the shutting down of blast-furnace steel plants in the U.S. and rendered the U.S. dangerously dependent on foreign imports and incapable in the near term of meeting its own national defense requirements. The U.S. raw steel production of 91 million net tons in 1984 represented merely 60% of its 1973 production level. And although the 1984 output level showed a 7.5% increase over the previous year's level, the basis for the increase was a transformation of the industry from ore-reducing to steel-scrap recycling.

Backfire on the U.S. economy

While the U.S. has been incurring trade deficits in 13 of the last 15 years (i.e., except in 1973 and 1975), the trend towards an increasingly widening trade gap started in 1982-83, coinciding with the time the IMF had concluded economic adjustment programs for the heavily indebted developing countries, particularly Latin American countries. What actually happened was that the creditor banks' and IMF's strategy of handling the debt crisis in 1982 had only enriched the U.S. money-center banks while shutting down the traditional markets for food and industrial exports from the U.S. to the Latin American countries, thereby bankrupting U.S. farmers and farm banks, and throwing U.S. industrial workers out of their jobs, and impoverishing the peoples of Latin America.

In the renegotiation agreements between debtor Latin American countries and the creditor banks and IMF, the latter moved to guarantee their own interests (i.e., to preserve short-term bank profits) by imposing on the debtor countries a policy of forced exports and drastically reduced imports.

In 1981, U.S. agricultural exports to Latin America amounted to $6.9 billion, representing 15% of total U.S. agricultural exports that year. By 1985, U.S. agricultural exports to this continent had declined by one-third to $4.5 billion. This drop in exports accounted for one-fifth of the overall drop in U.S. farm exports over the same four-year period. . . .

The Peruvian solution

The consideration of repudiation as the quick and easy solution to a country's debt problem is very much influenced by the Peruvian "10% solution," whereby the Latin American nation unilaterally pegged its debt repayment to 10% of its export receipts. The shock wave that this bold decision, made by such a relatively small developing country, is still felt throughout both the developed world and the Third World. . . . To the international financial community, the Peruvian shocker may yet be a foreshadow of similar courses of events in the Third World.

But what really tends to embolden the most desperate of debt-ridden countries to follow this example is not the boldness of the Peruvian decision itself but rather the indecisiveness of the international financial community's response, which has so far been practically limited to making repeated threats of sanctions against the repudiating debtor country and exhortatory appeals, with veiled threats, to other debtor countries seriously considering Peru's action. Meanwhile, the Latin American country enjoys the fruit of its bold decision: a real GNP growth of 3.6%
a slowed down inflation rate (from 163%
in international reserves; growth in industrial and other productive sectors in the economy, and rising employment.

Peru's present experience must, therefore, be viewed as a clear demonstration of favoring growth in favor of maintaining or regaining one country's creditworthiness. Only from growth, not additional debt, will a debt-ridden country be able to regain its debt servicing capability. . . .

National sovereignty and nationalism

All free peoples have sovereign rights to nationalism. Each free nation must respect all other free nations' exercise of such sovereign rights.

The infringement of Third World national sovereignties by the conspiracy has spawned growing disillusionment with and hostile feelings against the U.S. and its people, foreshadowing the same developments that led to the U.S. debacle in Vietnam. The U.S. can set a new tone in reshaping its relations with the Third World nations, with a footing very much different from what the conspiracy has established. But, first and foremost, the U.S. must dismantle and destroy the conspiracy.