

How the IMF's policies destroy the physical economy of nations

by Dennis Small

This speech was delivered on April 8 in Kiev, Ukraine at a conference sponsored by the U.S. State Department's Agency for International Development and the University of Indiana, attended by 50-60 Ukrainian parliamentarians.

There are those who maintain that the neo-liberal economic policies of the International Monetary Fund are just what the doctor ordered for the economy of Ukraine and other nations emerging from under the yoke of communism. There are those who will argue that the so-called "success stories" of Ibero-America prove that the policies of the IMF in fact work. There are even some who are trying to sell the smelly corpse of the "Mexican economic miracle" to the credulous.

The view I will present to you today is exactly contrary. My thesis is that there is in fact not a single case in recorded history of successful economic development premised on IMF and neo-liberal economic policies. I will prove this thesis using case studies from Ibero-America. I would also like to argue a related point: that every known case in modern history of actually successful economic development has occurred as a result of the more or less conscious application of neither Adam Smith liberalism nor of Karl Marxism, but of a third school of economic thought, that of cameralism or mercantilism. Cameralism springs from the philosophy and economic science of Gottfried Wilhelm Leibniz, and is responsible for the success of eighteenth- and nineteenth-century U.S. industrial capitalism, of the Meiji Restoration of Japan, the postwar German economic miracle, etc. The modern exponent of this school is the founder of *EIR* magazine, U.S. economist and former political prisoner Lyndon LaRouche.

Let's get one further preliminary point out of the way before proceeding: We must first define what we mean by "economic success." If a doctor defined success as reducing a patient's high blood pressure no matter what the cost, the quickest way to "succeed" would be to kill the patient: The blood pressure would drop to zero, every time. That's more or less the IMF approach to inflation, and financial stability more broadly. For example, this is the case of Jeffrey Sachs's model country Bolivia, where his policies did indeed reduce inflation back in 1985—with the minor complication that he also wrecked the Bolivian economy and promoted the drug trade.

EIR and LaRouche posit a different criterion. Success must be measured in physical-economic terms by a society's

increasing ability to produce market baskets of necessary consumer and producer goods, for a growing population, and to do so with progressively smaller proportions of society's total labor. This can only be achieved by continuous scientific and technological advance, by substantial investments in great infrastructure projects, and by organizing national credit and monetary policies to facilitate such real, tangible, physical economic growth.

That said, let us turn directly to the case of Mexico, perhaps the best available example of IMF-produced catastrophe.

The debt bomb in Mexico

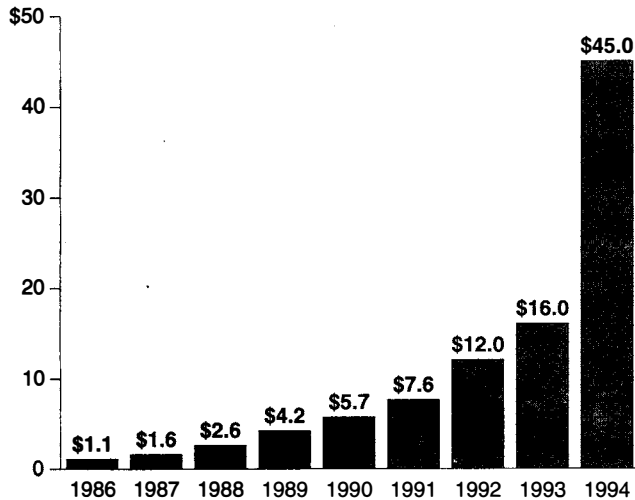
When the debt bomb exploded in Mexico at the end of last year, LaRouche noted that this was not a Mexican problem, but a New York and London problem, meaning a problem of the world financial system. He explained that it was the lawful follow-on to the Orange County, California blowout earlier in 1994, and that it would not stop in Mexico, but could hit next just about anywhere: Argentina, Hungary, some other American county, and so on.

Why did the debt bomb blow out in Mexico? Because of a world speculative frenzy called derivatives. Over the period from 1986 to 1994, the world derivatives market has grown from a mere \$1 trillion to over \$45 trillion—an annualized growth rate of 59% (**Figure 1**). As **Figure 2** shows, there is nothing on the face of the earth that has grown as fast as that speculative bubble—except some deadly cancers. The only thing that even came close was the world drug trade, which we estimate to be growing at the rate of about 25% per year—which might tell you something about just what is propping up the derivatives bubble. But as the speculative bubble has grown exponentially, the productive physical economy of the world—the food, steel, energy, and so on, on which the survival of the human race actually depends—has been collapsing. Over the last eight years, world steel production per capita has been dead flat. Grain production per capita has actually dropped by 1.3%.

Sooner or later, when the speculative cancer has devoured most of the physical economy underlying it, the system breaks down. The day or hour may be unforeseeable, but the process is inexorable.

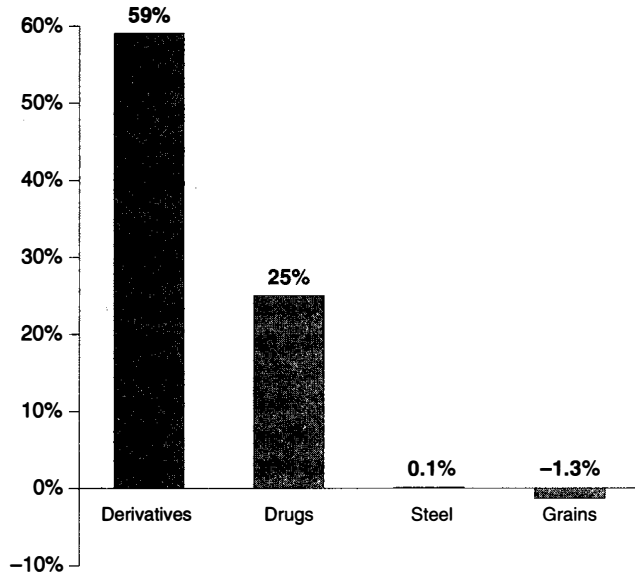
U.S. banks are heavily addicted to derivatives. Most of

FIGURE 1
World derivatives growth
 (trillions \$)



Sources: Bank for International Settlements, *Fortune*, *Swap Monitor*.

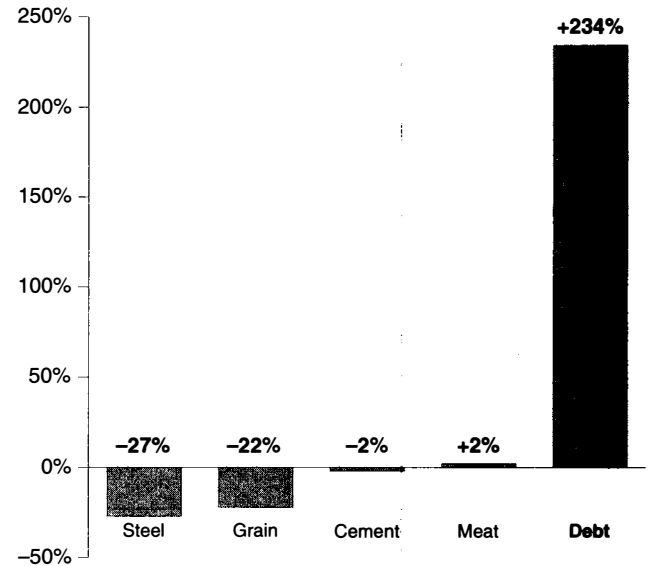
FIGURE 2
World growth rates, 1986-94
 (average annual percent)



Sources: U.S. Departments of Agriculture and Commerce, EIR.

these derivatives are held by a small handful of large banks, whose derivative exposure is generally an order of magnitude greater than their asset base. It is exactly this which hit Barings Bank like a ton of bricks, and there will be many more

FIGURE 3
Mexico: growth of foreign debt versus production, 1981-93
 (percent change)



Sources: World Bank, ECLAC (United Nations), INEGI (Mexico).

banks—British, American, and others—following them into bankruptcy soon.

What happened in Mexico is a microcosm of this big picture. Between 1980 and 1994, Mexico's official foreign debt soared, reaching \$141 billion by 1994. But in addition to the official debt, Mexico—like most of the so-called "emerging markets"—began taking on huge new quantities of other foreign obligations, such as dollar-denominated government bonds and foreign investments in the stock market. These speculative hot money flows increased Mexico's real foreign debt to about \$213 billion by the end of 1994. Those obligations are now being converted into official government debt through the so-called \$50 billion rescue package, which will bring Mexico's official foreign debt up to \$191 billion. And if the underlying policies which created the mess in the first place are not changed—which they certainly have not been thus far—Mexico is going to have a \$265 billion real foreign debt cancer by the end of this year.

Did the productive economy keep up with this growth? Absolutely not (see **Figure 3**).

EIR has developed indices of Mexico's per capita physical production of a market basket of 15 important consumer goods (corn, beans, meat, clothing, autos, and so forth) and of per household production of a market basket of 17 producer goods (steel, cement, tractors, etc.). Both rose respectably during the 1970s, as Mexico positioned itself to launch in-depth industrialization in the 1980s, which was the policy

FIGURE 4

Mexico: producer and consumer goods

(index 1981=100)



Sources: ECLAC (United Nations), INEGI (Mexico).

adopted by then-President José López Portillo. But the bankers thought otherwise. Nineteen eighty-one was the last year of growth, and then the IMF and the oligarchy launched all-out war on Mexico. In the subsequent two administrations, of Miguel de la Madrid and Carlos Salinas de Gortari, every aspect of British free-market dogma was dutifully implemented—and the Mexican economy collapsed as a result. Bean production dropped by 37% per capita; milk by 22%; steel by 27%. Overall consumer goods dropped by 20%, producer goods by 27% (Figure 4).

How did this catastrophe happen?

Bankers' arithmetic

During the early and mid 1980s, Mexico—like the rest of Ibero-America, serviced its foreign debt by running a large trade surplus. On IMF orders, these nations slashed imports—they stopped purchasing everything that was needed to run their economies and sustain their living standards, from food to machine tools—and exports were driven up as rapidly as possible. The difference between exports and imports is a nation's trade surplus, the amount gained in foreign currency, which is then used to pay foreign debt. If you add up the total amount between the import and export lines, you have the total cumulative trade surplus.

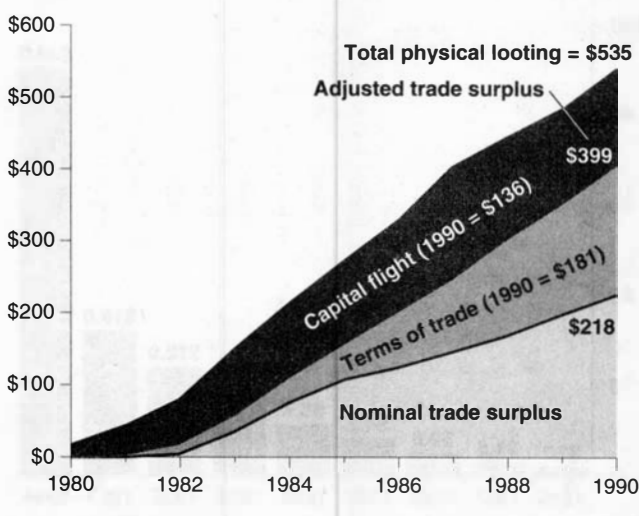
This adds up to a very sizable cumulative amount: \$218 billion between 1980 and 1990.

This is bad, but it is not the full story. During this period, we have an added factor: the collapse of the terms of trade for Ibero-America. This means that, if you are an Ibero-American country, each year you have to pay more for your

FIGURE 5

Cumulative physical looting of Ibero-America

(billions \$)



Source: EIR.

imports, and you get less for your exports. In other words, if you need to import a ton of steel, in year one, it takes a ton of your copper exports to get it; in year two, under worsening terms of trade, it takes two tons of copper to get the same ton of imported steel.

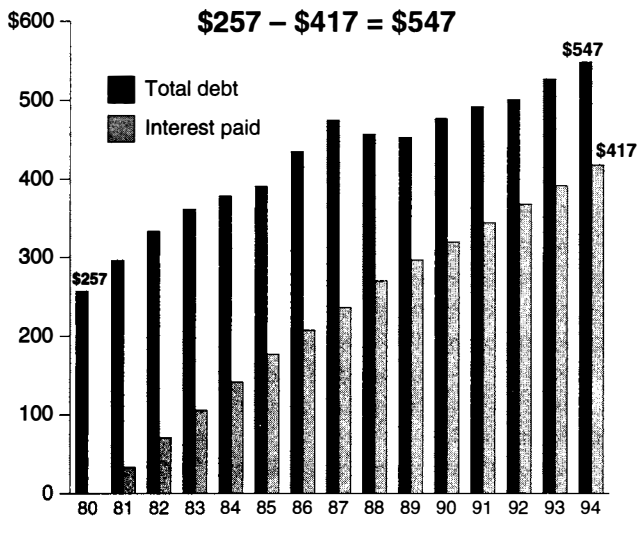
If the terms of trade factor is considered, we calculate an additional \$181 billion of physical loot which has gone out of Ibero-America since 1980 (Figure 5). So the actual adjusted trade surplus was almost \$400 billion. To put it differently, if the terms of trade had stayed exactly as they were in 1980, the cumulative trade surplus would have been \$399 billion which left the continent.

To that you have to add the amount that left illegally as capital flight, about \$136 billion cumulative for a grand total of physical looting of \$535 billion extracted, sucked out of the continent through this looting process over the decade. That corresponds to about 13% of the productive GNP of Ibero-America over the decade of the 1980s—and we are talking about a continent that was already in dire poverty at the beginning of the decade. This extraction of wealth needed for consumption and investment, in order to pay debt at all costs, produces "Africanization," a non-linear downward spiral of negative growth.

It is of course the payment of the foreign debt which is the principal mechanism through which this looting process works.

Ibero-America's total foreign debt in 1980 was \$257 billion (Figure 6). Over the course of the next 14 years, the nations of the region paid \$417 billion in interest payments alone, i.e., excluding amortization of principal. And yet at the end of that period, they owed more than at the beginning:

FIGURE 6
Ibero-American foreign debt, and interest paid
 (billions \$)



Source: World Bank.

\$547 billion. In other words, as you can see as clear as day, \$257 minus \$417=\$547. That's what is called "bankers' arithmetic."

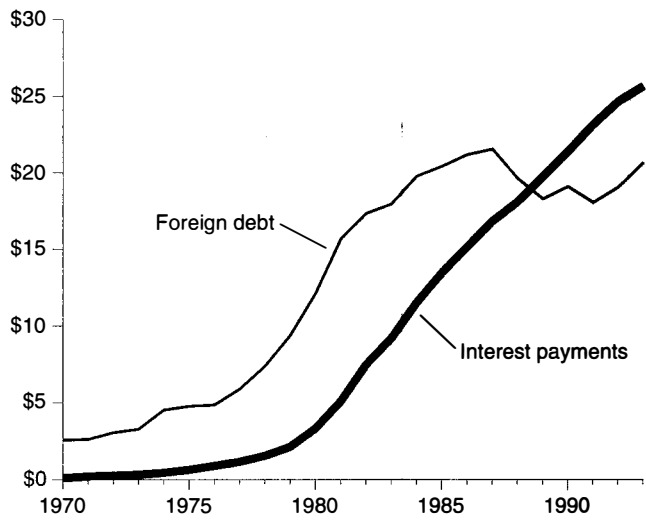
The irony is that the IMF and its apologists frequently argue their case on the grounds that if you liberalize, money will come pouring into your country. Open your economy, they say, so we can ship in capital. But the door that is opened is the door through which capital leaves the country, not arrives. There is in every case net capital exports, a looting of the national economy.

The case of Chile

The case of Chile also exemplifies this point. Although time does not permit me to present the evidence in full, the fact is that the Chilean crash of 1982-83 was caused by the "Chicago Boys' " neo-liberal policies. The modest recovery from those depths are a result of 1) abandoning the worst excesses of neo-liberalism after 1983; and 2) the high international price of copper over the last few years, which is Chile's main export commodity.

But the recovery should not be exaggerated either. GNP per capita is today scarcely higher than it was in 1973; and the small growth in employment, for example, has been principally in the non-productive services area—just like the rest of Ibero-America. As for Chile's much-promoted high savings rate, this is mainly related to the privatization of its social security system, which has simply meant that billions of dollars of these funds have been invested in large international financial institutions, such as Merrill Lynch or Bear Stearns. They in turn are heavy speculators in the world

FIGURE 7
Chile: foreign debt and accumulated interest payments
 (billions \$)



Source: World Bank.

derivatives bubble, so Chileans may soon find their savings wiped out, much like the citizens of Orange County, California, or the nation of Mexico.

Throughout, Chile has faithfully paid its foreign debt. In fact, the debt was very low when the Chicago Boys took over with Pinochet in 1973, about \$3 billion, but since that time it has grown to about \$21 billion today, despite the fact that over \$25 billion in interest has been paid (Figure 7). In fact, Chile has the second highest per capita interest payments record of Ibero-America from 1981 to 1990, after Venezuela.

In conclusion, let me shock you with the fact that Ibero-American foreign debt is actually the slowest-growing of any region of the world: It has been increasing at about 5.5% per year, compared to a world average of 8.0%. The countries of Europe and Central Asia have a foreign debt which is among the fastest-growing in the world, at 10.7% per year. This part of the world is also seeing bankers' arithmetic in action. The total debt of Europe and Central Asia was \$97 billion in 1980; over the next 14 years, \$192 billion in interest was paid, and at the end of this period, \$403 billion was owed. At this rate, and with IMF policies, this region is rapidly being transformed into Third World nations by the IMF.

The solution to this crisis lies in the opposite direction from neo-liberal reforms. Sovereign nations must take measures to protect their physical economies, and ally among themselves to have the political muscle to do this. And such nations must also act immediately to bring about a new world monetary system to replace the IMF, a system premised on the principles of mercantilist physical economy.