# The Discussion on external debt at the start of the 21st Century: a conceptual and propositive review

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**First**

The issue of the difficulties associated to external debt is as old as the creation of republics in Latin America. It is an invitation to study the relation between economic policies and the use of loans; corruption and loan contracts; macroeconomic growth and external saving; and imperialism understood as external interference in a Nation State's affairs. It is a subject that opens up horizons and perspectives.

Capital expands and searches for markets and appears in the form of loans for emerging economies. Apparently, when technology becomes obsolete markets become saturated and at the same time there becomes a need for new technologies on the leading markets. This brings pressure to bear on the demand for loans in these leading economies and leads to a fall in raw material prices and a rise in interest rates. This phenomenon is observed in the four loan cycles considered in this paper.

The first cycle is associated to independence and Peru was to be involved in this at the end of the cycle. Loans ceased in 1825 and the London Stock Exchange collapsed towards the end of the year. Loans were restored in 1849 and boomed from 1852 to 1870. Difficulties with guano prices and problems related to issuing long-term bonds finally gave rise to a default in payments in 1876 coinciding with a London Stock Exchange crisis. It will be in 1886 when Mr Grace travel to Peru to offer the Peruvian bonds to Marshal Cáceres in exchange for the country's railways and the shipping rights associated to its lakes and rivers. The decision will be delayed for four years and it is finally the new 1890 Government that signs the Grace Contract, thus re-establishing the loan that will be essentially used to re-arm the armed forces and develop some urban infrastructure and coastal irrigation projects. It will be in 1930 when the fall in raw material prices together with a cease in loans leads to the consideration of a moratorium. This decision is not reached until the Hoover year for leading countries is established in the United States in June, 1931. The moratorium will last until 1946, when what is even today a controversial agreement was made, by which the budget includes maximum debt payments and the payments that were not made between the start of the moratorium and the date of the agreement on October 1946 are ignored. The agreement does not imply an automatic re-establishment of loan conditions, but it defines the conditions for foreign investment in the country. Credit was re-established in the mid-60's for all Latin American countries and loans will increase from 1964 until 1978, when difficulties with raw material prices and increased rates of interest gave rise to a change in the loan policies applied by banks, changing from long-term to short-term operations. In August 1982, the default in payments in Mexico came to an end and Peru entered a moratorium with the commercial banks in 1983 and with the member Governments of the Club of Paris in April, 1984.

What follows in the 90's should be the end of the fourth and the start of the fifth loan cycle. Apparently what are observed at the end of the 20th Century are the final breaths of the fourth cycle. Either that or the fifth cycle is very short. The break-off in payments at the start of the 80's led to changes in the international rules. A series of bonds were issued, known by the name of their creator, the previous US Secretary of the Treasury, Nicholas Brady, in order to solve the problem of unpaid bank debt of the time. Final agreements were drawn up by the Club of Paris, with terms and costs similar to those of the Brady bonds, and in 1991 it was decided that the debt crisis had ended. What we can see now is that the debt crisis ended for the creditors but that the debtors who accepted these mechanisms suffer from increasing difficulties generated by the rise in international interest rates and the fall in raw material prices after the so-called Asian crisis (WB, 2000).

**Second**

The issue of external debt is recurring throughout the history of Latin America and Peru. It was a problem in Europe between the First and Second World Wars. It also applies to everywhere in the world and all kinds of credit source. It is clear that recurring problems have the same characteristics but not always the same solutions. The discussions on Germany's debt related to reconstruction after the First World War and the inter-allied debt in 1926 gave rise to changes in international financing rules, such as, for example, Hoover year. Over the years imaginative solutions have been invented to solve what was apparently an impossible problem, such as the German agreement in London in 1953. Each time, it was political objectives together with ingenious bankers and governors that created solutions for what was apparently impossible: The impossibility of paying because of the international crisis or because the debt itself was preventing nations from developing. For European countries, the problem was the destruction of their productivity by wars. In developing countries, the fall in raw material costs, the rise in the international interest rate and a fall back in loans have regularly been the causes of important crises.

**Third**

This text will present conceptual discussions that have been going on since 1924, and which were maintained by North American and European academics of the time, with the political results that will be described later. It is interesting to note that in the 80's and 90's no new argument was added to the debate on international debt as a drawback for development. What is extraordinary is that for creditors between 1926 and 1931 the main concern was Germany and the inter-allied debt. This concern started in the English Government in 1922 and was seconded by General Pershing, who in 1926 asked for the inter-allied debt to be condoned, starting a controversy in the United States between the Universities of Columbia and Princeton, on the one hand, and the Secretary of the Treasury on the other (Chew, 1927). This controversy is still open. It is even more interesting to note how the weight of the debt and its impact on annual service is estimated from this time on (Withers, 1931). The measures taken in relation to Germany in 1928 are primarily a result of this controversy (Mendoza, 1930). The end result, of course, is zero. The balance of the debt was reduced as a war repair, but the yearly quota was maintained, much like the World Bank now operates under the HIPC scheme according to the assessment made by the IMF in March 1999. The consequences are well known and part of history, but between 1928 and 1931 there was a change in the way in which deflation is understood due to the transfer of resources as payment of heavy debts. Finally, in 1931, the creditors ceased to receive payments and asked all the parties to condone the repairs from Germany and other debts. But it was too late. Deflation was rife (HMO Miscellaneous No. 19, 1931 and HMO Miscellaneous No. 12, 1932). Now that we are at the start of a new century, Krugman's text on the Return of a depressed economy should help us to consider something that is greater and older than commercial and financial transactions between unequal nations, now more unequal than ever before.

**Fourth**

The discussion on external saving is not now concerned with the use of resources but with the gaps in the development process. The reason for this is that before the Bretton Woods agreement in the 40's, the two requisites to consider a loan and a definitive agreement if payment was not made was that the debtor should have a primary budget surplus and a trade balance surplus equal to or greater than yearly debt repayments. This changed with the creation of the International Monetary Fund, which was supposed to help through difficult times, so that external or budgetary deficits became irrelevant. This is a theoretical and institutional change. The gaps, instead of remaining small, or relatively small, started to widen. The theoretical argument is that loans are necessary in order to attract investment and accelerate development, and that external and fiscal gaps break open because the State invests in economic development, either in infrastructure or public companies. These are eventually profitable and the loan is paid back. Loans are productive.

At the same time, the theory changed in the 70's and it was considered that bankers would never make loans to pay their own debts (the Ponzi scheme). Historical evidence shows not only that they make loans to pay prior debts but, because of the established dynamics that places no limits on external and fiscal gaps, that they have no other alternative. This leads to the popular reasoning that countries do not go "bankrupt" and that it is reasonable to "take out a loan to pay a loan".

**Fifth**

The credit risk associated to this is cancelled out by the acceptance of the losses by the creditor and debtor governments, respectively. In other words, international credits lend because they know that they will be rescued if the worst comes to the worst and the risk materialises. History proves this. The moral hazard, therefore, is present. This leaves the risk margin on the interest rate as income for creditors who never accept the risk or its costs. It is a mystery why contemporary theory accepts the rationality of loans when it is well known that banks are always rescued if they fall into difficulties. In the 19th Century, the figure of the International financial controller was created to ensure that the risks were not large. Initially it was the English and French Governments who acted inside the country, directly controlling its customs and excise revenue. This was after a brief military operation to gain control over the ports. In 1933 an international agreement put an end to this figure and it was ratified in 1936. The IMF was designed in 1934 to replace it. Since the 1940's there has been no need for military control over the ports. Since Bretton Woods, a debtor with problems asks for aid and the IMF takes over. What is extraordinary is that if the IMF was designed to function as an auditor and is inside the central banks of debtor countries with a view to informing that problems exist, why it does not do so. It acts as a collector of sovereign debts and improves the customs and tax organisations in the debtor State, but it does not play the role of international financial controller under the obligation to inform the national and international community that there is something wrong with an economy. In other words, it is a public institution to which the tax-payers of the leading States pay high salaries to alter the international financial community of possible problems with an economy, but it fails to do so. In the important crisis of the 1990's the IMF said nothing, aware that there was a crisis. In the Peruvian case, it was aware that the dictator had spent 5% of the GNP in the first three months of the election campaign of the year 2000, but it remained silent. Some say that they do not react because if they did warn the international community that a crisis was on the cards, this would bring the crisis forward and fulfil its own prophecy. The failure to do so, however, means that the creditor governments are finally forced to initially accept the cost of the crisis and finally pass it on to the debtor government. Instead of being a rational part of a system designed to give stability to world economy, it appears to be an organisation that is concerned with creditors' utilities, and not very well at that. For the debtor government the lack of this warning has a high cost and for the population, the cost is unacceptable. This has been seen in Mexico, South Korea, Thailand, Indonesia, Brazil, Russia, Argentina and some other countries in the 90's.

**The resource gap and the foreign currency gap**

The role of external saving has been discussed and considered many times. In national accounts it is known that the most basic definition is that external saving is a complement to internal saving to sustain an investment rate. The investment rate is defined as the amount of new capital injected into a national economy at a certain time. From the balance of payments perspective, external saving is what is required to finance the difference between the lack of commercial balance and the lack of external capital balance. In other words, it is what is required to finance the balance of payments deficit without changing the level of international reserves. The current account deficit is equal to the increase in external debt (see appendix 1).

**The neo-classical analysis**

This is Blanchard and Fischer's (1992) analysis, incorporating the consumption function into a closed economy. It is assumed that no-one takes out loans to pay prior debts (the opposite of the Ponzi scheme[1]), and that families will take out loans sufficient to maintain a level of consumption such that marginal consumption utility is zero (or infinite consumption is marginal utility is always positive) and that dynamic budgetary restrictions determine the dynamic conduct of consumer *a* (Blanchard and Fischer, 1992: 49). This leads to increasing indebtedness, which is not reasonable. It is therefore assumed as a natural condition that the rate of indebtedness of families will never grow more than the interest rate. This is known as a no Ponzi game condition (Blanchard and Fischer, 1992: 49).

The Government's role in this theory is based on the principle that public spending is determined is an exogenous manner and that spending is financed by taxes and loans. Consumption per capita is reduced by taxation per capita (Blanchard and Fischer: 53). In a state of static equilibrium, public spending *crowds out* private consumption but has no impact on capital growth. If the economy is balanced to start with, the change in government spending has an immediate impact on consumption with

[1] The Ponzi game is taking out a loan to pay prior debts.

no dynamic effects on capital growth. If the economy is not balanced, the momentary impact on consumption will depend on the characteristics of the happiness function (see appendix 2). According to this, a country will take out loans until marginal consumption utility is zero and then take out more loans to pay for the interest on the debt. "It is unlikely that creditors will be willing to continue making loans to a country if the only way it can continue to pay prior debts is by taking out further loans" (60).

Definitions and assumptions made in monetary theory sustain that foreign bonds stabilise the exchange rate by increasing monetary supply when the domestic supply is disturbed. It is assumed that the takers out of loans are private and that the sum of private debtors, when there are internal monetary disturbances that increase the interest rate, will take out foreign loans and thus increase the supply of internal loans by reducing the interest rate (Turnovsky and Eaton, 1982). In other words, any economic agent can take out a loan on any market and arbitrate the exchange rate and the interest rate. Foreign loans, then, determine exchange rates.

It will be seen that there is historical evidence that the Ponzi scheme is valid, that economic agents can not arbitrate because markets open and close for reasons that have nothing to do with debtors, and that the investment rate is not necessarily linked to the use of foreign loans. Foreign loans come from three sources: the international money market, governments and international financial institutions (IFI's). There is also direct foreign investment.

**Loan cycles, re-financing and defaults in payments**

Suter (1992), from a study of two hundred years of loan use, suggests that the natural state of things are defaults and that the opposite is what is extraordinary.

The most common consequence of foreign loans has been national bankruptcy that has lasted for years and sometimes for decades. This is true both for countries on the "edge" of Europe (such as Greece, Portugal, Spain and the Balkans) and for nearly all the States in Latin America and the independent Asian States in the 19th and 20th Century, such as the Ottoman Empire, China or Liberia (Suter, 1).

From the sample of countries included in this study, which covers the period from 1820 to 1988, he observes 130 cases of defaults in payment, which shows that what is seen in Peru is true for the sample studied by Suter. He divides loan cycles into three parts. 1. Growth in foreign loans. 2. The payment crisis. 3. The negotiation of final agreements between the debtor and creditor countries. He also defines four loan cycles from 1800 to the 1980's. The number of countries with defaults in payments per cycle compared with the total number of sovereign countries is 29% (1820´s), 37% (1870´s), 40% (1930´s) and 27% (1980´s) (Suter, 2).

He says that before World War I governments defaulted payments on sovereign bonds. As a result of this unilateral action, the flow of loans ceased because creditors were unwilling to grant new loans. Final agreements were reached after long negotiations. After World War II, these problems were postponed by the creation of multilateral re-financing mechanisms, which gave Governments immediate relief with restructured payback conditions. Since refinancing could be established before payments were defaulted, the flow of loans never ceased, says Suter. He suggests that loan cycles reach default stage when the Kondratieff cycle ceases to grow (Suter, 4). The evidence in Latin America, however, indicates that there was a turnaround in the flow of capital in the 1980's and that the increased debt is a result of the capitalisation of interest, which can be no means be considered as maintenance of the flow of loans, although it is true that some short-term trade was decreased and eventually multilateral public bodies granted loans for structural adjustments in the second half of the decade. The flow of long-term loans from international commercial banks did close and total flow was negative, but not frozen.

In spite of the periodical recurrence of the cycles, each one has specific characteristics. The length of the debt crisis in the first half of the 19th Century seems to be greater than in the second half. After the second World War, the international financial system appeared to have more resistance to a debt crisis because of the introduction of multilateral re-financing mechanisms, that is by the various sub-groups of creditors, debtors, private banks and governments. Like others (Marichal, 1989; Ugarteche, 1989), he sustains that individual loan cycles are linked to the rise and fall of hegemonic powers.

**Payment defaults**

There are two theoretical schools on payment defaults. The debtors' and the creditors' schools. "Governments do not go bankrupt" was the argument used in the 70's to fully restore the flow of loans that had been closed to Latin America since 1930. The question of bankruptcy is directly related to the foreclosure of guarantees. In a case of commercial bankruptcy, the creditor or creditors foreclose on the company's goods and sell them until the debts are paid. This is a normal bankruptcy process.

Some of the classical members of the debtors' school say that when a loan is sovereign, the only guarantee is the honour of the sovereign state. This is known as the Drago Doctrine, named for the Argentinean Foreign Minister, Luis Drago. In 1907, Drago said that national loans imply a contract that creates obligations for the state that takes out loans. However, he also said that not only contracts create obligations and that in any case they are special contracts with clearly identified distinguishing signs, in a category of their own (*The Proceedings of the Hague Peace Conferences, The Conference of 1907* quoted in Borchard, 1951: 5). In 1819, Hugo (Borchard: 5) said that national bankruptcy is not illegal and that whether it is immoral or unwise or not depends on the circumstances. The present generation, he said, can not be expected to pay for the previous generation's squandering and bad management, because otherwise the country would end up inhabitable because of the amount of public debt. In 1830, Zachariae said that the State could reduce its debts or completely repudiate them, if it is no longer in a position to obtain funds to pay the interest and the principal without an impact on current spending (Borchard: 5). Governments have more important things to do that pay its debts, such as keeping its citizens alive, and creditors have to be put on one side when there is no alternative. He distinguishes between voluntary and involuntary creditors. He says "only in extreme conditions can the State be considered as untitled to recognise payments to involuntary creditors (Borchard: 5). In 1889, K. Von Bar said that the State has ***beneficium competentiae*** in the broadest possible sense and first has to preserve itself and then pay its debts (Borchard: 6). In 1894, Politis said that when a State accepts a debt this constitutes a political act that the State carries out in its sovereign capacity as a public power in the name and the interest of the people (Borchard: 6). In the case of the Egyptian debt held in Paris, (*Negrotto v. Egyptian*

*Government, Gazette des Tribunales Mixtes, XXVI, 121* in Borchard: 7) it was sentenced that mixed courts have no jurisdiction on public debts issues if the act of issuing bonds is considered to be a sovereign act or it the decision made by the Egyptian authorities to violate the loan contract can be considered a sovereign act. National debt issued in France by a foreign government is a sovereign political act that involves the immunity of lending governments before the courts of the debtor's country (Borchard: 7).

The creditors' theory is based on the principle that when a State takes out a loan, it is technically renouncing its sovereignty and voluntarily accepting the rules of private law. In fact, all the contracts signed by a State, with IFI's or commercial banks, are protected by private law, either the American Federal Court on the London Tribunal, depending on the origin of the creditor. At times it is the Court of Paris. In other words, States waiver their sovereignty and accept the jurisdiction of the private lender, whether it is in fact private or a multilateral loan organisation. Borchard (8) says that it is not evident that when a State takes out a loan, it is renouncing its sovereignty and jurisdiction, and that there is no evidence for this. When a default in payments occurs, the affected bond holder is able to make use of international public law to protect himself from bad faith or discrimination in virtue of nationality (9). The creditors' rights school maintains than in a case of bankruptcy (when a State defaults payments) the creditor is not a defenceless victim of a sovereign act but has arbitration rights according to law.

In 1879, Thol wrote that the fact that a debtor is a State has no legal impact on the loan, over and above the exceptions established by positive law. They are obligations of a private nature (Borchard: 9). In 1900, Cosack sustained that when a bond goes from the State to a creditor, the creditor becomes the holder of a bond made out to the bearer and the debtor has no defence. In 1907, Freund wrote that the legal relations between a State and private individuals come under private law. The State acts, he said, in a business capacity, not as an exercise of public power such as when it collects taxes (Borchard: 9). This viewpoint is shared by Ruff, 1912; Guggenheim, 1925; Sack, 1927; and Von Daehne, 1907; and it was applied by the Federal Court of Switzerland in 1936 in the case of the German bond holders against the German government (Borchard: 11). An antecedent to this principle, sustained by Pflug in 1898, was used for the case of the French-Chilean Arbitration Tribunal in 1902. It was the court's decision in Cairo in 1925 with reference to this case. Lewandowski, in his classical ***De la protection des capitaux empruntés en France*** (Paris, 1898), said that a public loan is a private contract. When a State takes out a loan it loses its sovereign rights and enters into the field of private operations, subject to contract law. He concedes that in State bankruptcies, is the debtor has acted in bad faith, there is not much that the creditor can do and that it is therefore merely the debtor's moral obligation (Lewandowski: 27, 32-33).

The creditors' school has prevailed throughout the 20th Century, although it is maintained that when a State defaults payments, it is very difficult to legally force it to comply with its obligations. In some cases military force has been used, and so has coercion recently, towards the end of the 20th Century.

## The repudiation of debt: default of payments

If the unilateral decision of creditors to cease to collect payments is a way of solving impasse situations created by problems not controlled by the debtor government, the unilateral failure to acknowledge existing debts is a way of saying that it considers that they are illegitimate, either because they were used for murder (Adams, 1991), tainted by corruption, or belong to a previous political regime that took the resources out of the country.

Examples of failure to acknowledge debts are scarce but convincing. For example, in Mexico in 1867, Benito Juárez failed to acknowledge the debt taken out in 1865 by the Emperor Maximilian from the Societé Genérale de París to cover the cost of the French army of occupation in Mexico. According to Marichal, “they were considered to be a complete fraud, since Napoleon III used the money from the loans to finance the invasion and occupation of Mexico”.[2] A second classical example is the declaration of odious debt made by the Cuban Government after 1898 for a loan it failed to acknowledge based on the fact that the resources had been used to buy arms and fight against the Cuban people during the war of independence. Both cases refer to wars and new political regimes that inherit the loan contracts signed by the previous regime with a view to remaining in power. In both cases, the resources were used to dominate the population of the country that becomes the debtor under the new regime.

The third case of failure to acknowledge debt is the expropriation made on January 21, 1918, in a decree issued by the Government of the Union of Soviet Socialist Republics that says “All international loans, without exceptions, are unconditionally cancelled”.[3] This is particularly associated to the debts established in Paris, London and New York for the First World War and the debt with the Government of the United States. In this case, there were two arguments: in the first place, the communist party was ideologically pacifist and had been against the World War. Secondly, to acknowledge a debt from the past was to acknowledge continuity with the past (practically a debt with the past). The failure to acknowledge this debt is an expropriation of the credit of the French and English empires and at the same time a way of breaking with the past. This measure was taken by Lenin and was recently inverted in 1990.

Finally we have the most important of all as far as volume and level of conflict is concerned: the failure to acknowledge the debt of the Confederation of States of the United States of America. This is the least quoted and studied case, but it is vital to understand the mechanisms involved. It is also important because it violates articles I and XIV of the Constitution of the United States and therefore is evidence of the double standards accepted by the American Government in this field.

## The debt repudiated[4] by the United States of America

[2] Marichal, 96 table III, note c

[3] CFB, 1930: 45

[4] In this case, the debts were not only not paid, but repudiated.

| Name of the State | Description of the Debt | Approximate amount defaulted (US$) |
|---|---|---|
| Alabama | Rail guarantees, etc. | 13,000,000 |
| Arkansas | Rail guarantees, etc. | 8,700,000 |
| Florida | Bonds issued to establish banks and rail guarantees, etc. | 8,000,000 |
| Georgia | Rail guarantees, etc. | |
| Louisiana | Baby bonds, rail guarantees and stock certificates following the 1874 Agreement. | 13,500,000 |
| Mississippi | Planter's Bank 1831-33 bonds, US$ 2,000,000 | 7,000,000 |
| | Union Bank 1838 bonds US$ 5,000,000 | 13,000,000 |
| North Carolina | Special tax bonds and rail guarantees. | 6,000,000 |
| Carolina del Sur | Conversion bonds | |
| | | 75,200,000 |
| Total | | |

Source: Corporation of Foreign Bondholders, 1911, p. 395
Note: These bonds do not include war bonds or Confederate Bonds. The interest (around 6% a year) is not included. Payments ceased between 1860 (start of the Civil War) and 1890 (when the constitution of the U.S. was reformed to include the Confederation and the Western States taken from Mexico)

The question is why are they unknown. Historical evidence shows that the U.S. bonds are not recorded by the Corporation of Bondholders and that the first news of the failure to pay appears in 1904. In 1911, consideration is given to the details of a series of bonds issued by the State of Mississippi and the case is used to study the reason behind the failure to acknowledge the debt. This is important because it shows the double standards applied to international loans. The reactions depend on who the debtor is.

The debt was created by issuing bonds to establish the Planter's Bank in 1830, issuing two series for a total of 2 million dollars. The State issued the bonds and therefore became a shareholder in the bank. They were bonds at 6%, payable on a half-yearly basis. Interest was paid up to January, 1840. In 1939 the bank's shares were transferred by law to the Mississippi Railway Company, with a provision in the minutes book stating that the State's and all private shares in the company should be committed to pay the State bonds issued on the bank's account. In 1842, a law authorised the governor to take possession of the railway and all its assets and take the Company to court if it refused to hand them over. Two years later, a law was issued to allow for litigation against the bank and the Railway Company. This led to no results and in 1958 and 1859, shortly before the start of the War of Secession, two payments were made. The validity of the bonds and the State's obligation to cover the payments was never questioned. However, in 1852, a State law established a referendum and each voter was able to specify if he was willing to pay for the Planter's Bank bonds with direct taxation. The referendum took place at the presidential elections of 1852 and most of the electors voted against. Most of the electors new nothing of the amount that the bonds represented, the circumstances surrounding them of the size of the tax to be paid by each of them to pay for the bonds.[5] In 1859, the Governor recommended the legislative body to create a provision to pay for the Planter's Bank bonds but this message was sent to a commission and the majority voted against the Governor's recommendation, in spite of the fact that two payments had recently been made. After

[5] CFB, 1911: 385 - 388

the civil war, in 1875, an amendment to the constitution was proposed and approved by the population. The constitution was changed in 1876 with a clause that specifically prohibited payment of Planter's Bank and Union Bank bonds. This State constitutional reform became part of the federal constitutional reform of 1890. [6]

In 1927, upon the request of the British Government, in the League of Nations Conference for encoding international law (League of Nations, 1929), it was agreed that

> The Federal State is responsible for the conduct of its separate States, not only if it goes against its own obligations, but also if it goes against those same State's international obligations.
> In the same way, the State as a protector, is responsible for the conduct of the protected State in so far as it is capable of complying with its obligations and in so far as it represents the protected State before a third State (CFB, 1930:39)

In 1930, there were two outstanding occurrences related to the repudiated debt: Firstly, Lord Redesdale's proposal in the House of Lords on March 12, 1930,[7] to exchange the debts of the Confederated States in the London Stock Exchange for debts held by the British Government with the United States and derived from World War I (inter-allied debts). Secondly, on March 13, 1930, the Conference for Encoding International Law, at which the United States was represented, met to discuss the question of the repudiation of foreign debt and federal responsibility for the acts of its member states (there was a certain amount of concern about the foreign debts held by the states of Brazil). In the House of Lords, Lord Ponsonby expressed his disgust with the fact that there had been attempts to dialogue with the U.S. Government since 1843 and its position was that it was not responsible for the obligations of individual states, that it was unable to force specific states to pay and that it was impossible to obtain a list of the bondholders. "They (The British Government) have informed (the United States Government) that it corresponds to the National Government (of the United States) to guarantee compliance by protected or federated states, with what is known as the "contract clause" of the National Constitution (Article I, section 10), which prohibits states from approving laws that restrict compliance with contracts, and with article XIV, section 1, which prohibits states from taking a person's property without a prior court case." (CFB, 1930: 38). What is most significant is that the Government of Washington never reacted to these demands and blocked all the initiatives to create an international arbitration court where this case could be seen under the protection of the League of Nations. The representatives of the Southern states vetoed the initiative (CFB, 1930: 42) and there were no reprisals.

Repudiated debts are, then, odious debts (Adams, 1991), with reference to the arms financed by loans to main the *status quo* in Cuba before independence in 1898, or they belong to a previous regime and it is alleged that the government concerned was not empowered to take out the loans. This is the case of the repudiation by the government of Benito Juárez in Mexico, 1867, of the debt taken out by Maximilian during the Empire; and the loans taken out by Huerta in 1913, which were not recognised by the government of the Mexican Revolution in the 1922 negotiation (Borchard: 129). In the case of the debts of Mississippi or other Confederate States, repudiation occurred before the regime changed (1856 referendum) and the new regime simply accepted prior decisions (in the constitutional reform of 1876 and the federal constitutional reform of 1890). Borchard suggests that in these cases the reason is "that

[6] CFB, 1911: 385 - 388

[7] It must be remembered that the Great Depression started after the crack in October, 1929.

the loan was not taken out according to law, and the persons who claimed to represent the State had no legal authority” (129 and note 16). The situation is similar for the other confederate states in the table.

In the second half of the 20th Century, only Cuba has failed to acknowledge what were mostly interbank debts as of January 1, 1959, when the Cuban revolution removed Batista from power. The Nicaraguan case of 1979 reveals the new viewpoint in the political sphere. All the prior debts taken out by the Somoza Government were acknowledged and a study was made on corruption. It was shown that there was an investment bank that acted as intermediary for the international loans between the Somoza Government and private banks, and that this bank belonged to Somoza. In spite of this evidence, the Sandinist Government decided to re-negotiate the debt and to not pay for the new agreement. In political terms, litigation would have been more transcendental because of the precedent that would have been established, but the government at the time thought that it was more important to maintain the relations and simply to fail to pay as agreed. Nicaragua is important, because the U.S. anti-corruption law was passed in 1977 and, faced with evidence that Boeing had paid two Heads of State or their spouses (Prince Bernard of Holland and the Prime Minister of Japan) to approve an aircraft operation, Boeing was fined and the transaction was cancelled. This established the precedent that a tainted loan is null and void. Nevertheless, no European Government has a similar law and neither does the Japanese Government, well known for its corruption. Quite the contrary, sales commissions are tax free whereas whoever receives the commission is “corrupt”.

**New elements**

After Bretton Woods in 1944, international loan mechanisms underwent substantial changes. Although government-to-government loans were established during the First World War in addition to bonds issued with physical guarantees, after Bretton Woods came the concept of sovereign loans, with no more guarantee that the existence of the State that takes out the loan. New credit bodies are also established with clearly defined functions: the purpose of the International Monetary Fund was to stabilise world economy to avoid a repetition of the situation in 1930 when there were stampedes from one currency to another and banks closed down in most of the leading economies. Short-term balance loans were to solve devaluation pressures and remove pressure from national banks in critical situations. On the other hand, an International Bank for Reconstruction and Development (of Europe and Japan) was established, which after re-building these areas and promoting economic activities, started to operate in developing economies. The fourth loan cycle, unlike the three previous cycles, had several agents.

The Monetary Fund replaced the concept of international financial controller previously performed by creditor governments with the help of their armies, such as in Egypt, Turkey, Nicaragua, Santo Domingo, etc. What is extraordinary is that although the IMF is in all the central banks and the member States that have agreements with them, it does not warn either the governments or the public of problem cases. There was, for example a crisis in Thailand in 1997 and it was a surprise, and another in Indonesia in 1997 and that was also a surprise, one in Mexico in 1994 and another in Brazil in 1998, all surprises in spite of the fact that there were controllers in the central banks. What is being controlled?

Over time, multilateral bodies went from project-based to policy-based loans and in the mid 1980’s loan campaigns were started in which “correct” policies were important. By “correct” it is understood that the government that takes out the loan does whatever the bank asks it to do. In a similar way, at the end of the 1970’s the Club of Paris established a condition for re-negotiating with governments, which was that they had to have an agreement with the Monetary Fund. All this configured a world in which governments have to comply with conditions established by creditors with reference to economic policy, but also with regards to privatisations, handling of the debt, elimination of subsidies and practically universal charges for health and education services. The governing capacity thus goes from a national to a multilateral nature. Finally, regardless of who or which party governs, they all do the same on the economic sphere, in spite of what they say. This post-imperialism fulfils the demands of transnational capital and ties down the governments of developing countries, creating or increasing representativity crises.

Conditions, moreover, underwent an essential change in 1944 when the previous idea that to reach a final agreement on an unpaid loan the debtor had to have a fiscal and commercial surplus ceased to be the case. Now a fiscal and commercial surplus was not necessary, because the IMF would loan the resources to cover the foreign gap if necessary. In other words, the Ponzi scheme is possible and encouraged, even though economic theory says the opposite.

These economic advisors who establish conditions are also creditors, thus creating a conflict of interest that is only possible in banking circles in Germany. In other countries, a country’s economic advisors can not be related to its creditors because distance is lost and there is a clear conflict of interest.

**Suggestions put forward**

After the Pope’s call for the Jubilee year in 2000, different organisations have considered the subject of debt in different ways. What is most surprising is that in the 80’s no-one was interested in the subject, except for left-wing experts and politicians in Latin America and Africa. At that time, when the subject arose because of an international crisis that put a stop to loans in Latin America (except for Nicaragua, which managed to multiply its indebtedness by 8 in the years between 1980 and 1989), there were two official positions. One consisted of failing to pay the debt and it was defended by Fidel Castro in a conference in Havana in July 1985. The other consisted of paying 10% of exports and it was defended by Alan García in July 1985 at the investiture of the Peruvian Government. There was an attempt at creating a Debtors Club by the Rio Group, which was vetoed by the governments of Mexico, Brazil and Colombia because of pressure from the United States. The Latin American governments then faced a fall in raw material prices, an unprecedented rise in U.S. interest rates (21%), and the end of voluntary loans. However, with the above exception, the debt at the end of the 80’s was double what it was at the beginning of the decade, simply because of the capitalisation of unpaid interest. The exception should be taken into consideration because it allows us to confirm that whenever there is interest in supporting a government, in spite of international economic problems, that government receives support. No-one in Europe was then interested or capable of mobilising a political organisation of the G7, not even the radicals of the time.

The Jubilee re-opened the old boring subject that international financial bodies had considered as closed since 1991. There was a campaign to cancel the Third World's debts, based in Brussels and other organisations in different countries, including Jubilee 2000 Coalition and Southern Jubilee. There were meetings in Europe especially, but also in the United States, where the IMF, the World Bank, conditions and poverty relief programmes were questioned. Different coalitions were formed where different interest groups came together to consider the issue from different perspectives. More surprising still was that there were popular protests against Third World debt in Japan and Europe, which was remarkable, particularly since it was only ten or twenty years after Latin American political organisations (with the previous exception) had been protesting against the same thing. But no-one in the developed world was then interested in the subject. So much so that an organisation created in Latin America called Fondad (Forum on Debt and Development) became Eurodad in 1990, because of a changearound of its Dutch financiers. There is still a strictly Dutch Fondad.

In this framework, it is extremely important that there are people interested enough to move the issue politically. It is an interesting time for changing the international rules of the game. Proposals include:

1. Total cancellation of all Third World debt with no conditions
2. Cancellation of the debts of the poorest countries with positive conditions
3. Creation of an international court of arbitration
   - Creation of an insolvency procedure to protect social spending levels using the criteria included in Chapter 9 of the United States bankruptcy law.
   - Creation of an independent international arbitration tribunal, using an international financial code, that as yet does not exist. This court would also be used to judge cases of corruption that now remain unheard.

The first position, simple and clear, does not change anything but it takes resources from the First World. It somehow forces creditors to absorb losses unconditionally without changing international rules. It releases resources in economies to be spent as governments see fit. In the best possible sense, it assumes the principle of the Good Savage. "If it is a Third World government, it must be honest and wise". There is little evidence of this. There are evident cases of resource mismanagement in Latin America, Africa and Asia. Systems for democratic budgetary control in countries with fragile States are practically non-existent. A reduction of the debt could then end up being the start of frivolous presidential spending on presidential aircraft, firearms or, worse still, theft.

That is why the civil society concerned must establish conditions for the governments involved. Some of these conditions have been expressed in the Tegucigalpa Declaration and other in documents published in Jubilee 200 Great Britain. The most significant are:

1. Restrict amortisation of the debt renegotiated with final agreements to 3.5% of the national budget, based on the German agreement of 1950 and 1953.
2. Make trade agreements independent from debt agreements.
3. Commercial and fiscal surpluses as a minimum condition to pay the debt, thus encouraging the purchase of Third World products in the developed world. The present trend is the opposite.
4. At least 20% of the nation budget should be spent on education and health.

The following are parallel to these demands:

1. The World Bank and the Regional Banks should reduce debt without conditions because the present debt reducing mechanism has increased the conditions, thus creating taxes that create and/or increase poverty in the "beneficiary" countries.
2. The WB should return to its role as a project financier and the IMF should stick to supporting balance of payments loans within the framework of an international court of arbitration.
3. The Club of Paris, in view of its historical failure, should be dissolved.

It is clear that this is not as radical and the first line, but it changes the rules for the future and could lead to a single event, such as the cancellation of the foreign debt of one or all of the countries involved.

The discussion on the two aspects of courts of arbitration is ongoing. It is known as the FTAP (Fair and Transparent Arbitration Procedure).

At the start of the 21st Century, it can be argued that the reappearance of the issue of debt in the First World as a result of the Pope's call in the Jubilee Year has had no concrete results with regards to substantial debt reduction. Indeed, it established positions of the Church that can be counterproductive when combined with unhealthy views on birth control and sexual and reproductive rights where Rome has a fundamentalist viewpoint. As a civil organisation, Jubilee 2000 is possibly the first organisation with a militant base in all the G7 countries except France. There are also organisations in many Third World countries, particularly Africa and Latin America. Nearly all of this is based on prior organisations that were related to the subject in the 80's, with the above exception. The end of the year 2000 does not and can not represent the end of the cause that was the basis for the Jubilee 2000 movement, perhaps with the danger of reaching the 22nd Century with the same slogan and year. Whether there is consensus on the maximalistic position that does not change the global rules, or a mixture of all this, the debate is open and the pressure is at least creating a change of opinions. This pressure must continue, preferably with the help of civil society in the First World. As we learned in the 80's, if the civil society of the First World is not involved, a message from the South alone will not be heard by the Governments of the North. It must be made quite clear that the South is of no interest or significance for Capital or the Northern States. It must also be made clear that the cost of reducing of cancelling all Third World debt (including Argentina, Brazil and Mexico, the three most heavily indebted countries) is less than the heavy portfolio of Japanese banks. In other words, it is possible if there is a will or enough pressure. When the governments of the G7 realise that it is in their best interests, they will do it. It is in our interest as a civil society to use resources to cover social debt in the best possible way and not to leave this to the free choice of unforeseeable governments.

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