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Quo Vadis, Señor Brady? The Brady Initiative: A Way Out of the Global Debt Crisis?

Enrique Dussel Peters

ABSTRACT: This article examines the relation between the global debt crisis and the accumulation crisis of the capitalist system, in both peripheral and core countries. In contrast to the 1950s, since the 1970s despite its hegemony the U.S. has been unable to bear the costs of stabilizing the capitalist world market and has taken a selective approach to the solution of the global debt crisis, as the case of Mexico clearly shows. This article argues further that the U.S. attempts to socialize the loan losses of private creditors through the instrumentalization of multilateral agencies and the Brady Initiative, shifting the costs from private creditors and debtors to civil society. However, this strategy has shown few signs of success, and the creditor banks and the indebted countries are far from solving their global contradictions. In Latin America, after the "lost decade" of the 1980s, the possibility of total collapse and pauperization in the 1990s cannot be dismissed.

INTRODUCTION

When U.S. Treasury Secretary Nicholas Brady unveiled his initiative at the beginning of 1989, great expectations arose. International debtors and creditors anticipated a new guiding principle of international debt strategy, directly involving the U.S., the International Monetary Fund (IMF) and the World Bank. After the failure of the Baker Plan in 1985, the U.S. was apparently attempting for a second time to find a "final solution" to the global debt crisis of the periphery. This article examines the relation between the global debt crisis and the accumulation crisis of the capitalist system, in both peripheral and core countries, and emphasizes the contradictions of the capitalist world market and the crisis of U.S. hegemony, as it has become the world's largest net debtor since the 1980s. Essential in this context is the understanding of the external debt crisis of the periphery as a dual process, i.e., not only as the structural necessity of the periphery to borrow since the 1960s but also as the opportunity for the Organization for Economic Co-operation and Development (OECD) countries to lend money-capital up to the early 1980s.

The first part of this paper briefly summarizes the historical conditions of the external debt of the periphery, stressing the role of the U.S. since the Second World War. In particular, I will argue that the "myth of the recycled petrodollars" impedes the theoretical and historical analysis of the debt crisis

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in its totality. The second section concentrates on the market-oriented financial innovations developed in the 1980s, which are fundamental to the "solutions" of the external debt presented in the 1980s, i.e., the Baker and Brady Initiatives. I will conclude with the consequences of the Brady Initiative and some reflections on the future, stressing the socialization of the loan losses of the creditor banks and private debtors in the indebted countries, with reference to the case of Latin America. In this paper I can only outline some of the causal relations between the development model followed by the Latin American countries and the function of the external debt.[1] Further exploration of these causal relations requires concrete studies of each of the Latin American nations, which have already been carried out in some cases (see for example: Altvater 1987; Huerta 1985; Pollin and Alarcon 1988).

FROM THE BRETTON WOODS SYSTEM TO THE EURODOLLAR MARKETS

The outbreak of the international debt crisis can best be explained starting with its most elementary form, i.e., the debtor-creditor relationship. Therefore, this section analyzes the historical process of supplying and demanding money-capital among nation-states in the capitalist world market.

After the Second World War the U.S. was undoubtedly in a hegemonic position.[2] Its productive sector had been left intact and, in contrast to Europe and Japan, it was the only nation with considerable export and trade potential. Through the imposition of the Bretton Woods System in 1944, the U.S. institutionalized its hegemony at a financial and political level in the capitalist world market, demonstrating its productive and military superiority. The U.S. accumulated the highest gold reserves (60% of the world reserves), became the biggest net creditor since the First World War, and showed chronic trade surpluses since the beginning of the century. In this context, the intensification and reconstruction of international trade and full convertibility among currencies and their sufficient circulation in the world market were some main U.S. interests. Similarly, institutions as the IMF,[3] the World Bank, and the General Agreement on Tariffs and Trade (GATT) stimulated international trade and the global accumulation process, expanded the circulation of U.S. dollars, and sustained an unprecedented economic and political stability in the OECD countries in the 1950s and 1960s. The U.S. was able to finance these institutions in this historical moment owing to its productive superiority, which began to vanish in the 1960s.

In the 1950s and 1960s a restructuring of the capitalist world market occurred. This process was characterized by the transnationalization of production and the development of the U.S. dollar as world money (Arrighi 1982; Kindleberger 1981). Furthermore, the competition among national capitals and the relative fall of U.S. productivity compared with Japan and

most of the West European countries since the 1950s[4] provoked two trends in the OECD countries. On the one hand, a tendency for the rate of profit to fall (Glyn et al. 1989; Lipietz 1986), especially in the U.S. and Great Britain; and on the other hand, a tendency to equilibrate among these countries (OECD 1983). This process substantially influenced the capital transfers from the OECD countries in their different forms, searching for the highest form of valorization in the world market, and already contains the possibility for the independence of the financial sphere from the production sphere.

Already in the late 1950s Triffin indicated some of the contradictions caused by the instability of the global financial system. The U.S., as the hegemonic power, had to impose acceptance of U.S. dollar as a measure of value, medium of circulation and means of payment. In a system of fixed exchange rates, such as Bretton Woods, the initial growth of world trade could only be sustained by an increasing circulation of U.S. dollars, made possible by U.S. capital outflows in the form of military spending, loans, donations and direct investments. But the limited availability of gold in the U.S., on the one hand, and its increasing expansion of money supply, generated on the other hand a de facto inconvertibility of U.S. dollars from the beginning of the 1950s. This overvaluation could only prevail as long as private and official U.S. dollar holders agreed to accept these conditions (Triffin 1960). It was this financial erosion of the U.S. — reinforced by the reluctance of official institutions and private corporations to hold U.S. dollars and their subsequent speculation — that determined the collapse of the Bretton Woods System between 1971-1973: With only 15% of U.S. dollars backed with gold, the U.S. was unable to maintain the fixed exchange rate. These developments were exacerbated by the military balance achieved by the Soviet Union and the liberation movements that emerged in Latin America in the 1950s and 1960s and were sharpened in the 1970s by the military defeat (and economic costs) of the U.S. in Vietnam. In this context, the crisis[5] of U.S. hegemony since the late 1960s not only manifested the existent productive contradictions in and among the OECD countries, but also constituted an open questioning of the Pax Americana. This process created on the one hand an apparent excess liquidity of money-capital in the world market prior to the first oil shock in 1973 (Dufey and Giddy 1978; Lichtensztejn and Baer 1985; MacEwan 1986), and on the other hand the possibility of international borrowing, either by private corporations or national states. The accumulation crisis in the OECD countries, particularly the crisis of U.S. hegemony, created the possibility of massive money-capital supply. It is in this historical context that the transnational banking system in the free banking zones (or Eurodollar Markets) gained an essential role channeling money-capital in its search for profitable lending.

The establishment of several free banking zones since the late 1950s is particularly significant because they operated as relatively autonomous international mediators of the excess money-capital originated in the OECD countries. What was qualitatively new about these juridical spaces was that they offered the lowest international cost of borrowing at "floating interest rates," that money-capital did not have to change name or form, and that their operations were not subordinated to official regulations (Devlin 1989b; UNCTC 1981, 1987). Although investments and savings in the OECD countries tended to decrease after the 1970s,[6] the annual growth rate of the transactions of the transnational banks surpassed by more than 20% the growth rate of world trade. Governments, banks and transnational corporations of the OECD countries provided until 1984 around 65% of the deposits of the free banking zones. Based on sources of the Bank for International Settlements (BIS), Schubert (1985) emphasizes that even after the second oil shock the deposits of the OPEC countries to the free banking zones increased by $37.4 billion and $41.9 billion in 1979 and 1980, although the total liabilities of the reported region, i.e., of the industrialized countries, increased from 1978 to 1980 by $290 billion. In this sense, the petrodollars played an important role in continuing and increasing the size of the international indebtedness process, but the outstanding growth of the free banking zones was largely a result of the accumulation crisis of the OECD countries and the subsequent restructuring of their economies. Another essential factor was that the transnational banking system prevented the negative consequences of a devaluation of the world money dollar, "exporting inflation" through the free banking zones (Schubert 1985).

On the other hand, the crisis in the periphery, particularly in Latin America, appears at the beginning of 1970s, when most of these countries were no longer able to continue the accumulation model established since the 1930s.[7] To put it as briefly as possible, a rising "inward-oriented" and imitative industrialization took place, based on a socioeconomic and political consensus, an import substitution policy, external financing as a complementary source of investment and favorable external conditions. Based on the transfer of surplus value and labor power from the agricultural to the industrial sector and on foreign direct investments, a number of Latin American economies — especially countries like Argentina, Brazil and Mexico — initially seemed to carry out a successful strategy, achieving annual growth rates of GDP per capita of 2.8% between 1950 and 1979 (ECLAC 1990c).[8] But the "big push" (Nurkse 1955) and its "forward and backward linkages" (Hirschman 1958) did not develop in the expected form. On the one hand, the postwar Fordist accumulation in the OECD countries began an impressive "autocentric" form of capitalism (Hurtienne 1989). The decreasing demand for primary agricultural goods from the periphery[9] and the resulting falling export revenues, one of essential pillars to finance industrialization, revealed some of the structural limitations of the national

industrialization. Similarly, since the 1960s the transnational corporations increasingly substituted profits from existing investment for new foreign investments.[10] The increasing inward-oriented production, along with declining trade surpluses and foreign direct investments, sharpened the financial difficulties for the governments concerned. Foreign loans presented the possibility of overcoming, at least partially, their balance of payments difficulties. On the other hand, apart from corruption and prestige investments, the contradictions among the agrarian and industrial bourgeoisie and the transnational corporations and the tensions that resulted from social differentiation and unequal distribution of income, which manifested itself in limited domestic demand, eroded the consensus generated decades before (Marini 1969; Cardoso and Faletto 1969). Already in the 1960s the development strategy began to show the first critical signs, expressed through increasing trade balance deficits and capital flight;[11] but from the late 1960s on Latin America began to finance an enormous part of its increasing foreign exchange requirements with external credits (Pollin and Alarcon 1988; Wionzcek 1970). However, and this is important for understanding the contradictions of the accumulation model, Latin America was a net exporter of capital between 1950 and 1990, with the exception of 1970-1981 when the international indebtedness process developed (ECLAC 1990c).

In this explosive historical situation, exacerbated by increasing oil prices in 1973, the periphery faced the choice either of looking toward alternative political and economic forms of production and breaking with the capitalist development model followed up to then, or of continuing this model and thereby prolonging the structural crisis of the industrialization strategy. The second option required new capital through external financing, a gradual shift to an export-oriented economy and the imposition of authoritarian regimes to repress popular discontent, as last resorts to prevent the collapse of these governments. It is in this context that the external borrowing process — now one of the essential guarantors of economic and political stability — tripled in Latin America from $4.1 billion to $12.6 billion in 1957-1966 and increased again in 1974-1982 from $56 billion to more than $400 billion. It becomes clear then that the Latin American governments' need for money-capital in form of loans did not emerge from solvency or liquidity problems, but was the product of a complex sociopolitical and economic development process.

THE OUTBREAK OF THE DEBT CRISIS AND THE "MENU OPTIONS"

The development of the debt crisis since 1982 can be divided into three phases (1982-1985, 1985-1989 and 1989 to the present) according to the changing relations among the role of the multilateral agencies, the interests of the U.S. and of the transnational banking system, and the economic and

political conditions of the periphery. This section stresses the importance of the financial innovations since 1986 for the understanding of the Brady Initiative in 1989.

As outlined before, one of the manifestations of the crisis of the world capitalist system in Latin America was its increasing external debt and its subsequent incapacity to pay the debt service (amortization + interest payments). The initial period after the outbreak in 1982 indicated the profound crisis of Latin America: The sharp decrease of the investment coefficient (fixed investment/GDP), which fell from 22.7% in 1980 to 16.2% in 1985, the decrease of per capita income (which in 1985 was equal to the per capita income of 1977), the increase of unemployment, the sharp fall of real salaries (which were higher in 1974 than in 1985) and an unsustainable inflation, which averaged 440% in 1985 (ECLAC 1986, 1987, 1990c).

The external debt crisis erupted in 1982 mainly because the U.S., the principal capital exporter and creditor since 1945, became a net importer of capital, which manifested the contradictions in and among the OECD countries, as explained before. While in 1982 the U.S.'s capital balance showed a surplus of $27.9 billion, in 1983 it reached a deficit of more than $29 billion. The U.S.'s need to finance its trade and fiscal deficit with external credits drastically changed the direction of capital flows and the function of the transnational banking system. Moreover, the U.S. was a far more secure debtor than the countries in the periphery for international creditors. As in the 1950s, this process created an apparent money-capital shortage with respect to Latin America in the international financial markets which appeared also in the striking increase of international interest rates. For the first time since the 1970s, Latin America faced the necessity of realizing trade surpluses to service its debt payments. As in the international crisis of the 1930s (Ziebura 1984), during the 1980s the recycling of money-capital could not be sustained any longer: The net transfer to the periphery decreased from $18.2 billion in 1982 to −$43 billion in 1988 (World Bank 1989a). In parallel, Latin America was forced to decrease its imports from $97.6 billion in 1981 to $56 billion in 1983 and to transfer approximately $223 billion to its creditors between 1982 and 1990, although the nominal amount of its external debt increased by around $100 billion (ECLAC 1990a, b). Also important for the understanding of the money-capital shortage is that private creditors — commercial banks and savings and loan associations — were threatened by losses on outstanding loans to U.S. corporations and highly indebted countries and began a massive national and international securitization process,[12] characterized by a sharp reduction of foreign debt exposure: The growth rate of long-term debt from the transnational banks decreased from 23.8% in 1973-1980 to −0.7% in 1988 (World Bank 1989b), and the exposure of the nine biggest

U.S. banks declined in 1982, 1984, 1986 and 1989 to 179.8%, 145%, 109.7% and 74.9% of their primary capital respectively (ECLAC 1990b).

It is in this context, assuming the problems of the indebted countries to be a short-term "solvency" or "illiquidity" crisis, that multilateral institutions began to assume a global function again, which they had lost after the collapse of the Bretton Woods System. In this first phase, 1982-1985, the IMF and World Bank acted as the international lenders of last (and only!) resort, preventing the collapse of the international financial system and the formation of an international debtors' cartel and thereafter protecting the interests of the private creditor banks, mainly in the U.S. Through an aggressive neoliberal policy toward the periphery since the 1980s they encouraged a monetary vision of the balance of payments, productive restructuring in tune with international standards and a review of the economic space and function of the state (Lichtensztejn 1986). Between 1982 and 1984 these austerity programs produced only minimal economic improvements in the periphery while drastically increasing the economic, political and social turmoil of the region.[13] The failure of the multilateral agencies' policies and the reluctance of the transnational banking system, especially the U.S. banks, to increase loans and the political and economic implications of the global debt crisis in the Highly Indebted Countries (HIC) made a direct intervention by the U.S. necessary.

Against this background in 1985 U.S. Treasury Secretary Baker proposed a new debt strategy scheme. To summarize briefly, the Baker Plan related the debt crisis directly to the economic growth of the HICs and attempted to resolve it by the liberalization of international trade, a privatization process in these countries and punctual debt service payments.[14] These policies were reinforced by fresh money and capital flows from multilateral agencies and creditor banks. Apart from the negligible amount provided — $29 billion in three years, compared with the total external debt of the HICs of $445 billion in 1985 — the failure of the Baker Plan revealed on the one hand that it could neither force the private banks to "contribute" to voluntary debt agreements nor prevent the "free-rider" behavior of mainly smaller creditors. On the other hand, the selection of 17 HICs, 12 of them Latin American, reflected the particular interests of the U.S. in Latin America. Owing essentially to the financial limitations of the U.S., an international process began to crystalize, which instrumentalized the multilateral agencies for U.S. hegemonic interests and neglected the issue of a global solution of the debt crisis. It was the failure of these policies that encouraged private creditors and indebted governments to enhance the different financial innovations developed since 1982 to solve or relieve the debt and debt service of the periphery.

Given the inability of the multinational agencies to face the structural problems of the debt crisis and the failure of the Baker Plan, private creditors, potential investors and the various indebted governments began to

establish direct negotiations. Through financial innovations in this second phase of the debt crisis (1985-1989), private creditors accepted for the first time that they had to realize losses.

The policies followed by the official institutions were displaced by financial innovations ("market menu"), based on the voluntary conversion of debt issues to more secure forms of assets for the creditors. In general, these transactions are agreements between two parties to exchange liabilities (debt issues) of indebted countries at a discount. Given variable or fixed interest rates, different currencies and maturities of the nominal value (or "face value") of the liabilities, several forms of financial innovations have developed since 1982. The debt-equity swaps and the exit bonds stand out qualitatively among these financial innovations.[15]

Debt-equity conversion schemes, established for the first time in 1985, were based on purchases of debt papers by (mainly) foreign investors for a variable percentage of their nominal value. The difference between the nominal and the real value (established by mutual consent or in the secondary markets[16]) of these debt issues, the discount, determines the extent of the debt reduction. In general, a high percentage of the nominal value of the debt issues was exchanged into the debtor's local currency, which could be used either to service domestic debt or as an investment. For investment purposes in Mexico, for example, the German transnational Volkswagen bought from creditor banks Mexican debt issues with a nominal value of $283 million for $170 million. As agreed beforehand with the Mexican government, Volkswagen sold these debt issues to the Mexican government for $260 million (in Mexican pesos), realizing a net profit of $90 million (Lerbinger 1987). These transactions apparently yielded positive results to all the participants: The Mexican government reduced part of its external debt and payed in Mexican pesos, foreign investors realized extra profits and private creditors decreased their liabilities against HICs.

However, these financial innovations also presented significant qualitative and quantitative limitations for all the involved parties. Most of the indebted governments implemented stabilization programs, which also implied drastic expenditure cuts. Increasing debt buy-back programs would have either reduced their expenditures further, unlikely given the already low social and investment expenditures, or increased inflation by increasing the money supply. Similarly, given the uncertain economic and political conditions in these countries, private corporations were unwilling and unable to invest in the quantities required to significantly reduce the HICs' outstanding foreign debt. Finally, as clarified in the next section, private creditors were incapable of realizing the massive real losses that these transactions relied on. This was the main cause for the limited effects of the "menu options."[17] In this context, in the case of Mexico, the debt-equity transactions did not attract new investments or the repatriation of capital flight: Transnational corporations already established in Mexico substituted debt-equity swaps for

investments. In this sense, the debt-equity swaps did not develop the expected diversification of the productive sector and were an important element in worsening inflationary tendencies in some countries that purchased the debt issues by increasing the money supply (Bouzas and Ffrench-Davis 1990). The debt-equity swaps were suspended in Mexico in 1987 and, owing to similar tendencies in other countries, restricted in most of the affected countries in the same year.

From the perspective of the indebted countries, an important share of the discount granted by the creditor banks was realized as extra profits for private corporations or potential investors. In response, in 1987 several countries — initially Argentina, then Brazil and Mexico — began to carry out direct transactions between creditors and debtors (exit bonds), leaving the discount to the indebted government. Mexico hoped to replace up to $20 billion of its external debt with new debt issues, whose principal would be secured by zero-coupon bonds.[18] The Mexican government announced at the end of 1987 that it was expecting bids of the creditor banks to exchange "new debt for old" at a discount of 48%, comparable to the price of Mexican debt papers on the secondary market. Like the debt-equity swaps, the exit bonds apparently created an optimal solution for all parties: The private banks were able to write off part of their insecure assets, the indebted countries reduced their total external debt and, for the first time, the U.S. found a new source to finance its fiscal and trade deficits by selling zero-coupon bonds to indebted countries. What was qualitatively new was that for the first time since the outbreak of the global debt crisis, the U.S. government directly endorsed this conversion scheme and facilitated a guarantee on the principal of the Mexican public debt. The innovation in this mechanism was that, assuming a future increment of the exit bond transactions, the transnational banking system, and so part of the world economy, would increase its dependency on the U.S. However, the outcome of the exit bond transaction was more than disappointing: The average discount offered by the banks was only 30.33% and only 139 (out of 500 creditor banks) bid for the bonds. The total debt reduction for Mexico was similarly meager, only $1.1 billion distributed over 20 years — an insignificant fraction of its total debt of $105 billion.

The qualitative limitations of the financial innovations, the still explosive situation in the periphery, the potential consequences of direct negotiations between creditors and debtors (for example the creation of a debtor cartel) and the inefficiency of the multilateral agencies enforced for the second time since 1982 a direct intervention by the U.S. — the Brady Initiative.

SOCIALIZATION OF LOSSES AND SELECTIVE APPROACH TOWARD THE PERIPHERY: THE BRADY INITIATIVE

This section examines the proposal of the Brady Initiative and highlights the selective approach of the U.S. toward the "solution" of the global debt crisis. As the case of Mexico, the country treated most favorably by the U.S. since 1982, reveals the national and international attempt to socialize real loan losses not only fails to provide a solution to the global debt crisis, but might also exacerbate the existing critical political and economic conditions among the involved indebted and OECD countries.

When the Brady Initiative was unveiled in 1989 — beginning the third phase of the debt crisis since 1982 — three essential processes were evolving. They were severe economic and political deterioration of the indebted countries, the continuing retreat of the creditor banks and the development of the secondary markets. Since the announcement of the Baker Plan in 1985, slight economic improvements have been accomplished in a few Latin American countries (especially in Chile), but the burdens of the "lost decade" after nine years of neoliberal policies are unambiguous. The cumulative change in 1981-1990 of the growth of per capita GDP was a negative 9.4% and the terms of trade declined similarly by 20.6%, while interest payments as a percentage of exports accounted for 32.1% annually, and the annual net transfer of resources from 1983 to 1987 was 4.0% of Latin America's GDP (ECLAC 1990a, b). Several countries publicly or de facto suspended their debt servicing — arrears accumulated in 1990 to nearly $30 billion — and the political situation deteriorated drastically. Riots in Argentina, Brazil and Venezuela, and especially the uncertain economic and postelectoral political situation in Mexico, increased pressure on debtor governments, the multinational lending agencies, and the U.S. At the same time, the creditor banks continued their securitization process increasing their loan loss provisions.[19] In 1987 Citibank was the first big U.S. bank to increase its provisions to 25% against outstanding loans from HICs. However, the different provisioning and exposure levels among the creditor banks is one of the fundamental motives for their discrepant policies against the external debt crisis. In 1988 West German and Japanese banks, for example, already built up loan loss reserves of between 55% and 100% against their outstanding loans and were subsequently more favorable to forgiving or discounting substantial parts of the external debt, which increased the pressure on the biggest U.S. banks, who were accounting considerably lower provisions (Brady 1989b; ECLAC 1990a). Meanwhile, the average prices for the external debt issues (as a percentage of their nominal value) of Latin American countries on the secondary markets declined from 45.1% in 1988 to 34.7% in 1990 (ECLAC 1990a). These

processes increased the pressure on the multilateral agencies, public debtors and creditors to pursue real debt and debt service reductions.

Under these circumstances Secretary of the Treasury Brady acknowledged the failure of the Baker Initiative and of the adjustment programs of the multilateral institutions (Brady 1989b) and proposed a new initiative to apparently confront the global debt crisis of the periphery. The novelty of the initiative is the official recognition of the U.S. that the global debt crisis could only be solved assuming real losses from both multilateral and private creditors, substantially reducing the debt and debt service of the indebted countries. The Brady Initiative required that multilateral agencies and private creditors reduce the international outstanding debt of 39 selected countries by an average of 20% (or $70 billion, $24 billion provided by the IMF and the World Bank, the rest by the private creditors) within three years. The aim of the Brady proposal was to encourage voluntary debt reductions by debt-equity swaps and exit bond schemes, which was supposed to strengthen direct investments, repatriation of capital flight and reverse capital flows in the debtor countries in the future. Also essential in this initiative is the role of the IMF and World Bank, acting as mediators between debtors and creditors in order to prevent their direct negotiations.

In summary, the Brady Initiative can be considered a milestone for a future solution of the global debt crisis, as long as: 1. It institutionalizes the financial innovations developed in the secondary markets, although it prevents direct negotiations between debtors and creditors initiated by the debt-equity and exit bond transactions. 2. The U.S. and the OECD countries endorse these transactions directly (with zero-coupon bonds) or indirectly (by the multilateral agencies). 3. The function of the multilateral agencies as mediators between debtors and creditors is ensured. Likewise, only the countries that carry out the IMF and World Bank "austerity programs" will be rewarded (Brady 1989a), following "the formula of the carrot and stick" (Maier 1989). 4. The creditor banks are obliged to negotiate. The "sharing clauses" of the multilateral agencies, which empower them to make decisions regarding the debt crisis only in conjunction with private creditors, are de facto suspended for three years.[20] 5. Newly granted loans will automatically achieve a preferential status, creating at least two conflicting forms of assets, "old" and "new" debt issues. This process raises the possibility of a potential bailing out of the total banking system, as long as most of the assets against HICs — the ones not considered in these transactions — could be judged as "bad debts." As with the Baker Initiative and the exit bond transactions, Mexico was again the guinea pig of the Brady Initiative, although Costa Rica and the Philippines were considered later. However, the negotiations with Mexico were qualitatively and quantitatively by far the most significant, while the agreement with Costa Rica was limited to $1.5 billion and the Filipino government has been confronted with the impossibility of obtaining new loans for the buy-back scheme.[21]

In 1989 the Mexican government faced, as in 1982, 1984-85 and 1987, serious difficulties in servicing the debt payments and required either fresh money or a substantial debt reduction. The public external debt of Mexico, $48.5 billion, was to be renegotiated with the creditor banks who were offered three options: a) to convert old debt issues, with a discount of 35%, for bonds with floating interest rate and a maturity of 30 years; b) to purchase old loans for 30-year maturity bonds (with the same nominal value) and a fixed interest rate of 6.25%; or c) to grant new loans (or recycle interest payments) for four years in an amount equivalent to 25% of their outstanding exposure. And, finally, the interest payments of the first two options were guaranteed for eighteen months. As with the exit bonds, the success of the "Frankenbonds" (*Euromoney*, September 1989) is guaranteed by the U.S. Owing to the special features of Mexico's case, the U.S.-Treasury issued zero-coupon bonds at a price notably below market level, as long as Mexico was playing the role of "the catalyst" for all the developing countries. The IMF, World Bank, Japan and Mexico itself provided around $7 billion to finance the guarantees under the agreement, demanding 20% of the total funds of the multilateral agencies conceded by the Brady Initiative. With these loans the Mexican government acquired zero-coupon bonds, which secured the new bonds' principal payment, in a similar manner to the exit bond transactions. On the other hand, the Mexican government agreed to enhance the liberalization process, to reintroduce the debt-equity transactions suspended in 1987 for around $1 billion annually in the next three and a half years and to increase the service on the new bonds up to a maximum of 3% a year beginning 1996 if the price of oil exports should exceed $14 per barrel. After fierce negotiations and the direct intervention of the U.S. Treasury Department (*Financial Times*, July 25, 1989), Mexico reached an agreement on the credit package, retroactive to July 1, 1989. According to the bids, 41% (for $19.7 billion) of the banks responded to the discount bond, 47% (for $22.5 billion) to the fixed interest rate bond and 12% (for $6.9 billion) to new loans. The first option will provide an annual debt reduction of $700 million, the second of about $840 million, and the third will enable Mexico to receive loans for $1.5 billion in the next three years (*Proceso*, February 12, 1990). In net terms the annual debt service reduction amounts only to $1.47 billion or less than 15% of Mexico's annual interest payments during 1983-1988, bearing in mind that Mexico provided $1.3 billion of its reserves and including the service of the granted loans of $5.7 billion for the transaction.[22] But even under these favorable terms, compared with the rest of the periphery, this debt and debt service relief is a necessary but not sufficient condition for Mexico to experience significant economic growth in the 1990s. Considering the current political and social difficulties, and the rising deficit on the balance on current account — from $2.6 billion in 1988 to $6.3 billion in 1990 — the Brady Initiative will provide few new development possibilities. The

possibility cannot be dismissed that in 1992-1993, after the 18-month guarantee of the debt service payments expires, new debt reduction negotiations will have to be prepared for Mexico.

In this context, the Brady Initiative points in three directions. First, it institutionally socializes the loan losses of the creditor banks at an international level.[23] The transnational banking system, which realized huge profits in the 1970s also owing to granted loans to the periphery (Devlin 1989b), is able to redistribute its loan losses in the 1980s, through the tax deductibility of loan loss provisions and other mechanisms or through the multinational agencies. For example, as noted, these agencies are to provide new loans for the purchase of zero-coupon bonds and the ultimate source of the multilateral agencies funds is, of course, the tax revenues of the OECD countries. The agencies directly endorse future debt service payments, as the cases of the exit bonds and the Brady Initiative reveal. Taxpayers in the OECD countries are already paying indirectly for the loan losses of the creditor banks (Abbott 1989; Dussel Peters 1988). As with the privatization of profits and the socialization of the loan losses of the transnational banks in the OECD countries, the dominant classes in Latin America have socialized the costs of its external debt since the beginning of the 1980s. Through the nationalization of highly indebted banks and private corporations (and their later privatization, excluding external debts) and the "democratization" processes in Argentina, Brazil, Chile, El Salvador, Guatemala, the Philippines, etc., the external debt granted to military and national dominant classes has been "nationalized." But these are just the most obvious socialization forms of the accumulation process of the region. Far more important is to analyze how the external debt of Latin America was and still is an essential element in maintaining and reproducing, in spite of the economic, political and social crisis of the development model, the existent economic and political structures. A manifestation of these processes is the capital flight of the HICs which, enhanced by the overvaluation of the different currencies of the region, amounted to 103% of its long-term external public debt in 1987 (Bulow and Rogoff 1990). The essence of this "legal" process is structurally compatible with and developed by the capitalist societies in Latin America and capitalism in general, although it engenders serious economic contradictions among the dominant classes, especially during the crisis.[24]

Second, the Brady Initiative shows that the U.S. supports this strategy, as it was unable to pay the costs of the financial stability of the capitalist world economy as it did in the 1950s and 1960s. This is obvious in the case of the external debt crisis of the periphery.[25] In this sense, the "carrot and stick" policy of the Brady Initiative tries to make use of the multilateral agencies to maintain U.S. hegemony. The IMF and World Bank become mediators to negotiate quasi-bilateral agreements according to the strategic interests of the U.S., as the case of Mexico repeatedly demonstrates.[26] Third, in the

tradition of the Baker Initiative, the Brady Initiative does not attempt to solve the global debt crisis of the periphery but reveals that strategically important indebted countries have been selected. Mexico — a possible member of a future Free Trade Agreement with the U.S. and Canada — Costa Rica and the Philippines are the ideal candidates for this Initiative, while the future of Argentina and Brazil, which take a more populist and nationalist attitude, still remains uncertain. It is also doubtful whether this strategy is compatible with the efforts of the so-called multilateral agencies and the OECD countries to solve the global debt crisis.[27]

CONCLUSIONS

The previous analysis examined the external debt process of the periphery as one of the manifestations of the contradictions in the capitalist world market — a consequence of the productive crisis of the totality of the capitalist system, the OECD countries, the periphery and the relations among them. Similarly, the growth of the free banking zones in the 1960s and 1970s, when more than 70% of their transactions were realized in U.S. dollars, in part prevented the financial collapse of the U.S. But this monetary process lacked any real foundation in the U.S.: Neither the growth of its productivity, nor of GDP, nor of international trade reflected the amazing development of the U.S. dollar as world money. This development sharpened since 1982, when for the first time in this century the U.S. evolved to a net capital importer and, since 1985, became the biggest debtor country, external debt accounting in 1991 for around 17% of its GDP. It is by this process — through capital transfers from the OECD countries and, to a smaller extent, from the HICs — that the U.S. financed its huge trade and fiscal deficits in the 1980s. Regarding the external debt crisis of the periphery, two final questions arise: Will the U.S. in the future still be able to finance its deficits through external borrowing, and subsequently, what will be the consequences for the indebted periphery, with respect to the Brady Initiative and future solutions?

The current international situation can last as long as the OECD countries (especially Japan and Germany) continue to finance the hegemonic policy of the U.S. Independently of this, the crisis of the mode of production in the U.S., the shift of the world production and financial centers from the Atlantic — the traditional production and trade center of the U.S. — to the Pacific Basin, and the declining role of the U.S. dollar seem to indicate that we are in a historical transition moment, in which the crisis of U.S. hegemony has not yet produced an alternative nation able to guarantee and lead the capitalist world market. At the present time, there is no nation that could substitute for U.S. hegemony, since the hegemonic development of a nation does not only depend on its productive sphere, although it cannot be maintained in the long run without it. It is doubtful that the OECD countries

will continue these "subsidies" in the future. The increasing official discount rates in Japan and the strong inflow of capital into West Germany, reversing the tendency since the beginning of the 1980s, leave the Federal Reserve Board with few possibilities of attracting foreign capital, apart from significantly increasing its interest rates. Apart from the reticent loan policies of the transnational banking system, the actual possibilities for the U.S. to grant new loans of the required dimensions — in contrast to the postwar period when the U.S. was able to strengthen and reconstruct the capitalist world market — are minimal and will probably remain so.[28] Also very important is the concentration and centralization process of the transnational banks, while U.S. banks are relegated to a "second foreground."[29]

However, far more important are the dramatic consequences of these transactions in the developing countries. The financial innovations examined here all present serious structural "limitations." Apart from their quantitative restrictions, they exhibit economically expensive and politically unsustainable instruments for debtor countries. Most of them are intended for the private sector debt and depend on the provisions accumulated by and the willingness of the creditor banks. It is also important to note that apparently successful debt rescheduling and financial innovations — and less risky debtor countries in general — have a direct positive effect on the debt issues on the secondary markets; a "Sisyphus effect" occurs, in which "good debtors" are punished with higher debt issue prices, substantially decreasing the real debt and debt service reductions.[30] They not only enhance inflationary tendencies, in some cases, and tend to substitute direct foreign investments, but they also make a "clearance sale"[31] of these countries possible, in which the transnational and national corporations — the main agents responsible for the external indebtedness — will be the primary beneficiaries. For Latin America, after the "lost decade" of the 1980s, in spite of austerity plans, the Baker and Brady Initiatives and future "XYZ-Initiatives," the development possibilities are very dim. Focusing on "more growth — less debt service payment" (Dornbusch 1988) or even more efficient market-oriented models (Sachs and Kneer 1990a) is neither an economic nor a political alternative for Latin America. After a net transfer of $223 billion in 1982-1990, the promise of marginal reductions and future economic growth — already experienced in the 1950s and 1960s, in which Latin America failed to develop a "stable" capitalist economy — cannot provide the solution of the problem.

The external debt crisis of Latin America goes far beyond a mere economic or technical problem, as addressed by the Baker and Brady Initiatives. But even the political decision to discharge Latin America of its external debts altogether would only alleviate some of the historical problems of the region. The declining trade and credit possibilities for these countries, the decline of the investment coefficient, decreasing from 22.7% in 1980 to 16.4% in 1989 (ECLAC 1990c), the selection process among the indebted countries and the instrumentalization of the multilateral agencies begun with

the Baker Plan, all seem to foreshadow an even "worse decade" for Latin America in the 1990s. Apart from Chile, Costa Rica and Mexico, the pauperization of Latin America appears to be accepted by the national governments concerned and the "international community," as the cholera epidemic in Peru — the first in the last 120 years — and the situation in Central America, the Northeast of Brazil, etc., seem to evidence. Fundamental economic and political structural changes are required in these countries, although they look nowadays more distant than ever. Future solutions to the external debt crisis can only arise in Latin America itself, through direct participation by and a critical and organized response from the working class and civil society in general, since it is they who have carried the burden of the accumulation model, the "austerity plans," the increasing repression and the socialization of the external debt.

NOTES

1. It is important to stress here that Latin America has had several "debt crises" since the last century, although their causes and consequences have been quantitatively and qualitatively different (Felix 1987; Marichal 1989).
2. The concept of "hegemony" is not only related to the dominant mode of production and the circulation of capital but also implicates the hegemon's military power and, in the case of the U.S. hegemony, an international consensus on a democratic-liberal political project and the attractive "American way of life" (cultural hegemony) for the dominant classes.
3. It is important to stress that until 1970 the IMF was fundamentally an institution "of and for the OECD countries," as long as over two-thirds of its loans were granted to them.
4. This appeared in the declining participation of the U.S. in world industrial production (from 48.7% in 1950 to 37.8% in 1970) and in international trade (from 18.8% in 1950 to 15.5% in 1970). See OECD (1989) and BIS (several years). An excellent account of this process can be found in Glyn (1989).
5. In this paper "crisis" will be understood as the process of destruction of capital and of the existent social and political structures, which implies an historical moment to create new forms of production and political regulation. See Altvater (1983).
6. While the investment rate in the U.S. remained relatively constant, it decreased in Japan from 33.5% in 1971-1979 to 28.2% in 1985 and in West Germany from 23% to 20.3%. Likewise the net private savings rate fell in the U.S. from 9.1% in 1971-1979 to 6.5% in 1985, in West Germany from 23.9% to 22.3% and in Japan from 20.3% to 15.1% (BIS 1986).
7. As stated before, this central issue cannot be examined here in detail. Further, the discussion on "peripheral Fordism" has not reached satisfactory conclusions yet, especially regarding the conditions for the increasing differentiation of the periphery and the relation among its postwar mode of production, the Fordist development model and the extensive accumulation regime. For different positions in this broad discussion, see Altvater (1987), Hurtienne (1989), Lipietz (1982, 1986, 1989) and Marini (1969).

8. The "enclave economies," as the case of Central America shows, differ substantially from the accumulation model described here. See Torres-Rivas (1987).
9. The proportion of agricultural primary products fell from almost half of world trade in 1913-1917 to a fifth in 1970, while the proportion of world exports by the periphery, excluding the OPEC countries, fell from 24% in 1950 to 11% in 1970 (Hurtienne 1989).
10. Hinkelammert emphasizes that the external borrowing process of Latin America "derives almost exclusively from the transfer of profits owing to direct foreign investment. This direct foreign investment did not arise from the transfer of profits from the exterior, but exclusively through the national mobilization of resources in Latin America. ... For the entire period from 1950 to 1983, these domestically generated profits exceeded foreign direct investment" (Hinkelammert 1989: 23-24 Translation by the author).
11. In this sense, capital flight is an important expression of the class conflicts in the respective countries, increasing their public external debt on the one hand, and exporting private capital on the other. As Fishlow (1987) points out, capital flight played an important role, accounting for around 20% of the total investment in Latin America and increasing especially during the late 1970s and 1980s.
12. This process, known also as "asset and liability management," implied for the U.S. banks a gradual restriction of loans and a turn to more liquid assets and liabilities. The Highly Indebted Countries (HICs) were only one element of this development: The decline in profitability and increasing debt service requirements of corporations in the U.S., the financing of the impressive merger and takeover process in the 1970s (Singh and Hughes 1987), the extreme volatility of banks' purchased funds and the governmental credit controls in 1980, all enhanced this process (Wolfson 1986).
13. Between 1982 and 1984 66 countries of the periphery were submitted to the "structural adjustment" and "stabilization programs" of the World Bank and IMF. In the same period the total external debt of the periphery showed an annual growth of 12% (mainly through capitalization and rescheduling of debts), while since 1984 the HICs became net capital exporters. Similarly, the loans granted to the HICs by multilateral agencies declined from $8.2 billion in 1983 to $2.3 billion in 1985 (Chahoud 1987; World Bank 1989a, b).
14. There is considerable literature on this issue. See for example Chahoud (1987); Payer (1986).
15. For detailed analysis see UNCTC (1987); Kapner and Marshall (1990).
16. The secondary market is the place in which debt issues or other financial instruments are traded after their initial issue.
17. Until 1988 the total swap transactions amounted to $17.5 billion, less than 2% of the total external debt of the periphery, and were mainly concentrated in Brazil, Chile, Mexico and the Philippines (Bouzas and Ffrench-Davis 1990; Brady 1989b).
18. A zero-coupon bond is a debt issue of the U.S. Treasury with a maturity of 20 or 30 years. It is normally purchased at a substantial discount and its interest is paid only at redemption. Mexico bought $492 million in zero-coupon bonds of its own currency reserves with redemption in 2008, which were the guarantee for the new Mexican debt issues.

19. Loan-loss provisioning is the process on the part of the creditor banks of increasing their reserves against particular risk debtor countries, enhanced by favorable regulatory and tax policies. Considering the differences in the international tax and regulatory systems, loan-loss provisions are generally debited against tax-deductible profits for the year in which they are realized (Abbott 1989; Bird 1989a, b).
20. In this sense Brady threatens: "The United States questions whether the international financial institutions should delay their initial disbursements until detailed commitments have been provided by all other creditors to fill the financing gap. In many instances this delay has provided a false sense of security rather than a meaningful financial support" (Brady 1989a: 75).
21. For a detailed analysis of the Brady Initiative, see Brady (1989a, b), ECLAC (1990a, b) and Kampffmeyer (1989).
22. Lustig (1990) discusses the different interpretations of this debt and debt service reduction.
23. In this sense, the Brady Initiative echoes the essence of the proposal of Fidel Castro in 1985, when he declared that the solution of the external debt of the periphery was only possible if the OECD countries would assume their responsibility by an annual reduction of their military spending (Castro 1985).
24. In the case of Mexico, for example, the debt crisis in 1982 exacerbated the crisis of the import substitution model and initiated export promotion and trade liberalization in 1986. However, this process not only sharply reduced real wages after 1981 but also directly affected small and medium industry. In this sense, the big industrial corporations in Mexico seem to endorse the neoliberal policies followed since 1982, while bureaucrats and the middle class are far more critical of these policies, which is also manifest in the political turmoil since then and in the results of the 1988 and 1991 elections (Dussel Peters and Kim 1992).
25. After several decades of unilateral international monetary policies dominated by the U.S., Brady recognizes: "The international debt problem has been a major challenge to the international system over the past seven years ... [It represents] a truly international problem for which no one set of actions or circumstances is responsible. And no one nation can provide the solution. Ultimately, resolution depends on a great cooperative effort by the international community" (Brady 1989a: 69).
26. Here, the future negotiations between Japan and the U.S. will be decisive for the Latin American debt crisis. Just some days after Mexico signed the new agreement, Japanese banks announced a plan to write off up to 70% or around $6 billion of their loans to Mexico, a debt reduction much more substantial than that agreed on with the Brady Initiative (*Financial Times*, February 8, 1990).
27. "Since the Europeans and the Japanese contribute substantially more to these institutions than the US, this is rather a clever way for a fiscally constrained US to resolve a major security concern at the expense of its allies" (*Financial Times*, April 5, 1989). See Rotberg (1989).
28. The Marshall Plan provided Europe with financial aid totaling $13.5 billion or 1.2% of its GDP. This would represent today approximately $50 billion.
29. Out of the 10 biggest transnational banks (by assets) in 1978, two were in the U.S., five in Europe and one in Japan. In 1986 this relation changed to 1:2:7 respectively (*Euromoney*, June 1989; UNCTC 1987).

30. As a representative case for most of the financial innovations, Bolivia offered to purchase its own debt issues on the secondary market at 6% of their nominal value. Preceding the transaction, the price increased to around 11% and the debt reduction almost vanished (Devlin 1989a). Chile, Colombia and to some extent Mexico are in a similar situation as "good debtor cases," who display the highest debt issue prices in the secondary market.

31. Or, as the *Economist* emphasizes: "It's auction time in Latin America. On the block are bargains ranging from state-owned telephone companies and steel mills to cement works, railways, hotels, a racecourse and a banana plantation" (*Economist*, March 23, 1991).

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