5
DEBT

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Introduction

Over the last ten years Greece has been a prime example of how a country and a people can be deprived of their liberty through clearly illegitimate debt. Since the 19th century, from Latin America to China, Haiti, Greece, Tunisia, Egypt and the Ottoman Empire, public debt has been used as a coercive force to impose domination and pillage (Toussaint, 2017a). The combination of debt and free trade constitute the fundamental factors subordinating whole economies as from the 19th century. Through these two inter-related processes, local elites ally themselves with big financial powers in order to subject their own countries and peoples to methods of power that transfer wealth towards local and foreign creditors.

Contrary to commonplace ideas, it is generally not the indebted weaker countries that are the cause of sovereign debt crises. These crises break out first in the biggest capitalist countries or are the result of their unilateral decisions that produce effects of great magnitude in indebted countries. It is not so-called 'excessive' public spending that builds up unsustainable debt levels, but rather the conditions imposed by local and foreign creditors. Real interest rates are abusively high and so are bankers' commissions. The indebted countries unable to keep up with repayments have to continually find new loans to repay old loans. In the past, when that became impossible, the great powers had license to resort to military action to ensure they were repaid. Today, debt crises and their outcomes are directed by the big banks and the governments that support them.

Over the last two centuries, several countries have successfully repudiated or unilaterally restructured debts by arguing that they were either illegitimate or odious. Portugal (1837), Mexico (1861, 1867, 1883, 1914, 1943), the USA (1837, 1865, 1898), Russia (1917–1918), Costa Rica (1919), Brazil (1931, 1946), Cuba (1909, 1934, 1959), China (1949), Indonesia (1956), Iran (1979), Paraguay (2005), Ecuador (2007–2009), Iceland (2008–2009) have all done this (Toussaint, 2017a). Conflict involving debt non-payment has given birth to a judicial doctrine known as Odious Debt which is to this day pertinent (see box).

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Odious Debt

According to the Odious Debt doctrine theorized by Alexander Sack in 1927 a debt may be considered odious if it fulfils two conditions:

1) **The population does not enjoy the benefits:** the debt was incurred not in the interests of the people or the State but against their interest and/or in the personal interest of the leaders or persons holding power; and
2) **Lenders' complicity:** the lenders had foreknowledge, or could have had foreknowledge, that the funds concerned would not benefit the population.

The democratic or despotic nature of a regime does not influence this general rule.

The father of the Odious Debt doctrine clearly states that '**regular governments** (may) incur debts that are incontestably odious.' Sack defines a regular government as follows:

> By a regular government is to be understood the supreme power that effectively exists within the limits of a given territory. Whether that government be monarchical (absolute or limited) or republican; whether it functions by 'the grace of God' or 'the will of the people'; whether it express 'the will of the people' or not, of all the people or only of some; whether it be legally established or not, etc., **none of that is relevant to the problem we are concerned with.** (Sack 1927, emphasis added).

Sack says that a debt may be considered odious if:

> a) that the purpose which the former government wanted to cover by the debt in question was odious and clearly against the interests of the population of the whole or part of the territory, and
> b) that the creditors, at the moment of the issuance of the loan, were aware of its odious purpose.

He continues:

> Once these two points are established, the burden of proof that the funds were used for the general or special needs of the state and were not of an odious character would be upon the creditors.

This doctrine has been invoked and applied several times in history (King 2016).

Historical examples

Creditors, whether powerful states, multilateral organizations that serve them, or banks, have become very adroit at imposing their will on debtors. From early in the 19th century Haiti, the first independent Black republic, was an early testing ground. The island gained freedom from the yoke of the French empire in 1804, but Paris did not abandon its claims on the country and obtained from Haiti payment of a royal indemnity granted to the former colonial slave owners. The 1825 agreements signed by the new Haitian leaders created a monumental debt of independence untenable from 1828, which took a full century to pay off, thus preventing any real development.

Debt was also used to subjugate Tunisia under France in 1881 (Toussaint 2016a) and Egypt to the British in 1882 (Toussaint 2016b). The lending powers used unpaid debt to impose their will on countries that had so far been independent. Greece too, was born in the 1830s with a burden of debt that held it in the sway of Russia, France and the British (Toussaint 2016c). Newfoundland, which had become the first autonomous dominion of the British Empire in 1855, well before Canada and Australia, had to renounce its independence in 1933 because of a grave economic crisis and, in order to face up to its debts, it was eventually incorporated into Canada in 1949. Canada agreed to take charge of 90 per cent of Newfoundland's debt (Reinhardt and Rogoff, 2010).

Debt during the 1960s and 1970s

Similar processes were again repeated after the Second World War, when Latin American countries sought capital to fund their development and Asian and African colonies gained independence. Debt became the principal instrument used to impose neocolonialist relations. It became frowned upon to use force against a debtor country, and new means of coercion had to be found.

The massive loans granted from the 1960s to an increasing number of peripheral countries (not least those in which the Western powers had a strategic interest such as Mobutu's Congo, Suharto's Indonesia, the military regimes in Brazil, Argentina, and Pakistan) oiled a powerful mechanism that took back the control of countries that had begun to adopt policies that were independent of former colonial powers and Washington.

Three big players have incited post-colonial countries into debt by promising relatively low interest rates:

1. leading global (Western) banks seeking to put massive amounts of liquidities to work;
2. industrialized countries seeking to stimulate their economies after the 1973 oil crisis and the world recession of 1973–1974; and
3. the World Bank seeking to increase US influence and to avoid being edged out by the increasing expansion of private banks.

Local elites in borrower countries also encouraged higher debt and made gains, contrary to the populations, who derived no benefit.

Theoretical ideas promoting high levels of foreign debt

In neoclassical theory, savings should precede investment and are insufficient in developing countries. This means that shortages of savings are seen as a fundamental factor explaining why development is blocked. An influx of external funding is required. Paul Samuelson (1980), in *Economics*, took the history of US indebtedness in the 19th and 20th centuries as a basis for determining four different stages of borrowing that would supposedly lead other states to prosperity:

1. young borrowing nation in debt (from the War of Independence in 1776 to the end of the Civil War in 1865)
2. mature indebted nation (from 1873 to 1914)
3. new lending nation (from the First to Second World Wars)
4. mature lending nation (1960s)

Samuelson and his emulators slapped the model of US economic development from the late 18th century until the Second World War onto one hundred or so countries which made up the Third World after 1945, as though it were possible for all those countries to quite simply imitate the experience of the US.

On the need to resort to foreign capital (in the form of loans and foreign investments) Paul Rosenstein-Rodan (1961: 107) identified the following formula:

> Foreign capital will be a pure addition to domestic capital formation, i.e. it will all be invested; the investment will be productive or 'businesslike' and result in increased production. The main function of foreign capital inflow is to increase the rate of domestic capital formation up to a level which could then be maintained without any further aid.

This statement contradicts the facts. It is not true that foreign capital enhances the formation of national capital and is all invested. Often, a large part of foreign capital rapidly leaves the country where it was temporarily directed, as capital flight and repatriation of profits.

Rosenstein-Rodan who was the assistant director of the Economics Department in the World Bank between 1946 and 1952, made another monumental error in predicting the dates when various countries would reach self-sustaining growth. He reckoned that Colombia would reach that stage by 1965, Yugoslavia by 1966, Argentina and Mexico between 1965 and 1975, India in the early 1970s, Pakistan three or four years after India, and the Philippines after 1975. What nonsense that has proved to be!

Development planning as envisaged by the World Bank and much Western academia amounts to pseudo-scientific deception based on mathematical equations. It is supposed to give legitimacy and credibility to the intention to make the developing countries dependent on obtaining external capital. There follows an example, advanced by Max Millikan and Walt W. Rostow (1957: 158):

> If the initial rate of domestic investment in a country is 5 per cent of national income, if foreign capital is supplied at a constant rate equal to one-third the initial level of domestic investment, if 25 per cent of all additions to income are saved and reinvested, if the capital-output ratio is 3 and if interest and dividend service on foreign loans and private investment are paid at the rate of 6 per cent per year, the country will be able to discontinue net foreign borrowing after fourteen years and sustain a 3 per cent rate of growth out of its own resources.

This theoretical assumption has never been confirmed by a single practical example.

In fact, these authors who favoured the capitalist system, dominated by the US, refused to envisage the deep reforms that would have allowed for forms of development that were not dependent on external funding.

The debt crisis of the 1980s

At the end of 1979, in what is generally called the Volker Shock, the US decided to increase its interest rates. This had a flow-on effect on the rates applied to indebted Southern countries whose borrowing rates were variable and had already been subject to sharp rises. Coupled with a downturn in export commodities prices (coffee, cacao, cotton, sugar, ores, oil, etc.,) which caused reduced revenues for the countries, the trap was sprung.

In August 1982, Mexico, among other countries announced that they were unable to assure debt repayments. So, the International Monetary Fund (IMF) was asked, by the creditor banks, to lend the countries the necessary funds at high interest rates, on the double condition that they continue debt repayments and apply the policies decided by the IMF 'experts.' These included: abandoning subsidies on goods and services of primary necessity; reducing public spending; devaluing the currency; introducing high interest rates in order to attract foreign capital; directing agricultural production towards exportable products; freeing access to interior markets for foreign investors; liberalizing the economy, including suppressing capital controls; introducing a taxation system that aggravates inequalities, including increases in consumption taxes; and privatizing profitable publicly owned industries. This list is not exhaustive.

These structural adjustment loans were aimed at the suppression of independent economic and financial policies in the peripheral countries and tying them to world markets. Also, they ensured access by the industrialized economies to the raw materials and fossil fuels they needed. By gradually putting the developing countries into competition with each other and encouraging the adoption of an economic model based on exports and the extraction of raw materials for foreign markets, the goal was to reduce the price of those exported commodities, which in turn favoured the developed economies in that it reduces their production costs and increases the profits of their companies.

A new form of colonialism sprang up. It was no longer necessary to maintain an administration and an army to put the local population to heel; debt did the job of creaming off the wealth produced and directing it to the creditors. Of course, the colonialists continued to interfere in local politics and economic policies whenever they considered that it suited them.

Developments in the 2000s

From 2003 to 2004, in a context of strong world demand, commodity prices started to increase. Exporting countries improved their foreign exchange incomes. Some developing countries increased their social spending but most preferred to buy US treasury bonds and thus put their increased means at the disposal of the principal economic powers. This increase in developing countries' incomes whittled down the power of the World Bank and the IMF.

Chinese economic expansion became a major factor in this period. China had become the world's principal sweatshop and was accumulating important financial reserves and using them to significantly increase funding to developing countries in competition with the offers of funding from the industrialized countries and the multilateral institutions. While some scholars underline the fact that this funding is provided with no structural adjustment programs attached, it must be noted that many of the loans provided by China seem to be collateralized by public assets such as infrastructure and national resources, allowing Chinese private or state-owned enterprises to take control of national assets of debtor countries unable to repay.

During the 2000s, the reduction of interest rates by the central banks in the industrialized countries in the North decreased the costs of debt in the South. Because of the 2007–8 financial crisis in North America and Western Europe, massive amounts of liquidity were injected into the financial system to save the big banks and corporations that were themselves too heavily indebted. A decrease in the costs of financing the debts of the developing countries followed naturally and the governments of developing countries gained a false sense of security.

A new debt crisis is looming in the Global South

The situation began to degrade in 2016–17 when the US Federal Reserve started to raise its interest rates, from 0.25 per cent in 2015 to 1.5 per cent in October 2019 and tax breaks were granted by the Trump administration to big business to attract US foreign investment back to the US. What's more, commodities prices fell, and exporter countries' revenues slipped with them, making debt repayments that are mostly owed in strong currencies more difficult. In consequence, since 2018–19 a new debt crisis is hitting countries such as Argentina, Venezuela, Turkey, Indonesia, Nigeria, and Mozambique. Repayments are mostly in dollars, so difficulties are further aggravated by any devaluations of the local currencies.

The COVID-19 crisis saw interest rates fall again but is accelerating and further aggravating the debt crisis in other ways. With governments implementing lockdowns all over the world and with the just-in-time production brought to a halt for several months – a halt which will not be completely reversed any time soon as countries take differentiated approaches in order to limit the spread of the virus – export revenues dropped. Domestic consumption obviously declined as well as households were forced to stay at home, millions of workers became unemployed, and general insecurity about the future set in for many of those who were not yet in a state of precarious living conditions. Still with limited capacity to raise revenue domestically many states are turning to the World Bank and other international financial institutions (IFIs) for more loans.

States are facing an economic crisis the size of which was not seen at least since the Great Depression of the 1930s, if not ever. They have used large amounts of money to bail out corporations and enable the economy to stay afloat. What is more, many transnational corporations and rich households accelerated the capital flight that had been going on for a few years with the rise of interest rates in the Global North. All this contributes to a depreciation of most of the developing countries' currencies and an important decrease in their domestic as well as foreign exchange reserves, to the point that some of them are on the brink of partially or fully defaulting on the payment of their public debt – this happened in Argentina and in Lebanon in 2020, and it is likely to happen to other countries in the near future.

Debt in the South

These last years have seen a significant increase in constant values of foreign debt; between 2000 and 2019 it has more than tripled (Table 5.1; Rivié 2021). The greater part is in the private sector.

Foreign public debt has also increased although less abruptly than in the private sector.

Table 5.1 Foreign debt by region (USD billions)

Country name	*1980*	*1990*	*2000*	*2010*	*2012*	*2019*
Latin America & Caribbean	227	413	723	1.064	1.360	1.927
Sub-Saharan Africa	60	175	215	296	374	625
Middle East & North Africa	64	137	144	191	200	340
South Asia	37	124	163	410	528	789
East Asia & Pacific	54	218	456	1.192	1.738	2.993
Europe & Central Asia	42	138	339	1.148	1.412	1.465
Total	**485**	**1,205**	**2,040**	**4,301**	**5,613**	**8,138**

Source: World Bank (2020a; 2020b)

Whatever the World Bank and the IMF may cheerfully repeat, the debt of developing countries is still a major obstacle to meeting basic needs and safeguarding human rights. Inequalities have sharply increased and progress in terms of human development has been very limited.

Africa

In sub-Saharan Africa, outgoing flow of capital via debt service and corporations garnering their profits are significant. In 2012, the profits repatriated from the poorest area on earth amounted to 5 per cent of its Gross Domestic Product (GDP) versus 1 per cent in public aid to development (Toussaint et al. 2015). In this context, it is legitimate to raise the question: who is helping who? If we take into account the plundering of Africa's natural resources by private corporations, the brain drain of African intellectuals, embezzlement of goods by the African ruling class, manipulations of transfer prices by private corporations and other misappropriations, we cannot but be aware that Africa has been drained dry.

European Union (EU) relations with Africa illustrate the continuation of neocolonial policies. These have developed beyond the framework of the African, Caribbean, and Pacific (ACP)-EU Partnership Agreements (2000), generally known as the Cotonou Agreements, which covered over 100 countries. Nowadays, the EU has enforced other frameworks that are more significant in its relation with Africa such as an EU partnership framework for migration (the Valletta Action Plan with the Khartoum and Rabat processes), to which we should add the bilateral frameworks and agreements that European countries have with African countries or regions. Not forgetting the two CFA franc currencies used in 15 African countries, which has been guaranteed by the French treasury. Though, in order to regain monetary and fiscal independence from France, the eight states of the West African CFA are aiming to introduce the Eco.

Many European citizens have no idea of the extent to which conditions and clauses imposed under such agreements are setting the ground for a new debt crisis in the developing countries. Some basic facts that are not known by most people are that, whereas the total volume of aid received annually by Africa from Europe stands at around $21 billion, African migrants in Europe remit around $30 billion to their families in their home countries, almost 50 per cent more than the amount of the European aid. The funds currently available from the European Investment Fund (the small and medium enterprise lending arm of the European multilateral development bank, the European Investment Bank) for the whole African continent stand at just $3.3 billion, which is equivalent to the cost of one mid-sized infrastructure project like a port. Furthermore, the EU proposed budget for 2021–2027 plans to allocate more than $34.9 billion to various mechanisms of migration control (Valero 2018). It will end up costing Europe more to patrol its borders than what is allocated to Africa as development aid or what Africa suffers from trade losses with Europe. Indeed, it seems that the new trade deals have worsened things in this latter regard. From 2003 to 2014, Africa always had a trade surplus with Europe, whereas since 2015, the trend has reversed amounting close to a $30 billion deficit.

Latin America and the Caribbean

Latin America has one of the highest negative external debt balances among developing continents for 1985–2019. As Table 5.2 demonstrates this debt stock grew significantly over the 2010s and the repayment burden is large.

Table 5.2 Debt and resources devoted to repayment: Latin America and the Caribbean

Debt and repayments	*External debt USD (billion)*	*Public external debt USD (billion)*
Debt stock in 1970	30	14
Debt stock in 2010	1064	479
Debt stock in 2012	1360	583
Debt stock in 2017	1789	878
Debt stock in 2019	1927	919
Repayments 1970 = 2010	2969	1612
Repayments 1970 = 2012	3332	1833
Repayments 1970 = 2017	4493	2222
Repayments 1970 = 2019	5059	2484

Source: World Bank (2020a; 2020b) DataBank using indicators for total external debt (DT.TDS.DECT.CD) and public external debt and guarantee (DT.TDS.DPPG.CD).

Note: repayments cover the total of depreciation and debt interests

Table 5.3 Net transfers on external debt 1985–2017: Latin America and the Caribbean

Net transfers on external debt	*1985–2017 (USD billion)*	*1985–2019 (USD billion)*
External debt	205	244
Public external debt	-90	-123

Sources: World Bank (2020a; 2020b), DataBank, indicator public external debt and guarantee.

Table 5.3 on net transfers on external debt indicates that Latin American and Caribbean countries paid back much more in debt service between 1985 and 2019 than they received in loans during the same period. The net transfer on debt is the difference between what a country or a region receives as loans and what it pays (capital and interest included, also called debt servicing). If the amount is negative, it means that for that year the country or the region paid more than it received.

Table 5.4 shows that public debt servicing consumes a greater percentage of both GDP and the budget than does expenditure public expenditure on education and health care in three of the four Latin American countries listed. Only in Ecuador in the case of education – but not health care – does public expenditure exceed debt payments.

Debt servicing's impact on government expenditure

If we examine the evolution of public expenditure of some 50 low-income countries from 2015 to 2017, we notice an increase of expenditure related to debt repayment, a decrease of health-related expenditure and a stagnation in terms of education (see Figure 5.1).

There was also an increase in public expenditure related to debt repayment in Africa, South Asia and in general for Least Developed Countries (LDCs). According to Milan Rivié (2019) using IMF information, in July 2019, among low-income countries, nine were over indebted and 24 were on the brink of being over indebted, that is 39 per cent of them (IMF 2019, UN 2019). As evidence of the inability (and the lack of determination) of IFIs to find an adequate and sustainable response to over indebtedness, half of those countries had strictly applied the adjustment policies of the Heavily Indebted Poor Country (HIPC) initiative launched by the G7, the World Bank and the IMF in 1996. And according to a German NGO, 122

Table 5.4 Distribution of expenditure in national budgets (as % of GDP and as % of the budget) in Select Latin American States in 2013

	% of the GDP			*% of the budget*		
	Public debt servicing	*Public expenditure for education*	*Public expenditure for health care*	*Public debt servicing*	*Public expenditure for education*	*Public expenditure for health care*
Argentina	9.6	1.8	1.0	38.4	7.3	4.0
Brazil	22.7	1.8	2.1	42.2	3.9	3.4
Columbia	6.3	3.5	1.6	24.3	13.4	6.2
Ecuador	3.7	7.1	3.1	8.3	15.9	6.8

Sources: Argentina Ministry of Economy and Public Finance (2013); Brazil Fattorelli (2014); Colombia Ministerio de Hacienda y Crédito Público (2013); and Government of the Republic of Ecuador (2012).

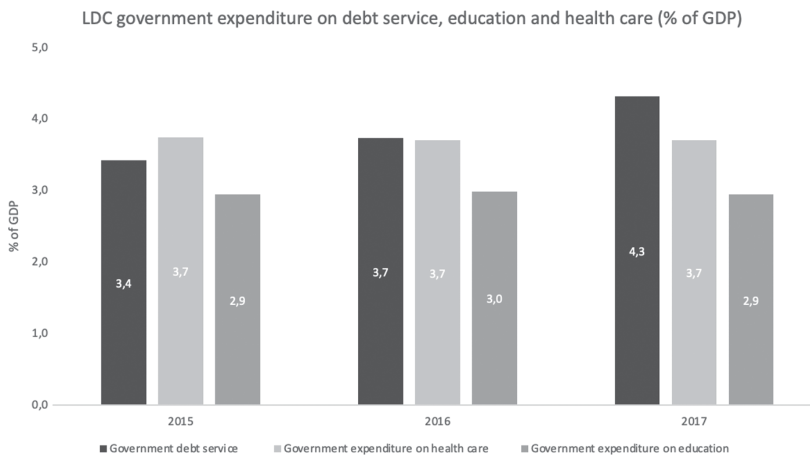

Figure 5.1 LDC government expenditure on debt service, education and health care (% of GDP)

Source: UNCTAD secretariat calculations based on World Bank, World Development Indicators data and IMF DSA LIC country reports published between 2015 and 2018. Based on 50 low-income countries.

were actually in a critical debt situation in 2019, before the COVID-19 crisis even erupted (Kaiser 2019).

It is possible not to repay an illegitimate debt

It is quite possible to resist creditors, as evidenced by Mexico under Benito Juárez, who in 1867 refused to repay loans contracted by emperor Maximilian from the Société Générale de Paris two years earlier in order to finance the occupation of Mexico by the French army (Toussaint 2017b). In 1914, at the height of the revolution, when Emiliano Zapata and Pancho Villa were victorious, Mexico completely suspended payment of its external debt, which was considered to be illegitimate; the Mexican government only repaid symbolic amounts from 1914 to 1942, just in order to pacify creditors. From 1934 to 1940, President Lázaro Cárdenas nationalized the railway and the oil industry without any compensation; he also expropriated over 18 million

hectares of landed estates to give them over to Indigenous communities. His tenacity paid off: in 1942, creditors renounced about 90 per cent of the debt value and said they were satisfied with limited compensations for the companies they had been evicted from. Mexico was able to undergo major social and economic development from the 1930s to the 1960s. Other countries such as Brazil, Bolivia and Ecuador successfully suspended debt repayment from 1931. In the case of Brazil, selective suspension of repayment lasted until 1943, when an agreement made it possible to reduce debt by 30 per cent.

More recently, in July 2007, in Ecuador, then President Rafael Correa set up a committee to audit public debt. After 14 months of work, its findings gave evidence that a large part of the country's public debt was illegitimate and illegal. In November 2008, the government decided to unilaterally suspend repayment of debt securities sold on international financial markets and were maturing in 2012 and in 2030. Eventually, the government of this small country won its case opposing North American bankers who held those securities. It bought for US $900 million securities that had been worth $3.2 billion. Through this operation Ecuador's Treasury saved about $7 billion on the borrowed capital and the remaining interest. It freed resources to finance new social spending (as shown in Table 5.4). Ecuador has not been targeted by international reprisals (Toussaint 2021).

It is obvious that refusing to repay illegitimate debt is a necessary measure, but it is not enough to generate development. A consistent development programme must be implemented. Financial resources have to be generated through increasing the State's resources through taxes that respect social and environmental justice (Millet and Toussaint 2018).

Questions for consideration

1. Consider the concept of 'odious debt' (discussed on page 1–2). Can you think of any recent examples of development lending that might constitute odious debt? Working in small groups, identify a development project of your choice and demonstrate (1) how debt for this project was incurred 'not in the interests of the people or the state,' and (2) evidence that the lenders had foreknowledge, or could have had fore-knowledge, that the funds concerned would not benefit the population.
2. Global debt levels have increased substantially following the 2019-onwards COVID-19 pandemic. Choose two countries of your choice and collect data on their debt profiles since the pandemic commenced.
3. This chapter argues that debt functions as a tool of neocolonial imperialism. Discuss this claim.
4. China has become a leading financier of global infrastructure projects, many of which are linked to its ambitious Belt and Road Initiative. Alongside China's increased lending, there has been much criticism that it is expanding unsustainable debt burdens, particularly within heavily indebted poor countries (HIPCs). However, while some scholars have accused China of engaging in 'debt diplomacy' others have rejected such suggestions. Interrogate these debates. Resources on the CADTM website will provide a useful starting point. www.cadtm.org/China?lang=en
5. As south-south development cooperation has increased, a number of new multilateral development banks (MDBs) have been established. Two examples include the Asian Infrastructure Investment Bank and the New Development Bank. How do these new MBDs differ from existing multilateral banks? Are they reproducing the same problems regarding debt expansion or do they present new challenges and opportunities?

6. A key historical event for global development lending was the 1980s debt crisis. What caused this crisis and where did it begin? How did lenders and borrowers respond?
7. The heavily indebted poor countries (HIPC) initiative was initiated by the International Monetary Fund and the World Bank in 1996 to provide debt relief to the most indebted countries. (1) Examine the criteria to be eligible to HIPC relief. (2) Examine critique of the HIPC initiative.

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