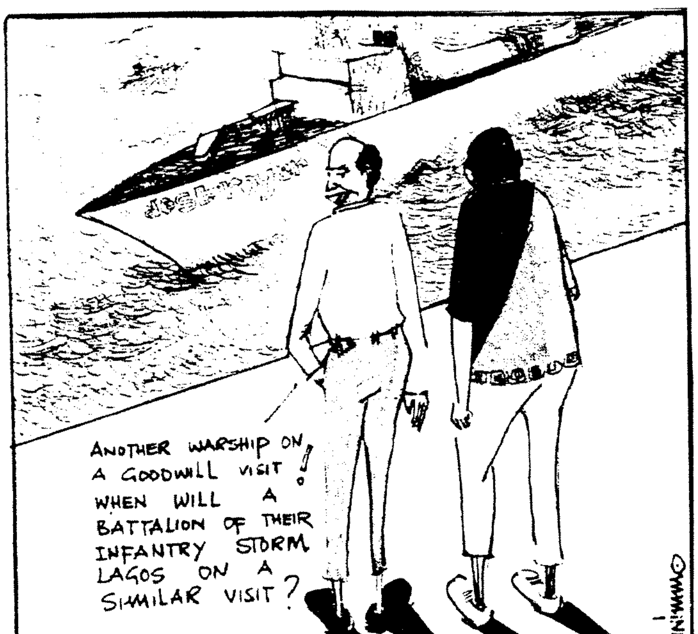
Notes on the Origin of the Debt Crisis

by
Harry Cleaver, Jr.

Analyzing the emergence of the debt crisis requires discovering how financial problems constitute parts of the evolving structure of class relations—a process which involves situating the fetishized world of money and finance as moments of class struggle. On the surface, the debt crisis is a purely monetary and financial problem: how to manage international flows of capital so that the debtors of the Third and Second Worlds can repay their debts. Thus, the current literature on the debt crisis deals primarily with issues of liquidity vs. solvency, the relations between private bank loans and official, especially IMF, sanctions; conditions of debt rescheduling and internal policy changes in the debtor countries.[1]

But understanding these problems of liquidity, debt financing and adjustment in class terms requires analyzing prior phenomena, both rooted in the changing structure of global class relations from about 1970 to the explosion of the debt crisis in 1982.

The onset of the crisis is to be found in an international cycle of working class struggle which swept around the world in the second half of the 1960s, rupturing capital's global order—West and East, North and South. That international cycle of struggles, which escaped capital's ability to manage and plunged the Keynesian era into a crisis to which capital has yet to discover an adequate response, included rebellion both in production and reproduction. In the United States, the civil rights and black power movements, the Chicano and Native American movements, the urban insurgencies that burned Watts, Newark, Detroit and other central cities, the student and anti-war movements, a wage offensive that ruptured the post-WWII productivity deals in the factories, and increasingly, the women's movement. In the Third World: new insurgencies in South East Asia, South Asia, Latin America, and the last anti-colonial struggles in Africa. In Western Europe: May 1968 in France, the revolt of Italian factory workers and students that led to Italy's "hot autumn" of 1969, and an upsurge in the struggles of immigrant workers throughout Northern Europe. In Eastern Europe: a spreading insurgency that erupted from Prague's "spring" to the Polish worker riots of 1970. In the USSR and China: growing resistance to state-organized exploitation that can be traced from the Moscow food riots in 1962 through the "Cultural Revolution" to the sympathy strikes of Soviet workers at the time of the Polish upheavals. Not only did all these conflicts occur in the same period, but they were often directly linked, as in the case of the circulation of rebellion from the rice paddies and jungles of South East Asia to U.S. campuses, and in the circulation of insubordination from the ghettoes of U.S. central cities to its factories.



The first economic signs of the extent and seriousness of the damage inflicted on the Keynesian order by these struggles included, at the national level, accelerating inflation, a growing productivity crisis, a decline in average corporate profit rates, and unmanageable government budget deficits; at the international level, there were growing difficulties with trade balances, exchange rate instability, and speculative capital outflows culminating in the U.S. abandonment of the Bretton Woods system of fixed exchange rates in 1971. The change from fixed to floating rates which took place between 1971 and 1973 constituted a de facto admission on the part of national governments that they no longer had the power to manage accumulation internally in ways compatible with global accumulation. This change also constituted a deft shift of terrain on capital's part from the concrete worlds of production and reproduction to the abstract and fetishized world of money, apparently taking the struggle from the city streets, factories, college campuses and rice paddies to the obscure back rooms of central banks and distant markets for foreign exchange.

This shift set the stage for the debt crisis. But in order to understand its origin the following three questions must be answered: (a) what were the reasons for the heavy borrowing in the 1970s? (b) how did such large quantities of capital become available for loans simultaneously? (c) what triggered the global recession and the high interest rates of the end of the 1970s and early 1980s which made the debt crisis inevitable?

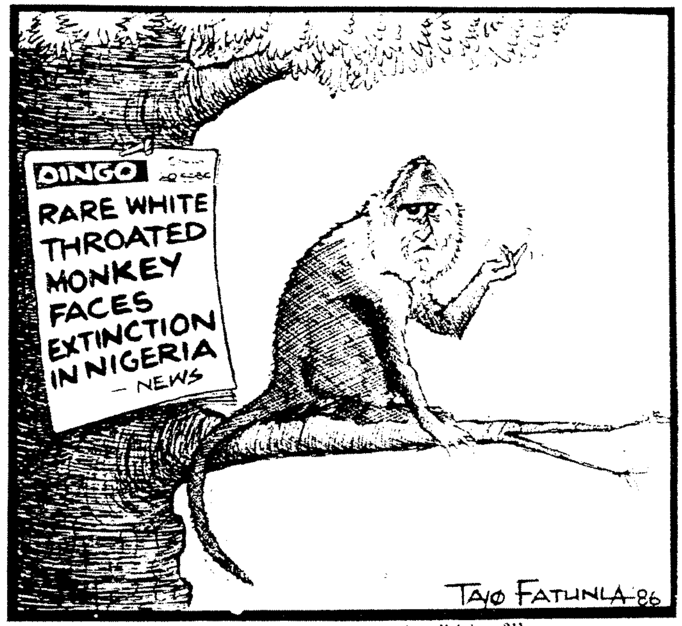
First, what were the reasons for the heavy borrowing? A complete answer to this question obviously requires a detailed analysis on a case-by-case basis of the class struggle in each of the "debtor countries" and of why the actual debtors (capitalists, elected officials and generals) were willing to borrow enormous sums from their foreign counterparts. Although such an analysis is beyond the scope of these notes, nevertheless I think we can give something of a general characterization of this borrowing. In most cases, the local administrators of capital wanted to use the borrowed funds to finance both their short-run response to local struggles, especially military/police control of the working class, and their longer-run response, local industrialization with all of its attendant costs including substantial infrastructure investment.[2]

In the three largest debtor countries—Mexico, Brazil and Argentina—such development investment was clearly predicated on the political repression of local struggles. The imposition of military rule in Brazil in 1964 came as a response to an upsurge in workers demands; the background of Mexican borrowing included the massacre of students in 1968 and widespread repression of peasant land seizures in the late 1960s; the military in Argentina sought to build factories on the unmarked graves of some 30,000 murdered insurgents. The borrowed money was a weapon in the re-establishment of accumulation after intense moments of struggle, for it was brought in with the hope of turning it into capital by exploiting what were, at least temporarily, stabilized populations of workers. [3]

In other parts of the Third World, such as the Sahel, where the working class was weaker and "nature" provided capital with alternative weapons, the response to struggle was not "development" but underdevelopment as drought was turned into famine and starvation was wielded against insurgent nomadic populations. In those countries, borrowing for productive investment was a secondary response to popular resistance to capital (Cleaver, 1977).

In Eastern Europe, especially in Poland and Hungary, the heavy borrowing came after the failure to generate local surpluses and investment adequate to meet the growing demands of the working class. The violent rejection by the Polish people in December 1970 of government attempts to shift resources from consumption to investment by cutting food subsidies caused reverberations throughout Eastern Europe and the Soviet Union. With direct attacks on working class consumption ruled out by the level of militancy and organization, socialist managers were forced to resort increasingly to borrowed capital to finance the industrial restructuring they needed to meet local demands and to regain control over accumulation. This was by no means the only response - the Soviets, for example, faced with poor harvests in 1972, also concluded the largest grain pact in history with U.S. grain companies to immediately increase food availability in the Soviet Union—but it was a common and important one. When violence erupted again in Poland in 1976, this process was accelerated, and even the Soviet government revised their 1976-1980 five-year plan to increase the production of consumption goods (Cleaver, 1977).

Second, how did large amounts of loanable capital become available in the 1970s? The superficial answer to this is well known: the bulk of the capital loaned during this period came from the Eurodollar market, at first from deposits that found no takers in crisis-fraught Western Europe and then from the enormous dollar surpluses generated by the OPEC countries through their nationalizations and quadrupling of the price of crude oil in 1974. While part of these surpluses were used to import the goods required for development at home, the largest part of it, which exceeded their "absorptive capacity" in the short term, was deposited in Western financial institutions, especially U.S. banks. Those banks then found themselves with huge new resources available for loans—loans which were both desired and needed.

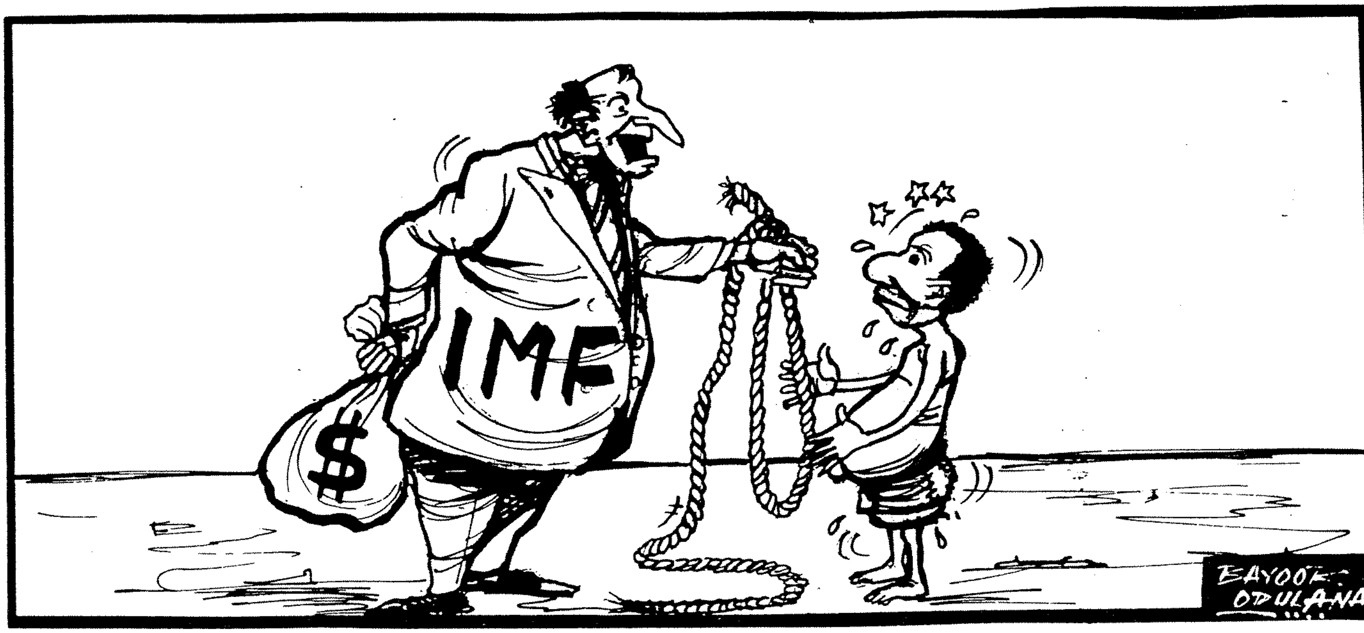


"Why me...? Why not corrupt politicians?"

But while this story is well known, let us look below the surface of this dollar flow. To do this we must first and foremost recognize that the rise of OPEC and extraction of petrodollars from the rest of the world was not simply an affair of nation-state competition, either among OPEC nations or between OPEC nations and "oil importing countries."

In the first place, the motivation of the OPEC governments was not simply greed, as it was popularly depicted in the Western media, nor even was it the justified demand for reparations for decades of exploitation, as some of their apologists have argued.[4] Rather, the need for control over oil production, higher oil prices and balance of payments surpluses was dictated by the growing, uncontainable demands of the workers and peasants of those countries. To show this clearly would require a detailed examination of each case; I will only sketch a couple of examples here.

The most obvious case, and one central to the story of the debt crisis, is Iran, whose government under the Shah at that time was attempting to carry out two simultaneous projects: developing an industrial economy at home and becoming a major military power in the region. Both were costly and both were reflections of popular struggles in the area. With respect to indus-



"The rope first,... then the loan. It's either you CLIMB with it or HANG".

trial development, the situation in Iran was similar to that in Latin American debtor countries—rising popular demands were met by a combination of police-state repression and social investment. The Iranian counterpart of the Brazilian "miracle" of accumulation based on military repression was the image of the Modernizing Shah who undertook a vast project of nation building backed by the torture chambers of Savak, the secret police.[5] Certainly the region's armed and volatile struggles, epitomized by the Palestinians, should make the class roots of his military project obvious.

A second example of OPEC motivation, taken from outside the Middle East, is that of Nigeria in West Africa. The history of Nigeria since decolonization is one of constant battle between the efforts of its neo-colonial governments to go on managing the structure of exploitation put into place by the British and the struggles of its workers and peasants to escape or reduce that exploitation. Time after time, the Nigerian government responded to popular demands by formulating multi-year development plans of accumulation only to see each one of them in turn undermined by popular resistance and upheaval. The culmination of one such cycle of struggle was the Nigerian civil war from 1967 to 1970. It involved a terrible cost for substantial sectors of the working class (especially in "Biafra"), but it eventually was followed by the reemergence of class conflict. With a tradition inherited from the British of buying cheaply from Nigerian producers and selling at higher prices in world markets, the Nigerian government saw in OPEC and high oil prices a vital new source of capital to impose its development plans on both peasants and workers. It needed those external resources to restructure class relations at home in such a manner that more surplus value could be generated internally with less dependence on both volatile world markets and the workers who produced for them.[6]

To sum up this part of the argument: the immediate source of the loan capital which financed the build up of debt derived from OPEC government responses to the struggles of people in their own countries and regions.

At the same time, we also know that the original source of the OPEC surpluses was the consumption income of workers in the oil importing countries as the higher prices for crude oil were passed on by capital to the final prices of everything from gasoline to football helmets. Why did Western policy makers allow OPEC to carry out this gigantic process of surplus value transferral to the oil exporting countries? We know from past Western intervention in the Middle East that Western governments have never felt helpless or reluctant to influence the evolution of politics either in the region or in particular countries. We also know now, from those who were involved, that despite the official condemnation of the "extortionary" quadrupling of oil prices, and Kissinger's sending of the Marines into the Mohave to practice intervention in desert regions, that the U.S. negotiators quietly let the OPEC countries know that the U.S. government would not oppose oil price increases (Oppenheim, 1976-1977). Why did those policy makers look upon those increases with such tolerance?

U.S. policy makers saw a great opportunity in the OPEC price increases. That opportunity lay in the combination of a reduction of working class income in the U.S., through further price increases, and the necessary recycling of the petrodollars which would make them available for capital investment. This investment was widely understood to be necessary in undercutting working class power and restoring productivity. The Western tolerance for OPEC stemmed, at least in part, from a vision as to how OPEC could be used as a financial intermediary to transfer value from Western consumers to Western capital—something that Keynesian management had failed to accomplish.[7] The emergence of the petrodollar surpluses which would fuel the debt crisis can thus be seen to have been a worked out compromise among various national managers of capital seeking to deal with working class insurgency in both the oil exporting and oil importing countries.

The success of this project depended on the ability of capital to convert higher oil prices into a reduction in the real wage, i.e., in holding nominal wage increases below oil boosted inflation. In terms of international trade accounts, this would translate into reductions in consumption imports to offset the higher costs of oil imports. As we now know, despite the global recession of 1974-75 and the substantially increased unemployment, this strategy failed to a considerable degree. Faced with the joint assault of higher unemployment and accelerated inflation on their standard of living, workers in the U.S. (on the average) were able to mobilize the power necessary to force increases in nominal wages enough to offset the additional inflation.[8] This had the effect of further undermining the profitability of investment in the U.S. while increasing non-oil imports. Consequently, the propensity to use the surplus capital as investment in the U.S. was reduced and more funds became available for loans to socialist and Third World countries.

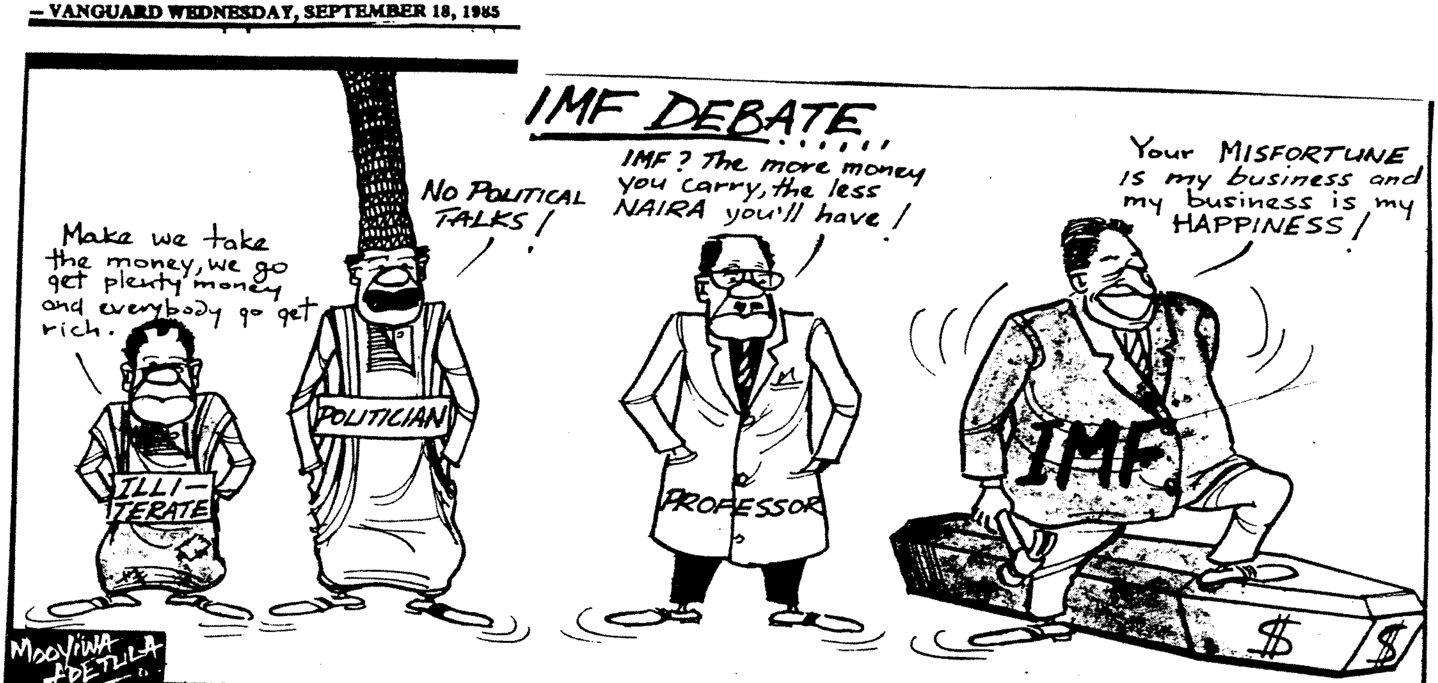
The third essential question concerning the origin of the debt crisis is, "What is the source of the global recession that undermined the debtors' ability to earn foreign exchange and caused the rise in interest rates which dramatically raised the cost of debt?" Once again the answer must be found in the changing patterns of class conflict.

The anti-inflationary shift in U.S. monetary policies managed by Federal Reserve Bank Chairman Volcker triggered the recession and the interest rate hikes. But why did U.S. monetary policy change? Throughout the 1970s "anti-inflationary policy" was aimed at wage reduction or control, but all such efforts failed. Therefore, by the end of the 1970s many capitalist planning agencies, most notably the IMF, called in increasingly urgent and strident terms for a globally coordinated attack on inflation that would include not only tight money but also demand reduction measures (e.g., cuts in social welfare expenditures) and the breaking of "structural rigidities" in labor markets (e.g., trade unions and wage indexation). In the U.S. and later in Europe, those monetarist policies were accompanied by an explicitly supply-side effort to shift resources from workers to capital.[9] Those were policy recommendations whose class meaning should be recognized: direct and indirect attacks on a working class whose struggles have escaped control and whose behavior must be brought into line with accumulation.

This shift in monetary policy had the direct effects of dramatically raising interest rates and precipitating the Reagan Recession, the latter in conjunction with an initially mild fiscal stimulus (from tax cuts and increased defence expenditures—partially offset by reduced social expenditure). This constituted another major moment, after the shift to floating exchange rates and the recycling of debt, in the capitalist manipulation of money to regain control in the class struggle. Such were the means by which the highest unemployment rates since the Great Depression, coupled with reductions in average real support for those losing their jobs, were able to bring about substantial reductions in average real wages in the U.S. To the degree that this occurred, the Carter-Volcker-Reagan monetarist attack on the working class succeeded, not only in the U.S. but elsewhere, as real wages slumped and wage hierarchies were restructured around the world.

Thus both the dramatic rise in the interest rates (which raised the cost of debt service so substantially) and the global recession (which increased the difficulty of earning foreign exchange for those who had borrowed during the 1970s) must be understood as another phase in a decade long effort by capital to turn the crisis against the workers who had precipitated it. In this case, the focal point was conflict with workers in the U.S., but the size and centrality of the U.S. moment of global accumulation meant the rapid circulation of this new phase in the conflict to all parts of the world. In the case of the other creditor nations, such as Europe and Japan, the effect would be to cause a similar monetary tightening and parallel attacks on the working class through high unemployment. In the case of the debtor nations, in both East and West, the result was to dramatically increase the pressure on local managers to resolve their local difficulties with workers. The increased cost and difficulty of servicing the debt would be the proximate cause of the explosion of the crisis in August 1982 when Mexican capital declared its inability to cope and demanded a rescheduling of the debt in line with more realistic prospects of gaining control over accumulation.

– VANGUARD WEDNESDAY, SEPTEMBER 18, 1985



NOTES

1. One well known example of an analysis which deals with the crisis primarily in terms of capital's own categories is Cheryl Payer's work. While careful in tracing and critiquing the action and interactions of the capitalist players in the debt story, Payer hardly recognizes the working class as a substantive actor. For example, in her article (1987) we learn much about the actions of private banks, the U.S. government, and various international agencies (such as the IMF). Of workers and their power, we learn almost nothing: workers in the developed countries can be threatened by debtor country exports (pp. 199, 203) and "poor people" (presumably at least some of these are considered workers) have been hurt by the debt crisis. In such analyses, we lose the ability to view the situation, past or present, from our own point of view and thus to find strategies most appropriate to our goals. See also the articles by Wood (1985, 1988). Further examples are found in two other radical books on the current crisis: Watkins (1986) and Wachtel (1986).

2. I don't want to ignore the more private but all too common motives of borrowers: the corrupt practice of skimming personal wealth off the edges of the massive loans, and often depositing that wealth in foreign banks. Muckrakers have had a never ending source of dirt in this regard, but given the amounts that have been spent on investment in social control, I see no reason to think this skimming is a prime motivation. Regardless of the percentages diverted into capital flight, be they high or low, the reason for the export of capital is the exporters' perception of high risk in their own countries as a result of intense class struggle—which is the same perception that motivated the official borrowing in the first place.

3. The successful utilization of borrowed money to finance accumulation is not a "gain" to be recognized and defended by the Left, as Robert Wood (1985) claims in an otherwise interesting article, but rather simply another case of putting people to work and exploiting them—the standard method of social control, whether carried out by private or state capitalists. When Wood quotes Peter Kilborn of the *New York Times* that "few Brazilians would undo much of the work of the technocrats...networks of roads, banking, telecommunications and electric power...a widely diversified industrial base," he shows little empathy with the mass of the Brazilian people whose virtually forced labor created these wonderful by-products of development and who continue to be rendered miserable by them. Do we have to repeat endlessly the case against roads built for the rape of a country and its people; against banks whose only purpose is ripping off a share of surplus value; against telecommunications which serve primarily to facilitate social control; against electric power, 90% of which is used for exploitation and pollutes rather than improves people's lives; and against "diversified industry," which in Brazil not only exploits people and nature but produces mainly for the rich and foreign markets.

4. The argument that OPEC acted to stem a decades-long drain of wealth, and was especially motivated to do so after the decade of the 1960s which saw a steady decline in the terms of trade between oil and Western manufactured goods, is undoubtedly truth. But this explanation does little to explain the timing of the shift in policy (which began well before the Seven Days War) nor the uses to which the money was put.

5. Moran (1976-77) shows how internal pressures were prompting Iran to demand ever higher prices in OPEC negotiations.

6. In a remarkable work that analyses the entire history of Nigeria from colonialism through to the 1980s, Izielen Agbon (1985) has delineated, in considerable detail, the cycle of struggle that led up to the Nigerian Civil War and that has followed it.

7. At least two parts of the economic discussion of the early 1970s have to be combined to see this clearly. The first is made up of the preoccupations with a "capital shortage." Martin Feldstein's work is a good example of this. The second is associated with the Trilateral Commission whose study groups on the international monetary crisis and the energy crisis were among the first to see the opportunities in the new situation (Campbell et al., 1974a, 1974b, Gardner et al., 1975). Together this material illustrates capital's own view of what Midnight Notes has called the neo-Ricardian strategy of manipulating the prices of basic goods to undermine wages and shift value to Capital (*The Work/Energy Crisis and the Apocalypse*, 1980).

8. This maintenance of average real wages, however, was bought at the price of substantial widening in the differentials between those with the power to maintain or increase their real wage and those who could not. Such widening differentials tended, ceteris paribus, to decompose previous structures of power in the working class in favor of capitalist control.

9. For a more detailed treatment of supply-side economics and capitalist strategy in this period see Cleaver (1981). (English original is available from the author.)

BIBLIOGRAPHY

Agbon, Solomon Izielen (1985) *Class Struggle and Economic Development in Nigeria: 1900-1980*, Ph.D. Dissertation, University of Texas at Austin.

Campbell, John C., de Carmoy, Guy and Kondo, Shinchi (1974a) *Energy: The Imperative for a Trilateral Approach*, New York: Trilateral Commission.

___________, (1974b) *Energy: A Strategy for International Action*, New York: Trilateral Commission.

Cleaver, Harry (1977) "Food, Famine and the International Crisis," *Zerowork #2*.

__________ (1981) "Supply-side economics: Splendoi e miserie," *Metropoli*, 7, Anno 3, Numero 7, Dicembre, pp. 32-48.

Gardner, Richard N., Okita, Saburo and Udink, B.J. (1975) OPEC, *The Trilateral World, and the Developing Countries: New Arrangements for Cooperation, 1976-1980*, New York: Trilateral Commission.

Midnight Notes Collective (1980) *The Work/Energy Crisis and the Apocalypse*, Jamaica Plain. See also "Audit of the Crisis", Midnight Notes, Vol. IV #1.

Moran, T.H. (1976-77) "Why Oil Prices Go Up: OPEC Wants Them," *Foreign Policy* #25, Winter.

Oppenheim, V. H. (1976-77) "Why Oil Prices Go Up: We Pushed Them," *Foreign Policy* #25, Winter.

Payer, Cheryl (1987) "Causes of the Debt Crisis," in Cherry, Robert, et al. (eds.), *The Imperiled Economy*, New York: The Union for Radical Political Economics.

Watkins, Al (1986) *Til Debt Do Us Part: Who Wins, Who Loses and Who Pays for the International Debt Crisis*, New York: University Press of America.

Wachtel, Howard (1986) *The Money Mandarins: The Making of a Supranational Economic Order*, New York: Pantheon.

Wood, Robin E. (1985) "Making Sense of the Debt Crisis: A Primer for Socialists," *Socialist Review*, 81, vol. 15, no. 3, May-June, pp. 7-33.

___________(1988) "Debt Crisis Update: 1988," *Socialist Review*, 88/3, vol. 18, no. 3, July-September, pp. 103-115.