



SERIES SOCIO-ECONOMY OF SOLIDARITY

Debt and adjustment

PROPOSAL PAPERS FOR THE XXIST CENTURY - CHARLES LEOPOLD MAYER EDITIONS

Proposal booklets for the 21th century

The proposal booklets are a collection of short books on each decisive area of our future, which assemble those proposals that appear the most capable of bringing about the changes and transformations needed for the construction of a more just and sustainable 20th century. They aim to inspire debate over these issues at both local and global levels.

The term 'globalisation' corresponds to major transformations that represent both opportunities for progress and risks of aggravating social disparities and ecological imbalances. It is important that those with political and economic power do not alone have control over these transformations as, trapped within their own short-term logic, they can only lead us to a permanent global crisis, all too apparent since the September 11th attacks on the United States.

This is why the Alliance for a Responsible, Plural and United World (see appendix) initiated, in 2000-2001, a process of assembling and pinpointing proposals from different movements and organisations, different actors in society and regions around the world. This process began with electronic forums, followed by a series of international workshops and meetings, and resulted in some sixty proposal texts, presented at the World Citizen Assembly held in Lille (France) in December 2001.

These texts, some of which have been completed and updated, are now in the process of being published by a network of associative and institutional publishers in 6 languages (English, Spanish, Portuguese, French, Arabic and Chinese) in 7 countries (Peru, Brazil, Zimbabwe, France, Lebanon, India, China). These publishers work together in order to adapt the texts to their different cultural and geopolitical contexts. The aim is that the proposal booklets stimulate the largest possible debate in each of these regions of the world and that they reach their target publics whether they be decision-makers, journalists, young people or social movements.

Presentation of the Paper « Debt and adjustment »

The subject of the debt is one which affects the every-day life of the citizens of the South in that resources are transferred for the development of the South to the North, thus slowing down the accumulation of capital of the countries of the South. The theoretical modes of approximation of the interest rates used by the IMF and international banks suggest that the banks will never lend resources so that the debtors can pay. The evidence shows that the creditors do lend so that the debtors can pay thus generating a pyramid of debts under which the legally contracted country cannot escape. But legitimately they can and must escape, if they do not want to remain definitively in the condition of post-modern colonies: at the top of this pyramid, the creditors built up illegitimate amounts in essence by the mechanism of the capitalisation of interest. In this way, the countries of Africa and Latin America and some in Asia ended up transferring resources which even today stop the development of their nations.



Debt and adjustment

Paper coordinated by Oscar Ugarteche



1. VERIFICATIONS AND CRITICISMS

The subject of the debt is one which affects the every-day life of the citizens of the South in that resources are transferred for the development of the South to the North, thus slowing down the accumulation of capital of the countries of the South. The theoretical modes of approximation of the interest rates used by the IMF and international banks suggest that the banks will never lend resources so that the debtors can pay. The evidence shows that the creditors do lend so that the debtors can pay thus generating a pyramid of debts under which the legally contracted country cannot escape. But legitimately they can and must escape, if they do not want to remain definitively in the condition of post-modern colonies: at the top of this pyramid, the creditors built up illegitimate amounts in essence by the mechanism of the capitalisation of interest. In this way, the countries of Africa and Latin America and some in Asia ended up transferring resources which even today stop the development of their nations.

The matter of the illegitimacy of the debt moves around such varied elements as leaders acting illegitimately if they were de facto regimes and debt contacted in a corrupt way where the creditors pay commissions to ministers or public businessmen in the debtor country for them to accept the loans. There is a lack of consensus about the illegitimacy of the debt because in the North the financial redemptions are not seen as a transfer of private sector debt to the public sector and a way of redemption not of the commercial banks of the North but of the Governments of the South. Governments are seen by the population of the South as intermediaries between the private debtors of the South (commercial banks in the countries) and the banks in the North. The population of the South does not have the duty nor the responsibility to pay for the loans granted to commercial banks at the cost of their tax resources.

The development of the international system has been derived from ways of controlling the armies in the 19th century to ways of control through financial resources and associated conditions, so that finally, the perception is that all the governments in the Third World apply the same policies. The conditions imposed by international financial organisations have awful consequences for the poorest sectors of each society and open up breaches of income in the world that have never been seen before. At the same time the transfer of resources to the development agreed on in 1974 of 0.7 of the GDP of the developed countries is in real recess. That is to say that there is more poverty, the breaches are growing and the public resources transferred from the North are being reduced. It can be seen that instead, the resources are transferred from the South to the North again with a perverse pattern of domination through the conditions imposed by the IMF/WB which limit the sovereignty in decisions on the running of the economy of the nations, a growing discourse on democracy. In this way the democratic processes in the Third World have been de-legitimised. While the governments make economic reforms they have the support of the IMF/WB they are legitimate. Simultaneously, there is a discourse on the need to reduce poverty and special programmes designed by them (PRSP), when the poverty and living conditions deteriorate as a result of the policies imposed and carried out. There is no evidence that the living conditions of the world population are improving because of the policies but

there is more vulnerability and volatility in the economies of the Third World in the 90's. This stems from the policies imposed.

Toussaint suggests that after five years of debt reduction programmes for the poorest countries, they have received a pittance and that in fact it does not affect the poor countries that are most severely in debt. They transferred 1.6 thousand million dollars in debt service in 1999. There is a loss of legitimacy of the IFIs because of the above reasons.

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

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

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

What follows in the 90's should be the end of the fourth and the start of the fifth loan cycle. Apparently what are observed at the end of the 20th Century are the final breaths of the fourth cycle. Either that or the fifth cycle is very short. The default in payments at the beginning of the 80's lead to modifications in the international rules of the game. An issue of bonds was established which bear the name of their inventor, the ex-Secretary of the United States' Treasury Nicholas Brady in order to solve the unpaid debt with the banks in the 80's. Final agreements were drawn up by the Club of Paris, with terms and costs similar to those of the Brady bonds, and in 1991 it was decided that the debt crisis had ended. What we can see at the beginning of the new century is that the debt crisis ended for the creditors but that the debtors who accepted these mechanisms with the terms above suffer from increasing difficulties generated by the rise in international interest rates and the fall in raw material prices after the so-called "Asian crisis ". (WB, 2000)

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

At the same time, the theory changed in the 70's and it was considered that bankers would never make loans to pay their own debts. Historical evidence shows not only that they make loans to pay prior debts (Ponzi Scheme) but, because of the established dynamics that places no limits on external and fiscal gaps, they discovered a definitive way of subordinating the debtors in this mechanism. This leads to the popular reasoning that countries do not go "bankrupt" and that it is reasonable to "take out a loan to pay a loan" (Arruda, 2000)

The credit risk associated to this is cancelled out by the acceptance of the losses by the creditor and debtor governments, respectively. In other words, international creditors lend because they know that they will be rescued if the worst comes to the worst and the risk materialises. History proves this. The *moral hazard*, therefore, is present. This leaves the risk margin charged on the interest rate *as income for creditors who never accept the risk or its costs*. It is a mystery why contemporary theory accepts the rationality of loans when it is well known that banks are always rescued by States if they fall into

¹ In 1998 the payment of the debt increased for \$ 296.1 thousand million the interest being \$ 125.3 thousand million (World Bank, 1999:188). The interest paid is equal to five times the amount received as donations (excluding technical assistance) and this would be sufficient to increase the 800 million of hungry people in the world by 70% (Arruda, 2000: 79-80).

difficulties. In the 19th Century, the figure of the International financial controller was created to ensure that the risks were not large. Initially it was the English and French Governments who acted inside the country, directly controlling its customs and excise revenue. This was after a brief military operation to gain control over the ports. In 1933 an international agreement put an end to this figure and it was ratified in 1936.

The IMF was designed in 1934 to replace it. Since the 1940's there has been no need for military control over the ports. Since Bretton Woods, a debtor with problems asks for aid and the IMF takes over. What is extraordinary is that if the IMF was designed to function as an auditor and is inside the central banks of debtor countries with a view to informing that problems exist, why it does not do so. It acts as a collector of sovereign debts and improves the customs and tax organisations in the debtor State, but it does not play the role of international financial controller under the obligation to inform the national and international community that there is something wrong with an economy. In other words, it is a public institution to which the tax-payers of the leading States pay high salaries to alter the international financial community on possible problems with an economy, but it fails to do so. In the important crisis of the 1990's the IMF said nothing, aware that there was a crisis. In the Peruvian case, it was aware that the dictator had spent 5% of the GNP in the first six months of the election campaign of the year 2000, but it remained silent. Some say that it does not react because if it did warn the international community that a crisis was on the cards, this would bring the crisis forward and fulfil its own prophecy. The failure to do so, however, means that the creditor governments are finally forced to initially accept the cost of the crisis and finally pass it on to the debtor government. This is done in order to prevent the creditors from losing. Instead of being a rational part of a system designed to give stability to world economy, it appears to be an organisation that is concerned with creditors' utilities, and not very well at that because it does not have a strategic and authentically pragmatic vision! For the debtor government the lack of this warning has a high cost and for the population, the cost is unacceptable. This has been seen in Mexico, South Korea, Thailand, Indonesia, Brazil, Russia, Argentina and some other countries in the 90's.

The role of external saving has been discussed and considered many times throughout the economic thought. In national accounts it is known that the most basic definition is that external saving is a *complement* to internal saving to sustain an investment rate. The investment rate is defined as the amount of new capital injected into a national economy at a certain time. From the balance of payments perspective, external saving is what is required to finance the difference between the lack of commercial balance and the lack of external capital balance. In other words, it is what is required to finance the balance of payments deficit without changing the level of international reserves. The current account deficit is equal to the increase in external debt. In situations of over-debting there are two roads: Or the debt is renegotiated in order not to sacrifice the essential investments in order to satisfy the needs and well-being of the population or the economy is adjusted to the priority of paying the debt without considering those needs. The latter has been the road chosen by the creditors, the international financial institutions (IFIs) and the local elites.

2. VISION AND NEW PARADIGM

Definitions and assumptions made in monetary theory sustain that foreign bonds stabilise the exchange rate by increasing monetary supply when the domestic supply is disturbed. Any economic agent can take out a loan on any market and arbitrate the exchange rate and the interest rate. Foreign loans, then, determine exchange rates. In history, from the evidence obtained, the Ponzi Scheme is valid; The economic agents cannot arbitrate because the markets open and close for reasons that have nothing to do with the debtor and the investment rate is not necessarily linked to the use of external credit. Foreign loans come from three sources: The international capital market, the governments and the IFIs. There is also direct foreign investment.

Suter (1992), from a study of two hundred years of loan use, suggests that the natural state of things are *defaults* and that the opposite is what is extraordinary. The most common consequence of foreign loans has been *national bankruptcy* that has lasted for years and sometimes for decades. This is true both for countries on the "edge" of Europe (such as Greece, Portugal, Spain and the Balkans) and for nearly all the States in Latin America and the independent Asian States in the 19th and 20th Century, such as the Ottoman Empire, China or Liberia. (Suter, 1) From the universe of countries in his study which runs from 1820 to 1988, 130 cases of default in payments are observed, which indicates that what is observed for Peru is true for the universe shown by Suter. He divides loan cycles into three parts: (1) Growth in foreign loans; (2) the appearance of payment crisis and (3) the negotiation of the definitive agreements between debting countries and their creditors. He also defines four loan cycles from 1800 to the 1980's. The number of countries with defaults in payments per cycle compared with the total number of sovereign countries is 29% (1820's), 37% (1870's), 40% (1930's) and 27% (1980's) (Suter, 2) Governments in general do not want to default in payments because this threatens their credibility together with the creditors and foreign investors. Nevertheless, they are often forced to do so in the condition of financial crisis or change. When the debting government waits to demand negotiations on its debt until its reserves are almost nil, the tendency is that the negotiation will be extremely unfavourable for them, with the creditors in the position of imposing their conditions. In this, as we have seen, they have the complicity of the IMF, which acts as the protector of their interests and not of the countries in difficulty. Nevertheless, there is another way of defaulting the payments, which is what is called "sovereign moratoria" In this case, the debtor country poses the negotiation and, in the limit, defaults payments when its reserves are still significant. In this case, it does so preventively, before the crisis explodes, and in conditions to negotiate its interest without losing its sovereignty in the process.

The vision, in short, is that countries naturally need the goods and services they do not possess and they need to import and take out loans or look for lines of credit is a normal mechanism in order to make the importation of products, technology and investment capital viable. What is not normal is that they get too much into debt, taking more from outside than the minimum necessary, or taking out loans under conditions that facilitate usury and speculation. To return to a situation of financial solvency is essential in order to have the socio-economic growth and social and human development of the nation again.

In the situation of neo-liberal globalisation it is very difficult for a single county to achieve a satisfactory negotiation of its debt. While the creditors join forces in commissions and clubs in order to negotiate as a block with each debtor, they will not accept that the debtors do the same. The debtors must join together also and impose negotiations in a block of all common aspects related to over-debting.

The new paradigm consists of a development process from the families and communities of each country towards the national, the regional and the global. A development from the bottom and from inside, in which the human and natural potential of each person, community and country are valued and cultivated so that in exchange with other communities and countries is based on complementariness, reciprocity and mutual respect. In this context, the foreign loan will have its place as a means to facilitate the main aim, which is the socio-economic development of the communities and of the country in conditions in which they can remunerate with justice and without prejudicing the external saving.

3. INITIATIVES AND INNOVATIONS

Suter says that before World War I governments defaulted payments on sovereign bonds. As a result of this unilateral action, the flow of loans ceased because creditors were unwilling to grant new loans. Final agreements were reached after long negotiations. After the second world war these problems were disregarded on the creation of the multilateral mechanisms of re-financing. Through these the governments have immediate temporary relief on restructuring the repayments. Since refinancing could be established before payments were defaulted, the flow of loans never ceased, says Suter. He suggests that loan cycles reach default stage when the Kondratieff cycle ceases to grow (Suter, 4).

The evidence of South America, however, indicates that in the 1980's, there is a revision in the flow of capital and that the increase in the debt is the result of the capitalisation of interest. This could not be considered in any way as the maintenance of the flow of credit, although it is true that some lines of short term trade were maintained very cut back and eventually the multilateral public organisms granted some credits, centrally of structural adjustment in the second half of that decade. The flow of long-term loans from international commercial banks did close and total flow was negative, but not frozen.

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

Some of the classical members of the debtors' school say that when a loan is sovereign, the only guarantee is the honour of the sovereign state. This is known as the Drago Doctrine, named for the Argentinean Foreign Minister, Luis Drago. In 1907, Drago said that national loans imply a contract that creates obligations for the state that takes out loans. However, he also said that not only contracts create obligations and that in any case they are special contracts with clearly identified distinguishing signs, in a category of their own (*The Proceedings of the Hague Peace Conferences, The Conference of 1907 quoted in Borchard, 1951: 5*). In 1819, Hugo (Borchard: 5) said that national bankruptcy is not illegal and that whether it is immoral or unwise or not depends on the circumstances, 1951:5).

Hugo in 1819 (Bochard, 1951:5) stated that a bankrupt nation is not illegal and the determination of whether it is immoral or unwise depends on the circumstances. The present generation, he said, can not be expected to pay for the previous generation's squandering and bad management, because otherwise the country would end up inhabitable because of the amount of public debt. In 1830, Zachariae said that the State could reduce its debts or completely repudiate them, if it is no longer in a position to obtain funds to pay the interest and the principal without an impact on current spending (Borchard. *Governments have more important things to do that pay its debts, such as keeping its citizens alive, and creditors have to be put on one side when there is no alternative*. He distinguishes between voluntary and

involuntary creditors. He says "only in *extreme conditions* can the State be considered as entitled to recognise payments to involuntary creditors. K. Von Bar in 1889 stated that the State has the *beneficium competentiae* in the widest sense and must first preserve itself and then the pay its debts (Bochard, 1951:6) Politis, in 1894, stated that contracting a debt by the State constitutes a *political act* that the State concludes in its sovereign capacity as a public power in the name and interest of the people. In the case of the Egyptian debt held in Paris, (Borchard, 1951: 7) it was sentenced that mixed courts have no jurisdiction on public debts issues if the act of issuing bonds is considered to be a *sovereign act* or if the decision made by the Egyptian authorities to violate the loan contract can be considered a *sovereign act*. National debt issued in France by a foreign government is a sovereign political act that involves the immunity of lending governments before the courts of the debtor's country.

The creditors' theory is based on the principle that when a State takes out a loan, it is technically renouncing its sovereignty and voluntarily accepting the rules of private law. In fact, all the contracts signed by a State, with IFIs or commercial banks, are protected by private law, either the American Federal Court or the London Tribunal, depending on the origin of the creditor. At times it is the Court of Paris. In other words, States waive their sovereignty and accept the jurisdiction of the private lender, whether it is in fact private or a multilateral loan organisation. Borchard (8) says that it is not evident that when a State takes out a loan, it is renouncing its sovereignty and jurisdiction, and that there is no evidence for this. When a default in payments occurs, the affected bond holder is able to make use of international public law to protect himself from bad faith or discrimination in virtue of nationality, (1951:9). The creditors' rights school maintains that in a case of bankruptcy (when a State defaults payments) the creditor is not a defenceless victim of a sovereign act but has arbitration rights according to law.

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

The repudiation of the debt: The extreme in default of payments

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

Examples of failure to acknowledge debts are scarce but convincing. For example, in Mexico in 1867, Benito Juárez failed to acknowledge the debt taken out in 1865 by the Emperor Maximilian from the Société Générale of Paris to cover the cost of the French army of occupation in Mexico. According to Marichal, "they were considered to be a complete fraud, since Napoleon III used the money from the loans to finance the invasion and occupation of

Mexico".² A second classical example is the declaration of odious debt made by the Cuban Government after 1898 for a loan it failed to acknowledge based on the fact that the resources had been used to buy arms and fight against the Cuban people during the war of independence. Both cases refer to wars and new political regimes that inherit the loan contracts signed by the previous regime with a view to remaining in power. In both cases, the resources were used to dominate the population of the country that becomes the debtor under the new regime.

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

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

The debt repudiated⁴By the United States of America

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

² Marichal, 96 table III, note c

³ CFB, 1930: 45

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

Source: Corporation of Foreign Bondholders, 1911, p. 395

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

The question is why are they unknown. Historical evidence shows that the U.S. bonds are not recorded by the Corporation of Bondholders and that the first news of the failure to pay appears in 1904. In 1911, consideration is given to the details of a series of bonds issued by the State of Mississippi and the case is used to study the reason behind the failure to acknowledge the debt. This is important because it shows the double standards applied to international loans. The reactions change depending on who the debtor is. Ugarteche (Dec. 2000) makes the historical narration and criticism that would be too long to include in this synthesis. We just take the main lessons of this jurisprudence.

The debt was created by issuing bonds to establish the Planters' Bank in 1830, issuing two series for a total of 2 million dollars. The State issued the bonds and therefore became a shareholder in the bank. They were bonds at 6%, payable on a half-yearly basis. Interest was paid up to January 1840. By a law in 1839 the shares in the bank were transferred to the Mississippi Railroad Company. However, in 1852, a State law established a *referendum* and each voter was able to specify if he was willing to pay for the Planter's Bank bonds with direct taxation. The referendum took place at the presidential elections of 1852 and most of the electors voted against. Most of the electors knew nothing of the amount that the bonds represented, the circumstances surrounding them or the size of the tax to be paid by each of them to pay for the bonds.⁵ In 1859, the Governor recommended the legislative body to create a provision to pay for the Planters' Bank bonds but this message was sent to a commission and the majority voted against the Governor's recommendation, in spite of the fact that two payments had recently been made. After the civil war, in 1875, an amendment to the constitution was proposed and approved by the population. The constitution was changed in 1876 with a clause that specifically prohibited payment of Planters' Bank and Union Bank bonds. This State constitutional reform became part of the federal constitutional reform of 1890.⁶ Repudiated debts are, then, "odious" debts (Adams, 1991), with reference to the arms financed by loans to maintain the *status quo* in Cuba before independence in 1898, or they belong to a previous regime and it is alleged that the government concerned was not empowered to take out the loans. This is the case of the repudiation by the government of Benito Juárez in Mexico, 1867, of the debt taken out by Maximilian during the Empire; and the loans taken out by Huerta in 1913, which were not recognised by the government of the Mexican Revolution in the 1922 negotiation (Borchard: 129) In the case of the debts of Mississippi or other Confederate States, repudiation occurred before the regime changed (129 referendum) and the new regime simply accepted prior decisions (in the constitutional reform of 1856 and the federal constitutional reform of 1890). Borchard suggests that in these cases the reason is "that the loan was not taken out according to law, and the persons who claimed to represent the State had no legal authority". (129 and footer 16). The situation is similar for the other confederate states in the table.

⁵ CFB, 1911: 385 - 388

⁶ CFB, 1911: 385 - 388

In 1930, Brazil spent 25% of its export receipts on the payment of its debt, which was equivalent to 237.3 million pounds sterling (64.5% to England and 30.3 to USA). In 1931 the government of Getúlio Vargas was obliged, by the circumstances created by the 1929 crash, to default payment. Vargas established an audit of Brazil's external debt and discovered that 60% of the federal loans that Brazil was paying did not have written contracts. Based on the results of the audit, *Brazil successfully negotiated the cancellation of most of the debt* and reduced the annual payment to the exterior sensitively (Gonçalves e Pomar, 2000:8-9). The Brazilian constitution of 1988 (*Transitory Constitutional Dispositions, Art. 26*) envisages the taking of a new audit of the debt within one year. The National Congress did not carry out this disposition in the time envisaged. The Brazilian Campaign of the Jubileu is currently putting pressure on Congress to promote the audit of the external debt with the aim of distinguishing legitimate and illegitimate debt as the basis for a sovereign re-negotiation with the creditors.

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

4. PROPOSALS

The national and international social movements have been proposing a variety of measures for overcoming over-debting from the cancellation of the unpaid debts of the poorest countries to the identification and cancellation of illegitimate debts which harass the highly indebted countries with average income. A critical synthesis of these proposals is to be found in the fourth part of the book by Arruda (2000:77-158) as well as in Toussaint (1999). Those which the sources pose as the most important are:

1. **Towards mechanisms of participative budget.** To promote community participation in the definition of budgets. The participation of society in budget planning will guarantee that the basic needs of the majority, accumulated so long ago - the social debt - are considered with priority over the payment of financial debt.
2. **The conditions should be pushed and sustained by the debtors.** It is necessary to re-signify the conditions so that the civil society can place them. Otherwise it would seem that the civil society does not place any kind of conditions. One condition for the society to benefit from the reduction or cancellation of the debts is that there is transparency with regard to funds freed by the reduction or cancellation. These funds should be used as a priority for the socio-economic recovery and the elimination of the factors of impoverishment - including the internal and external over-debting, unfair terms of exchange, the incorrect structure of taxation that protects the rich from paying taxes, incentives and subsidies to foreign investors and the lack of democratic control of the development process of the country. This will not be obtained without the democratic participation of the civil society in the respective countries.
3. **Conditions are proposed related to economic, social and cultural rights as the basis of the economic adjustment.** This includes the democratisation of the control and management of the productive goods and the respect of the dignity of work, including respect of women and children.
4. **To promote audit mechanisms in the process of over-debting with social participation and transparency, and international arbitration related to the illegitimacy of the debt.** There is a need to consider the matter of international arbitration and see how the matter of the illegitimacy of the debt can be related. A wide audit of the over-debting process by means of local courts, with the participation of civil society organisations in order to guarantee the transparency of information to all the citizens, would be the instrument for distinguishing the legitimate debt from the illegitimate one and the base of the claim to the international arbitration court.
5. **To reinforce the international campaign for the end of the SAPs.** To transform SAPRIN into a global campaign which calls for the end of the Structural Adjustment Programmes. This campaign should also focus the costs for the poor of the official programmes of debt reduction, like the HIPC and ESAF initiative, all totally dominated by the creditors. The

- demands should include the consideration of reparations to compensate for the economic, social and environmental damage that has affected the population - above all in Africa - on being directed towards the reconstruction of the society and the environment and towards the restoration of human dignity.
6. **The protection of the basic needs of the debtors is fundamental.** Negotiation forums must be established where the important voice is not the creditors.
 7. **To promote national plebiscites on the debts.** To establish civil consultations throughout the world like those which were carried out in Spain and in Brazil as mechanisms for creating awareness. Through a plebiscite on the cancellation of the debts and the policies of doing away with the debt capable of cancelling the illegitimate debt and re-opening the road of socio-economic and human development.
 8. **The churches must continue supporting.** The churches must not withdraw from these initiatives but continue supporting them. Among the objectives proposed by Christians is that we recognise ourselves in all the permanently poor pilgrims, in the immigrants, the socially excluded, the victims of discrimination, thus guaranteeing that we all enjoy the same rights.
 9. **The illegitimate debts must be clearly defined and legally recognised.** It must be established that illegitimate debt is:
 - That which violates human rights or that whose payment would affect the population,
 - The debt contracted by illegitimate debtors or creditors acting in an illegitimate way,
 - The debt contracted for illegitimate ends, like debts deriving from the cold war,
 - The debt contracted in an illegitimate way, including private debt which ends up being public debt,
 - All the debts which stem from refinancing are also illegitimate.
 10. **A system of arbitration in which the creditors and debtors respect the basic social expenses of the debtor country.** The idea of international arbitration is based on the protection of the tax expenses faced with the reduction of the income. This would mean a system of arbitration where creditors and debtors in an independent space, negotiate on the basis of respecting the basic social expenses of the debtor country. This has not happened in this way to date. Also, an international financial code must be constituted in order to ensure the legal independence of the process faced with the reality that the laws that are applied today to credits belong to the juridical system of the creditor nations. It is important to use the German historic reference of 1953 and the Hoover year of 1931 as well as to introduce in international credit contracts. The notions of (a) Force majeure and (b) Act of God. These concepts are used in foreign trade but not in its instrument of exchange, the credit. They should be introduced in order to allow a fairer and more fluid financial relationship in the future.
 11. **The Ponzi Scheme should be declared illegitimate where the debtor capitalises the interest because it cannot pay it and therefore the debt increases.** Theoretically, this scheme does not exist and theoretically a

bank cannot lend in order to be paid, but in the international reality this does happen but it must not continue to occur. A "Standstill" mechanism must be created in order to ensure that a debt will not increase for being unpaid for an amount greater than the current interest and in order to ensure that it is due. In another way, the problems of liquidity can be converted into problems of insolvency for reasons of world financial architecture.

- 12. IMFs must recover their dimension of multilateral institutions of development and guarantee a fair global stability.** There is discussion about whether the IFIs should continue to exist, they must go back to being what they were or they must disappear. The proposal is that the IFIs must return to their dimension of multilateral entities of development which ensure a fair world stability and they must stop playing the part of an authoritarian world government, who does not answer to anyone. Multilateralism is important in the light of the unilateralism which has arisen in the United States since the fall of the Soviet Union.

5. STRATEGIES AND ACTORS

The Jubilee campaigns in Europe were intended to establish the German precedent of 1953 as the basis for limiting what a debtor can or must pay. It is unlikely that this can be repeated because neither the geopolitical conditions nor the context of the cold war exist. To link cancellation or relief of the debt to the so-called positive conditionality seems rather unacceptable for some of the *Southern campaigns* even when it is the growing position of some *governments*. The word conditionality for some is linked to those imposed by the IFIs. We must fight for conditionalities dictated by the debtors themselves and which actively involve the civil society organisations of the indebted countries.

The crisis in the balance of payments stems from the fall in prices of raw materials and rises in the international interest rates. The Southern governments have no say over these elements. Despite these difficulties, serious problems of liquidity are attended through mechanisms of capitalisation of interest. There are NO mechanisms that prevent crises of payments for force majeure imposed by the aforementioned elements, which are out of the hands of the debtor governments. These crises then are what force the governments to sit down at the negotiating table like criminals who are imposed conditions if they want to be set free. In fact the conditions are a greater yoke than the restriction of the credit and in this case it stops the possibility of having autonomy in handling the economic policy or the pattern of capital to be developed in a country. To negotiate in a position of strength, that is to say, collectively and *before* using up the country's international reserves, is, therefore, essential and requires a firm and well-informed political will.

There are no courts to vent cases of corruption and acknowledgement of the illegitimacy of the international debt. Beyond ethical courts there are no courts where these cases are discussed because the legal jurisdiction corresponds to the creditors. This is a subject that is not popular in the North. There is a proposal to use the mechanisms of the municipal bankruptcy law in the United States (Chapter 9 of the law on bankruptcy) in order to allow the elements of social expenses to be protected. To use this mechanism stems from the principle of the legitimacy of the debt and the acknowledgement of the internal dis-handling and does not allow the external causes that provoke the majority of the cases of crisis of payments to be recognised and which make simultaneous the cases of default and the determination of the credit cycles mentioned above.

It is a demand open to the creation of a space that is not linked to the creditors in order to solve the conflicts over credits. This is known as an *international arbitration court* where there must be representatives of the debtors and the creditors. There is an initiative in the North as regards arbitration using the arbitration mechanism without affecting the jurisdiction. There are Southern judgement elements which allow a new jurisdiction to be created, by creating an international financial code following the model of the international code of trade. The contemporary precedent would be the creation of an *international criminal code*. When an international code can be established, then an international court following the model of that of trade based in Paris.

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

The Jubilee re-opened the old boring subject that international financial bodies had considered as closed since 1991. There was a campaign to cancel the Third World's debts, based in Brussels and other organisations in different countries, including Jubilee 2000 Coalition and Southern Jubilee. There were meetings in Europe especially, but also in the United States, where the IMF, the World Bank, conditions and poverty relief programmes were questioned. Different coalitions were formed where different interest groups came together to consider the issue from different perspectives. Perhaps the most surprising was that in Europe and Japan people came out onto the street to protest against the Third World's debt. This has never been seen before. Just a decade later or between one and two decades later that Latin American political organisations brought out the masses onto the streets for this same subject, with the exception already mentioned. But no one in the developed world was then interested in the subject. So much so that an organisation created in Latin America called Fondad (Forum on Debt and Development) became Eurodad in 1990, because of a changearound of its Dutch financiers. There is still a strictly Dutch Fondad.

In this framework, it is extremely important that there are people interested enough to move the issue politically. It is an interesting time for changing the international rules of the game. Faced with this strategies to reach the objective of overcoming the crisis of over-debting include:

1. Total cancellation of all Third World debt with no conditions
2. Cancellation of the debts of the poorest countries with positive conditions
3. Creation of an international court of arbitration
4. Creation of an insolvency procedure to protect social spending levels using the criteria included in Chapter 9 of the United States bankruptcy law.

5. Creation of an independent international arbitration court, using an international financial code, that as yet does not exist. This court would also be used to judge cases of corruption that now remain unheard.

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

That is why the civil society concerned must establish conditions for the governments involved.

Some of these conditions have been expressed in the Tegucigalpa Declaration and other in documents published in Jubilee 200 Great Britain. The most significant are:

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

The following are parallel to these demands:

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

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

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

At the start of the 21st Century, it can be argued that the reappearance of the issue of debt in the First World as a result of the Pope's call in the Jubilee Year has had no concrete results with regards to substantial debt reduction. Indeed, it established positions of the Church that can be counterproductive when

combined with unhealthy views on birth control and sexual and reproductive rights where Rome has a fundamentalist viewpoint. As a civil organisation, Jubilee 2000 is possibly the first organisation with a militant base in all the G7 countries except France. There are also organisations in many Third World countries, particularly Africa and Latin America. Nearly all of this is based on prior organisations that were related to the subject in the 80's, with the above exception. The end of the year 2000 does not and can not represent the end of the cause that was the basis for the Jubilee 2000 movement, perhaps with the danger of reaching the 22nd Century with the same slogan and year.

Whether there is consensus on the maximalistic position that does not change the global rules, or a mixture of all this, the debate is open and the pressure is at least creating a change of opinions. This pressure must continue, preferably with the help of civil society in the First World. As we learned in the 80's, if the civil society of the First World is not involved, a message from the South alone will not be heard by the Governments of the North. It must be made quite clear that the South is of no interest or significance for the powerful of the world nor for Capital or the Northern States. It must also be made clear that the cost of reducing or cancelling all Third World debt (including Argentina, Brazil and Mexico, the three most heavily indebted countries) is less than the heavy portfolio of Japanese banks. In other words, it is possible if there is a will or enough pressure. When the governments of the G7 realise that it is in their best interests, they will do it. It is in our interest as a civil society to use resources to cover social debt in the best possible way and not to leave this to the free choice of unforeseeable governments.

The Alliance for a Responsible, Plural and United World

Working together towards the challenges of the 21th century

Ever since the late eighties of the 20th century, numerous initiatives have been put forward from different regions of the world and extremely diverse contexts. Different social actors were thus put in motion with the aim of organising a vast worldwide process seeking to explore values, proposals and regulations capable of overcoming the modern challenges humanity is faced with.

A large number of thematic, collegial and continental meetings were organised in the early nineties, a process which led, in 1993, to the drafting of the *Platform for a Responsible and United World*.

Regional groups were set up, international professional networks and thematic networks on the fundamental issues of our era were developed: the Alliance was created. It is financially and technically supported by the Charles Léopold Mayer Foundation for the progress of Humankind (FPH), among others.

The Alliance is focussed on inventing new forms of collective action on both a local and global scale, with the aim of shaping together the future of an increasingly complex and interdependent world.

The challenge of the Alliance is to actively support unity in diversity by asserting our societies' capability to understand and appreciate the complexity of situations, the interdependence of problems and the diversity and legitimacy of geo-cultural, social and professional perspectives.

The Alliance, as a space of discussion, reflection and proposals, is built around three main orientations:

Local groups aiming to bring people of a community, a region, a country or a continent together by looking at the realities and issues of their own societies. This is the **geo-cultural approach**. It reflects the diversity of places and cultures.

Groups of socio-professional actors wishing to provoke dialogue and mobilisation within a given social sector or profession (youth, peasants, scientists, local representatives, etc.). This is the **collegial approach**. It reflects the diversity of social and professional milieus, their concerns and responsibilities towards society and the challenges of today's world.

Thematic workshops seeking to create reflection groups centred around the major issues of our common future (sustainable water management, regional integration and globalisation, financial markets, art and society, etc.). This is the **thematic approach**. It reflects the diverse challenges humanity is faced with in the 21st century. Thematic workshops are organised into four areas: Values and Culture, Economy and Society, Governance and Citizenship, Humanity and the Biosphere.

Seeking both to draw on the richness of materials and experiences gathered by these reflection groups whilst networking with other citizen dynamics with a similar focus, the Alliance fixed itself the objective of obtaining collectively developed, concrete proposals. The following meetings were thus organised:

- **international meetings**, for each thematic workshop and each college,
- **synchronized continental assemblies** (Africa, Americas, Asia, Europe) and a regional meeting in the Arab world (Lebanon) in June 2001.
- a **Citizen World Assembly**, held in December 2001 in Lille, France, bringing 400 participants together from around the world.

These meetings together contributed to the drafting of some sixty *Proposal Papers for the 20th century* and a *Charter of Human Responsibilities*, published in several languages in different countries.

The Alliance has been involved in a process of disseminating and developing these outcomes since the beginning of 2002. Networks are expanding, branching out and their work themes are becoming increasingly transversal. They also strengthen links with other approaches aiming to create an alternative globalisation.

For further information, please visit the **alliance website** at www.alliance21.org, where the history of the Alliance, the challenges it is engaged in and the workshops and discussion forums being held can be viewed in three languages (French, English and Spanish).

E-mail: info@alliance21.org

The proposal papers on the internet

Whether in their provisional or definitive form, all the proposal papers and their corresponding translations can be accessed on the website of the Alliance for a Responsible, Plural and United World, at:

<http://www.alliance21.org/fr/proposals>

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