How did international power relations contribute to the Third World debt crisis?

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The Third World debt crisis (TWDC) is still a major issue in the current international political economy and has yet to have been fully resolved. Without a basic definition of the TWDC the above statement cannot be analysed, therefore this will be addressed first. There is debate among IPE scholars over the exact definition of the TWDC and when and where it started. However, for the purpose of this essay, I will define a debt crisis as "problems arising from the foreign indebtedness of states; whereby the debtor cannot generate enough income to service the payments." [1] As for time and location, it is widely understood that the TWDC began in Mexico in 1982 which later caused a chain reaction, in particular in Latin America and a number of African and East European countries, which were no longer able to meet their foreign debt payments. [2]

With regards to the political-economic origins of the TWDC, there is much discussion within the discipline over its' exact causes .Firstly, I will argue that domestic factors including capital flight, corruption and loans used for consumption were all influential in causing the TWDC. However, I will then argue that these factors were not the main causes as international power relations had a far greater contribution. I will defend the argument portrayed by Duménil and Lévy; that the main cause of the TWDC occurred in the US due to the rise of interest rates by Volcker in 1979. Firstly, I will illustrate the shift in global power relations with the rise of economic-political power within the Third World, in particular the OPEC nations.

Secondly, I will contrast this with the decline of the main western capitalist countries, in particular the US, which was suffering from a decade long structural crisis with high rates of stagflation. Thirdly, I will explain how the wealthy elite within the US were strongly affected by this crisis and as a consequence were trying to find a solution, leading to the 'Volcker Coup' of 1979 which represented the beginning of neoliberalism. Fourthly, I will explain why these series of events of international power relations indirectly caused the TWDC.

With regards to the domestic factors, capital flight was extremely important in causing the TWDC.[3] The World Bank estimated that between 1979 and 1982 capital flight amounted to an astonishing 67% of capital inflows in Argentina, Mexico and Venezuela.[4] For example, 84% of the tremendous increase in foreign loans to Argentina was offset by the outflow of private capital and for Venezuela the figure was over 100%.[5] Thus, in Venezuela, capital flight was so extreme that the outflow of private capital in three years exceeded the inflow of foreign loans.[6] Capital flight is inherently a political phenomenon involving the role of the government and usually the wealthy with access to foreign exchange and hence it is not surprising that this was a major factor in causing the TWDC. [7]

The second domestic cause of the TWDC was corruption as a huge fraction of the foreign loans were misused and made for projects without proper checks on their viability.[8] According to the Corruption Perceptions Index (CPI), Mexico in particular, was recognised as having a serious corruption problem. For example, the CEO of the Mexico's government owned Petroleum Company (which had also been the recipient of the largest share of foreign funds borrowed by the Mexican government) was accused of involvement in frauds for amounts of up to a billion dollars.[9]

A famous Latin American historian, Carlos Marichal, agreed that "In no period of modern Latin American history has financial corruption reached such heights".[10] However, unfortunately corruption was not only present in Latin

America as there were also "various dictators in Africa and Asia with large appetites for personal wealth".[11] In the Philippines for example, the dictator Marcos was estimated to have pocketed a third of all loans to the country as it was estimated he had a personal wealth of $10 billion.[12] Thus, it is evident that corruption was an important factor in causing the TWDC as it made the prospect of repaying the loans even more unrealistic.

The third domestic cause was loans used to finance consumption (often in the form of military expenditure or luxury goods) rather than investment. [13] In Argentina, extensive borrowing was devoted almost exclusively to luxury imports and arms purchases as the Argentine military dictatorship was reported to have borrowed $40 billion from 1976 to 1983 and leaving no records for 80% of the debt.[14] It is also clear that the military used some of the loans to buy weapons for the Falklands War as in 1982 the government suspended payments on its 37$ billion in external debt. [15] In Chile, for example, luxury goods imports, largely financed by foreign borrowing by private companies, were 491% higher in 1979 than in 1970.[16]

Another problem, such as in the case of Nicaragua, was that loans were often invested in projects that had long growth periods and would yield low rates of financial return.[17] Therefore to sum up, these three domestic causes described above were all important factors in causing the TWDC as the majority of the petrodollar loan money was squandered on grandiose and ill-considered projects with despotism being present throughout Latin America, Asia and Africa. However as I will argue these domestic causes were by far the main causes of the TWDC with international power relations having a much greater contribution.

In the early 1970s, global power relations were beginning to shift as newly decolonised Third World countries (which were part of the non-aligned movement) fought at the UN for a New International Economic Order (NIEO). [18] It was based on economic justice and was a means of increasing their bargaining power with the industrialised countries in Europe and North America.[19] In addition, in 1973 the Organisation of Petroleum Exporting Countries (OPEC) increased the price of petroleum three-fold to over $30 a barrel with OPEC members receiving windfall surpluses of $310 billion during the period of 1972-1977.[20]

This 'oil shock' rippled through the global economy, triggering double-digit inflation and a massive currency 'recycling' problem. OPEC nations, enriched with a vast new wealth of 'petrodollars', invested their money in Northern financial centres and commercial banks. [21] Western banks flushed with this new OPEC money, began to search for borrowers. Soon millions in loans were contracted to non-oil-producing third world governments desperate to fund development goals.[22] This rise in political-economic power of the OPEC members contrasted with the decline of the main western capitalist countries, in particular the US, which were suffering from a structural crisis including high stagflation.[23]

The decline of US led domination can be traced back to the late 1960s as embedded liberalism, which had resulted in high rates of growth to the advanced capitalist countries post Second World War, was "clearly exhausted and no longer working".[24] In the late 1960s, as a result of the crisis of Fordism and the costly Vietnam War the US economy was "firing on all cylinders and beginning to dangerously overheat".[25] Unemployment and inflation were both surging everywhere while foreign debt ballooned to pay for the war in Vietnam. In addition, with the rise in European economic development and export-led growth in Japan, the US dollar was plummeting in value.[26] Even before the OPEC oil embargo of 1973, the Bretton Woods dream of a stable monetary system of fixed exchange rates with the dollar as the only international currency was collapsing under the strain of American trade and budgetary deficits.

The gold exchange standard was abandoned in 1971 as the world moved to a system of floating exchange-rates.[27] Meanwhile, the World Bank contracted huge loans to the South during the 1970s both for 'development' and to act as a bulwark against a perceived worldwide communist threat.[28] Thus, this golden age of controlled capitalism came to halt with the severe economic and oil crises of the 1970s as Keynesian policies were no longer working. It was clear at the time that there needed to be an alternative if the crisis was to be overcome.

This structural crisis of the 1970s led to the income and wealth of ruling classes being strongly affected as wealthy investors had seen the values of their assets, particularly bonds, decline sharply in the 1970s.[29] These elite groups, with various business and financial interests, strongly influenced the appointment and actions of Paul Volcker as chairman of the Federal Reserve in August 1979.[30] The real rate of interest, which had often been negative during the double-digit inflationary surge of the 1970s, was raised overnight and by July 1981 stood close to 20%.[31] This, Volcker argued, was the only way out of the crisis of stagflation that had characterized the US and much of the global economy throughout the 1970s.[32] This "1979 coup" rewarded the wealthy primarily as the "top 10% of the population owned 72% of corporate and federal bonds….plus 86% of state and local bonds".[33]

According to Duménil and Lévy, this ' 1979 coup' can be seen as a restoration of class power as according to the US Census, only families in the top 20% of the economic ladder enjoyed real increases in their after-tax household incomes from 1980 to 1983. The others, the bottom 80%, actually lost.[34] Thus, for the extremely wealthy, the rise of interest rates had three advantages: it raised the income and wealth of creditors, fought inflation and was used as an argument to launch an attack against the welfare state.[35] As a challenge to the leftist approach of communism and central planning, within US policy-making there arose a new alternative for a global economic system "concerned with liberating corporate and business power and re-establishing market freedoms" which would later become known as neoliberalism.[36]

Unfortunately, for the Third World, the further away from the centre the more damaging the transition towards neoliberalism was. As interest rates shot up, Duménil and Lévy argue that countries reeling under OPEC oil-price hikes had the cost of their Eurodollar loans double, even triple overnight.[37] The debt of the non-oil producing TW increased five-fold between 1973 and 1982, reaching a staggering $612 billion. The crisis started in August 1982, when Mexico announced that it was unable to ensure its earlier commitments.[38] A chain reaction was initiated, and one year later, 27 countries had rescheduled their payments. Four countries (Mexico, Brazil, Venezuela, and Argentina) in Latin America held 74% of the international debt.[39] During the 1980s much of the Third World's growth stagnated as debt doubled to almost $1,500 billion by the decade's end.[40] Not surprisingly, widespread panic began to sweep through the world of international finance as Third World nations were on the brink of economic collapse. [41] In response much of the debt shifted from private banks to the IMF and World Bank as they both began to demand major changes in the way debtor nations ran their domestic economies.[42] This restructuring known as the 'Washington Consensus' came in the form of neoliberal policies including structural-adjustment programs advocating financial liberalization, deregulation of the economy and privatization of state enterprises.[43] Thus, it is evident that a series of events of international power relations in particular the actions of the US élite caused the TWDC.

In conclusion, there is no doubt that domestic factors including capital flight, corruption and loans used for consumption were all significant in instigating the TWDC. However, as I have argued throughout the essay these factors were not decisive as international power relations had a far greater impact. As Volcker's raised the interest rates this meant higher interest payments on foreign debts as the Third World plunged into a debt crisis. As OPEC nations rose in political-economic power, western banks were flooded with OPEC money, allowing them to loan to non-oil producing Third World governments. This contrasted with the decline of the main western capitalist countries, in particular the US, which suffered from a decade long structural crisis including high rates of stagflation. With wealthy US investors having their assets severely reduced, the 'Volcker Coup' of 1979 represented the restoration of class power. Thus, the international power relations I have explained above indirectly caused the TWDC which characterised the beginning of a new form of re-structuring the global political economy, called neoliberal-globalisation.

[1] Gilpin (2001) p.313

[2] Gilpin (2001) p.313

[3] Epstein (2005) pp.3-4

[4] Buckley (2008) p.34

[5] Buckley (2008) p.34

[6] Buckley (2008) p.34

[7] Epstein (2005) pp.3-4

[8] Buckley (2008) p.34

[9] Jain, A (1998) p.2

[10] Marichal (1989) p.238

[11] Ellwood (2006) p.49

[12] Ellwood (2006) p.49

[13] Kambhampati (2004) p.123

[14] Wood (1986) p.251

[15] Wood (1986) p.251

[16] Wood (1986) p.251

[17] Wood (1986) p.251

[18] Cox (1979) pp.257-302

[19] Cox (1979) pp.257-302

[20] Ellwood (2006) pp.45-50

[21] Ellwood (2006) pp.45-50

[22] Ellwood (2006) pp.45-50

[23] Harvey (2005) p.12-32

[24] Harvey (2005) p.12-32

[25] Ellwood (2006) pp.45-50

[26] Harvey (1990) pp.1-2

[27] Ellwood (2006) pp.45-50

[28] Ellwood (2006) pp.45-50

[29] Duménil and Lévy (2005) pp.9-19

[30] Duménil and Lévy (2005) pp.9-19

[31] Schaeffer (2009) p.66

[32] Harvey (2005) p.33-35

[33] Schaeffer (2009) p.66

[34] Duménil and Lévy (2005) pp.9-19

[35] Duménil and Lévy (2005) pp.9-19

[36] Harvey (2005) p.13

[37] Duménil and Lévy (2005) pp.9-19

[38] Lipietz (1984) pp.1-12

[39] Duménil and Lévy (2005) pp.9-19

[40] Ellwood (2006) pp.45-50

[41] Ellwood (2006) pp.45-50

[42] Ellwood (2006) pp.45-50

[43] Steger (2009) pp.19-20

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