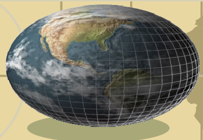

The Jus Semper Global Alliance
Living Wages North and South

The Neo-Capitalist Assault   Essay Two of Part II (Asymmetric Order and Collapse)

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Development Collapse:
Stagnation and Crisis in the Capitalist System

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From time to time TJSGA will issue essays on topics relevant to The Living Wages North and South Initiative (TLWNSI). This paper is the sixth in the series "The Neo-Capitalist Assault" –a collection in development about Neoliberalism.

The purpose of this essay is to discuss the stagnation of the capitalist system with the end of the recovery of the developed economies and the subsequent collapse of Third World development and the unilateral abandonment of the gold pattern by the U.S., effectively breaking with Keynesian economics –not because of its failure but because of the lack of U.S. fiscal discipline and its geopolitical interests– and replacing it with the current Neoliberal ethos. The essay opens by briefly describing the strong growth of the developed economies in the sixties, which then fall into stagnation and inflation in the seventies.

Summary

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As the European nations and Japan recovered from the devastation of World War II, they reestablished their industrial plant. Until the end of the 1950s, they were net importers of both raw materials and manufactured goods, most of them from the U.S. However, as they recovered, they began to produce many industrial products and recover their agricultural output. Western Europe increased its trade within itself and, along with Japan, began to export heavily to the U.S. and secondarily to Third World countries. As a consequence, trade increased dramatically between the industrial nations, and the GATT worked well for them. Tariffs on non-agricultural products dropped to an average of 10% among them, and, as trade grew, it became an important portion of their GDPs. Between 1960 and 1970, the annual average GDP of the OECD countries grew at a strong 5%, whilst trade grew at an even stronger rate of 8.5%/year.[1] Thus, by 1970, trade accounted for roughly 24% of these countries' GDPs.[2] However, the expansive growth of the post-war era began to wane by the end of the 1960s, and in the 1970s stagnation and inflation began to dominate the scene. Between 1974 and 1979, the GDP in the OECD countries dropped to an average of 2.7% and inflation went up from 2.7% in the 1960s to 13.4% in this period.[3]

The Dependencies of the System

The slowdown that began at the end of the 1960s signalled the beginning of a recessionary period and the beginning of the end of the Keynesian paradigm. The roots of these changes laid in a number of factors inherent to the capitalist economic system as it emerged from the accords of Bretton Woods and GATT and in the political dynamics that developed after the immediate post-war years. As noted in essay four of part I, there were substantial differences between the capitalist economic system envisioned by John Maynard Keynes in Bretton Woods, and the actual outcome of the subsequent negotiations after his death. As noted in essay four of part I,

there were substantial differences between the capitalist economic system envisioned by John Maynard Keynes in Bretton Woods, and the actual outcome of the subsequent negotiations after his death. In fact, after Keynes death in 1946, his writings were either ignored or used according to convenience.[4] The driving force in these differences was the will of the U.S. to lead the system, in an unbalanced manner, to its favour and that of its major trading partners, and to both U.S. domestic and foreign policy interests, which were placed above economic discipline. Thus, the inherent imbalances of the system and the subjection of economic discipline to political factors gradually took the system into a breakdown and into its abandonment under the scope of Keynesian economics. The requirements of Keynesian economics, in order to successfully keep the system growing under reasonably stable conditions, were anchored on strict fiscal discipline. This discipline was supposed to focus on the support of full employment to maintain good levels of aggregate demand and general welfare, while controlling public spending, so not to exceed reasonable limits of public deficit. Public deficit was supposed to occur during slow periods, but it was not supposed to accumulate during good periods. On the contrary, public deficits were supposed to be eliminated during good economic times by using the incremental tax revenue that derived from the increase in economic activity. None of this occurred because economic policy was subservient to domestic and foreign policy. This detachment or inobservance of the discipline required by the demand-side economics of the Keynesian paradigm, along with the asymmetrical terms-of-trade within the U.S. and the other major trading nations, and between these and the developing world, and a slow down in productivity and competitiveness in the developed nations, lead to the breakdown of the system. The system required a discipline that was too rigid for the key participants, given their individual economic and political interests and the changes that these interests provoked in the structure of their economies.

Trade, unquestionably, is an engine for economic growth, but its very capitalistic nature of competition always draws losers and winners. By liberalizing the national markets, the less competitive industries of each nation are naturally exposed to direct foreign competition that will take away a portion or all of their domestic markets. Thus, trade has a direct impact on the welfare of each nation. Those nations with competitive industries will benefit at the loss of the non-competitive industries of other nations. In those cases were a nation does not manufacture a product, the impact of importing from another nation tends to be less damaging than those cases were a local industry is displaced by a stronger, more efficient foreign industry. The factors that allow a nation to develop an efficient industry might be the result of natural or historical and cultural variables. For instance, a country endowed with high quality and sufficient quantities of iron mineral may be in a better position to compete selling steel than less endowed nations; or a nation that has a very large domestic market will enjoy greater economies of scale that will generate the resources required to invest more in research and development, which will enable it to become even more competitive by producing technologically advanced products at more competitive prices. However, whatever the specific factors are in each case, the trade of goods or services always draws winners and losers, and these outcomes have a direct effect on the welfare of the trading nations. For this reason, nations have always erected protectionist barriers. During the age of mercantilism, the trading companies owned by the monarchies and the aristocracy were highly protectionist and monopolistic in order to protect their own personal welfare. Later, with the advancement of liberalism and democracy, protectionism intended to protect the domestic economies and the general welfare of their civil societies. This, especially, was the ultimate intention of governments after the Great War and the Great Depression. However, even though the Great War was, to a great extent, the result of trade conflicts, nations have remained, to this day, always guarded against the negative consequences of trade on the welfare of their population.

Therefore, the inherent imbalances of the capitalist trading system trigger their own dynamics, which continuously generate further instability. If we add to this fact the political interests of individual nations, which are always ultimately driven by economic interests, we have a capitalist system that is inherently unstable. In a

nutshell, in a capitalist society, "it indeed is all about money," and competing for it will always trigger dynamics that are pulling the system in all directions, thus, generating a systemic instability.

The following dynamics provoked the gradual breakdown of the post-war capitalist economic system:

- *Protectionism*. The European nations and Japan refused to open their markets, once they had fully recovered from war, and continued to base their economic development on exports and economic protectionism. Moreover, Europe was progressing in the formation of the European Economic Community, which could only reinforced its stance. By the early 1970s, it had nine members, and it was slowly but surely moving towards a full economic integration. Japan was adamantly restrictive of foreign goods. Thus, it tried to maintain the same asymmetric conditions on trade that the U.S. had accepted during the period of recovery and remained highly protectionist.

- *Negative U.S. trade balances*. The U.S. had enjoyed great surpluses in its balance of payments since 1893. This was especially evident during the fifties when it was supplying capital goods, consumer goods and raw materials to Europe and Japan to support their recovery. However, the surpluses began to turn into deficits in 1965 with Japan and in 1972 with Europe.[5]

- *Big public deficits fuelled by foreign policy interests*. The U.S began to run big public deficits fuelled by overspending to finance its war in Vietnam.

- *Inflation and loss of competitiveness*. The growing U.S. deficits fuelled inflation not just in the U.S. but also among its key trading partners. Thus, some of them devalued their currencies to account for inflation. This made the U.S. currency less competitive. However, the U.S. refused to devalue its currency because it wanted to preserve the monetary preeminence of the dollar and because Nixon wanted to protect his position for re-election. As earlier noted, the U.S. wanted its trading partners to reverse their devaluations and revalue their currencies, which, of course, they refused to do. This resulted in greater U.S. trade deficits due to the cheaper cost of imports and higher cost of exports. The Europeans and Japanese obviously preferred it this way.

- *Monetary interdependency*. The preeminence of the dollar made other nations run a portion of their reserves in dollars. Thus, the U.S enjoyed, for a long time, the privilege of not having to constrain domestic economic policy to its monetary position, as long as its trading partners kept large dollar reserves. But the increasing trade deficits, the competitive devaluations of the currencies of its key trading partners and the public deficits of military spending, which fuelled inflation, did made the U.S. dependent, for the first time, on the international monetary system.

- *Protectionism of the agricultural sector*. Contrary to free trade philosophy, all major economies had always been –and still remain– staunch protectionists of their agricultural sector. All of them had traditionally subsidized their farmers and erected high barriers to protect them. This, naturally, had become a frequent point of conflict. In the case of the developing nations, this had particularly infuriated them. They were being pressured to open their economies to manufactured goods while the major economies remained protectionist; placing barriers against many of the Third World's agricultural commodities which, for many countries, were the major source of exports. This is one central reason why the First World did not want to support the ITO. In fact, the agricultural sector has been one of the most difficult sectors to harmonize in the formation of the European Union.

- *Loss of U.S. labour competitiveness*. An additional effect of the inflationary U.S. economy and of its refusal to devalue was the surge of U.S. investment abroad due to lower costs. This directly hurt the growth of domestic employment, and it was infuriating the U.S. Congress, who eventually turned to protectionism as the situation worsened.

- *Third World Protectionism*. The systematic negative stance of the U.S. and its partners against fairer terms-of-trade with developing nations united the latter and mobilized it

towards import substitution, as noted earlier. This had the double effect of putting pressure on U.S. companies to invest directly in these nations and of stimulating the emergence, in several developing nations, of a competitive manufacturing base in specific industries, which began to take market share away from the U.S. and other developed nations. The most typical case is, probably, that of the steel industry, where nations such as Brazil, Mexico and others became internationally competitive in specific market niches. All of this decreased the dynamism of the major economies and put further pressure on their labour endowments.

- *Increased First World protectionism of non-competitive industries.* As the import substitution era enabled certain sectors of industry to become competitive, the First World; which had been a staunch advocate of free trade before the Third World, turned hypocritically to protectionism when it was getting hurt. The U.S. AFL-CIO labour organization, which had previously advocated free trade, began to demand protectionism from 1970 on. Thus, the U.S. Congress became very protectionist, as it had traditionally been, and forced the executive branch to impose import quotas to all major trading partners. This was completely against the GATT agreement; thus, it hurt the trading system in a very meaningful way.

- *The oil embargo retaliation.* The growing animosity of Third World nations against the double standard and the win-lose exploitative and coercive attitude of the U.S and the other major industrial nations was finally galvanized in the two oil embargoes organized by the OPEC (Organization of Oil Exporting Countries) nations. The history of oil trade is perhaps the most illustrative example of First World imperialism; and we will revisit it later in this essay. For now, it is sufficient to state that, after a long struggle, the nations that formed OPEC retaliated against the "Seven Sisters" who controlled oil production in the world and nationalized their oil industries to increase the price of oil. Before the first crisis, the price of a barrel of oil was at around $1.80/barrel. But, after the nationalization by key producing countries was consummated, the price of oil shot up to $11.65. The second oil crisis began with the Iranian revolution of 1978 and moved the OPEC price of oil, by 1980, to around $33 dollars/barrel.[6] These two drastic increases added to the disruption of the capitalist system by fuelling recession in the First World, and even more so in the U.S., as the trade balance deficit worsened and inflation further increased.

The Decline of the Empire

In 1971, because of increasing deficits and the personal political interests of Richard Nixon, the U.S. unpegged the U.S. dollar from the Gold Standard. This marked the official end of the Keynesian Paradigm. The inherent instability of the system, due to the dynamics imposed by differing interests and the nature itself of capitalism, could not bring the will of the leading nations to work cooperatively to seek a balance between participants to lessen the negative effects of a system of winners and losers. The determination of the U.S. to rule the system and benefit unilaterally drew dissent among its key partners. As noted earlier, Europeans and Japan acted to protect their economies from the effects of U.S. inflationary pressures and the U.S. reacted by protecting its own market from greater trade deficits. The U.S. was losing competitiveness in its products and services against its key trading partners. Moreover, in the sixties and seventies the Third World had also moved to isolate itself as much as possible from a system designed for the centres of power to extract the surplus of their economic activity and had become competitive in itself in certain sectors.

Between 1974 and 1980, the U.S. continued to lose competitiveness against Europe and Japan, and the outcome of the Vietnam War showed that the capitalist lion was clearly weakened. It had become evident that its economic and political emporium was no more. By 1980, the U.S. was still the strongest among others, but the base of the material hegemony had disappeared and had ended simply as a strong centrist state;[7] but, clearly, not the imperial leader that it used to be. Its economic and political prowess was in tatters. From the fall of Nixon, and throughout the Carter administration, the U.S. economy continued to decline because of its weaker competitiveness and the impact of the oil crises. This clearly showed that Keynesian economics could not be afforded unless other public spending, especially in the military, could be controlled in order to cut

the deficit spending. Carter was criticized for being too soft. He worked to maintain the welfare of the country, but he was attacked by the U.S. economic centres of power for not supporting U.S. imperialist interests. Meanwhile, the U.S. deficit continued to grow forcing it to choose between reducing the welfare state or military spending. Unfortunately, with the victory of Reagan, militaristic obsessions prevailed, and the stage was set for the new Republican era of the so-called Reaganomics.

Oil Crises and Third World Indebtedness

After World War II, the developing nations became increasingly frustrated by the negative stance of the First World against the exports of their commodities. In addition to the pursuit of industrialization through import substitution strategies, as a defensive approach against the First World's double standard in trade, there were many attempts to form cartels to control the supply of commodities and, thus, control their world price. However, none, except for the oil cartel, was successful in commanding such control of supply and price.

Increasingly frustrating was the attitude of the U.S. against manufactured goods coming from the South. The U.S. implemented escalating import tariffs for products with more added value. Thus, tariffs were higher for finished goods than for parts and even higher than for raw materials. With this posture, the U.S. was consciously coercing the South to sell commodities at declining prices. In addition to the escalating tariffs, non-tariff barriers were also erected to preclude the entry of manufactured goods from the South and were systematically abused as an excuse to block imports. This resulted in a decline by one-third in the South's share of world trade.

Since the beginning of the post-war era, the Southern nations had tried to receive non-reciprocal treatment from the U.S. and from the other Northern economies in order to achieve development. This was based on the same principle applied to the warring nations that received immense aid and support to reconstruct their economies. Although most Southern nations were not involved in the war, the decision to support reconstruction and development in the North was seen as an equally valid reason in the South. The South felt that, since it was coming out from colonialism and it was struggling to achieve development, it also needed a special arrangement. Nonetheless, the U.S., instead of supporting this view by allowing terms-of-trade that would asymmetrically benefit the South for some time, took the opposite position and imposed an asymmetrical relationship to its benefit.

The growing frustration in the South led to the use of the UN to push trade initiatives, banking on the belief that a united South could control the UN voting system. In fact, the South formed the G77 non-aligned nations and was able to force the North to attend the first UNCTAD (Conference on Trade and Development) in 1964. But the North united and insisted on dealing with all trade issues at the GATT where it had total control. The South then pressed for a preferential system for manufactured goods, the GSPs, and, although it was implemented, the South was unable to coordinate its stance, and each developed country applied it with different criteria and for differing periods of time. Finally, as the South continued to send innumerable proposals for eliminating trade barriers and stabilizing prices of commodities, and the North continued to systematically resist, the oil producing nations of the South found in oil their only opportunity to at last be united to confront the North.

For most of the XX Century, oil had been dominated by the oligopoly of the "seven sisters": seven British, Dutch and U.S. oil companies. The "sisters" were used to enjoy the support of their governments including the use of military intervention in order to impose their will on the host nations, regardless of law, democracy or national sovereignty, such as in the U.S.-British imposition of their puppet: Muhammad Reza Shah Pahlavi, in Iran in 1941. In the 1950s, the price of oil was still very cheap, and it helped to propel the post-war economic growth of the Northern nations. However, with the need to feed and develop its growing population, many oil producers such as Venezuela, Iraq, Libya and Nigeria were poised to substantially increase their oil revenues. Although the Arab nations were able to strike a deal where they would share at par oil revenues with the "sisters", the latter controlled most of the world's distribution and, thus, they set the price. Subsequently, as more

developing countries began to produce oil, the U.S. imposed quotas and forced the world price to drop below the U.S. oil price. For all practical purposes, the "sisters" effectively constituted an oil trust by refraining from competition and by jointly operating the market.

Therefore, as could be expected, when the oil producing nations tried to increase the royalties for rights of extraction, the "seven sisters" –accustomed to oligopolistic unilateralism– confidently entered into a direct confrontation and refused to pay more for these rights. However, oil was now the dominant source of energy, and the U.S. and its allies were dependent on it. Subsequently, when many producing nations, beginning with Libya under Muhamar Qaddafi, retaliated by expropriating their oil industries, and the U.S. did not send its gun ships, the "sisters" lost control of the market. Of course, the U.S. had strongly considered it, and it tried unsuccessfully to mobilize its allies to join in military action. This event became the catalyst for the successful consolidation of OPEC in the early seventies. As earlier noted, first in 1971-1974 and then in 1978 during the Iranian Revolution and the break of the Iraq-Iran war, OPEC generated two oil crises. However, the success of OPEC has largely depended on the cooperation of its members and this has not always been the case; for there are moderate members, such as Kuwait, Saudi Arabia and the UAE, who frequently gave in to the pressure of the U.S. and its allies. The true origin of the Gulf War, for example, was the aggression of Iraq when the price of oil dropped due to the refusal of Kuwait to abide by its assigned OPEC quota. To be sure, the OPEC retaliations, which sent many countries, both rich and poor, into deep recession, would not have occurred had the South not been engaged in unrelenting confrontations with the North, about the unequal terms-of-trade that still prevail today. In any case, all these events: the collapse of the BWIs due to the surrender of U.S. economic policy to its geopolitical interests and the consequent lack of cooperation of other centres of power; the increased monetary interdependence of the U.S. and its key trading partners; the unilateral protectionism of the First World against the Third World; the retaliation of the Third World with more protectionism, and, finally, the oil crises, sent the capitalist world into a deep recession. Without a doubt, the Third World suffered the most, so much, that most of the Southern nations have backtracked their development twenty or more years with the consequent impoverishment of the majority of their societies.

At the time of the oil embargo, the South, banking on the perceived leverage of the oil cartel, pressed for a new capitalist economic order. However, the South did not manage to stick together and lost much credibility when its lack of unity became obvious. There was a great diversity of interests and views. Perhaps one of the most damaging aspects to the South's cohesion was the lack of cooperation of most of the oil producing nations. Many non-oil producing countries desired special treatment from the oil cartel and their support to demand a radical change in the rules between North and South. Nonetheless, OPEC, who was flooded with petrodollars, was more interested in channelling its wealth through private banks to lend to any borrower at commercial prices instead of showing solidarity. As a result, the North laughed at the South's demands for change.

A deep depression now faced the South. Population explosion, stagnation of the import substitution model, the recession of the North, the oil crises –for those nations not blessed with oil– the same unequal terms-of-trade, plus the political pressures from the U.S. and some of its partners, disbanded the South into individual strategies. Then came the gravest consequence: indebtedness. As earlier noted, Third World oil-importing countries suffered drastically when the oil prices boomed and the recession of the Northern countries cut into their exports. But it was also a lack of effective management and the corruption of many that placed them in a dire situation. In my opinion, it was the corruption and lack of democracy of many where the roots of the mismanagement and indebtedness lay. When things got tough, many governments did not cut spending nor did they stop the illegal personal appropriation of their nations' treasuries. Instead, they resorted to populist measures of spending, without the appropriate reserves, in order to artificially keep the economy moving by printing money and by irresponsibly over borrowing. Even oil rich countries such as Mexico and Venezuela over borrowed and overspent speculating on their future oil revenues.

Thus, when the price of oil dropped, they collapsed. Some of them embarked on grandiose projects of public spending to keep their economies moving without fiscal discipline. Their private sectors also embarked on buying local companies partially owned by MNCs or expanded their own, forming their new conglomerates, by borrowing from First World private banks. Total annual borrowing and cumulative debt increased tremendously after 1973. By 1982, severely indebted countries, with Brazil, Mexico, Argentina and Venezuela at the top, had an outstanding debt 305% higher than in 1975. Even worse, the proportion of private sector financing had increased from 60% to 75%. Thus, debt service ratios also increased dramatically to 38%.[8]

Conditions worsened further when the growing indebtedness forced developing countries to open their markets in order to concentrate on exports. When countries concentrated on import substitution strategies, many neglected their agricultural sector in order to feed the booming urban population that was joining the ranks of their manufacturing sector. This was done by keeping the cost of food purposely low to feed the growing urban masses that were paid very low wages, compared with those of blue-collar workers in the North. Thus, when they focused on manufacturing exports in order to generate positive foreign exchange, wages were kept depressed and the agricultural sector was further neglected. This created food shortages in many countries. Some countries like Mexico, for instance, became net food importers, putting further pressure on their trade balances.

Developmental Collapse

By the beginning of the 1980s, the most severe debtors began to collapse. As the crises unfolded in the Third World, the credibility of their capacity to control them began to disappear. From 1979 to 1981, lending shifted to short-term as a precaution. In the case of Iberian America, this was exacerbated by substantial domestic capital flight to the U.S. and Europe. Of course, private and multilateral banks and borrowing governments were equally imprudent and irresponsible for over lending and over borrowing. But, as we shall later see, the banks were the North's boys and, thus, they were carefully protected from any chasm. In any event, Argentina collapsed after the defeat of the Malvinas (Falklands), and Mexico defaulted after the drop in the price of oil precluded it from generating enough revenue to cover payments. At the time, 70% of export revenue came from oil. Thus, with a peso now collapsed by more than 50%, an immediate increase of interest rates, and further capital flight, the entire economy collapsed.

The crises drained the economies of many nations, now better addressed as "highly indebted nations", because the total transfers of capital to pay for the principal and the servicing of private and multilateral loans, in addition to all other transfers made by the MNCs by way of royalties, licensing fees, imports of components and profits, turned the balance completely in favour of the Northern economies. Indeed, there was a net transfer of capitals. This situation simply cancelled any possibility of development for the South and became the most devastating event since the end of the war. Scholars mark 1980 as the year in which the outflows of capital clearly surpassed the inflows into the Third World for the first time since the end of World War II.[9]

With these developments, the stage for the next phase was set. Neoliberalism was now taking its place, replacing the demand-side economics driven by the pursuit of the welfare of all ranks of society. As part of that, a select number of, sardonically called, Newly Industrialized Countries (or NICs) were chosen to become part of the global factory. These are the also called "Emerging Economies": "the chosen ones" the same whose economic indicators are reported every week on the last page of The Economist magazine. This, of course, is no honorary title. It is the label given to the unfortunate countries that provide the cheap labour for the MNCs. The new imperial master plan calls for these nations to become two countries within themselves: the first is a tiny elite with a shrinking middle class; and the second is formed by an enormous mass of impoverished people, representing from 40% to 70% of the population, whose only role is, if at all lucky, to be the commodity of cheap labour. To be sure, the net transfer of capitals from these countries effectively precludes development and creating a Fourth World and, within each nation, two very distinct social groups. This Fourth World, however, according to economists such as

Ankie Hoogvelt and Manuel Castells, is not exclusively a problem of the developing world.[10] With the new neoliberal paradigm, the stage was set for growing portions of the world's civil societies to rapidly become totally irrelevant, both in the centres of power and in the periphery, as we shall see in essays ahead.

As the crises unfolded in the South, with several countries defaulting on their payments to private and multilateral lenders, the centres of power moved to secure repayment of the loans by mobilizing the IMF to impose stabilizing programs on the defaulting nations. However, the programs of the IMF brought in the neoliberal economic vision based on supply-side/monetarist economics. It was in these situations that the IMF began its move to change the economic strategy to the new paradigm and away from Keynesian economics. These views, as it could be expected, contained, essentially, a U.S. agenda. Thus, as countries fell into economic instability, the IMF began to prescribe restructuring programs designed to change the economic *ethos*. Since the mid 1970s, the IMF began to prescribe its new strategy, and Mexico was one of the first countries the IMF tried to "help" after it suffered its first devaluation in more than twenty years in 1976.[11]

If we recall from earlier essays, the responsibility of the IMF is to secure monetary stability among its members. However, when the crises began to unfold it treated borrowers and lenders with an asymmetric approach. This approach has become a major defect of the current international architecture. This defect is the asymmetric treatment given to borrowing countries. The asymmetry, also know as "Moral Hazard", occurs when the IMF policies impose responsibilities and conditions on borrowers that are not required from the private lenders.[12] The asymmetry lies in the fact that borrowing countries are expected to pay for their loans, regardless of the circumstances, whilst the lenders are not forced to take responsibility for the risks inherent in lending. The thinking is that the support of the private lenders by the IMF is important so that they remain willing to lend. Moreover, the good health of the banks is vital for the centres of power. Thus, if a country defaults, the IMF comes in and arranges a restructuring of the debt and more loans, if necessary, in order to force the countries to pay. But, in order to do this, the economic policies that are required put the burden on the civil societies of the borrowing countries; for they will have to endure the austerity measures aimed at restricting demand and public spending in order to fulfil its debt servicing. On the other hand, lenders, in most cases, are not required to take a loss and write it off. This became even more evident when the economies of the borrowing nations were opened to short-term investments by speculators. The 1995 bailout of speculative U.S. institutional investments in Mexican Treasury notes is perhaps the most vivid example of this asymmetry. As a result, most borrowing countries have not been able to repay their debts and sustain their economic growth, whilst their public and private foreign debts have not diminished, if not increased.

A New Economic Thought

The move to the neoliberal paradigm began to consolidate at the start of the 1980s at the same time that Third World indebtedness exploded. The implementation of Neoliberalism moved into full swing when Reagan and Thatcher came into power under staunchly conservative tickets. Thatcher became the Tories' Prime Minister in 1979, and Reagan brought back the Republican Party into power at the end of 1980. The staunch conservatism of Dracula's girlfriend, as writer Carlos Fuentes calls Thatcher, moved Great Britain into a frenzy for supply side-economics. She particularly disliked social programs and began dismantling the Welfare State. Thatcher drastically cut the social programs that had been in place since the beginning of the post-war under both Labourites and Conservatives. Thatcher cut taxes, mostly among the upper echelons, to promote investment in free enterprise, privatized state companies and some social programs such as public housing, followed a tight monetary policy restricting public spending to cut deficits and supported the industrialists by providing all types of incentives, including cuts in taxes, and the restriction of union activity. Thatcher's conservatism became so obsessive that she was forced to resign in 1990 after she created the "poll tax", which she levied equally on all income segments to support local government, and after she arrogantly tried to block Britain's integration into the European Union.

Reagan followed a very similar approach, altering the economic ethos, radically, into a cynic pragmatism on behalf of big business and against the Welfare State. He, too, drastically cut public spending to dwarf social programs and, to reduce the public sector, he cut taxes for the upper income brackets and business and deregulated industries to encourage investment. Reagan promoted this new strategy in a clearly populist fashion, arguing against government and promising non-inflationary progress. Nevertheless, the cuts in social spending were transferred to military spending which clearly offset the savings, and, thus, public deficits continued to climb even more.

This was genuine supply-side economics dominating the political spectrum on both sides of the Anglo-Saxon axis. The new economic strategy of both governments was directly influenced by the work of British and U.S. scholars, especially by the theoretical work of the monetarist economics of Milton Friedman from the University of Chicago. I will review in detail, in essay three of part II, the monetarist theoretical framework, which is the backbone of the neoliberal paradigm. For now it suffice it to say that Friedman began to question Keynesian economics since the early 1960s, when he wrote, along with economist Anna Schwartz, "A Monetary History of the United States". Friedman's central criticism is that Keynes overlooked the importance of money supply on the degree of economic growth while overemphasizing public spending. Friedman believes that the central element for economic growth is the level of money supply, which should be managed according to the need to supply or restrict liquidity. Concurrently, he opposes fiscal policies and argues for the smallest possible governmental structure. The degree of market liquidity is determined by the management of the banking system reserves and by the cost of borrowing money. When the central banks buy government securities from the private banks, the ability of the banks to lend increases as their reserves increase. If the interest charged for lending is low, this stimulates economic activity centred on the industrial and commercial sector that borrow and invest at these times. This logic is supposed to be enough to manage the level of economic activity centred on the entrepreneurial portion of the market or on the supply side of the economy: the ability to produce for the market. This contrasts with the Keynesian paradigm, which focuses on the demand side of the economy: the ability to consume of the individual member of civil society. All other things should be left to market forces.

As should be obvious, the policies of "Reaganomics" and "Thatcherism" fully embraced the monetarist school, by supporting the corporate class and diminishing the government's role in balancing the negative effects of capitalism, thus weakening the government's inherent responsibility for the welfare of the entire social fabric. Because of the vicissitudes of history, this economic ethos is popularly known as Neoliberalism, and it is often manipulated to make it synonymous with freedom. In fact, one of Friedman's most popular books is titled "Freedom to Choose". However, judging from the actual developments of the last twenty years, Neoliberalism can only mean the freedom to choose of the corporate entrepreneurial class.

The embodiment of neoliberal economic policies in the governments of the U.S. and Britain had a profound effect on the rest of the developed world. The two oil shocks, and the U.S. recession and its inflationary effects on its major trading partners, placed Europe into a deep recession as well. The Reagan Administration abandoned any cooperation with its key trading partners and managed domestic economic policy based on its unilateral domestic and geopolitical interests. Tight monetary and fiscal policies were observed to fight inflation but disregarded the effect of a strengthened dollar on the world. While this caused the flow of foreign capital to the U.S. to enjoy the benefits of high interest, it damped the economies of its trading partners.

Reaganomics and the Third World

In the Third World, these measures, combined with its growing indebtedness, made things much worse. A number of elements of U.S. economic policy exacerbated the situation and plunged the Third World into stagnation, –especially in Iberian America– and, in many cases, into a reversal of the social gains that had been achieved in the previous decades. These elements were:

- U.S. recession reduced U.S. imports of Third World products affecting the oil importing nations the most.
- Reagan cut the flow of aid funds (those given directly by governments under very lenient conditions) to the Third World and pushed private financing for programs that were previously supported with aid.
- The increase of interest to fight inflation induced more capital flight from the Third World and put further pressure on their economies by forcing them to raise local interest much higher.
- The U.S. and many developed countries reduced the consumption of commodities, further depressing their prices and directly hurting Third World exporters.
- The U.S. increased its protectionism against Third World manufacturers to protect ailing domestic industries in which Third World countries were becoming highly competitive.
- The refusal of the U.S. to devalue the dollar during the inflationary years increased the cost of U.S. imports for Third World importers, further fuelling inflation.
- While aid to the Third World lost complete support, the Reagan Administration shifted to military assistance, open or undercover, to protect its geopolitical interests, further exacerbating the budgets of military aid recipients.

As the situation in these developing countries worsened, many governments tried to maintain economic growth by resorting to more public spending, as earlier noted, deepening their economies into an even sturdier crisis. The debt load and deep recession of the Third World exacerbated the net loss of capital and killed any chance for recovery and for the continuance of its economic development.

Debt Restructuring by Economic Restructuring

This was the moment of history when the neoliberal paradigm was imposed on Third World nations, for a series of events that took place changed the structure of the economies of Third World nations. In order to receive assistance in finding solutions to the debt crises, all highly indebted nations were placed under a neoliberal restructuring program:

From 1982 to 1984 the IMF's recipes for debt restructuring concentrated on three major economic restructuring strategies that have been very familiar to Third World Societies for the last twenty years:[13]

1. Elimination of budget deficits through spending restraint, subsidies' elimination, and tax increases.
2. Reduction of trade deficits by currency devaluations, increased exports and all other measures that would cut domestic demand.
3. Stopping inflation through tight monetary policy, supposedly competitive devaluations [a fiasco], fiscal austerity, real interest rates above inflation and limits to wage increases below inflation.

Under this scheme, no principal or rate reductions were allowed because the real objective was not to reduce debt exposure with indebted countries but to reduce loan exposure among private creditors. In 1983, the lending nations' central banks replenished the IMF reserves in order to provide refinancing to debtors with the ultimate goal of reducing the private creditors' exposure among Third World borrowers.[14] The net result was dismal. The strategy did not reduce debt nor assure the viability of its long-term management. The austerity measures imposed killed the capacity for growth and, thus, for reducing debt. Productive investment was reduced to minimal levels and, in some countries, the result was negative growth. Except for moderate debtors, devaluations precluded debtors from adequate debt servicing. Clearly, the formula for highly indebted-countries failed. Between 1982 and 1985, long-term debt increased from $391 billion to $454 billion, and the GNP to debt ratios of highly-indebted nations increased from 32.4% to 49.5%.[15] Appalling! What was going to be a temporary arrangement became a problem that, twenty years later, is still far from resolved.

As if the restructuring recipes of the IMF imposed on Third World debtors were not enough to change their economic ethos, U.S. Treasury Secretary James Baker had the brilliant and treacherous idea that structure rigidities were the origin of the lack of growth, and, thus, in 1985

Baker devised the Baker Plan –a three-part plan for the fifteen most indebted nations as follows:[16]

1. Market oriented liberalization, meaning liberalization of trade and FDI; elimination of subsidies; privatization of state companies, deregulations of industries in order to leave everything to the free forces of markets where MNCs can take over less efficient domestic companies; elimination of artificial exchange rates and of interest rate controls.
2. In exchange, the international banking industry would support the economic growth of indebted nations by providing additional lending for $20 billion over a period of three years.
3. The multilateral development banks were to provide an additional $3 billion per year to support structural change to a free market economy.

Without going any further, suffice it to say that these measures failed to generate economic growth, much less wealth distribution. In the case of Iberian America, the 1980s became known as the "Lost Decade." Although the IMF and the World Bank blamed, for the lack of growth, a slow move or an unwillingness to implement the structural changes on the part of the debtors, the true reality was that their economies were strained due to the negative flow of funds. Despite the fact that private lenders and multinational institutions did meet their commitments for additional lending, the servicing of the debt load far outweighed the inflow of new funds, resulting in a net loss of capital. Not only that, the new loans, instead of helping, made the situation worse, and between 1980 and 1996 the long-term debt of indebted nations had climbed 271% to $1.65 trillion.[17] The reality was that the highly-indebted nations were bankrupt, but the lending nations were still refusing to make lenders suffer the consequences of the risks inherent to lending, albeit the failure of the plan eventually did force the banks to take losses by selling their portfolios in the secondary markets at a discounted price.

The resulting criticism against the IMF and the World Bank was answered, cynically, by blaming indebted nations for failing to implement the structural adjustment measures, when it is of common sense to know that no country can grow with negative net transfers of capital year after year. Furthermore, it is evident that what both the BWIs and the commercial banks wanted was to reduce their exposure, collect interest, ripe a good business and force the most docile countries to open their economies. In summary, the Plan failed to achieve its announced purpose because, in reality, it was designed to reduce the exposure of creditors and benefit the centres of power. Furthermore, it is impossible to believe that, once the debts of the highly indebted nations were refinanced and rescheduled and the Baker Plan defined, the lending nations did not know that the outflow of funds into indebted nations was going to be greater than the inflows. Accusing countries for not implementing structural adjustments and tight monetary policies fast enough, when they had suffered or implemented devaluations which decimated their aggregate demand and made their economies stagnant, is trying to cover the sun with one finger and to add insult to injury. The recipes of the BWIs for these nations only intended to open their markets for the benefit of the MNCs of the centres of power and to reduce the exposure of creditors. Afterwards, new schemes, such as the Brady bonds and other strategies, have been implemented, supposedly, in order to reduce the debt load of these nations. But, as they were forced to make the structural changes to liberalize their economies, by conditioning all financial support from multilateral institutions, abundant evidence clearly shows that high debt is still here, and that the gaps between rich and poor have worsened, with true sustainable development in actual regression, while the gap between developed and developing nations continues to grow. In Iberian America alone, in the lost decade of the 1980s, social conditions turned dramatically worse. According to Mexican political scientist Jorge Castañeda, the total number of poor people doubled between 1980 and 1990 from 120 million to 240 million.[18] If the World Bank reported a population of 358 million in Iberian America and the Caribbean in 1980, and it grew to approximately to 438 million people by 1990, then poverty has grown from 29% in 1980 to a horrific 55% in 1990. Moreover, total external debt in the Third World has more than doubled from $915 billion to $2 trillion between 1985 and 1997, a nearly apocalyptic trend, and its weight, as a proportion of GDP, has been only barely alleviated by a small reduction during the same

period from 39.9% to 36%.[19] It must not be forgotten that neoliberal economics was the force behind this regression in socio-economic development which occurred in most of the developing world; and that it was forced upon these nations by conditioning lending to its acceptance. We will discuss in detail in future essays the validity of these actions from both an economic and a democratic perspective. To be sure, by the early 1980s, the encroachment of conservative forces in the strings of political power in the First World, and the corruption and mismanagement in many governments of the Third World, ended the era of Keynesian Economics and of Third World economic development.

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14 *Ibid,* 191.

15 *ibid*, 192

16 *ibid,* 192

17 The World Bank "External Debt" 1998 World Development Indicators, 240

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