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The International Monetary Crunch: Crisis or Scandal?

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Today there is probably no other area of human concern that affects more deeply the living conditions of people all over the world than that of international finance. Nevertheless, the main policy-making in this field is in the hands of an amazingly small group comprising central bankers and finance ministers in the rich countries, heads of international organizations such as the International Monetary Fund and big commercial bankers. The opinion of people outside this charmed circle of financial managers is hardly ever taken into account. This is a pity, since economic policy-makers tend by both temperament and training to be rather narrow-minded; their thinking moves in a groove.

Robert Triffin, an expert on international finance for nearly 50 years, and one of the interlocutors in the following narration, explained it in this way: 'Just as Clemenceau once said that war is much too serious a thing to be left to the generals, I think the economy is far too serious a thing to be left to the economists.'

The truth of his statement is brought home when we look at the way Western financial authorities are handling the so-called international debt crisis. In their view, most of the blame for this crisis must be laid on the developing countries. They say that it all started with the oil 'shock' of 1973, when the Organization of Petroleum Exporting Countries (OPEC) abruptly quadrupled oil prices. Developing countries then had either to 'adjust' to the new situation, or borrow their way out. Most chose the second, easier, option. Easier because OPEC deposited its multi-billion dollar surplus with the private Western banks, and the banks were willing to lend them these dollars. This 'recycling' of OPEC dollars went smoothly until the end of the 1970s, when another oil shock emerged: interest rates soared and prices of raw materials nosedived. But developing countries still refused to adopt the necessary adjustment policies; a debt crisis was the inevitable result. Eventually, 'adjustment', i.e. harsh austerity measures prescribed by the International Monetary Fund, was the only solution left.

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This standard explanation of the debt-crisis by financial authorities, however, is extremely biased; it cleverly side-steps their own responsibility. I have interviewed financial experts from various parts of the world, and they tell quite a different story. The story is intriguing, and it has many facets. One of the most revealing sides of it is the amount of attention paid to the recent foreign debt problems of Third World countries while the biggest debtor in the world, the United States whose debt is at the heart of the problem, is hardly ever considered. Here is the story based on these interviews.

Stories taken out of wraps

My first interviewee, Netherlands central banker Wim F. Duisenberg, starts off by describing how the richest country in the world is being financed by the rest of the world, including the developing countries.

The president of the Dutch central bank gave me an insider's view of the international debt crisis. During the 1960s, Duisenberg was a staff member of the International Monetary Fund in Washington. During the 1970s in the Netherlands, he was a professor of economics and a scrupulous minister of finance. Before becoming president of the central bank in 1982, he was director of one of Holland's leading commercial banks.

When asked to give his version of the origins of the debt crisis, Duisenberg began with the same old story of the Arabs dramatically increasing oil prices in 1973. But this was a standard explanation. I was interested in other stories with which Mr. Duisenberg must surely be familiar. Was he prepared to tell them? Yes, he was. In the middle of the conversation he mentioned two of them.

The first one concerned the so-called Mexico crisis in the summer of 1982. The standard version is that, from one day to the next, Mexico could no longer fulfil its debt obligations to the Western banks, pushing the world banking system to the brink of a crash. Duisenberg, however, confided that the Mexican crisis did not arise because Mexico had suddenly stopped paying the banks, but rather because the banks suddenly stopped giving Mexico any more money. 'The whole problem started when the financial flows to Mexico ran dry', he says. To bring the private banks into line again, the central banks of the rich countries had to take immediate action on two fronts.

First, they had to lend Mexico $1.8 billion within 24 hours in order to enable Mexico to pay this money to the banks so that these could balance their books again. So, in fact, $1.8 billion dollars went straight into the private banks. Why did the central banks do this? 'Because, if they didn't, Mexico would have been forced to stop its payments on short-term credits, and the eleven hundred banks which had lent money to Mexico would not have received their interest payments in time. These banks, therefore, would have no longer been able to fulfil their obligations to their creditors—individuals, pension funds, and others who had deposited their money with them. The entire financial system would have tumbled.'

On the second front, the central banks had to change radically their attitude towards private banks. 'We were placed in a very curious position', says Duisenberg and adds, 'normally you say to a private bank: "Be cautious with lending to a dubious debtor." But now we had to say, "Please, go on lending, keep the money flow going." It took a tremendous effort to keep the system going. Particularly my British and my American colleagues worked day and night to achieve this.'

The second story Mr. Duisenberg relates is about how the richest country in the world has repeatedly made the world pay for its selfish financial policies and yet has received more financial aid from abroad over the past few years than any other country in the world. He says, 'The situation we are in now is completely absurd. A sound situation would be that the rich countries lend or give money to the poor countries. There should be an *export* of capital in the form of loans and grants from the rich to the poor countries. But, surprisingly, the richest country in the world, the United States, actually *imports* capital from all over the world. In this sense the United States is being financed by the rest of the world, including the developing countries.'

How did we arrive at this 'completely absurd' situation? Duisenberg's initial answer is still totally technical. 'It is to a large extent the consequence of extremely high interest rates in the United States which suck in money', he says. But as I want to know how, in their turn, these high interest rates have arisen, Duisenberg becomes somewhat political. He states, 'They are mainly the result of the budgetary policy of the United States. From 1980 onwards the budgets of the American government have shown a huge yearly deficit.' Finally, when he is asked to comment on the view that the sudden booming of the US budget deficit is, above all, caused by the enormous American arms build-up, Duisenberg loosens up and begins calling a spade a spade. Here is what he said:

> What the American government has done is implement a programme of tax reduction, which means less income for the government, while at the same time raising its expenditures, particularly in the military sector. Military expenditure increased in real terms by 7–8% a year. That's how the United States has acquired these tremendous budgetary deficits.

Can one accuse the United States of making developing countries pay for its arms build-up? Initially Duisenberg does not want to answer the question. Then he starts laughing and says: 'It won't be the first time they let other countries pay for their arms expenditures. The war in Vietnam was in fact not financed by the United States either, but by other countries.'

How is it that the United States has shifted its military expenditures to other countries? 'In short', Duisenberg replies, 'this amazing fact is the result of the privileged financial position the United States has in the world.' (In the following pages the topic will be explored further.)

Normally a country which spent so much money on arms would have had to either cut its domestic expenditures drastically or borrow huge sums abroad. The United States, however, did not need to make this choice because of the international role of the US dollar. After the Second World War the US dollar became the key currency of the international financial system, and this placed the United States in a unique position. It could virtually spend as much as it wished as long as the rest of the world was willing to accept the dollar and attach a certain value to it. Over the past few decades the dollar's key role has not only given the United States extraordinary space for financial manoeuvring, but also has meant the extraordinary dependence of the world on US economic policy.

So far Duisenberg has tried to avoid a moral judgement. But at the end of his story he says what he really thinks of the behaviour of the US government:

> The United States has at once a very privileged and a very responsible position. A country which is conscious of that responsibility should not only look at the internal effects of its policy, but also look at the international repercussions. America produces tremendous shockwaves affecting the whole world—in both the industrialized and the developing countries—but continues to be strongly inwardlooking. That's why we, presidents of central banks all over the world have been shouting, 'America, get your own house in order!' The situation we now find ourselves in is going to be unbearable, both for the United States and for the World.

It all started with the foreign debt of the United States

Exactly at the point where the president of the Dutch central bank ends his story, my next interlocutor, Maria da Conceição Tavares, Brazilian economist, begins hers.

Maria da Conceição Tavares grew up in Portugal, where she studied mathematics. Upon receiving her degree she went to Brazil and studied economics. For several years she worked for the United Nations' Economic Commission for Latin America, based in Santiago de Chile, before becoming a professor of economics at the University of Rio de Janeiro. Her intellectual and temperamental qualities have made her a striking personality on Brazilian television and at international conferences. A Brazilian journal once characterized her as a woman who is 'feared by ministers and authorities, and admired by her students'.

None of the economists I have interviewed responded so promptly and forthrightly as Tavares. My first question was: 'Let us take the foreign debt problem, shall we? Why has Brazil borrowed so much money abroad?' Tavares retorts, 'It all started with the foreign debt of the United States, not with ours.' She pauses for a moment (perhaps because she has seen my puzzlement) and then explains:

> Countries all over the world began to borrow a lot of money abroad when the Eurodollar market expanded. The Eurodollar market expanded because the foreign debt of the United States expanded. And the foreign debt of the United States expanded because the United States has the privilege of being able to pay its debts in an international means of payment which it can print itself, and which is accepted by the international banking system.

This formulation by Maria da Conceição Tavares is crucial to a correct understanding of the origins of the international debt crisis as she sees it.

Reading it one sees that she links three phenomena in a cause-and-effect chain, viz. the foreign debt of the United States, the Eurodollar market and the proclivity of countries for borrowing abroad. In this way she has described a whole series of post-war events in one succinct statement. Let us look at some of those events.

How did the United States develop a foreign debt? Simply because it started, after the war, to spend more than it earned. Its military spending overseas, its development aid to Western Europe and the Third World, and its MNCs investments abroad caused its total foreign expenditures to exceed its revenues. Initially, the annually incurred foreign debt was quite modest—around a billion dollars. By the end of the 1950s, however, and particularly from the second half of the 1960s, the debt grew increasingly large. Two factors were responsible for this. One was the shrinking export earnings in the face of stiff competition from Western Europe and Japan. The other was the escalating expenditures because of the Vietnam war.

Normally, a country that finds itself in such a situation would cut its spending drastically, if only because borrowing cannot continue endlessly. But, as Duisenberg aptly remarked in the course of interview, the United States is not a normal country. It is a privileged country that can continue to spend virtually as much as it wants by the simple device of printing dollars (the dollar having acquired the status of international currency because other countries accept its use as such).

The second phenomenon Tavares refers to is the Eurodollar market (Eurodollars simply means dollars kept outside the United States). Why did the expanding foreign debt of the United States result in an expanding world money market? This seemingly complex question is not really complex. The dollars the United States printed to cover its foreign debt went to the international banks which jointly represent the world money market. Hence the higher the foreign debt of the United States, the more the world's money market was swamped with dollars.

Now we come to the last phenomenon, viz. countries borrowing abroad. Why did Brazil, for instance, go to the international money market? The stock explanation of most financial experts is that the oil crisis of 1973 forced them to seek support from the Western banks, which, with stockpiles of 'petro' dollars, were willing to enable them to pay the bloated oil import bills. Tavares, however, has an entirely different explanation. Her very first sentence demolishes a myth:

> Countries all over the world had started borrowing money *before* the oil crisis. And do you know why? Because in the early seventies the world money market was flooded with dollars as a result of the rapidly rising foreign debt of the United States. The Western banks offered these at very low interest rates, even at negative rates if you make allowance for inflation. It was at this stage that most governments recommended the private sector—both the national and multinational companies—to borrow money on this wonderful Eurodollar market. Not only was this foreign credit cheaper than the credit offered on the domestic market, but it also suited the orthodox

> monetary policies governments of both the Third and the First Worlds pursued in general, and which implied that their central banks restricted the domestic money supply. Moreover, the Western bankers themselves applied pressure on countries to borrow these dollars. What else were they to do with all that money?

What Tavares says next is even more astounding. It reveals the story of the borrowings by Brazil and other countries, which had been put under wraps. This is how it goes:

> Do you know what the most absurd thing is? There was absolutely no need for most of them to borrow these dollars! It did not have anything to do with 'the need for external savings', as the Brazilian government wanted us to believe. That is nonsense, because external savings should come into the country as direct investments, or in the form of long-term loans from the World Bank for specific projects. It also did not have anything to do with the need to import goods, because imports should be financed with suppliers' credits. It did not even have to do with the oil crisis of 1973–74. Just look at the countries which then started to borrow most heavily on the world money market: Mexico, Venezuela, Argentina—all of them without the slightest need to borrow dollars for their oil imports, because they had oil themselves! And in the case of Brazil, which has to import 75% of its oil consumption, one must not forget that there was not only a boom in the prices of oil at that time, but also in the prices of raw materials Brazil was producing. In the eyes of the Western banks Brazil was quite a good risk and could therefore borrow billions of dollars.

The 'needless' borrowing of Brazil and other countries inevitably resulted in steadily increasing foreign debts. Tavares's indignation, however, might not have been so intense had this borrowing continued to be as cheap as it originally was. But the price of the foreign loans, that is to say, the international interest rate, rose. In 1978–1979, the rise was spectacularly sharp. Tavares describes how this gave a dramatic turn to the debt problem:

> The really big problem started at the end of 1978, when the American government of Jimmy Carter decided that it could no longer allow the dollar to decline. During 1977 and 1978, the value of the dollar had been falling drastically against hard currencies such as the German mark and the Swiss franc. At the end of 1978, Carter said to the European central bankers, 'From now on we'll make the dollar strong again.' The way he did this was to increase sharply interest rates. And when the dollar fell again in 1979, interest rates were increased even further. This steep rise in interest rates, and the connected world recession which caused the prices of raw materials to fall, had a tremendous effect on Brazil's foreign debt.
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> In 1978, Brazil owed \$35 billion, while only four years later, in 1982, it owed \$82 billion. So this sudden change in United States'

> policy caused Brazil's foreign debt to rise by $47 billion! And of these 47 billion dollars not one entered the country. They were merely used to 'roll-over' (renew) the existing debt. This happened, not only in Brazil, but also in Mexico, Venezuela, Nigeria, Poland. It was, in fact, the same everywhere. So you ended up with the absurd situation: the Western banks were lending to countries, not in order to enable them to import goods, or whatever, but simply in order to have all that money paid back to themselves.

This curious phenomenon of banks paying themselves is a reminder of the story Duisenberg told about the so-called Mexico crisis in the summer of 1982. Duisenberg touched the heart of the matter when he said that the Mexico crisis started 'when the financial flows to Mexico ran dry'. What were these financial flows? They were short-term credits Western banks kept extending almost automatically ('rolling-over') so that Mexico could continue to pay its ever increasing debt to the banks. This is the process Tavares describes as 'banks paying themselves'. They did not do this out of altruism, but out of self-interest. The banks knew that, if they stopped their credit flows, Mexico would not be able to service its debts. Why did this flow run dry then? Because the big banks which organized this flow, such as Citibank and Morgan Guaranty, could not ensure its continuation by themselves. They had to depend on the smaller banks. The smaller banks, however, started worrying about their money being invested in Latin America, particularly after the outbreak of the Malvinas/Falklands war, in 1982, between Argentina and Britain. When the smaller banks began to withdraw their money from Latin America on a large scale, Mexico was the first country to fail to fulfil its short-term obligations to the banks. This sparked off a chain reaction. More banks withdrew their money from Mexico, and a crisis ensued. The only way out was, as Duisenberg emphasized, to pressure the banks to go on lending, 'keeping the system going'.

Tavares adds:

> The financial system cannot stop lending, because then everybody goes bankrupt. But it is a crazy system that has created a trillion [thousand billion] fictitious dollars. Why do I call them fictitious? Because they don't really exist. They are the product of ridiculously high interest rates. They represent nothing other than dollars produced by these interest rates and then lent again at higher interest rates. 'Es un ro-bo, ro-bo, ro-bo!' It is robbery, robbery, robbery! Indeed, a scandal! The banks have a trillion false, robbed dollars in their books!

Tavares's anger is aroused not so much by the fictitiousness of these dollars as by the reality they represent for the people of Brazil and other indebted Third World countries. Harsh austerity programmes were forced on them just to keep the interest payments to the lending banks as high as possible, regardless of their disruptive effect on the production processes, which in turn made the peoples' precarious living conditions even worse. Western financial authorities claim that these measures are necessary to solve the international debt crisis. But Tavares strongly disagrees: 'one of the silliest ideas is that "austerity" will resolve the debt crisis. If you pursue a recessive policy, enterprises go bankrupt, people become unemployed, investments go down, the economy contracts. That's not the way to solve the crisis!'

Tavares holds Third World countries no less responsible than Western financial authorities for the debt melodrama. 'Most of these governments', she says, 'are extremely conservative, and so are their central bankers and ministers of finance. The international business community, into which the Third World ruling élites have been co-opted, does not give a damn to the fate of their countries.'

Tavares's criticism, however, is directed more at institutions than at countries: 'The people who have a special responsibility for the mess we are in are the central and private bankers. In all parts of the world central banks pursue very conservative monetary policies, and there is no parliamentary control whatsoever. And the private banks? Their main concern is to make the highest profits possible, no matter what the circumstances and what the costs are. And nobody is really controlling them either.'

But, according to Tavares, among the world's banks (central and private), the US ones happen to be the most influential. They, more than anybody else, have created the present situation. She therefore insists on giving them the largest share of responsibility. 'The big American banks like Chase Manhattan, Morgan and Citibank are', she says, 'the masters of the world. Together with the Federal Reserve—the central banking system of the United States—they can disorganize, paralyse, or break the world. *We* are not the ones who can solve the debt crisis. *They* are the ones who can solve it, and therefore ought to.'

Is Maria da Conceição Tavares right in blaming the United States for the crisis? Let us find out what a US economist has to say.

'The Western banks were the heroes of the 1970s'

Jan A. Kregel is a US economist; he has written books with such impressive titles as *The Reconstruction of Political Economy: an Introduction to Post-Keynesian Economics* and *Theory of Capital.* He has lectured at Bristol, Southampton, Louvain and Bologna. He worked for the General Confederation of Italian Industry (the Italian employers' organization); and for the past few years has been professor of monetary theory at the University of Groningen in the Netherlands. At the end of 1985 he became a professor at the Bologna Center of the Johns Hopkins University. Part of his knowledge of the international banking system was acquired in Italy while acting as advisor to the chairman of the Italian Employers' Federation, Carli, formerly president of the Central Bank of Italy.

Kregel, who knows Maria da Conceição Tavares personally, is in certain respects exactly the opposite of the Brazilian economist, both in temperament and views. His speech is very controlled. Soft-spoken Kregel characterizes the Western private banks as heroes, rather than scoundrels, of the 1970s. He puts forward his view that it was not the US government that brought about the radical changes in monetary policy in 1979, which resulted in a sharp rise of both the interest rates and the value of the dollar. 'This change of policy', says Kregel, 'was primarily imposed on them by the European central bankers.'

Curious to know Kregel's appraisal of Tavares's basic postulate that 'it all started with the foreign debt of the United States', I ask him if he agrees. Kregel responds:

> Some years after World War II the United States indeed began to run a chronic deficit on its balance of payments, or, in other words, to run a foreign debt, thereby creating substantial dollar surpluses abroad. The question is, however, who was responsible? The position of American economists is that it was not the fault of the United States, but rather the fault of the foreign central banks. They say these banks were eager to accumulate dollars as international reserve; nobody forced them to take dollars. They could always bring them back to the United States and encash them in gold, or they could always buy American goods. By not doing so, they imposed the need of running this deficit on the United States.
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> However, this explanation shifts the responsibility too easily onto the foreign governments and their central banks. The argument that the foreign—notably European—central banks were so eager to accumulate dollars as reserves should, in fact, be taken with a grain of salt. By the middle to late fifties European central bankers had already started worrying that the United States' gold supply was insufficient to continue supporting the gold value of the dollar. But, as they had started to hold dollars as reserves, they were caught in a dilemma: if they all tried to convert their dollars into gold, the value of their reserves would certainly have drastically fallen because the United States would then have been forced to change the dollar parity. So, they were stuck. They thought it was better to keep dollars as reserves than convert them into gold, which would have almost destroyed their value.
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> This meant the United States continued to run deficits and the central banks continued to accumulate dollars. Not wanting to buy more unwanted American goods, which was their other option, and eager to invest their locked up dollars, the solution they eventually hit upon was to lend them to private banks. But these banks themselves had to find outlets for them, so they looked for clients who needed long-term credits; and the underdeveloped countries seemed to be the best bet. This is where the process Maria da Conceição Tavares is talking about actually started.

Kregel clearly agrees with the first part of Tavares's thesis about how countries such as Brazil gained access to, in Tavares's words, 'this wonderful Eurodollar market'. Kregel, however, adds that there are all kinds of fairy-tale explanations of how the Eurodollar market was founded. They ignore the main reason for its existence:

> It is said, for instance, that it was created by a Soviet controlled French bank, which, when the cold war intensified, did not want to

> hold its dollars in American banks. While there may be some truth in these stories, they are not the basic reason for the existence of the Eurodollar market. It was founded simply because there were large amounts of unproductive dollars held in European private banks and in the reserves of the central banks. The central banks themselves could only lend them with great difficulty, because central banks usually don't engage in these sorts of activities, and this is where the private banks came in. A large proportion of the Eurodollars came into the system through the Bank for International Settlements in Basel. This bank, a kind of a central bank of the central banks, placed dollar reserves in the commercial banking system. This is how the Eurodollar market started.

Another point Kregel makes is the inevitability of central banks using the dollar as the principal vehicle for accumulating reserves:

> There would have been another option had the financial authorities created an alternative international reserve asset. During the sixties there were discussions on whether the International Monetary Fund should create a new asset as an alternative to dollar reserves. If this had been created in time, the central banks could have replaced their dollar reserves with this new asset.

When asked what Kregel thinks about the second part of Tavares's argument (namely, that governments of both the Third and the First Worlds pressured enterprises to borrow abroad rather than at home because this perfectly suited their restrictive monetary policies), he replies:

> Many countries did use external borrowing as a policy tool. That is, their central banks determined a certain rate of expansion of the internal money supply and a certain interest rate internally, and then encouraged domestic banks to borrow externally. Why? Because this allowed the central banks to keep the growth of internal credit strictly to the limits they had decided upon. Central banks like to set up quantitative credit restrictions which are intended to ensure that total credit does not grow, say, for the manufacturing sector, by more than a certain percentage. If the private banks go above this rate they are made to deposit a certain amount in reserves with the central bank. But, if the banks succeed in borrowing money externally, they can avoid these restrictions. That was the built-in incentive which drove the banks to the Eurodollar market. Moreover, they were attracted by the very low interest rates in the Eurodollar market.

But does Kregel agree with Tavares that the big problem with this foreign borrowing was caused by the US government in 1978–1979, when it suddenly raised the interest rates to a very high level? Kregel replies:

> The reason everybody got into trouble (the oil crisis complicated things but was not the chief cause) was that half-way through this procedure the United States suddenly switched policy and initiated

> a draconian monetary policy. This caused interest rates to shoot up, and at the same time it caused the value of the dollar to rise. So, in fact what happened was that you first convinced the horse to come to the well to drink for free, and then suddenly you say, "Well, not only do you have to pay to come, but we are going to charge you every time you drink again."
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> So the underdeveloped countries were first hooked on international loans and then the costs of these loans shot up. This was caused on the one hand, by the increased value of the dollar (in some cases the value of the dollar caused doubling of the internal currency value of these loans) and, on the other, by the perpendicular rise in interest, rendering payment of interest on loans impossible.

In replying to the question of why the US government decided to suddenly switch its monetary policy, Kregel parts company with Tavares's view:

> There was little choice; it was imposed on the United States, primarily by the European central bankers. One has first to understand how the European central banks operate. If you take the block of strong European industrial producers, viz. France, Germany, Belgium, the Netherlands, you will find that their central banks all work together, but the tone is set by Germany. Now, one of the main worries of central bankers is to keep inflation under control. In Germany, they are particularly worried about it, partially due to their traumatic pre-war experience with inflation. The German central bank primarily attempts to control prices by exercising strict control of the money supply. However, since Germany's is an economy dominated by international trade, the Bundesbank can only keep control of the money supply if there are no substantial external disturbances. These can be sparked off, for instance, by sharp downward movements in the exchange rate of the dollar. And that was exactly what happened. The dollar was so unstable that it was impossible for the German central bank to control its domestic money supply. So the Bundesbank complained to the Federal Reserve that because of the fall of the dollar there was a run on the Deutsche Mark, forcing the bank to increase its own money supply. Finally, the instability of the dollar created such difficulties that the Germans demanded that the American government do something.
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> For the United States, the problem in 1978 was that the value of the dollar was in a free fall, and there appeared to be no bottom to stop it. When the American government finally attempted to correct things they found they could no longer control its value. The remedy which was eventually applied was restricting the growth rate of the money supply and increasing the interest rates.

Kregel emphatically disagrees with Tavares when he is told that she calls the Western banks 'robbers'. He puts forward his own view:

> In my view the international banks were rather the heroes of the

seventies, because they allowed most underdeveloped countries to escape the restrictions that normally would have been imposed on them had they borrowed from the International Monetary Fund. Now some say that if the banks had not lent so much money, they would not have had to go to the International Monetary Fund in the first place. But this does not take into account the fact that the rise of the oil price in 1973 would have forced most countries to go to the International Monetary Fund for at least short-term temporary help; and the cost of this would have been a very sharp decline in their growth rates.

On the other hand, it is also true that if the underdeveloped countries had not been prompted to borrow so much money, they would not have found themselves in such a disastrous position once the US policy changed. But this change could not be foreseen. Banks always receive a lot of criticism, some of it perfectly justified. However, one has to realize that a banker will always try to arrange things in a way that best suits his preferences. If, for instance, he sees a borrowing firm perform badly, he will change the management of the firm to ensure that he continues to receive a return on his loans. This is no joke, I know people who do this. This is now happening on an international scale. The problem is that sometimes the undesirable behaviour of banks is not the result of the banking system itself, but of other forces which are part of the international financial system, such as the American government or the European central banks.

What exactly, then, has been the responsibility of the governments and central banks of the United States and Western Europe? This is the main question that will be tackled in the following conversation with one of the best informed economists on this subject, Robert Triffin. Whether you pronounce his name the French way or the English way, he could not care less. He says he considers himself a 'citizen of the world'. Triffin lived in the United States from 1935 to 1977 and acquired American citizenship when he went to work at the central bank for a few years in 1942. He returned to the country of his birth, Belgium, in autumn 1977 to work more intensely to promote the realization of the dream of his youth: a European monetary unification. But let us hear all this and more from Triffin himself.

Why did they not listen to Robert Triffin?

Says Triffin: 'My book *Gold and the Dollar Crisis* greatly impressed John Kennedy. He asked me if I would care to work for the Council of Economic Advisors (a board of economic advisors to the American president). I accepted the offer on condition that I could have the job part-time and keep total freedom of publication and speech. I was also working as part-time consultant for the European Community. It was this combined role that caused a rather amusing thing to happen. As Kennedy presented my suggestions for reforms in the international monetary system at a cabinet meeting, Douglas Dillon, who was then Secretary of the Treasury, suddenly asked, "Who is this Triffin actually? I saw him in Paris in April, where he was representing the United States at an OECD (Organization for European Cooperation and Development) meeting. I saw him this week in Washington, where he was representing the European Community at the annual meeting of the International Monetary Fund. Is he American or European?" Kennedy patted him on the back and said "Shut up, Doug! He is our first Atlantic citizen, and we need more of them."'

Robert Triffin's eyes twinkle as he relates this anecdote. The incident is more than just a pleasant memory: it is a reflection of the role Triffin has played over the last 40 years on the world financial scene—as an economist advocating fundamental reforms of the international monetary system and dedicating himself to European monetary cooperation.

According to Triffin, the fundamental problem of the international monetary system is that it is still based on the dollar. The pivot of the system should not be the dollar, but an international currency such as Keynes' *bancor*, or the Special Drawing Right (SDR) which has been introduced by the International Monetary Fund on a small scale. If the world had possessed a truly international currency, we would not have had the current world debt crisis, claims Triffin. Turning to the debt problem of the Third World, he says:

> What is the fundamental cause of this Third World debt which has accumulated beyond any reasonable possibility of repayment? It is the fact that the dollar is still being used as the world currency. That is the basic flaw of the system, and as long as this flaw remains, we will continue to be plagued by major crises, be they dollar crises or international debt crises.

And here Triffin adds a personal note. 'I began with pure theory and thought I would teach economic theory for a while', Triffin says about his initial career as a professor at Harvard. It was the Second World War a few years later that brought him back to what had been his basic reason for studying economics, viz. international cooperation. He elaborates:

> While I was studying in Louvain in the early thirties Hitler was beginning to rise, and as a reaction to the views of some people of my milieu, and under the influence of people like Einstein, I became a committed pacifist. My idea was to influence the international political and economic scene through the central banks, which are themselves very influential, and by definition have much do to with the outside world.

In 1942 Triffin was given the opportunity to work at a central bank, when, like many of his US colleagues, he was asked to temporarily exchange his position in the ivory tower for practical work in Washington. The Federal Reserve Board in Washington (the central bank of the United States) commissioned him to establish a Latin America section. Triffin narrates his response, with a touch of pride: 'I immediately grabbed the chance and gave up monopolistic competition and pure theory without the slightest difficulty. I visited all the Latin American countries; and within a year I was busy setting up or reforming monetary systems and central banks in several of these countries.'

Triffin's energetic way of working did not go unnoticed. When the International Monetary Fund was established, after the war, he was one of the first people recruited. They asked him to head the Latin American department; but Triffin felt that they should appoint a Latin American instead, so he became director of exchange control.

It was not long before Triffin's voice was heard again. He felt that the IMF was trying to decide far too much from Washington, so he suggested decentralization of the IMF and the encouragement of a European Payments Union. 'But', he says, 'the Fund, and particularly the US Treasury which dominated it, did not want to hear of it because they were afraid it would weaken the power of the United States.' Nonetheless, the European Payments Union was a reality within a year. Thanks to its establishment in September 1950, the so-called bilateral trade and payments came to an end, and inter-European trade took off. History books later described Triffin as 'the father of the European Payments Union'.

In 1952 Triffin returned to university life as professor at Yale. But he continued his involvement in practical affairs: he worked as a part-time consultant for many different international organizations, governments and central banks. He broke new ground with research on present and future weaknesses of the international monetary system. His plan for fundamental reform to the system became known as the Triffin Plan.

The fundamentals of this plan were developed in his standard work, *Europe and the Money Muddle*, which appeared in 1957. Triffin further refined his proposals in his classic, *Gold and the Dollar Crisis*, which, although published in 1960, had for the most part already been published in the first half of 1959 in the magazine of the Italian *Banca Nazionale del Lavoro*. Triffin's plan was so remarkable that he was almost immediately invited to present it to the Joint Economic Committee of the American Congress. Triffin says his submission to the Committee on the 28 October 1959 is still fundamentally valid today.

Triffin argued that the major defect in the international monetary system 'lies with the use of *national* currencies (the British pound, and especially the American dollar) as *international* reserves'. The value of the dollar was guaranteed internationally at the time because it was convertible into gold. But this 'gold exchange standard' would, according to Triffin, inevitably come to its end should the dollar remain the principle international monetary reserve. With the rapid growth of the world economy more dollars would find their way abroad than the United States would be capable of backing with gold.

The imminent dollar crisis could simply be avoided, argued Triffin, by making it possible for other countries to invest their reserves in international deposits at the IMF instead of investing them in dollars. Advantages of creating such an alternative to the dollar would be (1) that the IMF would then be able to control the growth of international reserves; (2) that the IMF could play a far greater role in the extension of international credit; and (3) that speculating in different currencies could be restricted. Part of the deposited reserves could then be channeled, via institutions such as the World Bank, to finance development in the Third World.

Triffin did not expect immediate adoption of his plan. In his presentation to the Economic Committee of the US Congress in 1959 he quoted a former colleague of his at the Federal Reserve Board as saying, 'Triffin, you are probably right, but, in this matter as in that of the European Payments Union, your proposals come several years too soon, and this time I don't honestly think you will get anywhere until people are shaken into action by a real crisis. Then may be!'

Triffin's reform plan was received with mixed feelings. President John F. Kennedy (elected president in 1960) was enthusiastic about it, but his Secretary of the Treasury was not. Triffin explains how the plan was thrown overboard: 'Kennedy really wanted to do what he could to implement the Triffin Plan; but when he pressed the point at a cabinet meeting, the undersecretary of the Treasury, Bob Roosa, said if Kennedy did so, he (Roosa) would no longer assume responsibility. Then secretary Dillon said that he did not want to go on without Roosa. And so the two of them killed the plan.'

How did Western Europe react? Triffin replies:

> Soon after publication of my book in 1960, the European Community asked the president of the German Bundesbank, Emminger, to form a committee to write a report on my plan. Emminger came to the conclusion that there was no reason to believe the dollar would be a problem in the foreseeable future. He wrote this in 1960, and in October 1960 we already had our first dollar crisis. Even so, Emminger continued to believe in the dominating role of the dollar. Why? Let me tell you a story.
>
> I remember a meeting of the IMF in Washington, in 1963, where I explained my plan and where I urged in a discussion with the Europeans for communal restraint in the purchasing of dollars. Afterwards Bob Roosa came to me and said, 'Robert, do you see what you are doing? You are undermining our position in relation to the Europeans. As long as we can approach them separately we have no problem, but if we have to confront them jointly we will be very much weakened.' Then Emminger added: 'Triffin, do you realize what you are saying? At the moment, when the United States asks us to take more dollars, we can just say, "By all means, but it does not suit us right now, can't you address yourself to Italy or Belgium?" But if we have to confront the United States jointly we cannot say "no" without putting the Atlantic Alliance in danger.'

In the 1960s the Triffin Plan still drew too much criticism; but at the beginning of the 1970s the time seemed ripe for its implementation. The serious dollar crisis, predicted by Triffin in 1959, broke out and culminated in the abolition of the gold exchange standard. On 15 August 1971, President Nixon of the United States told the world that the dollar would no longer be convertible into gold. At the same time the internationally agreed upon system of fixed—though adjustable—exchange rates was abandoned. In this way the international monetary system, adopted in Bretton Woods at the end of the war, lost its two main pillars. The 'real crisis' Triffin's colleague at the Federal Reserve had spoken of had broken out.

In financial circles solutions to the crisis were feverishly sought. A few months after Nixon's statement, members of the International Monetary Fund (consisting of most of the world's countries) ordered the executive directors at the Annual Meeting to work out a report 'without delay' to solve 'the dangers of instability and disorder'. The executive directors presented their report in 1972, pleading for a restructuring of the international monetary system. Triffin recalls the subsequent developments:

> Ninety per cent of my reform proposals were to be found in it. At the same time the IMF set up a commission consisting of representatives from industrial and developing countries (the Committee of Twenty) to prepare detailed reform plans. These were ready in 1974. They were rather similar to my plan. It is disgraceful that proposals like these which took ten years of difficult discussion and negotiation, were again just shelved.

And so the international monetary system, or rather the international monetary scandal, continued to be based on the dollar. What explanation could there be for shelving the reform plans at the eleventh hour? Triffin points out at least four reasons:

> First, the United States would have lost what French President Charles de Gaulle, called its 'exorbitant privilege' to cover its balance-of-payments deficits with its own dollars. According to supporters of the dollar standard, this privilege was not only beneficial to the United States, but also to the rest of the world, since in this way the United States supplies the world with the necessary international monetary reserves. So why get rid of a system which had paid off, and to which financial experts were accustomed, and replace it with a new one which had yet to prove itself?
>
> Second, by holding on to the dollar the United States was able to continue spending huge amounts on defence. Although this is never openly said, the Americans, and most Europeans, too, saw the maintenance of the dollar as *the* reserve currency as a way of financing their joint defence. And this is still true today, I think.
>
> Third, West European and Japanese exporters gained by keeping the dollar as the key currency of the system. Owing to the demand for dollars the American currency remained overvalued against the European and Japanese currencies. The exporters in these countries were delighted by the efforts to reinstate the dollar. Because if the role of the dollar had been limited, it would certainly have lost value, and the European and Japanese exporters would have faced increasing competition from American exporters.
>
> Fourth, European central bankers were not happy with reforming the system because they feared the erosion of their power of decision. In the present system central bankers decide where to invest their

countries' reserves—in US Treasury Bills, in the First National Citibank, in Chase Manhattan, or wherever they wish. But if all this were decided through international agreements, it would obviously involve participation by the governments, and the central bankers would lose their absolute freedom. The central bankers have always resisted a reform of the international monetary system, and the establishment of a real European monetary system, by arguing that these measures would jeopardize the sovereignty of their countries. But, in fact, they are talking not of *national* sovereignty, but rather of their *own* sovereignty *vis-à-vis* their governments.

According to Triffin, one can thus explain, but not justify, why the reform of the international monetary system was laid aside. There were actually very good reasons why it should have gone through.

Take the manner in which the United States has supplied the world with international reserves. Although Triffin had warned at the very outset that the dollar standard, with or without the backing in gold, was just as unhealthy as the earlier British pound standard, he concedes that initially it had a positive effect:

The dollar introduced some sort of monetary order in a post-war world of clashing monetary authorities. It was good to have that kind of a pillar. The system was used until the mid-sixties with moderation, and for purposes most people enthusiastically supported such as Marshall Aid to rebuild countries devastated by the war, and development aid for the Third World.

The United States used its privilege with restraint until 1965. The yearly balance-of-payments deficits had indeed begun to cause some concern; but, mercifully, they remained manageable (only one to two billion dollars a year). The turning point in US policy came after 1965 when the government started pumping enormous amounts of money into the Vietnam war. Triffin traces the process:

President Johnson feared that if he asked for tax increases to finance the war, Congress would vote against it, and he would then be forced to change his Vietnam policy. He therefore said, 'Why should I create problems for myself as long as the Bundesbank and the Bank of Japan are willing to finance the war?' Those two countries were the two most important investors in dollars.

From then on, and with a clear conscience, America used its privilege to cover its balance-of-payments deficits, or in other words foreign debt, with its self-created dollars. Then, because of the absurd arms race between the two superpowers, the foreign debt of the United States rose from 100 billion dollars, in 1969, to more than 1000 billion in 1984. The amount of dollars in foreign hands caused an inflationary growth of international monetary reserves, rising in this period at 13% above the world's gross national product. Here was an exclusive situation. A reform of the system would have prevented it. For, just like other countries with balance-of-payments

> deficits, the United States would have had to drastically cut its military expenditures or raise the money through stiff tax increases.

Triffin now turns to the ethical aspects and advances this as the second reason for reform:

> Ironically, the richest and the most capitalized country in the world is actually being financed by the poor countries through the creation of international monetary reserves. Economic logic as well as humane concerns should lead the richer and more capitalized countries to help economic development in the poorer countries. This is piously stressed again and again in United Nations resolutions. But the United States is doing exactly the opposite; it is having itself financed by poorer countries, even the poorest countries. To tell the truth, the United States is the only debtor of international reserves. The creditors—or claimants—of international reserves are: other industrialized countries for a small amount, OPEC countries for a larger amount, and the other developing countries for the largest amount.

Triffin's third argument for reform is that there is an enormous overflow of capital to the United States from the rich countries. Explaining the reasons for the overflows, Triffin says:

> It started when the Shah of Iran fell and embassies were being burned, and when there were fears of a third world war. Some people thought that West Germany and Switzerland were not as safe as the United States, so they began to switch their capital from Europe to safer American havens. Then came the enormous rise in interest rates in the United States. And, more recently, the United States has introduced attractive terms for investment. But the fundamental cause is, of course, that the system has continued to be based on the dollar.

Why is Triffin so concerned about the rich countries investing their money in America rather than Europe? 'Because', says Triffin, 'European savings are not being used to finance European investment, economic recovery or increasing employment; they are being used, instead, to finance the US budget deficit. More than half the gigantic American budget deficit is financed by this exported capital.'

Triffin finally turns to the 'sovereignty argument' of the opponents of his reform proposals, and to prove its speciousness, recalls an incident:

> Some years ago, I was discussing with a central banker the proposal of the European Commission to strengthen the position of the ECU (European Currency Unit). He said, 'Triffin, I am all in favour of strengthening the European currency, but as a governor of the central bank I must advise my government that this would be a loss of sovereignty for our country.' And I said, 'Are you serious? Isn't it you who told me only a few weeks ago that with the way interest rates were rising you had become totally dependent on the United States and had no real sovereignty left?'

And what does Triffin think of the much quoted argument that Jelle Zijlstra, ex-president of the Dutch Central Bank, once gave for maintaining the dollar standard? He had said, 'When we left the pound we could go to the dollar. But where could we go from the dollar? To the moon?' 'Well', comments Triffin, 'that was nicely put, but Zijlstra's argument is too simple. Why was there no alternative to the dollar? Because people like Zijlstra were not willing to create an alternative to the dollar in the form of the SDR, the ECU, or whatever.'

Although Western Europe, Japan and the United States alike are to blame for the international monetary scandal, Triffin feels that the first two are the most blameworthy. He elaborates the statement:

> In the end, I think you can blame them more than the United States. The dollar remained the world's key currency because the central banks of West Germany and Japan continued to buy dollars. Thanks to its privileged position as world's banker, the United States could go on spending enormous amounts on the military. It perhaps sounds a little strange that I put the blame more on Western Europe and Japan than the United States. But imagine that I said to you, 'Go to the best restaurant you can find, invite your friends and tell the waiter to send the bill to me rather than to you.' It would be very hard for you not to abuse that kind of privilege. I wish the United States had acted more responsibly; but the main fault lies with Western Europe and Japan. For, if you tell the United States, 'You can spend whatever you like; we will pay the bill' then this is no way to encourage reasonable policy by the United States. Those who accumulate dollars (Europe and Japan) have more power to curtail the use of the dollar than those who are offering them (the United States).

Triffin still believes in a fundamental reform of the international monetary system. He is sure that through an 'orderly interim period' a new, and possibly serious, dollar crisis could be averted. What, then, does he suggest the European monetary authorities should do? Triffin's answer:

> Ideally, from a world point of view, we should base the system fully on the SDR or, preferably, on reserve deposits with the IMF, because the SDR is still too dependent on the dollar. The main rule would then be that the IMF increases these reserves by no more than 5% annually. I say 5% because this will probably be the maximum non-inflationary growth of world trade and production.
>
> If these reforms were to take place, the IMF would help the United States tide over its balance-of-payments problem. But on some conditions—conditions regarding the US budgetary performance, conditions regarding the interest rate management in the United States, conditions regarding the tax provisions which attract foreign capital.

Does Triffin see any chance of these reforms being introduced? He replies:

> It is certainly impossible to introduce them as long as the United States does not support them. You can't have a world-wide

> monetary reform without the cooperation of the United States because it is, after all, the richest country with the biggest capital market in the world. This therefore means the Europeans must do all they can for regional monetary cooperation. A stronger European monetary system and a stronger ECU would function as the carrot and the stick. It is a stick because the United States would no longer have the ability to use the dollar as they do now, in a nefarious way. And a carrot because it would help the United States improve its policies concerning lower interest rates and lower exchange rates for the dollar.

Does Triffin think that Western Europe's central bankers have the will and insight to push for this? His answer:

> Quite honestly, I have my doubts. I think they are sceptical about their own influence. Not so long ago I spoke to one of them and he agreed that it was absurd and untenable that the United States should suck in hundreds of billions of dollars from the rest of the world. But what can we do about it? Interventions in the market [central banks selling dollars to make them less attractive—JJT] would be a drop in the ocean, and we don't achieve anything by that.
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> Let me give you another example. At the end of 1984, I spoke to a central banker who had just returned from the last annual meeting of the IMF. He said things had gone much better than he had expected. He had been afraid of a clash between the Europeans and the Americans; and, instead, they talked about all sorts of problems in a very friendly fashion, and decided to carry on as before, and so things were fine. And I said, 'But do you realize what you are saying? You are confronted with a situation which can only be described as the world upside down, and you drink nice cups of coffee and cognac, or whisky and soda or whatever; and you didn't give a fight! Which means you just go on with the same world-upside-down policies.'

Is Triffin ever accused of being naïve by still believing in the possibility of reforming the international monetary system? 'Yes', he answers frankly. And how does Triffin react to this reproach? He says, 'Well, I give the answer Ben Gurion once gave: to be realistic today you need a great deal of utopianism. I think that running away from the most obvious solutions is not realism. It's crisis management, condemning you to more and more crisis management.'

'Triffin ought to kill himself'

Dutch central banker, Duisenberg; Brazilian professor in economics, Tavares; American professor in monetary theory, Kregel; and authority in international finance, Triffin, have given an illuminating picture of the international monetary system and the debt crisis. However, Tavares and Kregel seem to disagree on a variety of issues. Their widely diverging appreciations of the private Western bankers is one clear example. In order to enable the two to further elaborate, face to face, their points of view they were invited to debate the issues.

The debate took off with the proposition that both Tavares and Kregel appeared to agree on, viz. that 'it all started with the foreign debt of the United States', because international liquidity was created by the chronic deficit in the US balance of payments.

Teunissen: Should financial authorities have said at the very beginning, 'This is a bad situation'? Should they have immediately taken steps to create an independent international reserve currency under the umbrella of the IMF? Or, was there in fact no alternative?

Maria da Conceição Tavares: Jan says this was a natural way of doing things. But it is not my opinion; neither was it Triffin's opinion. Triffin already said in 1957, 'this is a crazy way of doing it. If the United States continues to run a balance-of-payments deficit, the dollar will drift into a crisis at some point, and the whole Bretton Woods system will collapse.' Triffin had criticized the world financial system when the pound sterling was still the dominant currency. Like Keynes, he was always against the idea of having an international system with the dominant power backing the money. So was Prebisch in 1947, when the IMF laid down the rules. They all said, if it went wrong with England, then with the United States it will be much worse, because the United States cannot be the centre of an international division of labour in trade terms. It is a very closed, continental economy, and its pattern of imports, exports and production will in principle be incompatible with any new division of labour growing out of the system.

When the system collapsed in the early seventies, the IMF was right in saying we should implement the Special Drawing Right. At that time it was the position of the IMF that central banks put their reserves with the IMF so that the IMF, not central banks, recycled this liquidity. It was also obvious that this new routine of letting the exchange rates float, instead of keeping them fixed, would produce very rough capital movements across borders, and would stimulate American enterprises to speculate against the dollar.

So it was obvious for anyone who understands international finance that the whole thing was rotten. But Jan is right in saying that the central banks of Europe did not do anything at all. They kept up with this damn orthodox monetary policy of theirs while the private banking system was creating liquidity. Not the central banks, but the private banks between them. It was *endogenous* money—created within the private banking system. So this money creation did not attract the attention of central banks, and the central banks went on with their monetary–fiscal tuning, making this beautiful combination, and thought it was okay. And of course the private banks, since they earned a lot of money in this business, also thought it was okay. Nobody put any money into the IMF, and the result is perfectly well known. So, in my opinion, it was crazy from the very beginning.

Jan Kregel: To a certain extent we are now paying rather dearly for the post-war recovery. When World War II ended, Europe believed that it would permanently be in a position where its productive capacity would be insufficient to provide any kind of self-sufficiency. Therefore, they thought it was necessary to draw on the resources of the United States. The United

States came out of the war with its productive capacity not only intact, but reinforced. That is, the United States benefited from the Second World War as if it were some sort of full employment policy. It got as close as it ever has to its full productive potential.

So, there was the belief there would be a long-term dependence, and this long-term dependence was considered, not in terms of ten or fifteen years, but in terms of thirty, forty and fifty years. There was the belief that until the year 2000 there would be a more or less permanent dependency of the war-devastated European countries on the productive capacity of the United States.

In the beginning we had the famous problem of dollar scarcity; there were not enough dollars to buy goods from the United States. But the recovery came about so much more rapidly than anyone expected that when people started to look at the reserve positions of the various European central banks, there were plenty of dollars. Maria mentioned Triffin. Triffin was in a unique position because he was the father of the European Payments Union. He had a very close knowledge of the position of the European central banks in the first reconstruction period. He watched as a father watches his children developing. He was one of the few who saw this problem developing, and it was he who elaborated proposals for its solution. The response to Triffin's proposals, however, was, quite simply, 'you are asking us to give up national sovereignty over financial issues; but no nation is willing to give up sovereignty in this area, and therefore the problem cannot be discussed'.

Tavares: It still went okay during the sixties because then there was a certain balance between the productive capacity of Western Europe, the United States and Japan (the triangle was already made) and finance. Because, after all, at the beginning of the seventies the Eurodollar market was still relatively small—only 100 billion dollars.

In the early sixties, only Triffin, Prebisch and some other intellectuals saw the problem. The general opinion was that the way international liquidity was created was to everybody's advantage, so why should anybody care? It was good for the United States; it was good for the international companies; it was good for the central banks of Europe; it was good for everybody! But at the end of the sixties and the beginning of the seventies, when we had the crash of the dollar, it was obvious that the system was doomed.

Kregel: Discussions on other ways of expanding international liquidity started in the early sixties in response to the factors that were brought up by Triffin, Prebisch and other people. The point is, however, that by the time they did something about liquidity there was in fact no need to do something about it, because the private banks had already stepped in. By the time you got the IMF to take a decision on liquidity, the world was full of liquidity. Nobody wanted it. The Special Drawing Right was a great disaster, because there was absolutely no use for it: nobody needed it by the time it came.

Tavares: But in a sense this is crazy. The world was full of liquidity . . . , but exactly then, in the good years of liquidity, like Joseph and his brothers in Egypt in the days of plenty, you store for the scarcity to come. Everybody knows, or should know, that the capitalist system works in cycles. So they should have realized that in the next ten years they would again be out of liquidity. In the early seventies, when there was plenty of liquidity and nobody was fighting about the dollar, they should have accepted the IMF recommendations, and the central banks should have put part of their reserves into the IMF in order to regulate liquidity when scarcity returned.

In fact, in the mid-sixties, the monetary system was already split. It was only because Germany was continually supporting the dollar—in its own interest, of course—that the dollar stood until the seventies. It would otherwise have collapsed between 1965 and 1968.

When the dollar finally collapsed and they let the parities float, there was a heated debate in the technocratic world of international finance. All of them agreed that the floating dollar rate would produce what it did produce—sharp capital movements from one place to another. London began to be a speculative place, Luxembourg became a fiscal paradise, and so on. It was obvious for anybody in the international bureaucracy that this damned thing ought to be tackled immediately, otherwise it would get out of control because the private banking system had now joined the action.

Teunissen: Quite obviously there were not that many people thinking this way.

Tavares: Why not? I learned this from the reports. The first ones to mention it were the IMF guys in the Staff Papers, the World Bank guys in their meetings, the OECD guys, and some bankers. The trouble is that the Central Bank of Germany never went along with it. Germany never agreed with Triffin's ideas of cutting the European monetary system off from the dollar. It never went along because the tie-up was, and still is, to its advantage.

Teunissen: Why did the German Central Bank not want any change?

Tavares: Because this way it did not have to expand the money supply. It could go on with the orthodox monetary policy without creating any liquidity. The whole world provided liquidity for the German banks, for the German entrepreneurs, for the German multinationals all over the world, so it was okay! Their business guys were having a wonderful time around Europe with this Eurodollar business which was beyond the control of central banks. The German Central Bank was afraid of inflation, so it said, 'We are not going to expand the money supply, our mark is going to stay as a rock in the middle of this mess, those American guys can move.'

I am exaggerating and dramatizing, but it was more or less like that.

Kregel: Basically this is true. The German economy is based primarily on exports. Germany is one of the few countries which have been able to survive on an overvalued currency. For it, there was no reason to take the risk of inflation. The German Central Bank has one sacred principle—to maintain the value of the mark. In so doing the rest of the system is supposed to move. For it, there was really no reason to change.

Teunissen: You both said the oil crisis complicated things, but it was not the chief cause of the problems. To what extent do you blame OPEC for the current debt problems?

Kregel: All these underlying basic structural factors existed prior to the oil price increases of 1973. There were certainly changes in the international monetary system which favoured some changes within the oil sector. But if you are looking at causation, it was not the oil sector which influenced what happened in the international monetary system; it was the international monetary relations that made certain policies, actions and reactions within the oil sector possible.

Tavares: It is the breakdown of the international monetary system which produced the oil crisis, and not the other way round. By the way, the oil-exporting countries had every reason to raise the price of oil; it had been going down since the beginning of the fifties. They could not do it before the breakdown of the monetary system because, if they did, then the price-makers of the world—the United States, Germany and Japan—would have passed on these prices. Suppose the OPEC guys had pushed up the oil prices before the breakdown of the monetary system? It does not matter, they are not price-makers; but even so the Americans, Japanese and Germans—who are the price-makers—would then have passed on the costs, the overhead, and so on, and the world price system would have continued completely unchanged. I mean, the oil guys could have done nothing before the breakdown. But when it occurred they said, 'Now it is our turn. Let's run.' And they ran. And, of course, they were then at the mercy of the private banks, because it was in the interest of the private banks to recycle the surplus of OPEC.

Teunissen: Do you agree, Jan?

Kregel: Well, I don't know. If you look at this from a global perspective the private banks, irrespective of their incentive to do this, managed to recycle the surplus at a time when no one else was willing to do it. This is my judgement of the private banks.

Tavares: That is why you call them heroes?

Kregel: Yes. In a period when no national government was willing to play the role of either lender or spender of last resort, and the IMF also refused to do it . . .

Tavares: But refused to do it because they did not have the money . . .

Kregel: Because the governments were unwilling to support it. So the private banks—fortunately, I say in this sense—were willing to step in and recycle the money to those countries which were willing to expand.

Tavares: That is not my opinion. Had the private banks not been so disposed to do this, the OPEC countries could have lent money directly to Brazil, for instance. This would have been much better for them as also for Brazil. Now the Arabs got only pieces of paper and assets in the banking system. And, of course, they got a tremendous rumble with their balance of payments because they were forced to import lots of things they had no interest in at all. If this private banking system had not stepped in, they would certainly have found a way to put their money elsewhere.

Kregel: But it might have come too late. If you look at the widespread responses to the oil crisis of 1973, you see a number of countries which chose to expand their way out of 1973.

Tavares: I disagree completely. You assume that the Third World took money for development purposes.

Kregel: If you look at the statistics, you discover that the rates of growth in the underdeveloped countries were substantially higher than . . .

Tavares: But that was because of the investment made between 1968 and 1973, *before* the oil crisis.

Teunissen: Let us go back to what you both said in the preceding interviews. Jan, you said that the rise of the oil price in 1973 forced a lot of underdeveloped countries to borrow money abroad, while you, Maria, said that Latin American and other Third World countries did not need to borrow this money.

Tavares: Let me explain it clearly. After the war there was this big expansion. Then the period 1955–1958 was a period of transition. The European Common Market was formed, and everybody went to the North, and the South entered this damned thing. But, the important thing is this: after 1967–1968 we entered a period of high investment.

The rate of investment was heavy on capital. For instance, the rate of Japanese investment was much higher than before, because all those industries which could be created with little capital already existed. If you look at the data on south Asia, Mexico, Brazil, and even Argentina (which was a slow country), you realize that the rate of investment was rising rapidly. It was made by public enterprise, multinational enterprise and national entrepreneurs, connected all over the world. This was so in Iran, in South Africa, in Mexico, in Chile, in south Asia, everywhere. So, this last boom, 1968–1973, was a period of heavy investment all over the world.

This meant we had spare capacity everywhere in the world to face the following crisis of prices, and to go on growing only with national credit because the bulk of investment had already been made. Everybody could have gone on growing with those investments by only using internal credit. And for the big projects, such as ores and mining, there was a capital market.

So these petrodollars could easily have gone into lending directly to enterprises through the capital market. But the OPEC countries did not want this because the private banks offered to take their money on a short-term basis and lend it on a long term basis.

We did not need this damned money that the private Western banks offered us. It is not a question of opinion; it is a question of figures. Argentina had a surplus, Mexico too, Venezuela had a surplus, south Asia had a surplus, Nigeria had a surplus, everybody had a surplus. The only country which did not have a surplus was Brazil. The oil shock did produce a problem in Brazil because we were a major importer of oil. But it did not produce any shock in the oil-producing countries such as Mexico, Venezuela and Nigeria. There was no deficit in these countries. They lent money to countries with a surplus! The accounts are there; everybody can look at the figures.

Kregel: The result of the oil crisis was that a certain amount of purchasing power was redistributed from areas in which it was being spent to areas in which it clearly was not being spent. The level of global spending was drastically reduced and the argument was: is there anyone willing to step in and close the gap? The answer was 'no'. There was no organization, there was no country willing to look after the level of global spending. No one was willing to do so. The profit motive led the private banks to . . .

Tavares: By 'no one' you mean the countries in the North? Are you speaking from their point of view?

Kregel: No, I am speaking from the point of view of the places where the money was deposited. The problem was that OPEC was not willing to deposit money with the Brazilian Central Bank.

So, the problem was: how to get the money out of the banking system and back to someone who was willing to spend it? All the banks did was look around and find out where the most profitable loans could be made. And once these were made, it turns out that the growth rates in these areas were in fact higher than they were, on average, in the developed part of the world.

Now, you say, the investment had already been made, and my response is 'yes', but . . .

Tavares: What was the money for, Jan Kregel?

Kregel: The money was in place of what would have been required had these countries had to go to the IMF to borrow . . .

Tavares: But they simply did not have to go to the IMF. You think this money went in place of the money the IMF ought to have given us when we had balance-of-payments problems? This is a fallacy of composition, because we would not have had any balance-of-payments problems had we not taken that money.

We did not need imports of capital goods. We, the industrializing Third World countries, made the debts because we had the capacity. That was also the case in Poland and Yugoslavia.

You are saying that the bankers were heroes because they played the role someone had to play and which nobody was disposed to play. But the point is that we ran into problems *because* we took this money. We did not have any balance-of-payments problems before—between 1968 and 1973—when we were really investing. But since we took this money we had to pay for it.

Remember, it was lending on ten-year, eight-year basis, but the rate of interest was adjustable every six months. So, every six months you had to rebuild the capital account. In the beginning the rate of interest was 3%, which was a negative rate if you subtract inflation. But, then the rate of interest started to rise from 3 to 5%, from 5 to 7%, from 7 to 8% . . . In 1979 everybody noticed the problem only when the interest rate exploded to 20%. But the problem did not arise in 1979.

The problem already started in 1973, when we entered the period of world economic recession, which was produced by the monetary policies of the United States and Germany. You cannot produce recession without making a tight monetary policy. They did it! And everybody except Japan started to apply a tight monetary policy. That is why the interest rate increased from 3 to 5 to 7 to 8%; and that is why the rate of growth of trade went down substantially.

Now, if trade increases more slowly than the rate of interest, then you get a balance-of-payments problem in the capital account of any country.

The oil shock of 1973 was not the major problem. Even in the case of Brazil it played a minor role. Only 25% of our deficit came about because of the increased oil prices; 75% was due to the rise of interest rates and because of speculation with raw materials. So, the main problems were: unnecessary borrowing; the deterioration of the terms of trade which resulted from the economic crisis the United States and Europe produced; and the rise of interest rates. That is why the balance of payments of our countries went out of control. And then, in order to keep it going, we got into more debt. That is where we have to start.

Teunissen: Jan, your comment please.

Kregel: I would be interested to know what Maria's scenario would have been had the international banks *not* recycled, had the IMF *not* entered into the recycling process, and had the Western governments pursued the kind of policies that they in fact did. *Then,* what would have happened?

Tavares: The OPEC countries would have bought some multinationals; they would have bought real estate, meaning that they would not have taken *debt* but *assets* in exchange for their money. Moreover, they would have been willing to lend money directly to Brazil. They were in Brazil in 1973 to do it. Then we would not have been the victims of American monetary policy because they would *not* have lent to us as the bankers did with a fluctuating rate of interest but, instead, with a fixed rate through the capital market. Because the bankers entered this damned thing there is no capital market anymore.

Kregel: Maria, we could not even get them to lend to Italy!

Tavares: Because the bankers were prepared to take their money! If the bankers were not prepared to do so, they would have been obliged to lend through the capital market, just like everybody else.

Kregel: We have to take into account the fact that the banks were actively encouraged to carry out this policy. Most governments were perfectly happy to allow the private banks to do so. The internal reports of almost all governments and all central banks in this period congratulated themselves upon the efficient operation of the international financial markets. They did everything they could to insure that the private banks lent to underdeveloped countries. If I were a banker, I would have done exactly the same thing, because I would have evaluated the risk at almost zero.

Tavares: So would I, if I were a banker. I quite agree. But I am not a banker, and not a central banker. I am a former United Nations expert; and I am speaking from the point of view of the international agencies. Nowadays it is in fashion to call the IMF the bad guy. But the IMF guys were not in favour of this recycling by the private banks, neither were the people at the World Bank, nor the OECD technocrats. I think I am in very good company when I criticize those stupid, conservative men at the central banks, who do not understand anything except that they want to maintain stability at all costs. But they do not understand anything about stability.

Teunissen: Maria, in the interview you called the banks 'robbers', while you, Jan, stressed that one should not blame them for their bad behaviour. You said it is the result of other forces in the international financial system—the major governments and central banks. Do the banks rob? Can you blame them? Can they act differently?

Kregel: Certainly they could have acted differently. The whole disagreement Maria and I have is: why did they not act differently? My argument has consistently been that the conditions that were created for them led them to do what they did. It is as if you were training a dog to go and fetch a stick, and after you have taught him to go and fetch the stick, you take a stick of dynamite and you throw it. The dog then goes and fetches it, and it blows up in his face, and you say, 'What a stupid dog!' No, the dog is not stupid. You are the stupid one for having thrown the stick of dynamite for him. The banking system performed in precisely the way people wanted it to perform.

Tavares: It is clear that the Bundesbank of Germany, the Bank of England and the Federal Reserve Board in Washington are very much responsible.

Teunissen: You both agree on that?

Tavares and Kregel: Oh, yes.

Teunissen: And on the robbery, you both agree?

Kregel: It is not so much the fault of the banks that they rob, but it is the fault of having placed them in a position where they can rob. And then, if they in fact do rob, you don't cry about it.

Tavares: I am not crying on moral grounds. If it were only five robber barons—the biggest banks—they could always be called to reason by their governments and central banks. But it is not. There are two thousand robbers—small robbers and big robbers.

Kregel: When the Eurodollar market expanded without control, there were discussions: do we stop it now, or do we let it go? And the clear decision was: we let it go. In the face of this decision you cannot say, 'It is the fault of the banks that they have used their power to their own benefit.'

Teunissen: The sudden change of monetary policy in the United States—who was to blame for that? Jan, you said you could not just blame the US government; but you have to take the role of Western Europe into account as well.

Tavares: We do not disagree on this. The Europeans don't take their share of the responsibility. Your central banks of Europe are really something to cry out about. This damned European business on money . . . Triffin ought to kill himself. Europe did not do anything! When the United States was in serious trouble because its dollar was tumbling, the Americans said, 'Okay, we'll do it.' But the way Mr Volcker, who is the chairman of the Federal Reserve, did it, it was a show of extreme arrogance.

It happened during the annual meeting of the IMF which was held in Yugoslavia in 1979. In 1979 it was already a mess: the Yugoslavians were in default, the Polish debt had started to explode. Everybody looked at the accounts and said, 'Jesus Christ, it is a mess.' I remember, because afterwards I spoke with Mario Henrique Simonsen, then our minister of finance, who was at the meeting in Yugoslavia. He said, 'I think we should do something, may be with the Special Drawing Right.' And then Volcker said, 'Well, you want us to agree that the dollar won't be the international money any longer?' They replied, 'As a matter of fact, yes.' And Volcker said, 'Forget it.' He went back to the United States and, while the IMF meeting was still going on, pushed the discount rate (the rate private banks have to pay when they borrow money from the central bank) to 12% so that interest rates quickly jumped to around 19%!

Kregel: If you take the idea that you have to have a top country at some place in the system, then we are currently in a situation where the United States is neglecting its role as the top country. The Germans would now like to be a partially top country; the Japanese would like to be a partially top country; and the rest of the European Community would like to be the partially-top group. But nobody wants to take responsibility for the system.

Among themselves they are unable to decide who is in fact going to be the top country, and then the United States says, 'Well, if you people don't want us to dominate any more, we will withdraw and take care of our own affairs.' This is what happened when US policy changed in 1979. The United States became much more unilateralist. And when the effects became clear, everybody said to the United States, 'Why aren't you playing top country?'

Teunissen: Western economic policy-makers hope that the debt crisis will in the end be solved by a recovery of the world economy. The United States is still considered to be playing the role of a locomotive.

Kregel: The United States is now much less a locomotive force than in the past. Secondly, the expansion that does exist in the United States is rather unique in history. It is not an expansion which produces increases in employment, income, or productive capacity. Productive investment stays away because of fundamental changes in the structure of employment and the distribution of income, which are currently taking place in the United States.

To put things simply, the upper middle class—traditionally the sector which, by its consumption of durable goods and consumption goods, has stimulated productive investment—is being eliminated. There is now increasingly a bimodal distribution towards the lower end of the income scale and towards the higher end of the income scale, which means that the traditional market is disappearing. So, if you are the head of a corporation and you have to decide what sorts of investment you are going to make, instead of investing in a market that is in a state of flux, you will tend to go into US government debt which pays you a rate of return certainly 5% higher than you can expect on any productive investment.

Teunissen: The debt which the US government has accumulated is much higher than the total debt of the Third World. Don't you think that is a problem?

Tavares: The debt of Latin America is not so big, maybe 10% of the whole international debt. The big, important thing is the roll-over of the US government debt.

Kregel: This is the point. The biggest problem the Federal Reserve has sitting behind it is the problem with the US government debt. In a sense they have handled this problem smartly. They have sort of cycled it around-or, to be more precise, not around but underneath New York, and through New York into the foreign markets. The amount of US government debt which is now being sold overseas is 40 to 50% of the total, which opens to the Federal Reserve the possibility of keeping control over the domestic monetary situation.

What the United States in fact has done, from 1979 onwards, is trade a dollar overhang for a Treasury bill overhang. Before 1979 we talked about the problem of the dollar overhang—too many dollars abroad. The United States got rid of this overhang by trading it in for US government debt, for Treasury bills.

For the world system as a whole this has created a very serious structural problem. The United States is now doing everything exactly the opposite of what it should be doing as the top country of the system. Instead of playing the role of lender of last resort, the United States is now the borrower of first resort. The United States is sucking in capital from the entire rest of the world instead of sharing it out.

This is, I would say, *the* problem. If you look at the world economic system as a sort of bottle, as long as the United States continues to close its own books by borrowing from the rest of the world, you have an implosion of the system.

Maria talked of the necessity for the developing countries to equalize the rate of interest they have to pay to the rate of increase of their exports. This is a rule which also applies to the developed countries. It is absolutely impossible for any developed economy to run real rates of interest which are higher than the long-term rates of real growth.

Tavares: The Germans should stop being stupid and orthodox. You have to rebuild Europe. Only if you push it back again on the path of growth will you be able to produce the necessary liquidity inside your system. Now there is no liquidity left: it has been taken away. The private banking system, which was so beautifully expensive, is now contracting because everybody wants to protect his money.

The ones who create money are the private banks. But they cannot create it if you have this lunatic idea that you cut your expenses in order to solve a deficit. When there is no expansion, banks cannot create money. It is as if Keynes never existed. They are saying, 'I have a deficit, so I cut my expenses.' And then they cut their expenses, and the next year you get a worse deficit because the income doesn't go up.

In my opinion, Europe should take care of itself and make its own Union of Payments independent of the dollar. For this it is necessary to have social planning in terms of income policy, fiscal policy and monetary policy. We all have to withdraw from the dollar system. Japan has to do it in Asia, Europe has to do it in Europe, we have to do it in Latin America. Let the United States take care of itself. That is the best solution.

Temporary illness or chronic disease?

Here we have provided an analysis of the debt crisis which is fundamentally different from the standard view. The alternative view stresses that the debt crisis emanates from serious mismanagement by Western financial authorities. Their continued choice of the US dollar as pivot of the system resulted in a chronic disease. As long as the system revolves around the dollar, we will continue to be plagued by major problems, be they dollar crises or international debt crises. Both Triffin and Tavares are of the view, therefore, that the reform of the international monetary system would be the best way of solving the problem. The standard view, in contrast, is that the debt crisis has not arisen from a chronic disease of the system, but that it is a temporary illness produced by unforeseen shocks.

The world behind the shocks

This is a rather superficial view of the problem. It foists the responsibility for the crisis on a scapegoat. We are told, for instance, that greedy Arab sheiks provoked the oil shock of 1973, or that in 1979 interest rates happened to climb to extraordinarily high levels because of market forces. In the preceding pages, however, it has become clear that these so-called shocks were the result of clearly identifiable decisions taken by the main actors in the system. The most important of these was the United States. So during the interview with Jan Kregel, I asked him how far the United States was responsible. His judicious reply ran as follows:

> It is unclear how much the US government did or did not have to do with that whole experience. We will probably never know with any degree of certainty. But one can certainly identify interests within the United States which were not damaged by the petroleum prices rise. In particular, one can start with petroleum companies.
>
> Petroleum companies indeed saw their profits soar after the jump in oil prices: their rate of profit rose from 10% in 1972, to 19% in 1974, and to 24% in 1979. In addition to the obvious benefit the petroleum companies ran away with as a result of the OPEC price rise, other interests may have played a role as well.

A fall-out of the oil crisis was that it helped the United States surmount a serious dollar crisis and regain the supremacy of its dollar. What follows will show how.

The collapse of the Bretton Woods system precipitated the oil crisis of 1973. The oil-importing countries set about looking for sources of money. The United States need not have been one of these. For, until 1970, it was 90% self-sufficient in energy. Curiously, however, in 1971 (i.e. two years before the oil crisis broke out) it began to increase its oil imports rapidly and ended up demanding 30% of OPEC's total production. That is why Riccardo Parbony says in his *The Dollar and Its Rivals,* 'Without the enormous US oil imports, the OPEC cartel would have been unable to sustain itself.'

The availability of enough money to pay for much higher oil prices was a real problem. Under the Bretton Woods system the amount of money—that is, dollars—available for international payments was determined by the size of the gold reserves of the central bank of the United States; for the US was under the obligation to count dollars into gold on demand. But when on 15 August 1971, the US government abolished the convertibility of the dollar, the limit on the amount of dollars available for international exchange disappeared. And since the 'gold exchange standard' was the arch-stone of the Bretton Woods system, the system collapsed.

In his *Gold and the Dollar Crisis: Yesterday and Tomorrow* Robert Triffin shows the rapid increase in international reserves for the three subsequent years before the oil crisis of 1973:

> The world's reserve pool rose moderately from 58 billion dollars at the end of 1959, to 79 billion dollars at the end of 1969, but it doubled in the next three years to 159 billion dollars at the end of 1972, increasing as much in this short span of three years as in all previous years and centuries since Adam and Eve.

This unprecedented boom in international reserves not only gave OPEC the opportunity to increase its oil price, but also provided OPEC with a good argument to do so. It led to galloping world inflation which was gutting oil prices. The oil price explosion of 1973 was in part a reaction to this staggering world inflation.

What has all of this to do with United States' interest in the oil crisis? To understand this one has only to turn to Triffin's account of the early 1970s on the advent of a serious dollar crisis. Solutions to the crisis were feverishly sought. In 1972, IMF executive directors suggested phasing out the dollar as the principal reserve currency and replacing it with the Special Drawing Right. Had the IMF proposal been implemented, the United States would have lost its 'exorbitant' privilege. That is why it did everything in its power to thwart the proposal. Slowing down the negotiation on international monetary reform was one method. Another way of undermining reform proposals was to try to make them obsolete. The oil crisis of 1973 gave a magnificent opportunity.

The advocates of international monetary reform proposed that dollars held by foreign banks should be transferred to the IMF. In return, the banks would receive SDR's. The United States would then pay off its dollar indebtedness to the IMF over a few decades. In this way the SDR would gradually replace the dollar as reserve currency. However, in the face of the oil crisis, this idea was considered out-of-date, since a whole new scenario had emerged.

A substantial part of the dollars held by other countries was now used to pay for the higher oil import bills. 'Petrodollars' were deposited with the private Western banks operating on the Eurodollar market, and then invested in US Treasury bills. It was thanks partly to the oil crisis that the United States was able to re-establish the dollar as the pivot of the international monetary system and to keep its 'exorbitant' privilege.

I am not arguing that the oil crisis inevitably resulted in the reaffirmation of the dollar, nor that the dollar crisis automatically led to the oil crisis. Other events contributed, too. But it cannot be denied that it might have followed a completely different course had the main actors in the system chosen another policy. In his study referred to earlier, Triffin observes:

> An earlier adoption of my proposals for reform would have channelled into reserve deposits with the IMF the bulk of the surpluses of the OPEC as well as of other countries. The IMF would then have been able to recycle these funds instead of having to solicit meager lending contributions from OPEC countries and to leave the bulk of the recycling responsibility to the United States and the Eurocurrency market.

The jump in interest rates in 1979, just like the oil shock, can be traced back to a concrete decision taken by policy-makers; it cannot be ascribed to abstract 'market forces'. Tavares described, for instance, how Mr Volcker, chairman of America's central bank, in 'a show of complete arrogance' pushed the interest rates to 19%. Dutch central banker Duisenberg said the continuing extremely high interest rates were 'mainly the result of the budgetary policy of the United States', that is, the simultaneous reduction of taxes and increase of, particularly, military expenditures, leading to a huge budget deficit attracting capital from all over the world. Triffin referred to another conversation he had had with a European central banker in which the banker complained that with the way interest rates were rising he had become totally dependent on the United States. Kregel, on the other hand, stressed the responsibility of the European central banks for the rise in interest rates: 'There was little choice; it was imposed on the United States, primarily by the European central bankers.'

Both examples—oil crisis and high interest rates—point to policies that must be analysed if one wishes to solve the problems these shocks supposedly created. A prerequisite for any just solution is that the people affected by it are given adequate information to judge it. Policy makers should make clear to them what the exact diagnosis of the problem has been and why these specific measures have been chosen to solve it. Furthermore, it should be made clear whether the shocks indeed created the problem they were supposed to have created. In the case of the oil shock it was, for instance, disputed by Tavares that this was the main reason why Third World countries ran heavily into debt. She said, 'It did not produce any shock in the oil-producing countries like Mexico, Venezuela and Nigeria. Even in the case of Brazil the oil shock played a minor role.'

I am the greatest: US debt and Third World debt

Let us recall that Ms Tavares began her comments on the debt crisis with: 'It all started with the foreign debt of the United States, not with ours.' It now appears that the debt story not only starts, but also ends with the foreign debt of the United States. Tavares and Kregel concluded that the debt of the United States is actually a far greater problem than the debt of the Third World.

Indeed, it is surprising that international concern has been focussed almost exclusively on the debt of the Third World. The debt of the United States is not only much larger, but it is also growing much faster. Comments Triffin, 'We were worried in the sixties by US deficits of 1 or 2 billion dollars a year. *Now it is 120 billion dollars a year, and very few people really care.*' Can it be that the blitzkrieg-type publicity of Third World debt problems deflected the world's attention from a much more serious but less visible crisis that is embedded in the US debt of astonomical proportions? How else can we understand this paradox? A simple answer is that after the abolition of the convertibility of the dollar into gold in 1971, there could just no longer be a US debt problem. However large the US debt might be, or however fast it might grow, the United States would always be able to pay its debts simply by printing more dollars. However, this explanation is contradicted by the facts. In 1979, there was a serious US debt problem again, although at first glance it appeared to be different from the Third World's debt problems of the 1980s. I say 'at first glance', because a closer analysis reveals a similarity.

The debt crisis of 1982, we have seen, was the result of a sudden fear on the part of banks of not getting their debt payments in time from a number of Latin American countries. They therefore stopped their usual credit flow. Generally speaking, the key to any debt crisis is that some creditors lose their confidence in a debtor, discontinue their customary lending to it, cause general panic among creditors, and thereby create a crisis situation. That is exactly what happened in 1979 with the United States.

What essentially happened in 1979 was that those who held dollar-denominated assets began to lose confidence in the United States, and they therefore started converting their dollars into German marks, Swiss francs, gold, silver and other assets they trusted more. The basic reason for this loss of confidence was that the dollar's value was falling steadily, relative to that of the other currencies. Then, because more and more dollars were converted into other assets, the dollar fell even lower and lower with no end in sight. Then came the IMF annual meeting in Belgrade, Yugoslavia. The chairman of America's central bank, Volcker, energetically reacted to proposals to phase out the dollar as the international reserve currency. In his *The World's Money*, Michael Moffitt describes the scene:

> In Belgrade . . . it became obvious to Volcker that a collapse of the dollar was a very real possibility, perhaps leading to a financial crisis and pressure to remonetize gold, which the United States had fought doggedly for over a decade. To forestall this, there was only one possible course of action: do whatever was necessary to strengthen the dollar. The strategy was simple: in order to lure funds into dollar-denominated assets, dollar interest rates would have to be raised. On 6 October, Paul Volcker did exactly that.

Although the US debt crises of 1971 and 1979—generally defined as dollar crises—were in fact very similar to the Third World debt crisis of 1982, the solutions in the two cases were diametrically opposed. Third World countries were forced to squeeze their expenditures, while the United States increased them. Especially after 1971 the world was flooded with dollars emanating from the United States' huge balance-of-payments deficits. After 1979, and particularly since 1982, the opposite occurred: huge deficits on the US government budget deficit have sucked in enormous amounts of money from abroad.

It is therefore no coincidence that 1982 is the same year the debt crisis in the Third World broke out. From 1982 onwards US banks lent less and less to the Third World. Robert Triffin gives the figures: 'Commerical banks in the United States were lending more than 100 billion dollars in 1982. In 1983 it fell down to 25 billion dollars. In 1984 it further decreased to 9 billion dollars, and in 1985 their foreign lending disappeared completely—their net lending became *minus* 9 billion dollars.'

The temporary effect of the way in which both dollar crises were resolved was a restoration of confidence in the US dollar, even though the US debt would rise even further as a result. The solution to the 1971 US debt crisis created a 'dollar-overhang'—too many dollars circulating outside the United States. The 1979 solution produced the reverse—too many dollars going to the United States, largely invested in US Treasury bills.

Will there be another US debt crisis because of the rapidly growing US government debt? In this regard, Dutch central banker Duisenberg said, 'The situation we find ourselves in now, will, in the long run, become unbearable, both for the United States and for the world.' Triffin found that more European central bankers were thinking like Duisenberg: 'Not so long ago I spoke to one of them and he agreed that it is absurd and untenable that the United States sucks in hundreds of billions of dollars from the rest of the world.' The former Bundesbank president, Emminger, who had dismissed, at the beginning of the 1960s, Triffin's reform plans was now on Triffin's side. In his *The Dollar's Borrowed Strength*, Emminger writes:

> The present payments imbalance (the wealthiest country in the world borrowing abroad on an unprecedented scale) and exchange rate distortions (the high dollar) *are not sustainable* forever. However, nobody can predict when the *inevitable turnaround* will come. . . . Nor is it as yet foreseeable whether it will be forced upon the United States from abroad—e.g. by a decline of confidence on the part of foreign investors—or whether the United States will itself be lowering its need for foreign funds—e.g. by cutting its budget deficit [author's emphasis].

When the next US debt crisis emerges, the interesting question will be what response is chosen. The two preceding crises demonstrated the paradoxical power of the United States; the largest debtor of the world made its creditors—the rest of the world—see a stake in keeping it going and helping it incur an ever higher debt.

So, as far as its debt is concerned, the United States can claim, in more than one sense: 'I am the greatest.'

It is not the widows who will cry

Triffin and Tavares argue that fundamental reforms of the international monetary system would be the best way to tackle the debt problems of both the United States and the Third World. But even if one day these reforms were to become a reality, one would still need to answer the question as to how the banks should handle their troubled Third World loan portfolios. Kregel suggests a simple solution. He says:

> I think the only way to get out of Third World debt problems is by writing them off. Essentially what we have now is a problem of reduction in capital values. The value of the outstanding Third World loans on the books of the banks would be found to be higher than the value of these loans, were the banks to dispose of them by either selling them in the private market, or trying to call them in. The banks, to be sure will incur losses; but is it not more sensible to take those losses today and try to go on from there? It is not unusual for banks to run sometimes into losses. The only problem is that the loss ratio this time may be high relative to those in the past; for some banks they might be so high as to threaten their solvency. But we can get out of the problem only by either increasing the income available to pay off the debt, or by rewriting the debt.

Tavares agrees with Kregel and stresses that a re-write or writeoff of Third

World debt would hardly affect people with deposits in the bank; for it is just an inter-bank transaction—a transaction between central and private banks. The widows will not cry because they have lost their bonds, as they did in the 1920s and 1930s. Since it is essentially a matter between the private and central banks, why do they not just write it off or transform it into a long-term debt, as the world system has traditionally done? 'Remember, England rolled over the American debt for a hundred years, but now they want us to repay in five years! If they just rewrite our debt into a twenty-five-year debt at a reasonable rate of interest, we will pay it.'

Triffin thinks along the same lines as Kregel and Tavares. He proposes transforming Third World debts into a form of borrowing that was quite common in the 19th century—'consols'. He elaborates his argument:

> In the nineteenth century France and England were borrowing in the form of consols, which meant that the interest was fixed at a low rate and amortization would be paid only if those countries came to be in surplus. Why? Because as long as a country is in deficit it cannot repay its debt; it can only accumulate more debt. And as long as a country is in surplus, like Germany, it is not being repaid its loans; it only accumulates more claims. These are inescapable facts of life. To repay, you must be in surplus; and to be repaid, you must be in deficit. If a country which was previously in surplus and was accumulating consols ran into deficit, it could use its consols to pay its deficits. There would be a market for such bonds. In this way you would reconcile the contractual arrangements of the loans with the facts of life.

Would lenders be willing to accept a low rate of interest and no amortization? Triffin replies:

> Yes, I think lots of people would be willing to lend at a rate of, let's say, 2% if these bonds were expressed in a fixed purchasing power. But now they want high rates of interest to offset an eventual loss in the capital value of their asset as a result of inflation or devaluation. But if they were guaranteed a fixed purchasing power for their investments, they would accept a low rate of interest. With respect to amortization I think that lenders generally don't want to be repaid. For, if they are repaid, they have to re-invest! The banks particularly would be terrified if all their lendings were repaid.

Did Triffin discuss his proposal with other financial experts and how did they react?

> Recently I discussed it with John Williamson who said he had thought of putting my proposal in one of his books. He said: 'I wanted first to put your consols, but when I talked about it I saw that people were not ready for it, and so, as a second best, I put "longer maturities".' I have talked about it to quite a number of people. They agree, but somehow they cannot get used to this simple idea.

Tavares states at the end of her discussion with Kregel that Europe should become independent of the dollar, that Asia and Latin America should do the same, and that we should 'let the United States take care of itself'. According to her this would be the best solution. Does Triffin agree?

> I agree with all except the last two sentences. If you have this tripolar monetary system, one should still try to better the world monetary system and make it more attractive and unavoidable for the United States to participate in it. It is easier for the Europeans than for anybody else to delink from the dollar, because most of their trade is mutual. That is what the European Monetary System is trying to do. You should go on with that, but not with the view that you let the United States take care of itself. You tell the United States: 'We are now better able than we were before by our own monetary union to develop our own policies, so we do no longer have to finance your bad policies, but we are quite willing to help you finance readjustment of your policies.'