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Economic crisis and third world debt

The triple failing of the big private banks

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Since August 2007, US and European banks have constantly made headline news concerning the deep crisis they are going through and its knock-on effect on the neoliberal economic system as a whole. Asset depreciation for these banks currently stands at over 200 billion dollars. Several banking research services and seasoned economists estimate that the final damage will exceed 1,000 billion dollars [1]

[https://internationalviewpoint.org/IMG/jpg/Lehman.jpg]

How did the banks manage to build such an irrational lending system? Eager for profit, mortgage companies made loans to a sector of the population that was already heavily indebted. The conditions attached to these mortgages – highly profitable for the lender – amounted to daylight robbery for the borrower: the interest rate was fixed and reasonable for the first two years but thereafter rose sharply. Lenders assured borrowers that the property they were buying would quickly appreciate thanks to the boom in the real estate sector. The problem was that the real estate bubble burst in 2007 and house prices started to go steadily down.

The number of defaults on payment soared and mortgage brokers had trouble repaying their own loans. To protect themselves, the big banks either refused extra credit to the mortgage lenders or agreed to new loans at far higher interest rates. But the spiral did not stop there, since the big banks had bought up a large number of the original loans as off-balance sheet operations by creating specific companies called Structured Investment Vehicles (SIV), which finance the purchase of high yield mortgages converted into bonds (CDOs, or Collateralised Debt Obligations).

As from August 2007, investors stopped buying the unguaranteed commercial papers issued by SIVs, which no longer looked like a safe or credible option. Consequently, the SIVs lacked the liquidity needed to buy up mortgages and the crisis worsened. The big banks who had created the SIVs therefore had to bail them out to stop them going bankrupt. Up to then, SIV operations had not appeared in the banks' accounts (thus allowing them to conceal the risks involved), but now the SIV debts had to come out of the closet and onto the books.

The result was general panic. In the US, 84 mortgage companies either went bankrupt or partially stopped doing business between 1 January and 17 August 2007, as opposed to only 17 similar cases for the whole of 2006. In Germany, the IKB BANK and SachsenLB were saved by the skin of their teeth. Recently, in England, the bankrupt Northern Rock has had to be nationalised. On 13 March 2008, the Carlyle Capital Corporation (CCC) fund, known to be close to the Bush clan, collapsed with debts 32 times its capital. The following day, the prestigious US bank Bear Stearns (5th US investment bank) called on the US Federal Reserve to provide an emergency credit line. Bear Stearns is being snapped up by JPMorgan Chase for a mere pittance.

Several branches of the lending market are shaky constructions on the point of collapse. They drag into their misadventures the powerful banks, hedge funds or investment funds through which they were created. The salvage of these private financial institutions requires massive intervention on the part of the public authorities. And thus once again, profits accrue to the private sector, and losses to the public purse.

Which brings us to a key question: how is it that banks can readily waive bad debts to the tune of tens of billions of dollars yet have constantly refused to cancel the debts of developing countries? Why should the one be feasible and the other impossible? It should be remembered that the debts claimed today from these countries go back in the past to criminal dictatorships, corrupt regimes and leaders pandering to major powers and investors.

The big banks lavished loans on such notorious regimes as that of Mobutu in Zaire, Suharto in Indonesia, the

Latin-American dictatorships of the 1970s and 1980s, not to mention the apartheid regime in South Africa. How can the banks persist in inflicting the burden of debt on people who have suffered the consequences of despotic regimes funded by the banks themselves? From a legal standpoint, many of the debts appearing in their accounts are odious and as such should not be repaid. But the banks continue to demand their pound of flesh.

We should also remember that the Third World debt crisis was caused by the drastic unilateral hike in interest rates imposed by the Fed in 1982. Up to then the private banks had been happily handing out variable rate loans to countries that were already over-indebted. The crash came when these countries could no longer sustain repayments. Today history is repeating itself, this time in the North: overindebted households in the US are faced with mortgages that they can never repay as they watch the value of their properties plummet.

The recent waiving of debts by banks can only justify the claims of those who, like the CADTM, demand the cancellation of Third World debt. Why? Because the long-term debt of Third World public authorities towards international banks reached 181.9 billion dollars in 2006 [2]. Since August 2007, the banks have had to cancel a far greater amount, with more still to come.

It is clear that the big private banks have failed in three ways:

– they have built up catastrophic private lending structures that have led to the present disaster;

– they have lent to despotic regimes and forced the democratic governments that replaced them to repay this odious debt down to the last cent;

– they refuse to cancel the debts of developing countries, for whom repayment means ever-worsening living conditions for their people.

For all these reasons, the banks must be held to account for their actions over the last decades. The governments of the countries of the South must make a full audit of their debts, as Ecuador is doing today, and repudiate all debts that are odious and illegitimate. The bankers have shown them that such a step is perfectly feasible. It would also be the first step towards restoring the true role of finance, which is to be of service to men and women. Everywhere, without exception.

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Original at CADTM

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[1] On 7 March 2008 Goldman Sachs research department estimated losses of 1,156 billion dollars, George Magnus of UBS in February floated a figure in excess of 1,000 billion, and Nouriel Roubini of New York University put the figure at 1,000 billion dollars at the very lowest (see http://www.rgemonitor.com/blog/roubini).

[2] World Bank, Global Development Finance 2007.