

# The historical model for the IMF's debt reorganization policy

by Richard Freeman

Since the 1815 Congress of Vienna divided the world up into satrapies of the leading powers of Europe, world debt management has been run on the same colonialist principles: Load a country up with debt, form a creditors' cartel which makes the non-payment of debt the issue to crack a country politically, make it surrender its sovereign right to regulate its credit and finances, and then force it to slash population and industrial and agricultural growth.

Every week a spokesman for the Ditchley Group creditors' cartel or the International Monetary Fund announces yet another "new" plan to reorganize the world's debt and make it more liquid. These "new" schemes are a fraud on two counts: Not only are they as old as the Congress of Vienna, but their real object is to wield the debt as a weapon to gain political concessions and to destroy the nation state.

The colonialist principles worked out at the Congress of Vienna are most apparent during two periods: that from 1874-76 until the commencement of World War I, and that extending from the 1919 post-war Treaty of Versailles until the U.S. stockmarket crash of 1929 and the failure of the Austrian Kreditanstalt in 1931 obliterated the remains of the world monetary system.

The period from 1874-76 to the outbreak of World War I is most often described in history texts as a time in which four Great Powers—France, Great Britain, Germany, and Russia—ruled most of the world through shifting alliances and "spheres of influence." But a real understanding of the period proceeds from the standpoint that the Great Powers game is mostly a chimera, the inter-Power rivalries mostly charade. Standing behind the four Great Powers were the leading banks and insurance companies of each country. Further off-stage, but controlling real power, were the old oligarchical families of Europe and their concentrations of pooled funds—the *fondi*. The *fondi* sought to enmire the rest of the world in debt and achieve the fragmentation of the two rotting empires of the time—the Ottoman and Austro-Hun-

garian empires. The rivalries of the Great Powers often facilitated this break-up, orchestrated by the *fondi*.

The British and Swiss control centers for the *fondi* reorganized the world financial system. Turkey's repudiation of its debt in 1876 created the opening for the reorganization of the Ottoman Empire; a similar process went on in the Austro-Hungarian Empire. The British succeeded in enforcing a strict contractionary gold standard on the world, drawing the wealth of the United States and Germany, in particular, into the service of stabilizing the overextended and world reserve currency, the pound sterling.

## The looting system

The case of Egypt demonstrates how the *fondi* extended credit to a country just long enough to seal it into the vicious cycle of servicing the debt. Nominally a province of the Turkish Empire, Egypt was granted the right to borrow on its own account in 1841. The country borrowed liberally to construct the Suez Canal, which, however, was never allowed to be under Egyptian sovereignty. The Khedive (ruler) of Egypt had inherited a debt in 1863, related to the construction of the canal, of 367 million francs. The imperial banks of Britain and France helped Egypt load up with more debt, so that by 1879 the debt had risen to 1,712 million francs.

Most of the loans that Egypt received were pre-discounted; that is, Egypt did not get the full value of the loan, but usually only three-quarters, two-thirds, or less. The rest was raked off as bank commissions, fees, and counter-balances. This was a universal practice of the lending of the period.

The banks allowed Egypt to borrow until no new sources of revenue could be found. In 1875, despite collection of taxes in advance and selling off of government shares in the Suez Canal, Egypt could find no new income to guarantee the debt. The creditors then demanded from Egypt in 1876 the establishment of a creditors' cartel—just like that formed to handle Brazil's, Mexico's

Called the Caisse de la Dette, the cartel demanded and received a long list of revenues to be assigned as security for the loans: the as-yet-unattached provincial government taxes, the local customs duties of Cairo and Alexandria, the foreign customs of main Egyptian ports, the salt and tobacco taxes, among others. But this was only the start. Other Egyptian assets were attached and placed under international creditors' cartel commissions: the Caisse, the Controllers, the Daira-Sanieh Administration, and the Railway and Port Commission.

In 1880 the powers of the Caisse were extended; it was made into an international body in law and its subordinates were declared exempt from the authority of the Egyptian government. In 1881 the British fomented riots and revolution in Egypt, a new ruler came to power who repudiated Egypt's debts, and the banks responded by having the British government attack and eventually conquer Egypt.

Another case study is Serbia, where the bankers set up a "blocked account" for debt payment—the model for that being put into place in 1983 in Ibero-America by the New York and California banks. Serbia was born as an independent state as a result of the 1878 Treaty of Berlin which partly broke up the Austro-Hungarian Empire. From the standpoint of the banks, a new country is a new juridical entity which can be loaded up with debts. In 1893, Serbia was forced to cede its tobacco monopoly to the Austrian Wiener Bankverein. By 1895 Serbia was 350 million francs in debt. When Serbia exhibited inability to pay the debt, the banks set up a Monopolies Administration, which assigned sources of revenue which were pledged to meet the service of a new debt reorganization loan. A special fund—a "blocked account"—was set up into which revenues would flow earmarked only for debt-service payment. Did Serbia's surrender of its sovereignty stabilize or reduce the debt? On the contrary, it nearly tripled from 350 million francs in 1895 to 903 million in 1914, with the yearly debt service tripling also.

In Romania, after a debt was contracted, the German banks, primarily Diskonto-Gesellschaft and Bleichröder, used it to obtain partial or total ownership of the following Romanian companies: the tobacco monopoly, petroleum, lumber, textiles, locomotives, and electrical equipment production. Similar methods were used in Greece, Turkey, Bulgaria, Persia, Morocco, and other countries.

### **Central banks ran post-Versailles Europe**

During the 1920s, it was central banks, not governments, that ruled the world—according to the provisions of the 1919 Treaty of Versailles. Germany, though perhaps the primary target of the Versailles debt negotiations, was not the only one; ultimately all of Europe was to be brought under central bank control.

Versailles established a complex web of inter-indebtedness. Britain, France, Belgium, Serbia, Yugoslavia, Italy, and other "allied" Powers owed the United States \$9.5 billion

at the war's end for loans the United States had extended to them during World War I. Other European countries owed either Britain or France. Germany, the loser of World War I, owed the European allied powers, principally France and Britain, between \$25 and \$40 billion in war reparations.

When in 1921 Britain placed a 26 percent import tax on German goods, this extinguished the last glimmer of hope that Germany would be able to pay its war reparations, and that these funds could be re-exported by the debtors to the United States to pay off their own war debts. Once Hjalmar Schacht was installed as head of the Reichsbank in 1924, as part of the international bankers' Dawes Plan for German debt reorganization, Germany's fate was sealed.

From 1919 on, world finance was run by central bankers Montagu Norman of the Bank of England and Benjamin Strong of the U.S. Federal Reserve Board. Isolationist sentiment in the United States prevented the federal government from entering into any "entangling alliances," leaving the Federal Reserve to implement foreign policy. Norman and Strong used the Financial Committee of the League of Nations—of which the United States was not a member—as their own private creditors' cartel. Based in Geneva, Switzerland, the Committee had such power that no government could get a loan without its approval.

Norman and Strong flatly refused to deal with national governments, only with central banks—thereby raising the central bank to the status of supreme power. This same rule is being applied today by Federal Reserve chairman Paul Volcker and Bank for International Settlements Chairman Fritz Leutwiler.

Strong and Norman had a standard prescription which they imposed on every European country. Step one was to balance the government budget and end deficit spending. Then the banks would fund most of the government's floating debt. Step three was to adopt a noninflationary monetary policy. Finally, the government had to assure the independence of the central bank and a "reasonable degree" of continuity in its management, to prevent the resumption of "inappropriate monetary policies."

The power of the central banker-run creditors' committee can be seen from the case of fascist Italy. In September 1926 dictator Benito Mussolini delivered a demagogic speech vowing to defend the lira from forced upvaluation. "I will fight for the lira with my last drop of breath and to my last drop of blood," he said. "Upon this wonderful people of Italy that for the last four years has been toiling in self-denial and is ready for further sacrifices, I will not inflict the moral humiliation and the economic calamity of the bankruptcy of the lira." But after Norman and Strong had met with Italian Finance Minister Volpi and outlined the terms Italy would have to meet to get a new loan, Volpi announced a reduction of Italian prices by a third, wage reductions, and the upvaluation of the lira by a whopping 67 percent—Mussolini's protestations notwithstanding. Then Italy got its loan.

Poland was held hostage by the banks at the end of World War I for a measly \$25 million loan to get the war-ravaged economy back on its feet. Poland had four different depreciated currencies in different zones of the country—German marks, Austro-Hungarian kronen, Russian rubles, and German-Polish marks. Norman and Strong created a new currency, the zloty. But they held up the loan *until 1927*, when the Polish government finally agreed 1) to renounce the right to issue any paper currency, entrusting that instead to the central bank, 2) to run budget surpluses, 3) to restrict part of the loan “to increase the capital of the Bank of Poland,” and 4) to accept a foreign adviser on the board of the Bank of Poland. Poland complied, surrendering its sovereignty.

Romania was forced to agree to pay off tens of millions of dollars of prewar debts before Norman and Strong would allow it to tap the international credit markets.

In 1924 Norman and Strong decided to put heavily-indebted Europe under the discipline of a contractionary gold system. Britain joined the gold standard in 1925—after shutting down a section of its industry—and other European and eastern European countries were forced to join the gold standard before they could get new loans. The contractionary gold standard within a Europe bloated by escalating levels of interindebtedness was the perfect recipe for disaster, which hit fully with the 1931 Kreditanstalt collapse.

The same deflationary recipe is being demanded again today to solve Ibero-America’s debt problems.

### **The *fondi* vs. the United States**

Since 1876 the *fondi* have used the U.S. dollar as the instrument to bail out the world monetary system. Never during this time has the dollar been under the sovereign control of the U.S. government, nor has it been used, as it should be, to finance world trade and industry.

Starting with the Specie Resumption Act of 1875, the U.S. currency was placed on a gold standard and made a junior partner to the pound sterling—an arrangement which allowed the pound to attach the dollar’s wealth. In 1913 the U.S. Federal Reserve was created for the express purpose of financing Britain’s role in World War I.

At the Versailles peace conference, the dollar was internationalized. New York became in 1924 the chief lending market for world debt management.

After World War II the dollar was made the international debt currency, and a huge mass of claims arose against it, now totaling \$1.7 trillion on the Eurodollar market—threatening the dollar with bankruptcy if the system collapses. In November of this year, the dollar once again was called upon to bail out the *fondi*: the U.S. Congress was blackmailed into allocating an \$8.4 billion bail-out to one of the chief instruments of the *fondi*’s creditors’ cartel, the International Monetary Fund. Now the *fondi* plan to bring down the overextended and overexposed world dollar system and the United States with the same surgical precision they used to topple the Ottoman and Austro-Hungarian Empires 100 years ago.

## **Banks defy sovereignty,**

by Christian Curtis

“They may *think* they can take over our assets,” a senior executive in a Brazilian state firm said angrily when told by *EIR* of the objectives of the bankers’ cartel. “But they’re crazy if they think they can get away with it.”

The banks, however, are getting away with it. The scheme is being sold under the rubric of “debt relief.”

Within the past 16 months, Ibero-America has been transformed from a region of immense development promise into a group of economies with the profiles of classical colonies. These nations have become record net exporters. Their revenues are funneled entirely to the world financial centers. Their currencies have been devalued by up to 2,000 percent, which has made imports practically prohibited and has turned their governments from sovereign economic powers into mere administrators for foreign interests. Simultaneously, these governments have signed away sovereignty through contracts that grant foreign banks access to state sector assets, submit their citizens to the jurisdiction of foreign courts, and allow creditors to buy up national resources at ever-cheaper prices.

At the same time, contrary to those Ibero-American leaders who think they are “getting by,” the debt bill continues to grow through refinancings, and no principal is being retired. Beginning roughly in the first quarter of this year, even interest payments were falling into arrears (see **Figure 1**).

Ibero-America is ripe for colonialist looting. It will be relatively easy for the creditors to compel the Ibero-Americans to surrender equity—mineral deposits, land, tax liens, utilities, plant, and equipment—in exchange for “generous” concessions on terms and interest rates.

Almost every debtor had its late 1982-83 principal payments rescheduled—either formally or de facto through moratoria and rollovers—usually over eight or nine years. Is this relief? Quite the contrary. The patterns of trade and currency devaluations shown in the accompanying graphs explain the real cost Ibero-America is paying to have its debt “stretched out.”

The crucial point is not the absolute amount of debt falling due over a given period, or even the rate of interest. Rather it is *how much of a debtor’s earnings are devoted to servicing*