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The way out of the debt crisis . . .

By Hyman P. Minsky

A competent banker's main question when a loan is being negotiated is, "How are you going to get the money to service and repay the loan?" If the negotiators agree that the prospective receipts exceed expected operating expenses by a satisfactory margin, the loan will be approved; if not, it will be rejected.

It is now evident that when the Latin loans were made the great bankers of the world did not ask the essential questions about prospective cash flows or if they asked, they accepted soft answers.

The burden of the Latin debts is forcing unemployment and impoverishment of already poor countries. The repercussions of the banking crisis may threaten the prosperity of the creditor countries. Innocent bystanders are likely to pay a high price for the avarice and incompetence of the great bankers.

Debts that now threaten the world's prosperity are mainly, though not exclusively, denominated in dollars. If interest (let alone the principal) is to be paid, the debtor countries must, sooner or later, earn a surplus of dollars through their international trade accounts. Borrowing or selling assets to pay what is due only moves the basic problem of earning a surplus into the future.

But for the debtor countries to earn a large enough surplus in dollars on their current trade and services account so that they can meet their commitments, the United States must furnish dollars by a deficit on its trade and services accounts that is at least as big as the interest on the debts.

Today's dollar-denominated international debts are viable only if the United States runs a huge deficit on traded goods and services. The emergence of a huge deficit on current trade forces unemployment on some workers and distress on some firms. This quite naturally leads to defensive political reactions and demands for protection.

If effective quotas and "volunteer" export restrictions are imposed on some goods, then U.S. imports of these protected goods decrease, creating a global dollar shortage. This will trigger market reactions that raise the exchange value of the dollar against almost all currencies, lowering dollar prices of imports. This exchange rate effect of a successful program of quotas and export restrictions leads to new U.S. markets being penetrated by imports; unemployment and distress spread.

The International Monetary Fund (IMF) is trying to get Argentina to agree to what is by now a standard program of fiscal and monetary constraint, which imposes a deep recession upon debtors. This was done to Mexico and Brazil in 1982-83, and they still have not recovered. Argentina is balking.

If Argentina is forced to accept such a program, its share of the global pool of dollars made available by the U.S. trade and services deficit may increase. But it will not increase the global pool of dollars, unless imports conquer some additional United States market.

International Monetary Fund programs to "save" a particular debtor's currency lead to a shift of dollar earnings among countries. The IMF does not solve debt problems; it imposes beggar-my-neighbor policies upon the country in crisis that lead to other countries going into crisis: Mexico getting healthy leads to Argentina getting sick, Argentina getting healthy leads to the Philippines getting sick, etc.

The center remains the United States. If the United States is able to achieve a close approximation to full employment in the face of the need to run large deficits on current trade and service accounts and simultaneously have interest rates that are substantially below current rates, then the international debt problem is more than manageable; it will disappear.

If, however, the need for a large international deficit implies U.S. unemployment and recessions unless the government runs a huge deficit, which in turn leads to high and rising interest rates, then the IMF approach leads to the international debt crisis migrating from one country to another until either defaults or "concessionary" loans, (which require subsidies from the United States treasury) reduce the global dollar cash flow that is needed.

Thus the "international" financial problem of 1984 comes down to whether th United States can achieve a close approximation to full employment and low interest rates even as it runs an international deficit large enough to provide the funds that are needed to service international debts.

The IMF points an accusatory finger at the debtor countries and requires that they mend their ways. However, the global problem is beyond the present control of the accused. They were victimized by the merchants of debt in the 1970s.

For the IMF to be even-handed it would need to impose conditions on the United States, in whose currency the debts are denominated. These IMF conditions would require the United States to maintain full employment without inflation even as it maintains free access to United States markets.

The hypothetical IMF condition describes the situation that ruled from 1949 through the mid-1960s. At that time, the United States was characterized by a robust financial structure that was largely the legacy of the Great Depression and the Great War.

Today's Latin financial crisis points to the need for the capitalist world to go through the economic equivalent of a great depression or a great war without actually experiencing either, so as to once again achieve a robust financial structure. Unfortunately no one knows how to do that; "if," as Portia remarked, "to do were as easy as to know what were good to do, chapels had been churches, and poor men's cottages princes' palaces."

(Hyman P. Minsky is professor of economics at Washington University in St. Louis.)

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