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## THE 1953 LONDON AGREEMENT - LESSONS FOR NEW TRADE AND DEBT POLICIES BETWEEN DEBTORS AND CREDITORS

### ★ SUMMARY

This study examines the judgement underlying the London Agreement, that successful debt regulation must be followed by changes in trading policy by both creditors and debtors. The London Agreement recognises the economic reality that, in the long term, a country can only free itself from foreign debts through a surplus in the balance of trade. It is therefore logical that creditors need to take active steps to enable balance of trade surpluses in debtor nations. Corresponding deficits for creditors (i.e. industrialised countries) are the logical consequence of this reality. The London Agreement showed that this kind of calculation in trade policy is a necessary component in any integrated, long-term debt relief. Even more important, however, was that after this 'insight into what was necessary', the political will was there on the part of both creditors and debtors to translate the concessions made on paper into reality. The development of West Germany's trade links with its creditors are an impressive witness to this.

This study transfers this experience of the necessity of a balance of trade surplus to the present day situation between creditor and debtor nations. The debt service of 66 debtor nations to the governments of 19 significant creditor nations will be examined. It becomes apparent that of these 66 debtor nations, 45 have a habitual trade deficit with the group of 19 creditor nations, and that there is therefore no realistic perspective of them ever being able to free themselves from their burden of debt in an orderly way. As far as the remaining 21 countries are concerned, their balance of trade surplus is not always large enough to cover the debt service owed to the creditor nations. The situation looks even worse when we consider that neither the debt service owed to private creditors (in particular private banks, investment and pension funds etc.) has

been taken into account at all, due to a lack of data on individual liabilities, nor has the debt service owed to multilateral creditors (amongst others the IMF and the World Bank) been taken into account either, due to there being no historical comparison which could be drawn. The 'basic principle' of a balance of payments surplus is, in practice, simply ignored by the current creditors. To put it another way, the indebted developing countries are not being offered any option of release from their indebtedness in an orderly way through a balance of trade surplus. Instead, the policy of refinancing debt servicing through capital inflow (in other words further indebtedness), which has already failed in the 80s, is simply being continued. If the creditors themselves don't want to be the main reason that the debtors are unable to meet their liabilities, then they will have to make concessions in their future trading policy.

This study, therefore, makes a number of suggestions as to how the creditors, in cooperation with the debtors, could pursue a serious and consistent integration of debt and trade policies in the spirit of the London Agreement. For that to happen, the creditors would have to open their markets to exports from the debtor nations. This would also include an opening of the agricultural and textile markets, which have been highly protected up till now, as well as the creation of realistic access to marketing outlets which are often controlled by a small number of multinationals. And finally, a limit should be set to the net creditor and debtor positions, so that the gap between the debts of the poor and the assets of the rich does not continue to increase.

### ★ INTRODUCTION

When one makes a connection today between the management of international debt today and the

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discussion of possible solutions to debt and financial crises, and the London Agreement of 1953, then this initially appears to be surprising and inappropriate for two main reasons. Firstly, the agreement is nearly 50 years old and belongs to the historical context of the post-war and cold war era, which seems to be a very long way away from the current situation. And secondly, the then debtor, the Federal Republic of Germany, has now become a significant international creditor. So why should anyone refer to the London Agreement of all things?

The answer lies in the fact that the London Agreement is one of the few historical examples which show how circumspect and long-lasting debt management can be when, on the one hand, the creditors have the political will to find a serious solution to a debt crisis, and on the other, the problem of debt is not seen in isolation from the international and political context. This claim is already clearly expressed in the preamble to the London Agreement as a desire

**“to remove obstacles to normal economic relations between the Federal Republic of Germany and other countries, and thereby to make a contribution to the development of a prosperous community of nations.”<sup>(2)</sup>**

Now we all know that expressing an intention is one thing, and there is no shortage of expressions of good intentions these days. The London Agreement is not, however, content with these general statements but goes on to suggest specific ways in which the creditor countries and the German federal government could contribute to a successful implementation of debt regulation by appropriate foreign exchange, finance and trading policies. Now it is also the norm today that debt problems are not tackled independently from economic policy measures. The economic reforms demanded of debtor countries by creditors as a necessary condition for a renegotiation of the terms of debt and for debt reduction (conditionality) have achieved a sad notoriety under the name of Structural Adjustment Programmes.

The particular character of the London Agreement lies in the fact that the economic policy measures embod-

died in it affect not only the debtor, the Federal Republic, but that the creditor countries also declared themselves prepared to make concessions. The London Agreement poses an alternative to the contemporary prevailing pressure on debtors to comply with the creditor's conditions, a highly relevant alternative.

This study will concentrate above all on the connection between debt and trade policies, as set out in the London Agreement. While the Structural Adjustment Programmes currently being imposed by the creditor countries, and by institutions such as the IMF and the World Bank which are under their control, concentrate exclusively on the demand for exports by the creditor countries, Germany's creditors in the 1950's committed themselves to the import of those German products which were being supplied to international markets. The last twenty years have shown only too clearly where it leads when debtor countries increase their production of goods for export, but creditor countries do not want to increase their imports. In this situation debtor countries do increase the supply on the world market, but then creditor countries either refuse to buy the increased supply or only buy it at a considerably reduced price. The ultimate implication of this is that the debtor countries can only export their increased quantities of export goods at reduced prices and so often receive hardly any increase in income, despite considerable extra effort. They divert an increasing proportion of their resources into the economy (for example, in agricultural acreage or labour) into export production which limits the production, for example, of basic foodstuffs for their own population (who are often suffering from starvation). They receive hardly anything in return for these restrictions because the drop in prices triggered by the increase in internationally available supply swallows a large proportion of the increase in volume. So every extra dollar or euro earned in this way is connected to an extreme and, in economic terms, inefficient waste of resources. Today we have a better understanding than ever before, that this 'waste' and 'exploitation' of resources is a significant driving force of ecological and social destruction. The response of market economic theorists to this would be that inefficiency and destruction have less to do with an increase in exports than with the choice of products for export. The debtor countries shouldn't just

<sup>2</sup>The Agreement and its appendices were published trilingually in the Bundesgesetzblatt 1953, Part 2 p.333ff.

export more and more untreated coffee and copper ore, they should specialise in top quality espresso and telephone cable. However, anyone who knows about the trade barriers in the creditor countries, both in terms of tariffs (customs duty) and also non-tariff barriers, such as quotas, safeguards, norms, health regulations, the control of markets by oligopolies etc., would be clear that that kind of advice is often miles away from the reality of things.

The necessity for a connection to be made between debt management and trading policy is also easy to demonstrate in another way. From the perspective of a debtor country, international indebtedness can take two forms. The first is debt in its own currency, that is, indebted firms or the state are paying interest and repayments in their own currency. The best example of this type is the USA which is able to pay its debt service to foreign creditors, even under the adverse conditions of a great economic crisis, because it is in possession of the US\$ bill printing presses.

The second form is far more serious as it involves payment in foreign currency. Then, in addition to the problem of finding the resources for debt servicing in domestic currency raised in the previous paragraph, there is the additional demand of transferring this debt service to the creditors in hard currency (the transfer problem). The US\$, euro or yen necessary for interest payments and principal repayments can only be acquired by debtor countries if they sell more goods abroad in return for hard currency than they spend abroad themselves. By contrast, the currently much practised method of simply servicing old debts with foreign loans is obviously no solution to the problem, as the debts then increase every year, either in absolute terms in the amount of interest payments or the proportion of average interest rate of foreign debt increases.

Although there are two economic development models which consider an increase in foreign debt for a temporary period to be quite bearable, or even desirable, this sort of strategy can obviously not function in the long run.

If the debtor nations have to service their debts by their own efforts, then this will only work on the basis of a surplus of exports over imports; in other words a balance of trade surplus. This brings us to the level of a balance mechanism.

If one regards the world as a closed trading system, it should be obvious to everyone that the total of all the trade balances of every country must be nought. If individual countries aim for a balance of trade surplus, then this automatically means an import surplus for others. If debtor countries are not to fall into deeper and deeper indebtedness then, logically, the creditor countries will have to have balance of trade deficits in relation to the debtors. The 66 countries examined in this study, taken as a group, did not manage in even one single year between 1980 and 1998 to achieve a surplus in relation to the 19 creditor countries taken as typical here. In total, the 66 debtor countries showed a deficit of nearly 315 thousand million US\$ in relation to the 19 creditor countries between 1990 and 1998, of which more than 260 thousand million was incurred in the last 5 years alone. These figures provide little hope for immediate improvement.

Of course one can't draw any general conclusions about individual countries from this, as both the creditors, and in particular the debtors, include very different countries.

So this study begins in the first part by taking stock of the London Agreement and its message and implications for trading policy.

In the second part, the principles established by the London Agreement are applied to the current situation of debtor and creditor countries. How do creditors and debtors need to reorganise their current trade links in order to come closer to a sound solution to the debt crisis? The study attempts to give a variety of answers to this question as a contribution to a lively discussion.

Part two is based on data concerning foreign trade and indebtedness from a total of 66 debtor and 19 creditor countries. The 19 creditor countries were selected on the basis that data was available concerning their bilateral demands and the corresponding debt service payments. (cf. EURODAD 1996).

The criterion used for the choice of indebted developing countries was that from 1993-1997 they spent, on average, more than 5% of their export earnings on debt servicing and count as moderately or highly indebted countries with low or moderate incomes according to

the World Bank criteria. Fixing the level at 5% was determined by the Erlassjahr 2000 campaign's use of 5% as an indication of the existence of a debt overload.<sup>(3)</sup>

In its most recent report, the World Bank (World Bank 1999) uses the figure of 74 developing countries (not including the European and central Asian region) which it considers are moderately or highly indebted. 66 of these countries in fact exceed the debt servicing

quota barrier of 5%. Since many of the poorest countries are way behind their contractual obligations as regards debt servicing, one can assume that the number of countries whose debt servicing quota lies over 5% is much higher. This applies, above all, to countries who are paying practically no debt service at all due to civil wars (e.g. Sudan, Somalia, Liberia etc.). A list of the 66 countries is given in part 2.

## **PART I** The message of the London Agreement for trading policy

### **1. The London Agreement: an overview**

The London Agreement of 27<sup>th</sup> February 1953 dealt with the public and private pre-war German debts which the Federal Republic of Germany had taken over as the legal successor to the Third Reich, as well as those debts owed by private west German debtors remaining from the pre-war period (in particular, business debts and trading agreements). In addition to that, the post-war debts incurred through foreign economic assistance (in particular the Marshall plan) were also dealt with.

A central aim of the agreement was to consider all the different commitments made to all creditors when making the overall settlement. With this in mind, the agreement included the commitments to 20 creditor nations, the BIZ and private creditors. As far as the debtors were concerned, it was concerned with both public and private commitments. An important trigger for the beginning of negotiations about the German foreign debt problem was the condition set by the western occupying powers that an end of occupied status would only occur if the debts of the Third Reich were recognised and adopted. The western allies formulated a draft document in the autumn of 1950, in which the German federal government was to accept responsibility for these debts. In the accompanying letter to this document of 23<sup>rd</sup> October 1950 the Allied High Commission (AHC) consisting of the French, British and US governments already recognised:

**“The three Governments are in unanimous agreement that the plan should involve a**

**regulated settlement of the claims to be made on Germany, the total effect of which should not be allowed to throw the German economy off balance through undesirable repercussions in the domestic financial situation, and should not make excessive claims on Germany's actual or potential foreign currency reserves. The three governments are confident that the Federal Government shares this view, in the light of which it would be desirable to restore Germany's credit and provide for an orderly regulation of Germany's debts, which would safeguard fair treatment of all those involved and take Germany's economic problems fully into account.”**

In March 1951, the federal government announced an acceptance of responsibility for pre-war debts. The western allies, who in the meantime had set up a ‘Tripartite Commission on German External Debt’, then suggested procedures for a possible negotiated settlement of pre- and post-war German debt. It was already apparent at this point that they were prepared to forgo some of their claims resulting from the post-war economic assistance if there was sufficient willingness to make concessions on the part of both debtors and creditors.

The negotiations themselves were then divided into four stages.

Initially, the three power commission worked with the German government to produce an initial framework for decisions as to which debts for what amounts exi-

<sup>3</sup> Cf. Erlassjahr 2000 (1998, pp.14, 35), Hersel (1998)

sted and should be included in negotiations and how, for example, the German transfer ability could be assessed. These first negotiations took place in Bonn in June 1951 and were firmed up under the heading of 'First Talks.'

In a second step, the four governments were joined respectively in the negotiations by representatives of the private creditors from France, Great Britain and the USA, and by both government and central bank representatives from Belgium, the Netherlands, Sweden, and Switzerland, to consider the previously mentioned initial framework. There were also representatives of the German private debtors present. These discussions took place in London from the end of June to July 1951 under the respective headings of 'Initial discussions about German debts' and the 'Preliminary Conference'. In the third stage, the pre- and post-war debts were negotiated separately. This separation arose from the fact that the pre-war debts were almost exclusively owed to private creditors by both private and public debtors in the Federal Republic. Whereas the post-war debts to be negotiated resulted mainly from the economic assistance given to the Federal Republic by the western allies (the Marshall plan, GARIOA<sup>(4)</sup> etc.) and therefore consisted exclusively of debt arrangements between governments, in other words bilateral public debts. While the negotiations concerning the post-war debts only involved a manageable number of parties, at the 'Main Conference concerning German Foreign Debt', where negotiations concerning the pre-war debts took place in February 1952, countless representatives of different significant private debtors and debtor groups, of creditor representatives and central bankers came together from a total of 26 countries. The governments of the Three Power Commission took the role of moderators who supported the negotiating process between private debtors and creditors. The federal government, however, had to fulfil two roles, because it was there as the state supporting the interests of private German debtors, but was also negotiating on its own behalf as the largest debtor represented.

The results of the main conference were published in August 1952 as 'Report of the Conference on German External Debts'. This document consists of a relatively

short general part and several appendices. In these appendices, the agreed rescheduling arrangements and withdrawal of demands for the individual debt agreements are listed and arranged in four categories.

Appendix 1 deals with public debts, Appendix 2 with private loans, Appendix 3 with standstill debts and Appendix 4 with trade and other miscellaneous debts. (For a more detailed description see: Abs (1959; 1991, pp.1-53); Gurski (1955, pp.17-38).)

These appendices took the form of recommendations and draft resolutions for the fourth and last step of the negotiations: the drawing up of a governmental agreement. It only took effect with the adoption of the appendices as elements in a legally binding governmental agreement under international law. This governmental agreement was negotiated between autumn 1952 and February 1953 and consisted principally, in addition to the adopted recommendations of the main conference, of further clarification of questions of international law; like, for example, provision for a resumption of negotiations in the event of a reunification of Germany or various mechanisms for the arbitration of disputes. The governmental agreement 'Report of the Conference on German External Debts' was signed in London on 27th February 1953. At the same time, the agreement between the federal government and the western allies, which had been produced concurrently, was completed. So, to be precise, its not a case of the 'London Agreement' but of the 'London Agreements'. All future references to the 'London Agreement' refer to the agreements on both pre- and post-war debts in their entirety.

The material result of the London Agreement was a drastic reduction in the debts of over 50% of their original value and the extension of the remaining commitments over a long period.

Depending which data base and form of measurement are used, the amount of debt reduction is calculated at a different level. This is because it is impossible to determine the exact extent of the pre-war debts.

Depending whether the calculations are made on the basis of Gold Marks or Reichsmarks they result in very different amounts when expressed in DM.

Furthermore, it was often impossible after the war to

<sup>4</sup> Government Appropriation for Relief in Occupied Areas. The first US aid programme, June 1945, for the prevention of starvation and epidemics in post-war Germany. In general discussions it was often included under the heading of the Marshall plan.

determine whether the original debtor (and sometimes also the creditor) - whether firms, private individuals or public bodies - was still in existence or, in the case of individuals, alive. In individual cases it was equally difficult to separate the local government debts. So the debts owed by local authorities in the GDR were not covered by the London Agreement. The situation as regards Berlin or Prussia was also difficult. The stoktaking was further complicated by the fact that the pre-war debts had not been serviced for a long time. Does the backlog of interest theoretically have to be added to the total amount of debt when measuring the reduction of the original amounts? <sup>(5)</sup> If so, for which period? Do backlogs of interest due which have not been called-in count as debt reduction?

One has to keep these unknowns in the back of one's mind when one mentions a specific amount for the original level of pre-war debt. Usually, the debt total without the backlog of interest is reckoned to be 13.5 thousand million DM, of which public debt comprised 7.7 thousand million and private debtors were responsible for 5.8 thousand million. The backlog of interest is sometimes estimated to be amounts of up to 2.6 thousand million DM (Gurski, 1955, p.25 cf. Kampffmeyer, 1987, p.55).

In contrast, the post-war debts are relatively easy to calculate, at 16.2 thousand million DM. The amount of pre-war debt was reduced to 7.5 thousand million DM (including a small amount of backlog of interest), and the post-war amount to nearly 7 thousand million by the London Agreement. The German federal government took over responsibility for public debts to the tune of about 11 thousand million DM, together with their share of the pre-war debt of nearly 4 thousand million DM. The remainder of 3.5 thousand million DM was shared between German private debtors (cf. Bank Deutscher Laender 1953, p.82).

The following repayment terms were agreed on the basis of the remaining debts (converted into DM): after five repayment free years (the annual total of interest due from 1953-1957 being 567.2 million DM) an annual debt service of 765 million DM was to be paid to the creditors from 1958, which was divided into commitments in both German and non-German currencies. The possibility of early repayment was agreed on, as

well as an arbitration procedure for possible disputes concerning the implementation of the agreement. The most important basis for measurement for the agreed debt service was the Federal Republic's transfer ability at the time of the negotiations. "That means that debt service payments on frozen DM accounts, which would have had to be transferred after the lifting of the foreign exchange controls were waived." (Kampffmeyer (1987), p. 52)

This arrangement led to radically equal treatment of private debtors and creditors. Because of the restricted transfer ability of the Federal Republic, the recommendations for a reduction in the backlog of accrued interest (of 33%) and in the future interest payments (of 25%) also counted for the loans of those German private debtors who, as profitable concerns, would have been quite capable of paying their original foreign currency debts and their debt backlog in the domestic currency. Private debtors were even granted corresponding rebates in instances where debts had been incurred in Reichsmarks and, according to the agreement, were to be serviced in DMs. This general rule was the only possibility of providing a solution to the very different categories of debt that would be both acceptable and practicable, due to the countless competing creditor interests.

The aspiration of the London Agreement to mediate between as many creditor and debtor parties as possible and to find a compromise was expressed in para. 11b of the final report of the main conference. The Agreement should

**“ (i) take into account the general economic position of the Federal Republic and the effects of the limitations on its territorial jurisdiction; it should neither dislocate the German economy through undesirable effects on the internal financial situation, nor unduly drain existing or potential German foreign exchange resources, and it should not add appreciably to the financial burden of any of the three governments; (ii) provide for an orderly overall settlement and assure fair and equitable treatment of all the interests affected.”**

<sup>5</sup>This is, at any rate, normal practice in the case of partial debt relief by members of the Paris club. Paris club is the place where the creditor governments coordinate their debt policy.

## 2. Trading policy considerations and regulations of the London Agreement

The following will look in more detail at the considerations concerning trading policy raised during the negotiating process and the regulations which relate to this set down in the agreement. As the Allied High Commission conceded in their letter of 23<sup>rd</sup> October 1950 already quoted above, the main creditors were quite clear that the Federal Republic only had a restricted ability to raise or transfer funds. In a discussion paper for the 'first talks' in June 1951, the Allied High Commission already hinted at their insight into the necessity of concessions being offered by the creditors. Although the Federal Republic could be expected to resume debt servicing under appropriate conditions

**“On the other hand the extent of German pre- and post-war debts would be out of all proportion of Germany’s expected ability to pay. In view of these factors, a realistic treatment of the problem on the part of the creditors will be necessary and this would probably involve a corresponding adjustment of the conditions.”**

This willingness to make concessions included a willingness on the part of the western allies to give priority to the debts incurred in private trade agreements which matured after 1945 over the servicing of what was owed to them as a result of the post-war economic assistance, if there were balance of payments difficulties, even before the settlement in the London Agreement, so that the already very restricted access of West German firms to international trade credits was not entirely cut off (Letter to the AHC 6th March 1951 in *Deutsche Auslandsschulden*, 1951, p.12). The restoration of German access to international capital markets was a central political aim of the allies as much as for the Federal Republic. However, for that to happen, a stabilisation of the German balance of payments was necessary, which the agreed opinion was would be more likely to be achieved through a strengthening of German exports than by the restriction of foreign imports. Although the AHC assessed the long term German transfer ability as very positive (*Deutsche Auslandsschulden*, 1951, p.17), a partial waiving of

their claims by creditors at the London negotiations, in the interests of a speedy resolution of the problem, was preferred to simply waiting for better times. The reason for this was obvious: the creditors were not just concerned with the implementation of their demands, but rather with the quickest possible integration of West Germany into the western international economic and security structures.

West Germany’s transfer ability was given a great deal of attention in the London negotiations. Indeed the creditors considered what they themselves could do to promote German transfer ability. It was obviously clear to them that an increase in the sales of German goods abroad depended on the participation of a second party abroad; a foreign buyer. In a discussion paper produced in July 1951 on ‘The question of Germany’s ability to pay’ which the Three Power Commission presented as a contribution to the preparation for the London Preliminary Conference it is stated that:

**“Germany’s ability to pay depends not only on the ability of private and governmental debtors to raise the necessary amounts in DMs without inflationary consequences, but also on the ability of the national economy to cover the debts out of the current trade surplus. ...**

**The examination of Germany’s ability to pay requires the investigation of a variety of problems including:**

- (a) Germany’s future production capacity with particular consideration of the production capacity for export goods and the ability to substitute the products currently imported.**
- (b) The possibility of selling German goods abroad.**
- (c) The probable future German trade conditions.**
- (d) The internal fiscal and economic measures in Germany required to ensure an export surplus.”**

(*Deutsche Auslandsschulden*, 1951, pp.64ff.)

Points b) and c) at least touch very clearly on the question of markets and purchasing conditions for German goods abroad. But points a) and d) have something to say on the subject too. When the governments of the Three Powers Commission ask, in connection

with point a), about the extent to which the Federal Republic can replace currently imported products with domestic production, they are obviously prepared to reduce their own exports by the corresponding amounts, since these three countries alone provided over 41% of German imports in 1950-51. If one includes the share of imports provided by the other creditor countries represented at the Preliminary conference (Belgium, the Netherlands, Sweden, Switzerland) this proportion rises to 66%. Point d) can be understood in the same way. Classic government measures, designed to ensure an export surplus, are either open or hidden subsidies, or a devaluation of domestic currency. In both cases the export surplus is achieved at the expense of the foreign competition. It would certainly be going too far to regard point d) as an encouragement to the federal government, on the part of the creditors, to subsidise the German export sector. However, point d) does express the general attitude of the creditors that a debtor may legitimately actively pursue an increase in export output, in conjunction with the emphasis on the necessity of "covering debts from the current foreign balance of trade". That such a policy, given the similarity in export products between debtors and creditors, will lead to a reduction in exports for the creditors, is inevitable. If one takes point d), with this in mind, as the expression of a economic policy attitude, this partly explains the great patience which the creditors, as members of the IMF, showed in relation to Germany's monetary policy. With reference to the permanent trade and invisibles surpluses of the federal republic, the other industrial countries could otherwise have been far more insistent on the necessity of a revaluation of the DM. The mercantile undervaluation strategy followed by the federal republic was accepted relatively patiently.

Certainly it was not only the creditors who raised the subject of the problem of transfer ability and the German balance of payments balance. The German delegation also obviously argued for an increase in the foreign trade surplus. Hermann Josef Abs, the leader of the German delegation, expressed this very clearly in the course of the preliminary conference.

**"The transfer question is above all so difficult and complex because its solution cannot be based solely on the observation and evaluation**

**of already given facts, but is largely dependent on the future economic policy of all the countries involved. One can quite rightly expect from Germany, the debtor country, that it will do all in its power to develop its transfer power. But it is also up to the creditor states and the trading partners to create substantial favourable preconditions for an increase in German transfer ability."** (Deutsche Auslandsschulden, 1951, p.45)

But Abs addresses the creditors in this way for a further reason. He saw a successful debt arrangement as a necessary prerequisite for being able to regain access to foreign trade credits, which in their turn would represent an important condition for any increase in transfer ability. In addition, he gave a reminder that simply adding up the receipts of foreign currency, as the Federal Republic was doing during the negotiations, left important things out of consideration. On the one hand, the Federal Republic continued to receive further foreign economic assistance during this period, which would soon be coming to an end, and on the other, completely new expenses were in store for the federal republic as a result of the cold war, since they would be involved in the cost of strengthening the allied forces in West Germany.

These two circumstances had already been repeatedly admitted by the creditors as well. For example, Sir George Rendal, the Chairman of the Three Power Commission, declared at the beginning of the Preliminary Conference, with reference to the representatives of private creditors, that

**"one must be aware of the difficulties which Germany was facing in respect of its budget and also its balance of payments. It would also have to be recognised that that Germany was still receiving foreign aid and that new problems would arise with reference to Germany's contribution to the defence of the west, and in connection with the increase in allied forces in Germany. That would inevitably lead to a limitation in the level of payments in the near future..."**

We must therefore avoid coming to an arrangement that would put the German balance of

payments under so much pressure that Germany would be driven to introduce discriminatory and restrictive foreign exchange and trade policies, which had led to such unhappy consequences as we had experienced in the thirties.” (Deutsche Auslandsschulden, 1951, p. 35)

From all this one can draw the conclusion that by the middle of 1951 at least the French, British and US governments were aware of the transfer difficulties and they saw the support of a German trade surplus as the only possible solution, or at least not actively to fight it.<sup>6</sup>

This view also prevailed in the larger group of negotiating parties during the main conference. The final report of the main conference in August 1952 states:

**“The Conference recognised the principle that the transfer of payments under the Settlement Plan implies “the development and maintenance of a balance of payments situation in which those payments, like other payments for current transactions, can be financed by foreign exchange receipts from visible and invisible transactions so that more than a temporary drawing on monetary reserves is avoided. In this connection, due consideration should be given to the fact that the convertibility of currencies has not yet been re-established. The Conference therefore recognised that the development and maintenance of this balance of payments situation would be facilitated by the continuance of international cooperation to promote liberal trade policies, the expansion of world trade and the revival of the free convertibility of currencies. It recommends that due account should be taken by all concerned of the principles referred to in this paragraph.**

**Transfers of interest and amortisation payments due under the Settlement Plan should be treated as payments for current transactions and, where appropriate, included in any arrangements relating to trade and/or payments between the Federal Republic and any of the creditor countries, regardless of whether such agreements are of a bilateral or multilateral nature.”**

Hans Gurski (1955, page 265), who was himself involved in the negotiations in London as a representative of the Federal Finance Ministry, explains the choice of words ‘payments for current transactions’ in his legal commentary on the London Agreement. The term was “obviously taken from the Articles of Agreement of the IMF” and refers to the “enforcement of payments and transfers for current international transactions”. In chapter XIX (i) of the agreement on the IMF, which the Federal Republic also joined in 1952, it states: “Payments for current transactions means payments which are not for the purpose of transferring capital”.

The payment of the debt service through capital inflow, for example through an influx of foreign currency through direct investment from abroad is thereby consciously excluded. Instead, both interest payments and principal repayments were to be financed through a current surplus in both the balance of trade and the balance of invisible earnings. Since the interest being paid abroad appeared as a large item of expenditure in the invisibles balance of the Federal Republic, these would have had to be significantly overcompensated for in the balance of trade. This overcompensation would arise from the fact that repayments, which would otherwise count as reimbursement for previously received capital inflows and so appear in the capital balance, should be met from the trade surplus.

The government agreement of February 1953 explicitly recognises these principles of the main conference. Paragraph 9 of the preamble states, with reference to the final report of the main conference, “that the present agreement has been inspired by the principles and objectives set forth in the above mentioned report”. This recognition becomes even more concrete in articles 9 and 34 of the agreement. Article 9 is taken almost word for word from Article 22 of the conference report quoted above:

**“transfers of interest and amortisation payments made under the present Agreement shall be treated as payments for current transactions and, where appropriate, provided for in any bilateral and multilateral arrangements relating**

<sup>6</sup> See also the “Report of the Committee for ‘Questions of Principle’” of the London preliminary conference 20th July 1951 (Deutsche Auslandsschulden, 1951, p.193)

### to trade or payments between the Federal Republic of Germany and the creditor countries.”

According to that, the German debt service to a creditor country should be seen from the German point of view as real imports, in the case of bilateral payment and trade agreements.

“A commitment ,or rather a claim - depending on your point of view - to an active trade balance in relation to the respective contractual partners, would thereby be justified, since the full implementation of these guidelines would mean a German balance of payments surplus of the same magnitude as the amortisation payments.” (Kampffmeyer 1997, p.53)

If this had been thought through to its conclusion, theoretically there could have been a case made for a German trade surplus not only in relation to the creditors seen as a group, but also in relation to each individual creditor country, of the same size as the bilateral debt service.

This kind of bilateral claim, if it was made at all, was not made by the Federal Republic. The Federal Republic already had a global trade surplus of over 2.5 thousand million DM by the beginning of the debt service payments in 1953, and so was able to cover the costs of the debt service -of 567 million DM or 765 million DM -, due under the London Agreement, from the total trade surplus in relation to the eight most significant creditor countries (USA, England/GB?, Switzerland, France, Holland, Sweden, Belgium, Italy) alone (See Table 1). However, there remained a trade deficit in relation to the USA, the main creditor, until the end of the 1960s. So it is even more remarkable that that this enormous deficit in relation to the USA was more than compensated for by trade with the European creditors. However, the surpluses in relation to the European trading partners did not bring any dollars into the German foreign exchange reserves and so the deficit in relation to the USA remained problematic until the full convertibility of the DM was restored in 1958.

**Table 1:**  
**Balance of trade totals and the proportion of German foreign trade listed by creditor country**

FRG versus:	World	USA		Western Allies: USA, Großbritannien, Frankreich		8 most important creditors: Western Allies, Schweiz, Holland, Schweden, Belgien, Italien		Debt Service Due according to London Agreement
		Trade Balance	Percentage	Trade Balance	Percentage	Trade Balance	Percentage	
in Mio. DM	Trade Balance	Trade Balance	Percentage	Trade Balance	Percentage	Trade Balance	Percentage	
1952	708	-1680	10,8%	-2052	28,1%	-492	61,9%	567
1953	2496	-720	9,0%	-1044	25,1%	876	59,8%	567
1954	2698	-1001	8,4%	-761	17,7%	2112	48,0%	567
1955	1245	-1591	9,6%	-1418	19,1%	1328	49,1%	567
1956	2897	-1896	10,3%	-1184	20,0%	2480	49,3%	567
1957	4272	-3132	12,0%	-2160	21,4%	2220	50,5%	567
1958	5868	-1548	10,0%	-876	19,7%	2580	48,7%	565
1959	5364	-792	10,8%	-552	22,6%	2244	52,3%	565
1960	5232	-2256	10,7%	-1860	24,3%	2736	53,4%	565
1964	6084	-3276	10,4%	-2196	25,9%	3576	60,1%	565
1968	18372	1992	10,9%	5076	27,2%	11124	62,2%	565

Table 1 clearly shows that the Federal Republic was capable of producing a permanent surplus in both its global trade and also its trade with its creditors. Now it would doubtlessly be too easy to simply put this surplus down to the arrangements in the London Agreement. The industrial infrastructure, and the high levels of education and training in West Germany were, without doubt, a favourable climate for being highly competitive as far as foreign trade was concerned. However the trading concessions made by the creditors under the London Agreement should not be underestimated. For a high German competitiveness would have contributed much less to the trade surplus if there had been stronger trade barriers imposed by the creditors.

In this connection, another mechanism provided in the London Agreement should be mentioned: that conceded the right to renewed negotiations in the case of smaller trade surpluses. This possibility was included in Article 34 under the heading of 'consultations'.

**“In the interest of the continuing and effectual carrying out of the present Agreement and the Annexes thereto to the satisfaction of all parties concerned, and without derogating from the obligations which the Federal Republic of Germany has assumed -**

**(A) consultations will be held between the Parties to the present Agreement principally concerned, if the Government of the Federal Republic of Germany or the government of any of the creditor countries holding a substantial share of the debts covered by this Agreement so requests. Any Party to the present Agreement shall have the right to participate in these consultations, and if it participates it may invite representatives of the interested creditors or debtors of its country to attend;**

**(B) if the consultations are concerned with a situation which the Federal Republic of Germany finds that it is faced with difficulties in carrying out its external obligations, attention shall be given to all relevant economic,**

**financial and monetary considerations which relate to the ability to transfer of the Federal Republic of Germany, as influenced by both internal and external factors, and which relate to the continuing fulfilment by the Federal Republic of its obligations under the present Agreement and the Annexes thereto and under the Agreements concerning post-war economic assistance. Due regard will be paid to the principles by which the Conference on German External Debts was guided, to the objectives at which it aimed, and to the undertaking of the government of the Federal Republic of Germany to do everything in its power to ensure the fulfilment of these obligations. Advice shall, if the principle consulting Parties to the present Agreement so decide, be sought from appropriate international organisations or other independent experts. A request for such advice may be made to by the Federal Republic of Germany or by any of the Parties to the present Agreement principally concerned.”**

Here too there is a reference to the principles laid out in Article 21 of the final report of the Conference on German External Debts, and with regard to the Federal Republic's ability to transfer it was once again recognised that it would be “influenced by both internal and external factors”. One should certainly not interpret Article 34 as an ‘escape clause’ which would allow the Federal Republic to discontinue debt servicing in a one-sided way, if in its opinion “difficulties in carrying out its external obligations” are foreseeable. However, in the case of a transfer problem, as could arise from a lack of trade surpluses in relation to creditors, the Federal Republic could insist on the consultations envisaged in Article 34. Corresponding to section b), a compromise would then have had to be found between debtors and creditors in the course of those consultations. This would not have been legally binding on the participating governments, but “the outcome of the consultations would have had a similar significance to a binding commitment as a result of the authority of the committee”. (Gurski 1955, p.469)

The federal government originally wanted an even cle-

arer regulation in the text of the agreement. It wanted an actual 'escape clause' which, above all, would have allowed it to abandon its commitments under the London Agreement in the case of a small balance of trade surplus, and request consultations. However the creditors emphatically objected to further concessions of that kind. A compromise solution was then found in the inclusion of a reference to the basic principles expressed in the final report, together with the possibility of consultations in the form of paragraph 9 of the preamble and Article 34 of the Agreement. The federal government gave Article 34 "particular significance" among the "articles dealing with questions of transfer" in its 'Memorandum on the Agreement on German Foreign Debt' which was presented to the Bundestag together with the draft legislation for the ratification of the London Agreement in 1953. (Denkschrift 1953, p.166) At the same time, it referred once more to the final report of the main conference in which the principle that "the payment of transfer commitments must only be made from a current surplus in the balance of trade and current accounts" had been "unanimously agreed by creditors and debtors, and by

the representatives of all 31 countries". (Denkschrift 1953, p.158) cf. also Abs , 1991, p.194)

To sum up this first part, the London Agreement makes a clear connection between debt management and trade policy. It recognises the economic reality that in the long term a country can only release itself from its foreign debt through a trade surplus. The London Agreement leaves us in no doubt that the achievement of such a surplus, requires an effort on the part of both debtors and creditors. Creditors must make their contribution so that debtors are able to pay their debt service from a trade surplus in relation to those creditors. Creditors must accept those deficits as concessions consciously made.

The London Agreement showed that this kind of trade policy commitment is a necessary element in any comprehensive, long-term solution to debt problems. Even more important, however, was the fact that after this 'insight into what was necessary', the political will was there on the part of both creditors and debtors to translate the concessions made on paper into reality.

## PART II

### Lessons for a new regulation of trading links between current creditors and debtors

The development of trading links between West Germany and its creditors gives an impressive example of this.

Part 1 closed with the assessment that any comprehensive solution to debt problems requires provisions in trading policy which demonstrate a concern with how the debtors will be able to work their way out of their indebtedness through the achievement of a trade surplus in relation to their creditors. This insight will be described from now on as either 'the trade surplus principle' or the 'surplus principle'.

Part 2 will attempt to transfer this principle to the situation of the 66 indebted developing countries. The first step will be to determine to what extent their present

trading positions deviate from this principle. What do their trade balances in relation to the 19 creditors look like? <sup>(7)</sup>

As will become apparent, the majority of those balances are negative, and so the debtors are falling into ever greater indebtedness.

How can this state of affairs be overcome? This is the second main question addressed in this section.

#### Methodological considerations

We will begin with a calculation model. In order to be able to apply the surplus principle to the current situation of the 66 debtors, one needs to know all their bila-

<sup>7</sup> For an explanation of the selection of countries see the introduction.

teral trade balances and also their levels of debt service payments. The first are well documented in the annual Direction of Trade Statistics from the IMF (IMF 1999), but the second are only available in very inadequate measure. Most creditor countries persistently refuse to release information on their bilateral debt service receipts. The most recent figures available, for example for Germany, originate from a parliamentary inquiry to the German federal government in 1994. Up till now, there has only been one single source of systematic information about the bilateral debt service payments to a number of creditor countries (EURODAD 1996). This table includes the known payments of all debtors to the 19 creditor countries, but only examines the debt service on long-term debts to governments ('public creditors') for the period up to 1994. A list of the 19 countries is included further on. However, what about the long-term debt service being paid to private creditors (above all banks, and investment and pension funds) and the payments on short-term debts (of less than a year's duration)? Nor is the debt service being paid to multilateral creditors like the IMF, the World Bank and regional development banks included in the considerations.

If one wanted to transfer the London model, one would of course need to include the debt service for all these categories of debt, too.

The debt service payments for those last categories are known in aggregate, but cannot be broken down into the figures for individual creditor countries or groups. For this reason it is almost impossible to discover who exactly the creditors are or how the debts and the debt service are divided between them.

There are a number of other difficulties as well. For example: How should the multilateral creditors be handled? They cannot be ascribed to any of the creditor countries and a trade surplus relation to the IMF or the World Bank is an economic impossibility. In theory the bilateral creditors should take on trade deficits to cover debt service to the multilateral creditors as well, for example proportional to the size of their share in the IMF and the World Bank.

The assigning of debt service to private creditors is equally difficult. Many of the large western commercial

banks and investment houses handle a lot of their business through daughter companies and subsidiaries in offshore locations and tax havens, although the debt service ends up at the headquarters in New York, Tokio, London and Frankfurt. The payment of this debt service too should really be enabled by the USA, Great Britain, Spain and Germany through trade deficits, too. There are similar problems in relation to the servicing of short-term debts, too.

Since a complete solution to these problems is impossible, we can only make a tentative suggestion of a possible model here. It will be characterised by a high degree of caution, which will always be to the benefit of the creditors in financial terms. All debt service in relation to private and multilateral creditors, and the payments made in relation to short-term debts remains unconsidered. So it is only demanded of creditors to accept bilateral trade deficits of the same size as the payments that they as governments receive from the debtor countries.

An illustration: The proportion of long-term debt servicing by the 66 debtors to bilateral creditors in relation to their total debt service commitments to all these creditors is less than 16% between 1990 and 1997 (according to World Bank figures, 1999).

The central argument of the surplus principle is that the debtor countries must be able to earn the foreign currency necessary for the servicing of their debts themselves. Up to now there has been an unspoken assumption made that this foreign currency can only be earned through trade surpluses. The debtor countries do, of course, have other sources of foreign currency income. So the focussing on trade surpluses requires further explanation. It goes without saying that foreign currency income from credit inflows should not be used for the financing of debt servicing, for the reasons given in the introduction, since this only increases indebtedness. The same goes for income from direct investments, since these sources bring profit transfers in their wake. And there remain other categories of balance, namely invisibles and transfer balances.

There is no reason why the invisibles balances should not be given the same weight as the trade balances.

Debtor countries could also earn their foreign currency surpluses through dealings in invisibles. However since interest payments as reimbursement for capital loans only appear in the invisibles balance as imports, a debtor position, by definition, puts pressure on the invisibles balance.

Of the 66 debtor countries, 55 show a deficit in invisibles. (See Appendix 2, column 7) If the debt service is to be paid out of a trade surplus, as we have assumed up to now, then the invisibles balance can be allowed to show a deficit also in respect of interest payments. In the case of 49 of the 66 countries, however, the deficit in the invisibles balance is in excess of the total interest payments, and so they also have a deficit in other areas of invisibles dealings (cf. Column 8). Not a single one of the countries with an invisibles surplus can compensate for its trade deficit through invisible earnings.

In principle, trade balances and invisibles balances should be given the same weight under the surplus principle. But unfortunately there are no synchronised international statistics for bilateral invisibles dealings available. Since, as we have seen, the balance of invisibles is normally an additional burden on the balance of payments of debtor countries, instead of making a positive contribution towards their trade deficits, to not take the invisibles balance into account seems permissible. In fact were they to be taken into account, in the case of most of the debtor countries it would be an indication that they are even further from a surplus in relation to their creditors.

In Appendix 2 there is a table giving details of invisibles balances.

There remains the final category of foreign currency earnings, the income from transfer balances. The transfer balances include the inflow and outflow of foreign currency without a corresponding concrete return.. For the debtor countries, these entries consist largely of aid payments. This is a clear indication that foreign currency income from transfer balances can in no way be compared to a trade surplus, nor should they be taken into account in the same way. Were one to regard aid payments as normal foreign currency income for the debtors which could be added to their income from trade, this would mean, for one

thing, regarding aid as simply a transition point for the balancing of debt servicing accounts. Aid has a much more far-reaching aim than to simply be 'recycled' in interest and principal payments. Secondly, aid payments cannot be controlled by debtor countries, either in their amount nor in their future development. To place too great a dependence on them only increases the dependency of the debtors on the donor countries (which usually means their creditors) still further. Thirdly, aid payments are not freely available monies - they are tied to specific projects. Often the donors set conditions that the aid payments are to be spent, at least partially, on imports from the donor countries. Foreign currency income from aid and from regular trading activities are also, however, not in any way comparable with each other for reasons of development strategy. A balance of trade surplus indicates a high performance export sector, which is often in itself a centre of technological innovation, and a motor for research, development and training. So a trade surplus indicates an active and high performance sector of the economy, which, in interplay with the internal economy can make a significant contribution to economic development. The situation in the case of aid payments is completely different. This is often simply a question of maintenance which, in connection with its economic conditionality and compulsory imports contributes very little to the release of a dynamic for economic development. On the contrary, it often increases the dependency of the recipient countries, even when this is not the donor's intention.

To summarise, it can be seen that debtors need to acquire their surpluses in relation to their creditors exclusively in the areas of trade and invisibles dealings.

### **Bilateral trade balances between the 66 debtor and 19 creditor countries.**

Although under the London Agreement all creditors equal expectations were placed on all creditors to ensure bilateral trade surpluses for those in debt to them to the extent of their debt servicing obligations, there were also exceptions to the rule, for example in the case of the USA. Before we examine individual creditors therefore, we need to look at whether the individual debtor countries could finance their debt service in relation to the 19 creditors, seen as a group, from a continuous trade surplus.

**Table 2:**  
**Bilateral balances of trade in relation to the group of 19 creditors** (Sources: IMF (1999), World Bank (1999))

Millions US-\$, unless indicates otherwise	Trade Balance towards group of 19 creditor countries		Is there a trade balance surplus 1990-1994?	How much would debt service have been reduced, if it had to be serviced from trade balance surplus alone? (Trade balance and debt service on average for the years 1990-1994)?			
	1990	1994				Amount	in %
Algeria	1.550,7	-6,9	Yes		0 %		
Angola	1.914,1	1.712,0	Yes		0 %		
Argentina	3.706,6	-6.537,5	No	100 %			
Bangladesh	-370,2	675,2	Yes			231,2	17,8%
Belize	-59,4	-54,3	No	100 %			
Benin	-67,2	-251,5	No	100 %			
Bolivia	128,5	-3,6	No	100 %			
Brazil	-4.881,0	-16.907,3	No	100 %			
Burkina Faso	-228,7	-151,1	No	100 %			
Burundi	-88,4	-64,5	No	100 %			
Cameroon	436,0	519,0	Yes		0 %		
Central African Republic	-26,6	-2,9	No	100 %			
Chad	-46,3	-32,9	No	100 %			
Chile	2.093,2	322,2	Yes		0 %		
Colombia	1.149,2	-1.503,1	Yes		0 %	2.012,2	99,3%
Congo, Rep.	644,8	443,3	Yes		0 %		
Cote d'Ivoire	468,6	498,5	Yes		0 %		
Dominica	-40,2	-33,2	No	100 %			
Ecuador	359,2	295,8	Yes		0 %		
Ethiopia	-481,4	-324,0	No		0 %		
Gabon	1.290,3	1.346,5	Yes		0 %		
Gambia, The	31,0	-95,3	No	100 %			
Ghana	-11,0	-159,9	No	100 %			
Guinea	19,2	5,0	No	100 %			
Guinea-Bissau	-71,9	-35,7	No	100 %			
Guyana	18,0	195,2	Yes		0 %		
Haiti	-232,9	-292,1	No	100 %			
Honduras	78,2	-140,9	No	100 %			
India	-3.739,9	1.267,5	No	100 %			
Indonesia	3.645,8	3.919,0	Yes		0 %		
Jamaica	-417,0	-183,7	No	100 %			
Jordan	-1.326,5	-1.633,0	No	100 %			
Kenya	-886,2	-511,0	No	100 %			
Lao PDR	-26,0	-12,0	No	100 %			
Madagascar	-44,1	-22,5	No	100 %			
Malawi	17,5	117,0	Yes		0 %		
Malaysia	-3.548,7	-8.171,1	No	100 %			
Mali	-213,0	-172,7	No	100 %			
Mauritania	63,1	-0,7	Yes			47,4	70,7%
Mauritius	300,7	264,6	Yes		0 %		
Morocco	-1.698,6	-1.960,6	No	100 %			

	Trade Balance towards group of 19 creditor countries		Is there a trade balance surplus 1990-1994?	How much would debt service have been reduced, if it had to be serviced from trade balance surplus alone? (Trade balance and debt service on average for the years 1990-1994)?			
	1990	1994				Amount	in %
Mozambique	-396,8	-212,8	No	100 %			
Myanmar	-209,1	-0,9	No	100 %			
Nicaragua	-49,6	-82,6	No	100 %			
Niger	17,6	-72,8	No	100 %			
Nigeria	6.166,5	5.700,1	Yes		0 %		
Pakistan	-653,4	-25,5	No	100 %			
Panama	-475,5	-956,7	No	100 %			
Peru	721,5	-176,2	Yes		0 %		
Philippines	-646,7	-3.113,9	No	100 %			
Rwanda	-101,8	-88,6	No	100 %			
Sao Tome and Principe	-28,8	-43,0	No	100 %			
Senegal	-476,3	-477,3	No	100 %			
Sierra Leone	12,1	69,6	Yes			29,9	89,0%
St. Vincent and the Grenadines	-41,4	-63,8	No	100 %			
Syrian Arab Republic	372,5	-813,7	No	100 %			
Tanzania	-492,3	-356,9	No	100 %			
Thailand	-5.351,4	-7.507,9	No	100 %			
Togo	-255,5	-108,9	No	100 %			
Tunisia	-1.678,2	-1.632,7	No	100 %			
Uganda	-125,1	49,0	No	100 %			
Uruguay	205,8	-383,6	No	100 %			
Venezuela	7.844,3	4.300,6	Yes		0 %		
Vietnam	61,9	399,6	Yes		0 %		
Zambia	-360,4	97,4	Yes		0 %		
Zimbabwe	61,1	177,2	No	100 %			
<b>Total</b>	<b>3.530,7</b>	<b>-33.007,6</b>	<b>21 Yes 45 No</b>	<b>45 100 %</b>	<b>17 0 %</b>		

This question can be answered in general in the negative, and in a differentiated way by reference to Table 2.

45 debtor countries had a trade deficit in relation to the group of 19 creditor countries between 1990 and 1994. If the surplus principle had been applied, they would have been allowed to completely suspend their debt service in relation to those creditors between 1990 and 1994. In the case of three further countries, the trade surplus was smaller than the debt service paid. Colombia, Bangladesh, Dominica and Sierra Leone would have only had to pay significantly reduced levels of debt service, as shown in the last two columns. Only

17 of the 66 countries paid their bilateral debt service from a trade surplus. However one has to bear in mind, that here we are only concerned with the bilateral debt service that was in fact paid. If one looked at the contractual bilateral debt service due, the list of 17 countries would be reduced still further. (Between 1990 and 1993 the 17 countries only paid an average of 65% of the total debt service due. Moreover, the list should be further qualified by the fact that the bilateral invisibles balance could not be taken into account due to the lack of available data. There are good reasons to suppose that a significant proportion of the total invisibles deficit (not including interest payments) was incurred

through dealing in invisibles with the 19 creditor countries (for example in the building, advisory, financial and insurance sectors. The trade surpluses of 10 of those 17 countries was not sufficient to cover the deficit in the invisibles balance over and above the interest servicing. (8)

The balance of trade of all 66 debtors in relation to the 19 creditors from 1990-1994 amounted to an annual average of approx. -16 thousand million US\$ (see Table

3). During the same period of time, 10.5 thousand million US\$ were paid annually by them in debt servicing. Had the debt service had to have been paid from a continuous trade surplus, the 19 creditor countries would have had to import additional goods to the value of approx. 26 thousand million US\$ from the debtor countries.

And not much is likely to have changed in these relative positions since 1994. In fact the trade deficit of all

**Table 3:**

**How many debtor countries achieved a trade surplus (TS) in relation to individual creditor countries ?**

Saldo Annual Average (Mio. US-\$)	For all 66 Debtor Countries 1990-1994				Need to import how much additionally from Debtor Countries?
	Number of Debtor Countries with Trade Balance Surplus	Bilateral Debt Service Received		Trade Balance	
		Amount	Share of Total		
Australia	7	36,7	0,3%	-3.110,6	3.147,30
Belgium-Luxemburg	30	74,7	0,7%	128,6	-53,90
Denmark	9	67,5	0,6%	-403,6	471,10
Germany	22	1.594,4	15,2%	-6.941,3	8.535,70
Finnland	10	8,9	0,1%	-811,7	820,60
France	17	814,4	7,8%	-3.730,5	4.544,90
Britain	24	479,3	4,6%	-23,6	502,90
Italy	21	199,4	1,9%	-425,6	625,00
Japan	12	4.017,7	38,2%	-13.172,9	17.190,60
Canada	21	342,8	3,3%	-1.331,3	1.674,10
Netherlands	32	330,0	3,1%	7.167,0	-6.837,00
Norway	15	15,5	0,1%	-238,1	253,60
Austria	7	71,8	0,7%	-496,8	568,60
Portugal	49	15,2	0,1%	559,8	-544,60
Sweden	10	49,9	0,5%	-1.857,3	1.907,20
Switzerland	12	50,6	0,5%	-3.043,3	3.093,90
Spain	40	382,7	3,6%	1.554,2	-1.171,50
USA	25	1.953,1	18,6%	10.240,0	-8.286,90
G7	20	9401,2	89,5%	-15.385,3	24.786,50
<b>All 19</b>		<b>10.504,7</b>	<b>100,0%</b>	<b>-15.937,2</b>	<b>26.441,90</b>

Sources: IMF (1999), World Bank (1999)

debtors referred to above has actually increased from 16 to 57 thousand million US\$ (On average from 1995-1998).

Table 3 shows that there is a qualitative distinction between creditors in terms of the surplus principle. Let us

first consider column one. This shows the number of debtors who could aim for a trade surplus in relation to individual creditors. This number is lowest in relation to Australia and Austria -9- and highest in relation to Portugal -49. The second and third columns give a

<sup>8</sup> This deficit does not, however, necessarily exist in relation to the 19 creditors. It refers far more to the deficit in the total invisibles trade with all countries.

clear indication of the very uneven distribution of debt service. Over 38% of the bilateral debt service in the period 1990-1994 went to Yespan. The three most significant creditors, Yespan, the USA and Germany between them received a total of 74% of the bilateral debt service payments.

The fourth column shows the surprising fact that the 66 debtors taken together were quite capable of producing a substantial trade surplus in relation to certain individual creditors, for example, the Netherlands, Spain or the USA. But taken in conjunction with column one, however, it becomes clear this doesn't necessarily mean a surplus in each of the 66 debtor countries, but rather that some of the debtors are over-compensating for the bilateral deficits of the others. A detailed analysis of the 66 bilateral trade balances can be found in Appendix 3.

By comparing the 5 columns it also becomes clear that the trade surplus of the 66 debtors in relation to the USA, Belgium/Luxemburg, Spain, Portugal and the Netherlands is actually large enough to cover their actually paid debt service. This is indicated by fact that the necessary increase in imports to fulfil the surplus principle is shown as a negative. Notwithstanding the fact that some debtors only pay part of their contractual obligations, these countries are already importing enough from the group of 66, seen as a whole. This does not, of course, mean that each individual debtor country of the 66 has a surplus in relation to those three creditors. In practice, therefore, these countries would have to accept a further increase in imports since it does not appear to be desirable to greatly reduce the trade surpluses of the countries with those surpluses.

On the other extreme to these six creditor countries with trade deficits we find Japan, Germany, France, Canada, Sweden, Australia and Switzerland. Each of these countries would be obliged to import at least an additional 1 bn. of goods and services from the debtor countries, in order to comply with the surplus principle. These 7 creditors do hold a combined trade surplus of more than 40 bn. \$. Additionally another six countries would each have to import goods and services

worth up to 1 bn \$. With surpluses of 17 bn and 8.5bn. respectively, Japan and Germany are the farthest away from fulfilling the surplus principle. Unfortunately the Federal republic of Germany does not recognize any obligation to treat her debtors of today with the same amount of fairness it has received itself.

### **What would a new debt management policy have to look like in view of the chronic trade deficits of the debtors?**

The entire first part of this study was concerned with the economic insight that a positive balance of trade balance for the debtor must be possible for the successful resolution of a situation of indebtedness. If this is systematically impossible, for whatever reason, the debtor is stuck with a situation of being in a permanent debt crisis. The only exit is then a total debt cancellation since not even a small debt service is possible from their own resources.

If debt cancellation is not to be the only option, then creditors and debtors have to develop strategies together as to how the debtor can achieve a long-term trade surplus. The initial contribution of the creditor should be giving the debtor free access to the creditors markets. That implies the removal of tariff and non-tariff trade barriers, in particular in the agricultural and textile sectors which are of such significance to the debtors. This then also means that the creditors give the debtors active support in actually exploiting the opportunities provided by the improvement in access formally speaking. There are many possibilities in connection with this. For example, the marketing opportunities in creditor countries are often dominated by a few food companies, so that even if, formally speaking, a policy of completely open borders is in operation there is, in reality, hardly any chance for the debtor to gain access to the creditors markets. A policy of active competition on the part of the creditor government can help to overcome such adverse conditions, but often practical technical support and advice for the debtor in the building up of distribution channels are necessary. Who knows the marketing opportunities in the creditor country better than the creditor country itself? Experts from the creditor country can therefore be par-

ticularly invaluable in the area of marketing consultancy. This is only one example from a whole range of policy options which are available to creditor governments. Of course all that it is expensive. But this would often be a particularly appropriate use of development aid. The reason why this is not happening at present must largely reflect the fact that the creditors are trying to protect their agricultural and textile markets by every possible means and the political will to make any concessions is simply not there.

Besides the encouragement of imports, the creditors could certainly also reduce their export subsidies.

Through the aggressive dumping exports of European overproduction, the EU has destroyed the local markets for cereals, tomatoes and beef in many debtor countries. When these markets have been destroyed, a new dependence on imports from the creditor countries is thereby created. This sort of avoidable import dependency is a particular burden on the already precarious balance of trade between debtors and creditors.

The promotion of imports described above must, however, go hand in hand with a systematic change in the debtors palette of export products. If the current escalation in duty on processed products focuses the exports of debtor countries in the areas of raw materials and basic agricultural products, in future this needs to operate in the opposite direction. The debtor countries must be able to add value to and process their products so that they acquire a greater proportion of the added value. For this to happen, there needs to be an opening of the creditor markets on the one hand, and also, at the same time, their support in the area of the necessary technology for this increase in value.

Integrated strategies by which the creditors open their markets and, at the same time, provide the technical support to enable the debtors to take advantage of the opportunities provided by this opening of the markets are currently very rare.

If that sort of strategy were to help the more industrialised debtor countries to increase the level of processing of their exports, they could thereby pull out of exporting raw materials. This would also help the very poorest debtors who would then be subject to less competition in the export of their primary products, which could lead to a stabilisation, or even an increase, in the price of many raw materials. This process could be supported by targeted funds for the stabilisation of

raw material prices. At the same time, the debtors would have to be allowed to limit imports from the infinitely stronger economies of the creditor countries, in accordance with an economic development strategy, far more effectively than they are at present (for example, strategic duty policies for the protection of 'infant industries' etc.).

Both would require the opposite of the current structural adjustment policies imposed by the creditors, for a liberalisation and export policy at all costs, as it is at present, would no longer be able to exist. On the contrary, trading policy would be given new room for manoeuvre in the interests of economic and social development and, for example, much greater consideration could be given to ecological and human rights concerns.

However, one must not lose sight of the fact that, even with this kind of reformed export opportunities for debtor countries, there would still continue to be debtors who were unable to pay their debt service. If debtors and creditors were unsuccessful in laying the foundations for a long-term trade surplus through common strategic planning (for example, the agreement of the creditors to buy a particular product at a particular future point in time), then the debtor would have to be considered to be irretrievably insolvent. In this case, the debts should be cancelled in their entirety, since a self produced debt service is not to be expected from a debtor of that kind.

The relinquishing of both open and hidden export subsidies by creditors, and the opening of domestic markets is, in the final analysis, only an expression of a much more fundamental rethink necessary on the part of the creditors. The creditors must stop wanting to extend their creditor position ever further, as this creates debtors to the same extent. They need to completely rid themselves of the idea of wanting to be creditors, so that others don't have to be debtors for ever.

Finally, two practical suggestions.

The experience of history has taught us that a certain level of indebtedness can of itself become the basis for ever increasing indebtedness. If not even the interest can be paid from a trade surplus, a hopeless downward spiral of interest, and interest on interest is created. The recognition that debts can only be paid off through a

trade surplus, could justify the consideration of the introduction of an international insolvency law. The net debtor position could be limited to the total of annual exports and imports, and in this way the tendency towards polarisation between creditors and debtors could be counteracted. This should, of course, conversely, also apply to creditors. The creation of a net creditor position greater than the import and export total should not be allowed. The British government made a similar suggestion in 1944 in the negotiations concerning the post-war economic system in Bretton Woods. For John Maynard Keynes, the leading British negotiator at the time, the limitation of net creditor and debtor positions was a central element in any future stable world economic system (cf. Keynes, 1980, page 118ff.).

The second practical suggestion consists of only paying debt service in the domestic currency of the debtor country in future. This would probably be the simplest and most elegant way to force the creditors to provide themselves with imports from the debtors and thereby guarantee a trade surplus for the debtors. With debt service payments restricted to debtor currencies, which often have only waste paper value outside the debtor country, the creditor couldn't really do anything else

with them other than to exchange them for goods, which means exports, in the creditor country. Of course they could be used to finance imports which had previously been paid for in foreign currency, but the result would be to force a trade surplus of the same amount as the debt service payments. In the interests of fairness, the payment of debt service in domestic currency would naturally have to be index linked, that means the creditors must be protected against inflationary losses, as otherwise the temptation for the debtor country to simply 'inflationise' the debt away and just print the amount of money necessary to service the debt would be too great. If, however, the stability conditions were observed, then this could lead on the one hand to a general strengthening of trust in the domestic currency and on the other even, in the long-term, to foreign loan contracts being made in that currency. If the creditors gradually gain confidence in the domestic currency of the debtor then perhaps they might soon be prepared to offer the debtor credit in its own currency. If a debtor country achieved this decisive step of only taking out loans abroad in its own currency, then the principal of the trade surplus can be safely abandoned, because a country in debt abroad in its own domestic currency can never, as every one knows, have a transfer problem.

## **APPENDIX 1: EXTRACTS FROM THE LONDON AGREEMENT**

Extracts from the preamble to the London Agreement, paragraphs 8 and 9:

The Government of the Federal Republic of Germany on the one hand and the Governments of... (list of 20 creditor countries) on the other, considering  
**...that...an International Conference on German External Debts, which was attended by representatives of interested Governments and of creditor and debtor interests, was held in London from 28th February 1952, to 8th August 1952;**

**Considering that these representatives made agreed recommendations as to the terms and procedures of settlement (the texts of which are reproduced as Annexes I-VI, inclusive, to the present Agreement); that these recommendations were appended to the Report of the Conference on German External Debts (the text of which is reproduced as Appendix B to the present Agreement); and that the present agreement has been inspired by the principles and objectives set forth in the above mentioned Report;**

...

have agreed as follows: -”

### **Article 9 of the London Agreement**

Transfers of interest and amortisation payments made under the present Agreement shall be treated as payments for current transactions and, where appropriate, provided for in any bilateral or multilateral arrangements relating to trade or payments between the Federal Republic of Germany and the creditor countries.

### **Article 34 of the London Agreement**

“In the interest of the continuing and effectual carrying out of the present Agreement and the Annexes thereto to the satisfaction of all parties concerned, and without derogating from the obligations which the Federal Republic of Germany has assumed -

consultations will be held between the Parties to the present Agreement principally concerned, if the Government of the Federal Republic of Germany or the government of any of the creditor countries holding a substantial share of the debts covered by this Agreement so requests. Any Party to the present Agreement shall have the right to participate in these consultations, and if it participates it may invite representatives of the interested creditors or debtors of its country to attend;  
if the consultations are concerned with a situation which the Federal Republic of Germany finds that it is faced with difficulties in carrying out its external obligations, attention shall be given to all relevant economic, financial and monetary considerations which relate to the ability to transfer of the Federal Republic of Germany, as influenced by both internal and external factors, and which relate to the continuing fulfilment by the Federal Republic of its obligations under the present Agreement and the Annexes thereto and under the Agreements concerning post-war economic assistance. Due regard will be paid to the principles by which the Conference on German External Debts was guided, to the objectives at which it aimed, and to the undertaking of the government of the Federal Republic of Germany to do everything in its power to ensure the fulfilment of these obligations. Advice shall, if the principle consulting Parties to the present Agreement so decide, be sought from appropriate international organisations or other independent experts. A request for such advice may be made to by the Federal Republic of Germany or by any of the Parties to the present Agreement principally concerned.”

### **Extracts from the final report of the Conference on German External Debt, paragraphs 11 (b), 21 and 22 (Appendix B of the London Agreement):**

“11. In carrying out its work the Conference has been guided by the following facts, principles and objectives:-

(b) The Settlement Plan should -  
take into account the general economic position of the Federal Republic and the effects of the limitations on its territorial jurisdiction; it should neither dislocate the German economy through undesirable effects on the internal financial situation, nor unduly drain existing of potential German foreign exchange resources,

and it should not add appreciably to the financial burden of any of the three Governments;  
provide for an orderly overall settlement and assure fair and equitable treatment of all the interests affected;  
...

21. ... The conference recognised the principle that the transfer of payments under the Settlement Plan implies the development and maintenance of a balance of payments situation in which those payments, like other payments for current transactions, can be financed by foreign exchange receipts from visible and invisible transactions so that more than a temporary drawing on monetary reserves is avoided. In this connection due consideration should be given to the fact that the convertibility of currencies has yet to be re-established. The Conference therefore recognises that the development and maintenance of this balance of pay-

ments situation would be facilitated by the continuance of international co-operation to promote liberal trade policies, the expansion of world trade and the revival of the free convertibility of currencies. It recommends that due account should be taken by all concerned of the principles referred to in this paragraph.

22. Transfers of interest and amortisation payments due under the Settlement Plan should be treated as payments for current transactions and, where appropriate, included in any arrangements relating to trade and/or payments between the Federal Republic and any of the creditor countries, regardless whether such agreements are of a bilateral or multilateral nature.

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**ANHANG 2:  
WARENHANDEL UND DIENSTLEISTUNGSBILANZEN**