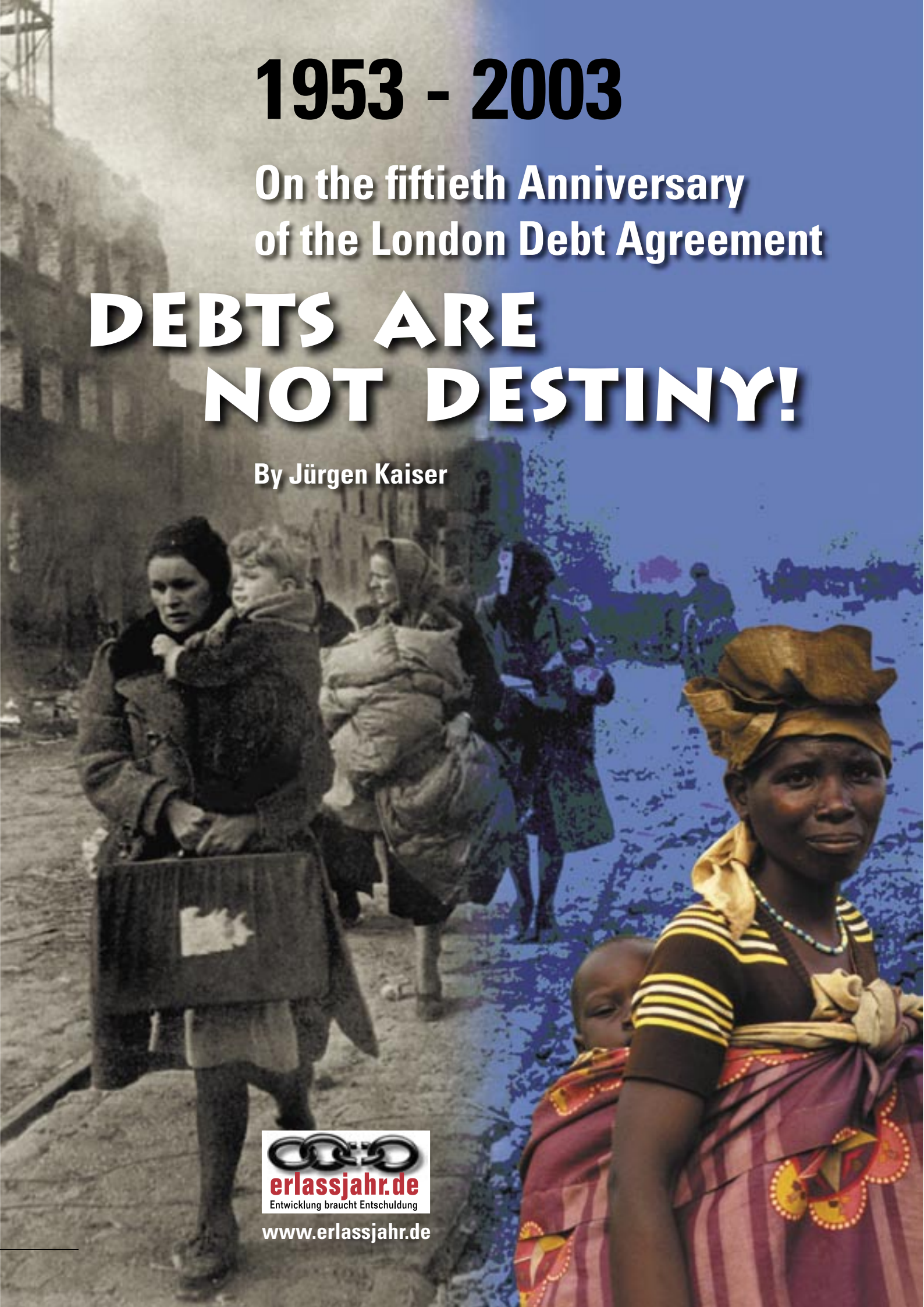


1953 - 2003

On the fiftieth Anniversary
of the London Debt Agreement

DEBTS ARE NOT DESTINY!

By Jürgen Kaiser



www.erlassjahr.de

1953 - 2003 On the fiftieth Anniversary of the London Debt Agreement

DEBTS ARE NOT DESTINY!

By Jürgen Kaiser

The 27th February 1953 is an historic date for the Federal Republic of Germany. This is the day on which the 'London Agreement' was signed in the British capital by partners who had been enemies only a few years previously: on the one hand the new Federal Republic, the successor to Hitler's Germany, and the western allies, represented by England, France and the USA, and other creditor countries on the other; in all, representatives of more than 20 states took part.

The London Agreement with its unusually humane conditions for the highly indebted post-war Germany made a significant contribution to the German economic miracle of the fifties and sixties and to a speedy reconstruction of the devastated country. The agreement is today still one of the few historical examples of how circumspect and long lasting debt management can be – if the political will is there. So 'London 53' provides an example and a direction for the current discussion about debt relief for southern countries, at least as far as the politics of debt are concerned. Even though we do not want to disguise the fact that, through the controlling interest of former Nazis like the financial expert Hermann Josef Abs, Germany's guilt was granted a kind of absolution only eight years after the end of the second world war. The London Agreement relieved the new federal republic of external debts to the sum of nearly 30 billion marks consisting of pre- and post-war debts. This happened in such

a definite manner, that there was practically no more discussion, either internally or externally, on the subject of Germany's national debt until the discussion about the fulfilment of the Maastricht criteria in connection with European unification in the 90s.

That this was the intention of the western allies, Germany's creditors, is expressed in the preamble of the London Agreement where it says the treaty was:

"based on the intention of removing obstacles on the way towards the reestablishment of normal economic relations between the Federal Republic of Germany and the other states and thereby to make a contribution to the development of a flourishing international community."

Using the example of London '53, this erlassjahr.de brochure, shows where debt management can lead to when the debtors have the political will for a serious solution to a debt crisis and the debt problem is not considered in isolation from the international political and financial context. It also shows that 'debts are not destiny', but can become a political football for the creditors – to the disadvantage or the advantage of the debtors, depending on political interests.

In Germany's case, there was a great deal of interest in the west in stabilising the country both politically and economically as quickly as possible, so that it could function as a 'bulwark against

communism'. So at that time the federal republic experienced the positive version of international debt management. But exactly the opposite has been the case for the countries of the south as regards the debt crisis there since the eighties: they have to witness the debt repayments and structural readjustments demanded of them driving their countries deeper and deeper into poverty.

This text is based on extensive research which the 'Erlassjahr2000' campaign (founded in 1997) undertook between the 45th anniversary of the London Agreement on 27th February 1998 and the year 2000 - designated as a 'jubilee year' (Friedel Huetz-Adams and Philipp Hersel). A decade before the campaign, in 1987, the researcher Thomas Kampffmeyer of the German Institute for Development Policy had already published a

ground-breaking paper, which contributes to the basis of this erlassjahr brochure too.

Then as now, the historical perspective points to London 1953: things can be different! Debts do not have to turn into a trap from which there is no exit. That provides inspiration for the present and is worth a detailed reminder. For the Federal Republic of Germany – then a petitioner and a country with multiple debts – has today become one of the most powerful creditor countries with respect to the South. As in the past, the federal republic will be present at the negotiating table when sovereign debt is being negotiated in the year 2003, 50 years after London. Taking this background into account, German history contains a responsibility towards the southern debtor countries today.

1. Background information: Germany's debt in 1952 and its relief under the London Agreement

A Germany destroyed by war, which also saw the dismantling of part of its industry, was incapable of paying its external public debts in the post-war years. That's why in December 1951 the USA, Great Britain and France had already negotiated with the federal republic a reduction in the repayments of the economic support given after 1945. However, this reduction could only come into effect after the Federal Republic of Germany had also agreed a settlement with regard to its pre-war debts. In order to reach such a comprehensive solution, all the pre-war debts of

the German Reich, its federal states and German private individuals with states, commercial banks and bonds from private investors were to be restructured at a central conference. Even though this conference was really only concerned with pre-war debts, it bore the potential of reaching an agreement on all of Germany's liabilities, because of the link between the agreement which had already been negotiated and the results being aimed for. With this in mind, and also because the pre-war debts really consisted of a whole series of individual agreements about different credits

and loans, it is really more accurate to refer to the "London Agreements" rather than the "London Agreement".

The conference on pre-war debts met from 28th February to 28th August 1952 in London (with a six week break). Taking part were representatives from 22 creditor countries (three further countries sent observers), the Bank for International Settlements (BIS) and representatives of private creditors. The driving force behind these negotiations was the USA. Amongst other things¹, they wanted to prevent a long drawn out and smouldering discussion about the Federal Republic's old debts prohibiting Germany's access to the international capital markets, and the country remaining dependent on public loans from the USA.²

The claims made by both governments and private creditors of the Federal Republic of Germany in the London Agreement consisted of two constituent parts:

- Loans that Germany had taken out during the time of the Weimar Republic to meet the reparation arrangements of the 1919 Treaty of Versailles, which had twice been rescheduled and later partially cancelled. According to the agreement reached in London, these amounted to 7.7 billion DM. In addition, there were the debts of other public institutions and German private debtors to the tune of 5.8 billion DM, so that in all pre-war debts of 13.5 billion DM were established and discussed³.
- Loans that the federal government had received from the western powers, in particular the USA, after the second world war to finance the reconstruction. These amounted to about 16.2 billion DM.

So the negotiations in London concerned a total external debt of 29.7 billion DM.

It must be remembered that the amount of the pre-war debt was the result of far reaching concessions which had already been made in Germany's favour. The 132 billion Gold Marks which the allied reparations' commission had originally demanded from Germany⁴ had already been significantly reduced by rescheduling under the Dawes and Young plan, before the 'Hoover Moratorium' of 1932 led, in effect, to all outstanding payment liabilities being cancelled. As a result of that, the only remaining debts Germany had consisted of bonds and loans taken out before to complete previous payments.⁵

In the agreement itself both the pre- and post-war debts were each reduced by 50%. The remaining debt totalled 14.45 billion DM. From this remaining debt stock, further relief was granted through a reduction in interest: 2.5 billion DM stayed interest free, 5.5 billion were carried a rate of 2.5% and the remaining 6.3 billion DM an average rate of 4.5 to 5%. Compound interest was not charged for the long period during which the debt had not been serviced.

The repayment plan agreed in London initially allowed for a grace period of five years between 1953 and 1957, in which annual interest of 567.2 million DM had to be paid. From 1958, fixed repayment and interest rates of 765 million DM were agreed. In the interests of an arrangement that would be unified and equally binding on all debtors and creditors, a principle of equal treatment for all debtors and creditors was agreed. All claimants had to accept equivalent cuts in interest and repayment demands. All non-public debtors benefited from the same relief, which the federal republic's creditors had granted it in the interests of maintaining its capacity for economic activity.⁶

2. The political context of the agreement

The London Debt Agreement is unthinkable without the political alignments of the cold war, in which the young federal republic was a 'front state' facing the eastern bloc countries, and, in particular, provided a contrast to the other German state, the German Democratic Republic. The western allies, in particular the USA, had a predominant interest in the economic stability of the federal republic. Were it not for this political interest, the constructive spirit with which the creditors, the majority of whom were former wartime enemies, looked for a solution that would be sustainable for Germany less than ten years after the end of the war and the fascist reign of terror would be inexplicable.

In its "guidelines for the recommendations" it was laid down that:

"The Agreement should

- take into account the general economic situation 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 (...)

- ■ provide for an orderly overall settlement and assure fair and equitable treatment of all the interests affected."

Not only the actual outcome of the negotiations indicated to what extent the concern to avoid a possible overloading of their former wartime enemies characterized the creditors' attitude, in addition to western political interests. The breathtaking self-confidence with which the German delegation on the one hand pocketed the significant relief provided by the agreement, and on the other even began using it as an instrument of blackmail to ward off possible reparation demands was even more impressive.

“

The German negotiator Hermann Josef Abs reported in 1959:

"There was only one point on which it proved impossible to reach an agreement with the creditors and to embody it in the final conference report – and that is the question of the political preconditions under which we could implement the debt agreement, namely the problem of reparations. (...) But the German delegation had declared - very clearly and in all seriousness - in the most important final session, that Germany would not be in a position to implement the debt agreement, if demands were still to be made to it under the heading of 'reparations'."

“

After 1953, Germany made no reparation payments of the kind that were agreed in 1919 at all.

3. Germany then and the HIPC's now

There is a sharp contrast in both the method of approach and the results between the historical case of the Federal Republic of Germany and the current practice since the outbreak of the debt crisis. The federal republic, which, in present

day terms, was a middle income country with an average income of 2,000 DM per person in 1950, was not only treated better than present day middle income countries, but also came off better, in both qualitative and some quantitative

respects, than the countries which are able to obtain relief from their creditors today under the debt relief initiative for heavily indebted poor countries (HIPC).

The London agreement operated on the following basis:

- Orientation to the realistic transfer ability of the debtor rather than to the creditor's predetermined cancellation quota;
- Stock regulation in a single process instead of a cycle of flow reschedulings;
- Safeguarding implementation through far-reaching rights of appeal for the debtor rather than rigid conditionalities imposed by the creditors;
- Structural adjustment not only by the debtors but also by the creditors.

In both this chapter and chapter 4 the relative burden of Germany's debt service both before and after the London Agreement will be compared with the burden which the net-debtor countries -severely indebted countries with low or middle incomes- are up against today. In chapter 4 will also be shown how relatively far-reaching the relief then was in comparison to today.

First, the **three main indicators** will be examined, before further criteria are considered. These three indicators are:

1. the debt service ratio: i.e. the debt service paid annually consisting of interest and repayments in relation to the annual export income

2. the debt ratio: i.e. the total external debt in relation to GDP

3. the fiscal debt ratio: i.e. the debt service paid on the public external debt as a proportion of total public spending.

The following **Table** compares Germany's burden in the years 1953 and 1958 (in other words before and after implementation of the agreement) with the burden of individual selected debtor countries or groups of countries. **The countries and groups selected for comparison are**

- The 24 heavily indebted poor countries (HIPCs) which have reached their respective 'decision points' (the moment when the amount of relief is agreed upon by the creditors) before April 2002;
- The group of severely indebted middle income countries (SIMICs) according to the World Bank's definition (eight countries with a per capita income between 756 \$US and 9,265\$US);
- The two biggest countries in the SIMIC group: Brazil and Argentina;
- One country from the group of severely indebted low income countries (SILICs), which so far has been excluded from partial cancellation: Indonesia.

In the 'Germany 53' column the data on debt service ratio and the fiscal ratio refer to the payments actually made on the basis of the agreement. The debt ratio refers to the total debt before its reduction as a result of the agreement.

Table 1: Indebtedness indicators for Germany 1953/1958 and current countries selected for comparison

all data in %	Germany 1953	Germany 1958	Selected HIPCs 2000	Selected HIPCs 2004 (Worldbank Projection)	SIMICs 2000	Argentina 2000	Brasil 2000	Indonesia 2000
Debt Service Ratio	3,96	2,86	14,9	8,0	69,6	71,3	90,7	25,3
Debt Ratio	21,21	6,24	167,73	81,96	51,0	52,6	41,8	99,4
Fiscal Debt Ratio	4,49	2,20	22,37*	10,53*	k.A.	33,7	26,6	25,0
* 23 countries								

Sources: IMF/IDA: The Enhanced HIPC Initiative and the Achievement of Long-Term External Debt Sustainability, Washington April 2002; Hesel a.a.O.; Hütz-Adams 1998, eigene Berechnungen; World Bank: Global Development Finance 2002; Jubileeplus: HIPC - Flogging a dead process, London 2001.

■ Debt service ratio

Germany's exports grew from 4.1 billion DM in 1949 to 16.9 billion in 1952. The payments made in 1953, on the basis of the London Agreement, were already proportionately modest compared to export income. No debt servicing payments were made by Germany before 1953 on the basis of demands which had not yet been negotiated and therefore cannot usefully be compared proportionately to export income.

Before the relief granted in 1953, Germany was already in a better position by a whole order of magnitude, with regard to its burden of debt service, than the severely indebted middle income countries. Their exorbitant debt service ratio is, however, also related to the relatively small proportion of the total economy provided by the export sector, compared to the poorer countries. This results in these countries above all mainly repaying their debts by taking out new loans. A strategy of this kind isn't, at least for a limited period of time, bound to be a failure right from the start if high enough growth rates can be achieved.

The economic and financial difficulty for southern states, in this respect, became very clearly evident in the financial crises of South East Asia in 1997 and Argentina in 2001, when the creditors were no longer prepared to provide new money, not even at particularly high interest rates.

In Germany's case in the fifties, this difficulty was taken into account right from the start. In response to pressure from Hermann Josef Abs, the German chief negotiator, Germany's transfer capacity – in other words its ability to earn the necessary foreign currency to cover the ongoing debt service itself through exports – became the

principle criterion for estimating the debt relief necessary. However, it is also useful to compare the burden of external debt to the total economic performance and to the fiscal receipts, over and above this most common indicator.

■ Debt ratio

The debt ratio reflects the debtor country's capacity to raise enough income in domestic currency for servicing its external debt in contrast to the transfer capacity, expressed by the debt service ratio. Today, a debt ratio of 80 – 100% is normally seen as problematic. Germany, however, was a long way from something of this order with its total debt of 29.7 billion DM assessed at the beginning of the London negotiations.

In the present day debtor countries in Asia, Africa and Latin America, the HIPC's are a long way the other side regarding their ability to pay before cancellation. In the exorbitantly heavily burdened – as regards their debt service ratios – middle-income countries the burden is less dramatic compared to their ability to raise income. However, it should not be overlooked that Indonesia is still well within the bounds of the critical and the values for Argentina and Brazil have risen steadily since 2000.

■ Fiscal debt ratio

The German national budget in 1952 totalled 23 billion DM, so that, on the basis of the federal budget alone (without Laender and municipalities), there was a fiscal ratio (total public indebtedness⁸ in relation to the total level of debt) of almost 100%. Through the above average level of interest for German repayment commitments a 'Net Present Value'⁹ (NPV) based ratio would have been even higher. Nevertheless,

1953-2023

it is still well below the fiscal transfer capacity criterion of 250% that forms the basis of the HIPC-II initiative. The corresponding values for the three non-HIPC countries Indonesia, Brazil and Argentina are set at 225, 102 and 176% respectively. In any comparison with debt service met from public funds present day debtor countries also come out at a disadvantage, although it must be remembered that only payments that have already actually been made on the basis of the agreement can be taken as a basis.

Conclusion: All in all, the German situation before relief was significantly less dramatic than that of the present day position of both the poorest countries who now have access to debt cancellation, and also the non-HIPCs. Only if a complete rejection of all debt relief for Germany and a possible default interest arrangement for the unpaid pre-war interest payments during the Nazi regime were to be accepted, would Germany theoretically fall into a position comparable to that of the present-day debtor countries of the south. We have no evidence to show that in connection with the London Conference any such position was seriously considered.

4. The relief granted to Germany in 1953 and the current relief arrangements

A. Debt service ratio

After the relief granted within the framework of the London Agreement, Germany contracted to pay a maximum of 3.06% of its annual export income to the servicing of the rescheduled old demands. In fact, the federal republic paid a maximum of 4.21% (at the start of the repayments in 1958) as it was in a position to make repayments ahead of schedule, due to the unexpectedly positive economic development.

In contrast to this, under the HIPC initiative of 1996 a debt service ratio of 20 - 25% was defined as sustainable for the poorest countries of the earth. In the middle of the nineties, the 41 countries of the so-called HIPC group were either paying more than that, or they were building up significant arrears. At the 1999 G7 world economic summit in Cologne the sustainability threshold was reduced to 10 - 15% due to the proven nonsense of the level previously set.

While only six countries received the benefit of any debt relief at all under HIPC I, there are now

up to 36 countries. At the 2002 spring meetings of the IMF and the World Bank, an examination of the countries accepted for relief showed that out of all countries which had passed their "decision points" up to then, half at the most, would really be able to avoid falling into a renewed inability to pay following their HIPC II relief. This examination was only undertaken at all as the result of fierce criticism by quite a few NGOs.

In its 'Decision Point Documents', the World Bank had previously assumed that most HIPCs would achieve a debt service ratio of 5 - 10% within the first five years. However, it now became apparent that many of the poorest highly indebted countries would be unable to achieve a debt service ratio of this order, but would have to continue to reckon with a higher one. The ratio implemented as a target by the Bank and the Fund was too high for most of the poor, and often war torn, countries. So the upper limit of 5%, consciously only roughly calculated by the Erlassjahr 2000 campaign in 1997, proved, in retrospect, to be frighteningly accurate.

B. Debt ratio

The total debt of 29.7 billion DM assessed at the beginning of the negotiations, compared to a GDP of around 140 billion DM in 1953, gives a debt ratio of 21%. By 1958, the annual GDP had increased to 231.5 billion DM. Through the agreement, the debts were reduced to 14.45 billion DM, of which, however, nothing had been repaid prior to 1958. The resulting debt ratio was a good 6% and was, therefore, at a level which can be considered to be insignificant for the national economy.

In contrast, the current relief given to the HIPC only starts at an about eight times higher level, and reduces this it by about a half. So the relative relief is considerably less than in Germany's case. It can, however, be assumed that no one involved in London could have imagined the enormous growth in the German economy (the 'economic miracle'). By contrast, the World Bank and the IMF start from unrealistically high economic growth expectations in their over optimistic calculations of the relative relief for the HICPs.¹⁰ For middle- and low-income countries which do not belong to the HIPC group there is no projected relief at all which would lead to a reduction in the debt ratio under current debt management.¹¹

C The Fiscal Burden

Compared with the German budget in 1958, which had totalled 34.8 billion DM, the debts that remained after the relief granted under the London Agreement¹² comprised a fiscal quota of less than 30%. The ratio based on cash value was also approaching that based on nominal value, due to the reduction in interest rates. In addition, the German budget expanded significantly in the following years, due to the success of the London settlement, so that the actual relative fiscal burden of debt servicing was significantly less. This is reflected in the fiscal burden ratios in Table 1, which are only a fifth of those of the HICPs after their relief under the initiative.

Conclusion: Overall, it is evident that, starting from a position of significantly lower level of indebtedness, the relief offered to Germany was much more far-reaching than that offered to the HICPs today. By present day criteria, Germany would not qualify for relief under the HIPC initiative in the first place; it would not even be eligible for the concessionary rescheduling from the creditors of the (then not yet in existence) Paris Club. Looked at like that, the relief granted to Germany should be compared to the -so far not granted- relief for Brazil and Argentina.

5. Qualitative aspects of the London Debt Agreement

The London Agreement is remarkable not only in relation to the amount of relief granted to Germany. It also indicates a few qualitative characteristics, which are significantly better than those that either public or private creditors are prepared to offer the southern debtor countries today.

1st characteristic:

The debt servicing can be suspended if there is a balance of payments deficit

A special feature of the London Agreement, in contrast to current debt agreements, is that conditions are not only put on the debtors, but on the creditors too. They should make sure that

the agreed relief achieves their aim of enabling the debtor to become a fully functioning member of the world economy again. The most important principle for this was that "Germany could only cover repayments out of genuine export surpluses and there was no question of having to cover the costs by making ongoing demands on currency reserves".¹³

In the final report of the 1952 main conference it says:

“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 not yet been re-established. The conference therefore recognised that the development and maintenance of this balance of payment 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.

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 of whether such agreements are of a bilateral or multilateral nature.”

On this basis, Germany's creditors declared their willingness to implement **three benefits**, to Germany's advantage, relating to the balance of payments:

1. The commitment to allow a German trade surplus so that the debtor would be in a position to make remaining payments from current income. The federal government did not need to fall back on its currency reserves and so was able to avoid creating inflationary pressure. De facto, this particularly affected the European creditors/trading partners of the federal republic, whose trade deficit in relation to (the Federal Republic of) Germany more than compensated for their deficit in relation to the USA throughout the whole of the fifties.

2. When the bilateral trading relations were reviewed, the resultant payments were to be treated, in accordance with the London Agreement, as German imports from the respective creditor country. This meant that compensatory measures could only be effected after Germany had completely earned each respective debt service payment through export surpluses. Conversely, Germany would have had the option of imposing import restrictions if the bilateral balance of trade had only been equal, not to mention negative.

3. Not least, the creditors silently accepted a strong undervaluation of the DM as a result of these guidelines and thereby created an important precondition for the German balance of trade surplus. Only in the sixties, when repayments under the London Agreement had become marginal to the German balance of payments, due to payments made in advance by the federal republic, did the DM come under pressure to revalorize.¹⁴

Philipp Hersel's study (1998) of the relation between debt servicing payments and the balance of payments balance in the years 1990 to 1994 (the most recent coherent data available to him) shows that, in relation to the group of -at that time- 66 highly or moderately indebted southern countries, the 19 members of the OECD's did not meet with the criterion of a balance of payments surplus. Had they wanted to apply the principle fixed in 1953 for good reason, they would have had to import additional goods to the value of more than 26 billion US\$ from the 66 countries annually – or, as a matter of principle, gone without any debt servicing at all. In fact there were a few creditor countries (the Netherlands, Spain, USA) which met with the surplus criterion in the period under consideration, while Germany would have had to import a further 8.5 billion US\$ worth of goods.

2nd characteristic:

Arbitration as an instrument of conflict resolution

Principally in connection with the federal republic's transfer problem in relation to the settlement of their payment commitments, there is another remarkable regulation in the London Agreement: in the event of payment difficulties, which were principally expected if there was a shortage of foreign exchange due to insufficient balance of trade surpluses, it was agreed that upon request by one of the creditor states holding a substantial share of all debt covered by the present agreement or by the Federal Republic of Germany, consultations will be held between the parties.

It went on to state: 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...¹⁵

What is remarkable about this regulation, is that, in the case of an infringement of the very generous above agreement by the debtor, there are no sanctions laid down to be applied by the creditor but rather, the convening of direct negotiations is envisaged, if necessary, by seeking advice of an appropriate international organization.

From the perspective of the current discussion on impartial debt reduction procedures it is almost regrettable that the London Agreement was so successful and so (the Federal Republic of) Germany never needed to reconvene the parties and therefore never had to request advice from an appropriate institution. Otherwise, it would have been interesting to observe whom the parties would have chosen, and to what extent they would have followed the advice of any such institution.

Characteristic 3:

Comprehensive solution to public and private liabilities

One of the serious weaknesses of the actual management of international debt consists of its splitting up into different fora, in which the demands of only one creditor group at a time on a sovereign debtor, or the private debtors of the country in question, are dealt with. Recently this fact has led to problems, in particular in the case of middle- and low-income countries outside the HIPC group. The most recent IMF proposal for a new, comprehensive negotiating mechanism (Sovereign Debt Restructuring Mechanism, SDRM) attempts, although still inadequately, to address this problem.

1953-2003

In contrast to this, the comprehensive character of the London Agreement, with its clear orientation towards the restoration of the German transfer ability to meet all demands on public and private debtors on the part of all foreign creditors, is impressive. This occurred three years before the foundation of the Paris Club, which has tried, since then, to regulate the public bilateral debts of the southern countries from a very partial point of view, while at the same time claiming for itself,

in an incompetent manner, a leading role in the overall debt management.

If, on the other hand, the London Agreement had excluded a creditor group or a category of debtor, the aim of an acceptable solution could hardly have been achieved. In addition to that, the comprehensive character of the agreement was an important precondition for its acceptability to all creditors.¹⁶

6. The perception of the London Agreement: From the press in the fifties to the apologetics of the German government

The London Debt Agreement was not recognised in Germany as the great breakthrough that it was immediately after its signing. On the contrary, Hermann Josef Abs, the leading negotiator, was criticized by the board of the "Bank Deutscher Laender" for exceeding the 500 million DM debt servicing threshold in the years prior to 1958.¹⁷ Nor can Abs' assessment of the agreement as an overall successful solution shared by the German media. The tabloids even went as far as personal attacks in their interpretation of the agreement as (once again) a German capitulation in the face of allied interests. Apart from the misinterpretation of the facts in relation to the implications of the contract, that kind of 'we are someone again' attitude of German public opinion, only a few years after the end of the war, revealed an astonishing measure of self-confidence.

While Abs himself considered the "inconspicuous settlement" of the agreement as "an indication

of its success"¹⁸, it disappeared astonishingly quickly from the consciousness of German public opinion.

Not till 1987 was the scientific debate about the agreement revived in a study by Thomas Kampffmeyer for the German Institute for Development Policy (DIE).¹⁹ However, the federal government of the time attached no importance to a reopening of the discussion and didn't encourage the Institute (which was publicly financed) to undertake a publicity offensive with the results of his research. As from 1993 onwards a number of non-governmental organizations (NGOs) began to use the results of the Kampffmeyer study for their campaigning on behalf of debt relief for southern countries, they realized that the London Agreement was largely unknown to German public opinion.²⁰

The conservative-liberal federal government felt itself obliged to say something about the

relevance of the agreement to the present situation, in view of the growing weight of the debt cancellation movement, in particular, the growth of the 'Jubilee 2000 campaign'. It followed a very superficial interest, because it was mainly concerned with the rejection of the demand made by NGOs that the southern creditors should at least be given equal treatment.

In 1994 and 1998 the federal Ministry of Finance (BMF) submitted a short paper on that question. Astonishingly, in the paper published in 1994, the BMF comes to the conclusion that the London Agreement "made no provision for cancellation of capital". The ministry could only make this statement by regarding the reduction of the originally established total demands from 13.5 to 7.4 billion DM as an advance adjustment and not a result of the London negotiating process. Even if one accepts this description – contrary to the perception in the scientific research, which sees the above-mentioned reduction as a genuine component of the London negotiations – then this relief is, of course, a concession to the debtor anyway.

From that we can see what significance the 'Verification of Claims' has as a first step in debt negotiations. In view of these experiences, the importance of an independent scrutiny of all claims and debts submitted respectively by the parties cannot not be overestimated. This is all the more the case, since for Germany in 1953 as for the present day debtor countries – irrespective of their incomes – there is frequently a high measure of uncertainty concerning data referring to the level of outstanding debts.²¹ In 1952 too, an assessment was made, which principally served the political intentions of the parties involved.

To the disappointment of the debt relief movement, the red/green federal government continued the approach of the Kohl government to the London Agreement. Memo No. 2/99, issued on 12th February 1999 by the Ministry of Economic Co-operation (BMZ) says:

“*It is often overlooked, in the debt relief debate, that the debt service payments of the poorer developing countries are only one aspect of the financial relationships with the creditor countries. If one takes into account new disbursements through official development co-operation, a positive flow to the developing countries becomes apparent. In the case of heavily indebted poor countries above all, new money from both bilateral and multilateral sources, exceeds their debt service payments so significantly that in each respective country there remains so much of a net inflow that, in the majority of cases, the alleged strong limitations placed on education and health spending, as a result of debt servicing, could be covered. We consider the frequently made comparison between the rescheduling of the debts of developing countries and the 1953 London Debt Agreement to be inappropriate. The demand that developing countries should also pay a debt servicing ratio of no more than 5%, as in the case of Germany then, as a result of debt relief, does not take into account the aspect of new payments made in development co-operation, either. Germany received the last Marshall Plan disbursements in 1952, in other words, before the London Debt Agreement, whereas developing countries, as already mentioned above, continuously receive substantial assistance from development aid, which is far in excess of their debt service.*”

The BMZ is treading on very thin ice with its method of argument. Until now, there was an unspoken consensus between the creditors and (most) NGOs to define **debt sustainability** narrowly as: *“the ability of a country to completely fulfil its debt service commitments without building up long-term backlogs”* (World Bank/IMF) or *“...without impeding social development”* (NGO definition). Both definitions are based on an assumption that the ability to service debt is earned through one’s own economic activity, in other words gained through the export of goods and services – even if the reality of indebted countries does not always correspond to this ideal.

Consequently, the most important ‘burden indicators’ refer to the relationship between debt service or debt stock and export income. An acceptable middle- term level of debt cannot therefore be considered as such if it is dependent on transfers within the framework of development cooperation. To offset this against debt service contradicts the concept of an acceptable level of indebtedness, as it is understood, for example, by the creditors within the framework of the HIPC initiative.

If the creditors open up the term debt sustainability to include other factors, which up to now have been excluded, this could be understood by the debtor countries as an invitation to throw other aspects into the debate from their perspective too; things like:

■ **The question of reparations**, which countries have a justifiable claim to when they have been plundered for five hundred years by the legal predecessors of those governments and banks currently appearing as creditors and, as a result of decolonialisation, have been released into independence with crippled national economies.

■ **The question of the legitimacy** of debts, which with the full knowledge of the creditors, were incurred for useless and harmful projects.

Secondly, this argumentation throws up the question of what development aid is really given for, particularly when it is posed by the BMZ.

Federal minister Wieczorek-Zeul frequently emphasised, amongst other things, in discussion about the Cologne Debt Initiative, that the development aid budget must not degenerate into a debt service fund. Thus it is surprising to see, that in her ministry the use of development aid for debt servicing (via balance of payments assistance) or to fill gaps caused by debt servicing, is obviously not considered problematic.

Development aid is commonly understood as being for countries, which are unable to finance either the provision of basic social services, or the accumulation of capital for independent and sustainable development. If those funds are used instead, either directly or indirectly, for the servicing of old obligations this contradicts the aim of development co-operation.

7. Learning from London

Four points seem to be decisive in the question as to what we can learn from the London Agreement for contemporary debt management.

1.

Debt management needs to be flexible

Interestingly, the creditors concentrated on the argument: 'London cannot be taken as a model' in their attempts to dismiss any analogy between the relief granted to Germany under the London Agreement and the treatment of contemporary debtor countries. This is true. The relief for Germany occurred in a very specific political and economic context and cannot, as demonstrated above, be seen in isolation from the former in particular. Any 1:1 transfer is therefore impossible.

Rigid models of debt management, whether in the form of fixed ratios for relief, or of upper boundaries to sustainable debt world wide, are, however, not the invention of NGOs. On the contrary, they were developed by the Paris Club since the end of the eighties to enable it to handle those southern countries affected by the debt crisis which broke out in 1982. It is not completely without irony that the authors of the notoriously unsuccessful Toronto Terms, London Terms, Houston Terms, Naples Terms, Lyon Terms, Cologne Terms, HIPC-I and HIPC-II of all people issue a warning about not taking a demonstrably successful debt reduction scheme like the London Agreement as a 'model'.

Nevertheless, one has to agree with them. International debt management needs no 'model' which can be applied worldwide and regardless of

the surrounding circumstances. On the contrary, it needs flexibility in the application of guidelines. The 'Jubilee 2000' campaign introduced the debt service ratio of 5%, which had actually been achieved under the London Agreement, into the discussion as something like a guideline.

2.

What was actually different then from now?

Commentators who are critical of a comparison between Germany in 1953 and southern countries currently in debt correctly point out a number of differences:

- Germany had been destroyed by the war, but it remained an industrial nation with a comparatively highly trained workforce and technical intelligence.
- Germany had at its disposal a financial infrastructure which had remained largely intact.
- Germany never lost its strategically significant central position with a high interest potential for its creditors.

Interestingly, all these arguments indicate that Germany then really needed less generous treatment than the indebted countries of the south need now. If there are arguments for a more generous treatment of Germany by comparison, it is high time that they were introduced into the debate by the current creditors.

3.

What kind of amounts are we talking about?

If the London Agreement is used as a basis for a debt reduction along the lines of point 7 a. above, then a scale can be calculated which, in its turn, provides a basis for saying which reductions in revenue, in other words costs, would be linked, for the creditors, to a debt reduction based on London. Erlassjahr 2000 attempted this in 1998²². The result was that a reduction in the debt service ratio of 35 HIPC's, 5 SILMIC's, (severely indebted lower middle income countries) and 4 SIMIC's (severely indebted middle income countries) would lead to a fall in income for the German taxpayer of around 2.5 billion DM in the first year of relief, and German private creditors would have to carry costs of about 1.5 billion DM. In the following years, these losses would decrease. The relief would cost the German taxpayer about 55DM pro capita (of which 43DM alone would be for the four SIMIC's) and the German saver/investor/ shareholder 32DM pro capita (28DM of which would be for the SIMIC's). To compare: the costs to the public purse for the currently planned Metrorapid in Bavaria and Northrhine Westphalia alone come to 2.3 billion EURO. And that, in the opinion of the majority of independent experts, is a classic white elephant, that is the kind of economically useless prestige project that politicians and the public enjoy criticising, and have every right to criticise, in the indebted countries of the south.

A breakthrough in international debt reduction,

as was often demanded in the context of the Johannesburg environmental summit in September 2002 in the north's own interests, is therefore not 'unpayable', as long as it is based on 'London 53'.

4.

Quality is decisive

Even if the Erlassjahr campaign itself has contributed to particular notice being taken of the quantitative implications of the London Agreement, the qualitative elements of the agreement referred to in section 5 above contain the most important impulses for further debt relief for the south:

- The referral of debt sustainability to the transfer capacity of the debtor country, expressed by a balance of payments surplus;
- The involvement of neutral bodies when there are disputes in connection with the application of the agreement;
- The basic inclusion of all demands being made on all of a country's debtors in a comprehensive settlement.

These points should not only be further developed by NGOs and academics. After all, it was not them who negotiated the London Agreement, but governments, the majority of whom have once again today become central actors in the international debt management process.

LITERATURE

Abs, Hermann Josef: Entscheidungen 1949-1953;

Die Entstehung des "Londoner Schuldenabkommens", Mainz-München 1991

BMF (Bundesministerium für Finanzen) 1994: Das Londoner Schuldenabkommen von 1953

Deutsche Bundesbank: Das deutsche Geld- und Bankwesen in Zahlen 1876-1975, Frankfurt 1976

Hersel, Philipp: Das Londoner Schuldenabkommen und die aktuelle HIPC-Initiative der Weltbank, Berlin 1997 (no publicado)

Hütz-Adams, F.: Das Londoner Schuldenabkommen von 1953; Erlassjahr 2000; Siegburg, 1998. Kampagnenkurier "Was kostet der Schuldenerlaß die Gläubiger?", Nr.5; Juli 1998

Kampffmeyer, Thomas: Die Verschuldungskrise der Entwicklungsländer - Probleme und Ansatzpunkte für eine Lösung auf dem Vergleichswege, Berlin 1987

Kolb, Eberhard: Die Weimarer Republik, Oldenburg, 1984

Link, Werner: Die Beziehungen zwischen der Weimarer Republik und den USA, in: Knapp/Link/Schröder/Schwabe: Die USA und Deutschland 1918-1975, München 1978

Michalka, Wolfgang: Deutsche Außenpolitik 1920-1933, in: Bracher/Funke/Jacobsen (Hg.): Die Weimarer Republik 1918-1933. Politik - Wirtschaft - Gesellschaft (Bundeszentrale für politische Bildung, Band 251), Bonn 1988

Meyer, Gerd: Die Reparationspolitik - Ihre außen- und innenpolitischen Rückwirkungen, in: Bracher/Funke/Jacobsen (Hg.): Die Weimarer Republik 1918-1933. Politik - Wirtschaft - Gesellschaft (Bundeszentrale für politische Bildung, Band 251), Bonn 1988

Pohl, M.: "Er hatte keine Freunde, auch keine Affären"; Frankfurter Rundschau 13.10.01; pág.16

THE AUTHOR:

Jürgen Kaiser es el coordinador político de la Alianza Nacional orientada al desarrollo "erlassjahr.de – Entwicklung braucht Entschuldung" (Jubileo.de – Desendeudamiento para el Desarrollo)

BUBLISHER: erlassjahr.de

The 'erlassjahr.de' coalition has more than 800 members in Germany, amongst them development organizations, church charities such as Misereor and Brot fuer die Welt, protestant state churches, roman catholic dioceses, one-world groups, fair trade shops and local churches. It is the successor of the 'Erlassjahr 2000' campaign, founded in 1997, and works within a network of more than 50 similar organizations worldwide. The initiative's principle aim is a reform of international debt management and the introduction of an international insolvency procedure.

TRANSLATOR: Margery Cartledge

erlassjahr.de:

Carl-Mosterts-Platz 1, 40477 Düsseldorf

Tel. 0211 – 46 93 – 196, Fax 0211 – 46 93 197

E-Mail: buero@erlassjahr.de

Internet: www.erlassjahr.de



FOOTNOTES

- ¹ The Federal Republic of Germany was to be strengthened politically and economically to act as a buffer state against communist regimes. In addition, the USA hoped Germany would rebuild its army and thereby relieve the Americans in Europe while they were waging war in Korea. The growing German economy was also to extend economic production and thereby make up part of the potentially inflationary shortage of goods which had been created through the conversion of US factories to arms production.
- ² F. Huetz-Adams, *The 1953 London Agreement*, Erlassjahr2000, Siegburg 1998
- ³ P. Hersel, *The 1953 London Agreement – Lessons for a new Trade- and Debt-Policy between Debtors and Creditors*, Erlassjahr2000, Siegburg 1998, pp.6-7
- ⁴ and accepted by the German government under pressure of the 1921 London Ultimatum
- ⁵ For further background details see: Huetz-Adams 1998
- ⁶ Hersel (op. cit.) p.7 emphasises the benefit that arose from this for individual profitable companies, who could easily have met their obligations.
- ⁷ H.J. Abs, *The Londoner Schuldenabkommen*, in: *Zeitfragen der Geld- und Wirtschaftspolitik*, Frankfurt 1959, p. 18
- ⁸ Total public indebtedness approx. 23 billion DM, as the approx. 7 billion DM private debts must be disregarded for the purpose of this calculation.
- ⁹ The HIPC Initiative does not express debt sustainability in nominal values in relation to the respective standard of comparison (in this instance: public income) but in so-called Net Present Value (NPV). NPV is the total value of all repayments made on a particular debt in the total repayment period, discounted at an average rate of interest. If a debt is at a low rate of interest therefore, its NPV will be lower than its nominal value; if it is at about the market rate of interest they will be about the same.
- ¹⁰ For further detail see: 'What goes down might not come up', EURODAD (Brussels) 2001.
- ¹¹ The only exceptions are limited debt conversions for which Indonesia might possibly qualify.
- ¹² Total public debt of c.11 billion DM, since the c.3.5 billion DM private pre-war debt remaining must be removed from this equation.
- ¹³ H.J. Abs, *Entscheidungen 1949-1953, Die Entstehung des Londoner Schuldenabkommens*, Mainz-Muenchen 1991, p.195
- ¹⁴ For further detail see: Hersel, op. cit., pp, 10-11
- ¹⁵ London Debt Agreement Article 34
- ¹⁶ From the current perspective, the fact that the London Agreement was reached without any internationally binding legal framework, and nevertheless was accepted and implemented by all parties without any difficulty, is particularly interesting. By contrast, in the discussion about its own role in a future SDRM, the IMF likes to point out that the complex debt situation of countries like Argentina, who are indebted to a broad variety of creditors, would require such a legal framework (to be provided by the IMF). In reality, the starting position of the London Agreement, with private and public debtors and creditors, as well as the politically charged question of the pre-war debts arising from first world war reparations, was as least as complex as that of present day Argentina, two thirds of which's debt is with private bond issuers.
- ¹⁷ M. Pohl, *Er hatte keine Freunde, auch keine Affairen*, Frankfurter Rundschau 13.10.01, p. 16
- ¹⁸ H.J. Abs, *Entscheidungen 1949-1953. Die Entstehung des Londoner Schuldenabkommens*; Mainz 1991, p. 272
- ¹⁹ Kampfmeyer loc.cit.
- ²⁰ Since 1993, the author has held nearly 100 large and small events on the subject of debt relief for the developing world in all parts of the country. At all these events he has only ever met one single person who had heard of the agreement (apart from those who had been made familiar with it through the work of the debt relief initiative itself).
- ²¹ See, for example: J. Kaiser, *Schuldenmanagement a la Louis XVI: Ein kleiner Gang durch Geschichte und Praxis des Pariser Clubs*, Erlassjahr2000, 1999
- ²² Was kostet der Schuldenerlass die Gläubiger?, *Kampagnekurier* No. 5, July 1998