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# The Business of Debt:

BRIEF 2

**WHAT WORKERS AND UNIONS  
SHOULD LOOK OUT FOR**



# The Business of Debt

## WHAT WORKERS AND UNIONS SHOULD LOOK OUT FOR

### DEBT & CRISIS

- Since 1970, 390 financial crises have taken place around the world: equivalent to 8 crises per year<sup>1</sup>
- Global debt levels have increased from USD 80 trillion in 1999 to USD 170 trillion in 2008.
- When the 2008 Global Financial Crisis hit, global debt was almost three times global GDP<sup>2</sup>
- More than 40 million people lost their jobs as a result of the GFC<sup>3</sup>

**D**ebt build ups and crises are an endemic feature of modern globalized capitalism. Their frequency and impact have increased in recent years.

The economic and social consequences of these crises continue today. With rising unemployment comes rising inequality. In Europe there is less work, reduced overall working time, less overtime, rising job insecurity, less choice for workers, wage freezes and wage cuts.<sup>4</sup>

**When crises happen, workers pay the price. For this reason, workers need to identify the causes and warning signs of a debt build-up and crisis - and fight against them.**

While individual country debt build-ups have their own characteristics, they tend to share a common set of elements. Crises are often preceded by periods of financial deregulation. They involve increases in international capital flows, and increasing debt levels over a short period of time.



# FINANCIAL DEREGULATION:

## A PRECURSOR TO DEBT BUILD-UPS

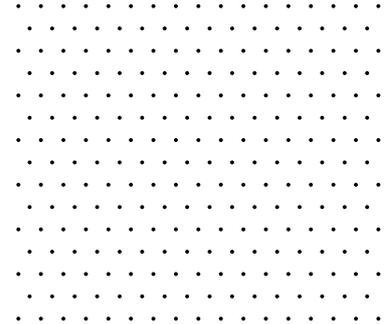
Financial institutions have been re-shaping government and international regulations in their favour since the 1970's, after decades of financial stability following WWII. Things started to change after the collapse of the so-called Bretton Woods system in 1973. This system of global economic governance was a concerted effort by leading economies to ensure peace and productive growth by promoting international trade, foreign direct investment and helping countries to bridge liquidity problems, while reining in short-term, speculative international capital flows. The role of governments in the economy shifted from a focus on structural controls and stability to market-friendly approaches to self-regulation and allowing banks to expand their involvement in a range of risky financial activities.<sup>5</sup>

There were at least three major consequences of this process:

**Financial institutions assets and power have grown like never before.** In advanced economies, the assets of banks as a share of GDP more than doubled since 1990, now representing more than 200% of GDP. In emerging economies, bank assets as a share of GDP tend to exceed 100%.<sup>6</sup>

**International capital flows have grown as controls on capital have been eliminated.** Gross capital flows increased from 5% of world GDP in 1990 to over 20% in 2007. During this period, cross border capital flows rose three times faster than world trade flows.<sup>7</sup>

Global debt levels have increased dramatically. Global debt stocks rose from only USD\$ 16 trillion in 1980 to USD\$ 152 trillion at the onset of the global financial crisis and have since risen again to an eye-watering USD\$ 213 trillion, or three times global output. Much of this extraordinary increase in global debt levels has been driven by the accumulation of private debt, fuelling financial speculation rather than productive investment, and explaining much of the growing recurrence of debt build-ups and crises.<sup>8</sup>



## VOLATILE INTERNATIONAL CAPITAL FLOWS: FUELLING DEBT BUILD-UPS

A key warning sign for crises is a sudden increase in international capital flows. These create several problems for countries:

- The size of global financial markets means even minor shifts in capital flows can dwarf the capacity of individual countries to respond

For example, global gross capital flows reached USD 4.3 trillion in 2016.<sup>9</sup> The power imbalance between global markets and countries is made worse by deregulation, as it allows large investors and corporations to overwhelm domestic institutions, such as governments and labour unions. To put this in context a 5% shift in global capital flows would be bigger than the combined stock market value of the smallest 55 countries.<sup>10</sup>

- Large capital inflows distort asset prices and economic activity

When capital flows into a country it often results in an expansion of domestic credit that can drive asset prices higher and fuel financial speculation. Under these circumstances borrowing no longer finances productive investments: instead, speculation in the real estate and stock markets accounts for most of the financial activity. This dynamic explains the link between capital flows, debt build-ups and crisis: countries receiving large capital inflows are four times more likely to experience a crisis.<sup>11</sup>

- Deregulation has led to an increase in the volatility of international capital flows

Without controls, capital can flow in and out of countries rapidly. This leaves countries in a vulnerable position. As international investors take flight - for reasons that might not be even related to the country itself - the system falters, asset prices drop, and borrowers struggle to service their debts. Depending on the severity of the bubble, a country can experience a combination of debt, currency and banking crisis. This dynamic was at play in Ireland and Spain in 2010, and more recently in Turkey and Argentina in 2018.

## DEBT BUILD-UPS AND THEIR RISKS

When used appropriately, debt can be a key tool to deliver productive investment and jobs. However, a debt build-up, in the context of financial deregulation and strong capital flows, can create significant problems including speculative investments, bubbles and crisis. Dangerous debt build-ups have a recognizable set of characteristics: they occur at a fast pace during a short period of time and often involve credit in foreign currencies. They are especially risky when they involve borrowing for consumption and real estate speculation.

Rapid accumulation of debt is a sign of future problems. Financial deregulation often leads to falling credit standards. In this context, both borrowers and lenders take increasing risks and speculative bets. As safety margins decline, the economy becomes vulnerable to a crisis. This dynamic makes credit booms a reliable indicator of trouble. The evidence is overwhelming: of 43 countries where the credit-to-GDP ratio increased by more than 30% over 5 years, only five didn't end up in a crisis.<sup>12</sup>

Borrowing in foreign currency increases the risks of a debt build-up. Accumulation of debt in a foreign currency is usually a consequence of large international capital inflows. These reduce the costs of borrowing in a foreign currency such as US dollars or Euros. Both public and private sectors respond by increasing their external borrowing. This creates a dangerous situation: while their incomes are still in local currency, their debts are in a foreign currency. Ability to repay now depends on access to foreign exchange, over which national authorities have no control. An external shock restricts access to foreign currency can quickly plunge countries into crisis. This is why large volumes of foreign-currency debt is one of the most common explanations of debt crisis over the last 30 years.<sup>13</sup>

As discussed in Brief I of this series, productive investment financed through debt does not usually represent a threat. Investment in activities such as manufacturing or infrastructure provides individuals or countries with income. This can be re-invested, saved or used to service debts. But the risks increase substantially when debt finances consumption and speculative investments. Most recent episodes of crises involved a period of rising household debt, often incurred as a result of wage stagnation.<sup>14</sup> With rising housing prices and cutbacks to the welfare safety net, workers increasingly rely on credit to maintain their living standards. The financial system preys on their situation, creating unsustainable debt. Increasingly, research is showing that as household debt increases, economic growth decreases.<sup>15</sup>

## UNIONS TAKE ACTION - CHAD

In 2014 the Chadian government accepted a significant oil-backed loan from Glencore - a mining corporation - in part, to avoid IMF Loan Conditionality. Within months, the price of crude had dropped by over half and the costs of maintaining the debt have cost the country over half its oil profits, forcing the government to go back to the IMF to seek assistance.

On top of this, tax avoidance and evasion have placed huge strains on the country's revenues, intensifying the debt crisis. In 2016 the government claimed an oil consortium led by Exxonmobil owed the country over \$800 million in unpaid royalties.

Dr Grieve Chelwa, of the University of Cape Town, [highlights](#) how creditors such as Glencore stand to benefit from this form of commodity-backed loans: "A lender faces limited risks whereas the bulk of the risks are carried by the borrower. If the price of a major commodity falls, the principal amount of the loan remains largely unaffected and the borrower is expected to pay back the loan in full. Default is highly unlikely: the IMF and other multi-lateral entities usually put together "rescue" packages (not free, of course)."

Meanwhile, Chad's public sector workers such as nurses and teachers ended faced salary cuts of up to 40%. PSI affiliates led a General Strike which avoided the worst of the austerity measures and ensured workers received their unpaid salaries. Journalists joined the protests, holding a media blackout to protest against intimidation.

The Chadian labour movement have sought support from unions in France, which still holds sway over its former colony. French Unions addressed a letter to Presidents Emmanuel Macron and Idriss Deby, urging social dialogue. "We call on Christine Lagarde, the IMF and the French and Chadian Governments to work to end the brutal austerity in Chad. Development cannot exist without strong public services, and the workers who make them happen," said Laurent Berger, General Secretary of the influential French CFDT union.

The protests helped stop the worst cuts and reforms, and won public sector workers months of back pay which had been withheld from them. Adjoujiu Gueme - leader of the Federation of Public Service Workers of Chad, says the struggle will still continue:

*"Why do we face imposed austerity when we know our country is rich in resources? We recognize the corruption of many of our leaders: but the real corruption is systemic."*

### QUICK CHECKLIST FOR DEBT BUILD-UP RISKS

1. Has the government introduced legislation to deregulate finance in recent times?
2. Has the country received large volumes of international capital flows over a short period of time?
3. Are prices of houses and stocks going up in value?
4. Is debt, either public or private, accumulating at a fast pace?
5. Is most of the new debt denominated in a foreign currency?

If the answer to most of these questions is yes, workers need to argue for changes to avoid the crisis and organize and prepare for the possibility of a financial crisis. This involves several elements:

1. Identify and monitor the most economically vulnerable sectors of the economy, as they are the most likely to be affected by a debt crisis, and publicly highlight their vulnerable conditions and build coalitions with interest groups who would be detrimentally affected.
2. Develop an agenda of political and social priorities to protect workers' rights in the event of a crisis.

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