

THE PROGRESS REPORT

Should There be a Debt Jubilee?

By Fred E. Foldvary

There is a world-wide movement to cancel the debts of many countries. The president of the U.S.A. has called for some debt cancellation. Literature is being circulated for "Jubilee 2000: a debt-free start for a billion people."

The governmental debts incurred in Latin America, Africa, Asia, Russia, and Eastern Europe are indeed burdens on their economies. Much of this debt was wasted or benefited a privileged few instead of being productively invested.

But debt cancellation also has a cost, aside from the loss to the taxpayers of the countries which lent the money. If the debts are simply canceled, then those same countries will borrow money over again and once again spend it wastefully or on special privileges. Even if the governments promise to shift the interest they are now paying into education and health, there is no guarantee that they will do so, or that the spending will be effective.

There is a concept in insurance called "moral hazard." The availability of insurance makes it more likely that folks will do things that will get compensated by insurance, and those who do these things, or are more negligent, will be more likely to want the insurance. When governments and international organizations such as the IMF and World Bank lend to misdeveloped or less developed countries, the knowledge that the debts are likely to be canceled encourages more wasteful and privileged spending.

Many less-developed countries cry for debt relief because they are poor and cannot afford the interest payments. But it is their own bad economic policies making them poor! Poverty has a known cause: excessive taxes, restrictive laws, and unequal land-rent tenure. Government officials insist on deliberately impoverishing their economies, borrow money because their economies are not generating wealth, and then cry that they can't afford the debt payments.

The concept of the debt jubilee should not be an excuse for continuously subsidizing bad economic policy. There should be no debt forgiveness unless the country adopts a prosperity policy. This policy would constitutionally prohibit the taxation of income and spending, adopt free trade, remove arbitrary restrictions on enterprise, and obtain public revenue only from voluntary user fees, charges for environmental destruction, and market-based rents on land, including all natural resources.

If I were to advise the government of a poor country on how to proceed, I would suggest it first liberate enterprise from restrictions and government bureaucracy. Then start taxing all land rent, and eliminate taxes on wages, spending, and produced wealth. Put these policies in the constitution, where they are more difficult to change. When the shift is accomplished, the government would then repudiate its governmental debt just that one time. The taxpayers and consumers would no longer be burdened by past debts that went to waste and elites.

The government would no longer be able to borrow money so easily, but that should not be a problem. Private people and enterprises would still be able to borrow money. There would be plenty of foreign investment to generate growth and development.

It is sound economics and finance to separate your accounting into operating and capital budgets. A government or enterprise should only borrow for capital projects, investments which make the economy or enterprise more productive, so it can more than afford to pay the interest. Current operating expenses should be paid for from current income, not borrowing. Governments should borrow for capital projects only with bonds that are specific to that project and are paid off after the project matures. Municipal governments typically do this, but the U.S.A. federal government and many other governments do not.

With sound economics and accounting, debt forgiveness would not be an issue. The best policy is also to have private enterprise do as much of development as possible. Then if a project fails, it is not the taxpayers' problem. The bondholders will lose, as they should, since they took on that risk. The pure free market has a natural way of canceling debts: bankruptcy.

But countries do not go out of business, so their debts need to be restricted to sound investments, with no debt cancellation. With public revenue from rent, bad debts would become rent payments with no corresponding benefits, so there would be more public pressure to avoid unsound projects that fail to generate rent. The public collection of rent and untaxed production would both generate the prosperity that eliminates poverty, and make it less likely that government would borrow for unproductive spending.