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Article — Digitized Version

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Suggested Citation: Nunnenkamp, Peter (1987) : Latin America debt and development: a review, Weltwirtschaftliches Archiv, ISSN 0043-2636, Mohr, Tübingen, Vol. 123, Iss. 4, pp. 734-738

This Version is available at:

<https://hdl.handle.net/10419/1349>

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Literatur – Literature

Latin American Debt and Development: A Review*

By

Peter Nunnenkamp

Among the long list of publications on Latin American debt, the recent books written by S. Griffith-Jones and O. Sunkel and edited by R. Thorp and L. Whitehead have something in common, which they claim has been neglected so far: according to the authors of the former volume, the fact has been played down “that the debt crisis is part and parcel of a more profound and longer-term growth and development crisis” [S. Griffith-Jones and O. Sunkel, p. 1]; the editors of the latter announce in their introduction that “this book considers the repercussions of these events [i.e., the credit crunch of 1982 and the following debt re-negotiations, P.N.] for Latin American economic development” [R. Thorp and L. Whitehead, p. 1].

Notwithstanding similar titles and the common focus on longer-term development issues of the debtor countries, rather than short-term crisis management assuring the stability of the Western banking system, there is hardly any duplicity, however. This is because fairly different avenues are followed in approaching the central development issue, and because the two volumes differ markedly with respect to the emphasis placed on the debtors’ policies on the one hand and the problems of international financial intermediation on the other hand. The work of S. Griffith-Jones and O. Sunkel starts from a global outline on the severity of the current crisis in Latin American growth and development [Chapter 2] and then turns to the historical background of the current situation. As regards the latter, the “increasing contradictions . . . of the Latin American development model” [p. 2] and the problems arising from the system of international financial intermediation are discussed. The limitations of the import-substituting policies are rather shortly addressed [Chapter 3]; whereas financial issues are dealt with extensively in three chapters on the mechanisms of the Bretton Woods system, the major actors in the international transfer of resources in the 1950s and the 1960s, and the subsequent privatization of financial intermediation via the increasing role of Western commercial banks.

* A review of: **Griffith-Jones, Stephany, Osvaldo Sunkel**, *Debt and Development Crises in Latin America. The End of an Illusion*. Oxford 1986. Clarendon Press. XII, 201 pp. – **Thorp, Rosemary, Laurence Whitehead (Eds.)**, *Latin American Debt and the Adjustment Crisis*. St. Antony's/Macmillan Series. Basingstoke, London, Oxford 1987. Macmillan Press in association with St. Antony's College. XV, 359 pp.

S. Griffith-Jones and O. Sunkel argue that "the weaknesses of the system of international financial intermediation existing in the late 1970s meant that the industrial countries' recession of the early 1980s provoked both an international debt crisis and a crisis of national development, particularly (but not only) in Latin American countries" [p. 81]. They consider the economic slump in industrialized economies to be a deep-seated structural problem rather than just a recession [Chapter 7], reason that it played a major role in sparking off the widespread debt crises in Latin America [Chapter 8], and analyse why the industrial countries' recovery in the mid-1980s seems to be insufficient for overcoming the debt and development crises [Chapter 9]. The authors conclude that a new international financial system is needed and Latin American countries must strive for economic re-activation and new development strategies. As regards the latter, debtors are required "to reformulate their development policies, directing them towards four fundamental objectives: concentration of available resources on meeting the basic needs of the majorities, employment, selective export expansion and diversification, and import substitution" [p. 182].

Again in contrast to the brief treatment of internal policy issues (justified rather surprisingly by stating that "there is so little to dwell upon in the present discussion" [p. 175]), the long chapter on financial relief presents a fairly complete review of major proposals as to how to deal with the problems posed by the debt crisis. The sharp decline in financial flows to Latin America since 1982 and the increase in the costs of servicing old debts are considered to have improved the bargaining position of debtors vis-à-vis their creditors; in the case of negative net transfers, the debtor is in the position not only to refuse the conditions of the lender but also to impose his own. Debtors are advised to make better use of their power and to exert pressure for changes to be made in the international financial system, to the benefit of developing countries and the world economy (including the commercial banks). The authors argue that an eclectic approach has to be followed, combining measures to reduce the debt overhang, to induce new lending and to strengthen the international banking system.

In sharp contrast to S. Griffith-Jones and O. Sunkel, reforms of the international financial system are dealt with only incidentally in the volume edited by R. Thorp and L. Whitehead. The latter book strongly concentrates on the economic policies of Latin American countries and their repercussions for economic development. In the introduction, the editors raise the hypothesis that "the developments of the 1980s have made short-term adjustment in the conventional manner more difficult and/or less rewarding" [p. 7]. The conflict between a narrowly-defined adjustment to debt crises and longer-term development goals figures prominently in the analysis, which is the result of collaboration and joint discussions between eight researchers based in the United Kingdom, the United States and Latin America.

Besides the introductory remarks, the volume contains nine chapters, including seven country-specific papers. C. Díaz Alejandro presents a broader discussion on major issues of the development crisis in Latin America [Chapter 2], and R. Thorp and L. Whitehead provide a concluding review of the country studies and some major policy issues in the final chapter. Díaz Alejandro's contribution is interesting, although it remained in draft form because he died shortly after the authors' final working session held in July 1985. This chapter represents a condensed version of the lengthy discussions by S. Griffith-Jones and O. Sunkel. According to C. Díaz Alejandro, it is due to the breakdown of international financial markets in 1982 that Latin America faced

a major development crisis in the early 1980s, rather than a manageable recession. “In retrospect, it appears that the fate and prosperity of a few international banks were much too rigidly linked to the stability of the international financial system” [p. 25]. This reasoning is largely in line with that of S. Griffith-Jones and O. Sunkel; but C. Díaz Alejandro expresses an opposite view as far as the consequences for the bargaining power of debtors and creditors are concerned, which he considers to have shifted decisively in favour of the latter.

Chapters 3–9 present detailed accounts of the economic adjustment to debt problems and its implications for longer-term development in Brazil (D. D. Carneiro), Mexico (J. Ros), Chile (L. Whitehead), Argentina (G. di Tella), Peru (R. Thorp), Colombia (J. A. Ocampo), and Central America (V. Bulmer-Thomas). From their analyses, it appears that:

- Brazil performed well with respect to the compatibility between short-term responses necessitated by the crisis and long-term needs, due to sophisticated and forward-looking economic management;
- Mexican adjustment was characterized by erratic and destabilizing shifts in policies and progressively declining trust in the governing authorities;
- the Chilean attempt to reshape the society as a whole had disastrous macroeconomic results;
- Argentina’s preoccupation with the short term caused a serious problem of long-run stagnation and failure to restructure the economy;
- Peru is an even more extreme example of a grave long-term problem compounded by the short term, since, in this country, poverty rests both in the lack of capability of the state and in the shortage of natural resources;
- Colombia represents a shining example of growth and successful macro-management which was often “exceptionally undogmatic” [p. 331];
- Central America was dominated by political crises and a clear conflict between short-run adjustment and long-run development.

In their summary, R. Thorp and L. Whitehead blame the International Monetary Fund for being mainly responsible for the deteriorated development prospects of Latin American debtors; this is due to the “essentially short-term, patchwork and anti-developmental content of the IMF-prescribed remedy” [p. 336], especially its “obsession with budget deficits” [p. 334].

Particularly the editors, but other authors of this volume as well, appear to be obsessed in another way, however. The discussion is frequently dominated by the attempt to unmask the archfiend of “orthodoxy”. It remains somewhat dubious what this term exactly means and what the opposite is about. In the introduction, the editors refer to “conventional adjustment” which “typically comprises credit and fiscal restraint, with targets for the reduction of the fiscal deficit and the money supply, and ‘correction’ of prices including exchange rates” [p. 4]. We also learn that orthodox economists must be separated from *very* orthodox economists; the latter “would in fact recommend different measures” [p. 7], but it seems not relevant to elaborate on their concepts. Subsequently, “orthodoxy” is more narrowly attached to deflationary demand policies on the one hand [see e.g. p. 62], but appears to include the “liberalisation of commercial practices” [p. 248] and the presumption that markets work efficiently, provided that they are allowed to do so, in a wider definition on the other hand (possibly, such inconsistencies may be resolved by subsuming the latter elements under the *very*

orthodox, "neo-conservative" [p. 117] or "conservative" [p. 56] approach). To make the confusion complete, G. di Tella distinguishes between a "necessary orthodox monetary policy" and an "'excessively' orthodox policy" [pp. 192f.]; and J. A. Ocampo identifies a "closed-economy orthodoxy" and an "open-economy orthodoxy" [p. 258] in the case of Colombia.

Evidently, R. Thorp, L. Whitehead *et al.* ignore that the short-term oriented approach followed in the crisis management of the early 1980s has been criticized by many economists as well, which they label orthodox or conservative. More importantly, they also ignore the serious doubts an important part of the economic profession raises against their concluding policy suggestions; the latter reveal an unduly strong confidence in the rationality and efficiency of comprehensive and complex government interventions and do not take into account the economic costs of policy-induced distortions. The best policy alternative suggested by J. Ros for Mexico, for example, i.e., a "heterodox shock" [p. 110] involving a freeze of key prices, including the exchange rate, a regime of price controls, a sharp reduction of nominal interest rates and, possibly, a monetary reform, seems somewhat naive, considering the recent experiences of Argentina and Brazil with such an approach. When the editors conclude that "import and capital controls have been an important ingredient of the relatively more successful adjustment efforts" [p. 338], the reader wonders whether it is no longer true what was said some pages before; i.e., that short-term adjustment of Latin American economies was often at the expense of their neighbouring countries. Moreover, what about the long-term consequences on economic development, if the symptoms rather than the causes of capital flight are tackled and discretionary import controls prevent specialization according to the country's comparative advantage?

The study edited by R. Thorp and L. Whitehead fails to formulate a longer-term oriented alternative to the short-term IMF-approach and its conclusions are highly debatable. But the reader is provided with useful and detailed insights into the economic policies of Latin American governments before and after the debt crises erupted, which allows him to draw his own conclusions. In this respect, this volume is clearly superior to that of S. Griffith-Jones and O. Sunkel, which largely lacks the analytical basis for the concluding suggestions. A "general inability of LDCs to repay their debts on schedule" [p. 169] does simply not exist, considering the favourable performance of most Asian borrowers. The statement that highly indebted countries will not succeed to attract further loans on a voluntary basis, provided that they re-orientate their economic policies, is apodictic rather than based on empirical evidence. The presentation of possible elements of a new financial system frequently does not take into account the economic costs involved; this refers, for example, to additional SDR issues, concessional capping of interest rates and government insurance of bank lending. The discussion on the central banks' role as lender of last resort does not distinguish between the insolvency of specific banks and global illiquidity.

Moreover, the recommendations on policy reforms in Latin American countries ignore the critical assessment of the import substitution model, which failed to reduce foreign dependence. What is the relevance of Chapter 3 when the authors conclude that "it will be impossible to continue importing luxury cars, electrical and electronic appliances, liquor, and other luxury goods" [p. 195]? Outward-looking policies are discounted, although empirical studies have shown the superiority of a balanced incentive structure towards domestic and overseas sales in overcoming external shocks,

even in times of depressed international demand. Evidently, “new development strategies ought to be based on . . . a critical appraisal of past failures” [p. 186]. But it is highly unlikely that this requirement is met by “a combined policy of selective restriction of demand and selective expansion of supply” and the confidence in an “efficient use of state planning and intervention” [p. 190].

S. Griffith-Jones and O. Sunkel have written a book for the believers in their ideology, which allowed them to substitute apodictic statements (such as “neoliberalism has ignored both the common and the particular characteristics of (Latin American) economies” [p. 186]) for a sound economic analysis; and it saved them the trouble of critically evaluating the explanatory power of different economic schools, rather than simply putting labels – similar to those used by R. Thorp and L. Whitehead – on them, such as “conventional economics”, “the ideology of free trade”, and “reactionary position”.