Floor Discussion of the Williamson Paper

Lessons from the 1980s debt crisis

John Williamson's assessment of the lessons that can be learnt from the 1980s international debt crisis provoked many comments. Various participants were particularly critical of the so-called 'Washington consensus' to which Williamson alluded in his paper.

One of the most outspoken critics was Ricardo Ffrench-Davis. He observed that the tough adjustment policies applied in Latin America in the 1980s had resulted in serious setbacks in economic development, employment, investment, and social conditions, while many Latin American countries had made net financial transfers abroad which, as a proportion of GDP, "were larger than those made by Germany after the First World War". Production losses during the decade were calculated at US$40 billion per year, he said. As a consequence, per capita output was now still lower than at the beginning of the crisis. By the early 1990s, over 40 per cent of the Latin American population, i.e. 200 million people, were living below the poverty line, he said.

Although Ffrench-Davis agreed that, at the beginning of the 1980s, adjustment was clearly needed and had also yielded positive results such as lower inflation rates and increased exports, he felt that a much better approach than the one propagated by the 'Washington consensus' would have been possible. "Not enough time was provided for doing the adjustment in the right way, and funds were curtailed too sharply," he said. Consequently, Ffrench-Davis advocated a "thorough revision" of the adjustment recipe.

"It should be better adapted to the reality of each economy and to the capacity of its markets and institutions to respond, be more comprehensive (including the impact on social and environmental variables), and explicitly address the questions of what would stimulate investment and growth, what would be the impact on the poor, and how productivity could be increased. It is a grave error to think that the problems of a low level of investment and of poverty would be automatically solved solely by liberalising markets and by a passive State," he warned.

Ffrench-Davis put special emphasis on the need for designing a policy recipe that would stimulate productive investment "rather than financial activism".

"If countries are faced for five or ten years with real interest rates of 20, 30 or 40 per cent, and an idle production capacity of 20 or 30 per cent, you have a very discouraging climate for private investment," he observed.

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The experience of Latin America during the 1980s shows that one should rethink the reform policies that were applied, French-Davis noted. "I think this will be quite relevant for Eastern Europe as well," he concluded.

Stephany Griffith-Jones endorsed Ffrench-Davis' plea, stating that "the Washington consensus of adjustment" had demonstrated a poor record in encouraging investment. "This is clearly shown by empirical evidence, including research by the World Bank itself," she said. Like Ffrench-Davis, she also felt that the social costs of adjustment ought to be taken more into account.

Gunter Baer raised the provocative question of whether a debt crisis was unavoidable or even desirable. He asked this question because John Williamson seemed to argue that the cooperative strategy that was chosen to deal with the crisis had been useful and beneficial to all three major players involved. Obviously there were costs too, he said. He therefore wondered what kind of advice one could give to those countries in Eastern Europe that did not yet have a debt problem. "How to avoid such a debt problem in the first place, I suppose," was his reply.

Gerald Helleiner drew some lessons for Eastern Europe from the African experience.

"First, Africans are being told by everyone to open their countries to foreign investors. But investors have no interest in putting their money into places with a debt overhang, and I suspect there is a similar story in Eastern Europe. Second, the African situation has gone terribly bad because of the collapse of primary commodity markets. In the case of Eastern Europe there is a similar problem that western markets are not opening up. Third, there is this issue of the link between government assistance and the treatment of government debt, both at the debtor and the creditor government level, which continuously comes up in the African context, and which is coming up again now in Eastern Europe. Fourth, if you put up the IMF when the changes that are required are long-term, you run the risk of landing the IMF in a situation, as in the case of Africa, which it is not equipped to deal with."

Percy Mistry argued that – though the debt problem of developing countries had become more tractable through restructuring, cancellation and conversion – private and bilateral debt had been partially offset and replaced by far less flexible multilateral bank and IMF debt. "In their liability portfolios debtor countries now have too large a proportion of hard and rigid debt service obligations to institutions which have, since 1987, been extracting instead of injecting real resources from severely-indebted countries. From being the solution as lenders of last resort for new money between 1982-85, multilateral lenders have now become the problem for most indebted countries."

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The debt problem

Drag Avramovic communicated the results of some work he had done recently on the question of whether the debt problem is really over. "Given the completion of the Brady Plan arrangements, and the euphoria that the debt crisis is over, I asked myself: how large is the residual debt problem?" Avramovic defined 'problem countries' as those with arrears that exceed 20 per cent of their scheduled debt service. On this criterion, there are 61 countries still in trouble.

"This is a very large number," he said, "consisting of 35 countries in Sub-Saharan Africa, 12 countries in Latin America, 8 countries in the Middle East and North Africa, and 6 countries in Asia. The total population of these countries is 770 million people, and the average per capita income for the group is 460 dollar, which is substantially below the poverty line which the World Bank is using. To whom is this amount owed? To bilateral official creditors, to the private sector – commercial banks and suppliers – and to the multilateral financial institutions."

Mahbub ul Haq advocated that special attention should be given to military debts. "I think we often ignore military debts in our analysis. However, in many countries they are larger than civilian debts. I know the figures for Pakistan, but I am prohibited from revealing them by the official secrets act. They will send shivers through the IMF. I know that in the IMF they have begun the analysis of Egyptian military debt, taking 5 billion dollars as a starting figure and then raising it to more than 40 billion dollars; it will turn out to be larger than civilian debts. But yet, somehow, in all the discussions in the IMF on conditionality, and on debt ceilings, they normally apply to development debts, not to military debts, and they enable the governments to incur more military debts. I think something has to be done now on military debts."

Peter Kenen observed that economic difficulties sometimes are unjustly ascribed to the debt problem. Referring to the case of Hungary, where it is argued that the debt burden has substantially crowded out domestic investment, he stressed that the key issue was the domestic banking system.

"There is every evidence of a shortage of bank credit to the new private sector in Hungary. Most of the analysts I have talked to tend to trace that to the difficulties of the banking system and not to the size of the debt burden," Kenen said.

Frans van Loon reported that, from the perspective of a banker, the view on the debt problem had changed dramatically.

"Certainly over the last two years or so, the way in which bankers have been looking at the question of debt has changed very profoundly. The idea of crisis is totally gone. The way in which bankers look at the problem

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now is much more one of flows than of stocks. They put more emphasis on finance as the quickest going element of economies worldwide, on the integration of various elements in the financial world, on the disappearance of previously important divisions between, say, commercial banking and investor banking, between insurance and banking, etc. All those elements which used to be looked at and regulated separately are gradually changing. The integrated financial markets are taking a much larger slice of economic activity generally, and even more so in the developing countries. So, in looking at flows, the interesting thing is that it is not the banks that are increasing their flows but the other elements of the financial world, such as foreign direct investment and securities. Cross-border flows are increasing in absolute and relative terms to everything else. That is the point, in my opinion. One should therefore look at the improvement of the system, at the allocation of savings and credit worldwide, rather than at stocks."

Barry Herman wondered whether debt relief would lead to a cash flow gain, given the fact that the value of the debt does not change very much as a result of debt restructuring under the Brady Plan.

"I mean, the enhancements that are given as part of the debt restructuring are not free. If they are financed by regular stand-by arrangements from the Fund they are fairly short-term loans. So if there is no benefit in cash flow terms, I suppose there will have to be one in terms of regularising the situation."

Comparing the Latin American to the Eastern European debt situation Onno de Beaufort Wijnholds agreed that there are both common aspects and important differences.

"One obviously is that the amounts involved with regard to Eastern Europe are much smaller, in both absolute and relative terms. So from the systemic point of view it is a much more manageable situation. Whether this means it is easier to solve I very much doubt. Probably precisely because it is not so much a systemic risk some parties are dragging their feet more than they have done in the Latin American case. Another difference is that most of the external debt of Eastern Europe is contracted with governments rather than banks. A third one is the conditionality, on which I very much agree with what has been said by Mr. Portes."

Philippe Moutot slightly disagreed with Richard Portes' statement that the World Bank rather than the IMF should have played the major role in Russia.

"I am not sure that the choice is simply between IMF conditionality or World Bank conditionality, or between putting one before the other. It is a bit more complicated. The problem is that the pace of progress on the macroeconomic side is very dependent on the pace of progress on the structural side, and vice versa."

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Bernard Snoy believed that Hungary had been right in its decision to service its debt punctually. It had been rewarded with large external flows, he said.

"Hungary has received more foreign direct investment than all the other Central and Eastern European countries put together. It has maintained access to the bond markets as well as to bank credits, and it has accumulated reserves. The good debt management has also underpinned its structural adjustment. I therefore have some doubts about the validity of findings that foreign direct investment has little to do with punctual debt servicing. In fact, foreign direct investment is based on that immaterial element called confidence, and this would certainly have been jeopardised if Hungary had given signals to the market that it wanted to reschedule or to get debt relief. As Mr. Kenen has said, the problems of Hungary in continuing adjustment lie elsewhere. They are situated in the reform of the financial sector and in the further reform of enterprises."

Snoy also doubted whether the generous debt reduction deal obtained by Poland had been so beneficial to the country.

"That very generous treatment has been associated mainly with political pressure, especially from the United States. And I wonder whether Poland is really reaping the benefits of that debt reduction in terms of foreign direct investment and when it will regain access to bank financing in the capital market."

Mohamed El-Erian followed up on this point, stating that debt restructuring involved costs as well as benefits.

"The very act of debt restructuring triggers a number of regulatory treatments in industrialised countries that immediately limit your access to external financing, to bank financing, to equity financing. So when one talks about debt restructuring for countries like Hungary, one has to pay close attention to the cost, and not only to the benefit."

Finally, Jan Tinbergen wanted to remind the participants that the developing countries would have had far less of a debt problem if the industrialised countries had given aid according to the 0.7 per cent norm. "We should never forget that the debt would have been only half as large if all developed countries had made available as development assistance the 0.7 per cent of GNP that was agreed to be the norm not only by the General Assembly of the United Nations, but also by the OECD."

Williamson's reply

John Williamson could take up only a few points of what he felt had been "a very interesting, stimulating and constructive debate".

On Gunter Baer's question as to whether debt crises are unavoidable, or even desirable as a way of imposing adjustment policies on debtor countries, he answered that he thought they were indeed unavoidable.

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"From time to time there will be some miscalculations. Unless we start learning how to build explicit contingent clauses into the loan contracts, there will be a necessity to re-contract at some stage. It seems to me that the best way to do that, as I suggested last year, is by establishing an International Debt Restructuring Agency."

Williamson did not think debt crises were desirable as a way of getting adjustment out of the debtor countries. "The changes in policy in Latin America were fundamentally a case of social learning. The countries saw what was working in East Asia and began to try to copy it. It was much more this type of effect rather than that they were forced to change their policies because of conditionality."

Addressing the question raised by Barry Herman as to how one can evaluate the outcomes of debt renegotiations, Williamson distinguished between three forms of relief.

"One is debt relief, which reduces the present value of the debt outstanding. A second form is cash flow relief, which is directed at interest payments in the near term. And the third one is regularising the situation, so that it becomes possible to go back to international capital markets, or even more importantly, to get capital repatriation. Now, the latter element is presumably going to be there anyway, but as between the first two elements, debt relief and cash flow relief, there is a trade off that a country can get more of one if it accepts less of the other. So one should ask which is going to be the most valuable one in each particular situation."

Williamson accepted the legitimacy of the criticism by Ffrench-Davis, Griffith-Jones and Martínez that IMF conditionality did not concentrate enough on the level of investment. However, he felt that, for instance, Mexico had made important investments over the last decade.

"The benefit that Mexico has got out of the adjustment is that it has become a serious exporter of industrial products. That is a major and important adjustment which places it in a much better situation to be able to grow in the future."

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