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Economic Theory and Latin American External Debt

1. Introduction

The prolonged debt crisis of the 1980s has given rise to recent theoretical debates on the fundamentals of international debt. As is to be expected, each of the different schools of economic thought adheres to its basic premises, and the resulting therapies vary accordingly. However, there are some converging views as well. This chapter will briefly describe where opinions agree and differ. Hopefully this summary will also shed some light on the past, even though the discussions of the 19th and early 20th centuries are not dealt with. Since most of the authors in this volume are distinguished historians but not necessarily professional economists, an effort will be made to keep the economists' often barely understandable jargon – for which the Brazilians invented the poignant term *economês* –, to a minimum. On the other hand, a rather broad range of bibliography is referred to and quoted so that readers with a particular interest in the pertinent theoretical discussions can find the necessary material. The paper will not go beyond economics into the much broader field of "development studies," firstly because there is enough food for thought in the field of economic theory, "debt" being undoubtedly a genuinely economic subject, and secondly because topics such as economy-ecology, -culture, -democracy, -happiness, -values, etc. would each warrant an essay of its own.

It would seem particularly appropriate to start the survey of contemporary theories on debt at a conference of historians with a reference to the work of Charles Kindleberger, one of the world's leading scholars of economic history, followed by a brief summary of Marxist approaches to the problem. The ruling orthodoxy, i.e., the World Bank's "debt cycle" theory, will then be discussed. In their turn Latin Americans have developed a body of heterodox "structuralist" theorems which counter and absorb large parts of the "Northern" doctrines and which are indispensable to an understanding of what the world looks like from the debtors' perspective. Finally, the "Monetary Keynesians" are introduced. These are particularly strong at the Department of Economics and Business Administration of the Free University of Berlin where they form a very active "Berlin School," and with whom our small group of economists at the interdisciplinary Institute of Latin American Studies have close contacts and largely identify with.

The debt crisis has not only revived the fundamental macroeconomic and political economy approaches to development and underdevelopment at the periphery of the world system, but it has also enhanced the microeconomic discussion on "institutions" dealing with the crisis. Both politically and pragmatically the interests of the individual actors are analyzed with regard to institutional change, gaps, hypertrophies, and dynamics in search of accommodating mutual interests rather than implementing specific development strategies based upon certain macroeconomic doctrines. This article thus ends with a short resumé, in the light of micro- or institutional economic theory, of some of the suggestions brought up by economists to improve the present debt crisis management or even to "solve" the crisis.

2. Kindleberger's Inductive Model of Financial Crises

In his pioneering study of financial crises from 1720 to 1970 and his subsequent work on the crash or near-crash of October 19, 1987, Charles Kindleberger (1978, 1988, 1989) developed a model which he himself summarizes as follows (Kindleberger 1989: 172-173):

> One starts from an autonomous shock to the system that alters profit opportunities,...it may be the outbreak of war or the arrival of peace, a good harvest, a bad harvest, a pervasive innovation such as the railroad or automobile, a discovery, an oil shock like those of 1973 and 1979. The displacement can be financial, rather than real.... Whatever the shock, a reordering of investment priorities is called for, an investment boom is started, and it may – I avoid saying it must – go too far. The boom may subside by itself.... Often, however, destabilizing speculation sets in...there may be a panic...to hold the panic...[t]here should be a lender of last resort, who makes money freely available against sound assets.

When applying this pattern to the debt crisis of the 1980s, Kindleberger is primarily concerned about the U.S.A.'s inability and unwillingness to act as "world stabiliser" (Kindleberger 1989: 312) and about the absence of a lender of last resort. He is sceptical with regard to "shared responsibility" and doubts the ability of the IMF to act as quickly as required in moments of panic. His reference to "Basle," i.e., the Bank for International Settlements (BIS) as the bank of the world's central banks shows, however, that he acknowledges the important role of this rather discreet institution which during the 1982 Mexico crisis was the fast-moving "fire brigade" bringing together the necessary "bridging loans" from its member central banks at very short notice (Nitsch 1987, 1989a), i.e., acting as some kind of collective lender of last resort.

Kindleberger's analysis is akin to conventional business cycle theories where "growth" and "development" play a secondary role, and his inductive method leaves theorists of the various denominations somewhat dissatisfied. It is therefore in-

teresting to examine what theoretical economists consider to constitute the inner logic of the phenomena which Kindleberger so aptly describes and summarizes in an inductive manner.

3. Marxist Approaches to External Debt and the Present Debt Crisis

In the tradition of Hilferding (1910) and Lenin (1960 [1916]) Marxists have always stressed the exploitative and crisis-, if not war-prone character of finance capital exports and their logical counterpart, debt, on the basis of overaccumulation and underconsumption in the metropolitan countries (for Latin America see Marichal 1980 and 1989). The capitalist world system is seen as a hierarchy with "hegemonic cycles." In accordance with Schubert (1985), Altvater and Hübner (1987, 1989) depict the present debt crisis, in a manner highly compatible with Kindleberger's view, as an outcome of the U.S. hegemonic crisis:

> The internal causes of national debt crises may very well vary from country to country, but the international debt crisis is a direct product of the transformation of the U.S. American hegemonic system (Altvater and Hübner 1989: 61; all translations from German and Spanish texts by MN).

The main economic indicator of the crisis is the interest rate which is kept high not only to attract foreign capital to the U.S.A. with both its budget and balance of payments deficits, but also because of the rising risk premium in a "monetary nonsystem" (John Williamson) approaching the characteristics of gambling in "Casino Capitalism" (Susan Strange). Their suggested way out which in 1987 still consisted of a "new international economic order" (Altvater and Hübner 1987: 28; quoting Fidel Castro, i.e., hinting at a socialist alternative) turned more modest two years later (Altvater and Hübner: 1989: 67-68), when only stricter political intervention and international regulation were advocated. Most recently Altvater (1991) has elaborated on the principles which were to guide such global

regulation, namely democratic participation, public discourse and control as well as ecological considerations.

For the developing debtor countries, a "net resource transfer" towards the North, i.e., a surplus of exports over imports by which the debtors service their obligations, is a highly scandalous phenomenon indicating a drain from the "open veins of Latin America" (Eduardo Galeano) rather than a reasonable cure by "growing out of debt" as the IMF tries to suggest (Altvater and Hübner 1987: 22). Franz Hinkelammert (1988) from Costa Rica sharply criticizes the recent export surplus of Latin America, comparing the resulting international transfer to the Marshall Plan – only that it works the other way round, i.e., from the debtor to the creditor.

The payment of interest on a loan is, of course, always a "net resource transfer," even at clearly nonusurious rates, and the accounting balance between imports and exports of a country can hardly be taken by itself as a reliable macroeconomic indicator of a "drain" (see the devastating criticism of the "myth of the resource transfer" by Riese [1986: 170-175]). Otherwise, industrial countries with chronic export surpluses such as Japan and Germany would also have to be categorized as drained and exploited. However, there is more than a grain of truth in the argument, once it is placed against the background of the traumatic, sudden compression of imports after 1982, the serious fiscal problems, the curtailment of investments, and the concomitant inflationary processes which went hand in hand with the export surplus of the 1980s. That is why Hinkelammert, who is not very convincing when he deduces the debt peonage of the Latin American countries from their recent export surplus, gains credibility when he refers to the sheer impossibility of servicing the debt in the face of high interest rates (due to the U.S. policies already referred to), to rising protectionism (particularly with regard to the first stages of raw materials manufacturing and other "sensitive" products) and to persistent export-promoting policies by Japan, Germany and some of the East Asian Newly Industrializing Countries (NICs). Therefore he is really arguing that the problem lies not so much with the net

transfer per se, but in the present environment which so drastically limits exportation that a net repayment of the debt becomes impossible. In Hinkelammert's own words (1988: 79-80):

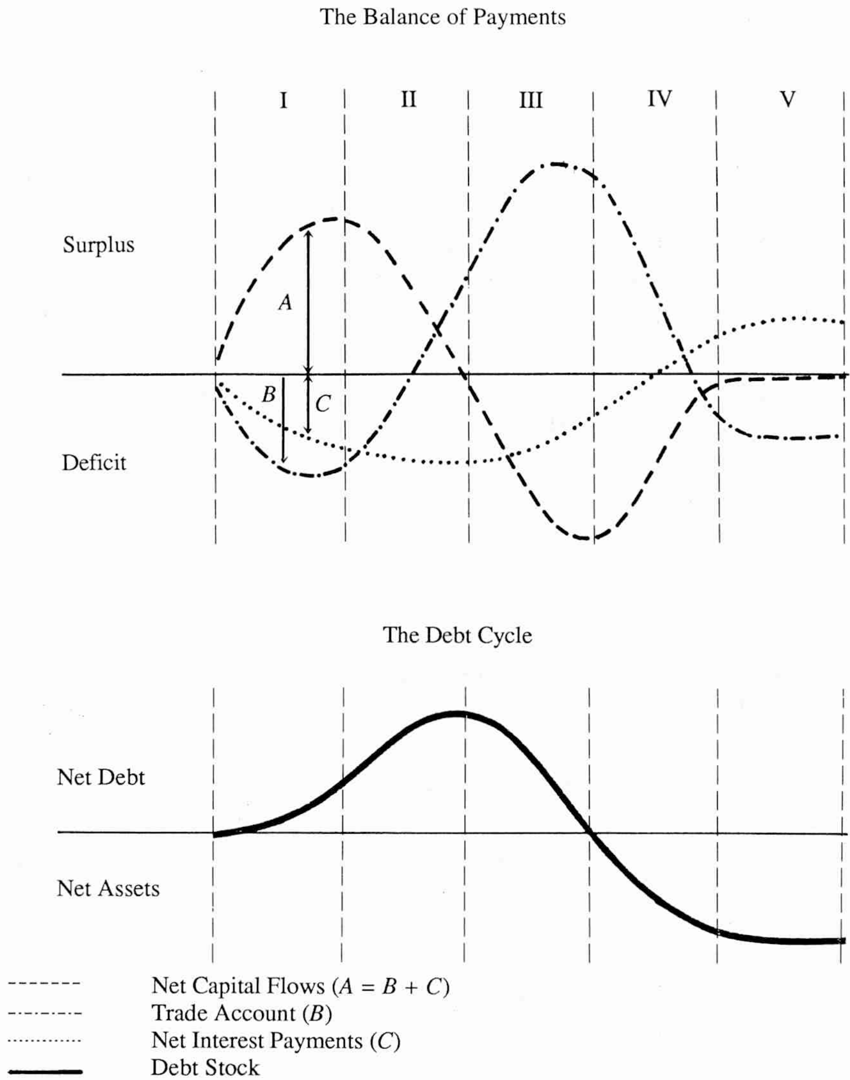
> That debts are unpayable is not a catastrophe for the creditor, – on the contrary. He who can service his debts, repays them and remains a free man. However, he who has unpayable debts, loses his freedom.... He falls into slavery: The unpayable debts have turned Latin America into a Sisyphus who never arrives where he wants to go and who never is allowed to rest.... That is why the declaration of the debts to be unpayable was a declaration of definitive victory for the international banks and the countries of the center, whereas it was a declaration of long-term defeat for Latin America.

4. The Orthodox View

In contrast to the global political economy inherent in both Kindleberger's and the Marxists' approach, the orthodox view, as epitomized by the World Bank's *World Development Report 1985*, takes the nation-state as its sole political framework and limits itself to rather mechanical economics. The leading textbook of development economics, Gerald Meier's (1989: 246-247) *Leading Issues in Economic Development* gives the following explanation to the reproduction of the World Bank's graph (see Figure 1):

> A borrowing country proceeds through a sequence of growth-cum-debt phases.... [W]hen investment and government expenditures exceed savings and taxes, there is a real resource gap, which is filled by an excess of imports over exports in the current account. The external debt that finances the excess imports is the financial counterpart to the real resource transfer. A developing country will therefore proceed through stages in which the resource gap, then the debt, and finally the income level rise. In the later phase, the resource gap declines first, followed by the debt, while the income level continues to rise.... Once savings become greater than domestic investment plus the interest payments, the resource surplus can be utilized for amortization, and the debt will fall...until the indebtedness is repaid.

Figure 1: Balance of Payments Flows and Debt Stock During the Debt Cycle



Source: World Bank (1985: 47).

The historical examples on which the debt-cycle hypothesis draws (Siebert 1989) are the U.S.A. between the Civil War and the end of World War I or II as well as post-war Germany, Japan and – more recently – South Korea. Since this view has been, and still is, highly influential as the implicit theory behind public opinion and policies as well as the explicit tool of formal modelling in planning ministries and financing agencies, it calls for a somewhat more detailed evaluation.

The political economy points of criticism have already been mentioned – that boom and slump have been global rather than national phenomena over more than the last two hundred years and that hegemonic cycles in hierarchical structures rather than symmetrical relationships between sovereign nation-states as equals have dominated the world economic system. This means that the corresponding willingness and ability of the trading and borrowing/loaning partners, assumed as perfectly suitable to the needs of the country in question undergoing the debt cycle, cannot be taken for granted.

However, the model is not only problematic in terms of its implicit political economy, but also highly doubtful with regard to its straight economics, particularly to savings and investment. The classical economists used to conceive savings as some kind of fund which was supposed to be the prerequisite for investment, and it is this approach which still makes Neoclassicists as well as some Marxists (e.g., Schubert 1985: 273) prone to the idea that domestic savings can and should be "supplemented" by external funds to close the "real resource gap," whereas a surplus of savings over investment and exports over imports would mean a "drain" abroad of real domestic resources. Although this concept is quite convincing to the non-economist and the planning model mechanic alike, because in the individual household, the idea of supplementing one's own internal "savings" with external mortgages to finance a housing or any other "investment" is easily understood on the microeconomic level, the transfer of this model to the aggregate macroeconomic level turns out to be utterly misleading, once

the implicit classical assumption of full employment is relaxed. Ever since the "Keynesian Revolution" of the 1930s and 40s, aggregate macroeconomic savings are considered a residual, determined by the more or less autonomous decisions of the individual firms, households and governmental bodies with regard to consumption, investment, fiscal incomes and expenditures, exports and imports. Whenever an unused potential of idle real domestic resources, including labor, is put into play – and that is, after all, what development economics is all about – investment and exports cannot be said to be realized at the expense of consumption, but should be viewed as income-generating activities which in turn make possible further consumption and accumulation.

Thus, as countries continue to borrow, i.e., during the debt-increasing phases, the model fallaciously insists that imports are the bottleneck of development. Given the century-old mercantilist view and practical experience of development via export promotion, this basic premise should have met with great scepticism, but it did not, largely because of the quasi-engineering suggestion that modern investments in infrastructure as well as factories be viewed strictly in terms of the imported machinery they often require; it was overlooked that "investment" in the economic sense comprises also all kinds of spending for buildings and other domestic goods which would generate a stream of monetary income as well as nonmonetary utility in the future. Some imported machinery is certainly crucial for the implementation of nearly every major development project, but the bulk of macroeconomic "investment" is always executed with local resources. Investment and exports are the bottlenecks of economic development, not savings and imports.

In addition, the proponents of the debt-cycle hypothesis hit further difficulties when trying to explain the transition from debt-increasing to -decreasing phases. Siebert (1989) gives the following reasons why countries may be stuck at "half cycle": borrowing for consumption, low productivity of capital, worsening terms of trade and a rise in the real interest rate. Quoting

Kindleberger, he mentions Guatemala as a case for a "cycle of debt and default" (Siebert 1989: 225) instead of a "full debt cycle." The blame for not completing the cycle is characteristically put on the behavior of the debtor, i.e., his "high time preference" or "great impatience," using foreign funds for consumption and/ or current budget deficits rather than for investment.

This argument can be criticized not only for its bias against the debtor which downplays external factors, but for mixing two different dimensions: In the first place, consumption and deficit financing of current public expenditure is always detrimental to long-term accumulation (not necessarily to short-term stabilization of employment), regardless of the state of external accounts; and on the other hand, changes in the stock of net debt are always a balance of gross foreign exchange receipts and expenditures in which individual loans only form a certain, mostly minor part. In macroeconomic terms, the use of the total of foreign exchange receipts of a certain period – export proceeds, transfers, and loans – has to be evaluated, since just like in a budget, a certain income cannot be directly related to a specific expenditure. That means it is possible that despite an apparently consumptive use of a certain foreign loan the rest of the foreign exchange income could be used for such highly productive purposes that the country's economic capacity is greatly advanced toward becoming a net creditor in the long run. Similarly, and more importantly, the productive use of a particular loan does not necessarily mean the enhancement of the country's economic development when it wastes its other foreign exchange resources and/or internal resources on consumption and imports. It is always the total of all items on a balance sheet which counts, not an individual transaction or item. That is also why Fishlow's (1995) distinction between "revenue borrowing" and "development borrowing" may not be as clearcut as it looks at first sight, even though one has to admit that the declared or obvious developmental misuse of a specific loan usually can be taken as a rather reliable indicator for the general mismanagement of the economy.

The debt-cycle model is not only convenient for the construction of planning models, for providing the developing countries with a justification for growth-cum-debt policies and for the case-by-case treatment of Third World nations by creditors and their clubs and committees, but it also serves to paint a harmonious picture of North-South economic interdependence: either the capital needs of the South require an export surplus from the North (e.g., Germany and Japan), or the switch from net debt growth to net repayment requires increased market access for the South, i.e., a deficit by Northern countries (e.g., the U.S.A.). Thus it is overlooked that complementarity is rather a North-North phenomenon at the South's expense: the U.S. deficit on current account (exports minus imports) is the outcome of large capital imports due to high interest rates, and German and Japanese surpluses are due to export promotion and undervaluation policies which – in a finite world – force their trading partners into a situation of overvaluation of their currencies making exports more difficult. Seen from this angle, the "net resource transfer" abroad from Germany and Japan benefits the U.S.A., not the developing countries. Consequently, as already pointed out, the highly indebted middle-income countries of Latin America confront both high real interest rates, stemming from U.S. policies, and structural export difficulties, except for cheap industrial raw materials, like iron ore, because of the German and Japanese export bias. These formidable handicaps can only be overcome by considerable debt reduction and export drives which successfully conquer world market shares from competitors and win market access from established interests. As the recent GATT talks remind us, this is hardly to be expected for and from the bulk of the Latin American countries, except perhaps for a small country of strategic interest such as Bolivia, – and even here the export drive (for coca) cannot at all be considered to be the outcome of complementary national interests.

The congruence of the debt-cycle model with the theory of "modernization" and Rostow's model of "Stages of Economic

Growth" (Rostow 1960) – from the "traditional society" and the emergence of the "preconditions for take-off" to the "take-off" with its rise in the rate of net investment, the drive to "maturity" and "selfsustained growth" and finally the "mass-consumption society" – gives the sequence a certain optimistic and quasi-deterministic touch. Any obstacle on the path of progress is easily reduced to a stumbling block, and crises tend to be viewed as accidents on that road rather than reshufflings of hegemonic hierarchies and definite defeats or victories as quoted in the preceding pages. With regard to the debt issue, that means an obvious bias toward considering the present Latin American crisis a "liquidity" problem rather than one of "insolvency." The corresponding therapy includes stretching of maturities, new money, adjustment, as well as growth and export policies in order to "grow out of debt." Only in very special cases and under extraordinary circumstances is the need for substantial debt reduction for individual countries recognized. It should be noted taht Figure 1 represents an overly optimistic bias even in its graphics: the implicit annual interest rate amounts to only 3.5 percent; once a realistic real interest rate of, let us say, eight percent is assumed, the volume of the necessary trade account surplus in phase III becomes much more formidable.

On the whole, the orthodox view of debt and development conveys a rather harmonious and optimistic picture of the status quo and the foreseeable future, and it stresses manageability and mutual interests over the antagonistic traits of the problem.

5. The Structuralist Tradition in Latin America

European textbooks about international economics start off with the closed, autarchic national economy which, in the case of a two-countries, two-goods and two-factors model, opens up in order to enjoy the benefits of international trade: each country tends to specialize in the good of its comparative advantage, and both are better off once free trade has its way. This

model, first formulated by David Ricardo (1817), reflects the experience of Europe where modern times, enlightenment, industrial revolution, colonialism, imperialism and increased mass consumption have marched in step with the opening up of relatively closed traditional agrarian economies.

However, former colonial regions of the world view history differently: modern times begin with the traumatic experience of colonialism on the victims' side, and ever since "development" as well as "underdevelopment" is largely shaped by outside forces, such as price movements, technological breakthroughs, new discoveries and world wars. No wonder that the Weltanschauung with regard to international economic relations tends to differ substantially between eurocentric orthodoxy and the views from the South.

In Latin America, the United Nations Economic Commission for Latin America (ECLA) – later to be renamed Economic Commission for Latin America and the Caribbean (ECLAC), Spanish: Comisión Económica para América Latina (CEPAL) and respectively Comisión Económica para América Latina y el Caribe (CEPALC) – took the intellectual and political lead in the post-World War II era under its first Executive Secretary Raul Prebisch (1962[1949]).[1] Prebisch became famous because of his argument that the terms of trade for the raw-material exporting countries suffered secular worsening. Even though his statistical basis did not prove to be completely reliable and the Korea Boom of the early 1950s seemed to belie his thesis shortly after its first publication in 1949, the subsequent slump in international commodity prices gave it so much credence that *cepalismo* became the dominant economic doctrine in the region. Its debate with orthodoxy over the causes of inflation and its cures centered around "monetarist" vs. "structuralist" approaches, the former stressing monetary factors and policies and the latter structural reforms such as land and tax reforms, import-substituting industrialization, modernization of agri-

1 For a summary of "Latin American Economics" see Fishlow (1985b).

culture, regional integration in Latin America and a new international economic order. The center-periphery model introduced by Prebisch was later radicalized by the *dependencia* school (see Sautter 1986 and Nitsch 1986 for a survey and a debate on its reception in Germany), before the Southern Cone swung toward the Right and monetarist experiments, which did not solve Latin America's development problems either. Ever since the outbreak of the present debt crisis in 1982, "a pragmatic neo-structuralism appears to be gaining influence throughout the region," as Fishlow (1985b: 142) puts it.[2] Most recently, in view of the crumbling of the Eastern bloc, the pendulum may even be seen as having again moved toward orthodoxy, i.e., more emphasis on markets, external openness and monetary considerations can be detected in virtually all political and academic *pronunciamientos* with regard to economic policy, without, however, discarding (neo-)structuralism altogether or openly propagating "Chicago Boys" economics, as the Southern Cone dictatorships had done in the 1970s.

Foreign exchange constraint has formed a basic tenet of the structuralist as well as the orthodox paradigm, so that running into debt has generally been seen as an easing of that constraint rather than a lure into the debt trap. Even though the more radical exponents of structuralism have raised a great deal of criticism against multinational corporations and their behavior in Latin America, the positive attitude of nearly all political and intellectual Latin American currents toward capital imports has made it easy for the Northern orthodoxy to gain general acceptance of its message of complementary interests between the export-surplus capital-exporting North and the import-surplus capital-importing "developing" South. Further, Official Development Assistance (ODA) gave this arrangement an even greater appearance of mutuality and altruism for development's sake because of the "soft" terms of some of the loans. On account of their inclination toward cheap money, a certain le-

2 See also Bitar (1988); Ffrench-Davis (1988), Ground (1986); Rosales (1988); Taylor and Arida (1988), and Villarreal (1986).

niency with regard to inflation, optimism with respect to the active role of the State in promoting development and an anti-oligarchic discourse, the structuralists have had, and still have, a hard time coming to grips with monetary discipline, as well as with export promotion. Leaving these "hard" aspects and facts of economic life to the "monetarists," however, made the advocates of heterodox approaches and the politicians who tried to put them into practice vulnerable to the criticism that they either, in fact, applied orthodox stabilization policies or let economic management slip out of their hands, thus provoking capital flight and hyper-inflation.

In the last few years the neo-structuralists have tried to gain advances in the monetary field, e.g., developing the theory of "inertial inflation" (Pereira and Nakano 1987), and various so-called "heterodox shocks" in Latin American countries were widely discussed, but Bitar's diagnosis of the structuralist approach being guilty of an "insufficient incorporation of the financial variables" (Bitar 1988: 47) is basically still correct. In the following pages an effort will be made to examine the possible contribution of Monetary Keynesianism to close this gap and eventually provide the missing link.

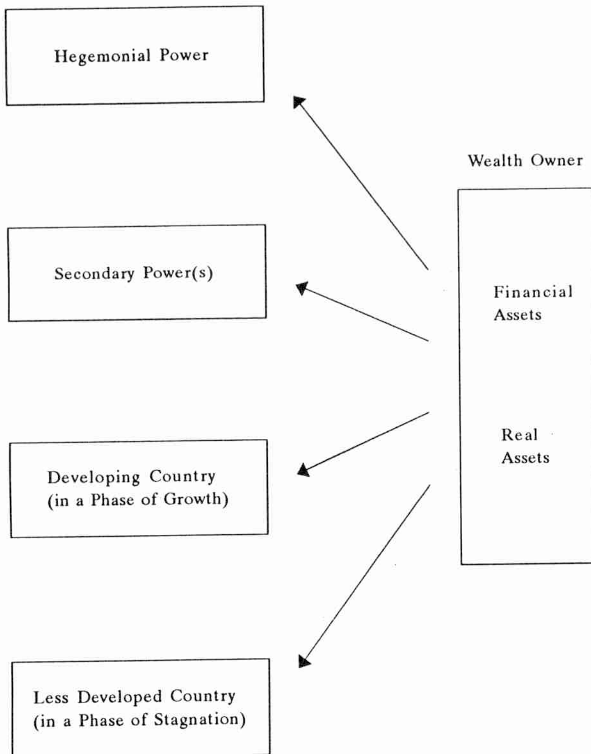
6. Monetary Keynesianism and Its Approach to the Debt Problem

In contrast to those who stress the "final demand" and the "fiscal policy" side of Keynes, Monetary Keynesians tend to emphasize the dominance of the financial over the real goods and factors sphere.[3] On the micro level, the key agent and sovereign of the modern, i.e. monetarized, economy is the wealth owner whose portfolio dispositions according to his or her liquidity

3 See Davidson (1983-84); Kregel (1980); Minsky (1977, 1980); Moore (1979), and the Journal of Post Keynesian Economics for the discussion in English, and Riese (1986, 1989) and his "Berlin School" with Hauptmann (1987); Herr (1989); Lüken-Klaßen and Betz (1989); Nitsch (1993); Riese and Spahn (1989); Stadermann (1986), and Tober (Ms. 1991) for the German debate.

preference and risk propensity determine whether money is held or spent, loans are contracted, serviced and redeemed and equity instruments, such as shares, but also all other types of participation in equity, are underwritten, bought, sold and serviced with profit shares. Before entering into the discussion about the international alternatives for the wealth owner, we should note the typically Keynesian underemployment equilibrium concerning labor and other real resources: the productive enterprise will hire only as much labor as is compatible with the servicing of its liabilities and equity; its financiers, not its customers nor its workers have the final say, which means that there is always a cut-off point in the queue of job-seekers.

Figure 2: The Wealth Owner and the Hierarchy of National Currencies in the World Economy



In a world of many national currencies the wealth owners (be it a net wealth owner or an intermediary such as a bank or another type of firm in any part of the world and of any amount of wealth) can choose to invest in financial or real assets, and within the category of financial assets (including equity in productive enterprises), to hold liabilities (financial instruments including banknotes) of the hegemonic power (e.g. U.S.$), the secondary powers (e.g. DM, Yen, Fr and £) or of the "developing country" or, finally, the "less developed country" (defined here in Figure 2 – for didactic purposes – as a country undergoing a phase of real income stagnation or decrease, whereas a "developing country" is defined as a Third World country in a phase of growth).

Productive enterprises in the "developing country" can attract the financial means necessary for real investment, thus providing income for labor and fuelling the process of accumulation and economic growth, only if they can offer a return on investment which can compete favorably with the alternatives, shown in Figure 2.

It is at this point that the peculiarities of Third World countries come into play: the huge international income and technology disparities are mirrored within those countries by what structuralists have called "structural heterogeneity," i.e., the apparently peaceful "dualism" of old and new, rich and poor, traditional and modern segments of society. At closer inspection, however, this turns out to be a conflict-ridden, precarious hierarchy of dominance and power between social groups and classes of various interlinked modes of production and reproduction. For a monetarized economy this means high risk premium, inflationary pressure, weak government with fiscal problems and foreign exchange control.

Coming back to the alternatives open to the wealth owners, any contract made in the currency of the "developing country," let alone the "less developed country," runs the risk of currency devaluation. Treasuries as well as commercial and savings banks have therefore introduced indexed bonds or other finan-

cial instruments in a number of countries, thus attracting funds which might otherwise flee abroad, but at the same time making the sources of finance for the domestic productive enterprises and for public services besides debt servicing more expensive so that they tend to be sustained by cheap credit and inflationary financing, respectively. Nevertheless, once the fiscal limits are reached, the wealth owners will withdraw their funds and – in spite of foreign exchange controls – switch into convertible currencies. Finally, within the "less developed country" only state enterprises and poor family enterprises in the countryside and in the so-called "informal" urban sector, both of which do not function according to the logic of a capitalist monetary economy, remain intact. The former have to struggle with all their well-known efficiency problems, and the latter can only keep on going so long as they are really poor. Money as a medium of exchange is, of course, also present with the *campesinos* and the urban *informales* in Latin America, but with increasing wealth the microeconomic integration in these household-enterprises of labor, land/dwelling and capital under the dominance of labor tends to break up when some members (typically men) start to behave as wealth owners, i.e., investing surpluses in lucrative financial and real assets beyond the control of the family.

The "developing country" is thus particularly prone to slip down the international hierarchical scale into the status of a "less developed country" when external debts have accumulated to such a degree that they are unserviceable, exposing the exchange rate to the risk of even further deterioration and when indexed treasury bonds and similar instruments have led to a fiscal crisis which will bankrupt the State on its internal debt as well. At that point hyperinflation must be checked through monetary reform and external debt rescheduling or relief, if a total collapse of the economy is to be avoided (Ms. Tober 1991). The Central Bank and the Government of the "less developed country" will have to regain the confidence of internal as well as external wealth owners in order to return to the position of

a "developing country." In this process the "state of confidence," a key term in Keynes' *General Theory* (Keynes 1936: chap. 12), plays a significant role, because the wealth owner's income from investment equals the sum of the non-pecuniary and the monetary net income from the respective asset. Consequently, the monetary return on investment in a productive enterprise must be all the higher when, given the returns and risks of international external investment opportunities, confidence in stable money and hence government and central bank policies, is demonstrably lowered. On the other hand, nationalist appeals can create a certain amount of non-pecuniary rewards for domestic wealth owners, and sanctions can increase the monetary as well as the non-pecuniary "transaction costs" of overcoming or eluding exchange controls.

Increased income for wealth owners, of course, then opens the questions of income distribution, structural reforms and democracy. The "state of confidence" for investors is not necessarily best guaranteed in a democratic regime, nor does a military dictatorship à la Pinochet or Marcos necessarily inspire "confidence." The post-1968 *dependentista* topics of capitalism vs. democracy and underdevelopment as the fate of the periphery in the world capitalist system (Frank 1968) thus return to the fore when we confront the implications of the simple portfolio model of Figure 2. After all, Lüken-Klaßen and Betz (1989: 218) state the purpose of their paper explicitly in *dependencia* terms: "We want to show...that the perspective of world-market related dependency can be analytically underpinned by the economics of Monetary Keynesianism."

Before turning to the question of how to make use of the benefits while avoiding the unquestionable flaws of the *dependencia* approach, let us look at the upper parts of Figure 2: the wealth owner can choose to invest in the financial instruments of the hegemon (if there is one) or of secondary economic powers. In a stable hegemonic system the key-currency country typically acts as the world's banker offering high non-pecuniary rewards to its foreign depositors, which correspond to low mo-

netary interest rates, while supplying the rest of the world with relatively cheap credit and investment. That was the arrangement under the Gold Standard which, to a great extent, was, in fact, a £-Standard (Ford 1962), as well as under the U.S.$-Standard in the Bretton-Woods System of the post-World War II era. The 1970s and 1980s, however, saw the advent of a multi-currency standard (Herr 1989; Stadermann 1986, and the above-quoted Marxist sources) with rivalling "strong," fully convertible currencies. While the U.S.A. as well as smaller countries such as Australia, Italy, etc., by offering high interest rates, were each in a position to attract foreign capital and not scare away local wealth owners, Japan and Germany were showing high and persistent export surpluses brought about by applying policies which have kept their currencies undervalued. Both strategies, however, run counter to the aspirations and development necessities of the developing and the less developed countries, which are put in a situation which require virtually impossible "adjustment" and "debt-servicing" efforts.

As Riese (1989: 196) emphasizes:

> The central thesis is that in view of their limited monetary and productive potential the developing countries are unable to counter the undervaluation strategies of leading industrial countries.... The conditions of the functioning of the world market make it thus impossible for the developing countries to carry the burden of the crisis – which means that the strategy of devaluation of the developing countries' currencies as propagated by recent academic research, as well as the strategy of consolidation of the balance of payments as the ruling monetary policy institutions advocate, are bound to fail.

This diagnosis rather bluntly confirms the famous characterization of economics as a "dismal science"; however, a great deal is gained by this sober reasoning, namely realism with respect to policy prescriptions and evaluations and the well-placed integration of monetary and financial variables into the non- or anti-orthodox analytical paradigm. In fact, even more so than during the 1960s when *dependencia* became the leading heterodox slogan in Latin America, in the "lost decade" of the 1980s

with its dragging debt crisis, it has become empirically evident that the asymmetries between Center and Periphery persist or grow and that the talk about "Newly Industrializing Countries" and "The Differentiation of the Periphery" (e.g., Hurtienne 1989; Mármora and Messner 1989) should not be misread as a general return to modernization theory and orthodox harmonism.

Academics and politicians alike have been paying increasing attention to pyramid climbing within the international hierarchy, not so much by the rich OPEC countries with their oil revenues, but focussing their analysis on South Korea and the other East Asian NICs. Although we cannot summarize here the results of all the very varied studies devoted to the NICs, we can refer to the explicitly Monetary Keynesian paper by Alfred Hannig (1989; see also Hauptmann 1987: 57-61, and Riese 1986) which should help to understand the policy implications of that approach.

Hannig (1989: 277-278) notes "three central contradictions" between the adjustment policies of South Korea and neoclassical theory:

> (1) There was marked, development-oriented protectionism – incompatible with liberal market theories.
> (2) The undervaluation of its currency, implemented by South Korea after 1980 signifies a price distortion....
> (3) Similar to Japan, South Korea has consciously concentrated on technology- and capital-intensive products with a high income elasticity of demand, i.e., goods which, under the aspect of comparative advantage, seemingly do not make sense, but in the long run strengthen South Korea's position on the world markets and satisfy increasing internal demand in the course of a rising propensity to consume.

The macroeconomic criteria for assessing an economic policy strategy or a constellation of market forces include not only these three – development- (i.e., investment- and export-) oriented ones, i.e., protectionism, currency undervaluation, and high-technology exports – but also the development of the internal market via progressive income and tax policies as well as wealth redistribution, the control of inflationary processes

under strong political leadership, including administrative measures, and the establishment of a functioning financial system – even if South Korea can hardly be seen as a model case for liberalization and "get-your-prices-right" policies in the financial sector, as some neoliberals would like to present it.

While the world markets and the international constellation of forces do not permit an advance on a broad front, an individual country, especially a small one, can still get through the eye of the needle. In the closing words of Lüken-Klaßen and Betz (1989: 263):

> Of course, it can happen that the dishwasher becomes a millionaire. But he does so within the framework of a market system which again and again enforces that there continue to be enough dishwashers....Similarly, individual countries can, of course, escape from the state of dependency, but not all countries can be dragons.

They echo the important contribution of Wallerstein (1976; also Hopkins and Wallerstein 1977) to the Center-Periphery model of the modern world system: not only for economic, but also for political reasons a strictly dichotomic structure would not be viable, since it would obviously condemn the majority to a permanent state of inferiority, and in the presence of exclusively polarizing processes the "Center" could be sure to enjoy a permanent state of bliss. That is evidently not the case, so that a third category, called "Semiperiphery" by Wallerstein, is essential for the stability of the system. Indeed, Figure 2 includes even four categories of countries, since for monetary affairs especially, there is a marked difference between a hegemonic and a multi-currency standard within the group of the "Center," while the thresholds between a "developing country" and a "less developed country" on the one hand, and a competing but "secondary power" with a convertible currency on the other, are still large enough to warrant each an additional distinction, without being so large as to exclude a change of status. Such "ex-developing countries" of Europe as Spain, Greece and Portugal have already undergone it, while Turkey, Cyprus and the other Southeast and Central European nations are eager to make

the transition. On the contrary, nearly all the Latin American countries have only experienced the ups and downs between the "developing" and the "less developed country" categories.

For the individual country and its policy-makers (and intellectuals) the system thus leaves a certain degree of hope and room for maneuvering which tends to reinforce its stability and to lend credibility to single-nation paradigms such as the debt-cycle model, – even though for the rest of the world the fantasy of the dishwasher turned millionaire is probably still considered to be much less likely than in one's own country. Seen from the outside, the hierarchical model as such is less interesting than the form of the pyramid, its detailed structure, its career patterns, dominance mechanisms, opportunities of emancipation and cooperation as well as its stability and its inherent germs of war and chaos.

To sum up the review of macroeconomic approaches to the debt issue, a high degree of complementarity can be found between the structuralist and the Monetary Keynesian schools, both of which confront orthodoxy based on neoclassical growth-cum-debt models but, at the same time, accept the global capitalist world economy with its benefits and fallacies as it is rather than measure it with the yardstick of "socialist forms of social life" and the "project of a new society" (Hinkelammert 1988: 80-81) or a fundamentally "new" international economic order, as Marxists tend to do. This means that an amalgamation of structuralism and Monetary Keynesianism could provide a rather comprehensive heterodox answer in analytical terms as well as with regard to economic policy, even if such a project is not only a permanent and probably never-ending task, but would have to include many essential non-economic aspects such as democratic participation, ecological sustainability, and social justice. For strictly economic diagnosis and therapy, at present it is probably not easy to find a better set of analytical macroeconomic tools.[4]

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4 Luiz G. Beluzzo provides in "Os keynesianos monetários," (*Isto é, Senhor*, São Paulo, July 17, 1991), p. 21, a competent Brazilian response to the "Berlin School" arguments, as exposed in this article.

7. Institutional Microeconomics and Debt Crisis Management

The main thrust of the recent economic literature about the Latin American debt crisis is, in fact, microeconomic in nature. Even famous authors of macroeconomic textbooks such as Fischer (1987) and Dornbusch (1989; Cardoso and Dornbusch 1989; Dornbusch et al. 1989) concentrate mostly on "burden-sharing" and institutional set-ups and reforms when writing on debt matters. Dornbusch's article on "overvaluation" (1988) quite interestingly reveals the uneasiness and undecidedness of this broad-minded economist with Latin leanings (but not to be counted as one of the Monetary Keynesians) when it comes to assessing an exchange rate policy on macroeconomic criteria between over- and undervaluation. He and Eliana Cardoso are obviously on much firmer ground when they present their "debt proposal" (Cardoso and Dornbusch 1989: 133) which reconciles the immediate interests of debtors and creditors in order to overcome the present crisis without trying to solve the differences in long-term macroeconomic thought.

Their pragmatic solution includes most parts of the "menu" offered and dealt with in recent debt negotiations: setting aside a certain amount of foreign exchange for servicing priority debts and for buying up, in the form of auctions, claims whose owners accept the highest discount; establishing a counterpart fund in local currency to be used for financing much-needed public investment and for debt-equity or debt-loan swaps. They complete the list by adding the international "Debt Guarantee and Refinancing Trust Fund" to be affiliated to the World Bank, as suggested by the Twentieth Century Fund Task Force on International Debt (Dornbusch 1989) and – in this and/or other forms – by other groups and individuals as well. And finally we should mention the debt-nature or -ecology link which tries to connect the protection of the environment, particularly tropical forests, with the reduction of debt (Oberndörfer 1989a, 1989b;

Speth 1987). It would certainly go too far to discuss the whole gamut of debt crisis management proposals, but some suggestions merit special attention in order to show the essentials of the microeconomic theory underpinning many of them.

The idea of buying up one's debts through regular auctions was elaborated on by Mike Faber in his Dudley Seers Memorial Lecture at the Free University of Berlin on the Sunday before the 1988 IMF/World Bank Annual Assembly in Berlin (Faber 1988). There he coined the phrase "theory of the second worst," which conveys a quite significant understanding of the pragmatic politics of debt negotiations, when the participating actors begin to move toward an official or silent agreement because all of them consider the alternatives worse than the proposed solution, even though nobody likes the outcome. It is even more significant for understanding the methodological approach of the new institutional economics, the mathematical expression of which is no longer the infinitesimal calculus for arriving at "optimum," i.e., first-best, or "second-best" solutions, but game theory, where two or more players try to win and/or avoid losses by following certain strategies whereby the result for each player depends on the behavior of the others, and where outright losses are often at stake.

The "rules of the game" (Dam 1982) evolve and change over time in such a way that repeated interactions lead to predictable behavior. The key concept is the "institution," defined as "a set of constraints which governs the behavioral relations among individuals or groups" (Nabli and Nugent 1989: 1335). Institution-building is thus particularly important when constraints lead to a situation in which all of the players in the game are better off than in a situation where each behaves freely without the constraint in question. The establishment of a traffic light is an easily understandable example for successful institution-building.

Another pertinent example relates to juridical norms and institutions, i.e., in the case of debt to bankruptcy laws and other rules related to illiquidity and insolvency of private persons as

well as business firms, municipalities, etc. The transfer of these institutional arrangements to the international sphere has been advocated and discussed rather widely,[5] but in spite of the generally accepted conviction that unpayable debts warrant a specialized legal procedure in every state and every legal system, very little progress has been made on the international level – at least as far as formal agreements are concerned. With regard to de facto arrangements, the Brady Plan (Brady 1989; Kampffmeyer 1989, Devlin and Lustig 1990) has finally recognized the need for debt relief, and recent debt negotiations have moved toward bankruptcy-type deals, linking internal and external reductions of the overall public debt overhang in more or less comprehensive "monetary reforms," as required for reestablishing a functioning monetary economy (Tober Ms. 1991). The microeconomics of debt reduction is thus directly connected with the macroeconomics of a monetary economy. However, there is still a long way to go until fair and equal treatment (of both debtors and creditors), systems of binding sanctions and all the other details which go with an orderly bankruptcy or composition procedure are at last firmly established. This is true not only for the international level, but also for the bankruptcy of central governments when loss-sharing is on the agenda, and the unwritten debts of the social security systems and other "invisible" obligations of the state are easier to curtail than bonds and savings accounts which are often even formally indexed. For too many powerful players in the game it still seems worse to have constraints than to be free to act; only when one player after the other learns that the freedom of the rest worsens his situation more than do generally accepted constraints, can the "theory of the second worst" be applied as the practical basis for viable institution-building.

To summarize, microeconomic institutional analysis can be applied to reconcile the immediate interests of the various actors involved, regardless of their differing long-term objectives

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5 See, e.g., Bacha (1982) and Fishlow (1982); Frank (1987); Kampffmeyer (1987); Malagardis (1990); Malagardis and Nitsch (1988); Nitsch (1987, 1989b), and Raffer (1990).

and macroeconomic approaches. How to deal with an overburdened debtor in a civilized way presents problems for orthodox and heterodox actors and intellectuals alike, and perhaps it is here, on the micro level, that economic theory can provide the most promising tools for policy-makers to contribute to the easing of the acute difficulties of developing countries. Equally, historians might be well advised to see if the tools of institutional microeconomics and game theory can also be useful for analyzing the management and/or mismanagement of past financial crashes and debt crises.

A final cautionary note should be added on the distinction between micro- and macroeconomics, since the borderline is not as clear as has perhaps suggested in the preceding pages. Every macro-economic approach struggles with its "microfoundations" and its institutional implications and varieties, and, on the other hand, the "new" institutional microeconomic approach does not content itself with the analysis of individual actors playing games, but, under the label of "New Political Economy," it seriously, and to a certain degree successfully, aspires to macro dimensions. That is why intermediate ("meso") terms such as "(de)regulation" and "regime" and the corresponding theoretical edifices have become fashionable, including in Latin America, and they have provided new and interesting stimuli across theoretical boundaries, from Marxism to Orthodoxy (e.g., Väth 1989). Those debates, however, have very rarely touched explicitly on the debt issue which is why they have been left out of this presentation.