

# Down the Great Financial Drain: How debt and the Washington Consensus destroy development and create poverty

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**ABSTRACT** *Susan George in her critique of the power of the Washington Consensus argues that leaving a nation's economy and people to the mercies of the 'free market'; in other words to the dominant international financial players interested only in short-term profits, is the equivalent of leaving the free fox to guard the free henhouse.*

**KEYWORDS** *neo-liberal globalization; IMF; World Bank; capitalism; neo conservative; Brazil; finance*

## Introduction

According to most received wisdom, globalization is not merely here to stay: it is good for everyone, for me, for you, whoever you may be, wherever you may live. If the evidence appears to show the contrary and if – assuming of course you have even heard of this phenomenon called 'globalization' – you sense it is definitely not good for you, that is because you have not one, worked hard enough two, made yourself competitive enough or three, waited long enough for its benefits to make themselves manifest.

Let us first make clear that the word 'globalization' on its own is virtually meaningless. Like its precursor, the word 'development', it needs an adjective to escape from a convenient conceptual fuzziness. The adjective used here will be 'neo-liberal'. This means that 'globalization' is another name for late-20th/21st century capitalism, qualitatively different from previous incarnations. When used in connection with developing countries, globalization is also synonymous with the various elements of the so-called Washington Consensus (WC) as first defined by John Williamson, the inventor of the phrase; but also includes other policies that have been grafted on to the WC. Williamson first coined the now-famous term in 1990, but the thing itself had already been in existence for a good 10 years. The WC came to the fore with the earliest manifestations of the debt crisis, usually dated from the first major quasi-default of Mexico in 1982.

## **What is the Washington Consensus?**

The components of the WC are as follows, based on Williamson's initial formulation and listed in shorthand form without elaboration or comment. When used as 'shock treatment' for indebted nations, the WC is also known as Structural Adjustment:

- fiscal discipline and an end to deficits,
- reduced public expenditure and reordering of government priorities,
- tax reform,
- flexible interest rates,
- competitive exchange rates,
- trade liberalization,
- a favourable environment for Foreign Direct Investment (FDI),
- privatization,
- deregulation,
- property rights.

These are Williamson's 1990 elements. Many people might agree with most or all of them.

However, the problem with this rather benign listing is twofold:

First, the interpretation and the practical application of these components often turns out to be quite different from what one might imagine simply from reading Williamson's own version.

Second, various other policies, not included by Williamson, were rapidly integrated into the policy package that now goes by the name 'Washington Consensus'. This mix has now become genuinely toxic for a large number of developing countries (not to mention countries in the North, but that is another story).

## **Will the real WC please stand up?**

In the first category, that of interpretation and application of the Williamson components, let us take just a few examples of the 'content-creep'. 'Fiscal discipline' comes to mean 'accumulate big budget surpluses and don't spend them even if large numbers of people in your country are going hungry'. 'Reordering government priorities' translates as practice 'cost-recovery' with regard to health and education and make people pay full price for

them. 'Reduce public expenditure' means 'eliminate subsidies' for basic foodstuffs, energy, public transport and so on. 'Tax reform' tends to equal, in practice, lower tax rates for the rich.

'Flexible interest rates' means raising these rates as the flexibility is rarely applied downwards, at least not for a long time. This makes credit scarce and expensive, particularly for Small and Medium Enterprises that provide most of the employment opportunities, with the unsurprising result of higher unemployment. 'Privatization' becomes a bonanza of get-rich-quick opportunities for wealthy local elites and transnational corporations. 'Openness and a favourable environment for Foreign Direct Investment' does not necessarily mean that the country will receive new so-called 'green-field' job-and-wealth-creating investment. Statistically, most of the funds classed as FDI will be directed only to mergers and acquisitions involving existing companies, generally resulting in downsizing the workforce. 'Property rights' sound impressive but somehow never trickle down to the informal sector where they would be most needed.

As for the supplementary policies grafted onto the WC, Williamson himself takes pains to stress that in his version, he recommended neither monetarist policies nor an end to the State's role in redistribution and the provision of welfare. Such monetarist, minimal-State policies were nonetheless adopted and applied, especially by the International Financial Institutions (IFIs). The most important of these, the International Monetary Fund (IMF) and the World Bank, are themselves exceedingly close to the US Treasury Department. The IFIs also placed great emphasis on 'flexible' labour markets, full participation in WTO-ruled trade agreements, or even more stringent rules featured in many regional and bilateral trade treaties. They also call for independent central banks on the model of the European Central Bank, exempt from any kind of political oversight.

Probably the major divergence between Williamson's initial version of the WC and the policy actually applied concerns 'capital account liberalization'. In economist's language, this simply means that the country applies the 'open borders' philosophy not just to goods and services but to

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financial flows as well. Capital can go where it likes, when it likes; it can flow in – and much more dangerously – flow out – according to whim. The welcome mat is out not just for FDI, but also for PEI, or Portfolio Equity Investment. Foreigners – generally large, institutional investors – can buy stocks, bonds, the national currency and any other available financial instruments; they can speculate freely. So can local elites with no nationalistic qualms about wrecking the economies of their own countries through capital flight or offshoring their businesses. These are the policies of the augmented or broad WC.

Opening one's borders to all financial comers might be a good idea if every country were at the same level of development and every currency as strong as, say, the euro. This, however, is far from the case. It might be useful to recall that just over 20 years ago, under the Socialist presidency of Francois Mitterrand, France practiced capital controls and restricted the amount of foreign exchange citizens could purchase. The euro, whatever its possible drawbacks, has put a stop to speculation against individual European currencies which were frequently and lucratively attacked in the 1980s and 1990s. Matters were far worse in the South, as we shall see in a moment.

As many observers of developing countries have noted, leaving one's economy and one's people to the mercies of the 'free market'; in other words to the dominant international financial players interested only in short-term profits, is the equivalent of leaving the free fox to guard the free henhouse.

### **Dire financial consequences**

Structural adjustment and broad WC policies have now been practiced for roughly a quarter century. Capital account liberalization and the rest of the augmented WC imposed by the IFIs often rendered governments powerless to halt sudden financial outflows. As the professional banker Sony Kapoor has brilliantly explained, the market is structured so that traders must 'chase the trend' as far as it will go. The fundamentals of an economy have little or nothing to do with the short-term actions of these traders whose income, bonuses and jobs

depend on volatility. These people, most of whom are to be found in the trading rooms of the 30 major banks of the world, are not 'evil speculators', but nor are they paid to take any interest in the welfare of a country or its people: they just do their jobs, or lose them. Once an outflow begins, it will not stop until it has run its course. The Bank for International Settlements in its 1995 Annual Report quite rightly described these outflows as governed by 'herd behaviour'.

The results were tragically clear, particularly during the Asian crisis of the late 1990s. Whenever a few star traders in New York or London stuck a moistened finger in the air and found the wind blowing against, say, the baht, the won or the real, they stampeded to the exit. No currency controls or taxes were in place to stop them (except in a few countries like Chile, Malaysia or China which escaped the worst).

A cascade of financial crises ensued. One sober appreciation of these comes from the International Labour Bureau. Its figures show that in the Latin American-Caribbean region alone, between 1980 and 1998, more than 40 financial crises occurred, during which per capita GNP dropped by more than 4 percent. More than 90 countries, from Algeria to Zimbabwe, experienced a 'severe financial crisis' between 1990 and 2001. 'Severe', as defined by the ILB-BIT, means that the value of the currency depreciated in a given month by at least 25 percent and that this drop was at least 10 percent greater than in the preceding month. We are thus talking about a brutal loss of purchasing power, savings, pensions and so on, of at least a third in two months.

### **Realpolitik of the WC**

What was this scenario about in political terms? The WC, in the broad, beyond-Williamson sense, was clearly intended to put a stop to any nationalistic leanings towards State-led development policies, particularly import substitution or the protection of national industries or local agriculture (the term 'food sovereignty' had not yet been invented). It was also about opening one's economy to the largest private actors in world markets, that is, to transnational corporations, banks and

other major financial actors like pension funds. It came down to forcing the government to leave the currency, jobs, local businesses, social system and *tutti quanti* to the decisions of outsiders, interested only in quick profits and possessed of far greater financial clout than most Central banks. It was, above all, a strategy invented by the North designed to ensure that southern countries continued to service their debts, but could never hope to pay them off. This in turn would ensure that they continued to obey orders, those of the broad WC.

Hundreds if not thousands of critical papers have been written about these policies, particularly as practiced by the Bretton Woods Institutions (the IMF and the World Bank). Mountains of evidence are available showing that in 'structurally adjusted' countries, without exception, growth has slowed, inequalities have worsened and poverty has deepened. John Williamson himself ruefully admits that the results of WC policies have been 'disappointing, to say the least, particularly in terms of growth, employment and poverty reduction'.

If economics were a science, the economists who work for the IFIs would have been obliged long ago to alter their hypotheses, because the results of their social experiments have been devastating – at least if the criteria of poverty reduction, inequality and growth are applied. If a bridge collapses or the purported cure for a disease makes peoples' illness worse, the engineer or the biologist is called on the carpet. They, or their companies, can be sued. Their stress calculations and scientific hypotheses are thrown out as worse than worthless – injurious, indeed lethal. None of this happens in the case of disastrous social policies. Their authors never take the blame for anything, because neo-liberal economics is not a science but an ideology and it is the ideology upheld by those who now hold the balance of global power. The institutions that serve their needs continue to serve them and the people who work there can continue to earn large salaries while destroying other peoples' lives.

The practitioners of structural adjustment WC policies, when faced with what Williamson modestly calls 'disappointing, to say the least' outcomes

'in terms of growth, employment, poverty reduction' and a host of other indicators, will never admit that their policies are wrong nor will they entertain criticism. The victims will hear, rather, that they have not (1) worked hard enough or (2) made themselves competitive enough or (3) waited long enough for the benefits to make themselves manifest. This sounds familiar; we seem to have come full circle.

### Is the WC an aberration?

If neo-liberal economic WC-type policies do not 'work', if by 'working' we mean that economic policies ought normally to serve the needs of the entire population of a given country, why are these policies still practiced; why do they remain so powerful and accepted virtually everywhere? This situation is not as mysterious as it might appear, especially if we remember that we are not really talking economics but politics.

For a fuller explanation of the 'mystery', it is useful to know first that in the United States, private right-wing foundations have for at least 25 years pursued a concerted policy of financing the development and dissemination of neo-liberal ideology. Between 1982 and 2002 alone, they spent over a billion dollars on think tanks, research centres, university chairs, individual scholars and sophisticated communications strategies. Fifty years ago, their Social-Darwinist, Hayekian ideas would have been seen as dangerous, extreme, even mildly crazy. Virtually no American leader or academic held them, whether of the Republican or Democratic Party persuasion. Now they have become mainstream. They permeate the curriculum of economics, social science and law faculties, particularly in the prestigious university breeding grounds of future leaders.

The 'Chicago Boys' have become the 'Everywhere Boys' and they are particularly prominent in the US Treasury, the Bank and the Fund, regardless of who might be in the White House. It is not possible to elaborate here on the strategy of the far (neo-liberal or 'neo-conservative') right-wing, but one should never forget that it has been eminently successful; that the ideas now dominant have been bought and paid for by people who

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knew what they were doing and what they wanted. Progressive forces have been utterly incapable of mounting any serious ideological challenge against neo-liberal thought and policy – in fact, they have not even seriously tried.

The second explanation of the ‘mystery’ is that financial-market-dominated globalization (let us consider the adjective ‘neo-liberal’ understood) has been exceedingly kind to some. Every year, the Forbes list of the world’s billionaires grows longer; it currently stands at 793. One analyst claims that their combined wealth easily surpasses the \$2,600 billion of global southern debt stocks. I have not added up the holdings of these gentlemen [and a few ladies], but the claim is plausible. It is striking to note, although not a scientific comparison, that the combined fortunes of the three richest individuals in the world are greater than the combined GDP of the world’s 48 poorest countries.

Furthermore, on a slightly less lofty financial plane, the number of High Net-Worth Individuals identified yearly by Merrill-Lynch and Cap Gemini in their ‘World Wealth Report’ also shows spectacular increases, adding roughly 500,000 newcomers a year. About 8.8 million of these fortunate souls are to be found scattered about the world – mostly in the US and Europe but also on other continents. Each owns more than a million dollars in assets above and beyond his principle residence; Merrill-Lynch estimates their combined wealth at some \$30,000 billion. Since such enormous sums are difficult to comprehend without a point of comparison, the combined GNP of all the OECD countries amounts to about \$35,000 billion. It is quite conceivable that the wealth of the High Net Worth Individuals will soon equal this GNP, doubtless to Merrill-Lynch’s satisfaction, as it is understandably interested in managing their money.

Worldwide, inequalities have never been more harsh. According to IMF figures, if we divide the world into advanced countries and the rest of the world (including China and India), in 1980 the advanced countries (18 percent of the world’s population at the time) captured 71 percent of the world’s income. In the year 2000, the advanced countries (now reduced to 16 percent of the

world’s population) had increased their share to 81 percent of the world’s income. Seen from the other perspective – that of the people in the ‘rest of the world’ – in 1980, 82 percent got 29 percent of the world’s income; a mere 20 years later, 84 percent was left with a paltry 19 percent. The size of the pie may have grown and the progress of part of the Chinese and Indian populations may skew the figures somewhat but they are still stark.

The third and probably most important explanation for the continued power of neo-liberal policies despite the fact that they do not ‘work’ shows that the WC is not an aberration but a political necessity. The worldwide income figures just provided are one clue. The political advantage of neo-liberal globalization is the renewed and reinforced hold it has given the North over the South. Broad WC policies have ‘worked’ very well indeed, not just by enriching the Happy Few, but above all by entrenching financial servitude. This servitude in turn promotes southern compliance with the North’s will. Debt in the South should not be seen primarily as a financial or an economic issue. It functions rather as a political tool and it far surpasses colonialism and classical imperialism when judged on criteria of efficiency, cost-effectiveness and invisibility. As Karl von Clausewitz said, the aim of war is to ‘force the enemy to do our will’. The Chinese strategist Sun Tsu wrote in 500 BC that the greatest generals were those who never had to do battle. With debt, we have successful warfare without a shot being fired.

### **Debt as power**

Debt is a far more useful strategy than colonialism because the latter requires an army and an administration. It is costly, it provokes resistance; it is hugely visible, it attracts bad publicity and, in our own time, it has become terminally unfashionable, even unthinkable. This does not mean that colonialism’s objectives have been abandoned – far from it. These objectives, as Clausewitz might also have said, are merely pursued by other means.

Debt is the mechanism that keeps much of the southern hemisphere obedient and under control. It is perhaps not superfluous to point out that the

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1970s were a time of great hopefulness and renewal in the South. Following many liberation struggles and the decolonization process, roughly from the time of the Bandung Conference in 1955, a coherent southern leadership was emerging. By the 1970s, the UN and other forums resounded with calls for a New International Economic Order; groups like the Non-Aligned Movement and the G-77 (later well over 100 countries) were making their demands heard. The northern leadership never said it in so many words but this situation was clearly intolerable.

Although it may be difficult to claim that the indebtedness crisis of the South was the result of a conscious strategy, 'tout se passe comme si' ('everything happens as if') that were the case. A recent book by John Perkins, *Confessions of an Economic Hit Man*, may be irritatingly self-serving but makes a convincing case that he was part of a political-industrial conspiracy to gain quasi-feudal control over southern countries by designing so-called 'development' projects whose huge costs these nations would never be able to pay back.

Conscious or not, the strategy paid off. The South was lured by easy terms. In the mid-1970s, people were actually paying these governments to borrow money. Real (i.e. minus inflation) interest rates, for example, were -1.3 percent in 1975 and only 1.8 percent in 1980. Then, in 1981, US Treasury Secretary Paul Volcker delivered the financial nuclear strike and raised them, in real terms, to 8.6 percent. Since the South had borrowed at variable interest rates, it was caught. The first crisis in Mexico was not long in coming (1982) and the noose tightened around southern countries.

They have remained well and truly trapped. The enhanced, jumbo-size WC has become their permanent fate. Naturally, the smaller and weaker a country, the more it will be obliged to follow free-market, capital-and-foreigner-friendly policies. African countries are far more vulnerable to the IFIs than, say, Brazil. But even Brazil has refrained from giving any offence to financial market actors, has respected the WC rules and also accumulated large budget surpluses despite serious poverty problems at home. That it has the largest debt of

any developing country is not, perhaps, foreign to its choice of policies.

However, this contribution is not about Brazil. Let us look instead at how debt has been and continues to be used as a tool and contributes to the reign of finance over the world. Whereas colonialism costs the imperial power money, debt servitude pays. Here is some financial evidence showing that the North's extraction of wealth has continued unhindered.

### What the figures say

In 1980, the South was already seriously indebted; its debt stocks amounted to \$540 billion. Twenty-five years later, in 2004, the stock had increased to \$2,600 billion, almost five times as much. Meanwhile, over the same 25-year period, these countries had reimbursed \$5,300 billion, nearly 10 times what they owed in 1980. Magic! Looking at the figures in another way, we may note that after the Second World War, the United States provided war-torn Europe with the Marshall Plan, about \$90 billion in today's dollars. The South's reimbursements to the North through 2004 provided the creditors with 59 Marshall Plans.

In 2004, Latin America had \$770 billion worth of debts and paid out \$121 billion in debt service, almost 16 percent (about the same percentage of service paid by Southeast Asia and the countries of the former Soviet bloc). Even sub-Saharan Africa paid \$15 billion on debts of \$220 billion, or 6.8 percent. How much money is this in understandable human terms? For Latin America, it meant a drain of \$331 million a day, \$13.8 million an hour; \$230,000 a minute. Sub-Saharan Africa, despite all the promises of the G-8 and the IFIs, provided its creditors (mostly public institutions) with \$41 million a day, \$1.7 million an hour, \$28,000 a minute in debt service. One could doubtless feed many hungry people or build many schools and clinics with \$230,000 or even \$28,000 a minute.

But perhaps these huge payments were in some way compensated by other inflows – after all, the point is not the total debt service paid *per se* but total financial transfers. Unfortunately the news is no more optimistic on this front. Again for the year 2004, Latin America's net transfer to the

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North was –\$34 billion and for the five-year period 1999–2004, –\$264 billion. For the entire world (2004) inflows arriving from the North to the South were \$78 billion from official public Overseas Development Aid and much more – \$126 billion at least – from migrant workers' remittances, for \$204 billion total. Outflows from South to North, however, counting only debt service of \$374 billion and transnational corporations' repatriations of profit and capital of \$104 billion, totalled \$478 billion for a net transfer of \$274 billion in the North's favour of the North. Not bad.

But it is still not enough. How do developing countries find that kind of money? Nobody in the North wants their bahts, wons and reals – they have to pay in hard currency. The only way to earn it is through exports (this includes exports of people, otherwise known as migrants). In accordance with its statutes, the IMF holds yearly 'Article IV' consultations with indebted countries and calculates among other items the proportion of export revenues a country can expect to pay in debt service. Its policy consultations with the Brazilian government in 2006 predict that Brazil will be paying fully 55 percent of the value of its exports of goods and services. Whatever is left over, Brazil can spend on the needs of Brazilians. Despite impressive figures – inflation down to less than 5 percent and growth projected at 3.5 percent – Brazil's interest rates have been maintained at over 18 percent to attract and remunerate foreign capital.

Brazil has a favourable export picture and its ethanol in particular will be ever more popular. Many smaller countries, however, are extremely dependent on one, two or three basic commodities and these tell a sorry tale. During the period between 1977 and 2001, average yearly declines in the prices of these commodities were according to UNCTAD the following: –2.6 percent for food-stuffs, –5.6 percent for tropical beverages, –3.5 percent for oilseeds and oils. Only metals – which unlike food and beverages are never produced by smallholders – did slightly better at –1.9 percent a year, although this still reflects a considerable decline. Increased Chinese purchases may help boost the value of some of these commodities, but the story is still not a happy one.

Unfortunately, despite the enormous piles of studies about debt, I know of none that has tried to calculate its contribution to these consistent drops in commodity prices. Granted, debt is not the only factor in these downward trends. Demand for tropical products is not growing much worldwide and commodity agreements on the model of OPEC have mostly failed. A suppliers' cartel for rubber limited to three countries has produced quite good results but the coffee agreement collapsed long ago. Still, pressure to export whatever one has to hand in order to service one's debt in hard currency must surely play a role in the excess of supply over demand and consequently falling prices.

Nor have I found any comprehensive study (not on the part of the power-holders in any case) on 'odious debt', nor even serious individual country studies ordered by the governments. 'Odious' debt is not an epithet but a legal concept elaborated by Paris Law professor (and former Tsarist minister) Alexander Sack in the mid-1920s and since accepted by some courts of law in some cases. Odious debts are those that were contracted not for the needs or the genuine interests of the State but in order to strengthen a despotic regime and to repress the population when it tries to rise up against such a regime. Such debts should not be considered the legal responsibility of a successor government, particularly a democratic one; it is the sole personal responsibility of the despots that contracted it. If the creditors can be shown to have been aware of the odious nature of the loans they made, the debt also becomes their legal responsibility.

Brazil, Argentina and many other Latin American countries would seem ideal candidates for odious debt legal recourse. All the classic conditions are fulfilled: the despotic military regimes, the repression, the large sums spent on armaments, the military, the police and the prisons. The creditors, both public and private, knew perfectly well the true nature of these regimes. Not only were they aware – they welcomed them and, particularly in the case of the United States, supported them materially, politically and militarily. Northern national treasuries and northern private banks loaned these despots vast sums of their own free

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will. Surely the present Brazilian government has the financial records or could obtain them. We know that it has the competent economists who could calculate what part of the present debt, whose interest has been mounting for decades, are truly odious.

### **Conclusion**

Brazil decided to pay off its \$15 billion debt to the IMF in advance and will thus economize on interest payments. Argentina has done the same. If enough countries followed suit, the Fund would have trouble surviving and from many peoples' point of view, this would be a positive development.

Outsiders wonder, however, why southern countries have shown so little unity around the debt question; why they never seem to have considered dealing with it collectively. They continue meekly to pay, if not every cent then at least as much as they can possibly afford, with no hope of every wiping the slate clean. Every country has a national debt – this is not the point. The question is whether, and when, it becomes a top priority and prevents governments from carrying out their true responsibilities towards their people. One cannot count on any concessions from the creditors. Even in the case of ultra-poor Africa, one

can see that the yearly hand-wringing and promises of the G-8 come to very little in terms of genuine relief, which must in any event be earned through additional years of painful structural adjustment.

Only the US can escape its enormous debt of \$8,000 billion, should it decide to do so, by printing money. It is quite possible that if this course were ever chosen, the entire economic structure of the world could come tumbling down. The global economy is based on debt (usually called 'credit' or 'leverage') and here we have touched merely on one aspect of it, however important it is for the countries concerned. Other financial pitfalls will be examined in other parts of this colloquium; undoubtedly the \$1,200 billion changing hands daily on foreign exchange markets or the astronomical \$117,000 billion spent on derivatives every day contribute to an ever-shakier structure.

Global turbo-capitalism is no longer as Marx described it, moving ponderously from investment to production to profit to reinvestment and so on. One no longer needs to produce anything tangible in order to make huge amounts of money. It is, in fact, distinctly inadvisable to involve oneself in anything so crude as actual things. Serious wealth comes from financial manipulation and for the manipulators, nothing is ever enough.

### **Notes**

- 1 The Celso Furtado Centre is named for Celso Furtado a famous Brazilian development economist whose entire life, inside government and out, was devoted to reducing the poverty of his fellow Brazilians and to creating a truly national development project for his country. The Centre bearing his name has been established in Rio de Janeiro, in the headquarters of the BNDES – the Bank for National Economic and Social Development. Headed by his energetic widow, Rosa d'Aguiar Furtado, the Centre is a space for debate, research and for rebuilding the development agenda in our time, so deeply influenced by neo-liberalism. This article is based on Susan George's contribution to the International Celso Furtado Centre Colloquium on 'Poverty and Development within the Context of Globalisation', Rio de Janeiro, 25–27 July 2006. For more details on the Centre and the many writings of Susan George, please see <http://www.tni.org/george/>