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A new Latin America in a new international capital market

*Albert Fishlow**

Introduction

The timeliness of another look at the development prospects and policy options for Latin America can hardly be disputed. Another shock from a significant increase in the price of petroleum is adding to the burdens of a world economy already mired in stagflation. The recent UNCTAD meeting has not produced a common programme for accelerating and spreading economic development: on the contrary, divisions among and between the industrialized and developing nations have widened. Even the conclusion of the Tokyo Round has failed to evoke enthusiasm among the Group of 77.

For all the failure to seize upon its possibilities, however, economic interdependence remains more than rhetoric, and for no part of the developing world is this truer than Latin America. The countries of the region substantially increased their integration into the world economy at the end of the 1960s and the beginning of the 1970s. Growth rates of their trade were superior to those of the gross domestic product, which were themselves accelerating. Terms of trade were favourable. Capital flows increased dramatically.

Since 1973, as the industrialized countries have performed less well, with corresponding reduction in the growth of trade, the regional statistics have mirrored the global adjustment problem. For all the success —in large measure unexpected— that the private banks have had in recycling the surpluses of the OPEC countries, the transfer of the extra petroleum revenue has not gone smoothly. This was true even as the OPEC surplus diminished from US$ 40 billion to some US$ 10 billion in 1978, and before the substantial increase now in prospect again.

Statistics for Latin America as a whole, of course, conceal the significant differences that have emerged between the oil-exporting and non-oil-exporting countries of the region. Of the latter, sixteen experienced lower growth in the period 1974-1978 than in the prior 1970-1974 period, and only three smaller countries (Honduras, Paraguay and Uruguay) registered an improved performance. In contrast, the oil exporters showed tangible gains, and even Ecuador —the only country not to gain markedly relative to the earlier period— nonetheless grew at one of the highest rates of the region, 6.8%.

The regional growth rate, heavily dominated by the non-oil-exporters, is in itself an obvious source of concern, sinking from a postwar high of 7.5% in 1970-1974 to 4.0% in 1974-1978. The current average is lower than that of the stagnant early 1960s, which provoked such concern. Slowing and uneven growth has been accompanied by generalized inflationary pressures. Excluding the extreme experiences of Argentina and Chile, consumer prices have climbed at more than 30% a year recently, compared to less than half this rate in 1970-1973. In short, even if we include the gains of its oil producers the Latin American economy has not fared well in the unsettled post-1973 circumstances, and this conclusion applies all the more when comparison is made with the performance of other developing countries.

What makes the Latin American experience of special concern is that this post-1973 decline in growth and resurgence of inflation have taken place despite record capital flows exceeding those to other areas. During the period 1974-1978 the non-oil-exporting countries of the region increased their indebtedness by some US$ 60 billion. As an order of magni-

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tude, this capital inflow should be compared with a *total* cost of petroleum imports of less that US$ 30 billion and an *incremental* cost of petroleum imports of about US$ 20 billion. To put it another way, and more comprehensively, the capital flow was sufficient to sustain the same 9.6% rate of increase of the purchasing power of exports experienced in the extraordinary 1970-1973 period. Thus it substantially compensated for both diminished volume and terms-of-trade effects.

It is difficult to sustain, therefore, that Latin America has suffered from inadequate access to foreign capital markets. Despite the substantial access it has enjoyed, however, the consequences have not been entirely satisfactory. While it is correct to argue that the payments deficits of Latin America, and of the developing countries generally, have provided a necessary counterpart to the OPEC surpluses, one should not exaggerate the efficiency of the transfer process.

In looking ahead to the renewed imbalance in global finances that is imminent, it is important to appreciate both the limitations and the possibilities inherent in the strategy of debt-finance adjustment which some countries in Latin America have opted for. The sections below address this fundamental issue from different perspectives. Section I considers the characteristics of recent capital inflow, sources as well as uses. Section II examines the capital requirements for continuing economic expansion in the region, as well as the means for meeting them, and attention is also given to some of the suggestions that have been made regarding ways to confront future capital needs more adequately. Section III considers the domestic side of integration into international capital markets and notes that reliance upon external capital inflows is not neutral in its consequences for internal policies.

I

The pattern of debt accumulation

The dimensions of the capital inflow into Latin America are tolerably clear from recent research on the subject. The disbursed debt of the non-oil-exporting countries now exceeds US$ 100 billion —roughly two-thirds official and one-third provided without government guarantee. Brazil and Mexico together account for some 70% of the regional total. The Brazilian debt stands at around US$ 40 billion, and the Mexican close to US$ 30 billion. Argentina, with a debt of US$ 10 billion, and Colombia, Chile and Peru, each in the range from US$ 5-US$ 8 billion, trail far behind.

That debt has increased more than eight times from its 1965 level, and more rapidly than for the developing countries as a whole. Debt has become the principal form of capital inflow into the region, and direct investment, which a decade ago provided almost as much resources, now accounts for little more than 10% of the capital inflow. Multinational enterprises have increasingly financed their requirements through bank indebtedness abroad rather than by resort to internal credits or to equity.

Accompanying the shift to debt finance has been a much greater role for private rather than public sources of credit. Commercial banks in particular have become the principal creditors. They have now become responsible for more than 40% of the officially guaranteed debt, compared to less than 10% little more than a decade ago, and with the rise in the importance of non-guaranteed debt, supplied almost exclusively as bank credit, their participation must stand at close to 70% of the total outstanding debt. Estimates for 1978 suggest a partial retreat from the proportions of the 1974-1977 period, partly for that very reason.

These capital inflows over that last decade cannot usefully be viewed as forming a single process of debt accumulation, but seem rather to correspond to three distint sets of circumstances. The first period, approximately from 1970 to 1973, is one of the initiation of access

to the rapidly growing Eurocurrency market. Supply, in the form of bank discovery of the profitability of application of resources in the middle-income countries, vied with demand. Increasing investment coefficients meant increasing need for imports of capital goods, and consequently for foreign exchange. At the beginning, despite buoyant exports and favourable prices, import requirements exceeded import capacity —hence the attractiveness of finance available for reasonable periods and at low interest rates owing to an excess of investible funds. In 1972 and 1973, however, the extraordinary rise in the prices of commodity exports increased the value of exports by more than 60%, thus providing a much larger supply of foreign exchange, and the continuing inflow of loans was substantially applied to the accumulation of reserves rather than to offsetting the current account deficit.

I have labelled this early period prior to 1974 one of debt-led growth, in order to emphasize the positive relationship between the flow of external capital and the acceleration in real growth of the product. In the early 1970s such supplementation of foreign exchange made it feasible to adopt high growth strategies without fear of foreign exchange constraints.

The years 1974 and 1975, in contrast, are those of debt-financed accomodation to the oil price increase. As a result of the increased demand for loans, interest rates rose perceptibly and maturities shortened. The purchasing power of exports fell sharply in both years owing to increasing prices of petroleum and other imports, while the volume of exports stagnated. Import capacity was sustained by resorting to the external market to finance unprecedentedly high deficits on current account. So substantial were the needs that there was even some modest depletion of reserves. The net effect was virtually uninterrupted growth in 1974, but perceptible reduction in 1975. Nonetheless, the performance in those two years, taken together, did not compare unfavourably with longer-term trends, and in both years the investment coefficient continued to rise.

The almost US$ 30 billion in current account deficits of the Latin American non-oil-exporting countries was largely offset from the surpluses accumulated by the OPEC countries. These balances found their way for the most part to the Eurocurrency market, where they were intermediated by the banks. Non all developing countries were equally fortunate, however. The lowest-income countries, whose growth rates had failed to respond favourably in the earlier period, did not have access to the new resources, and their unhappy alternative consisted of still slower rates of expansion and reliance upon public capital made available for the most needy.

Other countries, notably Korea and Taiwan, responded by accepting an immediate reduction in growth, and undertook diversion of production to the export market. This, of course, is the means by which the real income loss due to the adverse change in the terms of trade is palliated by translating it into reduced domestic absorption. While possible for some countries, it is not a solution for all simultaneously unless total world income were to fall significantly.

The large economies of Latin America opted for a third course —one of using the capital market to sustain domestic expenditure. They did so in part because private commercial banks effectively recycled the new petrodollars by making borrowing attractive. Latin American countries already in debt had an easier time obtaining more. But such differential access is not the only reason. Clearly there were important political advantages in seeking to sustain higher rates of growth that had recently given such striking advantages, and in avoiding economic recession or worse. This combination of circumstances led Latin America to emerge as an even larger participant in the capital market after 1974, and the two largest developing-country debtors to commercial banks became Brazil and Mexico.

A third period, after 1975, should also be distinguished. It has been marked by substantiallly reduced current account deficits compared with the 1974-1975 levels, the 1978 level in real terms —deflating for both inflation and real product growth— being less than half the 1975 peak. In addition, the composition of the deficit has changed, and whereas it was made up almost entirely of net payments of profits and interest in 1977 and 1978, in 1975

these formed only a third of it. The last three years have therefore seen a delayed adjustment to the altered external conditions prevalent since 1974: a rise in the rate of growth of exports, virtual constancy in import volume, a reduction in the rate of growth to less than 5%, and a lower investment coefficient.

Yet this last period has also seen an actual expansion of foreign borrowing rather than a reduction. Massive increases of reserves explain this apparent contradiction. The non-oil-exporting countries are responsible for an accumulation of more US$ 17 billion in reserves in the last three years, and almost half of the increment in debt has been used for this purpose. Much of the rest, in turn, has gone to compensate for the outflow of service payments on prior direct investment and indebtedness. Far from financing a necessary supply of imports essential to continued growth, real external resource transfer has sharply declined. Foreign borrowing satisfies domestic credit requirements rather than foreign exchange needs, and large international reserves create domestic monetary policy problems as well as complicating management of the debt. These reserves have become offsetting deposits feeding back into the Eurocurrency market, earning lower rates of interest, and of limited convertibility to material imports because of creditor apprehension.

For many of the countries of Latin America, therefore, the debt cycle threatens to come full circle in little more than a decade —from a process of debt-led growth to one of potentially debt-constrained growth. Foreign capital inflow, while staving off some of the worst consequences of the new world economic situation since 1974, has not been a panacea.

II

Capital requirements

This record accumulation of debt in Latin American and other developing countries has not gone unnoticed. Initial concern by some in 1974 and 1975 lest the entire world financial structure crash on account of generalized incapacity to repay has quite correctly abated, and more optimistic forecasts, showing how the record current account deficits of 1974 and 1975 would moderate and involving adjustments for inflation and product growth to assess more accurately the extent of indebtedness, have proved better founded.

Yet it is too soon to dismiss the debt problem entirely. It is clear from the experience of recent years in Latin America —even before the present petroleum shortage— that the inflow of increasingly private capital has not been performing its intended function. Potential savings both in the direct form of OPEC surpluses, and indirectly in the form of lesser investment in the industrialized countries, have not been translated into capital formation and sustained economic growth. Resources have not been allocated to those whose return was highest, but rather to those whose needs were less. That is, of course, one of the ironies of commercial-bank evaluation of creditworthiness: those who accumulate reserves are the best customers.

Underlying this failure of the market to produce more positive results is the reliance on a short-term, private profit motive criterion. Commercial banks could hardly be asked to function otherwise, since they have no pretensions of serving as development banks, and neither could the recipients. Each country, facing an uncertain supply of credit, could hardly risk larger current account deficits, given the short maturity of its large outstanding liabilities. It is not surprising, then, that Latin American growth rates and investment coefficients should decline and that the building up of reserves should be a favoured application of borrowing —and a key to continued access.

Furthermore, the optimistic assessments

tend to look backward rather than forward. Whether the calculations on which they are based involve deflating the debt by rising export prices, or extrapolating diminishing current account deficits, they fundamentally err in failing to tackle the question of the future means of meeting foreign exchange needs.

While export prices may rise, so do import prices. The real problem for non-oil-exporting countries since 1974 has been the combination of inflation and adverse terms-of-trade movements. Moreover, global inflation also means higher and immediately adjustable interest costs on debt of shorter average term. While we have seen that current account deficits for Latin America have indeed declined, we have also noted the lesser real transfer of resources consequent upon the rising incidence of interest and profit payments.

Once one projects forward to ascertain the capital inflows that will be needed, the essential characteristics of the Latin American debt problem become clearer. Firstly, the debt over next decade is likely to increase by a significant multiple, and more rapidly than gross national product. Gross inflows will have to rise even more in order to cope with amortization. Secondly, the ratio of service payments to exports is likely to increase further in the near future from its current average of more than 40% before stabilizing. Thirdly, the gain to debtor countries from inflation should not be exaggerated. Such a gain does exist, because price increases magnify the dollar merchandise surplus that can be used for amortization and service payments denominated at historical cost, but as the maturity of the debt shortens, and as interest rates reflect inflation —as they must with increased reliance upon commercial bank loans— this advantage is curtailed. More significant than inflation *per se* are the terms of trade, because they have a greater effect upon the size of the commercial balance. In crude terms, on the basis of a variety of actual projections using parameters appropriate to the Latin American experience, a one percentage point improvement in the terms of trade is equivalent to three percentage points of generalized inflation.

Fourthly, capacity to cope with the size of the debt and its servicing requirements depends critically upon real export growth rates that exceed the growth of the domestic product, that is to say, it depends upon an increase in the importance of the external market. Import substitution can help in increasing the commercial balance, but cannot be relied upon to the extent it was formerly. At the low ratio of imports to income that the larger countries now have, there is a limit beyond which the import elasticity cannot be pushed. Moreover, as one approaches that limit and relies upon import reduction to equilibrate capital needs, there is no further flexibility for economic policy: a decline in foreign exchange for any reason automatically becomes a serious economic constraint, whereas at higher levels of exports and imports there is more room for restricting less essential imports. Furthermore, an export-promotion policy reaps the gains of a much larger market and, if correctly pursued, stimulates increased productivity in response to the rigours of international competition, whereas an import-substitution policy runs the risks of excess protectionism and inefficiency.

Fifthly, the growing export surplus required to slow reliance on external capital inflow calls for a corresponding reduction in domestic expenditures. National savings must rise as a counterpart to the resources transferred from abroad earlier. One can postpone, but not avoid, the real income consequences of the higher petroleum prices, and the question of how to allocate that cost internally, as surpluses are transferred externally, is not a trivial matter.

Finally, and most important, a more causal projection structure makes it clear that the real cost of repayment of the debt under adverse trend and financial conditions is lowered economic growth. Foreign exchange must be allocated to service past inflows of capital rather than to purchase imported inputs essential to sustained capital accumulation. At low rates of continuing capital inflow and of exports there is a trade-off between adjustment in the current account deficit and economic performance. The debt problem is far from exclusively a creditor's problem, and it becomes an impossible one if creditors simultaneously choose to close off both capital and merchandise markets.

raise legitimate doubts in this direction— they are not a necessary concomitant of rising exports. It would be unfortunate, as more democratic tendencies stir in a number of countries, for nationalist, inward-looking development to become synonymous with an economic policy more responsive to popular needs. The reality is that import substitution, domestic austerity fairly distributed, and continuing capital inflow must all be coupled with aggressive efforts to increase exports.

The great bulk of these exports, moreover, will have to be directed to the market outside Latin America rather than within. Just as the shortages of foreign exchange in the late 1950s stimulated the creation of the Latin American Free Trade Association, so again there are suggestions that an expanded regional market may contribute to the solution. A recent CEPAL publication, for example, took the view that Latin America will now undoubtedly have to place more emphasis on intra-regional trade. Without denying the growth of intra-regional trade in recent years and its more than proportional significance in the field of manufactures, however, it seems to me unlikely that the formal integration process will much accelerate in the next several years unless two conditions are met: reversal of the diminishing regional political identity which has characterized Latin America in the last decade; and much slower growth of trade opportunities outside the region. A Latin American Common Market is more likely to have its origins in circumstances external to the region than to arise spontaneously from within. Even then, the capacity to bridge the significant differences between oil exporters and oil importers, large economies and small, advanced and lower-income countries, etc., seems to me doubtful. Intra-regional exports may contribute to the solution, but only to a limited extent.

Apart from assuring a continuing allocation of resources to exports, domestic policies must seek better to accommodate the external and internal capital markets. During the period of rapid debt accumulation, the restructuring of internal capital markets has been given secondary priority, since external credit has substituted for the need to capture domestic savings. The distribution of such credit is, of course, non-neutral. It favours larger enterprises relative to smaller; governmental relative to private; industry relative to agriculture; multinational firms relative to national. Government policies often seek to offset such biases, but at the cost of compartmentalizing the internal capital market still further. Those sectors receiving subsidies suffer from a shortage of real investment as loans are applied elsewhere.

This impact of capital inflow upon domestic financial institutions must be a matter of greater concern. There is no simple equalization of internal and external interest rates, as a simple theoretical model suggests. Moreover, as is well known, external savings are not a pure supplement to national savings, but to a considerable degree displace and substitute for them. Failure to take these structural consequences into account biases an otherwise rational calculus in favour of a larger resort to debt than may be necessary. In recent years, when foreign exchange requirements have been less pressing and debt has had such a large counterpart in reserves, these financial effects loom larger.

This accumulation of reserves has led to wider appreciation of the limits imposed upon domestic monetary and fiscal policy by integration into international capital markets. It is a measure of the excessive reliance upon debt that efforts have been made to sterilize the monetary increases resulting from even greater reserves. Far from the capital flows being an equilibrating mechanism, they threaten the effective management of the domestic economy. External credit must be neutralized by government sales of securities. It is not an easy operation —and one that more often than not has led to larger increases in the money supply than were desired or planned. This avenue of imported and magnified inflation has been an important component in the price rises of the largest regional debtor, Brazil. In undertaking such sales of securities with monetary correction it should be noted, moreover, that government nominal expenditures are given a significant upward impulse.

Apart from these effects on monetary and fiscal policy, there is a further constraint upon

of long-term funds by offering protection against inflation; encouraging commercial banks to intermediate some of their resources through public institutions, perhaps initially through some swap arrangement; creation of new public institutions directed to particular investment objectives in which there is a common global interest: agriculture, substitute sources of energy, natural resources.

These proposals share a common feature. They presume that the problem for Latin America is not a need for concessional resources but for more certain and longer-term funds on which social returns are high enough to offset interest costs. They also presume that exclusively regional arrangements —whether a short-term safety net or longer-term guarantee schemes— are not likely to be as efficacious as more universal arrangements that satisfy special Latin American needs.

Finally, they focus on measures directly relating to capital flows. This is not to ignore that the debt problem is in the last analysis a trade problem. Quite to the contrary. Without high growth of exports, these measures required in the capital markets would be quite inadequate. Unless the means are provided to sell exports in a volume sufficient to meet foreign exchange obligations, the alternatives are either lower Latin American (and world) growth or massive and more certain capital transfers. The former is unacceptable; the latter, unlikely. That is why the subject of capital flows is inextricably linked to that of real flows.

III

Domestic implications and policies

International capital flows must also be related back to the domestic economy. Three interfaces require brief comment in this respect. One is the ability to sustain the growth of exports needed to satisfy foreign exchange requirements. The second is the interaction between internal and international capital markets. The third is the interrelationship between debt management and domestic monetary and fiscal policies.

The progressive reintegration of many of the principal countries of Latin America into the world market at the end of the 1960s and beginning of the 1970s is well documented, as is the rising share of manufactures in total exports. Both the favourable growth of the world economy and domestic policies reducing biases against the external market contributed to this. In some cases, both significant subsidies and more favourable exchange rates were offered; that was clearly true in Brazil, for example, although the subsidies were to a large extent only compensatory for the combination of tariffs and exchange-rate overvaluation.

Such policies of frank export promotion may have been easier to sustain than the combination of import substitution and growing exports now advocated. They were easier because they were accompanied by high rates of growth of imports, and hence rapid expansion of domestic absorption. They were easier because integration into a buoyant world economy yielded tangible benefits in the shape of more rapid growth of the product. They were easier because they did not involve, as in recent years, heightened tariffs and quantitative restrictions against imports, with simultaneous complaints about protectionism in the industrialized countries.

Latin American commitment to the external market runs against deep sentiments to the contrary. An export orientation is feared as anti-industrialization, anti-national enterprise, and anti-more equitable income distribution. All of these concerns have their roots in historical experience. Yet it would be a sad mistake to extrapolate the past to the future. While particular policies to exploit the external market may have such features —and the proposals in Brazil to reorient the agricultural sector

I have emphasized these qualitative conclusions here rather than present a specific set of estimated capital requirements, because these considerations seem to me the more relevant context against which to evaluate different policy proposals. Particular values will change with altered circumstances. The additional cost of oil this year, for example, as well as higher interest rates, will alone add more than US$ 4 billion to the current account deficit registered last year, reversing its trend reduction.

These developments make all the more desirable a concerted effort to tackle the inadequacies of a capital flow monitored almost exclusively by the private market. Corrective measures should fall into two broad categories: conversion of a much larger proportion of current debt into long-term borrowing, and more effective means of coping with short-term shortfalls of foreign exchange. The aim of both these measures is to permit external resources to be used to better advantage, thereby stimulating growth not only within Latin America but also for the industrialized countries.

Bank borrowing through the Eurocurrency market, as we have seen, has in recent years failed to fulfill this objective. Foreign resources have been applied to reserve accumulation rather than investment, and growth rates have fallen below trend levels. The problem is not inadequacy of capital, but rather the availability of too much of the wrong kind.

Many specific proposals have been put forward since 1974 to address these needs, the great majority without success. As long as the Eurocurrency market increases by 25% a year, and as long as the larger Latin American countries enjoy favourable access to it, it is difficult to generate any sense of urgency. The Witteveen Facility of the IMF is one of the few concrete steps taken; it makes available an additional US$ 10 billion to compensate for short-term shortfalls, and we shall probably see greater use made of it after this round of oil price increases.

To supplement this facility, however, some means of more orderly debt restructuring remains necessary. Borrowing to meet immediate foreign exchange needs may avert bankruptcy, but it remains inadequate to finance the longer-term productive adjustments required. Experience suggest that it is precisely those countries already heavily overburdened with debt that repeatedly require emergency assistance. It would be better policy to facilitate a really fresh start than to engage in unrealistic roll-overs that merely stretch out very high service payments over a longer interval. Commercial banks are reluctant to write off foreign loans, although one presumes that the high risk premiums charged provide a financial reserve for doing so. They had no similar compunction with real estate investment trusts —despite larger losses— because a legal code of bankruptcy made settlement desirable. I continue to believe that international lending would benefit from a similar escape clause. Clear applications in Latin America would have been Chile and Peru.

Such a provision would not grant a license for irresponsible conduct by borrowing countries. They would have to pay the cost of failing to meet their obligations through less future access to the capital market, and moreover they could not default without establishing their need for such relief to the satisfaction of, say, the IMF. There would be a chilling effect on the willingness of commercial banks to lend directly for the short term, and some impact on interest costs. That would not be all bad, even when one is quite correctly concerned about the adequacy of capital flows. Reliance on short-term borrowing probably should be discouraged —particularly if its results are as mixed as those of recent years.

Furthermore, such a measure would correctly shift attention to the more fundamental need to make external resources available for productive longer-term investment. Such a need will be met only by increasing the pool of funds available for borrowing at extended maturities. One means of doing so is to enhance the role of the public development banks relative to the private commercial banks. Recent increases in the capital base of the World Bank and of the Inter-American Bank, and co-participations, clearly contribute to this end. More dramatic measures may be necessary, however, including explicit solicitation

the capacity to utilize exchange rate devaluation in a heavily indebted economy. The impact upon external liabilities does not have an even incidence upon sectors or firms. To offset it is to negate the attempt at reducing domestic expenditure, while to permit the financial consequences may be to invite serious displacements in production. One may therefore be forced into a situation of using selective measures to offset overvaluation rather than altering the exchange rate itself.

The essential point is that reliance upon external capital inflows is not an unmixed blessing. Effective management of the debt involves more than a computer print-out of projected amortization and interest payments. It involves the internal allocation of resources, the relationship with internal capital markets, and the synchronization of policy instruments. These tasks are complicated by uncertain conditions of supply determined externally.

Conclusions

Latin America's rising participation in the international capital market in the last decade reflects on the whole its gathering economic strength. Higher levels of income, apparent political stability, a facility to increase and diversify exports, and attractive future prospects are responsible for the differential access to the Eurocurrency market enjoyed by the principal countries of the region. That access has enabled many of those countries to protect themselves against the worst consequences of a much more sluggish and uncertain world economy since 1974.

Integration into international capital markets has not worked equally well for all, however, nor has it worked perfectly for any country. Peru remains saddled with a debt that exceeds its capacity to pay. Mexico's underdeveloped fiscal capacity has been compensated —through good fortune— by the timely discovery and exploitation of petroleum and natural gas. Brazil has embarked upon a stop-go policy in recent years reminiscent of its neighbours to the south. Some smaller countries have not been able to borrow readily or on favourable terms.

Capital inflows thus have not been a panacea, and they threaten to become a problem if they prematurely turn to outflows of real resources. If they are to recover their recent high growth rates, the countries of the region must be able to count on adequate continuing finance. Whether the private market, and the increasing concentration of commercial bank debt, can satisfy that need is doubtful. Uncertain and short-term borrowing does not translate efficiently into the long-term process of capital accumulation and sustained growth that is desirable. Stabilization packages that meet symptomatic excesses of domestic absorption by imposing unrealistically short adjustment periods do not address structural deficiencies.

Many specific proposals have been advanced to deal with one or another of these problems. Few have been seriously considered, because there is little sense of urgency. So long as modest product growth is sustained, debt obligations are met, and continuing capital is available, it will be difficult to arouse keen interest in suggested reforms to improve intermediation. Innovation in international financial markets seems to be dominated by private initiative rather than public policy. The danger is not that the financial markets will suddenly collapse, or that Latin American debtors will all find themselves unable to pay, but that the *status quo* will continue, with adequate, and indeed perhaps excessive availability of credit of the wrong kind.

The countries of Latin America are not entirely dependent upon the initiatives of others in responding to this real, if undramatic, threat. They can reduce their borrowing and rely more substantially upon national savings; they can engage more vigorously in a style of development directed to the internal market; they can insulate themselves to a greater extent against world economic circumstances. Such a strategy is not costless, either for Latin

America or the industrialized countries, for it involves a rejection of the mutual advantages inherent in a rational transfer of resources to more productive applications.

Yet that outcome may well occur, because policies are slow to evolve. Few trends have been foreseen with such monotonous regularity as the altered importance, needs, and role of the middle-income countries of Latin America. Up to now, we have successfully muddled through. But can we confidently rely on such an accommodation in the future?