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THE ECONOMIC RELATIONS OF LATIN AMERICA WITH EUROPE

IV. FINANCING

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IV. FINANCING

A. Changes in the external financing of Latin America 1/

In the last few years some important changes have taken place in Latin America in the field of external financing.

(a) The current account deficit in the balance of payments of non-oil-exporting countries in Latin America increased strongly, both in absolute terms and in comparison with exports. Although in 1977 the deficit dropped to 16.7% of exports, a ratio not very different from that corresponding to the 1966-1969 period, the price paid for this drop was a heavy sacrifice in the rate of economic growth. The gross domestic product of the region increased by 4.4% in 1977, compared to the 6% annual average for the 1966-1969 period. The domestic social implications of this retarded growth rate have been pointed out in earlier chapters.

The world recession has affected the growth rate of Latin American exports. In order to deal with it, the countries could either restrict their economic growth rates to such levels as their lower import capacity allowed, or borrow. In practice, Latin American countries opted for a combination of both alternatives. Thus, balance-of-payments deficits and the corresponding foreign debt were instruments used by the Latin American countries to prevent problems such as unemployment and critical poverty from becoming even more acute. At the same time, Latin American countries helped to avert a more serious drop in the growth rate of world trade, and also helped developed countries, from which they buy most of their imports, to tackle their own balance of payments, employment and recession problems.

(b) Public sources have, to a considerable degree, lost their relative importance as providers of external funds for Latin America. The region has

1/ This section summarizes and updates some of the main conclusions appearing in recent studies undertaken by CEPAL. See The economic and social development and external relations of Latin America (E/CEPAL/1024/Rev.1), "Dos Estudios sobre Endeudamiento Externo" Carlos Massad and R. Zahler, CEPAL, Cuaderno Nº 19 (spanish only).

/tended, save

tended, save exceptional cases, to be excluded from concessionary financing. Furthermore, its participation in non-concessionary public sources has decreased considerably. Conversely, there has been a steady increase, both in absolute and relative terms, of funds from the private sector, particularly from banks.

(c) The conditions of external financing have deteriorated. Grace-periods and terms have, on the whole, been reduced and rates of interest have risen. As regards Eurocurrency credits granted by banks (which constitute an important part of the funds required by non-oil-exporting Latin American countries) to all the developing countries, in 1974 48.5% corresponded to credits the terms of which ranged beyond 7 years, whereas in 1976 these had dropped to less than 5%.

(d) Accordingly, the foreign debt of non-oil-exporting Latin American countries 2/ rose considerably from 37,000 million dollars in 1973 (150% of goods and services exports) to 82,000 million in 1976 (220% of goods and services exports).

(e) The growth of the debt and the deterioration of lending conditions has caused greater attention to be paid to the ratio between debt-servicing and exports in many countries. Debt-servicing payments have not hitherto represented a serious problem since exports continue to show relatively buoyant growth. If this increase in exports were to slacken, payment of services would affect imports more seriously and foreign debt would become a more important problem for many of the Latin American countries.

(f) The fact that a considerable part of Latin American external financing comes from private sources makes many of the countries in the region very sensitive towards maintaining their credit worthiness.

2/ This refers to officially guaranteed debts and to an estimate of long-, medium- and short-term bank debt without official guarantee pending at the end of each year.

B. European financing 3/

Net flows from Europe to Latin America lost relative importance in the total external financing of the region although they increased in absolute terms. This high level of European flows, which between 1969 and 1973 remained relatively stationary ranging from 800 to 950 million dollars per year, increased by almost 70% in 1974 and was over 1,820 million dollars in 1975.4/ The European share of total external financing, however, dropped from about 32% in 1970 to 16.2% in 1972, rising to 25% in 1974.

Of the total 8,000 million dollars representing the net European flows towards Latin America accrued between 1969 and 1975, by far the most (92.5%) comes from EEC countries. Special mention, because of its importance and growth, should be made of the flow from France (a little over a quarter of the total),5/ West Germany (20.8%), the United Kingdom (18.5%), Italy (15.7%) and the Netherlands (8%).

Five groups of Latin American countries may be distinguished:

(i) Brazil and Argentina, for both of which European participation in external financing is important. In 1975 these countries absorbed 37.5% and 15.5% respectively of the net resources coming from Europe.

(ii) Countries in which the participation of European external financing is quite importante, but somewhat irregular: Chile, Peru, Bolivia, Venezuela, Costa Rica, Haiti and Jamaica.

(iii) Countries in which European participation is decreasing: Mexico (which however, in 1975 was still absorbing 6% of the resources coming from Europe), Cuba, Ecuador, Guyana and, to a certain extent, Trinidad

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3/ The lack of information available has made it necessary to use various sources to prepare this section. In some cases they use definitions and criteria which do not coincide with one another, and an attempt has been made here to bring these sources into line. The conclusions, should, however, be interpreted with some caution. European countries members of CMEA are not included.

4/ Data on European participation in capital flows received by Latin American countries were prepared on the basis of information supplied by OECD and on figures published by the IDB.

5/ Transfers from France to french overseas territories in Latin America have not been included.

and Tobago. In the case of Uruguay in particular, European participation has not only been decreasing, but the overall balance for the period between 1969 and 1974 has been in Europe's favour.

(iv) Countries in which European participation is of limited relative importance or of small magnitude: Colombia, Central American countries, Dominican Republic and Paraguay.

(v) The three off-shore financial centres of the region (Panama, the Bahamas and the Bermudas) jointly negotiated a high proportion of the resources received from Europe in 1975. This does not imply however that the final destination of this capital has always necessarily been Latin America.

The remainder of this section will deal with some of the principal components of European financing for Latin America, medium- and long-term capital markets, banks, suppliers' credits and official flows.

1. Medium- and long-term private markets

The problem of access to European bond markets is highly interesting for Latin American countries. Throughout the nineteenth century and the beginning of the twentieth century, many Latin American countries resorted to British, French, and even Belgian and German capital markets by floating loans or issuing bonds to finance public works. The crisis of the thirties put an end to a long phase in the relations between Europe and Latin America in this sphere. During the next forty years there were no new issues of Latin American bonds in any European market. Although at the beginning of the sixties there were some cases of isolated operations, it is only with the entrance of the IDB to the Italian market in 1962 and two years later to the British and German markets that a new stage in the Latin American presence in European markets begins. From 1966 onwards this presence was expanded with the first placements of Mexican, Brazilian and Argentinian bonds in the Euromarket.

In view of their individual characteristics it might be advisable to examine briefly the differences existing between national European capital markets and the so-called Euromarket.

Any type of bond issue in most of the European markets is regulated by the legislation existing in the country where it is made, which, besides protecting the national investor, also establishes the priority of national bond issues, particularly those of the government or of State entities. To this effect, maximum amounts per issue are fixed and a system of prior authorizations and waiting lists, which do not always respect the order in which the applicants appear, is established. Several countries also possess regulations restricting the purchase of foreign bonds by institutional investors (insurance companies, social security bodies, etc.).

The above reasons, often combined with ignorance about the solvency and reliability of the country making the issue, and sometimes with insufficient regulation by developing countries of their own bonds in the secondary market, have considerably restricted the access of most developing countries to European capital markets. This accounts to the fact that, in the case of Latin America, only Mexico has had regular access to some of those markets in the last decade, together with Brazil in recent years, and even more recently Argentina.

The distinctive characteristic of "international issues" or Eurobond issues (i.e., those made in the Euromarket, or "international market") is that they are made in more than one country, with a currency that is not the one used in the country where they are placed. The issue of Eurobonds is less regulated than issues in national markets.6/ The most important limitation lies in the fact that countries possessing a strong currency tend to discourage issues in their own currency. This affects in particular bond issues in Swiss francs and German marks. The latter are in fact treated like bond issues made in the German market. These limitations explain why most Eurobond issues are made in dollars. Moreover, in the remaining European markets, international issues are ruled by the same system of waiting lists as those in national currencies. Similarly, institutional investors are also subject to regulations in relation with the purchase of Eurobonds.

6/ Particularly because they are not subject to maximum limits and because they do not have to fulfill all the numerous requirements that, in matters related to information on issue and issuing entity, are in force in some countries.

/For the

For the purposes of the present study, another difference between these two kinds of issue should be analysed before considering the degree of European participation in the absorption of Latin American bonds.

It may be assumed that all or most placements in the European market are absorbed by nationals of the country making the issue or by foreigners who own funds deposited in the country. In contrast, given the peculiarities of the Euromarket it is impossible to determine the nationality of the ultimate possessors of the bonds issued. There is practically no systematic information on the destination of this type of issue. It is only assumed that a large part remains in the hands of the banks taking part in their placement and that, approximately half of all Eurobonds are finally placed in Switzerland.7/

For these reasons, the only possible way of evaluating European participation in the placement of Latin American bonds is in terms of the market in which the issue was carried out, in the case of issues in national markets, and of the currency denomination in the case of international issues (Eurobonds).

An important aspect which is worth stressing is that Latin American placements in European markets represent only a very small proportion of the total placements in these markets. This implies that on the one hand, Latin America has made very little use of these markets, partly because of problems of access to them, and on the other, that the access of medium- and small-sized countries of the region, which until now have had little or no participation in this market, would not necessarily involve competition with issues by larger countries of the region which already have a certain access to it.

7/ See Development Committee Secretariat. "Report on Regulations and Practices affecting capital market access" and OECD, "Financial Market Trends", June 1977.

(a) Issues in the national markets

Between the early sixties and mid-1977, Latin America issued bonds in European markets amounting to 1,114.6 million dollars. This figure equals 29% of all placements of the region for the same period. European participation in Latin American placements has been irregular and does not show any definite trends.

From this total amount, a little over three-quarters (838.2 million dollars) were placed by the IDB to finance Latin American development projects. The Latin American beneficiary countries include, in particular, Mexico, Argentina, Peru, Jamaica, Trinidad and Tobago and Ecuador.

The European market where the most placements were made was Switzerland (491.3 million dollars or 44.1% of the total), followed by West Germany (26.3% of the total) and Italy (11% of the total). Conversely, the limited amount of placements in France and the United Kingdom contrasts with their importance as financial markets, with the intensity of their financial links with Latin America in the last century and with the present day importance of their trade relations with Latin America.

The main problems Latin American countries have to face in connexion with placements in national European markets include institutional aspects related to European markets and existing regulations of bond issues; lack of information on the part of European investors about the Latin American governments and institutions issuing bonds; guarantee problems; and lack of information on the part of Latin American countries (save the largest) about procedures and modus operandi of European markets.

(b) Bond issues in the international market

Between 1966 and the first half of 1977, the Latin American countries placed a total of 938 million dollars in bonds in European currencies in the international European market. These placements increased enormously in 1976 and 1977: they reached 253.9 million dollars in 1976 and 304.1 million dollars in the first-half of 1977 alone.

/This slows

This shows that as from this period some Latin American countries have started once again to make substantial issues of bonds, a practice which had been almost negligible since before the Second World War.

Among Latin American countries, as in the case of issues in European national markets, in 1976 and in the first-half of 1977, Mexican bond issues were predominant (amounting to 535.6 million dollars in this period, and representing 57.1% of the Latin American total), followed by Brazil with 35% of the total over the same period.

The principal currency in which these issues were made was the German mark (832.7 million dollars, representing 88.7% of the total). Issues were also made in Dutch florins and in units of account of the European Economic Community.

Banks

The following information refers to outlays by private banks in the case of officially-guaranteed loans exceeding twelve months. Consequently, substantial amounts of credit from private banks are not included.8/

European banks disbursed 6,128.6 million dollars on long-term loans to Latin America. The figure does not include loans received by Chile and those received by Mexico in 1976.9/ 90% of these loans were absorbed by

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8/ The series used to determine European participation in the external financing of the region provided by banks are those published by the World Bank relating to private bank outlays, for loans exceeding twelve months, made to official organizations or those with official guarantee. Short-term loans have therefore been excluded, and only effective loans have been considered. For Chile and Mexico information is available only for the period 1971 to 1975. The data includes loans made by European banks, particularly where these are members of consortia providing loans to Latin American countries in the Euromarket, as well as direct loans from European banks and governments to public and private organizations in Latin America with official guarantee. They therefore also exclude operations carried out by the private sector without official guarantee, which, in the case of Euromarket operations, account for a considerable percentage of the loans received by some Latin American countries.

9/ Although exact figures are not available, it is estimated that these may have been in the region of 1,000 million dollars.

/four countries:

four countries: Brazil, Mexico, Argentina and Peru. Other Latin American countries which draw regularly upon European banking sources are Colombia, Guyana and Uruguay.

Financing provided by foreign private banks to Latin American countries has important economic and financial implications for these countries. On the one hand, these funds have in many cases been obtained more quickly and with fewer requirements than those obtainable from international finance institutions or from bonds; this may account for the intensive use that Latin American countries have made of this source. On the other hand, the future possible consequences for Latin American countries of having substantial debts with foreign transnational banks are not always clear. These banks have in some cases consulted the IMF of the credit-worthiness of the borrowing country when granting substantial loans or renegotiating a loan. However, there is no established set of rules in this matter, and private banks may decide to apply their own rules and conditions for granting or renegotiating loans.

In the period under consideration Brazil received 2,084 million dollars, which is 34% of the total; European loans amounted to 28.6% of the total of effective loans made by private banks to Brazil between 1969 and 1976.

Mexico received 2,074.7 million dollars up to 1975, which represents 33.8% of the total; between 1971 and 1975 European loans accounted for 27.5% of the bank loans made to Mexico.

Argentina received 957.6 million dollars, i.e., 15.6% of the total. European loans represent an important but variable proportion of the total of loans received by Argentina.

Peru received 355.8 million dollars, 5.8% of the total.10/

On the lending side, countries which form an important part of the Eurodollar market played a notable role: the United Kingdom (3,302.5 million dollars, representing 53.8% of the total); France (1,115.2 million dollars, 18.2% of the total); Luxembourg (212.9 million dollars, with 3.5%). The

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10/ The figures for loans negotiated in the United Kingdom are not available and in view of the substantial loans made by Peru in the Euromarket, in which the United Kingdom figure may have been important, Peru's share of the total may well be underestimated.

two other major sources of bank loans for Latin America have been the Federal Republic of Germany (600.3 million dollars, 10.7% of the total) and Switzerland (272.4 million dollars, 4.4%).

Official financial flows 11/

Official bilateral financial assistance for development between 1969 and 1975, in terms of a net flow from European countries members of DAC to Latin American countries amounted to 1,223.3 million dollars, or

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11/ This heading includes "official development assistance" (ODA) and "other official lines of credit". The ODA has been defined by the Development Assistance Committee (DAC) of the OECD as the total contributions provided for developing countries and for multilateral institutions by the official organizations of developed countries, including local offices and negotiating entities is each in turn and at every level of operation subject to the following criteria:
(a) They are made with the essential aim of favouring the economic development and the improvement of the standard of living of developing countries; and
(b) They have a favouring character and include an element of liberality of at least 25%. This "element of liberality" has in turn been defined as "equal to the nominal value of the financial commitment taken from the actual amount of amortization and of the foreseen interests (on the basis of an actualization rate of 10%)". On the basis of this definition, the countries members of DAC often label as ODA the donations of the public sector (in the form of technical assistance, foodstuffs and donations of technical equipment goods); the so-called "soft loans" including renegotiation of debts originated in loans of this kind; contributions made to multilateral entities either in the form of contribution to the United Nations or as capital subscription of development banks. Much has been said as to whether some of the financial flow included in this definition is actually "assistance for development" or not. In this report, considering that OECD information will be used, these financial channels will be considered as such, excpeting those loans made by countries to their colonies or dependent territories in Latin America. Because the report published by OECD allows the separations of such lines of credit (very important in the case of France and less so in the case of the United Kigndom and the Netherlands), this analysis has concentrated on the bilateral flow between European countries and the independent countries in Latin America. "Miscellaneous financial flow", although it has never been so precisely defined as ODA, includes all the rest of the bilateral financial transactions, among them government to government loans, public credits to exporters, their refinancing, and those contributions made to multilateral organizations under conditions similar to those existing in the market. See OECD, "Geographical distribution of financial flows to developing countries", op. cit.

/5.6% of

5.6% of the total of the net bilateral ODA allocated by these countries to developing countries as a whole. This proportion did not increase in 1975. The low priority given by European countries to Latin America for development aid is thus evident.

This low priority is practically confirmed in the case of all European countries. In four countries (Finland, the Netherlands, the federal Republic of Germany and Switzerland) the proportion allocated to Latin America ranged between 18.4% and 10.3% of the total between 1969-1975; in all other European countries the proportion was less than 10%. Particularly worth mentioning are the cases of France and the United Kingdom, which allocated to Latin America a mere 0.9% and 3.9% respectively of their net ODA, which contrasts vividly with the interests these countries have in Latin America and with their share of other types of financial flow.12/

Eighty-five per cent of the net European transfer accumulated in these 7 years refers to 3 countries: the federal Republic of Germany (54.7%), the Netherlands (almost 20%) and the United Kingdom (10.3%).

Two facts are worth mentioning in connexion with Latin American countries. In the first place, the relatively low amounts of European ODA received by countries which have greater need for concessionary assistance (El Salvador, Honduras, Guyana, Haiti, Nicaragua, etc.). Secondly, there is a concentration of ODA in a limited number of Latin American countries (Brazil, Chile, Colombia, Peru). In the case of Cuba, in 1975 the main source of European ODA came from 3 Scandinavian countries: Sweden, Finland and Norway.

European contributions to the capital and the fiduciary fund of the IDB are a recent development which is important not only because of the amounts involved, but also because of the implications in the diversification of capital in the IDB.

12/ It is probable that Latin America as a whole receives a higher proportion of less soft loans than donations. As the figures mentioned are for net flow (loans minus amortizations), the low priority given to Latin America is more clearly shown than if these were expressed in gross flow.

/Other official

Other official financial flows between 1969 and 1975 were the bilateral loans for terms exceeding 12 months made by European countries to Latin America and which amounted to 907 million dollars.13/

Although no systematic information has been compiled, the data available for certain countries and years indicate that European participation in the grand total received by Latin America from any source in the flows under consideration here, has been reduced, and has only exceptionally exceeded 30%.

The greater part of the loans to the region made by European countries came from the Federal Republic of Germany (54.5% of the total), Italy (12.3% of the total), Spain (10.6% of the total); followed by the United Kingdom, France and the Netherlands, in that order.

A concentration of loans in a few countries is evident and with the exception of Argentina, the beneficiaries are the same as the major beneficiaries of the ODA. In this period Brazil received 33.1% of the total of official credits of European origin given to the region, Argentina 20% and the rest, in order of importance, Chile, Colombia and Peru. These 5 countries absorbed 80% of the total of official bilateral credits of European origin.

13/ It has only been possible to obtain information on official bilateral loans for terms longer than 12 months to Latin American countries, according to series published by the World Bank on disbursements between 1969 and 1975. These statistical series present some problems. In the first place, it has not been possible to obtain data on Mexico and Venezuela; secondly, the World Bank has not published any information on Cuba, which is possibly one of the countries which have received more funds of this kind from European sources; neither does the World Bank publish any information on its Debt Reporting System on other Latin American and Caribbean countries such as the Bahamas, Barbados, Bermudas and Haiti nor on the Dominican Republic, Guyana and Paraguay; thirdly, the available information is probably incomplete and a certain number of operations may not be included; finally, it is quite possible that many of the operations appearing in these series are not actually "miscellaneous official financial flows" but ODA type operations which therefore have already been accounted for by the OECD series.

/Suppliers' credits

Suppliers' credits 14/

Europe provides Latin America with a high proportion of goods which are susceptible to payment on a long-term basis: principally capital goods for different activities and transport equipment. It is therefore not surprising that credits granted by European exporters should represent an important part of the total credits of this type received by Latin American countries.

European suppliers' credits received by Latin America in 1973 amounted to 65.2% of the total suppliers' credits received by Latin America; in 1976 the proportion was 49.6%.

In 1976 the Latin American countries for which information is available received a total of 655.3 million dollars in suppliers' credits, of which 352.2 million came from European exporters. In 1973 European credit sources accounted for 14% of Latin American imports of machinery and transport equipment from Europe.

In the case of Argentina, European suppliers' credits averaged 68.9% of total suppliers' credits it received between 1969 and 1976. In the case of Brazil, between 1969 and 1973 European suppliers' credits amounted to 1,037 million dollars, representing 58% of its total credits of this type. For Colombia, the European proportion of the total of these credits in the period 1969 to 1976 amounted to 76.9%. In Venezuela (1969 to 1974) Europe accounted for 92.9%. For Mexico, the figure was 40.1%; Jamaica (90.7%), Ecuador (80.4%), Costa Rica (58.6%), Bolivia (45.7%) and Peru (41.8%), are the remaining countries for which information is available on the proportion of European suppliers' credits in the total amount of suppliers' credits received.

Among European countries, the major sources of suppliers' credits are Italy and Germany, followed by France and the United Kingdom.

14/ The information available on suppliers' credits is both scarce and fragmentary. For this reason, the relevant data should be considered with caution. Among other sources, information provided by the World Bank on effective credits for terms exceeding 12 months was consulted. Consequently, suppliers' credits for periods of less than 12 months are excluded, and these may well represent a significant proportion of the total.