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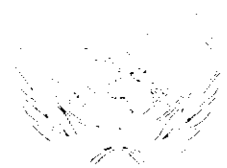

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THE PROBLEM OF THE EXTERNAL DEBT: GESTATION, DEVELOPMENT, CRISIS AND PROSPECTS */

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INTRODUCTION

After the first round of oil price rises, the rapid growth of the financial markets, which lasted for ten years, was followed at the beginning of the 1980s by an international economic recession whose magnitude was only exceeded by that of the Great Depression of the 1930s. This recession destabilized the external sector of the Latin American economies and made necessary an adjustment which had the effect of transmitting the effects of the crisis, in amplified form, to the economies of the countries of the region. The characteristics of the international financial system gave the adjustment policies a strong recessive bias which was reflected in a fall in the per capita product, increased unemployment, and a decline in real wages in the great majority of the countries of the region. In spite of the adjustment efforts, the continued deterioration of the external conditions and the procyclical behaviour of the international financial system made the normal servicing of external commitments impossible. In view of this, the debtor countries, the creditor countries and institutions, and the multilateral financing agencies are now looking for possible solutions while putting into practice some emergency measures which permit the problem to be postponed to some extent.

Chapter I of this document briefly examines the growth of the financial markets and the national policies which gave rise to the expansion of the external debt as a form of financing greatly increased external imbalances. It also deals with the consequences of these facts.

Chapter II analyses the changes in the world economic circumstances which generated problems in the external sector of the countries and the adjustment and financing policies put into practice in order to tackle the consequent difficulties and their negative effects on growth.

Chapter III presents two basic scenarios for the future growth of the countries of the region, and on the basis of them and of some possible variants set forth the external financial conditions needed in order for the economies of the countries of the region to recover their dynamism.

Chapter IV examines the strategies which have been proposed for handling the debt problem, the conditions in which alternative strategies could be effective, and more concrete proposals for putting such strategies into effect.

Chapter V briefly summarizes the strategy adopted by the signatory countries of the Cartagena Consensus, while chapter VI contains the general conclusions of the analysis carried out in the document.

I. THE GESTATION OF THE DEBT

A. THE GROWTH OF THE FINANCIAL MARKETS

In the mid-1960s, almost all the Latin American countries showed high growth rates, and the per capita income of the region was higher than that of other developing regions, which had the dual effect of making Latin America more attractive as a borrower and causing the diversion to other regions of the resources provided by international organizations and the governments of industrialized countries. This latter process, called "graduation" by the World Bank, increasingly limited the access of the Latin American countries to medium- and long-term official resources, and loans from private foreign sources began to replace foreign investment in the region in view of the greater risks of nationalization and the opening up of opportunities in other areas of the world (see table 1).

Table 1

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES):a/
STRUCTURE OF NET INFLOWS OF CAPITAL

(Millions of dollars and percentages)

	Direct and portfolio investment (1)		Long-, medium- and short-term capital (2)		Total ((1)+(2)) (3)	Direct and portfolio investment (4)
	Simple annual average	As a percentage of (3)	Simple annual average	As a percentage of (3)	Simple annual average	In constant 1970 dollars
1950-1954	361	62	220	38	581	391
1955-1959	764	69	350	31	1 114	1 079
1960-1964	331	30	772	70	1 104	384
1965-1969	732	42	1 030	58	1 762	702
1970-1974	1 251	18	5 650	82	6 901	1 035
1975-1979	4 690	23	15 926	77	20 596	1 189
1980	6 452	19	27 887	81	34 339	1 908
1981	9 570	20	38 149	80	47 719	2 346
1982	10 450	37	17 840	63	28 290	1 859
1983	3 687	72	1 443	28	5 130	1 026

Source: ECLAC, on the basis of official figures and information from the IMF (November 1985).

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

/The rapid

The rapid growth of financial markets was furthered by some institutional factors such as the lack of regulation of the Eurocurrency markets and some other structural factors such as the accumulation of liquid balances in the hands of countries having a marked preference for liquidity, such as the oil-exporting countries (see table 2).

Table 2

OIL-EXPORTING COUNTRIES: DEPOSITS IN THE INTERNATIONAL COMMERCIAL BANKING SYSTEM a/

(Billions of dollars and percentages)

	(1) Accumulated deposits	(2) Net international bank credit b/	Ratio (1) : (2) c/ (%)
1977	84.7	435	19.5
1978	90.9	530	17.2
1979	130.6	665	19.6
1980	172.1	810	21.2
1981	171.4	945	18.1
1982	148.1	1 020	14.5
1983 c/ I	137.4	1 085	12.7
1983 II	162.4	1 240	13.1
1984	171.7	1 280	13.4
1985 June	173.0	1 315	13.2

Source: Bank for International Settlements (BIS), "International Banking and Financial Market Developments", October 1985.
a/ Refers to banks reporting to the BIS system.
b/ Corresponds to an estimate designed to exclude the double counting of redeposits among reporting banks.
c/ Two different figures are given for 1983 in order to reflect the old and new coverage of the reporting banks. As of December 1983, this coverage was changed by the addition of banks in offshore centres and other countries.

The rapid expansion of these markets, based on the way the international monetary system operated, gave rise to an international capital market which was largely outside the regulation and control of any monetary authority or international agency. Capital movements came to be increasingly important in determining the international balance of payments of the countries and their exchange rates, and hence private sources of financing --especially banks-- increased in importance, while the role of official institutions and governments

/became weaker

became weaker in a monetary and financial system increasingly based on the market. This was reflected in turn in an appreciable reduction of the average repayment periods and in substantial increases in the cost of financing for the developing countries, especially those of Latin America.

B. NATIONAL POLICIES

With few exceptions, the increase in Latin America's external debt was observed in both large and small economies, in both oil-exporting and non-oil-exporting countries, and in nations which were opening up their economies as well as in those which were not doing so.

The total demand for external loans is due only in a relatively small proportion to the growth of imports and exports. The remainder is connected with the differences between the interest rates on domestic and external loans and also with the excessive spending of some sectors of the economy.

1. Divergences between domestic and external interest rates

The empirical evidence shows that differences in domestic and external interest rates can persist even in industrialized countries which permit substantially free movement of capital. This is so even after taking into account the expected variations in exchange rates, as measured by the futures markets for foreign currency (covered differential rates). Latin America is no exception to this fact, and in various countries of the region the domestic rates, expressed in terms of foreign currency, have diverged substantially from external rates (see table 3).

Two hypotheses have been put forward to explain the origin of this phenomenon in Latin America (in addition to the traditional explanation of control over capital movements):

a) Segmentation of the market

As most borrowers do not have direct access to external credit but can only obtain it through local intermediaries, they are not in a position to force a reduction in the spread between domestic and external rates. It is the intermediaries which appropriate the difference between the two rates.

b) The tradeable or non-tradeable status of assets

The maintenance of controls on capital movements leads to the issue and trading of securities which are not internationally tradeable because of the risks involved or the absence or high cost of the necessary information. It might take years to convert these assets into tradeables, in view of the costs involved in the process.1/ Moreover, the external indebtedness of individual domestic economic agents actually generates important effects for the economy as a whole. This is because when the external debt of a country increases, new borrowers (and the existing ones too) have to pay more to obtain credit in world markets. When the market operates without

/Table 3

Table 3

INTEREST RATES: DOMESTIC AND INTERNATIONAL

(Annual percentage rates)

	Domestic a/			International b/
	Argentina	Chile	Uruguay	LIBOR
1977	10.0	58.4	22.4	6.4
1978	37.2	51.1	33.4	9.2
1979	34.5	40.5	37.8	12.1
1980	45.6	46.9	40.7	14.0
1981	-30.3	51.9	38.2	16.8
1982	-65.8	-12.1	-	13.6

Source: Roberto Zahler, "Recent Southern Cone Liberalization Reforms and Stabilization Policies: The Chilean Case 1974-1982" in Journal of Inter-American Studies and World Affairs, November 1983, pp. 509-562; International Financial Statistics, IMF, April 1983; Central Bank of Argentina, Financial Series No. 484; ECLAC, Economic Survey 1981: Uruguay, E/CEPAL/L.268/Add.22, November 1982.

a/ United States dollar equivalents of domestic interest rates.

b/ LIBOR for United States dollar operations in London, annual rate for 180-day deposits.

the necessary controls and regulations, these additional costs are not adequately valued and assigned by the market among the agents involved. Thus, the social cost of external indebtedness may be distorted by market prices, that is to say, by the domestic equivalent of the international interest rate. The result of this situation is that debts build up to amounts higher than those which are socially optimum.

Domestic interest rates remained higher than external rates in several countries of the region because of the effect of structural or short-term economic policies and the behaviour of important groups of large related enterprises.

Thus, as external and internal inflation speeded up, the countries of the region gave priority to the struggle against inflation, and monetary policies tended to be restrictive. This situation brings about increases in interest rates and/or excessive demand for credit. As domestic interest rates rise in comparison with external rates, this encourages indebtedness with the exterior, and if at the same time governments eliminate the restrictions on external indebtedness the consequences are obvious.

/Furthermore, policies

Furthermore, policies of opening-up capital movements and trade, reducing controls on the financial system, making changes in tax systems and in some cases altering systems of social security have brought about changes in relative prices and thus given an incentive to resources to move to other activities. In the case of activities whose relative prices increase, external trade acts as a buffer through imports, but there is still a stimulus for the expansion of domestic production which means new demands for credit. In the case of those activities whose relative price falls, it could be expected that there will be a decline in production and resources will be freed, but this only happens slowly, because there is always the possibility that the changes in relative prices may only be temporary. Consequently, the enterprises affected seek loans even at high real interest rates in order to keep up at least a minimum level of operations until circumstances change. The economic reforms therefore tend to increase the total demand for domestic or external credit, and this pressure tends to raise domestic interest rates.

The establishment of links between banks and non-financial enterprises gives the latter a greater degree of security that they will not be pushed out of the market in spite of possible errors, and it may be that they are asked for fewer guarantees, too. Consequently, since they are risking less, they will be willing to pay higher interest rates.

Exchange policy, which is used in many countries as an anti-inflation instrument, may be reflected in high real dollar exchange rates 2/ or it may cause the exchange rates to move more slowly than domestic inflation, as well as having direct effects on the trade in goods and non-financial services.

2. Excessive spending

a) Public spending

In this case, the government spends more than it receives in revenue and finances the difference with domestic or external loans. If it seeks the necessary resources abroad, then it directly increases the official debt. If it obtains loans within the country, the increase is less direct.

When the public sector borrows resources on the domestic market, this generates money and quasi-money in an amount greater than the original demand. An excess supply of money is therefore created in the economy and the global demand for goods and services increases. To the extent that domestic consumption of exportable goods expands and imports increase, a disequilibrium is produced in the trade balance which may be aggravated by an outflow of capital. The country's reserves are reduced and the authorities are obliged to go into debt to cover the deficit or else to adopt adjustment measures. In this orthodox case, it often happens that the external public debt increases.

b) The private sector

In some cases, excessive private sector expenditure explains the rapid growth of the debt in Latin American countries where the public sector has kept its accounts

balanced or nearly so. Most analysts have assumed that even if intentions of excessive private sector spending exist, they cannot be put into effect because the authorities can control the growth of domestic credit. Even if this were so, however, intentions of excess spending by the private sector can nevertheless be fulfilled if alternative sources of financing arise in the exterior.

The private sector will tend to indulge in excessive expenditure if over-optimistic expectations are formed regarding the future evolution of the economy, so that it over-appraises its wealth.

To the extent that the excessive spending of the private sector is concentrated in tradeable goods (those that can be bought or sold in the exterior), it will be reflected in a deficit on the balance-of-payments current account, financed with an inflow of capital in so far as the private sector contracts indebtedness abroad. If there is also excessive demand for goods which are not tradeable abroad, part of the external indebtedness will be reflected in an increase in the country's reserves 3/ and the price of non-tradeable goods will tend to rise compared with the prices of tradeable goods, which is equivalent to a revaluation of the currency. There can then be a tendency to accelerate the process of external indebtedness. With fixed exchange rates, the nominal price of tradeable goods will be maintained, whereas that of non-tradeables will continue to rise, reflecting inflation in the domestic price indexes and causing a deterioration in the real exchange rate. Domestic nominal interest rates remain high because of inflation, so that, expressed in dollars, they become very high and promote greater indebtedness with the exterior. As a result, an increase takes place in the external debt component within the structure of the liabilities of the economy.

At a given moment, these events will make it essential to adjust the balance-of-payments current account, just as excessive public spending brings about the need for an adjustment. The symptoms leading up to this are considered signs of "good conduct", however: there are no problems with domestic credit, there is an increase in the inflow of capital and in the reserves, and there may also be rapid rates of economic growth. Without sufficient investment, however, this process is just as impossible to sustain as that generated by excessive public spending.

In cases where the situation is dominated by an excess of private expenditure, there is an increase in the private sector external debt, while in cases where a fiscal deficit prevails, the dominant indebtedness is official.

C. SUMMARY AND APPRAISAL

1. The change in the level and composition of the debt

As already noted, both the demand for international credit and the liberal supply of it were responsible for the rapid growth of the Latin American external debt, which increased by a factor of 16 in the 15 years from 1970 onwards. As the biggest supply came from private banks, especially of the United States, the rise in the level of the debt was accompanied by an even more rapid increase in the size of the debt

/from private

from private sources. After having represented 64% of the total debt in 1970, this reached a peak of 88% in 1981/1982, subsequently declining to 82% in 1985 (see table 4).

Table 4

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): EXTERNAL DEBT a/

(Outstanding disbursed debt at end of each year)

	Total debt	Debt from official sources		Debt from private sources b/	
	(billions of dollars)	Billions of dollars	As a percentage of the total debt	Billions of dollars	As a percentage of the total debt
1970	23	8	36	15	64
1971	26	9	36	17	64
1972	30	10	34	20	66
1973	40	12	28	28	72
1974	56	14	25	42	75
1975	75	16	22	59	78
1976	98	18	18	80	82
1977	116	21	18	95	82
1978	151	25	16	127	84
1979	182	27	15	157	85
1980	223	31	14	198	86
1981	278	34	12	246	88
1982	318	40	12	278	88
1983	344	51	15	293	85
1984	360	57	16	303	84
1985	368	65	18	303	82

Source: IBRD, World Debt Tables, editions 1982-1983 and 1983-1984; BIS, Annual Report, various years, and Review, April 1983; IDB: "External Debt and Economic Development in Latin America", Washington, D.C., January 1984.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela. The estimates include long-, medium and short-term debts and debts with financial institutions reporting to the Bank for International Settlements which do not enjoy an official guarantee. They do not include debts with other financial institutions and export credits without official guarantee.

b/ All the short-term debts are presumed to be from private sources.

/This change

This change in the composition of the debt has important repercussions. Firstly, in proportion as the concessionary elements of credits disappear and it becomes more normal to apply commercial conditions, the debt becomes more expensive and its maturities grow shorter. Secondly, there is a notable increase in the number of creditors, which makes negotiations more difficult in case of crisis. Thirdly, the debt is subject to floating interest rates whose variations affect the entire debt, and not just the new debt contracted. Fourthly, the banks become increasingly concerned over their exposure and analyse the risk indicators of countries with increasing attention. The absence of an established and organized market in which creditors can liquidate their bank portfolios means that there is no market value of their assets, so that the classification of bank portfolios becomes an important exercise requiring a formal valuation not based on the market.

This change in the origin of the debt also has other dimensions, however. It is traditionally assumed that private institutions do not decide their loans on the basis of political reasons. This is only so, however, as long as the level of indebtedness does not exceed a limit considered to be reasonable by the creditor in terms of such variables as total exports or the gross national product of the debtor. In proportion as the level of the debt increases in relation to the economic size and external resource availability of the debtor country, the risk of cessation of payments increases, as does the interest displayed by creditors in the debtor's macro-economic policies. This is characteristic of the big creditors, which in the case of Latin America are mainly United States banks.

As a result of the foregoing, what happens in effect is that there are certain restrictions on domestic policy, the probability of a real transfer of resources to the exterior increases, and a new external source of vulnerability appears. These consequences are less serious, however, in cases where the external debt has made a contribution to increasing the productive and export capacity of the debtors.

2. Restrictions on domestic policy

The level of the debt, and its maturity structure, impose certain restrictions on domestic policy. Part of the debt falls due every year, and the shorter the average maturity of the debt, the bigger this part will be. If it is desired to keep on receiving a net flow of real resources from the exterior, the financing that must be obtained is the sum of the maturities plus interest payments, less (or plus) the net income (or outgoings) produced as a result of direct foreign investment. In deciding whether to make a loan or not, the banks base their action on certain indicators such as the level and variations of the international reserves, balance-of-payments current account imbalances, and the ratio between debt servicing and exports; consequently, when faced with the need to seek loans, countries will tend to follow those policies which are likely to produce the desired results in these indicators. This implies restrictions on monetary, exchange rate, interest rate, fiscal, etc., policies, even though these restrictions are not imposed directly by the banks. Obviously, the higher the level of the debt for any given maturity structure, the higher will be the amount of new gross loans needed each year. Interest payments also need financing, and they are determined not only by the level of the debt but also by the level of external interest rates.

/3. The

3. The transfer of real and financial resources to the exterior

A second consequence of a high level of indebtedness is the greater probability of a real transfer of resources to creditors. A country receives real net resources from the exterior if its imports of goods and non-financial services exceed its exports, that is to say, if there is a deficit on its trade and non-financial services balance. This flow must be financed through a net inflow of financial resources, either through direct investment or through external indebtedness. The need for financing is increased by payments of interest to the exterior and possible increases in the international reserves. Given a certain level of net inflow of financial resources in the balance-of-payments capital account, and given a certain interest rate, then the higher the level of the debt the greater will be the payments of interest and the less the probability that the financing needed for the payment of these can be obtained through further increases in indebtedness. Thus, in proportion as the level of indebtedness rises, the trade balance must change its sign and become positive in order to cover at least part of the financing needed for covering external payments.

As long as the new credits exceed the amount of debt servicing by more than enough to satisfy the need to increase the reserves, it will be possible to keep up the transfer of real resources from the exterior to the country, which is reflected in the deficit on the trade and non-financial services account.

In proportion as the indebtedness increases in relation to the usual indicators (exports and GDP), however, the probability of obtaining new net credits goes down and that of having to transfer real resources to the exterior goes up.

The magnitude of the transfers of real resources involved in these operations is closely related to such variables as interest rates and the terms of trade.4/

4. New sources of external vulnerability

The increasingly pronounced commercial nature of the stock of external debt has also given rise to a new mechanism for the transmission of external shocks to the Latin American economies and thus increased their vulnerability. In proportion as the debt grew, the proportion of the total debt subject to floating interest rates also grew. Consequently, interest rate fluctuations have become an important source of impacts for the balance-of-payments current account. For Latin America as a whole, a variation of one point in interest rates, if maintained for one year, means a difference of some US$ 2.5 billion in interest payments, taking into account the level and composition of the debt at the end of 1985. Interest rates can rise or fall, but the fact is that they represent a new source of instability in the balance of payments, where the level of indebtedness is sufficiently high. This is an additional means for the international transmission of imbalances, in addition to the terms of trade, export volumes, the effect of interest rates on spending and investment, and the fluctuation of the exchange rate of the intervention currency *vis-à-vis* the rest of the world.

/A further

A further complication is that variations in interest rates have been associated with alterations in the terms of trade and in the exchange rate of the intervention currency *vis-à-vis* other currencies of importance in international trade. An increase in international interest rates as a result of the economic policy of the United States brings with it a weakening of the terms of trade, both because of its effect on the level of economic activity and because of its influence on the financial cost of maintaining stocks of primary commodities. Likewise, the increase tends to strengthen the dollar *vis-à-vis* other currencies, as a result of the movement of capital to the United States.

All these effects are reflected in an increase in the external deficit of the debtor countries which obliges them to apply recessionary adjustment measures. Thus, the negative effects of all the above-mentioned factors mutually reinforce each other instead of cancelling each other out.

In addition to these aspects, variations in interest rates tend to affect the quality of the bank portfolios. Increases in interest rates tend to bring about a deterioration in the quality of the portfolio, since the investments already financed, which were based on lower interest rates, become more onerous and the burden of debt is more difficult for the debtors to bear. Subsequent reduction of interest rates could improve the quality of the portfolios if the deterioration has not been so severe as to destroy any possibility that enterprises can normalize their operations again, but sometimes the effect of the increase in interest rates on enterprises is so strong that its subsequent reduction does not eliminate the harmful effect of the increase.

At all events, the variability of interest rates affects the willingness of the banks to lend, thus accentuating the instability generated by the direct effects of interest rates on the liquidity and solvency of the debtors.

5. The link between the external and internal financial system

The effects of variations in interest rates on banks in the exterior are not qualitatively different from the effects caused in the domestic financial system. Abrupt variations in domestic interest rates, regardless of whether or not they are induced by external rates, affect the portfolio of the financial system and its solvency. To the extent that these effects cannot be transferred to the holders of the liabilities of the financial system, asymmetrical effects are produced on assets and liabilities which can weaken the national financial system and make State intervention inevitable. This latter action is normally accompanied by support for the financial system whose cost has to be paid by the community as a whole.5/

II. THE DEBT AS A PROBLEM

A. THE CHANGE IN CONDITIONS

In the mid-1970s the industrial countries suffered the severest contraction since the Great Depression. Although the expansion of economic activity in them resumed as from 1976, it was still far from recovering the growth rates reached in the preceding period. As well as being relatively feeble, the recovery was also characterized by other negative features: the low level of fixed investment, on the one hand, and the simultaneous persistence of much higher rates of unemployment and inflation than those which had prevailed up to 1973, on the other.

It was largely because of these circumstances that the second round of oil price rises caused much more severe effects on the industrialized economies than those of the previous oil crisis, while the economic policy response was also very different. Thus, the recession which began in 1980, although not as far reaching as that of 1974-1975 from the point of view of its initial consequences on the level of economic activity in the industrialized countries, was on the other hand much longer. Furthermore, as the proportion of the labour force of the industrialized countries which was out of work when the new recession began was considerably greater than the corresponding proportion at the beginning of the previous recession, the stagnation of economic activity was accompanied by the highest unemployment rates registered in those countries since the Great Depression of the 1930s.

The recession which began in 1980 coincided with a change in the monetary policy of the United States. This policy had traditionally been oriented in line with the pressures that arose on interest rates, taking into account the conjunctural situation of the economy. This time, perhaps because of the stubbornness of inflationary pressures, the authorities decided to abandon the traditional indicators which had guided monetary policy and replace them with quantitative targets as regards the expansion of money and credit. This meant allowing interest rates to fluctuate freely, so that it was to be expected that they would be more volatile and that there would be upward pressure on them to the extent that the fiscal deficit generated greater public sector pressure on the credit market.

This set of factors resulted in a weakening of world trade, the accentuation of proteccionist tendencies, a rise in nominal and real interest rates, and the paralyzation of financial flows.

1. Trade and protectionism

As in other recessions, the stagnation of the economic activity of the industrialized countries has had unfavourable effects on the demand for imports and, hence, on the growth rate of international trade. In the last few years, however, these consequences have made themselves felt even more strongly because of the resurgence of protectionist practices in the trade policy of many of the central economies, and these practices became increasingly frequent and rigorous as unemployment increased and the recession persisted. In these circumstances, the volume of international trade --whose rapid expansion had played a fundamental role in the growth of the

/world economy

world economy after the war-- increased only very slightly in 1980, almost completely stagnated in 1981, went down by 2% in 1982 and in 1983 only managed to recover its 1981 level.

For Latin America, this evolution of international trade was extremely unfavourable. Because of the sharp decline in the international prices of most basic commodities, the terms of trade went down sharply and continuously between 1981 and 1983, recovered only marginally in 1984, and fell once again in 1985. In fact, over the five-year period 1981-1985 the deterioration in Latin America's terms of trade was over 16%. Had it not been for this drop, the countries of the region would have had some US$ 15 billion more in 1985, which, together with the trade balance (goods and services) of US$ 30 billion registered that year, would have made it possible to pay the interest on the external debt and at the same time increase the region's international reserves by some US$ 10 billion.

Although there was a deterioration in the terms of trade of both the oil-exporting countries and the other economies of the region during this period, the setback was particularly serious in the case of the latter, since their terms of trade had already gone down abruptly in the period 1978-1980. Thus, between 1977 and 1985 the terms of trade of the non-oil-exporting countries fell by 33%, so that their level during the period 1981-1985 was considerably below that of any year since statistics began to be kept, including the years 1931-1933, which represented the most critical stage of the Great Depression. These results bring out the close relation between trade and finance.

2. The rise in interest rates

No less serious for Latin America were the repercussions of the exceptionally high levels attained in recent years by the interest rates on international financial markets.

The sharp rise and instability of interest rates was due mainly to the macroeconomic policies of the industrial countries, especially the fiscal and monetary policies of the United States. The rapid increase in the fiscal deficit, its financing through the sale of securities on the market, and the monetary policy designed to achieve certain quantitative goals as regards the expansion of the money supply combined to bring about a rapid rise in international interest rates. Similar policies in other industrial countries supported this tendency, while the prevailing expectations that the fiscal deficits would not disappear in the short term even if there were a strong and lasting recovery helped to accentuate them further.

The average citizen of the United States or the United Kingdom does not suffer the full impact of interest rates, because interest payments can be deducted from taxes; it is therefore less difficult to maintain high interest rates in those countries. In the case of the United States, additional measures were adopted early in the present decade which helped to insulate the enterprises of that country still more from the effects of variations in interest rates. These insulating mechanisms do not apply, however, in the debtor countries, so that the latter suffer the full effect of changes in interest rates. In fact, during 1981-1982 dollar interest rates reached the highest levels ever recorded, and the real rates over the last five years have reached the highest levels recorded in the past half century.

/This situation

This situation also represented a radical contrast with the crisis of the mid-1970s, when real interest rates were consistently negative. Moreover, since at the same time that interest rates went up there was a sharp deterioration in the terms of trade of the Latin American countries, the increase in the real cost of credit which they had to face up to was much greater (see figure 1).

The unusually high interest rates had a clearly negative impact in two main ways. On the one hand, they adversely affected the debt service payments and the terms of trade. Interest payments now exceed the cost of oil imports in the developing countries. By increasing the cost of servicing the external debt, they enormously expanded the current account deficit and, as we shall see below, helped to give rise to a considerable transfer of real resources to the exterior. Thus, Latin America's gross remittances of interest payments rose at a dizzy pace from a little under US$ 6.9 billion in 1977 to almost US$ 39 billion in 1984, and they hardly went down at all in 1985. The decisive incidence of the increase in international interest rates in this evolution is clearly to be seen when we compare the growth of remittances of interest with that of the external debt. Whereas between 1977 and 1985 the total amount of the debt trebled, that of interest payments increased almost fivefold.

Interest rates have also helped to hold back the recovery of the North, however, by helping to strengthen the value of the dollar *vis-à-vis* other currencies through the flow of capital to the United States. This has affected the competitiveness of the less developed countries whose currencies are linked to the United States dollar and this has inflated the real cost of servicing the external debt, which is contracted primarily in U.S. dollars. With regard to this latter point, it has been estimated that if the indebtedness of the non-oil-exporting developing countries with the commercial banks --which came to around US$ 150 billion between 1979 and 1982, almost entirely in U.S. dollars-- had been diversified so as to fit in in general with the currency structure of their trade, the combined saving by these countries through lower interest payments and exchange gains would have been over US$ 30 billion.6/ In addition, the high interest rates in the United States, together with rigid exchange policies in some countries of the region and the uncertainty generated by the violent adjustment process, have encouraged the flight of capital abroad.

3. The reversal of financial flows

One of the most outstanding features of the international economic crisis of the 1980s has been the change of direction of flows of capital and finance. The long-term tendency of these flows has been in the direction of a transfer of resources from the industrial countries to the developing countries, but the crisis and the policy measures adopted by the industrial countries, together with the adjustment efforts of the developing countries, have given rise to movements of financial resources in the opposite direction.

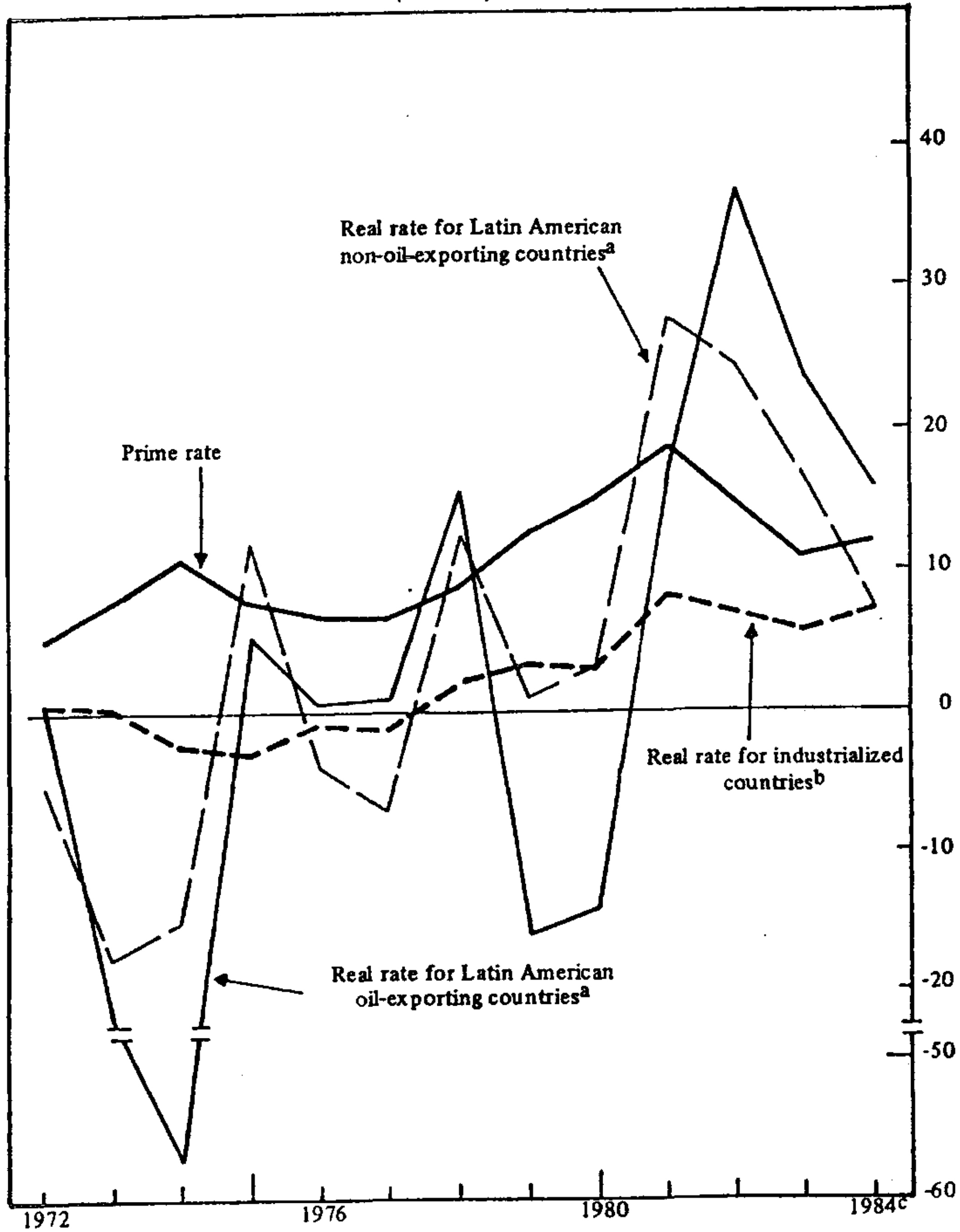
A leading role has been played in this change of direction by the abrupt paralyzation of bank credits to the developing countries in general and to Latin America in particular, the decline in the flows of external investments as compared with those registered up to the beginning of the decade, and "flights of capital" from the region.

/Figure 1

Figure 1

NOMINAL AND REAL INTERNATIONAL INTEREST RATES

(Per cent)



Source: ECLAC, on the basis of official data from the countries and from *Economic Report of the President*, February 1984.
Note: The nominal interest rate used is the United States prime rate.
[a]Nominal rate deflated by index of unit value of exports.
[b]Nominal rate deflated by Consumer Price Index of industrialized countries.
[c]Preliminary estimates.

a) Bank

a) Bank credits

The net flow of bank credits to the region, which had amounted to US$ 11.4 billion in 1982, was practically halved the following year and actually became negative in 1984 and the first half of 1985. This means that in these last 18 months the absolute level of the accumulated credits granted to the countries of the region, taken as a whole, by the banks reporting to the Bank for International Settlements in Basle (BIS) went down by almost US$ 500 million. This overall reduction did not affect Argentina and Brazil, whose bank credit continued to increase during the period, although only very slowly in 1985.

In sharp contrast with this reduction in the flow of bank credits is the situation as regards payments of interest and profits to the exterior, which has continued to fluctuate closely around an average of some US$ 36 billion per year throughout the period, for the countries of the region as a whole.

b) The flow of foreign investment

The flow of foreign investment to the countries of the region also went down drastically as from 1982. The available figures show that, from an average of US$ 5.2 billion between 1977 and 1982, foreign investment went down to half this level in 1983 and 1984.

c) The flight of capital

This item appears to show considerable increases. Although no direct measurements are available, the indirect estimates that can be made by using the "errors and omissions" figures of the balance of payments and the discrepancies between international export and import values clearly point in this direction.7/

The elements responsible for setting off this situation are to be found in the functioning of the international monetary and financial system itself, and specifically in the asymmetrical nature of the adjustment process. Thus, once a global imbalance has been created --generally as a result of economic policy problems of the great centres-- the obligation to adjust which is imposed on the rest of the countries obliges them to follow drastic policies which affect the confidence of private sector creditor institutions and investors as well as that of the citizens of the countries affected themselves.

In particular, it is well known that by acting as a group the commercial banks play a procyclical role which further accentuates the external imbalances. These imbalances, in turn, make necessary domestic adjustment policies which jeopardize the stability of enterprises in the debtor countries so that they seek to diversify their risk internationally by depositing a considerable part of their resources abroad by either formal or informal means.

By not distinguishing internationally between the adjustment needs caused by domestic mismanagement and others caused by abrupt changes in the international situation, the tendency is to exaggerate the importance of the first named, so that official sources of financing also limit their activities.

As a result of all this, the Latin American countries have been turned into involuntary net contributors of resources to the external financial sector in an amount which adds up to over US$ 100 billion since 1982. Over this period, the net inflow of capital in the form of credit and direct investments did not finance even 30% of the net payments of interest and profits, whereas in the previous seven years the net inflow of capital had been almost double the amount of such payments (191%).

B. THE CONSEQUENCES OF THE PROBLEM

The changes which have taken place on the international scene have created a serious problem in the external sector of the Latin American economies. The current account deficit, which reached a peak of US$ 40 billion in 1981, became absolutely unsustainable when the flows of financing stopped. This same deficit, which came to almost 6% of the Latin American GNP, would have been substantially lower if interest rates and the terms of trade had remained at levels similar to those of the past.

In effect, if the terms of trade and interest rates, together with other conditions, had remained at values similar to those registered on average between 1965 and 1980, the current account deficit of the non-oil-exporting countries in 1981 would not have been more than US$ 7.7 billion.

Financing the deficit registered in 1981 out of the reserves would have eaten up in one single year the entire reserves of all the Latin American countries together.

Thus, it was inevitable to apply adjustment policies in order to reduce the current account deficits which it was no longer possible to finance. The central countries, for their part, continued to heighten their protectionist measures, while the international private banking system paralyzed its credit operations with the vast majority of the developing countries, so that the latter became net exporters of financial and real resources.

1. The adjustment policies

Sooner or later, the debtor countries had to apply adjustment policies. These policies were applied with different intensity and in different ways by the different countries, but in all cases they included policies designed to control aggregate demand --such as fiscal, monetary and incomes policies-- and others which affect the relative price of internationally tradeable goods: exchange, tariff and export promotion policies.8/ These policies were accompanied in some cases by programmes directly designed to increase the substitution of certain imports. The trend to greater openness of foreign trade and capital movements which had prevailed in the second half of the 1970s was halted and in some cases reversed.

The adjustment policies had to be applied because of the change in external circumstances which made it impossible to finance the current deficit. The actual features of these policies were clearly defined, however, in the framework set out in the stand-by credit agreements which the great majority of the debtor countries had

/to sign

to sign with the International Monetary Fund. These agreements included restrictive provisions in monetary and fiscal matters which set limits on the expansion of the net domestic assets of the Central Bank and the internal and external indebtedness of the public sector and which stipulated that the government must reduce its deficit by raising taxes, increasing the charges of public sector enterprises and cutting current expenditure. At the same time, it was accepted in these agreements that during the adjustment process it would be necessary to raise the real exchange rate, reduce real wages, and maintain interest rates that were positive in real terms.9/

The strictness and persistence with which the agreed policies were applied in practice varied from one country to another. Thus, although the majority of countries made substantial devaluations which initially permitted a very marked rise in the effective real exchange rate, in some cases the rate subsequently declined again to a perceptible extent. Likewise, the targets as regards reducing the fiscal deficit were not always reached, and in fact in quite a few cases this deficit represented a growing proportion of central government expenditure.10/

There were also differences in the extent to which the policies applied achieved their basic objectives. Generally speaking, however, the progress was much less as regards the control of inflation than as regards the reduction of the external imbalance. Indeed, there was already a noteworthy turnabout in the merchandise trade balance of Latin America as early as 1982, when after having turned in a deficit of US$ 1.7 billion in 1981, this indicator registered a surplus of over US$ 9 billion. This tendency was further accentuated in 1983 --when the trade balance exceeded US$ 31 billion-- and continued in 1984, when the merchandise trade surplus reached the unprecedented figure of over US$ 38 billion. Mainly because of this evolution of the trade balance, the current account deficit went down spectacularly in both 1983 and 1984, and in the latter year, when it stood at only US$ 1 billion, it was equivalent to only 2.5% of the enormous deficit of over US$ 40 billion registered two years earlier (see table 5). The deficit grew again in 1985, when it came to US$ 4.4 billion because of a further deterioration in the external circumstances, but even so it did not come anywhere near the figures registered at the end of the 1970s and the beginning of the 1980s.

Because of the way it was achieved, however, this marked reduction in the current account deficit involved a high cost in terms of economic activity and employment. Because of the abrupt and extremely severe drop in external financing, the adjustment had to be made in an extremely short period, and for this reason it did not permit a proper reallocation of resources from the production of non-tradeable goods to export activities and import substitution: a process which, precisely because it demands a substantial change in the structure of production, can only be carried out over a longer period. Up to 1983, and then once again in 1985, the expansion of exports was also limited by the marked decline in the international prices of the majority of the basic commodities exported by the region and the drop in the volume of world trade caused by the prolonged recession in the industrialized countries, the increase in protectionist practices in many of them, and the loss of dynamism of the OPEC economies. In these circumstances, the value of exports of goods went down markedly in 1982, stagnated in 1983, grew a little in 1984 but fell once again in 1985.

/Table 5

Table 5

LATIN AMERICA AND THE CARIBBEAN (23 COUNTRIES): MAIN ECONOMIC INDICATORS a/

	1980	1981	1982	1983	1984	1985b/
Gross domestic product at market prices (index, base 1980=100)	100.0	100.4	99.0	96.5	99.6	102.3
Population (millions of inhabitants)	356	364	373	381	390	399
Per capita gross domestic product (index, base 1980=100)	100.0	98.1	94.4	89.9	90.7	91.1
			Growth rates			
Gross domestic product	5.3	0.4	-1.5	-2.5	3.2	2.8
Per capita gross domestic product	2.8	-1.9	-3.7	-4.8	0.8	0.5
Consumer prices c/	56.1	57.6	84.8	131.1	185.2	328.3
Terms of trade (goods)	5.1	-7.6	-8.9	-1.8	4.1	-2.9
Purchasing power of exports of goods	12.4	0.3	-7.5	5.2	11.6	-4.6
Current value of exports of goods	32.3	7.6	-8.9	0.1	11.5	-5.7
Current value of imports of goods	34.9	7.8	-19.8	-28.5	5.0	-1.9
			Billions of dollars			
Exports of goods	89.1	95.9	87.4	87.5	97.5	91.9
Imports of goods	90.5	97.6	78.3	56.0	58.8	57.6
Trade surplus (goods)	-1.4	-1.7	9.1	31.5	38.7	34.3
Net payments of profits and interest	17.9	27.1	38.7	34.2	36.1	35.1
Balance on current account d/	-28.1	-40.1	-40.9	-7.4	-1.0	-4.4
Net capital movements e/	29.5	37.3	19.8	3.0	10.3	4.7
Global balance f/	1.4	-2.8	-21.0	-4.4	9.3	0.3
Global gross external debt g/	222.5	277.7	318.4	344.0	360.4	368.0

Source: ECLAC, on the basis of official data.

a/ The figures corresponding to the gross domestic product and to consumer prices refer to Argentina, Barbados, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay and Venezuela. The external sector data correspond to the same countries except Barbados, Guyana, Jamaica and Trinidad and Tobago. b/ Preliminary estimates. c/ Variation December-December. d/ Including net private unrequited transfers. e/ Including long- and short-term capital, official unrequited transfers and errors and omissions. f/ Corresponds to variation in reserves (of opposite sign) plus counterpart items. g/ The estimates include long-, medium- and short-term debt.

Consequently, the spectacular US$ 33 billion turnaround in the merchandise trade balance in 1982 and 1983 was due entirely and exclusively to the very severe drop in imports. The value of the latter declined sharply from some US$ 98 billion in 1981 to US$ 56 billion in 1983, while their volume contracted in this short space of time by the almost incredible amount of 41%. The drops in the volume of imports were even greater in the cases of Argentina and Chile (where this volume had already been halved between 1981 and 1983), Venezuela (where the volume of imports went down by 50% in 1983 alone) and, above all, Uruguay (whose real imports shrank by over 63% in the three-year period 1981-1983) and Mexico (which reduced its imports by almost 65% in the two-year period 1982-1983).

Although these colossal drops in imports partly reflected the unusually high levels that external purchases had attained before the crisis, they did not only affect external purchases of non-essential consumer goods and capital goods but also included considerable reductions in imports of raw materials and intermediate products indispensable for keeping up the level of domestic economic activity. Thus, it is not surprising that the domestic product went down as early as 1982 in many countries and suffered a further decline in 1983.

As already noted, this extremely unfavourable trend in Latin America's external trade was interrupted in 1984 when, because of the recovery of the industrialized economies, and, above all, the enormous expansion that year in the imports of the United States, the volume of world trade grew appreciably for the first time since 1979. Stimulated by this more favourable external situation and also by the higher level attained by the effective real exchange rates of many countries from 1982 onwards, the volume of Latin American exports increased by around 10% and their value slightly exceeded that registered before the crisis.

Furthermore, for the first time since 1981, the bigger exports were accompanied by a 5.2% increase in the volume of imports, although these continued to be far below the volume imported in 1981.

In 1985, the region's volume of imports suffered a slight decline of 0.7%. This overall percentage, however, does not reflect the true impact of this new reduction, because of the disparities between the changes in different countries. Thus, Mexico increased its volume of imports by 20.2% and Ecuador by around 10%, whereas Argentina, Chile, Peru and Venezuela reduced their import volumes by between 11% and 16%.

In short, as a result of the radical drop in the net inflow of capital which took place between 1981 and 1985 the region had to reduce with the greatest urgency an external deficit which was much larger than it would have been if the circumstances as regards its trade and financial relations with the exterior had been more normal. In fact, in addition to carrying out the "normal" adjustment needed to correct the excessive current account deficits which many Latin American countries had incurred in the pre-crisis years, they also had to carry out a sort of "overadjustment" in order to face up to the consequences of the procyclical conduct of the international commercial banks. Because of this, and also because of the very unfavourable external context for Latin American exports which existed up to 1983, almost all the burden of correcting (in the short space of barely two years) the heavy initial external imbalance fell on imports, whose violent contraction gave the adjustment a marked recessive character.

/The adjustment

The adjustment process carried out during this period has suffered from three fundamental shortcomings. Firstly, an attempt was made to adjust the Latin American external sector to an international situation which cannot be considered as one of equilibrium. Such a situation is strongly influenced by the big macroeconomic disequilibria registered in some industrial countries and by the economic policies adopted to deal with them both in the fiscal and monetary fields and in the external sector. The debtor countries are obliged to adjust their own external sectors in view of the lack of financing, but the new allocation of resources in the production field resulting from the adjustment has to fit in with the particularly unfavourable situation existing in the exterior, which cannot last. When the latter situation is reversed, the resource allocation will have to be changed once again to bring it in line with long-term equilibrium conditions, so that part of the effort made during the crisis will have been wasted. This consequently produces an overadjustment which is unbalancing from the long-term point of view and has necessitated a reduction in real per capita income much more severe than that which would have been necessary in order to bring the external sector back to a situation of long-term equilibrium. Such an equilibrium situation involves a transfer of real resources from the exterior to the developing countries and not, as actually happened, the opposite situation.

Secondly, a sizeable group of developing countries has had to adopt severely restrictive policies all at the same time, whereas the rest of the world has on the whole failed to apply policies of an expansive nature. This lack of symmetry has done nothing to facilitate the sale of additional exports from the debtor countries in world markets, so that the recessive effort they have had to make has been accentuated and the efficiency of some of the traditional adjustment measures has been affected. In particular, export promotion measures (including exchange rate adjustments) which have helped to expand the supply of exportable goods have been more effective in bringing down the prices of exports rather than increasing their volume, so that they have become counterproductive in their short-term and even their medium-term effect. This is because many countries have simultaneously tried to expand their exports of mutually competitive products, whereas the buyer countries have not increased their demand correspondingly. It may be noted that the multilateral financing agencies only have any real influence over the countries which need their resources, so that the creditor countries or those whose currency serves as a reserve currency are outside this influence. Likewise, it should be noted that because of this uneven influence, the adjustment policies put into effect on the recommendation of those agencies are such that they would only be fully effective in a world where one particular country has problems but the rest are operating normally. Since, in fact, there are many countries with problems, their adjustment policies have an impact on the whole of the world economy, and this has negative repercussions on the countries which began the adjustment process, thus multiplying the negative effects. Certain policies tend to be self-defeating, as in the case of the effect of the "competing devaluations" already well known during the Great Depression of the 1930s.

Thirdly, the adjustment process implicit in the programmes applied with the support of multilateral financing agencies has not taken any explicit account of growth objectives, in that it has obliged the countries to achieve a degree of external equilibrium only compatible with high levels of unemployment and a sharp drop in the product, which have jeopardized the economic and political stability of

the countries and the consolidation of the democratization processes underway in the region.

The adjustment process has thus been unbalancing, simultaneous, asymmetrical and drastic, bringing with it a severe recessive effect for the economies of the debtor countries. This effect is summed up in the figures for the Latin American per capita product, which fell by over 9% between 1980 and 1985 and stood in the latter year at the same level already reached in 1977.

Another way of bringing out the magnitude of the adjustment carried out by the Latin American economies is to look at the transfers of real and financial resources to the exterior. Table 6 shows that up to 1980-1981 the region was a net recipient of real and financial resources. From then on, however, these transfers were reversed: the region became a net contributor of real and financial resources to the exterior. In the case of real resources, the amounts transferred between 1983 and 1985, as measured according to the trade balance (which includes non-financial services), amounted to nearly US$ 90 billion. The financial resources transferred to the exterior, for their part, as measured according to the financial balance (the net inflow of capital less net payments of interest and profits to the exterior) came to US$ 106 billion between 1982 and 1985. The difference between the trade and financial balances is explained basically by changes in the international reserves.

2. Trade, protectionism and the terms of trade

The insufficiency of external demand and the protectionist tendencies of the North have affected both the exports of the developing countries and their terms of trade.

On average, the products of the developing countries do not supply more than 3% of the market of the industrial countries, so that this relatively small share should leave an ample margin for future expansion. Because the share is much higher in the case of certain products, and because of the protectionist measures which tend to be concentrated against them, however, future growth is likely to be only modest. The protectionist measures of the OECD countries did not represent a serious hindrance for the most dynamic exporting countries in the late 1970s, but the export environment in the coming years is likely to be much more competitive than in the last 15 years, since the debtor countries must all make great efforts to increase their exports.

Achieving a significant increase in exports will need not only a sounder world economy, but also a process of restructuring of the economies of the industrialized countries: an essential aspect of the evolution of the international economy towards which the national policies of both the industrial and the developing countries should strive.

The international spillover of the economic recovery of the industrial countries is functioning less effectively than in the past. In the two-year period following the 1975 recession, the growth of world trade was appreciably greater than the increase in the world product, as it has been on average throughout the period since the war. In 1983-1984, in contrast, the growth of trade exceeded that of the product only by an insignificant amount, mainly because of the smaller availability

/Table 6

Table 6

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES): a/ TRANSFERS OF REAL AND FINANCIAL RESOURCES

(Billions of dollars and percentages)

	Trade balance b/		Financial balance c/	
	Value	As a percentage of GDP d/	Value	As a percentage of GDP d/
1970-74	1.0	0.4	3.3	1.4
1975-79	6.4	1.4	12.0	2.7
1980-81	11.4	1.6	11.0	1.6
1982	1.3	0.2	-18.4	-2.4
1983	-27.0	-3.5	-30.1	-3.9
1984	-34.9	-4.2	-25.0	-3.0

Source: ECLAC, on the basis of information from IMF, Balance of Payments Yearbook, November 1985.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

b/ Includes goods and services. Negative sign signifies transfer of resources to the exterior.

c/ Calculated as the difference between the net inflow of capital and net payments of profits and interests.

d/ Estimated figures for GDP in dollars, calculated by deflating constant values by the implicit deflator of the United States product.

/of financing,

of financing, due to the debt problem, and the proliferation of protectionist measures. Mention must also be made in this respect of the restrictions imposed on their imports by the developing countries with a high level of indebtedness.

3. External financing

Bank loans to developing countries, especially those of Latin America, grew at an extraordinarily rapid rate in the 1970s. A posteriori it can be seen that although in some countries the growth rates of the GNP and exports were high, development strategies based on external saving nevertheless had very weak foundations. The excessive reliance on short-term loans brought about a serious maladjustment between the investment maturity structure and the debt, and this increased the vulnerability of the countries to debt servicing problems. In some cases, external financing took the place of domestic saving, stimulating consumption. In others, it encouraged bigger imports of armaments. The abundant supply of foreign exchange encouraged over-valuation of the currency, stimulating investment in activities producing goods that were not internationally tradeable and taking away export incentives. Likewise, the effort to keep up levels of activity despite the oil crisis and the fact that the expectations of high interest and exchange rates in the domestic market of the United States stimulated the speculative outflow of private capital were further factors that joined together to bring about a partial neutralization of the flows of financing to the region and to weaken the incentives for their efficient use.

The initial reaction of the private banks to the problems of debt servicing in the 1980s was not only to try to reduce their commitments with the developing countries, whose debt with the banks amounted to over US$ 330 billion up to mid-1983, but also to impose new commissions and charges (which until only a short time before had tended to go down slightly) in the rescheduling agreements, on top of the already very high interest rates. It is obvious that because of the conjunction of active lending policies with inadequate project evaluation and ignorance of the countries and the trade risks involved, the banks are also responsible for giving rise to the present balance-of-payments crisis. They tend to argue that, because of the competition in offering loans in the 1970s, the spreads were very low and the guarantees were not sufficient to face up to generalized payments crises. Their present behaviour, however, with their effort to place subtle obstacles in the way of the access of "problem" countries to financial markets and their application of rescheduling procedures which considerably raise the cost of financing, are helping to accentuate the external imbalances and to transfer almost the entire burden of the adjustment to the debtor countries (see table 7).

Together with the rise in financial costs, there has been a reduction in the amount of bank finance, and there is little hope that it will increase in the near future, even with the pressure being exerted by the IMF. At the same time, however, as it is probable that the decline in interest rates will be slow and not very significant, if it takes place at all, the large and costly trade surpluses of the debtor countries will not be sufficient to cover the external deficit and the countries will need fresh loans. The only available sources would be the governments of the developed countries, which are themselves subject to serious budgetary restrictions, and the multilateral agencies, which, even if they could increase their capital and credit capacity to the highest reasonable level, would not be able to

/Table 7

take care of all the needs. Consequently, although it is essential that redoubled efforts should be made to induce the World Bank and the IMF to play an important direct and indirect role in international financing, it does not seem that any solutions to the debt problem of the developing countries which do not envisage a reduction in the real debt burden would be viable.

Table 7

EVOLUTION OF EXTERNAL ASSETS OF THE PRIVATE INTERNATIONAL BANKING SYSTEM a/

Year	Banks of Europe		Banks in Canada and Japan	Banks in U.S.A.	Offshore banks c/	Total reporting banks d/
	Total	Eurocurrency market b/				
a) Billions of dollars at end of each period						
1972	182.2	142.6	24.0	9.2	9.4	224.8
1973	224.4	199.4	29.4	15.2	23.5	312.5
1974	279.4	226.2	34.5	34.7	36.1	384.7
1975	329.9	369.1	34.2	48.3	51.1	463.5
1976	385.6	316.3	39.0	69.6	74.9	569.1
1977	466.3	384.9	39.9	92.6	91.1	569.1
1978	611.4	502.0	56.1	119.2	106.5	893.2
1979	776.0	639.9	71.0	136.4	127.6	1 111.0
1980	903.0	751.2	101.2	176.8	141.0	1 321.9
1981	998.9	847.3	122.8	256.6	172.0	1 550.2
1982	1 028.5	872.4	129.7	363.4	172.9	1 694.5
1983 I	1 029.8	882.0	151.0	396.6	179.8	1 757.1
1983 II	1 049.2	903.3	151.0	396.6	501.1	2 097.9
1984	1 063.0	921.3	170.2	409.5	517.7	2 160.4
1985 Jun	1 118.2	957.1	184.5	410.3	521.0	2 234.0
b) Annual growth rates (%)						
1973	23.2	39.8	22.5	65.2	150.0	39.0
1974	24.6	13.4	17.4	128.3	53.6	23.1
1975	18.1	19.0	-0.9	39.2	41.6	20.5
1976	16.9	17.5	14.0	44.1	46.6	22.8
1977	20.9	21.7	2.3	18.7	21.6	21.2
1978	31.2	30.4	40.6	28.7	16.9	29.5
1979	26.9	27.5	26.6	14.4	19.8	24.4
1980	16.4	17.4	42.5	29.6	10.5	19.0
1981	10.6	12.8	21.3	45.1	22.0	17.2
1982	3.0	3.0	5.6	41.6	0.5	9.3
1983 I	0.1	1.1	16.4	9.1	4.0	3.6
1983 II	2.0	3.5	16.4	9.1	189.8	23.8
1984	1.3	2.0	12.7	3.2	3.3	3.0
1985 Jun	5.2	3.9	8.4	0.2	0.6	3.4

Source: Bank for International Settlements (BIS): Annual Report, June 1977, 1978, 1979 and 1980; International Banking Developments, October 1985.

/Table 7 (conclusion)

Table 7 (conclusion)

a/ Up to 1982, refers to banks operating in Austria, Belgium, Luxembourg, Denmark, France, Germany, Italy, Netherlands, Sweden, United Kingdom, Canada, Japan and the United States, plus Switzerland and branches of United States banks in the Caribbean and Middle East. As from 1983 there was an expansion of coverage to include banks operating in Bahamas, Bahrain, Cayman Islands, Finland, Hong Kong, Netherlands, Netherlands Antilles, Norway, Singapore and Spain, plus branches of United States banks in Panama.

b/ Defined in the restricted form used by the BIS, which is limited to foreign currency assets of European banks.

c/ Up to 1983 I, this refers to United States banks in Bahamas, Cayman Islands, Panama, Hong Kong and Singapore. From 1983 II, also includes banks of other countries in these financial centres, excluding Panama but including Bahrain and the Netherlands Antilles.

d/ These figures include redeposits among reporting banks, which in the last two years came to around 40% of the total; for the purpose of this table, however, this sum has not been deducted nor has an estimate been made of the amounts not included in the totals.

III. TWO GROWTH SCENARIOS

In order to gain some idea of the external financing needs of the countries of the region, two scenarios covering the period 1985-1995 have been used. The first of these (scenario 1.0) is a scenario of slow recovery which postulates that the per capita gross domestic product will recover its 1980 level only at the end of the present decade and will thenceforth continue growing up to 1995 at the rate of 3.5% per year.

The second scenario (scenario 2.0) postulates a growth rate of the per capita gross domestic product at 3.5% per year up to 1990, rising to 4.5% per year from then until 1995.

Both scenarios have been prepared by countries 11/ and have two variants: a reduction of two percentage points in interest rates below those used for the basic scenarios (scenario 1.1 and 2.1) and a 2% annual improvement in export prices over and above the rate of international inflation assumed (scenarios 1.2 and 2.2).

The assumptions made in scenario 2.0 regarding the dynamism of the world economy are naturally a good deal more optimistic than those of scenario 1.0. Neither of the scenarios are forecasts but rather hypotheses which facilitate the analysis of the coherence of the results.

The basic scenarios have been worked out on the assumption of a uniform world inflation rate of 6% per year for the entire period. External interest rates, including expenses, commissions and spreads, have been fixed at 12% and 11.5% for private operations and 8% to 6.5% for operations with official institutions, depending on the conditions prevailing in each country.

A. SCENARIO 1.0

According to the assumptions postulated, the global economic growth of the region during the period 1985-1990 would amount to 3.8% per year. In a third of the countries considered the growth rates would be 3.5% or less; in another third they would be between 3.6% and 4.5%, and in the remainder they would be between 4.6% and 7%. In these three groups, the growth demands are less for the bigger countries, whereas the small countries tend to be concentrated in the two groups of highest growth. The growth rates required in order for the countries in the last group to recover the 1980 per capita product in 1990 seem to be too demanding, and it is not likely that they will be achieved.

It is assumed that the growth of exports at constant prices will be around 4% up to 1990 and 5% from then until 1995. As inflation of 6% per year has been foreseen, it can be inferred that the nominal growth rates of exports will be a little over 10% and 11%, respectively.

In view of the low level registered by the region's imports in recent years as a result of the severe adjustment processes put into effect, scenario 1.0 foresees that the growth of imports will be more rapid than that of exports.

/Another contributory

Another contributory factor in this is the need for the expansion of investment to support the economic growth foreseen. Even so, imports would not represent as high a proportion of the gross domestic product in 1995 as they did in 1980.

The external sector projections resulting from this scenario assume a net annual external financing requirement of US$ 25 billion dollars towards 1990 and US$ 55 billion dollars towards 1995. This net annual external financing would represent less than 13% of exports in 1990 and around 16.5% of them in 1995, which are levels well below those registered in 1980-1982. The total net external financing needed in this scenario between 1985 and 1990 comes to almost US$ 120 billion or a little under US$ 20 billion per year.

During the whole period considered, the trade surplus would tend to go down, although it would remain positive, and this means a sustained transfer of real resources to the exterior. This result is different for the different groups of countries, however: whereas in the larger countries the individual results would be similar to the global results, the trade deficit of the smaller countries would increase.

As a result of all these factors, the external debt would continue growing up to 1995, although the ratio between the debt and exports would go down from 3.2 in 1984 to 2.5 in 1990 and 2.1 in 1995.

B. VARIANTS OF SCENARIO 1.0

A reduction of two percentage points in interest rates (if the other conditions do not change) would reduce the indebtedness needed in order to grow at the rates foreseen, so that the ratio between the debt and exports at the end of 1990 would be around 2.2% and at the end of 1995 it would be less than 2 (around 1.7).

The reduction in the net external financing needed towards 1990 with respect to the basic scenario would be US$ 13 billion and the growth in the total external debt would be only half that provided for in the basic scenario.

An increase of 2% per year in the prices of basic commodities over and above global inflation would bring about an increase in the value of exports equivalent to US$ 7.7 billion towards 1990 and would enable the external debt to be reduced by over US$ 28 billion compared with the values given in the basic scenario.

The ratio between the debt and exports would be lower than in the basic scenario, but it would not go down as much as in the case of a reduction of two percentage points in interest rates.

/C. SCENARIO

C. SCENARIO 2.0

According to this scenario, which is of an essentially normative nature, the per capita gross domestic product of the region would grow on average at a rate of 3.5% up to 1990 and 4.5% between 1990 and 1995, so that the global economic growth rate of the region would amount to 5% per year in the first part of the period and 6.4% in the second. Taking the two periods together, this gives an annual average growth rate of just under 6%; a similar rate to that registered for the region as a whole during the 1970s.

In this scenario, it is assumed that the growth of exports at constant prices would be around 5.1% per year during the first five years and 6.2% during the second, giving nominal growth rates of over 11% and over 12% for the two periods. The increase in imports would be even greater, especially in the first period, since it would be starting from a very low level and heavy investment, with a higher imported component, would be needed to sustain the higher growth rates.

This scenario has assumed the reprogramming of the debt for a period of ten years with five years' grace, applicable to both the outstanding and the new debt. Under this scenario, the external debt would amount to some US$ 500 billion towards 1990 and the ratio between the debt and exports would be slightly below that registered in scenario 1.0. Towards the end of 1995, the ratio between the debt and exports would not be very different from that given in scenario 1.0, even though the economic growth rates are substantially different.

A reduction of two percentage points in interest rates would make it possible to save US$ 57 billion of external debt towards 1990 and US$ 150 billion towards 1995. A 2% increase in export prices over and above global inflation would also bring about substantial improvements in the level of indebtedness compared with the results of the basic scenario.

The results of the evolution of scenarios 1.0 and 2.0 and of their variants are given in tables 8 to 16.12/

D. LESSONS OF THE SCENARIOS CONSIDERED

The two scenarios considered lead to a reduction of the coefficient between the debt and exports during the period analysed, although they involve an increase of external financing. Although the latter exceeds the amounts foreseen at present by private and multilateral financial bodies, it is well below that registered in the early years of the 1980s.

Thus, the basic scenario, which is less ambitious from the point of view of growth, would require a little over US$ 100 billion of net external financing in the five-year period 1986-1990, while over the same period the more ambitious scenario would require 25% more additional financing.

/The variants

The variants of the basic scenarios, which are more optimistic regarding international interest rates and the terms of trade, involve smaller financial demands. However, the projections of the world economy prepared by such bodies as the International Monetary Fund and the World Bank do not give grounds for assuming that there is a very high probability of materializing these variants.

For these reasons, there is justification for exploring solutions to the problem of indebtedness and external financing which involve conscious action on the part of all the parties involved. In other words, there are grounds for seeking forms of solutions which assume a modification of the prevailing policies, as well as action to strengthen and correct the international monetary and financial system.

/Table 8

Table 8

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: GROSS DOMESTIC PRODUCT, EXPORTS AND IMPORTS OF GOODS AND SERVICES, AND GROSS DOMESTIC INVESTMENT

(Annual growth rates and percentages)

	1980	1981	1982	1983	1984	Scenario 1.0		Scenario 2.0	
						1985-1990	1991-1995	1985-1990	1991-1995
Gross domestic product	6.0	1.7	-0.9	-3.3	3.3	3.8	5.5	5.0	6.4
Exports of goods and services	4.2	7.8	-2.4	7.2	7.8	4.1	5.1	5.1	6.2
Imports of goods and services	12.9	1.7	-18.4	-26.1	1.6	8.5	7.0	10.1	7.7
Gross domestic investment	6.8	-2.2	-10.7	-20.1	1.1	6.3	8.0	9.6	8.2

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

/Table 9

Table 9

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: EXPORTS AND IMPORTS OF GOODS AND SERVICES AND GROSS DOMESTIC INVESTMENT

(Coefficients with respect to GDP and percentages)

	1980	1981	1982	1983	1984	Scenario 1.0		Scenario 2.0	
						1990	1995	1990	1995
Exports of goods and services	13.3	14.1	13.9	15.4	16.1	16.5	16.2	16.3	16.1
Imports of goods and services	16.3	16.3	13.4	10.2	10.1	12.9	13.8	13.2	14.0
Gross domestic investment	26.1	25.0	21.4	17.5	17.1	20.4	22.9	22.7	24.7

Source: ECLAC, on the basis of official data.
a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

/Table 10

Table 10

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: INVESTMENT, SAVINGS AND EXTERNAL RESOURCES

(Coefficients with respect to GDP and percentages)

	1980	1981	1982	1983	1984	Scenario 1.0		Scenario 2.0	
						1990	1995	1990	1995
Gross domestic investment	26.1	25.0	21.4	17.5	17.1	20.4	22.9	22.7	24.7
Gross domestic saving	23.1	22.8	21.9	22.7	23.1	24.0	25.2	25.8	26.8
Net external factor payments	2.5	3.6	4.9	4.8	4.9	3.6	2.8	3.5	2.8
Terms-of-trade effect	1.6	0.6	-0.7	-1.6	-1.4	-1.9	-1.9	-1.9	-1.9
Gross national saving b/	22.2	19.9	16.2	16.4	16.9	18.6	20.5	20.5	22.1
Net external financing b/	3.8	5.1	5.1	1.1	0.3	1.8	2.3	2.2	2.5

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

b/ Including net private transfer payments.

/Table 11

Table 11

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: BALANCE ON CURRENT ACCOUNT

	1980	1981	1982	1983	1984	Scenario 1.0		Scenario 2.0	
						1990	1995	1990	1995
	(Millions of dollars at current prices)								
Exports of goods and services	105770	114076	101956	100650	112239	194593	332490	205933	369770
Imports of goods and services	115900	126603	104332	75222	77218	172014	322331	188784	364817
Trade surplus (+)	-10130	-12527	-2376	25428	35021	22580	10160	17149	4953
Net external factor payments	18411	28393	38432	34869	37628	48001	65808	50276	73234
Net external financing	28087	40347	40717	8793	1878	25085	55026	32791	67659
	(Coefficients with respect to exports of goods and services and percentages)								
Imports of goods and services	109.6	111.0	102.3	74.7	68.8	88.4	96.9	91.7	98.7
Trade surplus (+)	-9.6	-11.0	-2.3	25.3	31.2	11.6	3.1	8.3	1.3
Net external factor payments	17.4	24.9	37.7	34.6	33.5	24.7	19.8	24.4	19.8
Net external financing	26.5	35.4	39.9	8.7	1.7	12.9	16.5	15.9	18.3

Source: ECLAC, on the basis of official data.
a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

/Table 1

Table 12

LATIN AMERICA AND THE CARIBBEAN (18 COUNTRIES)a/: EVOLUTION OF THE EXTERNAL DEBT AND ITS FINANCIAL SERVICING

	1980	1981	1982	1983	1984	Scenario 1.0		Scenario 2.0	
						1990	1995	1990	1995
	(Millions of dollars at current prices)								
Interest paid on the external debt	21031	31483	39567	35550	39479	48709	67589	51562	76487
Payments of principal on the external debt	18244	21433	22208	23838	23864	56269	77239	38177	51033
Total servicing of the external debt	39275	52916	61775	59388	63343	104978	144828	89739	127520
Gross inflow of foreign capital	48204	59603	43407	28460	33865	88091	144951	79333	133829
Net contribution of foreign capital	11692	10000	-17002	-29947	-27316	-15486	3535	-8692	10728
External debt	220231	275322	315610	340638	355431	474429	692151	500162	779318
	(Coefficients with respect to exports of goods and services and percentages)								
Interest paid on the external debt	20.2	28.0	39.4	35.9	35.7	25.3	20.6	25.4	21.0
Payments of principal on the external debt	17.5	19.1	22.1	24.1	21.6	29.3	23.5	18.8	14.0
Total servicing of the external debt	37.7	47.1	61.5	60.0	57.3	54.6	44.1	44.2	35.0
Gross inflow of foreign capital	46.2	53.0	43.3	28.8	30.6	45.8	44.2	39.0	36.7
Net contribution of foreign capital	11.2	8.9	-16.9	-30.3	-24.7	-8.1	1.1	-4.3	2.9
External debt	209.9	242.8	311.4	341.1	322.5	246.8	210.8	246.1	213.7

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela.

/Table 13

Table 13

LATIN AMERICA AND THE CARIBBEAN (18 COUNTRIES)a/: EXTERNAL DEBT AND NET CONTRIBUTION OF EXTERNAL LOANS, 1985-1995

	Scenario 1.0			Scenario 2.0		
	Basic	1.1	1.2	Basic	2.1	2.2
External debt at 31 December 1984	355.4	355.4	355.4	355.4	355.4	355.4
External debt at 31 December 1995	692.1	547.7	543.5	779.3	628.5	619.7
Increase in external debt, 31 December 1984-31 December 1995	336.7	192.3	188.1	423.9	273.1	264.3
Interest paid, 1985-1995	558.6	414.2	520.7	596.5	445.7	556.7
Net contribution of external loans, 1985-1995	-221.9	-221.9	-332.6	-172.6	-172.6	-292.4

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela.

/Table 14

Table 14

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: BALANCE ON CURRENT ACCOUNT

	1984	Scenario 1.0 b/						Scenario 2.0 b/					
		1990			1995			1990			1995		
		Basic	1.1	1.2	Basic	1.1	1.2	Basic	2.1	2.2	Basic	2.1	2.2
		(Millions of dollars at current prices)											
Exports of goods and services	112239	194593	194593	202264	332490	332490	358676	205933	205933	214069	369770	369770	398857
Imports of goods and services	77218	172014	172014	172014	322331	322331	322331	188784	188784	188784	364817	364817	364817
Trade surplus (+)	35021	22580	22580	30250	10160	10160	36345	17149	17149	25286	4953	4953	34040
Net external factor payments	37628	48001	34916	45477	65808	41752	51373	50276	36780	47652	73234	47343	57624
Net external financing	1878	25085	12000	14891	55026	30970	14406	32791	19295	22030	67659	41768	22962
		(Coefficients with respect to exports of goods and services and percentages)											
Imports of goods and services	68.8	88.7	88.4	85.0	96.9	96.9	89.9	91.7	91.7	88.2	98.7	98.7	91.5
Trade surplus (+)	31.2	11.6	11.6	15.0	3.1	3.1	10.1	8.3	8.3	11.8	1.3	1.3	8.5
Net external factor payments	33.5	24.7	17.9	22.5	19.8	12.6	14.3	24.4	17.9	22.3	19.8	12.8	14.4
Net external financing	1.7	12.9	6.2	7.4	16.5	9.3	4.0	15.9	9.4	10.3	18.3	11.3	5.8

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

b/ Includes the basic scenario and its two variants.

/Table 15

Table 15

LATIN AMERICA AND THE CARIBBEAN (18 COUNTRIES)a/: EVOLUTION OF THE EXTERNAL DEBT AND ITS FINANCIAL SERVICING

	1984	Scenario 1.0 b/ 1990			Scenario 1.0 b/ 1995			Scenario 2.0 b/ 1990			Scenario 2.0 b/ 1995		
		Basic	1.1	1.2	Basic	1.1	1.2	Basic	2.1	2.2	Basic	2.1	2.2
	(Millions of dollars at current prices)												
Interest paid on the external debt	39479	48709	36549	46873	67589	45245	55689	51562	38999	49677	76487	52338	63748
Payments of principal on the external debt	23864	56269	50642	54149	77239	61659	63536	38177	34392	36827	51033	40995	42608
Total servicing of the external debt	63343	104978	87191	101021	144828	106904	119224	89739	73391	86504	127520	93333	106356
Gross inflow of foreign capital	33865	88091	70304	76390	144951	107027	92841	79333	62986	67910	133829	99641	83313
Net contribution of foreign capital	-27316	-15486	-15486	-22916	3535	3535	-21815	-8692	-8692	-16554	10728	10728	-17355
External debt	355431	474429	416778	445874	692151	547786	543528	500162	443815	472762	779318	628461	619733
	(Coefficients with respect to exports of goods and services and percentages)												
Interest paid on the external debt	35.7	25.3	19.0	23.5	20.6	13.8	15.7	25.4	19.2	23.5	21.0	14.4	16.
Payments of principal on the external debt	21.6	29.3	26.3	27.1	23.5	18.8	18.0	18.8	16.9	17.5	14.0	11.2	10.
Total servicing of the external debt	57.3	54.6	45.4	50.6	44.1	32.6	33.7	44.2	36.1	41.0	35.0	25.6	27.
Gross inflow of foreign capital	30.6	45.8	36.6	38.3	44.2	32.6	26.2	39.0	31.0	32.2	36.7	27.3	21.
Net contribution of foreign capital	-24.7	-8.1	-8.1	-11.5	1.1	1.1	-6.2	-4.3	-4.3	-7.8	2.9	3.0	-4.
External debt	322.5	246.8	216.8	223.3	210.8	166.9	153.7	246.1	218.4	224.0	213.7	172.3	157.

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela.

b/ Includes the basic scenario and its two variants.

/Table 16

Table 16

LATIN AMERICA AND THE CARIBBEAN (19 COUNTRIES)a/: INVESTMENT, SAVINGS AND EXTERNAL RESOURCES

(*Coefficients with respect to GDP, and percentages*)

	1984	Scenario 1.0 b/						Scenario 2.0 b/					
		1990			1995			1990			1995		
		Basic	1.1	1.2	Basic	1.1	1.2	Basic	2.1	2.2	Basic	2.1	2.2
Gross domestic investment	17.1	20.4	20.4	20.4	22.9	22.9	22.9	22.7	22.7	22.7	24.7	24.7	24.7
Gross domestic saving	23.1	24.0	24.0	24.0	25.2	25.2	25.2	25.8	25.8	25.8	26.8	26.8	26.8
Net external factor payments	4.9	3.6	2.6	3.4	2.8	1.8	2.2	3.5	2.5	3.3	2.8	1.8	2.2
Terms-of-trade effect	-1.4	-1.9	-1.9	-1.3	-1.9	-1.9	-0.8	-1.9	-1.9	-1.3	-1.9	-1.9	-0.7
Gross national saving c/	16.9	18.6	19.5	19.3	20.5	21.6	22.3	20.5	21.4	21.2	22.1	23.1	23.8
Net external financing c/	0.3	1.8	0.9	1.1	2.3	1.3	0.6	2.2	1.3	1.5	2.5	1.6	0.8

Source: ECLAC, on the basis of official data.

a/ Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

b/ Includes the basic scenario and its two variants.

c/ Includes net private transfer payments.

IV. STRATEGIES FOR A SOLUTION

Strategies for finding a solution to the problem can have two types of objectives, which are not mutually exclusive: to gain time while the shortcomings of the world economy which gave rise to the problem correct themselves naturally, or to relieve the debt burden (naturally to a substantial extent).

The first type of strategy is based on the assumption that a recovery of the world economy is just around the corner and that this would correct real interest rates and the terms of trade to such an extent as to make the problem disappear. In order for strategies of this type to be successful, two requisites must be fulfilled: there must be recovery in the world economy, and this, in its turn, must be reflected in sufficient improvements in interest rates and the terms of trade, as well as in the volume of trade.

The second type of strategy is based on less optimistic assumptions regarding the performance of the world economy and its capacity to be reflected in sufficient improvements in both interest rates and trade. If these less optimistic assumptions prove to be true, the debt problem would necessitate an intolerably heavy degree of adjustment by the debtor countries, so that the debt problem in effect would not be solved except through a possibly substantial reduction, produced by direct means, in the burden of servicing it.

Strategies of the first type lend themselves more to case-by-case treatment. Those of the second, however, require at least a combination of general treatment with case-by-case approaches in specific aspects.

A. STRATEGIES DESIGNED TO GAIN TIME

The measures which have been adopted from 1982 onwards are of the type clearly designed to gain time until the normal functioning of the world economy solves the problems of interest rates, terms of trade and trade volumes. These measures consist principally of the case-by-case renegotiation of the external debt, the strengthening of the International Monetary Fund and its catalytic function in the financial market, and close co-ordination among creditors.

Successive rounds of renegotiation of the external debt have gradually corrected some of the initial shortcomings in the renegotiation process. Thus, although the first round of renegotiation operations, carried out in 1983, gave more time for the payment of amortization commitments on part of the debt, it increased the cost of the latter by raising spreads and commissions. Subsequent rounds have eliminated these surcharges and even, to a limited extent, reduced the cost of the debt by accepting changes in the interest rates used for reference purposes, smaller spreads over interest rates, the reduction or elimination of commissions and other expenses connected with the renegotiation process, the pluriannual reprogramming of amortization commitments, longer periods of grace and maturities, and the possibility of changing the currencies in which the debt is expressed. The World Bank has increased its co-financing activities and for the

/first time

first time has granted partial guarantees which should reduce the country risk and stimulate a larger flow of financing from private sources. The fact is, however, that the latter has suffered a drastic reduction. Tables 17 and 18 summarize the results of the various debt renegotiation rounds.

Not much more can be expected from the case-by-case renegotiation process. The economic results of 1984 did give a sensation that the debt problem might be on the way to being solved "naturally", but the figures for 1985 give a completely different picture: the terms of trade have continued to deteriorate and world trade is not expanding, while the current interest rates represent an excessive burden for debtors.13/

The evidence seems to indicate that growth rates of over 4% per year would be required in the OECD countries, together with the reduction of protectionist tendencies, the provision of additional financing, and some reduction in interest rates, in order to solve the debt problem gradually in this way.14/ Although growth rates of this order are not unknown, it is excessively risky to base on them a whole strategy for solving the debt problem.

B. STRATEGIES FOR REDUCING THE DEBT BURDEN

This type of strategy can follow one of two paths: that of limiting debt service payments as a function of certain given criteria on payment capacity, and that of directly reducing such payments. Financially, both these approaches are similar in that the debt servicing commitments exceeding the established limits are allowed to build up indefinitely.

The reduction of the debt can be effected either by reducing interest rates (below those of the market) or by directly reducing the principal. In this case, too, both procedures are financially equivalent, although they differ as regards their accounting treatment. The reduction of interest rates would be reflected in the balance sheets of the creditor institutions only with the passage of time, whereas the reduction in the principal of the debt would be reflected immediately and totally in the balance sheet. This difference may be important for the creditor institutions and their stability.

1. Limitations on debt servicing according to the debtor's payment capacity

There are a number of proposals which tackle the debt problem from this angle. The most important of them are that described in the Oaxtepec Communiqué and that put into practice by the Government of Peru.

/Table 17

Table 17

LATIN AMERICA AND THE CARIBBEAN (13 COUNTRIES): REPROGRAMMING OF THE EXTERNAL DEBT WITH THE PRIVATE BANKING SYSTEM, 1982-1985 a/

(Millions of dollars)

	First round 1982/1983			Second round 1983/1984			Third round 1984/1985		
	Maturities		New credits	Maturities		New credits	Maturities b/		New credits
	Amount	Years	Amount	Amount	Years	Amount	Amount	Years	Amount
Argentina	13 000	Sep 82-83 c/	1 500	-	-	-	13 500	82-85	4 200
Brazil	4 800	83	4 400	5 400	84	6 500	-	-	-
Costa Rica	650	82-84	225	-	-	-	280	85-86	75
Cuba	130	Sep 82-83	225	-	-	-	82	85	-
Chile	3 424	83-84	1 300	-	-	780	5 932	85-87	714; 371 d/
Ecuador	1 970	Nov 82-83	431	900	84	-	4 630	85-89	200
Honduras	121	82-84	-	-	-	-	220	85-86	-
Mexico	23 700	Aug 82-84	5 000	12 000 e/	Aug 82-84	3 800	48 700	85-90	-
Panama	180	83	100	-	-	-	603	85-86	60
Peru	400	83	450	662	84 Jul 85	-	-	-	-
Dominican Republic	568 c/	82-83 c/	-	-	-	-	790	82-85	-
Uruguay	630	83-84	240	-	-	-	1 600	85-89	-
Venezuela	-	-	-	-	-	-	21 200	83-88	-

Source: ECLAC, on the basis of official data and information from various national and international sources.

a/ For each round, the first column refers to the total amount of maturities reprogrammed, the second to the maturity years restructured, and the third to the additional credits granted by the private banking system as an integral part of the restructuring operation. The table does not include information on the maintenance of short-term lines of credit and bridging loans authorized by the United States Department of the Treasury, the Bank for International Settlements, etc.
b/ In some cases the figures include maturities already reprogrammed in 1982-1983.
c/ The agreement was never signed, and the maturities were included in the new agreement for 1984-1985.
d/ The values correspond to 1985 and 1986, respectively. They include US$ 150 million underwritten by the World Bank.
e/ Private sector commitments.

/Table 18

Table 18

LATIN AMERICA AND THE CARIBBEAN (13 COUNTRIES): TERMS OF RESCHEDULING OF THE EXTERNAL DEBT WITH THE PRIVATE BANKING SYSTEM, 1982/1985 a/

	First round 1982/1983			Second round 1983/1984			Third round 1984/1985		
	Spread over LIBOR (%)	Term	Commission a/	Spread over LIBOR (%)	Term	Commission a/	Spread over LIBOR (%)	Term	Commission a/
Argentina	2.16b/	6.8b/	1.25b/	-	-	-	1.44	11.5	0.15
Brazil	2.32	8.0	1.50	2.00	9.0	1.00	-	-	-
Costa Rica	2.25	8.0	1.00	-	-	-	1.66	9.4	1.00
Cuba	2.25	7.0	1.25	1.88	9.0	0.88	1.50	10.0	0.38
Chile	2.16	7.0	1.25	1.75	9.0	0.63	1.42	12.0	0.08
Ecuador	2.28	6.7	1.25	1.75	9.0	0.88	1.39	11.9	-
Honduras	2.38	7.0	1.38	-	-	-	1.58	11.0	0.88
Mexico	1.95	7.6	1.05	1.50	10.0	0.63	1.13	14.0	-
Panama	2.25	6.0	1.50	-	-	-	1.40	11.7	0.05
Peru	2.25	8.0	1.25	1.75c/	9.0c/	0.75c/	-	-	-
Dominican Republic	2.25	6.0	1.25	-	-	-	1.38	13.0	-
Uruguay	2.25	6.0	1.41	-	-	-	1.38	12.0	-
Venezuela	-	-	-	-	-	-	1.13	12.5	-

Source: ECLAC, on the basis of official data from the countries and information from national and international sources.

a/ Calculated as a percentage of the total amount of the transaction and paid on a one-time basis on signing the loan contract. Each column shows the conditions agreed with the banks for the reprogrammed maturities and/or new credits. When the country negotiated both the reprogramming of maturities and the granting of fresh resources, the figure represents a weighted average of the two elements.
b/ This agreement never came into force. The corresponding maturities were finally incorporated into the agreement forming part of the third round.
c/ This agreement has not been finalized.

The Oaxtepec Communiqué proposes, on the basis of the principle of "growth for payment", that rules should be laid down providing for the sharing of risks between creditors and debtors and a ceiling should be established on net transfers by the debtor countries, to ensure a certain minimum level of growth of the product in those countries. This procedure would enable economies to be safeguarded from the effects of drastic variations in their terms of trade, sudden drops in the value of their exports, and/or difficulties in gaining access to markets because of unforeseen protectionist barriers.15/

The Peruvian solution consists of defining a criterion of payment capacity as a percentage of exports. In the specific case of Peru this percentage was fixed at 10%, with payments to institutions which provide the country with net additional financing over and above the payment commitments being excluded from this limit.

There are two other types of proposals which fit into this same general category: those which propose the changing of securities in respect of the debt into securities on productive capital, and those which propose the conversion of part of the external debt into local currency. The first of these consist of the conversion of the debt into shares and other securities on the capital of the enterprises of the debtor country, so that the interest payments would be transformed into remittances of profits linked exclusively to the real profits of the enterprises, while the payments of principal would disappear as such and would be converted into remittances of capital. In view of the magnitudes involved, the relatively widespread application of this type of proposal would mean a substantial change in the structure of ownership in the debtor countries. The conversion of part of the debt into local currency could have similar effects, and it could also tend to accentuate pressures tending to cause a deficit on the trade account of the balance of payments, since the local currency would probably be directed towards the acquisition of capital securities and internationally tradeable goods.

2. Reduction of the principal of the debt

Various solutions have been put forward, based on the reduction of the total amount of the principal of the debt, which would have the effect of reducing the burden of servicing it even if interest rates were not adjusted. The analytical basis for the proposals for reducing the principal lies in the fact that the longer the delay in the recovery of the terms of trade and the reduction of interest rates, the more the problem of the payment of the debt becomes one of "solvency" rather than "liquidity"; in accordance with the principle of co-responsibility in the generation of the debt, the external creditors should thus bear some part of the corresponding loss of capital.

The proposals put forward include the partial or total conversion of the outstanding external debt into other financial or real assets, through market mechanisms, multilateral public action, or unilateral action. Such conversion would be effected at a value below the nominal value of the debt.

One formula which has been put forward is that of promoting the establishment of a secondary market where the banks could trade their debt securities. This method was widely used during the Great Depression of the 1930s in connection with transactions of bonds, which made up the major part of the debt at that time. At

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present, this method has been applied above all in the case of the smaller creditor banks, and it would represent a relief for the debtor countries only if they themselves recovered their debt paper at values below those of the market.

Another series of proposals suggests the transfer of bank securities to a multilateral agency which would change them for bonds with a longer term and a lower value than the present securities.

3. Reduction of interest rates

Under the present banking rules, the proposals based on the direct reduction of the principal of the debt would have an immediate impact on the solidity of the creditor institutions. This was one of the results, for example, of what happened during the Great Depression of the 1930s. The proposals providing for a reduction in interest rates are financially equivalent to those involving the reduction of the principal, but their effect on the creditor institutions can be spread over a long period of time, inasmuch as these institutions are not obliged by the existing rules to reflect the entire effect of a drop in the capital value of their outstanding accounts.

There is one type of proposal which, although limited in scope, would make it possible to reduce the interest rates charged to debtors without negatively affecting creditors. This type of proposal is based on the granting of a multilateral official guarantee in respect of the external debt: a guarantee which would permit the banks to reduce the interest charged in return for the greater security of their portfolio thus achieved.

Other proposals aim more directly at a reduction of interest rates even though this would affect the creditor institutions. They provide for the application to the external debt of mechanisms similar to those applied when a creditor bank has to negotiate with a debtor enterprise which is having difficulties in paying.

A third type of proposal is connected with the establishment of a special financing facility, or the expansion of some existing facility, which would finance increases in interest rates when these exceed their historical levels but would provide this financing at a lower rate than that of the market. Thus, as the debtor countries could cover the payment of their high interest rates with cheaper funds, the burden of the debt would in effect be reduced.

A similar mechanism is that providing for the automatic capitalization of interest when this rises above certain ceiling rates. This capitalization, too, would lighten the debt burden provided that the capitalized interest did not in turn generate interest commitments at the market rate. If it did, it would merely be a way of postponing the problem, although it would still make it possible to share the financial burden of the postponement of payment more equitably among the creditors and would avoid repeated negotiations. Proposals for the capitalization of interest may experience difficulties in the United States on the grounds of running counter to the prevailing rules in that country, but not in a number of European countries, where this is a relatively frequent mechanism.

/The capitalization

The capitalization of interest is equivalent to the use of instruments of variable term, which are used in various countries for mortgage loans. Through these instruments, it is possible to use variable interest rates while maintaining a constant level of servicing payments by varying the number of units of time over which the debt service must be paid. If interest rates rise, the interest commitments of the debtor rise also, but the increase is offset by smaller payments of principal, with the difference being transferred to the future. Thus, the higher interest payments are absorbed through the slower payment of principal, whereas a fall in interest rates accelerates the rate of payment of the principal. This type of instrument is only of very limited application in the case of restructuring of the existing external debt. Such restructuring normally leaves very little room to use the principal as a buffer mechanism, since all the maturities are reprogrammed into the future. It might be attractive, however, for future new loans on different terms from the loans existing at present.

The formulas providing for the capitalization of interest when interest rates exceed their historic averages have an additional advantage: like the financing facilities set up for this purpose, they help to reduce the impact for the debtor countries of changes in international interest rates. As these changes have become a source of very serious external impacts for the debtor countries, the desirability of introducing some buffering elements into the international economic system is clear. If this were done, it would maintain reasonable freedom of economic policy for the industrial countries, while avoiding this having a negative effect on the developing countries.

C. THE BAKER PLAN

At the meeting of Governors of the International Monetary Fund and the World Bank, held in Seoul, Korea, in October 1985, Mr. James Baker, the Secretary of the Treasury of the United States, put forward a proposed solution for the debt problem of a group of countries, consisting of seeking ways of achieving an additional expansion of about 3% per year in the total debt during three years. The financing would come from the international commercial banking system and the multilateral development banks, in return for increased conditionality governing the use of these resources by the debtors. As the prevailing rates of inflation are over 3%, the Baker Plan would make it necessary to reduce the real level of the debt and would only finance about one-third of the interest that the debtor countries have to pay at present. The rest would have to be covered through a favourable trade account balance, which would mean a sustained transfer of real resources from the debtor to the creditor countries.

/This plan

This plan also involves the extension of still undefined macroeconomic conditionality to all sources of financial resources, which might generate serious difficulties in the use of those resources and give rise to high risks due to the possibility of errors in defining the terms of the conditionality.

Nevertheless, this proposal constitutes the first important new development in the handling of the debt on the part of the creditor countries, and it recognizes the need for conscious action on the part of the governments of the creditor countries in order to seek a solution to the debt problem within the context of economic growth in the debtor countries.

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V. THE CARTAGENA CONSENSUS

A group of 11 Latin American countries, including all the main debtors of the region, has begun to carry out a joint exploration of the external debt problem and to seek certain common bases for a solution which, as far as possible, does not involve any disturbance of normal financial markets. These countries (Argentina, Bolivia, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Mexico, Peru, Uruguay and Venezuela) meet regularly, both at the technical level and at the level of foreign ministers and ministers responsible for economic policy, with the support of a temporary secretariat, to seek common positions and paths for dialogue with the creditor countries and institutions. The position of this group of countries has been evolving gradually towards increasingly specific proposals aimed at reconciling economic growth objectives and the transfers of real and financial resources.

The member countries of the Consensus have put forward an emergency proposal for the negotiations on indebtedness and growth which provides in particular for the return of interest rates to their historical levels, an increase in the flows of funds, and differential treatment of the current and future debt with the object of making the latter subject to market conditions, whereas the former would be subject to preferential conditions from the debtor's point of view. As a criterion it is proposed that the real levels of credit provided by the commercial banking system should be maintained, while there should be a net annual increase of 20% in the resources channelled to the region by the multilateral development agencies. It is also suggested that the Compensatory Financing Facility of the International Monetary Fund should be expanded to cover the impact of exogenous factors such as the deterioration of the terms of trade and the continued prevalence of high interest rates. The Consensus countries stress the need to avoid conditionality provisions which make it an obligation to adjust the economy in the conditions of external imbalance prevailing at present. At the same time, the close relationship between financing and trade is pointed out, as well as the need to put an end to protectionist measures which impede the access of debtor countries to the main world markets. The proposal also refers to the need to lay down a ceiling for net transfers of resources linked with a minimum target of growth of the product, and it includes the possibility of setting limits on debt servicing as a function of export income. Finally, the proposal declares that unless the proposed set of measures is adopted the region could be faced with an extremely serious situation which would leave it no option but to limit its net transfers of resources in order to avoid greater social and political instability which could reverse the processes of consolidation of democracy.16/

VI. CONCLUSIONS

The external debt of the countries of the region has grown both for external reasons (rapid expansion of private financial markets, low international interest rates) and as a result of domestic economic policies. The external debt became a major problem as from 1981 and entered into crisis in 1982 because of the sharp increase in international interest rates, the paralyzation of world growth, and the severe deterioration in the terms of trade. Consequently, responsibility for the debt problem must be shared both by the debtor countries and the creditor countries and institutions and the multilateral agencies.

In considering possible solutions for the problem, a decisive factor is the view taken of the prospects for the world economy and its effects on the debtor countries. The possible solutions can be classified in two main groups: the "natural" or "spontaneous" solutions, and those which involve the need to take direct action to lighten the debt service burden.

Dynamic growth of the world economy which succeeded in increasing trade, reducing protectionism, rapidly improving the terms of trade and reducing international interest rates would make it reasonable to adopt measures whose main aim is to put off the problem and gain time until it solves itself. A scenario of this type justifies measures designed to improve the liquidity of debtors by postponing payments of principal and refinancing or capitalizing at market interest rates a significant proportion of the interest commitments.

If, in contrast, it is feared that growth of the world economy will be slow for a number of years, then measures designed to gain time would not only be insufficient but would also be counterproductive, since they would only help to aggravate the underlying problem. In the light of recent experience, and taking into account the projections made in respect of the world economy by the main international agencies, the scenario forecasting feeble world economic activity clearly seems to be the most probable. Consequently, the search for solutions to the debt problem should be centered on those which lighten the burden for the debtor.

Recent experience has also made clear the need to introduce into the international monetary system certain stabilizing elements which can reduce the negative impact on the developing countries of the economic policies adopted by the industrial countries. In this field, the expansion of the IMF Compensatory Financing Facility seems an appropriate proposal, although it will undoubtedly be of limited magnitude. This measure could be supplemented by others of a transitory nature, including the automatic capitalization of interest commitments when market interest rates exceed their average real historical levels.

It could also happen that the situation of the world economy is not such as to permit a clear choice between options. In such a case, it would be in the interest of the debtor countries to promote those solutions which seem to come closest to ensuring a rapid way out of the problem while maintaining the normal functioning of the international financial system. In view of this, the simultaneous application of various proposals, including the acceptance of certain losses by creditors, the lightening of the burden of interest payments, the provision of additional financing

/and the

and the limited conversion of the debt into capital might well form a co-ordinated set of measures capable of securing the objective. The introduction of machinery to stabilize the world economy is also highly to be recommended in this case.

Whatever the solutions finally adopted, their political feasibility will be related to the degree of sacrifice they impose on debtors and creditors. The former have made a great adjustment effort in the last few years which has been partially wiped out by the persistent deterioration in international conditions. It is in the interest of all the parties involved in the problem to seek a better distribution of the burden to permit substantially more rapid growth rates for the debtor countries. Without growth, there is no hope whatever that the debtors will be able to fulfil their external commitments normally. Growth would strengthen the debtor nations, and by the same token it would cause the creditors' portfolio of international financial assets to recover their value.

The vulnerability of the countries of the region to external impacts, accentuated by the rapid growth of the debt in the period 1970/1981, has highlighted the need to seek ways --both at the international and the domestic levels-- to cushion the shock of such events.

The action taken in this direction must include additional efforts to increase national saving and to retain it in the region, and to ensure the most efficient possible use of the available resources.

/Notes

Notes

1/ Massad, Carlos, Movimientos de capitales en América Latina, Segunda Conferencia sobre América Latina y la economía mundial. Instituto Torcuato Di Tella, Buenos Aires, Argentina, August 1980.

2/ Domestic interest rates will reflect both inflation and the planned devaluation.

3/ To the extent that the demand for non-tradeables is in local currency, part of the foreign currency resources deriving from the external indebtedness will be converted into local currency, thus increasing the international reserves.

4/ Massad, Carlos and Roberto Zahler, Two studies on indebtedness, "Cuadernos de la CEPAL" series, No. 19, Santiago, Chile, October 1977; C. Massad, "The real cost of the external debt for the creditor and for the debtor", CEPAL Review, No. 19 (Sales No.: E.83.II.G.3), Santiago, Chile, April 1983.

5/ See Zahler, Roberto and Mario Valdivia, Asimetrías de la liberalización financiera y el problema de las deudas interna y externa, mimeo, ECLAC/UNDP project RLA/77/021, October 1985.

6/ Mohl, A. and D. Sobol, "Currency Diversification and LDC Debt", Federal Reserve Bank of New York Quarterly Review, 1983, third quarter, Vol. 8, No. 3.

7/ See for example Guy Pfefferman, Long-Term Dynamics of Latin American Economies, document presented at the conference on "Adjustment to impacts: a North-South perspective", University of Bergamo, Milan, Italy, 21-24 November 1984.

8/ For a detailed analysis of the way in which these two sets of policies contribute to the adjustment process, the avoidable and unavoidable costs of this process and its relations with external financing and inflation, see ECLAC, Adjustment policies and renegotiation of the external debt, E/CEPAL/G.1299, Santiago, Chile, 1984, pp. 80-91.

9/ See in this respect Richard Lynn Ground, "Orthodox adjustment programmes in Latin America: a critical look at the policies of the International Monetary Fund", CEPAL Review, No. 23 (Sales No.: E.84.II.G.4), August 1984, pp. 45-82.

10/ See ECLAC, Crisis and development: the present situation and future prospects of Latin America and the Caribbean, Volume II, LC/L.332(Sem.22/2)Add.1, 24 April 1985, tables 5 and 6.

11/ The scenarios cover 19 countries except in the case of the financial projections, which only cover 18 countries, since Panama was excluded because it is a financial centre.

12/ See also Economic development: an appraisal and projections 1985-1995, LC/L.367(CEG.11/13), chapter II.

13/ See the ECLAC press release (No. 424/425) Preliminary overview of the Latin American Economy, 1985 (December only).

14/ See C. Massad, "Debt: An Overview" in C. Massad (Ed.), "The Debt Problem: Acute and Chronic Aspects" in Journal of Development Planning, No. 16, United Nations publication ST/ESA/54 (Sales No.: E.85.II.A.12), 1985, pp. 1-22.

15/ Oaxtepec Communiqué, Eficiencia en el manejo de la deuda externa en América Latina, Oaxtepec, Mexico, D.F., July 1985.

16/ Cartagena Consensus, "Declaración de Montevideo", Montevideo, Uruguay, December 1985.