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Latin America and the new finance and trade flows

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This article explores Latin America's prospects with regard to international finance and trade in the 1990s. It is concluded that the external environment will probably be unfavourable, although there will be some opportunities for supporting the region's structural adjustment processes.

The external financing prospects of most of the countries of the region are bleak, as they are still suffering from over-indebtedness, and the main financial flows will come initially from the reduction in the current value of the existing debt through concerted or unilateral actions. Nevertheless, the countries of the region can take advantage of certain limited credit and investment mechanisms ("niche financing") which will give them access to foreign capital in spite of their current over-indebtedness. The few countries which have begun to emerge from this latter situation will have a chance to re-enter the international capital markets.

As the access to external finance will probably be severely restricted, export promotion and the search for a better form of insertion in world trade will be indispensable elements in the economic policy of the 1990s. In view of recent world trade trends, a policy aimed at greater openness could be insufficient to improve this insertion on a stable basis, and it will be necessary to follow two additional lines of action: firstly, to strengthen Latin America's bargaining power with the other countries and regions, especially in view of the growing emergence of regional blocs, and secondly, to apply an active industrial policy aimed at incorporating technical progress and raising the skill level of the labour force in order to achieve the authentic competitiveness which will make it possible to increase the region's share in world trade and simultaneously raise the living standards of the population.

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Introduction**

The 1980s was a period of severe crisis for Latin America. Because of its extraordinary breadth, this crisis gave rise to challenges on many fronts at the same time. On the one hand, it gave rise to a tremendous financial crisis which made it necessary to engage in five rounds of external debt renegotiations with creditors and was reflected in the precarious state of the public sector accounts.[1] Furthermore, the serious economic crisis which then hit the region highlighted the need to rethink the development strategy which had prevailed since the 1930s. Consequently, there is now a generalized awareness of the need to effect thorough-going changes in the economies so that they can be modernized and become more competitive on the international level. The high cost of the economic crisis, together with the exclusive economic policies inherited from the past, also sparked off a serious social crisis.[2] Finally, the region also had to face up to a political crisis resulting from the authoritarian systems of the 1970s which are giving way in almost all the countries to a fragile and shaky transition to democracy.

The crisis affected so many aspects of national life that it has been extremely difficult to deal with. In the 1980s, there was deterioration in many areas, but also some progress. Nevertheless, the economic, political and social changes still needed continue to be of enormous magnitude and represent the real challenges of the 1990s. One of the most important conditioning factors of these changes, both in the area of commerce and finance, will be the external sector.

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[1] For a detailed account of the crisis and the rounds of renegotiations with creditors, see ECLAC, 1984, 1988, 1989c and 1990d.

[2] For an analysis of the economic crisis, with proposals for achieving a change in the production patterns of the region, see ECLAC, 1990e.

This article contains some reflections on the external environment which the Latin American countries will probably have to face in the 1990s with regard to finance and trade, and it suggests some ways of taking advantage of the opportunities which may present themselves.

I
External finance

The prospects for securing finance in the 1990s are, generally speaking, gloomy. On the one hand, it is probable that Latin America's access to private international capital markets will remain relatively restricted on account of the crisis in the region and the persistent problems of the debt overhang. On the other hand, finance from bilateral and multilateral public agencies (which are generally not so strictly governed by private risk criteria) could be restricted by various factors: firstly, the serious fiscal constraints of the creditor countries are already giving rise to resistance to the granting of new development finance resources; secondly, the possibility that the new political priorities of certain industrialized countries may end up by diverting official resources from Latin America to Eastern Europe cannot be ruled out, and finally, there is a growing tendency to make the disbursement of official loans subject to conditions which the recipient countries frequently find difficult and burdensome. Consequently, it may reasonably be expected that the changes needed in the region in the 1990s will have to be carried out within the context of serious external finance constraints. Nevertheless, even in this context there are still opportunities for the Latin American countries to obtain larger amounts of finance in these years, and indeed, some countries of the region may already be on the threshold of a return to international financial markets.

1. *Reducing the debt and its service*

Since 1982, Latin America has made net transfers of resources to its foreign creditors amounting to almost US$ 20 billion per year (table 1). This massive transfer (equivalent to 3% of the gross domestic product of the region) represents an extraordinary drain on resources which seriously weakens Latin America's process of change. Consequently, as far as external finance is concerned, the first priority for many countries in the 1990s will be to reduce, or if possible eliminate, this negative resource transfer.[3] In theory, there are two options for this purpose: the disbursement of new loans, or a reduction in the debt and its service. For most of the countries of the region, it is probably the latter option which offers the best possibilities for the coming years.

a) *Incentives for seeking a reduction of indebtedness*

Many Latin American countries are over-indebted, a fact which is recognized by the capital markets and is reflected in the big discounts at which the bank debt of these countries is traded on secondary markets (table 2). Without any doubt, the existence of an obvious state of over-indebtedness reduces the willingness of creditors to grant new credits.

The majority of creditor banks consider that they are over-exposed in Latin America, and it is only logical that they should therefore seek to reduce their commitments in countries whose economic situation is seen as being difficult. Furthermore, the United States, Japanese and British banks are in an extremely delicate financial situation because of the new requirements of the Basle Committee regarding minimum levels of capital and the large number of loans of dubious value which these banks have given to clients in their respective domestic markets (*Financial Times*, 1990a, b and c and *The Economist*, 1990).

One of the few reasons why a bank might

[3] For fuller information on the negative effects of the outward resource transfer on the future performance of the Latin American economies, see ECLAC/SELA, 1989.

Table 1
LATIN AMERICA: NET CREDIT FLOWS[a]
(Millions of dollars)

	1970-1973	1974-1979	1980-1982	1983-1987[b]
Latin America	6 506	15 108	13 081	(19 819)
Oil-exporting countries	2 253	7 496	6 372	(9 851)
Bolivia	192	286	45	(123)
Ecuador	76	423	213	(167)
Mexico	1 306	3 397	4 834	(6 583)
Peru	250	658	(291)	33
Venezuela	429	2 732	1 571	(3 011)
Non-oil-exporting countries	4 253	7 612	6 709	(9 968)
Argentina	(380)	447	2 927	(3 309)
Brazil	3 856	5 335	(506)	(5 904)
Colombia	302	231	986	22
Costa Rica	78	243	118	(146)
Chile	128	349	1 331	(872)
El Salvador	61	145	193	(7)
Guatemala	46	168	240	(105)
Haiti	2	49	51	22
Honduras	72	172	117	51
Nicaragua	99	193	424	479
Paraguay	25	111	208	127
Dominican Republic	(11)	138	171	(199)
Uruguay	(25)	31	449	(127)

Source: ECLAC, Economic Development Division.
[a] Net flows of short- and medium-terms loans, less interest.
[b] Parentheses indicate a negative figure.

consider authorizing a fresh loan without any special guarantee would be to avoid default and the consequent losses that it would suffer due to the suspension of interest payments on the existing debt. This type of "involuntary" loan represents an effort by the banks to rescue the value of their existing loan portfolio. From another viewpoint, such an involuntary loan is equivalent to a disguised rescheduling of all or part of the interest payments due on the existing debt.[4] Although the private banking system granted a significant number of involuntary loans in the 1980s, during the various rounds of rescheduling the Latin American debt, the frequency and size of these loans gradually diminished during the decade as the heavy accumulation of loan-loss reserves effected by the international banking system increased its capacity to absorb debt service arrears (table 3). Today, even the biggest debtors —whose payment or default still has an impact on the balance sheets of the banks— face serious difficulties in obtaining new loans (ECLAC, 1989a). Indeed, the small amount of fresh finance obtained by the debtor countries on the bank market indicates that most of the banks, rather than authorizing new loans, prefer to admit to losses through the debt reduction options under the Brady Plan.

With regard to new or potential creditors, they can easily see when a country is over-indebted, and it is only natural that in such a case they do not want to get involved in the problem. These lenders will be reluctant to provide lines of credit unless they can find a special "niche" which gives them preferential access to the scarce foreign exchange resources of the country.

[4] For an analysis of the reprogramming of the debt and the role of involuntary loans, see Devlin, 1989, chapter 5.

Table 2
LATIN AMERICA AND THE CARIBBEAN: SECONDARY MARKET PRICES OF EXTERNAL DEBT PAPER
(As a percentage of the nominal value)

	1986			1987			1988			1989			1990		
	January	June	December	January	June	December	January	June	December	January	June	December	January	June	October
Argentina	62	65	66	64	52	35	32	25	21	20	13	13	12	13	13.5
Bolivia	---	6	7	8	9	11	11	11	10	10	11	11	11	---	---
Brazil	75	74	74	72	62	46	46	51	41	37	31	22	25	24	22.8
Colombia	82	81	86	86	85	65	65	65	57	56	57	64	60	64	63.5
Costa Rica	---	48	35	35	36	15	15	11	12	13	14	17	18	---	---
Chile	65	67	67	68	70	61	61	60	56	60	61	59	62	65	74.5
Ecuador	68	64	65	65	50	37	35	27	13	13	12	14	14	16	18.1
Guatemala	---	52	60	61	67	77	57	---	---	---	---	---	---	---	
Honduras	---	40	40	40	39	22	22	22	22	22	17	20	21	---	---
Jamaica	---	45	45	45	38	33	33	38	40	40	41	40	40	44	---
Mexico	69	59	56	57	57	51	50	51	43	40	40	36	37	45	42.7
Nicaragua	---	4	4	4	5	4	4	2	2	2	1	1	1	---	---
Panama	---	69	68	68	67	39	39	24	21	19	10	12	19	12	10.8
Peru	25	20	18	18	14	7	7	6	5	5	3	6	6	4	3.3
Dominican Republic	---	45	45	45	45	23	23	20	22	22	22	13	13	17	---
Uruguay	---	63	66	68	74	60	59	60	60	60	57	50	50	49	51.5
Venezuela	80	76	74	75	71	58	55	55	41	38	37	34	35	46	---
Average[a]	---	64.6	64.2	63.7	58.5	46.5	45.1	45.4	37.7	35.2	31.9	28.0	29.5	33.3	33.2

Source: United Nations Department of International Economic and Social Affairs, on the basis of offer prices compiled by Solomon Brothers, High Yield Department.
[a] Weighted by the amount of bank debt.

Table 3
INTERNATIONAL BANKS:
ESTIMATED LOAN LOSS RESERVES ON THEIR LOANS TO DEVELOPING COUNTRIES, AS A PERCENTAGE OF TOTAL EXPOSURE IN THOSE COUNTRIES[a]
(Percentages)

France	41-52
(BNP)	(52)
(Crédit Lyonnais)	(46)[b]
(Société Générale)	(53)
(Banque Paribas)	(41)[b]
Germany	50-80
(Deutsche Bank)	(77)
(Dresdner)	(50)
Switzerland	80[c]
United Kingdom	45-72
(Midland Bank)	(58)
(Barclays)	(48)
(Lloyds Bank)	(72)
(Standard Chartered)	(46)
(National Westminster)	(65)
Canada	45-70
(Royal Bank of Canada)	(70)
(Canadian Imperial)	(45)[d]
(Bank of Montreal)	(41)[d]
(Bank of Nova Scotia)	(45)[d]
Japan[e]	15
United States[f]	
Money centre banks	30-70
(Citicorp)	(30)
(Bank of America)	(32)
(Manufacturers Hanover)	(29)
(Chase Manhattan)	(39)
(Chemical Bank)	(33)
(Bankers Trust)	(70)
(J.P. Morgan)	(64)
(First Chicago)	(53)
(Bank of New York)	(-)
Super Regionals	30-75
(Security Pacific)	(30)
(Bank of Boston)	(75)

Source: ECLAC (1990a), p. 46.

[a] November 1989.
[b] December 1988.
[c] September 1989.
[d] June 1989.
[e] Uniform for all Japanese banks. The Ministry of Finance of Japan has issued a guideline of a 25% reserve by March 1990.
[f] December 1989.

Thus, in view of the serious over-indebtedness affecting most of the Latin American countries, it may be assumed that the flow of new credits will be very small, especially in the case of those coming from the private credit markets. Moreover, the recovery of general access to credit without special guarantees is by its very nature a slow process and can only begin when the financial circles perceive that the debt overhang has been overcome. In such circumstances, the over-indebted countries can maximize the discounted present value of the future flow of credit through formulas for the reduction of the existing debt and debt service.

Countries which do not have problems of over-indebtedness may also have good reasons for seeking a reduction in their debt. If the capital markets were efficient, it would not be in the interests of creditworthy countries to reduce their debt, as this would have a high opportunity cost: the discounted present value of the saving on debt service achieved through the mechanisms for the reduction of external commitments could well be less than the present value of the future flow of foreign capital lost through the negative reaction of creditors to a drop in the value of the financial assets involved.

However, the capital markets to which Latin America has access are apparently not so efficient, and this is reflected in the difficulty creditors have experienced in discriminating between the different countries of the region from the point of view of their creditworthiness. Thus, even clearly creditworthy Latin American countries such as Colombia have encountered tremendous resistance to their requests for fresh credits.[5] Apparently, many creditors make the mistake of seeing every country in the region —even if it is creditworthy— as just one more economy in a region in crisis. Because of this failure in the market's risk evaluation mechanisms, the creditworthy countries become victims of the negative externalities generated by the systemic financial crisis suffered by the region; in these circumstances, they could be led to behave as though they were insolvent too and request a

[5] This situation, which is linked with the negative externalities that tend to occur in systemic financial crises, was also observed in Latin America during the Great Depression of the 1930s. See ECLAC, 1965, chapters 1 and 2.

reduction in their debt. It would appear that investors are incorporating this perverse phenomenon in their calculations of the value of the debt, since even the bank loans of the apparently creditworthy Latin American countries are circulating at big discounts in secondary markets.

b) *Consensual debt reduction formulas*

As already noted, the capital markets are apparently not well placed to grant fresh finance to the region on a global basis.[6] The problem of overindebtedness which is largely behind this situation is systemic in both its origins and in the solutions needed for it: the overexpansion of external commitments arose from the interaction of the policies of the debtor countries, the private banks and the industrialized countries (ECLAC, 1990a). Ultimately, it was the market, and not a particular banker or borrower, which went wrong in a particular institutional context. Moreover, the overindebtedness not only adversely affects the relations between the debtors and the banks involved but also hinders the activities of economic agents who are not financially overextended: hence, the social or public nature of the problem calls for public action to share the costs of a solution among debtors, creditors and, if necessary, the international public sector in general.

Although the systemic nature of the problem was visible from the beginning of the crisis,[7] in its first years it was treated in official circles as exclusively a private matter which should be solved between creditors and debtors, with the least possible participation of the international public sector. Even when it became evident that the credit market had collapsed around Latin America, heavy emphasis continued to be placed on the need to respect private market criteria, ostensibly in order to restore the access of the debtor countries to fresh loans. Indeed, the possibility of obtaining fresh finance was usually used to justify the design of strategies whose aim was almost exclusively to avoid losses for the private banking system (Devlin, 1989, chapter 5). The other side of the coin was a massive net transfer of resources from the debtor to the creditor countries.

The truth is that in view of the systemic nature of the debt overhang problem, a reduction in the debt or its service should have been sought at the beginning of the crisis. This approach, which is quite widely used to solve a systemic problem in the domestic credit markets of the industrialized countries,[8] is the only way of promoting an efficient adjustment for all the parties in the system and thus equitably sharing the costs of a solution. Unfortunately, it was only in 1989, with the appearance of the Brady Plan, that this broader public approach gained currency as a response to the problem of the Latin American debt overhang.

i) *The Brady Plan.* While it is true that incentives for reducing the debt have existed for many years, thanks to the Brady Plan the debtor countries can now in principle pursue a debt reduction policy with the full support of the international community. The new plan earmarks financial and institutional resources of the international public sector for the process of reducing the bank debt. Four debt reduction agreements have already been finalized (for Mexico, the Philippines, Costa Rica and Venezuela), financed with a total of over US$8 billion in loans from the World Bank, the International Monetary Fund and various individual governments (especially Japan).[9] In addition, Uruguay and Morocco have signed agreements in principle with their creditor banks.

The existence of the Brady Plan gives the Latin American countries a chance to reduce their debt service payments (and the negative resource transfer) on a consensual and nonconflictive basis. Undoubtedly, in the 1990s more countries in the region will seriously explore the new opportunities available in this field. At the same time, however, it should be noted that the Brady Plan presents some serious problems which could cause difficulties for the debtor countries.

The Brady Plan is basically a voluntary

[6] However, there are opportunities for fresh finance which are examined below.

[7] ECLAC recognized this from the beginning: see ECLAC, 1982.

[8] As in the case of the rescue measures in favour of the Chrysler Corporation and the City of New York, for example. See ECLAC, 1990a, table 4.

[9] For details of the way the Brady Plan operates, see ECLAC, 1990a.

scheme whereby the private bank debt is repurchased, directly or indirectly, at a discount.[10] The amount of reduction of the debt is thus closely conditioned by the price at which the debt is traded on the secondary market and by the finance available for carrying out the repurchase. The agreements reached so far under the Brady Plan have been the subject of intense debate, since a significant number of analysts consider that the net debt reductions thus achieved, and the effect that these will have on the foreign exchange flow, will be really quite limited. There are three main reasons why these results may be unsatisfactory: firstly, an insufficient supply of public finance to carry out the bank debt repurchase operations; secondly, insufficient coordination of the banks by the public agencies, thus permitting the banks to evade options that would effectively reduce the debt to levels that could be reasonably serviced, and thirdly, the absence of specific measures for tackling the problem of serving the official debt, which represents a heavy burden in many countries.

In view of these three serious shortcomings, it is possible that the Brady Plan will not serve to eliminate the debt overhang problem completely, so that many Latin American countries may only achieve a partial reduction of their excessive external commitments. Unfortunately, such a partial debt reduction scheme could ultimately bring more problems than solutions.[11]

The benefits of the debt reduction are transmitted to the debtor country through two main channels: on the one hand, the cash flow improvement regarding foreign exchange and the fiscal accounts due to the reduction in the debt service; and on the other hand, the reduction in the private sector risk premium. There is thus, in principle, a greater possibility of achieving an effective structural adjustment and servicing the debt.

If the debt reduction operation does not clearly eliminate the overindebtedness, however, its benefits for the debtor country would seem to be rather ambiguous. Firstly, the cash flow effect will only be small compared with the finance needed to support a socially efficient adjustment, that is to say, one that also permits growth. Furthermore, it is well known that the partial repurchase of the excess debt may turn out to be a bad deal for the debtor country, since the marginal value of the debt thus retired may be less than the price paid for it.[12] Secondly, the unconditional defenders of the Brady Plan usually implicitly assume that there is a direct and continuous relationship between the debt reduction and the reduction in the private sector risk premium: thus, for example, a 30% reduction in overindebtedness would bring about a similar decline in the adverse expectations of investors. If we take into account the existence of barriers to information, the entrenched adverse expectations after eight years of crisis, and the interdependence of investors in regard to the taking of decisions, however, the most likely outcome is that in practice this relationship will not function in this way. This means that the reduction in the debt must pass a certain critical threshold before it brings about a significant decline in the medium-term private sector risk premium.

Thus, in the event that the Brady Plan only permits a partial reduction in the debt overhang, its benefits will generally speaking be ambiguous. For this reason, the participation of the debtor

[10] In a voluntary debt reduction scheme, the conversion of the debt into bonds sold at a discount, as illustrated by the agreement signed by Mexico, is an "indirect" debt repurchase operation. For an analysis of the equivalence between direct repurchase and conversion into bonds, see Dooley, 1988, pp. 714-722.

[11] ECLAC has estimated that with the present level of public financing (US$ 30 to US$ 35 billion) the Brady Plan could reduce the net indebtedness of the region by only between 13% and 15%. See ECLAC, 1990a, pp. 107-108.

[12] When the probability that a Latin American country will pay its debts is uncertain, the discount registered on that country's debt in the secondary markets will reflect this uncertainty. Let us assume that in an optimistic scenario the country can pay 100% of the debt, whereas in a pessimistic one it can only pay 25%. Let us also suppose that there is a one in four probability that it will comply with the optimistic scenario and a three in four probability that it will act according to the pessimistic one. In this case, the price of US$ 1 of debt on the secondary market will be 44 US cents, that is to say, the weighted average of the two scenarios. In the repurchase operation, the country will pay at least 44 US cents per dollar of debt, even though the marginal value of one rescued dollar for the debtor will only be 25 US cents, because of the low probability (25%) that the country will honour all its debt service commitments. Only if the overindebtedness problem is definitively eliminated can this dilemma be overcome. For a more detailed analysis of this problem, see Bülow and Rogoff, pp. 675-704.

countries in the plan could simply be an act of faith. This conclusion has real repercussions for the Latin American countries, since the Brady Plan urges debtors to use part of their scarce international reserves, the balance-of-payments support loans from the World Bank and the International Monetary Fund and the receipts from bilateral aid to finance the debt reduction operations. From the point of view of the alternative use that could be made of scarce foreign exchange resources, however, it is possible that the direct allocation of such resources to their original purpose (that is to say, balance-of-payments financing and investment projects) would give a greater yield than the ambiguous benefits provided by the partial reduction of the debt overhang.

Another drawback in a partial reduction of the debt overhang emerges when there is conversion of existing commitments into bonds, as an instrument for the repurchase of the debt on the secondary market. In this situation, regardless of the size of the discount, the debtor country could end up facing still greater rigidity in its future debt management. This is because bonds (unlike loans) are difficult to reschedule and to subject to the previously mentioned policy of involuntary loans. Thus, when the discount is not enough to eliminate the excess external liabilities, there is an even greater chance that subsequent payment problems will be solved through a formal default. Since bond holders are traditionally ill-disposed to put up with such default, the delinquent debtor country could eventually find itself swamped with lawsuits brought by discontented creditors.

These difficulties show that the Brady Plan —after having created expectations that it would offer a consensual mechanism for putting an end to the debt overhang problem in Latin America— will not necessarily be a panacea for the problem of the negative resource transfer. Furthermore, the Plan creates fresh dilemmas for the debtor countries (with regard to the best way of using their scarce official loans) and for the multilateral agencies, which are now under pressure to extend their loans to activities with a dubious return. In contrast, the banks have better prospects of ending up in a relatively more favourable position, since if they wish they can sell off their loans en masse and thus exit from the problems of Latin America.

In order to overcome these difficulties and increase its efficiency as a debt reduction vehicle and economic reactivation instrument, the Brady Plan would need, *inter alia*, to do the following: firstly, to treble to around US$ 90 billion the public resources available for financing the repurchase of bank paper on the secondary market;[13] secondly, to strengthen the International Monetary Fund's capacity to give official approval to the build-up of arrears by countries whose processes of adjustment (with growth) are being hindered by lack of co-operation from the private banks on debt reduction, and thirdly, to permit a sharp reduction in bilateral debt, together with the creation of new mechanisms to relieve the burden of multilateral obligations.[14]

These and other reforms could improve the efficiency of the Brady Plan and make its benefits clearer to the debtor countries. Unfortunately, the prospects for the Plan being strengthened in this way are not very bright. Faced as they are with their own fiscal imbalances, the governments of most of the creditor countries have shown themselves to be reluctant to finance large-scale international initiatives. Likewise, the possibility of creditor governments and multilateral finance agencies putting strong and sustained official pressure on the banks depends on a complicated set of interests and political forces which are indeed very difficult to control.

Consequently, in this early part of the 1990s the road towards a concerted and effective solution to the debt overhang problem still seems to be full of obstacles, and the Latin American countries will have to travel along that road with the greatest caution, since in some circumstances the

[13] With regard to the objective of rapidly eliminating the debt overhang, the alternative to more public financing for debt reduction would be an official scheme based on full coercion: for example, new legislation in the creditor countries obliging the commercial banks to adjust the debt to levels which the debtor countries can service. However, the possibility that such a conflictive scheme will be adopted in countries such as those of the North, where decisions are usually taken by consensus, is even more remote than the introduction of a well financed voluntary scheme.

[14] See these and other proposals for improving the operation of the Brady Plan in ECLAC, 1990a, Chapter IV and Rosenthal, 1990, pp,. 17-20.

Table 4
CONVERSION OF EXTERNAL DEBT TO EQUITY
OR LOCAL CURRENCY
(Millions of dollars)

	1985	1986	1987	1988	1989	1990
Conversion of debt to equity	497	815	3 167	6 198	4 500	8 853
Conversion of debt to local currency	156	438	796	1 639	2 238	1 244

Source: Michael Bouchet, *Transnational banks and external indebtedness of developing countries*, New York, United Nations Centre on Transnational Corporations (CTC), November 1990, *mimeo.*

options offered by the official debt reduction scheme could have undesirable repercussions on their development financing.

ii) *Debt/equity swaps.* For several years now, the conversion of bank debt into equity has been another consensual manner of reducing external liabilities. The total amount of these swaps grew from US$ 500 million in 1985 to US$ 9 billion in 1990 (table 4). The commercial banks have actively promoted such transactions, because they allow them to get out of the debt problem with lower discounts than those being registered in secondary market operations. On the other hand, the debtor countries have often expressed reservations about this form of conversion, mentioning among other aspects the subsidy that this represents for foreign investors, its impact on the money supply and domestic interest rates, and the question of sovereignty.[15]

It is quite true that the adverse effects of debt/equity swaps justify some reservations about the use of this approach as a general mechanism for the reduction of external obligations, but it may nevertheless offer real opportunities if applied selectively in order to achieve well-defined investment aims. For example, there are cases where it may be necessary to give subsidies in order to attract certain kinds of foreign investments; in these circumstances, a debt conversion operation may well be an appropriate channel for giving such a subsidy. Likewise, if it is desired to privatize some public enterprises rapidly, then debt conversion programmes may be effective means for attracting the participation of foreign banks and other investors. The repatriation of flight capital could also be promoted through programmes of this type.

Since the banks tend to take advantage of national debt/equity swap schemes, and since these programmes lead to rises in the price of debt paper on the secondary markets, the initiation of a conversion plan should be conditional upon the prior approval of a global definitive agreement for the reduction of the debt. This would eliminate the *ad hoc* nature of debt/equity swap programmes and make them part of a global solution calling for greater sacrifices from the private banking system.

c) *Unilateral debt reduction formulas*

In view of the shortcomings of the Brady Plan and the uncertain prospects that a true concerted public solution to the debt problem will emerge, unilateral restriction of external debt service commitments cannot be ruled out as a temporary second-best financing measure for the debtor countries. Indeed, the majority of the countries of the region have applied a partial or total restriction of their debt service commitments to commercial banks and other creditors.[16] Thus, for most of the Latin American countries

[15] For an analysis of some of these problems, see Lahera, 1987 and Ffrench-Davis, 1987.

[16] Latin America's arrears, solely in respect of interest payments on the debt, exceeded US$ 18 billion in 1989, and the figure may have reached US$ 25 billion by mid-1990.

the question is not whether they should restrict such payments but only how and for how long.

This is a tricky subject, and the benefits and costs of such a restriction will obviously depend on the specific circumstances of each country. Experience indicates that certain considerations should be taken into account if it is decided to formulate a national strategy in this respect, however.[17]

To begin with, the main motive for embarking on a restriction of payments is the lack of consensual options for dealing with excessive debt service payments and their destabilizing effects. Obviously, servicing an overvalued debt greatly prejudices the execution of programmes of structural change in the Latin American economies. In view of the operational problems of the Brady Plan, mentioned earlier, a unilateral restriction of payments may sometimes be the only way of securing the additional finance needed to support efficient programmes of adjustment and economic change.[18]

Secondly, a payments restriction may be the first step towards the negotiation of a definitive debt reduction agreement. It is worth remembering that it is difficult to negotiate a substantial reduction in the debt when the debtor country is punctually servicing its contractual obligations. Paradoxical though this may seem, this conclusion reflects the fact that the banks always compare any agreement, no matter how modest it may be, with the *status quo*. If the debt is being serviced punctually, then obviously they are going to prefer the *status quo*. In contrast, restricting the debt service indicates the physical incapacity of the debtor to service his debt. In such circumstances, both parties know that time may be on the side of the debtor country, because any stagnation of the negotiations maintains the *status quo* and thus maximizes the debt service relief. In contrast, any formal debt reduction agreement will mean an increase in the service payments compared with the *status quo*, thus improving the situation of the banks even though the formal reduction in the debt may be quite substantial.

Thirdly, the benefits that may be derived from a payments restriction will depend mainly on the way internal factors evolve. In order for the restriction to become an effective source of additional external finance and a basis for a possible definitive debt reduction agreement, the creditors must be made to perceive that this unilateral policy is viable and sustainable. Only then will they have an incentive to begin serious negotiations seeking a real solution for the debt overhang. The stability of the policy adopted with regard to the excessive service commitments on the old debt is also an important factor for minimizing the negative effects of the debt overhang on the behaviour of private investors: in other words, the adoption of clear and stable rules on the way the servicing of the old debt is to be handled may make it easier for new investors to identify "niches" offering them opportunities in the economy of the debtor country.

Still at the domestic level, the efficiency of the payments restriction will depend to a very large extent on the existence of a coherent economic programme aimed at securing effective structural adjustment. The coherence of the economic programme gives the payments restriction legitimacy, since it creates an objective basis for determining the medium and long-term payments capacity of the country, which will serve as a basis for the negotiations with the banks. It also inspires in the national economic agents a certain respect for the decisions of the economic team and generates a perception that the payments restriction forms part of a broader national initiative to improve the performance of the economy, with corresponding opportunities for obtaining profits. It has also been observed that foreign creditors and international agencies have shown some reluctance to level serious threats at a country's payments restriction when it has been applying a respectable economic programme. In contrast, experience has shown that if the restriction is not backed up by a serious and sustainable economic programme, it rapidly loses prestige and may involve very high political and economic costs, possibly ending up being

[17] ECLAC has made some studies on the experience of the countries with regard to payments restrictions. For some preliminary background see ECLAC, 1990a, chapter V, and Altimir and Devlin (in the press).

[18] It is interesting to note that against the background of the rather discouraging results of most of the adjustment programmes in Latin America, two of the cases considered to be "successful" (Costa Rica and Bolivia) used a moratorium to support their adjustment and stabilization programmes.

totally discredited as a means of neutralizing the debt overhang.

If the payments restriction is to be efficient, it also calls for careful political management. Fundamentally, the orderly management of the restriction depends to a large extent on the emergence of a national consensus which supports this measure as a reasonable temporary option in view of the limited alternatives offered by the creditors. Such a consensus does not arise automatically, but requires a political strategy and an information campaign directed at the national groups with the greatest influence on public opinion.

As well as establishing a firm domestic base to support the payments restriction, it is necessary to take precautions at the external level also. It may be useful to take measures designed to have a conciliatory effect on creditors, by presenting the restriction with the least possible fuss, for example, and emphasizing that it is a special measure forced upon the country by the unbearable burden of the resource transfer. Efforts may also be made to keep open the lines of communication with creditors by putting forward constructive formulas for overcoming the problem of the excessive nominal value of the debt. Finally, as a sign of goodwill, consideration may be given to the partial payment of the debt service commitments on the contractual debt, but only in amounts in keeping with the country's payment capacity and the requirements of its economic programme. Furthermore, these symbolic payments should be on the current debt service and not in respect of accumulated arrears, since the latter are an integral part of the debt overhang problem and their solution must therefore await a definitive global agreement with creditors. In certain cases, it might even be useful to announce unilaterally —but always in a conciliatory manner— a payment plan benefitting certain creditors (it could be announced, for example, that X% of exports or of the gross domestic product will be devoted to debt service), in order to stabilize the expectations of the private agents with regard to access to foreign exchange.[19]

It is normal practice to exclude debts with multilateral finance agencies from payments restrictions. These agencies are not bound by the same risk evaluation criteria as the private capital markets, and consequently they form a potentially flexible source of finance; furthermore, running into arrears with multilateral credit institutions could be interpreted by third parties as an act of desperation which would discredit the whole management of the adjustment and transformation process. It is also worth taking measures to avoid any possible interruption in access to short-term lines of trade credit. Finally, still at the external level, it might be useful to take measures to protect the international reserves from possible hostile action by some private creditors (ECLAC, 1990a, chapter V).

Fourthly, in a well-ordered unilateral strategy it is necessary to take account of the time horizon of the restriction. Unilaterally limiting debt service is, by definition, a temporary tactic. Running up arrears may relieve one of the main negative effects of the debt overhang (that affecting cash flow), but not necessarily the other (the private sector risk premium). Consequently, it is desirable that the country should reach a *definitive* debt reduction agreement as soon as possible. This may take some time, however, especially if the debtor country is small and of little relative importance to the banking system.[20] For example, Costa Rica was in arrears for five years before finally reaching agreement with the banks in May 1990, while Bolivia has been in arrears with the banks since 1982: despite two big repurchase operations of its bank debt on the secondary market (at a price of 11 US cents per dollar), one-third of its commitments are still currently in arrears, awaiting some kind of agreement. The long-drawn-out nature of the banks' response is another reason why the debtor country should take care to ensure that the payments restriction is orderly and sustainable and forms part of a successful economic programme in the areas of adjustment and stabilization.

[19] The only country in Latin America which has carried out a formal unilateral payments plan is Peru. Although the restriction functioned relatively well to start with, its benefits were largely dissipated because of serious problems in the country's economic programme. For an analysis of Peru's unilateral payments plan, see Figueroa, in Altimir and Devlin (editors) (in the press).

[20] The banks often hold up agreement with a small debtor in order to avoid setting precedents which could later become general in the negotiations with big debtors.

Finally, it may be noted that the Brady Plan has created circumstances whereby the IMF may become a potential ally of countries with payments problems, for the Fund now has general authorization to disburse loans even though the recipient country has not reached prior agreement with the private banking system to cover the servicing of its debt. Thus, during 1989-1990 this agency disbursed loans to various countries which had not signed any agreement with their creditors, including some which even registered serious arrears in their debt service. The banking system received these disbursements with alarm, since they seriously weakened its own bargaining power.

While this new policy of the IMF is potentially valuable for the debtor countries, it must nevertheless be noted that its application is still very uncertain and there are apparently serious disagreements among the Directors of the Fund regarding the role which that institution should play in debt reduction processes. The regrettable vacillation of the Fund and of other multilateral agencies in the face of the Brazilian moratorium in 1990 is a good example of how these institutions may be subject to changing pressures from the industrialized countries over debt service arrears (*Financial Times*, 1990d).

Consequently, before entering into a standby credit agreement or expanded facility agreement with the IMF, debtor countries should negotiate with that agency the total amount of debt service which their economic programme can support in the medium term, also incorporating into the calculation their needs as regards investment and growth. The resulting estimate of their payment capacity should be a firm and explicit parameter of the structural adjustment programme with the Fund, subject to modification only after indisputable proof has been given of the existence of a surplus of foreign exchange and fiscal resources in the medium term.[21] Indeed, it would be useful if the Fund undertook to defend that estimate of payment capacity so that it could become the basis for negotiation with the banks over the debt reduction. Finally, the Fund should accept selective arrears in the debt service commitments of the countries to the banks when the latter are not willing to respect the estimates of the debtor country's payment capacity.

2. *Obtaining fresh financing*

As already noted, the systemic nature of the external debt problem has meant that both creditworthy debtors and insolvent countries of the region have faced equal difficulties in obtaining fresh resources on the international capital markets. Unless there is a drastic change in the external environment, this restriction will probably continue to be severe for much of the 1990s. Even so, however, there will be some opportunities for obtaining resources abroad.

a) *The private markets*

i) *Credit financing*. At the beginning of this article, reference was made to the difficulties that the countries are likely to face in gaining access to external financing. In effect, it is not reasonable to expect an abundant flow of private capital to a region which is clearly overindebted. Nevertheless, there will be circumstances in which financing will be available for specific enterprises and projects. There will be foreign investors willing to take above-average risks if they are compensated with higher yields. At the same time, many of them will look for investment opportunities which permit them to insulate themselves as far as possible from sovereign and transfer risks. The financing of this type of investments can be termed "niche financing" (see some concrete examples of this in the appendix).

Transactions like these are already being carried out relatively frequently in Latin America.[22] In this type of financing, the loans enjoy special (direct or indirect) collateral which enables the creditor to protect himself from the risk globally associated with the country. This special guaran-

[21] For example, the possibility of a readjustment of the level of payments after the fifth year of a structural adjustment programme could be considered, provided that the actual situation of the country justified it. Similarly, the recapture clauses should be even-handed and should provide for a reduction in the debt service if there is a drop in the country's payment capacity.

[22] For a more detailed description of these transactions see *Business Latin America*, 2 April 1990, p. 102; *América Económica*, 1990, pp. 10-16; *The Economist*, 2 June 1990, p. 83; OECD, *Financial Market Trends* (Paris) (numbers corresponding to 1990), and *Latin Finance*, June 1990, p. 24.

tee may take the form of the freezing of future export income at its place of origin; a thoroughly solvent foreign partner willing to back up the loan either directly or indirectly, or some solid asset outside the frontiers of the debtor country. Loans of this type are frequently made in the form of bonds, since many creditors feel that these instruments are less vulnerable to default.[23] The cost of these new credits is usually very high (several points over LIBOR) and the maturity is usually quite short (for example, three to five years). Investors often prefer to carry out this type of transaction with the private sector, because unlike the public sector, many Latin American private enterprises enjoy a relatively solid financial situation.

This form of private finance is not totally satisfactory, since it is conditioned by special arrangements which are usually difficult to organize and negotiate. However, in extremely tight capital markets it does at least give some relief. In fact, the niche financing of the 1990s is largely a repetition of what happened in Latin America and the Caribbean in the 1950s and 1960s, when most of the private loans had special direct or indirect guarantees in the form of blocked assets, or else were connected with direct foreign investment projects.

In order to promote niche financing, it is important that the debtor country should have preferential rules for dealing with the new debt so as to separate it as far as possible from the problems of the old debt. It is also necessary that there should be a clear policy designed to promote direct foreign investment in line with national priorities, since foreign enterprises, including the commercial banks, can generate parallel fresh finance through their investment projects in the debtor country.[24]

It should also be noted that some countries are obtaining international credit without special guarantees. In 1990, Mexico will issue over US$2 billion of international bonds and other securities, and a significant part of these apparently do not have any special guarantee. Venezuela will also sell at least US$ 150 million of bonds in 1990 without any special security arrangements (West, 1990). Chile, for its part, obtained the first voluntary loan from the private banking system to a Latin American country since 1982, in the amount of US$ 20 million (*LDC Debt Report*, 1990).

Mexico is the country which has gained most access to international credit without special guarantees, especially through bond issues. An important factor in this new form of credit (which could mark the beginning of a new credit cycle for Mexico) has been the success of the structural adjustment carried out by this country. The turning point for creditors seems to have been the Government's announcement that it would privatize the national banking system (an important political symbol of the consolidation of the Government's economic programme) and the manifest interest shown by the United States in economic integration with Mexico, which will open up many new investment opportunities. Other factors which had an influence in this respect were the recent rise in oil prices, which has given the country an easier foreign exchange position after the only relatively modest relief obtained through the Brady Plan agreement, and the heavy return flow of Mexican capital from abroad, attracted by the very high yield of the bonds issued by Mexican private and State enterprises.

ii) *Direct foreign investment.* In view of the credit restrictions on Latin America, it is expected that in the 1990s the countries will take more decided steps to exploit the opportunities for attracting foreign investors. The truth is that many countries of the region have not had very transparent policies regarding this source of financing: this partly explains why the levels of direct foreign investment in the region are only half those for Asia (table 5). It seems essential to streamline foreign investment policies, since transnational corporations bring their own fi-

[23] So far, no Latin American country has defaulted on the service of its international bonds. For this reason, it is usually considered that bonds enjoy preferential treatment. At the same time, however, the situation regarding bonds is obviously linked to the fact they represent a very small fraction of the total external debt of the region. Thus, the optimism of investors with regard to bonds could run into the same error of composition which affected the decisions of the bankers in the 1970s. See Friedman, 1977.

[24] For example, a recently privatized Mexican airline purchased new aircraft partly financed with a loan from the Chase Manhattan Bank, which is one of the new shareholders in the enterprise.

Table 5
DIRECT FOREIGN INVESTMENT, AS A PERCENTAGE OF GDP

	1984	1985	1986	1987	1988	1989
Argentina	0.3	1.4	0.7	–	1.2	1.7
Brazil	0.7	0.6	0.1	0.4	0.9	0.2
Chile	0.3	0.7	1.9	4.9	4.6	6.0
Colombia	1.5	2.9	1.6	0.8	0.5	0.8
Costa Rica	1.4	1.7	1.5	5.0	1.8	2.0
Ecuador	0.4	0.4	0.7	0.8	0.8	0.9
Mexico	0.2	0.3	1.2	2.3	1.5	1.1
Peru	-0.4	–	0.1	0.1	0.1	–
Uruguay	0.1	-0.2	-0.1	0.1	-0.2	0.1
Venezuela	–	0.1	–	–	0.1	0.2
Average	0.5	0.6	0.5	0.8	1.0	0.7
Asia[a]	1.1	0.9	0.8	1.4	2.0	2.6

Source: Institute for International Finance, *Fostering Foreign Direct Investment in Latin America*, Washington, D.C., July 1990.
[a] Indonesia, Malaysia, Philippines, Singapore and Thailand.

nancing and foreign investors can formulate projects and secure financing even in difficult economic conditions.

It is worth briefly mentioning a new foreign investment mechanism which is giving satisfactory results in various countries of the region: namely, mutual country funds which channel foreign investments to the stock exchanges of developing countries. These funds can be either "open" (in which case an increase in the capital of the fund is allowed) or "closed" (in which case their activity is limited to the reinvestment of the capital originally authorized by the economic authorities of the country). In Latin America, the number of these funds (many of which are registered on the New York and London stock exchanges) increased from seven in 1988 to 19 in 1989, and it is expected that others will be authorized in 1990 (*Latin Finance*, 1990, pp. 28-56). They represent attractive options for investors who do not have the time or the facilities for evaluating the various opportunities on the developing countries' stock exchanges. They are also attractive to certain countries, since they open up new access to capital which would otherwise not come to the country. In Chile, half the direct foreign investment in 1990 (which totalled US$ 600) came from these funds.

b) *Multilateral finance agencies*

i) *Direct financing.* As in the 1960s, Latin America should find one of its most important sources of financing in the multilateral agencies. These agencies have already increased in importance, as is demonstrated by the fact that their share of the region's debt rose from 6% in 1982 to over 15% in 1988. All in all, these organizations apply broader criteria than those of the private sector, so that they may disburse their resources even in complex economic situations, such as that of Latin America in the 1980s.

The access to these agencies has deteriorated in recent years, however, and their net transfer of resources to Latin America has become negative. The region's net movements of resources with the World Bank and the Inter-American Development Bank (IDB) registered balances that were negative for the region in 1987-1988, and the same occurred with the IMF in 1986-1988 (table 6). The information suggests that in 1989 the IDB's transactions with Latin America left a small positive balance for the region, but those of the World Bank and the IMF continued to turn in substantial negative balances.

This discouraging result is due to two phenomena: the growing debt service commitments of the region with these agencies, and the restrictions on the disbursement of fresh loans. This latter element is related to many factors, among which mention may be made of the limitations on the base capital of those agencies and the rigid formulas governing the disbursement of their

Table 6
LATIN AMERICA AND THE CARIBBEAN: NET RESOURCE TRANSFERS WITH MULTILATERAL FINANCE AGENCIES
(*Billions of dollars*)

	1983	1984	1985	1986	1987	1988	1989
Total	*7.5*	*5.2*	*2.5*	*1.1*	*-2.3*	*-2.9*	*-2.6*
IMF	5.7	2.7	0.6	-0.8	-1.7	-2.1	-1.7
World Bank	0.8	1.1	0.7	1.4	-0.5	-0.7	-1.1
IDB	1.0	1.4	1.2	0.5	-0.1	-0.1	0.2

Source: ECLAC, on the basis of data supplied by the World Bank, the Inter-American Development Bank (IDB) and the International Monetary Fund (IMF). The 1989 figure for the IMF was provided by the Latin American Economic System (SELA).

loans, including frequently excessive conditionality.

There are solutions which could make the resource transfers of these multilateral agencies positive once again. One of these is to increase their capital. In this respect, IDB —which recently received over US$ 20 billion of fresh capital— is in a position to increase its resource flows to the Latin American countries considerably in the 1990s. The IMF, too, will receive US$ 60 billion of fresh capital through the recent approval of a 50% increase in its members' quotas. Nevertheless, the multilateral agencies must be strengthened even more. In particular, the increase in the IMF's quotas was a good deal less than that initially requested by that agency, so that the recent appeal by the Latin American countries to shorten the deadline for a new review of the quotas before 1993 is extremely pertinent (SELA, 1990).

It is also important to ease the conditionality in order to reverse the negative resource transfer. If the policy goals were less precise and the term of adjustment programmes longer, this would avoid the now frequent suspensions of disbursements for failure to meet the severe criteria of the structural adjustment programmes.

Finally, more direct ways should be sought to relieve the burden of the debt service owed to the multilateral agencies. In view of the fact that these agencies will be among the few creditors generally willing to disburse loans to Latin America in the 1990s, perhaps it is not wholly advisable at present to put forward a request for the rescheduling of the multilateral debt, since this could directly affect the credibility of these agencies as preferred creditors. In view of the growing pressure exerted by the multilateral debt service burden in many countries, however, it is urgently necessary that some special mechanisms should emerge in the 1990s for refinancing on a concessionary basis (directly or indirectly) the region's outstanding debts with these agencies. It is well known that a considerable amount of time elapses between the appearance of a good proposal and the moment when it is accepted by the multilateral agencies, so that the issue of the refinancing of the debt with these agencies should be brought forward immediately by the Latin American countries in the appropriate international forums.

ii) *Indirect financing*. The catalytic role that can be played by official multilateral bodies in the mobilization of foreign private resources could assume great importance in the 1990s. There are indeed many programmes —both multilateral and bilateral— which are aimed at promoting the participation of foreign private capital in the developing countries by providing direct or indirect security with the support of official bodies.

These programmes are of various types. Both the World Bank and the IDB offer co-financing programmes in which they loan resources jointly with private lenders. The participation of the multilateral body in these loans, or its direct guarantee of part of the payments schedule, acts as an incentive to attract fresh private financing to the developing countries.

The two bodies in question also have subsidiary organizations which act as catalysts for investments in the private sector of developing countries. Thus, for example, the International Finance Corporation (IFC) of the World Bank takes out equity in new enterprises in developing countries, lends to them from its own resources, and also organizes syndicated loans in the international credit markets for new projects proposed by the private sector in the developing countries. The mere fact that such multilateral agencies are participating in these new projects (as shareholders, lenders or agents) creates greater confidence and thus succeeds in attracting the participation of foreign investors.

Once again, perhaps the best way of describing the possibilities offered by this type of financing is to give a concrete example. In 1989 the Chilean enterprise "Celulosa Arauco y Constitución" succeeded in financing a fresh investment project totalling US$ 600 million, partly thanks to the participation of the IFC. The catalytic role of this official agency had various dimensions. On the one hand, the IFC used its high creditworthiness to organize a syndicated loan of US$ 41 million on the international markets, which was underwritten by a considerable number of foreign banks even though the loan did not enjoy any special guarantee. The participation of the commercial banks was also stimulated by the IFC's decision to grant the enterprise a direct loan of US$ 40 million, plus US$ 15 million in the form of quasi-equity.

The catalytic role that can be played by official agencies is nothing new. However, not enough use has been made of it, possibly because of the abundance of private financing that was available in the 1970s. In the 1990s, the Latin American countries should take decided steps to explore opportunities of this type and they should pressure the official agencies to expand the scope of such programmes as soon as possible.

c) *Repatriation of flight capital*

It is well known that the residents of many Latin American countries keep a large amount of resources abroad. Although all the experts agree that this flight capital has come to represent a considerable amount of resources, they are unable to agree on the proper way to measure it, so that no precise figures can be given in this respect. This has not prevented an extensive debate taking place on how to promote its return, however.

There can be no doubt that this private capital represents a potential source of external finance for the 1990s. Indeed, some analysts consider that its return could be a major factor in solving the problem of the net transfer of resources. Flight capital is a very volatile financial asset, however, and normally it is the first to leave a country and the last to return on a stable basis. Rather than being a potential solution to the debt problem, therefore, flight capital is rather a result of it. It cannot be expected to return in large amounts and on a permanent basis until there are expectations that the country can service its debt and grow at the same time. In many cases, these conditions can be attained only through a major reduction in the debt, carried out as part of a coherent structural adjustment programme.

The order of cause and effect should therefore be reversed: a prior condition for the return of this capital for longer than a few months is the achievement of a solution to the debt overhang. Even when this condition has been achieved, the return of such resources will also clearly depend on the adoption of coherent economic policies and clear rules on the treatment of private capital.

II
Trade

As the Latin American countries will probably have only limited access to external finance in the 1990s, the second challenge facing them is that of generating sufficient foreign exchange to offset this drop in the availability of capital. The only sustainable way of generating such foreign exchange is through the expansion of exports, since the region's imports have already been drastically cut: in 1988 the external purchases of the countries of the region were only 80% of their 1980 level. Furthermore, although measures to reduce the debt service may reduce net transfers abroad in the 1990s and hence lower the level of the trade surplus needed to service the debt, the expansion of exports will be the only dynamic means of increasing the import capacity of the Latin American economies.

The awareness of the urgent need to increase external sales has become so widespread that today export promotion has become a true *leitmotiv* in the whole region. For many countries, however, this is only a recent development; in this case it is not easy to formulate trade policies that can take advantage of the opportunities offered by changing and uncertain international markets. Before outlining Latin America's prospects in this field, it is worth reviewing the features of the region's current insertion in world trade and the latest lines of its trade policy.

1. *The shortcomings of Latin America's current form of insertion in world trade*

A few figures show that Latin America's position in world trade has deteriorated over the post-war period. Thus, for example, the share of the member countries of the Latin American Integration Association (ALADI) in world exports went down from 6% to 4% between 1960 and 1980, whereas that of the developing countries as a whole rose from 22% to 29% over the same period. This meant that the share of exports in the gross domestic product of the former countries virtually stagnated at between 10% and 11%, whereas it more than doubled for the developing world as a whole (table 7).

The fact that the share of manufactures in the external sales of ALADI has increased over this period is not much consolation. To begin with, this increase (from 18% to 34% of non-oil exports) was far below that registered by the developing countries as a whole (from 21% to 48%). As a result, the region's share in world trade in manufactures remained at only 3%, whereas that of the developing countries as a whole rose from 12% to 21% between 1965 and 1980.

An examination of the structure of these exports of manufactures reveals further shortcomings. Thus, the external sales of industrial goods by the ALADI countries are heavily concentrated on semi-industrial products involving little processing, especially metals. In contrast, the share of consumer goods in general (both those which make intensive use of labour and those which have a high research and technological content) is a good deal lower, although it is precisely the

Table 7
LATIN AMERICAN AND OTHER DEVELOPING COUNTRIES: SELECTED FOREIGN TRADE INDICATORS

	ALADI			Developing countries		
	1960	1970	1980	1960	1970	1980
Share of exports in GDP	...	9.7	10.8	10.3	10.7	23.4
Share in world exports						
—All exports	5.6	4.0	4.0	21.9	18.4	28.6
—Exports of manufactures	2.3	2.7	3.3	10.9	13.4	20.6
Export structure						
Manufactures as a percentage of non-oil exports	17.6	25.6	33.9	21.2	33.1	48.0

Source: Prepared by the authors on the basis of figures from United Nations, *International Trade Statistics Yearbook*, and UNCTAD, *Handbook of International Trade and Development Statistics*.

trade in these products which has shown greatest dynamism in past decades. In 1980, for example, the region only accounted for 4% of world exports of textiles, whereas the figure for the developing world as a whole was 60%. Likewise, ALADI's share in the trade in goods with a greater technological content increased only marginally, remaining below 1%, whereas that of the developing countries as a whole doubled and amounted to more than 7% in 1980.

In short, Latin America's share in international trade up to the 1980s was insufficient and inappropriate. It was insufficient, because in the years when the other economies were increasing their integration into world trade, Latin America reduced its participation. And it was inappropriate because in this period the region specialized precisely in those products whose trade was growing most slowly.

How are these shortcomings to be explained? External factors do not seem to have played much of a part in them. World exports expanded by almost 15% per year on average over the period in question, and as already stated, the other developing regions were able to take advantage of this extraordinary dynamism to increase their share of world trade. Nor does resource availability seem to have been an obstacle: as is well known, Latin America has relatively abundant natural resources; its social development (education and health) and economic (average income) indicators also place it in a relatively favourable position compared with other developing regions (Maddison, forthcoming); and finally, between 1960 and 1980 the region was not short of external resources either: in the 1960s Latin America was one of the favourite recipients of foreign investment, while in the 1970s it received a little under two-thirds of all the bank loans to developing countries (Devlin, 1989 pp. 40-41). Indeed, the region's degree of industrialization (and hence its level of production of precisely those goods which are flagrantly absent from its exports) was one of the highest in the developing world over this period.

The cause of this deficient insertion into international trade stems therefore from the use made of the available resources, that is to say, the policies applied. Indeed, Latin America's development strategy (known broadly as import substitution industrialization) has been the subject of much criticism in recent years. Such criticism cannot be applied indiscriminately, however, for initially this strategy was very successful, as it made it possible to increase the domestic availability of resources which should subsequently have permitted a wider insertion in international markets. Indeed, the need for an import substitution phase in order to initiate an industrialization process is now normally recognized in academic circles.

The error was, then, the failure to link that industrialization strategy with a coherent foreign trade policy. Latin America, unlike several South East Asian countries, conditioned its import substitution industrialization essentially to the growth of domestic demand, leaving aside almost completely any export ambitions. Latin American industry thus grew under an umbrella of high protectionism which ensured a good level of profits merely through control of the domestic market. The lack of exposure to external competition inhibited efforts to improve efficiency and reduce costs: a problem particularly acute in small countries, where scales of production are not sufficiently large to help reduce costs. The lack of participation in external trade also inhibited the achievement of higher levels of quality and compliance with international rules and standards, so that Latin American industry was gradually marginated from technical progress (ECLAC, 1989a). As a result, the region gradually lost competitiveness at the international level. Indeed, the growth of industrial productivity in Latin America between 1950 and 1980 is estimated to have been only half that registered in the world economy between those years (Maddison, forthcoming).

2. *Trade policies in the region in the 1980s*

It could be argued in a sense that the privileged access which the region had to external resources was actually a drawback, since it made it possible to conceal the serious shortcomings of its form of insertion into world trade. At all events, the abrupt cut in external finance from 1982 onwards clearly showed the size of the problem, since the ALADI countries'small trade surplus on goods and services did not even allow them to cover a one-hundredth part of the net transfer of resources which they had to make that year (table 8 and figure 1). The first policy response to this gap was a pronounced devaluation of nominal exchange rates, accompanied by various trade restriction measures, such as the almost generalized application of exchange controls, increases in tariffs and import duty surcharges, and greater use of non-tariff barriers and quantitative controls. Given the size of the external deficit, it is understandable that initially the countries preferred to use such direct controls, which were easier to manage and more rapid in their effect. Indeed, after adopting these measures Latin America managed to increase its trade surplus considerably in an extraordinarily short time (figure 1).

In most of the countries, however, this trade surplus was generated at the cost of a sharp reduction in imports and an acute domestic recession. Since this situation obviously could not be sustained, as from 1984-1985 the countries began to seek other policies which would enable them to maintain the trade surplus while at the same time promoting domestic growth. Obviously, any prescription in this respect must center around a new trade policy. In practice, however, this "new" trade policy boiled down to the application of a by no means novel recipe: rapid external trade liberalization, with the elimination of direct controls and non-tariff barriers; reduction of the average level and spread of tariffs; elimination of programmes of direct export subsidies, and devaluation.

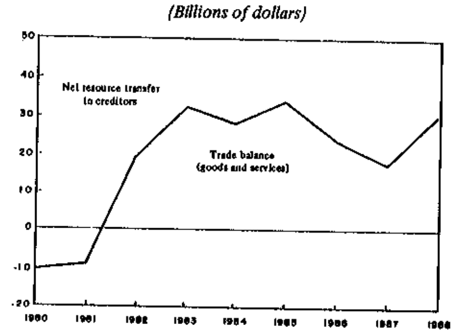
The multilateral agencies actively promoted this formula, particularly within the framework of the World Bank's structural adjustment loans: external trade liberalization measures have been included among the conditions for almost 80% of such loans, and have accounted for almost 30% of all the conditions applied (World Bank, 1988, p. 59). It is hardly surprising, then, that liberalization has been the main feature of trade policy in the region since 1985, although the forms and results have varied considerably from one country to another. Thus, one by one, the Latin American countries have moved towards a sometimes radical reform of their trade policies. As a result, the weight of non-tariff restrictions and the average tariff level went down by more than a third for the ALADI countries between 1985 and 1988 (table 9). The reduction in trade restrictions would be even greater if the figures

Table 8
LATIN AMERICAN INTEGRATION ASSOCIATION (ALADI): EVOLUTION OF EXTERNAL ACCOUNTS, 1980-1988
(Millions of dollars)

	Trade balance (goods and services)	Net resource transfer to the region
1980	-7 787	10 172
1981	-10 303	8 743
1982	148	-19 765
1983	28 336	-32 481
1984	37 266	-28 120
1985	32 822	-33 960
1986	15 873	-23 819
1987	20 917	-17 640
1988	23 435	-30 539

Fuente: ECLAC, on the basis of official figures.

Figure 1
LATIN AMERICAN INTEGRATION ASSOCIATION (ALADI): TRADE BALANCE AND NET RESOURCE TRANSFER
(Billions of dollars)



Source: Table 8.

for 1989 and 1990 could be included, when Peru and Venezuela embarked upon large-scale trade reforms while Argentina, Brazil, Colombia, Ecuador and Uruguay significantly extended their previous liberalization measures. Therefore, the trade regime of the region as a whole (with the possible exception of the Dominican Republic) can now be assessed as considerably more liberal than that in force in the early 1980s (ECLAC, 1990d).

3. *Performance and prospects of the region's international trade*

The indicators for measuring the precise effect of this change of policy in the external sector are not yet available. At first sight, however, the re-

Table 9
LATIN AMERICAN INTEGRATION ASSOCIATION (ALADI): EFFECT OF RECENT TRADE LIBERALIZATION POLICIES

	Non-tariff restrictions [a]		Average tariff		Export growth, 1987-1988[b]	
	1985	1988	1985	1988	All exports	Non-traditional exports
Total ALADI[c]	*32*	*21*	*51*	*31*	*32*	*52*
Argentina	50	31	28	26	33	18
Bolivia	20	1	20	20	-7	4
Brazil	34	16	81	42	51	62
Colombia	96	74	83	48	...	35
Chile	1	...	35	17	68	51
Ecuador	38	27	50	49	1	20
Mexico	19	12	34	16	29	64
Paraguay	...	...	...	...	...	...
Peru	50	53	54	66	6	17
Uruguay	1	1	32	29	29	26
Venezuela	30	33	17	18	14	34

Source: Prepared by the authors on the basis of figures from UNCTAD, *Trade and Development Report, 1989*.
[a] As a percentage of imports.
[b] Percentage. Cumulative growth rate for 1987 and 1988.
[c] Average percentage, weighted according to the imports of each country. Does not include Paraguay, for lack of comparable figures.

sults seem to have been positive, since between 1986 and 1988 the region registered a big expansion in its exports, especially of non-traditional products, which grew by more than 50% (table 9). This success is due at least in part to the two favourable effects which trade liberalization usually has for exporters. Firstly, such policies eliminate, or at least reduce, the administrative obstacles and inconsistencies which have been an almost constant feature of the Latin American economies. Secondly, they do away with many of the price distortions which lead to inefficiency in resource allocation, thus enabling the countries to make better use of their comparative advantages.

Indeed, an aspect of Latin America's external trade which has been frequently commented upon in recent years has been the spectacular growth in non-traditional exports of primary products: for example, fruit in Chile, flowers in Colombia and shrimps in Ecuador. Up to a few years ago, no-one would have thought that these products, considered to be of minor importance, could contribute so successfully to the expansion of Latin America's trade surplus. Thus, a policy of greater openness, by revealing more explicitly the natural comparative advantages, or in a broader sense the advantages of the installed capacity of a country, shows up the availability of products with hitherto unsuspected, but nevertheless significant, potential for sales abroad. This permits an increase in exports without necessarily requiring an increase in installed capacity or the incorporation of new technology.

Can it be deduced from these good results that an extension and intensification of the liberalization process will suffice to improve Latin America's participation in world trade? A more detailed examination of the facts does not back up this conclusion. Intuitively, there does not seem to be any systematic relation between the degree of liberalization achieved and exports: it is well known, for example, that Brazil, which was until recently one of the Latin American countries which placed most restrictions on trade, was the main beneficiary of the export boom of the 1980s. There are also substantive reasons for such doubt, however: without considering the domestic costs of liberalization, which may be extremely high but go beyond the scope of this study, one may question the capacity of such a policy alone to guarantee adequate export growth in the medium and long term, for better utilization of the natural comparative advantages of the country (which we already mentioned as a benefit of trade liberalization) will soon run into two types of limitations, some domestic and others external.

The external limitations are the easiest to identify. The international markets for primary commodities or semi-industrial products, where Latin America currently has clear comparative advantages, are paradoxically also the most severely restricted and controlled. The managed trade agreements governing trade in textiles, footwear, steel and motor vehicles, for example, to name only a few cases, are all too well known. Thus, Latin America's expanding exports have rapidly faced restrictions in these sectors, and the existing limitations (for example, on trade in textiles or steel) have become effectively binding as countries which were hitherto totally absent or not very active in such trade entered the markets. New barriers have also been erected in order to protect domestic producers of goods which were previously free from this type of restriction, such as flowers or certain particular types of fruit.[25] The practice of managed trade has undoubtedly been growing in recent years, reaching some 10% of world trade in 1984. It has a particularly harmful impact for the majority of Latin American countries, which are currently trying to increase their sales on world markets, since these agreements tend to protect the position of established exporters, to the detriment of those recently entering the market.

The adverse effects of this growing application of managed trade agreements is also complicated by the recent emergence or consolidation of big regional blocs in the world economy. One of these is currently taking shape in North America, with the free trade agreement signed in 1988 between the United States and Canada and the current negotiations for bringing Mexico into this scheme. One of the objectives of the so-called Bush Initiative, announced by the President of the United States at the end of June 1990, is to extend this free trade zone "from Alaska to Tierra del Fuego" through the negotiation of bilateral trade agreements which may be either straightforward free trade agreements or simply framework agreements that seek a gradual reduction of the barriers to trade between the United States and the other countries of the region.

With the consolidation of similar regional blocs in Europe and Asia and the stagnation of the multilateral trade negotiations in GATT, the prospects of a free trade zone for the Americas cannot but attract countries which, in its absence, would run the risk of being left on the sidelines of major world trade flows. Thus, by the end of 1990 five countries of the region (Bolivia, Chile, Colombia, Ecuador and Mexico) had already signed framework agreements with the United States and one of them (Mexico) was well advanced in the negotiation of a free trade agreement. The idea of a regional bloc is also perfectly logical in economic terms: the United States is, after all, the main market for the region's exports, since it absorbed 35% of the total external sales of ALADI in 1989. In contrast, the share of these countries in the total exports of the United States has remained relatively modest (12%), thus leaving open significant potential for expansion (ECLAC, 1990a).

The way to materialize this theoretically tempting objective does not appear to be so easy, however. Firstly, it will require negotiations between countries that are very different from the economic, trade and political point of view. The reciprocal concessions involved in such agreements could be very uneven because, for example, of the significant differences in tariffs currently observed. Latin American tariffs are still relatively high and uneven, even after the recent reforms, whereas the duties on Latin American

[25] An interesting example is that of the kiwi, a fruit which was until recently virtually unknown but which was introduced into the United States and European markets with considerable success by New Zealand producers. The growing demand for this fruit led a number of farmers in California to begin its cultivation, and consequently also to begin to pressure for restrictions on imports of this product. Likewise, Colombian flower exporters have had to defend themselves against an attempt to introduce a quota on the importation of roses equal to 30% of domestic consumption. For further details on this latter case, see ECLAC, 1990e, p. 70.

exports to the United States are generally relatively low. Thus, the bulk of the trade concessions which that country could offer would be basically concentrated on the elimination of non-tariff barriers, especially in the areas of steel, textiles and agricultural raw materials. It cannot be guaranteed, however, that the United States Congress will readily agree to eliminate protection for such sensitive sectors.[26] Furthermore, some countries —such as those of Central America and the Caribbean— could be adversely affected if they lost the preferential access to the United States market which they currently enjoy and had to compete with the bigger economies of the region.

In spite of these specific difficulties, the new features of world trade have made trade negotiation not so much an option as an obligatory step in order to achieve an efficient form of insertion in international trade. This means that in a context of more managed trade and tighter regional blocs, the factors determining the international insertion of countries have changed: thus, for an exporter country, its bargaining power has become even more important than its physical comparative advantages in determining its form of insertion in the market. Unfortunately, most of the countries of the region have not displayed much expertise in this field. To give a recent example, the Latin American countries have entered the GATT negotiations in a relatively disunited manner and have consequently not been able to play a leading part in the negotiations on the liberalization of agricultural trade: a sector in which they would have a great deal to gain. As a result, the initiative in this field has remained in the hands of the United States and the European Economic Community, while Latin America's role has been limited to accepting or rejecting the options presented by these two powers. It should also be stressed that the above-mentioned liberalization of trade in the region has been applied in a unilateral manner and has not been accompanied by the search for reciprocal concessions which is usual in a process of reduction of trade barriers.

It is therefore very important that Latin America should begin to link its external negotiation policy more explicitly with its domestic trade policy. At the national level, there are some easily implemented measures that could help in this respect: for example, the more extensive and systematic use of the diplomatic network in order to publicize the region's products; the provision of assistance in penetrating markets, and measures to prevent possible protectionist attacks (ECLAC, 1990c). At the regional level, matters will undoubtedly be rather more difficult. It may be argued that, in view of the big disparities which exist between the countries of the region, both with regard to their size and to their degree of trade openness, there is not much room for a joint negotiating strategy. This does not, however, rule out the definition of a common frame of reference or the formation of subregional negotiating blocs (ECLAC, 1990a). Another possibility is that of actually putting into practice the declarations of intent —so frequently repeated but so rarely fulfilled— regarding greater openness of intra-regional trade. The many regional bodies which exist could be used not only as forums for negotiations between Latin American countries, but also as negotiating instruments with countries from outside the region. Whatever the method adopted, it is essential to incorporate an aggressive negotiating strategy into trade policy, since without this Latin America will run the risk of remaining on the sidelines of the system of big regional blocs which is emerging.

There is another limitation, more of a qualitative nature, on strategies based on taking advantage of existing comparative advantages. This second limitation reflects the ongoing changes which are taking place in world production and marketing processes because of the constant advance of the technological frontier (ECLAC, 1990e, chapter IV). In recent decades, for example, natural resources and even labour have been making a decreasing contribution to industrial activity. This has been due, *inter alia*, to the efforts to save energy and non-renewable resources, the growing replacement of natural raw materials with synthetic products, and the increasing mechanization of industrial processes. As a result, the strictly "material" content of industrial activity,

[26] The difficult negotiations on the renewal of the tariff benefits under the Caribbean Basin Initiative and the adoption by the United States Congress of a law increasing restrictions on textile imports (subsequently vetoed by President Bush) are recently examples of potential difficulties in this field.

and consequently of the manufactures which are marketed, has been gradually going down in contrast with the growing share of the "intangible" content associated with information technology and scientific and technical knowledge. Furthermore, this tendency has been observed in a wide range of products, even in such traditional sectors as foodstuffs or clothing (*ibid.*, p. 69). These changes have played a major part in the relative loss of dynamism of trade in traditional industrial goods (metal products and motor vehicles, for example) compared with branches incorporating a higher degree of technological innovation (electronics, microcomputation, informatics, biotechnology, the development and use of new materials, etc.).

Competitiveness based on the use of comparative advantages (whether abundance of natural resources or of labour) and on the existing idle capacity will therefore be bound to suffer a progressive decline because of the lower weight of such resources in the new production processes. In order to progress from this now spurious form of competitiveness to a more authentic one, the countries must be capable of identifying, imitating and adapting new production processes: that is, continually incorporating the technical progress taking place at the international level into their own processes (Fajnzylber, 1988). This capability will depend not only on the reactions of enterprises to changes in prices, but also on many other factors (including the skill level of the labour force, the domestic entrepreneurial base, and the institutional configuration of the country) and their possible interactions. At all events, achieving authentic competitiveness is a process of a systemic nature, in the sense that it depends on a set of various types of synergies and externalities.

Consequently, the adoption of a system of appropriate relative prices and the maintenance of the main macroeconomic balances may well be a necessary condition for increasing the competitiveness of Latin America, but in no circumstances can it be sufficient on its own, especially in view of the lag in technology accumulated by the region over the 1970s and 1980s. This lag can only be offset through the adoption of an active industrial, technological and educational policy which is co-ordinated with trade policy in order to promote the incorporation of technical progress, higher levels of labour skills, and the linkage of the export sectors with the rest of the production structure.

There is no reason why such a policy should conflict with the trade liberalization efforts: on the contrary, as already noted, it calls for the elimination of the excessive tariff and non-tariff barriers which have hindered much of Latin America's exports for several decades past. Furthermore, the expansion of exports based on "natural" comparative advantages may be turned into a stepping-stone to exports of higher technological content if it is linked with the other activities and used to promote a "export mentality". Trade liberalization on its own will not be enough, however; nor should it systematically take the radical form in which it has frequently been incorporated in the currently prevailing formulas. Thus, in view of the domestic costs of rapid liberalization, some countries may prefer a policy of gradual openness (and even the maintenance of selective and conditional protection for some activities that help to further technical progress) in order to increase their competitiveness progressively in so far as this trade policy permits more decided action in the industrial, technological and educational fields.

III
Conclusions

The 1990s will probably be a period of financial restrictions for Latin America. In the area of conventional financing, access to private international capital markets will be difficult because of the systemic problem of overindebtedness of the region, the financial difficulties of many commercial banks, the very complex economic, social and political changes which will have to be made, and the traditionally slow recovery of confidence after such a serious crisis as that which shook Latin America in the 1980s.

Despite this complex financial picture, however, the countries of the region will have opportunities for finding some degree of relief. It has been demonstrated that some foreign lenders and investors are willing to commit themselves in the region provided they can find some external guarantees or forms of security which free this new finance from the risks associated with overindebtedness. While this niche financing, including direct foreign investment, is not sufficient to solve the problem of financial constraints at the macroeconomic level, at least it offers the possibility of promoting new activities of importance at the microeconomic or sectoral level. There are two drawbacks to this finance: it is often difficult to organize, and it is usually relatively expensive. For the countries which manage to eliminate, or at least bring under control, their debt overhang problem, there are prospects of a gradual and difficult return to the private capital markets. There were indeed some signs in 1990 that a few countries of the region were beginning a new voluntary relationship with these markets.

The multilateral finance agencies will probably become one of the most important sources of credit for Latin America in the 1990s. In order to overcome the problem of the negative resource transfer which they currently register with the region, these agencies must increase their loans (through new agreements to expand their capital), ease the conditions which often hinder their disbursements, and strengthen and expand their programmes to catalyze foreign private capital (such as those providing for co-financing and those providing risk capital for private enterprises in the developing countries).

Finally, in view of the region's enormous debt overhang and the current negative resource transfer affecting it, schemes for the reduction of debt and debt service will be another important source of financing. A consensual debt reduction programme is the best option in this respect. Although the Brady Plan raised hopes of a solution of this kind, it is now clear that it does not have sufficient public financial and institutional resources to eliminate the region's debt overhang. In these circumstances, unilateral debt service restriction by some of the Latin American countries may become a second-best but nevertheless effective solution for reducing the resource drain on the region. Indeed, in 1989-1990 most of the Latin American countries opted for this solution. Unless the Brady Plan is rapidly strengthened, this trend will probably become more pronounced in the 1990s and the countries of the region will make efforts to develop increasingly efficient unilateral schemes to back up their economic programmes aimed at adjustment with growth.

In spite of the above-mentioned possibilities of relieving the financial constraints, the region's severely limited access to foreign capital makes it essential to formulate a new trade policy, as trade in goods and services will be the activity which will offer the greatest opportunities for increasing the region's import capacity. In this field, the external environment does not look so negative: it is expected that in the 1990s world trade will grow on average 6% per year, a rate similar to that registered in the 1970s. Even so, however, an expansion of the region's exports will require profound changes in external trade policy, which has excessively resorted to administrative restrictions and supported a less than coherent system of relative prices during most of the post-war period. These features have clearly limited the full exploitation on external markets of the very considerable natural and human resources which the region possesses. Most of the Latin American countries are conscious of this, and have now begun, albeit to different degrees and on different scales, to liberalize their trade transactions and give more decided support to their exports. Some encouraging results have already been registered in their external sales of non-traditional products.

It is by no means certain, however, that the maintenance or intensification of these liberalizing efforts will be enough to ensure the desired expansion of Latin American exports. In order to achieve this result, it will also be necessary to make profound qualitative changes in the region's form of insertion in the world economy. In this respect, two main lines of action may be indicated. The first is connected with the region's external relations: a significant strengthening of Latin America's negotiating capacity with other countries and regions is essential for the region not to be marginated in a world of growing managed trade where a limited number of regional blocs is clearly emerging. The second concerns domestic policy: the experience of the countries which have secured a successful insertion in world trade (especially those of South-East Asia) shows the need for an active industrial policy to promote the incorporation of technical progress, improve the skill level of the labour force, and thus achieve an authentic and lasting competitiveness which will make it possible to increase the share in world trade while at the same time raising the living standards of the population.

In short, the management of the external sector in both its financial and trade aspects in the 1990s will call for a great effort of imagination and a good deal of pragmatism. Imagination, because the conditions in both these spheres are changing extremely quickly and leave no room for the use of old schemes. Pragmatism, because rigid ideological schemes are equally unfit for these new conditions and could again impede the countries from taking full advantage of the new opportunities that are arising. The task is by no means easy, but there is reason to hope that Latin America, with its enormous reserves of human talent, will succeed in returning in the 1990s to the path of economic and social growth.

Appendix

NICHE FINANCING IN LATIN AMERICA

Telmex

This Mexican telephone company obtained US$800 million in external financing in 1989. The secret of this agreement was the fact that the loan was guaranteed with future dollar income generated abroad. Thus, Telmex has a reciprocal agreement with the United States telephone corporation AT&T for the settlement of accounts in respect of telephone traffic between Mexico and the United States. As there are more telephone calls which originate in the United States, Telmex usually builds up positive balances with AT&T, and in recent years these have amounted to around US$1 billion per year. Telmex is using these accounts receivable from AT&T as a guarantee for the new loan. Thus, the real debtor in this transaction is AT&T, which, in the event of non-fulfilment by Telmex, will have to hand over its payments directly to the creditors of the Mexican company, so that in reality this guaranteed transaction represents an operation of very low risk for the latter.

Lan Chile

A Chilean enterprise made a bid for the purchase of Lan Chile —an airline which the Government wanted to privatize— and obtained US$29 million from Morgan Guaranty Trust Bank for this purpose. This unusual transaction was possible because of a link between the Chilean purchaser and the Scandinavian airline SAS. SAS, which is an important client of Morgan Guaranty, also undertook to purchase part of Lan Chile directly, and it was this commitment by SAS with Lan Chile which provided the transaction with the necessary security in order for the purchaser to obtain foreign resources.

Comisión Federal de Electricidad de México (CFE)

This enterprise has arranged to obtain US$235 million abroad. It usually sells part of its excess generating capacity to the State of California, United States, and is using this income from abroad as a guarantee for the foreign loan.

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