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THE IMPACT OF THE EXTERNAL DEBT ON THE ECONOMIC DEVELOPMENT OF LATIN AMERICA

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ABSTRACT

This paper considers the external debt crisis of Latin America and its impact on the economic development of the area. The analysis covers four stages. First, it will consider how the debt problem came to be what it is now and the way in which it evolved into its present circumstances. Second, it will address the reasons why the industrial countries should worry about the debt problems of the hemisphere. Third, it is also necessary to examine what Latin America is doing to handle its debt burden and its implication for the performance of its economy. Fourth, some possible solutions to the defusing of the remaining debt bombs, including those which have not exploded yet, will be examined. Finally, we emphasize the need to integrate the debt problem with the whole developmental strategy of the area in such a way as to promote compatibility between the policies designed to handle both issues.

This paper considers the external (which perhaps should be called the eternal) debt crisis of Latin America. The presentation is going to cover four stages. First, it will consider how the debt problem came to be what it now is and the way in which it evolved into its present circumstances. Second, it will address the reasons why the developed countries should worry about it. After all, why not allow the Latin Americans to stew in their own handling of the foreign debt. Third, it is necessary to examine what Latin America is doing to handle its debt burden and its implication for the performance of the Latin American economy. Fourth, some

possible solutions to the defusing of the remaining debt bombs, those which have not exploded yet, will be examined. It will be shown that, as long as there is no chain reaction in the arsenal, the eternity of the problem should arouse interest, but not deep concern.

The origin of the crisis which erupted in 1982, goes back to what occurred in the world economy in the 1950's. What happened then was the resumption of the trends that had worked for successful growth before, particularly in the period from the 1870's to the First World war. This was a period in which the economies of the world were most influenced by the international economy to whose trend they adapted. However, after World War I, an unrestful era began, which eventually erupted into the crash of 1929. The period that followed the crash was inimical to the international economy, whose health began to recover after the Second World War as it grew toward the relative levels that were normal in the 1910's. Slowly at first, debt ratios began to build up. If one looks at the Latin American debt indicators in the early 1960's, in that historical context, problems are seen cropping up already which began, even then, to worry some doomsayers.

However, the characteristics of the international economy differed in the fifties and sixties from what it had been at the turn of the century. Between 1950 and 1970, the developing countries became a major participant

in the world economy, something that was not the case early in the century. Furthermore, an environment of decontrol, deregulation, floating exchange rates and so on, increasingly began to take hold. This was illustrated by the emergence of an oil cartel of developing countries, which wrested the control of this crucial commodity from the major oil companies.

This set of circumstances eventually produced a counter-reaction in the position of the U.S. and the major countries of the West. They began to see that they were losing their hegemony over the international economy and, moreover, that the latter was affecting their domestic economies in detrimental ways.

Led by the ideas expressed in the late 70's by Paul Volcker (Chairman of the Federal Reserve System), the national economy of the U.S. changed radically from 1980 on, putting a damper on the growth of the international economy and on its inflationary creep. The other industrial countries followed suit. In the end, a disinflationary mode set in the domestic and world product and financial markets. These conditions brought about a crisis in the world economy that we are still experiencing to some degree at present.

On the second direction, why should the debt problems of Latin America draw so much attention in the West? Why not allow these countries to solve their own problems? What payoffs can be expected by the developed

countries from their involvement in this issue? These questions can be answered straightforwardly if they are considered in the context of the actual and growing size of these countries' economies. The gross domestic product (GDP) of Latin America can be estimated at about $994b. in 1993, which is not insignificant when compared to the total of the world economy. The region's G.D.P. increased by 4% in 1991, 3.1% in 1992 and 3.9% in 1993. The lackluster performance of the Latin economies eventuated in a 10% decline in the per capita income of the area during the eighties. Preliminary indications also reveal an average increase of about 1.5% in GDP per capita for the 1990-93 period. Typically, the Latin economies are relatively closed economies, particularly when compared to those in the Pacific Basin, and even relative to the European ones. Brazil, by far the largest country in the group is an illustrative case, with its trade balance in goods and services representing only 3.75% of its G.D.P. in 1993. Latin America had already achieved, by the mid-1980's, a market size very close to that attained by the European Common Market in the middle sixties. Thus, the region is the largest untapped market for the products, investment, technology and know-how of the West.

In 1990, the exports of goods and services from Latin American countries amounted to $123b. In 1991 the total value of exports had decreased to $121b. The

corresponding figures for 1992 and 1993 were $126b. and $132b., respectively. As is evident, the exports of the region are not even keeping pace with the increase in population. Meanwhile, the overall regional debt is approaching the $1,100b. mark, which exerts a strong pressure on future export performance in order to meet credit obligations.

Far more important than the past are the immediate prospects of Latin America. By the year 2000, its population is expected to be approaching 600 million inhabitants, which is going to be more than twice the population of the United States, and double that of the European Community. By then, its GNP in 1985 prices will probably be about $1.5 trillion. This large figure is something the Western world cannot afford to ignore. On the other hand, although the foreign debt will surpass its present $534b. level by the end of the millennium, it will not grow during this decade as fast as it did in the 1980-1989 period. Looking into the next century, Latin America is certainly going to be one of the major blocks in the world, rivalling the European community and the Pacific Basin in economic importance and in keen interest to the United States as a powerful neighbor.

Also, from a political perspective, it is important to realize that, even though a multiplicity of views exist in the Southern Hemisphere, Latin America is beginning to speak with one voice in economic issues,

often times adopting postures opposed to those of the United States. In political terms, the Contadora group emerged as a recent example of a collaborative Latin effort undertaken despite significant U.S. reticence. On another front, the Cartagena Declaration Group on debt matters, has continued to meet, pressing on a common Latin American point of view. For all the above reasons, the Latin American debt crisis has to be given policy priority by the industrial countries as the Latin American nations begin to play an increasingly important role in the international stage.

As repeatedly stated, the decade of the eighties was a most difficult period for Latin America. The annual average growth rate of the Latin American economies for that period was only 1.1%. By contrast, for 1990-1993 the annual average growth rate increased to 3.4% expanding to 3.7% in 1994. As for the foreign sector, growth in the region's exports has been modest for the early years of the present decade. On the average, exports have risen by about $10b. annually for 1992 and 1993 relative to preceding years. This performance is highly favorable if compared to events in 1986 when exports declined by 15%--of which 10% was in terms of lower prices and 5% in reduced quantities. As we know, there was a relative improvement in the total value of exports for the years 1987 and 1988. Altogether, the cumulative loss of purchasing power of Latin American

exports relative to imports due to the behavior of the terms of trade for goods has been approximately of -21.0 between 1981 and 1990 (1980=100).

As for the nineties, the value of exports went up by 3.6% in 1991, 8.8% in 1992 and 6.2% in 1993. Exports in 1994 reached $153b., a rise of over 14% relative to 1993. However, imports to the region have also climbed to $171b. in 1994, an increase of 15% compared to 1993. In the latter year imports had expanded by 8% in relation to 1992.

As a result, the deficit in the trade balance experienced a 19% expansion in 1994, continuing the tendency towards a widening current account deficit which itself is financed by large inflows of capital from abroad. Notice how that deficit has grown from $46b. in 1993 to $50b. in 1994, while capital inflows reached the $65b. mark in 1993 and $57b. in 1994. The cumulative current account deficit from 1987 to 1994 has amounted to approximately $185b.

This means that Latin America is transferring capital abroad. It uses part of its national savings to pay off the interest and dividends that have to be remitted abroad. Instead of the area being helped in its process of development by capital infusion, just the opposite has happened. Latin America has transferred capital to the advanced countries to the tune of $180 billion during the period 1987-1994, representing close

to 20% of its annual gross national product and surpassing its yearly exports of goods and services. Not surprisingly, these trends were reflected in a substantial decrease in the gross domestic investment figures of the area from 1980 to 1990. In fact, the average annual growth rate of gross domestic investment during that period was -3%. A recovery of sorts has occurred in 1990-1993, with a 7.2% annual growth rate recorded for that index. Meanwhile, the regional debt rose by close to 6% in 1994, reaching the figure of $534b., slightly higher than 50% of the G.D.P. of the region for that year. Meanwhile, the debt service ratio stood at 40% for that same date, the second highest figure since 1986.

It can be concluded from this brief analysis of how Latin America has been recently evolving, that things are not going well given the adverse circumstances faced by these countries. The Latin American nations have been practically cordoned off from foreign direct investment (only $15b. in 1994), and their terms of trade have continued to deteriorate. In light of the preceding, it is surprising that the region is growing at all, and that in fact it is more than covering its population growth, which has been about 1.9% annually for the period 1990-1993. The urgent need to resume per capita product growth in the area, and its appropriateness in terms of the foreign policy goals of the U.S. was finally

recognized in the Baker and Brady plans. The concepts of growth with domestic and economic adjustment is a major overall contribution to both the intellectual vision and the policy approach to the debt crisis.

As to the formulation of definitive solutions to the crisis, specific proposals have never seemed appropriate thus far. Yet, there are general propositions that should be considered as premises from which to derive wide-ranging policy measures. First, acknowledge the close and interdependent relationship between debt, development and trade. Second, recognize that world economic conditions, particularly those in commerce and finance, are the principal exogenous determinant of the degree of amelioration of the debt crunch. Nothing can really help as much as a growing, healthy international economy. Third, understand that policy coordination among the leading economies in the world is essential. After the number of attempts at economic summitry in the last decade and a half, this appears to be now happening for the first time. The Group of Five has been leading the economic coordination efforts among the Western economies. These have included monetary, fiscal and exchange rate policies. In order to address the problem at hand, it would appear that extending policy coordination to diminishing protectionism on debt-ridden country exports, and promoting acceptance of the principle of sharing the burden of relief with developing

countries, are constructive and timely steps. Fourth, from the Latin American point of view, it is important to open the region's economies more to international trade. A traditional lack of export orientation has been their Achilles heel for most of the Post-Was period. Latin America has been losing its share in world exports during this period and this has to change drastically, particularly when it is realized that developing countries are now important exporters of industrial products.

Finally, the institutional way of handling the debt problem has to be changed. This was partly proposed already by the so called Baker Plan. Instead of the IMF, the World Bank (IBRD) should now bear the brunt of a revival in Latin American lending policy, through the window of policy and structural loans change recently opened by the IBRD. The short-term loan conditionality which characterizes the fund, now becomes long-term under the new conception. In the managing of the debt, the private banks and the industrial countries' governments cannot be far behind in supporting this novel approach. This is a welcome financial and economic innovation because it transforms the substance of the problem from short term adjustment to long term growth. These two objectives are incompatible and simply cannot be pursued simultaneously in Latin America. The attempt to reconcile them has already created many complications in

the form of inconsistencies for decision makers down there. The success of these developmental policies is required if voluntary lending is ever to return from the cold, buoyed by renewed confidence on the ability of Latin America to service its debt through sustained growth.

Once again, it is necessary to distinguish between the amelioration of the debt problem and its solution. Practically all of the measures adopted since the crisis of 1982 fall in the former category. Rescheduling, rollovers, emergency lending packages by international institutions and private bankers, the conversion of debt into equity or long term public bonds, the reduction of interest rates, the adjustment of the outstanding debt total to actual market values, payments in kind or in currencies other than those in which obligations were contracted, and other like measures, do not address the central issue. Namely, the institution of a sustained process of real wealth creation in the debtor countries. This is the fundamental basis and necessary condition on which any permanent resolution of the debt situation must rest. The alternative to development can only be, in the end, the default of debt, which could hardly be regarded as a satisfactory solution to all parties concerned. Even the partial or total assumption of the principal by international institutions, unlikely as it may be, through the floating of negotiable documents, would not

constitute, properly speaking, a "solution", but rater a salvaging operation beyond the normal realm of economic relations as presently defined in the international system.

It is in the above context that the early Brady plan, whose particulars have not yet been fully specified (and probably will never be) may constitute a definite advance beyond the type of ameliorative measures tried in the past. Its central thrust is directed at the reduction of the principal of the debt. It thus squarely addresses the fundamental issue of the debt problem. By reducing the weight of the debt burden itself, it frees the debtors' resources permanently for developmental purposes. In this sense, the plan constitutes a new departure, a true qualitative change, in the approach to the solution of the problem. Once again, a true and lasting resolution of the debtor's situation requires the resumption of a high and sustained growth process. This, in turn, depends on resources and efforts becoming available to accomplish the task. The Brady plan signals a beginning in the right direction.

We should stop for a moment to broadly consider the criticisms leveled at the Brady plan by academics and functionaries. It has been said that it is not ambitious enough in scope; that it has not been defined and detailed as rigorously and minutely as it should; that it works too slowly; that it is too lenient on the creditor

banks and excessively harsh on the debtor nations; that the plan, in supporting the I.M.F., demands for LDC's to adopt severe adjustment policies that indirectly promote social and political instability in those countries; that it does not succeed in motivating bankers to restart the flow of fresh capital funds to accelerate the development process in LDC's, especially in Latin America; that in the end, it will not work because the guarantees given by debtor countries will not hold in the absence of sustained growth. All of this not to speak, on the other side of the issue, about the cost to the U.S. taxpayers of the various deals either completed or under consideration. In short, many countries thing that the Brady Plan is not well conceived to meet the needs of developing countries and that, in a few words, it is a classic example of a too little, too late, policy measure.

Obviously, in evaluating the Brady Plan, we are clearly facing a judgmental matter. One opinion with regard to the panoply of objections raised against the Plan will depend on our selection of criteria to measure its success, and on the relative weight ascribed to its different goals and objectives, as well as on the set of restrictions and parameters bounding the Plan's operation that we choose to allow for. Many outcomes are possible. Therefore, a reasoned critique of the Brady Plan should include information on the evaluative instruments and

methodology applied in reaching one's conclusions. However, it should also be pointed out that even if these requirements were to be fulfilled, they would not be sufficient to establish a verifiable conclusion. the reason being that a truly encompassing analysis of the effects of the Plan would have to include an in-depth study of the realistic alternatives to it and their practical feasibility. Without examining the alternative scenarios that may be obtained with a degree of probability in the absence of the Plan, no truly documented position could be taken on this issue.

Obviously, this is not the opportunity to undertake such a laborious and highly technical task. Consequently, we will limit ourselves to state, admittedly based on our own impressionistic perception of the very complex socio-economic and ideologico-political situation characterizing not only Latin American in general, but the developed and formerly socialistic block countries as well, that the Brady Plan can be considered a reasonably effective policy tool. This is not to say that it cannot be improved upon which, without question, it can. For example, bankers should be stimulated to become more heavily involved in financing the medium and long-term needs of the region. Complementary trade liberalization and promotion steps should be promptly implemented in order to increase the commercial flow between Latin America and the developed nations' markets.

The fine tuning and tailoring of the Brady Plan to the specific needs and circumstances of each debtor nation has to be further worked out. Also, much remains to be done by way of integrating each modified or individual version of the plan with the structural and functional features of each nation's developmental blueprint.

Undoubtedly, the debt problem has served to highlight the structural changes that have taken place in the international political and economic systems in the last four decades. The less developed countries are now an integral part of those systems. Their function is no longer a peripheral and subservient one. This means that their economic and even social policies must dovetail with those of the developed world. In the course of time, these developments will inevitably lead to a complete revamping of the international economic institutions. Likewise, the domestic fiscal and monetary policies of developed countries will have to strive for greater consistency and harmony for the sake of attaining mutually desired goals in the international arena. Less obvious at this point in time but ultimately equally unavoidable, will be the requirement of coordinating these policies with the domestic and external needs and functions of the less developed nations.

The institutional arrangements negotiated at Bretton Woods are now clearly passé. Naturally, it will take time for the full consciousness required for change to

take place, to emerge and solidify. Gradual modification and evolution rather than wholesale restructuring will in all probability prevail. but, in the end, a new institutionalization of the international system, now looming in the horizon, will come into its own. This new order will not necessarily consist exclusively of new organizations but, more importantly, it will have to be infused with a new spirit. That is, of a vivid realization that growth in developed countries and development in less advanced ones, international trade and finance, exchange rates, commercial and investment policies, along with domestic social and economic programs, will have to be coordinated and made compatible for the sake of stability and mutual prosperity.

In the above context, the so-called debt crisis may be symptomatic of things to come and a harbinger of the new mentality and kind of perspective that seems destined to gradually gain ground in the realm of international affairs.

Just like historical evolution required the constitution of a new network of institutions and arrangements at the end of the Second World War, which made viable sustained growth in developed countries and growth through trade in poor ones, the present times demand new changes and fresh views. The interdependence of the world economy and policy has reached such a point, that it is no longer possible to conduct a

compartmentalized, purely national or regional policy. In our own days, the almost continuous negotiations among industrialized countries, vide the Venice and Louvre agreements, the pressure upon Japan for this nation to liberalize its trade, the exhortations of Secretary Baker for Germany to stimulate its economy, vouch for the presence, in fact, of an international system quite different from the one in existence forty years ago.

What does not seem quite so evident to many, although in fact this is the case, is that the less developed nations are already a part of this new reality. In other words, compatibility, coherence and coordination of goals and policies on the part of developed and less developed nations is now an inescapable necessity if crisis of one sort or another are to be avoided in the future.

In closing, let it be repeated that the new perspective on the solution of the Latin American debt crisis, calls for the devising and adoption of a comprehensive domestic and international set of policies that will result in the reinvigorating of international trade, investment and lending policies, along with the resurgence of domestic savings and capital formation, leading to the kind of growth rates in excess of 5% annually that characterized the decades of the fifties, sixties and seventies. This kind of performance, if brought back, would make of the external debt not a

burden and an unproductive dead-weight but, on the contrary, as has been traditional in the history of economic development, a lively sign of vigorous growth and long-term expansion. The solution of the debt problem is for the debt not to be a ballast that impedes growth but for the debt to become, through its role in wealth creation, a stimulus and prod to growth. An increasing debt can be a healthy sign of growth, just like Adam Smith in the Wealth of Nations said back in 1776 that increasing salaries were an indication of growing wealth. On the contrary, a large and increasing debt has no "solution" if it doesn't cease to be part of the problem in order to become part of a true solution to the economic problems of developed and underdeveloped countries alike.

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