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The Latin American Debt Crisis (Dialogue #71)

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PREFACE

This dialogue paper is an edited version of two separate presentations given by Ulrich Merten and Jorge Salazar-Carrillo at Florida International University's Fourth Annual Journalists' and Editors' Workshop on Latin America, held March 14-15, 1986, at The Miami Herald. Both works deal with the Latin American debt crisis, but pose different viewpoints.

The workshop brings together a range of television and print correspondents, reporters and editors, and focuses on means to improve Latin American news coverage, as well as content specific topics on current area news stories. The workshop was funded with grants provided by Esso Inter-America, Inc., and The Miami Herald.

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THE LATIN AMERICAN DEBT CRISIS

Ulrich Merten

First of all, a brief summary of where we are today in regards to the Latin American debt situation. On the one hand, we have the commerical banks working jointly with the International Monetary Fund (IMF) and the debtor countries. On the other hand we find that there are two strategy alternatives existing today for dealing with the debt problem: one, the Baker Initiative and; two, what might be referred to as the Peruvian model. Finally, it is important to consider how this problem area of the debt is going to resolve itself.

Despite all the dire predictions of disaster--banks going under, insolvent countries in a state of anarchy, debtor countries in a state of anarchy because of the debt crisis, governments of the developed countries almost immobile because they do not know what to do--the approach that the banks have adopted of working together with the IMF and the debtor countries seems to have worked. Granted that the solutions proposed were meant to be short-term, they do, however, adjust the balance of payments problems of the countries according to classical theory. There is nothing new in this practice. The same methodology was applied to a lesser extent in the thirties. Around the turn of the century, too, the same methods were employed for addressing the balance of payments problems through the IMF's short-term adjustment program's reduction of the fiscal deficits' realistic foreign exchange rates, and for maintaining an export-driven policy to revise the economies. These type of policies have worked up to now, and the best indication of their success is that the banking industry is still in operation. None of the dire predictions forecasted have come true. In fact, when you receive the handouts from Morgan Guaranty, which contain information published in an excellent article on the debt crisis as seen from the principal players, it should be noted that in terms of trade balances the Latin American countries have improved from about 11.5 billion in the 1980-82 period to about 110 billion in the 1983-85 period. Even more importantly, the current account deficit has been reduced for the major Latin American countries, from about 96 billion to about 5 billion. Again, it needs to be emphasized that the short-term aspect of this approach has worked. Additionally, the major international commercial banks have been able to increase their prime rate capital, the base capital, at the rate of approximately 13 percent annually, whereas the expansion in terms of new money that the banks have provided has been in the area of 3 to 4 percent per annum--the difference with the rate of inflation.

Why does this system seem to work, and yet at the same time we are faced with the big problems today in the Mexico's and Peru's? Several developments have evolved: one, the terms of trade continue to go against the countries of Latin America and; two, the countries there remain net capital exporters. The drop in the price of oil is an example of this phenomenon, and a good reason why Latin Americans empathize so readily with what has happened with Mexico and Venezuela. It would seem more logical for Brazil and other Central America nations to be very pleased because the import bill has been reduced as a result of the drop in oil prices, but the camaraderie runs high because of the condition that all the countries face in terms of their raw material products. Latin America remains a net capital exporter; from the information on page two prepared by the Economic Commission on Latin America (ECLA) it can be seen that in 1985 the net transfer of capital was a -30.4 billion for all the Latin American countries.

Further exacerbating the problem of debt in Latin America is a lack of political consensus within these countries for more years on "adjustment policies." This is more of a political problem, however, and not necessarily an economic or financial one, since some of these indicators have been positive, as has already been shown.

Banks have grown tired of printing new money, especially those with only small exposure and ones who were never large players in the world of creative reserves. Consequently, there are two basic strategies being promoted; the first being the Baker Initiative, which is meant to answer the basic problem of stimulating growth in Latin America. Four participants play major roles in this initiative. One of the participants is the creditor banks who will continue to have to invest new capital at the rate of twenty billion dollars, cumulative for three years, but tied to the conditionality that these countries take steps now to reform some very basic imbalances in their economies. These imbalances include: high protective tariffs, protection of unproductive industries, and industries that are really "make work" organizations such as steel mills, usually owned by the government. Privately operated industries such as automobile assembly plants that produce twenty thousand units a year are not included in these "make-work" type of organizations. In these inefficient organizations there is a very poor application of resources, so conditionality becomes a question in order to get new money.

If there is going to be new money, then who will oppose conditionality? Conditionality is to be included now through the World Bank's structural adjustment loans. Without going into detail, these types of loans are meant to address problems of stagnant growth. There have been several examples of this approach in Central America, and one had been introduced in Chile with relative success. The measures that need to be implemented are extremely tough on the economies because in many cases some sectors will be negatively affected. Certain interest areas will suffer. Workers in unproductive sectors of the economy will see a drop in their consumption levels, but in the long run, these growth motivating policies will probably be the only way to solve the basic problems of many of these Latin American countries.

Another participant in this scenario is the debtor government, which will be required to implement these policies. The final major role player that needs mentioning is the creditor government. The governments of the creditor banks must propose to lower interest rates. Developments during the last week have been positive with the cut in the U.S. discount rate, as well as cuts in the rates of the Bundesbank (West Germany) and the Bank of Japan. If the conditionality is to be imposed that all term adjustments must be made, then there must also be a commitment on the part of the creditor governments to subscribe to an increase in capital of the World Bank and, in this case, the Inter-American Development Bank. In the case of the Inter-American Development Bank, it is important to remember that it is literally controlled by the debtor governments--the governments of Latin America. The loans made by the Inter-American Development Bank are all project loans. There will be a major vote of contention at the forthcoming meeting in San Jose. The U.S. government's position is that if it is expected to increase its capital input then it will insist on conditionality and policy loans similar to the sectorial loans of the World Bank. The whole impetus for new money, in support of lower interest rate terms and other further basic changes with the debt situation, is dependent on how these countries do business. This is the opinion shared by the commerical banks, the governments of the developed countries and the multilateral development banks including the IMF--a fairly consensus view.

What is the viewpoint then from Latin America? The Latin American countries espouse one basic point of view. There is full and unanimous support for the idea of growth since that is the element that is so obviously absent; again, however, it must be stressed that this reference is to overall growth--growth that addresses problems of a social and political nature as well as economic. We see from the Baker Initiative, however, a program long on conditionality, yet short on money. The bilateral credits in which the governments approve export programs and export incentive programs are not allowing for sufficient money. The other alternative, however, that of Peru's or Bolivia's last year, indicating that growth can only be achieved by not paying the debt is a very real threat. Bolivia took the posture of limiting its debt payments, though in actuality it did not pay anything. Nicaragua just stopped paying, but theirs is a unique case. Mexico, too, soon will need to make a decision on its debt situation. The limiting of debt payments, as in the Peruvian case, is going to cause great problems for the banks, and does not do anything for solving the long-term problems of Peru. Fortunately, up to now, when a smaller country follows this alternative the possibility of imitation is not so large. When a country of major size proposes this type of action, however, there are serious implications. There is another proposal presently being evaluated by the Cartagena Group for limiting debt service to a percentage of export of GDP growth.

In summary, the consensus opinion suggests that if interest rates do not go down, if trade restrictions continue to be imposed on Latin American products, and if coupled to this there is no increase in the capital offered by the World Bank, then other Latin American countries may be forced to follow this same non-paying route of Peru and Bolivia.

The most clear and pressing danger is in Mexico, and in my summary conclusion I will use Mexico as an example. In Mexico, the terms of trade have gone against its oil. The country has suffered through three years of austerity and unemployment and cannot take anymore. Mexico's balance of payments gap for this year can be helped by the banks making several billion dollars more available--a type of IMF sectorial program of the world banks. The IMF presently has two such programs: one for export promotion and the other for tariff reform by the bilateral creditors. No exceptional help is really needed. If Mexico follows the non-paying example, strictly for political and social reasons, it is doomed. When Peru opted for this route the effect was that they lost their trade lines. Peru has now turned to a barter system, particularly for paying off debts to the Soviets, who seem to accept textiles for tanks, or whatever they sold to the Peruvians. Banks not having a textile department, however, are more reluctant to accept this barter approach. If Mexico follows this same path, they, too, will lose their trade lines. The general feeling is that if they lose their trade lines--a country so integrated to the international financial system as is Mexico, and one of the great economic motives of the transformation in the streams along the border--then it is impossible to imagine just how they will continue. Tactics suitable for Peru are not suitable for a country of Mexico's size. In the end logic and reasonableness will prevail. Mexico will accept some long-term adjustment programs to open up their economy and to get rid of some of the government corporations that are so inefficient. At the same time, Mexico should receive lower interest rates from the banks, rates still at market value, yet with the lowest rate available, which is the creditor's factor in the interest rates. Mexico will need an assurance from the U.S. government that it will keep U.S. markets open for Mexican products and assurance, too, about capital entries.

Perhaps I am overly optimistic, but when the potential consequences are considered, the risks are literally jumping the tracks and are so great for all parties that, in the end, reason will prevail. There will be a loud stand-off, loud skirmishing, and some great articles about the "debt crisis" will abound. In the final analysis, there will be more government involvement, more commitments from both sides, and an end result that will witness an agreement of these interests.

THE LATIN AMERICAN DEBT CRISIS

Jorge Salazar-Carrillo

Here we are again talking about the external debt, which perhaps should be called the eternal debt. My presentation will cover four stages: first, I will discuss the origins and evolution of the present debt situation; second, I will explain why the situation should be regarded as serious, and why we need to avoid letting Latin America shoulder the responsibilities themselves when they are only partially responsible; third, I will review the present status of Latin America and; fourth, I will mention some possible solutions to the crisis--a crisis that has already exploded several times. Again, as already mentioned, the debt situation in Latin America is a problem that appears to be eternal; it simply does not go away. Let us see if that realization alone can arouse some interest and discussion.

The crisis, which erupted in 1982, had its beginnings in the world economies of the fifties. In the fities there was a re-emergence of the trends that had propelled a highly successful growth period, the second most successful growth period in history dating from the 1870s to the First World War. It was a period in which the economists of the world were mostly influenced by the international economy and adapted to it. The period after the First World War, the twenties, had some identifiable peculiarities to it in technical economic terms. For example, peculiarities such as those that made Keynes (John Maynard) famous before 1936, the debate about whether Britain should return to the gold standard, and at what level should the pound be placed and on what parity should it be placed with other currencies.

The twenties was a strange and difficult period in which there was an attempt to return to the pre-World War I situation, though never quite reaching this environment; then suddenly the crash of the thirties erupted. The interwar period was a time in which we did not return to the international economy, at least not until very early in the fifties. When we finally returned, lending resuscitated and began to grow to levels that had been normal in the 1910s. These circumstances were the origins for today's condition. By analyzing the Latin American debt indicators of debt in the early sixties, we see evidence of the debt problem surfacing. The problem of the debt was already present in the 1960's and beginning to worry people.

The second problem that has caused this situation, and that exploded again recently, is the new dimension of the international economy. From 1950 to the early seventies the developing countries became major participants in the world economy, something that had not been the case before. An environment of relaxed control, free trade deregulation, free floating exchange rates, and other phenomena meant that it was difficult to control the situation at hand, and that the developing countries could muster a lot of influence for themselves. The emergence of the oil cartel and later the oil shocks demonstrated this new influence.

Another final set of circumstances that has produced the debt explosion is the position of the United States and the other major industrialized countries in the West--the Group of Five (G-5): the United Kingdom, Japan, West Germany, France, and the United States. This major group began to see that they were losing control of the process; the international economy was beginning to affect their economies in ways they did not like and were not willing to tolerate. The reaction of the national economy in the United States and that of the other G-5 economies was to try to control the impact of the international economy on their own systems and, as a result, to rein inflation. They began to try to find more ways of regulating what was happening in the Eurodollar markets. In the end they caused a crisis situation at the beginning of the eighties in which the interest rates were set very high, and monetary policy was handled so as to defeat a major problem that the policy-makers in the major Western countries believed was going to be seeping the worst kind of consequences into their economies. They were not willing to tolerate these kind of consequences. They created conditions that, together with the situation that developing countries were bringing to the world economy and with the increasing integration of the international economy led, to the crisis that we are still living to a certain degree, and one that has affected the period from 1980-1985.

This is the background to the crisis that emerged in the early eighties, one that was already brewing in the sixties, and one, in fact, that was pervasive in the seventies. But why should we worry about Latin America and the Caribbean at all? Why not allow them to solve their own problems? What is in it for us and perhaps for the other Western nations?

I will provide some glimpses of what we are projecting that Latin America will become in fifteen years, assuming very meager growth in those countries. We know that the GNP for Latin America at the point of the 1985 crisis was about 800 billion dollars. This is not insignificant in the world economy. Latin American economies are relatively closed; they are not as open as the Pacific Basin economies or, in most cases, as the European economies. Brazil is one of the most closed economies in the world with 7-8 percent of its trade amounting in total GDP (essentially the same as GNP, the figure used in most of the world). The economies of Latin America had already achieved by the middle-to-late seventies an importance that was very close, in dollar terms, to the importance of the European Common Market in its early stages of formation. Latin America had a GDP very similar to Europe's in 1959. We can see the importance of how these countries were emerging; they were becoming very important participants in the world economy. In terms of exports of goods and services, Latin America is even now exporting over 100 billion dollars a year (1985 figures). Its population is barely above 400 million inhabitants. Its debt, as we know, is about 350 billion. Some people place it at 370, but the latest results from the OECD and the Bank of International Settlements have released new figures, which actually show a reduced level for Latin American debt.

What is Latin America to become? By the year 2000 we expect the population to be approaching six hundred million inhabitants, which will certainly be more than twice, perhaps two and half times the population in the United States and double that of Europe's. The GNP, we have estimated, will probably be in 1985 prices about 1.5 trillion dollars, which is about half of what the U.S. GNP is now. This is a very large number, especially for those that imagine Latin America to be an area that we and the rest of the world could live without. This does not seem to be that case, however, as we approach the year 2000. Their exports will probably be goods and services in excess of two hundred billion. I expect that the economies will still be quite closed. I think that the type of model that Latin America has been using for a number of years is very difficult to change; it has been maintained for decades. The debt may approximate near the order of five hundred billion dollars. We do not expect the Latin American debt to grow very fast. Last year it already began to grow at rates below those of inflation. In 1985, latin America for the first time incurred obligations to foreigners of about an increase of two percent while inflation in the major world economies of the West was four percent on an average.

We are discussing a group of countries, it is true, with quite a bit of disarray and squabbles among them--an obvious lack of cohesion. The recent occurrence in the Cartagena meeting in which Venezuela simply decided not to attend is a glaring example of this situation, and it will always be that way. It is very different in the United States, which is an example of a perfect common market. Latin America, economically speaking, will certainly rival the major blocs in the world, especially the EEC, the Pacific Basin, the Soviet Bloc and China. Latin America will be standing there right with them. The region will be a major force in the world economy and a force of integral interest to the United States.

From a political-economic point of view it is very important to realize that even though the internal dissensions still take place in Latin America, there have been changes. For the first time Latin America is adopting certain postures that do not coincide with the positions of the United States--the major influence over the region--and that are, in fact, confrontational to the United States. In political terms, you see the Contadora group emerging and sustaining its efforts, even though it has been under a barrage of controversy for many years from a U.S. policy standpoint. The Cartagena group, even though it has not really achieved anything in terms of concrete accomplishments has, nevertheless, stood as a unified force. It has continued to meet. It has continued to discuss Latin American issues and is a means of pressing for a common Latin American point of view. I would expect that by the year 2000 we will have as another megatrend, a more politically united Latin America. It is important for the United States and the other members of the G-5, via the Organization for

Economic Cooperation and Development (OECD), to keep in mind that the Latin American crisis has to be dealt with, whether this means appeased, massaged, or managed. Somehow the crisis must be responsibly addressed.

What is the situation in Latin America right now? It was a difficult year in 1985. The rate of growth of the Western economies dropped from a little over 5 percent on an average, mostly influenced by the U.S. growth of over 6 percent in GNP, to something a little less than 3 percent (1985 figures). As a result, the economies of Latin America were affected, and the export scape valve that had come to rescue the growth process in 1984 was not active in 1985. Growth for the Latin American and Caribbean countries averaged something on the order of 2.8 percent. The population weighted average, taking into consideration that Brazil influences the figure much more than Haiti, for example, was below the 3.2 mark of 1984. Nevertheless, for the ten major debtors in Latin America the rate of growth actually increased from about 3.2 to 3.4 percent, so the situation was not as bad as among the major debtor nations, which I think everybody realizes by now.

Exports went down 6 percent, of which 4 percent was in terms of the export prices of developing Latin American nations. There has been a loss of 17 to 18 percent in the purchasing power of Latin American exports over the last four or five years, so the terms of trade are still working against Latin America. There was also a 2 percent decline in the quantity of exports. Imports also went down and, in the end, the trade surplus, which had been close to 39 billion dollars in 1984, fell to a little over 34 billion dollars in 1985. The current account deficit in the balance of payments went up to 4.4 billion dollars from a one billion dollar deficit in 1984. Loans and foreign investments again slumped about ten billion dollars a year. In 1980-81, Latin America was sustaining inflows from foreign capital in the order of 35-40 billion dollars a year; now it is so far down that ten looks like a very good figure. In 1985 there was a further drop to 4.7 billion dollars in loans and foreign investments.

Latin America once more transfers capital abroad. It uses part of its national savings to handle a good part of the interest and dividends that it has to remit abroad. Instead of being helped in its process of growth and development, Latin America actually has to pay its dues to the international economy to be a valid member of the OECD countries. Over the last four years Latin America has transferred capital or resources abroad. In the transfer of interest and dividends other countries are able to buy your goods. Resources of 109 billion dollars over the last four years are still not so threatening, if we look at the GNP statistics that is about 5 of the GNP of Latin America. Everything should be kept in context, we should realize that the international economy is not as important in Latin America as it is in the rest of the world, probably even in the United States. The debt has grown only 2 percent, less than inflation. Interest represents just the interest to pay interest and dividends, which represents 36 percent on an average of Latin American exports of goods and services. This is certainly a very large amount, and a large down payment to be made every year from what is earned from exports. There are some countries that are obviously above this average--Brazil and Argentina--and others that are even worse.

We can make conclusions from this brief analysis concerning how Latin America is doing in 1985 and how it will fare in 1986. The region is doing remarkably well given the circumstances at large in which it has been cordoned off from the major lenders. It really does not receive anything but involuntary lending. It does not get any money from people that really want to invest there, and it has terms of trade going against it. Protectionism and the increasing diminution of the markets in the developed countries is a problem. If you look at all of this it is surprising that Latin America is growing at all, even without considering the population growth. Population growth in Latin America is now between 2.3 and 2.4 percent a year and growth is beginning to cover that. Overall, it is an encouraging picture that Latin America is showing the rest of the world, the major industrial countries, the private banks, the major traders, and the international institutions. I believe that the Baker Plan was, in many ways, acknowledging that. This is why the "Baker Plan" came into being, because not only is Latin America important, but it is really doing relatively well and trying to find a solution of its own to the crisis.

I have always shied away from proposing specific solutions to the debt problem. While studying international economics at Berkeley, we had to study about one hundred or so proposals directed at reform of the international monetary system. Each one had its own suggestions and idiosyncrasies, just as in the case of the debt. Nevertheless, there are clear general patterns that should be considered. First, as has already been done by the "Baker Plan," and dealt with in five conferences and books on the debt through Florida International University, we should acknowledge that there is a close, yet interdependent relationship between the debt crisis, growth, trading patterns, and the development of Latin America. The recognition of this relationship is essential, and I think, for the most part, has finally been accepted. Secondly, the world economic conditions, particularly trade and finance, are essential elements for solving the problem of the debt. Latin America cannot do it on its own; its most important contribution is a healthy economy. Nothing like interest rate reduction or export goals in terms of a certain percentage in interest payments of total exports can help nearly as much as maintaining a growing, healthy economy. The multiplier effects of increased exports are the best help that Latin America and the Caribbean can obtain, and not necessarily other formulas that try to reduce their cost.

Thirdly, there has to be increasing policy coordination among the leading economists in the world. Coordination is essential, and we see this happening for the first time in many years. We heard before the idea of the locomotive, that of the leaders and the followers in the industrial countries, but for the first time we see coordination from the Group of Five in economic, monetary, and fiscal policies. We can already see evidence of this coordination in the instruments--the interest rates going down in tandem, talk about exchange rates and about opening some new trade routes, diminishing protectionism, and so on. Another crucial element, which has not happened, is the sharing of the burden of the debt, dividing the cost of the debt between lenders and borrowers. This agreement might be arrived at through a conference of the major debtors and creditors, between fifteen or twenty of these, and including the banks and international institutions. This is not the only way; the important thing is that an agreement be reached to share the burden of the debt. This concept has been publicized, and it is obvious that there is some activity in this direction. The Group of Five is working through its effects, the interest rates, what happens to trade initiatives, and so on; an agreement is being sought.

In Latin America it is very important that the economies begin to open up. The export orientation of the Latin American economy has been its Achilles' heal over the last thirty-five to forty years, and this has not changed. Latin America has been losing its share of world exports; this has to change drastically, and a new policy system must be found. Finally, the institutional way of handling the debt must be changed; this is already proposed in the Baker Plan. I do not know if the World Bank or the IMF agrees, however. Supposedly, the World Bank with policy type of loans should now be rebearing the brunt of the Latin American adjustment. The short-term commissionality now becomes long-term commissionality. Clearly, these large international organizations should be the leaders in the managing of the debt, with the private banks, and the governments not far behind. This institutional type of change is effective because it moves us away from the very short-run conditionality that was emphasized by the IMF, which was detrimental to the growth objectives in Latin America, and which created many problems there.

In closing, I must say that we missed a great opportunity to elect a Nobel Prize winner. The Caribbean has had a representative, but not Latin America. I understand that the minister of finance of Bolivia was nominated, but did not win. The minister had proposed to make all Bolivians millionaires in three or four months--a tremendous miracle in itself. He did not quite achieve his goal, so Latin America still does not have a Nobel Prize winner.