all 40 cases -- contributed to a further increase of the deficit. The self-dynamism can be partly explained by the rigid tax systems prevailing in Latin America. Taxes did not fully adjust to inflation, whereas expenditures did. Therefore, fiscal imbalances are partially caused by inflation as well as a result of it. One can observe a decline of the ratio of taxes to GNP due to tax evasion accompanied by inefficient tax administration -- as manifested in collection lags and subsequent erosion of the real tax revenues. In this context, Argentina (1976, 1983), Bolivia (1984), and Peru (1984) are cases where the ratio of current government revenues to GNP declined by more than six percentage points during the five years prior to rescheduling [7].

The decline in revenues occurred concomitantly with the growing deficits of public enterprises. These enterprises account for a large part of total public revenues as the next chart illustrates.

Chart 2.2 : Size of Public Enterprises in Selected Countries, 1970-82
Revenues of Public Enterprises as Percentage of Total Public Revenues

Source : IDB : External Debt and Economic Development in Latin America, Washington, D.C., 1984, pp 151, 160, 170, 182, 188

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EXTERNAL DEBT RESCHEDULINGS
IN LATIN AMERICA, 1956-1984

by

Mag. Axel F.B. van Trotsenburg

(c) March 1986 by A.F.B. van Trotsenburg

A thesis submitted to the Faculty of Graduate Studies
and Research in partial fulfillment of the requirements
for the degree of
Master of Arts
in International Affairs

The Norman Paterson School of International Affairs
Carleton University
Ottawa, Ontario
Canada

March 1986

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ISBN 0-315-29843-X

The undersigned hereby recommend to the Faculty of Graduate Studies and Research acceptance of this thesis, submitted by Axel van Trotsenburg, in partial fulfilment of the requirements for the degree of Master of Arts.

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Abstract

The purpose of this thesis is the investigation of 40 rescheduling cases concluded by Latin American countries between 1956 and 1984. The thesis proceeds in four steps.

First, the origins of reschedulings will be discussed. The direction of major macroeconomic variables will be analyzed during a five year period before rescheduling. These trends in the 15 countries studied will be compared with each other.

Second, the thesis investigates whether the frequency of reschedulings can be related to the changing capital flows to Latin America or to previous reschedulings or both.

Third, the terms and characteristics of official and commercial bank reschedulings will be analyzed such as the amounts rescheduled, consolidation period, maturity, or interest.

Fourth, alternatives to "standard" reschedulings will be presented, including conversion of debt into long term bonds, changes in the international financial system, and the debtors' cartel.

As a conclusion, a new proposal is put forward, a rescheduling with growth strategy.

Acknowledgements

I wish to express my appreciation to my supervisor, John Burton, and my advisors, David Pollock and Roger Young for their assistance. Moreover, I would like to thank all those who have assisted me, in one way or the other, to complete my thesis, including my friends in the Development Stream, Linda Troyer for proofreading, Norma Hankin for typing the manuscript, the Australian Embassy in Rome for financial assistance, and last, but not least, my parents for their endless support. To all of them I owe my thanks for making my participation in the program of the Norman Paterson School of International Affairs a rewarding experience.

Acronyms and Initials

AID	- Agency for International Development
BIS	- Bank for International Settlements
CFE	- Compensatory Financing Facility
ECLA	- Economic Commission for Latin America
EHMIC	- Exports of Higher Middle Income Country
ELMIC	- Exports of Lower Middle Income Country
EPN	- Exchange Participation Note
GAB	- General Arrangements to Borrow
GDP	- Gross Domestic Product
GNP	- Gross National Product
IIDA	- International Development Association
IDB	- Inter-American Development Bank
IDDC	- International Debt Discount Corporation
IIF	- Institute for International Finance
IMF	- International Monetary Fund
LDC	- Less Developed Country
LIBOR	- London Interbank Offered Rate
MDC	- More Developed Country
MFN	- Most Favored Nation
ODA	- Official Development Assistance
OECD	- Organization for Economic Cooperation and Development
OPEC	- Organization of Petroleum Exporting Countries
RIAC	- Reimbursable, Interest Averaging Cap
RPPP	- Relative Purchasing Power Parity
SDR	- Special Drawing Right
UN	- United Nations
UNCTAD	- United Nations Conference on Trade and Development
US	- United States

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INTRODUCTION

During the last few years, much attention has been paid to the external debt problem of developing countries and, in particular, of Latin America. The literature on this topic has grown almost as fast as the debt itself. However, much less analysis was directed to the actual solutions in the form of rescheduling arrangements. Perhaps because it has been too difficult to acquire the necessary information, rescheduling processes have never been scrutinized to the same extent as have been stabilization programs with the International Monetary Fund (IMF). Therefore, this thesis is an attempt to shed more light on the reschedulings from 1956 to 1984 in Latin America.

Although foreign debt problems are encountered throughout the developing world, the study has been confined to Latin America. This region has the longest record of all debt restructurings since World War II.

The first debt rescheduling took place in 1956 with Argentina. It was followed by seven reschedulings during the 1960s, eight cases during the 1970s, and 24 cases from 1980 to 1984. This adds up to 40 rescheduling exercises involving 15 countries. They are the basis of the thesis. The 41st case, Cuba, will not be considered in full because its economic data - due to different accounting methodologies - are only to a limited extent comparable with the rest of Latin America.

A second reason to concentrate on Latin America is the fact

that the region dominates the Third World's international debt scene. Four out of the five largest debtors in developing countries (LDCs) are located in Latin America. Furthermore, since the 1950s Latin American countries have accounted for more than 30 per cent of total LDC debt. Over the last decade this share has augmented by eight percentage points, from 35 per cent in 1973 to 43 per cent in 1983 (11). Considering these factors, the number of reschedulings and the size of Latin American debt compared to total LDC debt, this serves to justify a hemispheric treatment of debt and reschedulings.

A rescheduling can be defined as a restructuring of the original repayment schedule with regard to a certain part of external debt. The outcome of such a rearrangement is that the debtor country can repay the principal, and often also the accumulated debt service in arrears, over a stretched-out period. Unlike the restructurings before World War II, which frequently settled debt after default, reschedulings over the last three decades have aimed at forestalling default with all its negative consequences.

The Development Committee of the IMF and World Bank has established two objectives for reschedulings (12):

- (1) Reestablishment of creditworthiness of the debtor country.
- (2) Promotion of the restoration and enhancement of financial flows through adjustment policies.

Rescheduling is, thus, embedded in a comprehensive framework of economic adjustment. The question is, how successful have

the reschedulings been in attaining those two objectives. The answer will be sought by taking the 40 Latin American rescheduling exercises as a representative sample. The earlier and the very recent historical analysis will not only allow the identification of changes in the reschedulings but also the deficiencies which have not yet been sufficiently addressed.

In order to give a balanced assessment of the performance of reschedulings, the thesis will proceed in four steps.

First, the origins of reschedulings will be discussed in Chapter Two. Since a clear cut concept does not exist to identify debt crises, one has to approach it through an assessment of macroeconomic indicators. In this chapter, five year trends prior to rescheduling of variables such as fiscal deficits, inflation, current account deficits, export prices and interest rates, will be compared in the 15 countries involved. This method will help to find similarities, although it does not permit generalizations in the absence of a control group of the non-rescheduling countries.

Second, the frequency of reschedulings is investigated in ~~Chapter Three. The number of reschedulings has increased~~ dramatically. This took place against a rapid build up of external indebtedness in Latin America since 1970. The increase of public and publicly guaranteed debt, including the undisbursed portion, from U.S.\$1.6 billion in 1945 to U.S.\$9.2 billion in 1970, U.S.\$ 161 billion in 1980 and U.S.\$257 billion in 1983 is illustrated in the next chart.

Chart 1.1: Growth of External Debt in Latin America, 1945-1983
(in billions of U.S. dollars)

Sources: Avramovic, D.: Debt Servicing Capacity and Postwar Growth in International Indebtedness, Baltimore, 1968, p. 163 ;
Avramovic, D.: Latin American External Debt, in: Journal of World Trade Law, vol. 4, no. 2, 1970, p. 123
World Bank: World Debt Tables, 1981-1985 Editions, Washington, D.C., 1981-85

The pursuit of a growth-cum-debt strategy since the late 1960s reveals major changes in the international financial system. Therefore, two explanations for the number of reschedulings will be tested. First, the frequency is an indicator for changing capital flows to Latin America. Second, the frequency is the consequence of previous reschedulings and, hence, a tacit recognition of the failure to accomplish the two goals of reschedulings spelled out by the Development Committee. Third, the terms and characteristics of reschedulings will be analyzed in Chapter Four. This chapter will, in its first part, discuss the experience of official reschedulings within

the Paris and The Hague clubs. The large portion of external debt owed to commercial banks during the past decade has significantly switched the importance of private bank reschedulings. The number of commercial bank restructurings bears sufficient evidence of this change. Therefore, the second part will examine the commercial bank reschedulings and elaborate the differences between the official and commercial bank arrangements with debtors.

Fourth, alternatives to existing rescheduling formulas will be presented in Chapter Five. The preceding three steps will have highlighted the problems related to reschedulings. The alternatives are categorized into four groups. One group of proposals deals with the conversion of debt into long-term bonds. The second group ties debt service to economic performance criteria in the debtor country. A third group emphasizes the possible reforms within multilateral financial institutions and commercial banks. The last group weighs the pros and cons of a debtor cartel and briefly examines the repudiation issue.

The conclusion will build upon the findings in these four chapters and end with a new proposal to tackle the debt problem.

~~Data on Latin America are primarily drawn from the International~~
Monetary Fund (IMF), the World Bank, and the Inter American Development Bank (IDB). However, in this thesis certain unpublished reports will also be used, and as has been requested, the source will not be disclosed. Instead, the utilization of such reports will be acknowledged by an asterisk [*].

A statistical appendix will complement the respective chapters and provide additional data on economic variables, lending developments, and terms and conditions of reschedulings.

NOTES

1. World Bank, World Debt Tables, 1981 and 1985 Editions, Washington, D.C., 1981 and 1985, pp. 118 and 158.
2. Development Committee, Non-Concessional Flows to Developing Countries, Washington, D.C., 1982, pp. 2-3.

CHAPTER TWO

The Origins of Reschedulings

This chapter provides a detailed overview of the main contributing, as well as the aggravating, factors to the Latin American debt problem.

Although this study does not work with a control sample of countries which did not reschedule, one can identify a strong political dimension in the 40 cases prior to their rescheduling. It is particularly interesting to note that most Latin American countries subject to debt renegotiation experienced political changes such as coups and new governments. There is not necessarily a causal relationship but certainly a positive correlation between rescheduling and political change. One observes the following:

In eight cases affecting six countries -- Argentina (1965, 1962, 1976); Brazil (1964); Chile (1974); Peru (1968), Nicaragua (1980); Bolivia (1981) -- the president was deposed within three to 16 months before the agreement on a debt restructuring.

In two cases -- Argentina (1965) and Peru (1968) -- the political situation was so unstable that both presidents were ousted within 12 months and one month, respectively, after the rescheduling agreement.

The political and economic uncertainty prevailing in three countries -- Peru (1983 and 1984) (guerilla activity and elections), Jamaica (1974), Ecuador (1983) (both one year before general elections), and Nicaragua (1981 and 1982) (Anti-Sandinista guerilla activity) -- coincided with

rescheduling arrangements.

Ten countries -- Argentina (1984), Bolivia (1984), Brazil (1961), Chile (1965), Costa Rica (1983), Dominican Republic (1983), Ecuador (1984), Jamaica (1981 and 1984), Mexico (1983) and Venezuela (1984) -- renegotiated their debt within one year after the elections. In the second year following the elections, Chile (1972), Honduras (1984) and Mexico (1984) - for the second time - reached an agreement on rescheduling parts of their external debt obligations.

Furthermore, five cases involving three countries could be classified as "countries in transition toward democracy" -- Brazil (1983 and 1984), Peru (1978 and 1979), and Uruguay (1983).

In two countries -- Chile (1975) and Guyana (1979, 1982 and 1984) -- the respective governments kept a firm grip on their countries, thwarting political change. Although the above findings should be interpreted with caution, the 40 cases clearly convey the political climate in the countries studied.

Domestic political events have often given the final shove to an already fragile economy. Political changes require creditors to reappraise the creditworthiness of, and their exposure to, the country involved. Due to the similarities of LDC economies, creditors often extend their assessment to a whole region. One could speak of a "domino effect" on credit. The most recent example of such a "domino effect" was the strong contraction of lending to Latin America in the wake of the Malvinas/Falkland war in 1982 and the Mexican financial crisis a

9-
few months later.

The possible volatility of international capital flows, which is the core of the debt problem, is well described by F.W. Taussig's statement that:

In fact, however, the loans from the creditor country, so far from being made at the same rate year by year, begin with modest amounts, then increase, and proceed crescendo. They are likely to be made in exceptionally larger amounts toward the culminating stage of a period of activity and speculative upswing, and during that stage become larger from month to month so long as the upswing continues. With the advent of a crisis, they are at once cut down sharply, even cease entirely. The interest payments on the old loans thereupon are no longer offset by any new loans; they become instantly a net charge to be met by the borrowing country. A sudden reversal takes place in the debtor country's balance sheet; it feels the consequences abruptly, in an immediate need of increased remittances to the creditor country, in a strain on its banks, high rates of discount, and falling prices. And this strain of events may ensue not only once, but two or three times in succession. The final outcome, when this long period of irregular movements has run its course, is that the debtor country has more to remit on interest account than to receive on principal account, and that the remittance is affected by an excess of merchandise exports over imports [2].

Although Taussig wrote this statement in 1927, it has not lost its validity today. However, since the 1970s, the major changes in international financial markets have elevated the problem of capital flows to a completely new quantitative dimension.

International capital offers a way to overcome the domestic savings gap and to accelerate economic growth. Since the first oil crisis, it has gained increased importance with the recycling of OPEC (Organization of Petroleum Exporting Countries) surpluses and financing of current account deficits. Since capital flows respond strongly to the ups and downs of the

business cycle as well as to political upheaval, the risks are inherent. To identify the changes in capital flows as the cause of the balance of payments crisis or the debt servicing capacity difficulties would ignore the actual underlying causes. Changes in lending may precipitate or aggravate the economic situation in a country but are, more often than not, the consequence of internal and external factors causing the debt crisis.

Considerable research has been devoted to determining an adequate measure of a country's debt servicing capacity [3]. Due to the deficiencies of the debt service ratio as an adequate parameter, a basket of indicators was selected in the attempt to establish a kind of early warning system which should signal if a country was on the verge of a debt crisis. However, the indicator systems seem to be of very limited applicability for lender and borrowers to forestall critical debt situations. All studies on this problem failed to develop a 100 per cent fool-proof index or system even with ex post data. One can imagine the formidable problems of developing an index based on ex ante data. The future is simply uncertain and perceptions and expectations play an important role in it.

As the author has noticed on numerous occasions, statistical data pose a great problem to an adequate assessment of debts. Data are often incomplete, inconsistent across countries and only available with a considerable time lag. No wonder that every indicator system, single or multidimensional, loses immediately its predictive strength, keeping the statistical limitations in mind. With this caveat, this thesis sets out to

observe trends of several important internal and external economic factors. Debt indicators will be used, even though they can not substitute for comprehensive country evaluations. As mentioned before, the absence of a control group precludes generalizations beyond the 40 case sample group.

The origins of rescheduling typically cannot be attributed to one factor. Rather several factors may be present, although one may predominate. Before analyzing each single factor the following chart illustrates the interrelationship of major economic variables influencing the debt servicing capacity before the outbreak of a debt crisis. This chart does not represent a model nor is it comprehensive in establishing all links between other economic variables such as savings and private debt. Rather, it shows the main factors on which the following discussion will be based.

Chart 2.1 : Major Relationships between Debt, Budget Deficits, Inflation, Exchange Rate and Capital Flight in LDCs before the Debt Crisis.

Arrow 1 : in case of a devaluation.

Arrow 2 : capital outflow due to political uncertainty.

Arrow 3 : capital outflow due to an anticipation of a devaluation.

2.1 Domestic Factors

The capability to absorb internal and external imbalances depends largely on the sustainability of such a situation. Debt servicing difficulties manifest themselves in a balance of payments crisis which has forced many Latin American countries to approach the IMF. The IMF sponsored programs have far more frequently been applied than reschedulings themselves. Between 1953 and 1984 Latin American countries signed 205 Stand By Arrangements -- out of an IMF total of 546 -- and 13 Extended Fund Facility Arrangements -- out of a total of 31. The major rescheduling countries -- Argentina, Brazil, Chile, and Peru -- had agreed 51 times on an IMF program while they rescheduled it 19 times. For the four countries, the ratio of IMF programs to reschedulings was 2.5:1 [4]. This indicates that the imbalances in the balance of payments caused by fiscal, monetary and exchange rate policy, are necessary, but not sufficient, requirements for debt renegotiations.

It seems that the country's ability to absorb shock varies over time, depending on the size of, and direction of, macroeconomic variables, public expectations and the duration of a recession. Furthermore, it also depends on the conflict solving potential of the various social groups. The widespread political instability of the countries concerned often led to a postponement of adjustment and aggravated the balance of payments problem. As a result, the country was required to request a restructuring of its debt obligations. The governments of the 40 cases have frequently pursued a set of

fiscal, monetary, and exchange rate policies that was inconsistent with their debt servicing capacity. Therefore, a solution to the debt problem must be considered not in isolation but in context of restoring the viability of the balance of payments. Thus, reschedulings have to be linked to economic adjustment programs. /

2.1.1 Fiscal Policy

The public sector in Latin America has traditionally played a leading role in the economy, often constituting half or more of GNP in countries such as Brazil and Mexico.

Latin American governments have relied heavily on deficit spending in order to overcome the adverse economic situation at home and/or abroad, to mitigate political and social unrest caused by recession, and to promote economic growth. This policy was financed by the central bank and foreign borrowing. Hence, a large part of the countries' external debt is owed by the public sector. Fiscal policy has, thus, been increasingly influenced by debt service to which a growing share of total expenditures had to be allocated. A fiscal imbalance could be sustained as long as the foreign funding was uninterrupted. However, with a reversal of foreign lending, the public sector had to deal more quickly with the deficit.

The causes for fiscal disequilibrium can be categorized into five groups: (1) export boom, (2) price-inelastic tax system, (3) public enterprise performance, (4) increased expenditures as a result of political pressures and administrative weaknesses, and (5) worsening terms of trade [5].

Since many LDCs depend on a few or even a single primary commodity as the main source of export and hence of government revenues, those receipts strongly influence fiscal performance. A boom phase often induces a government to embark on an ambitious infrastructure and investment program in order to accelerate economic development and increase employment. In general, however, the gestation period of those projects and its recurrent components are far longer than the duration of the boom, leaving the country with a widening fiscal deficit when export prices fall.

In our sample, the decline in oil prices since 1981 forced an end to the expansionary fiscal policies pursued by Ecuador, Mexico, Peru and Venezuela. This process was accelerated by the sharp curtailment of bank lending since the second half of 1982. Except in the Peruvian case, the other countries subsequently cut their deficits in half or more after the conclusion of an IMF stabilization program. An earlier example is Chile which experienced a doubling of copper prices between 1965 and 1969. However, the drop of copper prices by 37 per cent from 1970 to 1972 aggravated the budgetary imbalance still further [6].

With the advent of a recession caused by an economic downturn in industrialized countries and subsequent depressed export prices, many Latin American countries attempted to overcome these adverse effects by deficit spending. The budget deficits were covered by the central bank or external indebtedness. The ensuing inflationary process -- as can be observed in virtually

all 40 cases -- contributed to a further increase of the deficit. The self-dynamism can be partly explained by the rigid tax systems prevailing in Latin America. Taxes did not fully adjust to inflation, whereas expenditures did. Therefore, fiscal imbalances are partially caused by inflation as well as a result of it. One can observe a decline of the ratio of taxes to GNP due to tax evasion accompanied by inefficient tax administration -- as manifested in collection lags and subsequent erosion of the real tax revenues. In this context, Argentina (1976, 1983), Bolivia (1984), and Peru (1984) are cases where the ratio of current government revenues to GNP declined by more than six percentage points during the five years prior to rescheduling [7].

The decline in revenues occurred concomitantly with the growing deficits of public enterprises. These enterprises account for a large part of total public revenues as the next chart illustrates.

Chart 2.2 : Size of Public Enterprises in Selected Countries, 1970-82
Revenues of Public Enterprises as Percentage of Total Public Revenues

Source : IDB : *External Debt and Economic Development in Latin America*, Washington, D.C., 1984, pp 131, 160, 176, 182, 188

Governments have often selected certain enterprises, particularly petroleum companies, to promote investment and act as a "motor for growth". At the same time, they became a major revenue source for the government. For example, during the late 1970s the Mexican government received about 25 per cent of its total revenues from its petroleum corporation PEMEX [8]. This reliance became excessive, however, when oil prices began to decline.

The public enterprises have become a severe liability for two reasons. First, in Argentina, Brazil, Mexico and Venezuela public enterprises had incurred substantial amounts of short term debt which posed a serious problem when those short term obligations were no longer automatically rolled over by banks. Second, with the advent of the 1981-83 recession the enterprises switched from a revenue to a subsidy source. Their deficits measured as a percentage of GDP increased between 1979 and 1982 from 2.9 to 5.4 per cent in the case of Argentina, 3.5 to 8.6 per cent in Mexico, 1.1 to 4.4 per cent in Peru and 1.4 to 8.3 per cent in Venezuela [9]. As a consequence, the subsidies to public enterprises have aggravated the budgetary situation in the above mentioned countries as well as in Brazil, Bolivia and Costa Rica [10].

Another source of subsidies are those for consumer goods. A deterioration in the country's terms of trade has been neutralized by a reduction of import taxes or price controls. The failure to pass through those price changes increased expenditures and burdened the deficit even more. Again,

Argentina, Bolivia, Costa Rica and Peru can be mentioned as examples. [11].

In our sample, transfer payments and subsidies were definitely one of the most dynamically growing items of expenditures by the central government. One can single out Argentina (1976, 1984), Chile (1983), Costa Rica (1983), and Dominican Republic (1983) as those countries which significantly increased their subsidies and transfers prior to rescheduling [12].

The other fast growing item was interest payments. In all rescheduling cases since 1970, interest payments have become one of the main items of total expenditures. Its share reached about 20 per cent for oil exporters such as Ecuador, Mexico and Peru in the year before the rescheduling. Jamaica (1984) and Guyana (1984) did not experience significant relief from earlier reschedulings. Their interest obligations, in fact, increased to 27 and 35 percent, respectively, in the year prior to rescheduling [13].

In the Appendix, Table 1 provides an overview of the central government deficits as a percentage of GNP during the five years prior to rescheduling. Although the public sector comprises central, provincial, and local governments as well as public enterprises, its comparability is limited due to incomplete data and different accounting methodologies. In Latin America, the most homogeneous and comprehensive information on public expenditures and revenues is available on the central government [14]. Unfortunately, the trends described do not always reflect

the trends in the public sector as a whole. This is particularly evident in the case of Brazil, where the public sector deficit exceeded five per cent of GDP in the years prior to debt renegotiation, while the central government showed a small surplus [15].

In summary, one can observe that in virtually all 40 cases the deficits of the central government were increasing during the years before they rescheduled for the first time. As IMF stabilization programs usually have to be in place before external debt can be rescheduled, budget deficits declined sometimes sharply before debt was rescheduled for a second or third time.

Over time, central government deficits in proportion to GNP increased in general. Whereas during the 1960s the five year averages of the deficits were below five per cent of GNP, the deficits increased during the 1970s but did not exceed eight per cent of GNP, Guyana and Jamaica being the only exceptions. The 1980s showed a pattern similar to the 1970s.

Particularly since the 1970s, foreign borrowing was employed to cover the budget deficits. The constraints in international lending have made it imperative to address the fiscal imbalance. The issue at stake is summarized by Sjaastad:

Turning fiscal deficits into surpluses requires either an increase in public sector savings or a reduction in public sector investment. The former implies either increased taxes or reduced consumption. Both are politically difficult. Reducing public sector investment jeopardizes future growth, but, if default is to be avoided, those are the only choices [16].

2.1.2 Monetary Policy

Monetary policy is as much a cause as it is a consequence of the economic problems of the countries studied. Broadly, one can identify four important origins for inflation: (1) expansion of the money supply, (2) budget deficits, (3) cost push factors - such as real wage increases, and (4) import price increases and the "vicious circle" argument. A fifth cause is expectations.

As has already been explained, there exists a two-way relationship between inflation and budget deficits. In most of the 40 cases, budget deficits and inflation were concurrently increasing. The governments resorted to the central banks to cover the deficits, and the ensuing inflation resulted in larger deficits, which in turn were financed by printing more money.

Social and political pressures frequently do not allow the government to implement the austerity policies necessary to redress the internal and external disequilibria. Organized labor bargains for higher real wages which business, in turn, passes through in product prices, pushing inflation still higher.

In this context, the widespread application of indexation in Latin America perpetuates the inflationary process. Conceptualized as a system to combat the erosion of the real value of money against high inflation, the indexation has given an additional impetus to inflation.

Another factor has been the increase of import prices. The transmission of international inflation has been of particular

importance during the 1970s. Two oil price shocks plus the higher prices for imported manufactured goods from OECD countries have fueled the inflationary process.

In order to offset the external component of inflation, governments have pursued a policy of overvaluated exchange rates. This policy has failed completely in Latin America, for it has to be complemented by coordinated monetary and income policy. Instead of the desired "virtuous circle", the 40 countries under consideration found themselves caught in a "vicious circle". Latin America suffered from higher inflation than in OECD countries, usually three to six times as high, but occasionally - 1983/84 - reaching more than 20 times their figure [17]. Since the exchange rate of many Latin American countries is pegged to the U.S. dollar or a basket of currencies, regular corrections of the exchange rate became imperative. But most of the devaluations did not yield the desired results, as they were not accompanied by counter-acting measures. Therefore, within a short period of time the country was back at the point from where it departed, but with a higher price level, which in turn required another devaluation. Thus, the vicious circle leads from devaluation to higher inflation and the other way round.

A final and increasingly important cause entails expectations, particularly where inflation went out of control and feeds itself. Expectations, rather than the monetary aggregates, determine the inflation, with the central bank more or less accommodating. In the 40 case sample, there are four

examples of such galloping inflation -- Chile under Allende, Argentina under Peron (1973-76) and after the Falkland/Malvinas war, and Bolivia since 1982.

All factors causing or caused by inflation have been present in the 40 cases. The development of the money supply and inflation over a five year period prior to rescheduling is provided in Tables 1 and 2 of the Appendix.

The findings suggest that in virtually all cases the money supply showed an increasing trend over the 5 year period. Only in the Chilean (1983) case did the money supply decrease, whereas the oscillations in the Guyanese, Jamaican and Venezuelan cases are inconclusive.

Inflation, taken as a five year average, reached "traditional" Latin American levels, i.e., rates of over 20 per cent, in 65 per cent of the cases. In 25 per cent of the cases inflation even exceeded the 50 per cent mark. Only one country, the Dominican Republic, kept inflation under 10 per cent. Its government deliberately resorted to short term external borrowing in order to finance the public sector deficit. The measure did not affect the domestic money market and even led to a reduction of inflation. This accomplishment was, however, offset by an accumulation of short term debt and hence increased debt service. The concern about inflation has, thus, contributed to the debt rescheduling [18].

Table 2.1: Categorization of 40 cases, by Inflation
(5 year averages)

Inflation							
%	%						
Years		0-10	10.1-20	20.1-50	50.1-100	>100	Cases
1950s			1				1
1960s			2	4	1		7
1970s			2	3		3	8
1980-84		1	8	9	5	1	24
Total		1	13	16	6	4	40

Source: Appendix, Table 3:

A main characteristic of the countries which had to go through a second or even a third rescheduling within three years was the acceleration of inflation between those debt renegotiations. The higher inflation can be considered as "corrective" in nature, i.e., the result of the elimination of certain price distortions. This correction may be implemented as part of an IMF program. On the other hand, the higher inflation may also reflect the government's inability -- due to political and social circumstances -- to adopt austerity measures. As a result, the governments continue to pursue expansionary policies which lead to the next balance of payments crisis and rescheduling.

In Brazil, the populist administration of President Goulart (1961-64) caused a tripling in the inflation rate as a result of his expansionary demand policies. In Argentina, despite a new

IMF Stand-By-Arrangement in 1962, budget deficits persisted and were covered by the Central Bank. Inflation ranged between 20 to 30 per cent and the republic had to devalue three times between 1962-65, which indicates the presence of a vicious circle. In the Peruvian cases of the 1960s, inflation doubled from one year to the other after the 1967 devaluation. When Chile reached finally an agreement in 1972, inflation quadrupled within one year and went out of control afterwards, reaching 354 per cent in 1973 and 505 per cent in 1974. Peru rescheduled twice, in 1978 and 1979, and experienced again an acceleration of inflation. It had gone through a series of devaluations, beginning in 1975 through 1978, and adopted three Stand-By programs between 1977 and 1979, of which two were cancelled.

For the large double reschedulers in the 1980s - Brazil, Ecuador, Mexico, and Peru - one can observe sharply soaring inflation rates between the reschedulings. Although Ecuador and Mexico managed to reduce inflation after the initial surge, in Brazil and Peru inflation remains over 100 per cent. In both cases, political change left inflation as a secondary problem.

Many single rescheduling cases showed a sharp increase in their inflation rate from the second to the first year before rescheduling. However, as many cases - seven - reduced the inflation in that period. In four of them -- Chile (1965, 1983), Uruguay (1983), Honduras (1984) -- an IMF program was adopted, whereas in the Dominican Republic, Guyana and Venezuela independent policies were pursued.

From the above analysis, it appears that some countries were

able to comply to the IMF Stand-By-Arrangements, while, others were not. This finding would confirm the conclusion derived by the Inter-American Development Bank, stating:

This (finding) is not to suggest that a necessary relationship exists between the adoption of an IMF program and a surge in inflation in certain countries, but rather that some of the policies that are normally part of such programs (such as real depreciation of exchange rate and the reduction of price controls and subsidies for consumer goods) will, if not accompanied by strong counter-acting measures, inevitably result in upward pressure of the price level [19].

2.1.3 Exchange Rate Policy

Fiscal and monetary policy cannot be separated from exchange rate policy and vice versa. Their overlap has already become apparent from the previous analysis. The governments studied have employed the exchange rate mainly in an attempt to correct inflation and break inflationary expectations. As this policy was not embedded in a comprehensive economic policy, governments did not prevent the exchange rate from appreciating in real terms.

The exchange rate which, in most cases, is pegged to the U.S. dollar or a basket of currencies, has to be adjusted in the wake of high domestic inflation, if a real appreciation is to be avoided. The correction, however, often followed with a time lag and the nominal devaluation proved to be insufficient. As a result, all 15 countries had gone through a prolonged period of over-valuation before their rescheduling.

The extent of over-valuation can be assessed by the concept of the relative purchasing power parity (RPPP). In RPPP terms, a currency, say the peso, is defined as the product of the

equilibrium exchange rate in a base period multiplied by the ratio of the domestic and external -- weighted according to trading partners -- price indices. The relative version, thus, says that the change from the equilibrium exchange rate is due to changes in the relationship between the domestic and international inflation rates. The real exchange rate remains constant as long as the difference of the two inflation rates is adjusted in the nominal exchange rate.

Since Latin American countries suffer from chronic high inflation which exceeds the average OECD price level, permanent adjustment is imperative, in order to prevent the real rate from falling, i.e., appreciating. However, as can be observed in the 40 cases, the devaluation rate fell short of covering the difference between both inflation rates, causing the real exchange rate to appreciate [20]. Therefore, by the time of readjusting, those countries were required to devalue their currencies in real terms.

Countries which had adopted a crawling peg system such as Brazil, appreciated too, albeit not massively [21]. At the end of the 1970s, Argentina, Chile, and Uruguay introduced a system based on a preannounced devaluation table ("tablita"). The table was pegged to the U.S. dollar and was designed to curb inflation. In all three cases, this policy was abandoned by 1981 or 1982, without achieving a reduction in inflation [22].

The overvaluation has had, in general, negative effects on the economies studied [23].

First, the overvalued exchange rate failed to curb

inflation. As examples stand the three aforementioned countries as well as the "Dutch disease" cases, Mexico and Venezuela.

Second, the overvalued exchange rates harmed exports and stimulated imports. The Marshall-Lerner condition predicts a deterioration in the current account balance after an appreciation, for exports decrease and imports increase. In order to offset the anti-export bias in the exchange rate, some governments increased their export incentives - such as reductions in taxes and increased subsidies, etc. For example, Argentina, Peru and Uruguay introduced such measures [24].

Third, the price relationship between the traded and non-traded goods sector becomes distorted, thereby affecting the production structure of the economy. Exporters suffered from diminishing returns, because pass-through effects could not arise after a gradual appreciation. This means that the exporters could not charge a higher price on international markets as they are price takers and otherwise would lose their market share. ~~The actual winner is the non-traded good sector.~~

In order to prevent a reallocation of production from the external to the non-traded sector, one should ask when an exchange rate policy becomes counterproductive for the export sector which is often the most competitive and dynamic one. Continued competitiveness of the export sector is a basic requirement since it is this sector which has to generate the foreign exchange for the debt service.

Fourth, the overvalued exchange rate caused and/or reinforced the instability of the capital account. Governments

can only temporarily "lean against the wind" by defending a particular exchange rate, depending on the foreign exchange reserves and the country's borrowing capacity. The country must increase the interest rate in order to attract external capital. This policy proves to be exhaustive and is doomed to fail in the medium run. The anticipation of a devaluation, the lack of confidence in the economy and political circumstances finally manifest themselves in capital flight and subsequently in a balance of payments crisis.

Therefore, in all 40 cases the correction of the exchange rate was an integral part of a stabilization program prior to a rescheduling agreement. Three indicators have been selected to demonstrate the adverse effects of a prolonged period of exchange rate overvaluation. The indicators the current account balance, the ratio of reserves to imports, and capital flight -- are, of course, not exclusively the result of the exchange rate policy. Therefore, due reference will be made to other contributing factors.

2.1.3.1 Developments in the Current Account Balance

The following results of developments in the current account balance are based on observations during a five year period before rescheduling and can be found in greater detail in the Appendix, Table 4.

The five year averages showed a deficit in all but one - Venezuela - thus supporting the proposition that an appreciation will deteriorate the current account. In those cases where

there was a declining trend, a devaluation preceded this development. Since a currency is usually devaluated in real terms before the debt renegotiations, one notices the improvement in the current account already before the agreement. In a sample, comprising the cases from Brazil (1964) to Peru (1979), and Brazil, Ecuador, Mexico and Peru in the 1980s, the current account generally improved in the year following the devaluation. Interestingly, the J-curve effect, i.e., a temporary further deterioration of the current account due to time lags, appears to be absent in the Latin American context. Two reasons might explain this immediate improvement in the current account. First, the magnitude of devaluations is large, often more than 30 percent. Second, Latin American countries sharply compressed their imports, albeit at the expense of the economic growth and employment. The rigor of this compression was not paralleled in industrialized countries.

Until the Peruvian reschedulings in the 1970s, the average values of the current account deficit as a percentage of GNP did not exceed 3 per cent, with Chile (1965) and Peru (1968) being the only exceptions. At the end of the 1970s, three countries - Guyana, Jamaica and Peru - faced higher deficits, ranging from 5.5 to 13.9 per cent of GNP. However, the moderate average deficits changed in the 1980s. Disregarding the oil exporters and Argentina, in all other countries current account deficits to GNP rose well above four per cent. Particularly, the smaller Central American and Caribbean countries accumulated substantial deficits, reaching up to 30 per cent of GNP. Chile was the only

larger debtor whose ratio was comparatively high, namely 9.1 per cent of GNP.

The underlying causes of the current account deficits were myriad; among them: (1) overvalued exchange rate, (2) oil price shocks and deterioration of the terms of trade, (3) sharp increase of international interest rates and hence debt service, and (4) public sector deficits. Points (2) and (3) will be discussed in the section dealing with external origins of the debt problem. The overvalued exchange rate and the public sector deficit have certainly aggravated the magnitude of the current account imbalance. Particularly, the impact of the public sector deficits on the current account has been tested in various studies [25]. The results indicate that "external imbalances are statistically associated with fiscal imbalances and that reductions and increases in overall government deficits are associated with reductions and increases in the current account deficits [26]. In the next chart, this relationship is illustrated for three countries.

Chart 2.3 : Relationship between Government Deficits and Current Account Deficits over 5 Year Period before Rescheduling: Selected Countries

The financing aspect of the current account deficit has changed dramatically since 1974. Before that year, non-debt creating flows - particularly foreign direct investment - and official flows were of predominant importance [27], as well as long term borrowing. With the first oil shock and the recycling of OPEC surpluses, private capital, especially short-term, took over the leading role of financing the current account deficits in Latin America. Chart 2.4 provides evidence of the close association of financing requirements and private lending. This chart suggests that lending was geared to balance of payments finance, which is supported by the conclusions in another study [28].

Chart 2.4 : Current Account Financing of Latin America, 1977-84 (in billions of U.S.dollars)

1) Current Account Deficit plus Capital outflows
Source: Appendix, Table 5

2.1.3.2 International Reserves

According to the World Bank, a country "should maintain higher reserves the more variable are its export earnings, the higher its debt exposure, the less flexible its economic policies and structures, and the less likely it is to have access to a steady flow of external capital" (199). The Bank recommends LDCs to hold higher reserve coverage levels than the industrial countries. How did the rescheduling countries fare in this respect?

The number of months' imports covered by reserves in industrial countries declined from an average of eight in the 1950s, to six in the 1960s and has oscillated around four ever since 1981. However, only 20 per cent of the cases could reach or exceed the OECD levels. The two countries with the highest coverage are Venezuela -- because of its oil wealth -- and Uruguay -- because of a traditional maintenance of high reserves.

Chart 2.5 : International Reserves in Months of Imports¹⁾

1) Calculated as 5 year averages before rescheduling

Source: Appendix, Table 7

The World Bank recommendation should actually produce a right leaning distribution in Chart 2.5. Instead, our sample is left leaning with 60 per cent of the cases having reserves for less than three months of imports.

The smaller countries - Guyana and Jamaica - had the lowest ratios, namely reserves of less than one month of imports. In the second group, i.e., reserve coverage between one and two months, other small countries dominate, including Costa Rica, the Dominican Republic and Honduras. Even Mexico had a low mark which reached a precarious level in 1982; when its reserves could only cover less than one month of imports. However, the country was able to improve its reserve position before the next rescheduling. All other double reschedulers improved their coverage by accumulating reserves and compressing imports between the debt negotiations. In the Appendix, Table 5 recapitulates the figures over a five year period and their averages.

2.1.3.3 Capital Flight

Capital flight is the symptom of an economic situation which cannot be sustained over a prolonged period of time. The outflow aggravates an already shaky economy.

Usually, capital flight is related to (1) an overvalued exchange rate, (2) high inflation, (3) interest differentials between the domestic and international level, and (4) political events. The overvaluation was present in most cases (31, *1). Doubts about its sustainability triggered an outflow. The

anticipation of a major devaluation breeds speculation and causes additional downward pressure on the currency and a decrease of reserves. The central bank can temporarily intervene, but if the exchange rate is too far from its equilibrium position, this policy will fail. Therefore, the exodus of capital tends to accelerate the process leading to a devaluation.

In Latin America, inflation and a pegged exchange rate often resulted in a real appreciation. Moreover, the inflation adversely affects interest rates. Due to an interest rate ceiling or a faulty credit policy, interest was sometimes negative and discouraged saving at home. The negative rates disrupted the efficient allocation of resources and encouraged capital flight. High inflation, negative interest and a weak economy manifest themselves in a tense political atmosphere. As was described at the beginning of this chapter, political change and conflict was associated with rescheduling but also with capital flight. For example, Nicaragua transferred capital abroad to the amount of U.S.\$710 million between 1979 and 1981 as has been calculated in Table 6 of the Appendix.

Since the beginning of the 1980s, the interest differentials between domestic and the U.S. level have resulted in substantial outflows. Ecuador and the Dominican Republic were reported to have serious problems to cope with the differentials [32].

There does not exist an exact method of estimating the amount of capital flight. One way of getting an idea of the magnitude is to look at the "errors and omissions" entries in

the balance of payments. They reveal the illegal capital flows and should be supplemented by the recorded outflows of private short term capital. The following results are based on this definition.

Table 2.2: Capital Flight and Increase of External Debt Stock, 1977-83

	Capital Flight [1] (in millions of U.S. \$)	Increase of Debt Stock [2]	Capital Flight as % of Increase in Debt Stock
Argentina	19,371	30,030	64.5
Bolivia	1,270	1,277 [3]	99.5
Brazil	3,102	44,617	7.0
Chile	1,290	10,307	12.5
Ecuador	1,026	5,095 [3]	20.1
Mexico	32,853	48,740	67.4
Nicaragua	942	2,550	36.9
Peru	737	5,041	14.6
Uruguay	2,114	1,862	113.5
Venezuela	16,652	6,323	263.4
Total	79,357	155,842	50.9

1. Capital flight as defined in Appendix, Table 6.
2. Increase of public, publicly guaranteed, and non-guaranteed debt outstanding disbursed between 1977 and 1983.
3. Only public- and publicly-guaranteed debt.

Source: Appendix, Table 6; World Bank, World Debt Tables, 1984 and 1985 Editions.

Argentina, Mexico and Venezuela accounted for 86 per cent of total capital flight. But smaller debtors recorded high outflows in relative terms. For example, in Bolivia and Uruguay the increase of external debt was completely offset by the capital flight. Peru and Brazil are noteworthy cases in which capital flight was contained by exchange rate policy. Brazil's crawling peg combined with strict capital restrictions was, at

least, successful in this respect. Capital controls are, however, not sufficient to prevent outflows. Underinvoicing exports and overinvoicing imports are one way of circumventing the controls.

Capital flight goes back to the first reschedulings, albeit not in size. During the 1950s capital outflow averaged about U.S.\$300 million annually for the region [33]. This figure increased in the 1960s and 1970s and culminated in 1981/82.

The capital flight seriously hampers the country's recovery. It leaves the country concerned with the debt burden and concurrently undermines its creditworthiness. In its harsh conclusion the Annual Report of the Bank of International Settlements (BIS) for 1984 stated:

It is too much to expect the rest of the world...to perform the development functions that the countries' own nationals refuse to assume. Clearly, the burden of interest charges would look much less frightening, if it could be calculated in terms of net interest owed to the rest of the world; i.e., the interest to be paid on external debt minus the income received (but not necessarily repatriated) by the owners of the exported capital [34].

Therefore, it will be critical for a recovery in Latin America and the resumption of net lending that flight capital is repatriated.

2.1.4 Problem of "Overborrowing"

The notion of "overborrowing" indicates the country's limited debt servicing capacity, when market conditions change. It is a vague concept for the judgement whether or not a country borrowed in "excess", depends largely on expectations. Since

rational expectations are relative over time, in hindsight we tend to be "more" rational than at present time.

In our sample, a growth-cum-debt strategy was often launched in response to a boom in commodity prices. The quadrupling of oil prices in 1974 and the ensuing recycling process facilitated the final breakthrough to capital markets for Latin American countries. They were eager to borrow in order to sustain their growth rates and development process, but partly postponed the adjustment of their economies to the new realities of the world economy. Therefore they traded temporary relief in the form of increased indebtedness for permanent vulnerability of their economies, due to the reliance on volatile capital markets. Bankers' herd behavior is subject to abrupt changes. They were as much responsible for "overlending" and in the 1980s for "underlending" as debtor countries for "overborrowing".

According to the U.N. Economic Commission for Latin America (ECLA),

It was the interaction between this attitude on the part of the international banks and the external indebtedness strategy followed by many Latin American countries which to a large extent made it possible to mobilize abundant financial surpluses generated in the international system from the time of the first oil crisis....Finally, it was the abrupt change in the international banks' perception of the viability of development based on this strategy which constituted one of the main factors behind the present crisis [35].

In order to operationalize "overborrowing", one might analyze the concept in relation to the growth of debt and its impact on GDP growth. In the long run, the return on external capital should yield a rate in excess of the interest charged. Since this rate should be positive, its impact on GNP should also be positive. The

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Aliber uses a very broad criterion in selecting cases of overborrowing. According to him, "if the debt is too large, a disturbance or change, external or domestic in origin, might trigger a crisis" [36]. This conclusion is not sufficient. Instead, the development of short, medium, and long term debt will be briefly discussed. In our findings, the growth of disbursed outstanding debt does not allow a general conclusion. The growth rates were in 31 and in 16 cases in excess of 15 and 20 per cent, respectively.

Table 2.3: Categorization of 39 Cases, by Growth of Disbursed Outstanding Debt: 5 Year Averages Prior to Rescheduling

Years	Percent					Cases
	Below 10	10.1-15	15.1-20	20.1-30	30.1-40	
1960s	1	2	1	2		7
1970s	1	3		1	3	8
1980-84	1	6	8	7	2	24
Total	3	11	9	11	5	39

Source: Appendix, Table 8.

Due to this diversity, the growth rates of medium and long term debt are not conclusive and it appears that the real problem of overborrowing is on short term. The reliance on short term debt is a double-edged strategy. If medium or long term loans were not extended in sufficient amounts, countries tended to resort to short term borrowing. The lack of access to

those funds, however, reflects the wariness of the banks with a particular economic situation. In order to diminish their risks and to guarantee a quick redemption, banks prefer to lend short term in those cases. The major difference between the debtor and creditor is their time horizon. The creditors believe that the financial needs of the region are short term, while debtors incur short-term debt to finance long-term projects. As those projects do not immediately yield a return, the roll-over procedure of short term debt is crucial to keep the country financially afloat. The 1980s have shown that this procedure cannot be taken for granted. The curtailment in lending was a consequence as well as a cause of an indebtedness strategy gone awry.

Short term debt rose by 330 per cent between 1978 and 1982. In five selected countries depicted in Chart 2.7, short term debt nearly doubled its share of total external debt from 1978 to 1980. The constraints in borrowing, imposed by banks in the 1980s, led to a return of the proportion between total and short term debt prevailing during the mid 1970s.

Since much international trade is financed by short term credit, maturing between 90 and 120 days, the World Bank recommends that countries should not accumulate short term debt in excess of three months of imports [37]. In this respect, Latin American and especially the selected countries of Chart 2.7 did not fare well. In the region, short-term debt as equivalent of imports doubled since 1979, rising from 5.1 to around 10.4 months in 1982/83. The selected countries showed

even higher figures. Their short term external obligations nearly doubled from 5.3 to 10 months between 1978 and 1981. In 1982/83 the short term debt exceeded one year of imports.

Chart 2.7 : Short Term Debt In Relation to Total External Debt, 1978-81, Selected Countries ¹⁾
(In per cent and months of imports)

1) Includes Argentina, Chile, Mexico, Peru, and Venezuela

Note: Short Term Debt to Total Debt: ———
Short Term Debt to Imports: - - - - -

Sources: IDB: External Debt and Economic Development in Latin America; IDB: 1985 Report, p. 413

In summary, overborrowing has manifested itself in ambitious investment programs which were designed on faulty assumptions about the permanence of a commodity boom or oil wealth. Furthermore, overborrowing was reflected in excess reliance on short term finance; thereby adversely affecting the maturity distribution of the countries' debt portfolio.

2.1.5 Maturity Distribution of External Debt

Short term debt was one factor leading to bunching, i.e., the repayment of debt falling due within a short period of time. The other factor was the change that occurred within the structure of external public debt in Latin America.

Chart 2.8 : Structure of the External Public Debt Outstanding in Latin America, by Maturities, 1966-1982¹⁾
(Percentage on the basis of the total outstanding debt at year end)

1) Public and publicly guaranteed debt with a maturity of over one year.
Sources: IDB: 1982 Report, op.cit.p.66; IDB: External Public Debt of the Latin American Countries, Washington, D.C., 1984, p.18.

Chart 2.8 illustrates the increasing importance of loans with maturities of up to five years as well as loans of up to 10 years. The former augmented by 13 percentage points from 45 per cent of total debt in 1970 to 58 per cent in 1982, whereas the latter surged from a 23 per cent level between 1966 and 1970 to 35 per cent in 1980/81. This sort of finance has been pivotal in the early reschedulings. During that time, the public and

private sectors together undertook extensive medium-term borrowing, in the form of suppliers' credit. This happened for instance in Brazil and Argentina. The competition for new OECD export markets reinforced this lending without analyzing the possible impact of export credits on the debt portfolio and balance of payments [38, *1]. All cases until 1970 had subsequently to settle their suppliers' credit obligations.

The access to long term finance has become restricted since 1970. Since then, the share of long term capital in total inflows declined from 32 to 12 per cent in 1982 [39]. This trend was more pronounced for the semi-industrialized countries which had to rely increasingly on international capital markets. It was as much a symptom of their maturing economies as it was the failure by the OECD to live up to its commitments with regard to official development assistance (ODA).

Argentina's share of long term loans to total was cut in half between 1973 and 1982, while Brazil's share in 1982 was a mere 22 percent of the level in 1970. Similar trends were evident in Chile and Mexico. For Venezuela long term funds dried up almost entirely in 1982 [40].

It was in the realm of loans with maturities between one and five years in which some dramatic changes took place for certain countries. Bolivia more than tripled this share (1-5 years) to total debt from 1966 to 1982, as well Venezuela and Costa Rica more than doubled their share.

If a particular percentage should indicate the limits of a country's debt servicing capacity, it appears that figures of over 60 per cent of one to five year loans out of total medium

and long term debt, is a reason for concern. In 1982, examples of a maturity mismatch are Argentina with 65.2 per cent, Mexico with 70 per cent and Venezuela with 77.3 per cent. Considering that all countries had also contracted substantial amounts of short term debt, this limit could be lowered to perhaps 50 per cent and would still serve as a warning sign for debt difficulties. In cases exceeding 50 or 60 per cent, bunching and an exchange shortage are almost inevitable.

Although the deterioration of the debt profile is a precursor of the debt problem, one can not conclude that it will necessarily lead to an exchange crisis. In comparison between two groups -- rescheduling and non-rescheduling countries -- it has been observed that the proportion of bank debt maturing within one year was not larger for reschedulers than for non-reschedulers. However, the bank debt falling due in the next year as a ratio to total claims was four times higher for rescheduling countries than for other countries. Moreover, the ratio of undrawn credit lines to outstanding bank debt for rescheduling countries was half the ratio prevailing for nonreschedulers (*). These developments between 1978 and 1983 increased the vulnerability of debtor countries to changes in bank lending.

Thus far, it has been shown that the restructuring of the debt portfolio has resulted in a shortening of the average maturity. Table 9 in the Appendix documents the substantial accumulation of short term debt which became a source of liquidity problems. This development is also reflected in the debt service ratio which draws attention to the short run cash flow squeeze of a country [41].

This ratio relates debt service payments -- amortization and

interest -- to export revenues. It has been the most popular ratio describing a country's debt servicing capacity, mainly because of its simplicity and the absence of a better alternative. However, one should not overlook its deficiencies. First, the ratio is a cash-flow concept and ignores the long run aspects of profitability and productivity. Second, although it is true that a rising ratio indicates the increasing burden of debt, the ratio has also an inflation bias. With inflation interest rises and so does the debt service ratio. What is not revealed in it, is that the real value of debt is reduced and the higher interest payments actually should be considered as part of the amortization. This idea has been incorporated by the Argentine public accounting methodology [42]. Third, the ratio deals only with three variables which affect the balance of payments. Therefore, it seems futile to find a "critical" level of the debt service ratio. The history of debt shows cases in which a country sustained a relatively high ratio without encountering serious balance of payments problems, and cases to the contrary. Fourth, the debt service often refers only to public and publicly guaranteed debt, leaving aside short-term and private non-guaranteed debt. The difference is striking in the 40 case sample.

In analyzing the debt service ratios on public external debt five years prior to rescheduling, one observes a generally increasing trend of the ratios. About half of the cases show five year averages of 10 to 20 per cent and 14 cases had averages above the 20 per cent.

The ratio's conclusiveness becomes less clear when one compares

the fifth and first years before rescheduling with each other. In 20 per cent of the cases the ratio doubled, but in 40 per cent of the cases the ratio did not change significantly and even declined [43]. Among these declining ratios were, for instance, Peru and Mexico in the 1980s. In contrast, their debt service ratios on total external debt - thus including short term and non-guaranteed debt - were rising. The ratios for Argentina, Brazil, Chile, and Venezuela moved in the same direction. Comprehensive data on total debt service could only be found for the six reschedulers. Chart 2.9 depicts the trend of the ratios from 1975 to 1983.

Chart 2.9: Debt Service Ratios, 1975-1983¹⁾
(in per cent)

1) Debt service on public, publicly guaranteed, private non-guaranteed, and short term debt. No inclusion of amortization on short term debt.

Sources: IDB : External Debt and Economic Development in Latin America, Washington, D.C., 1984, Appendix, Section A
IDB : 1985 Report, Washington, D.C. 1985, Statistical profile in country summaries

When one compares the average ratios on public and total debt, the figures deviate substantially from each other. For example, the average ratios on total debt for Peru (1984) and Mexico (1984) were 60 per cent above the debt service ratios on public debt for the two countries. The other four countries had average ratios which were at least double the comparable ratios on public debt. For this reason, one has to interpret the debt service ratio with caution, especially as regards which debt is included or excluded.

In summary, the following factors have contributed to the worsening debt profile: (1) accumulation of short term debt, (2) excessive reliance on suppliers' credit in the 1960s, (3) ineffectiveness of debt management, often manifested in the heavy borrowing by state enterprises, and (4) macroeconomic policies such as deficit financing of the current account and the public sector.

The maldistribution between short, medium, and long term debt has caused a rise in the debt service ratio as well as credit rationing. Due to growing concern, creditors have interrupted or slowed down the roll-over process and in certain cases (e.g., Chile under Allende, Brazil under Goulart) curtailed credit lines.

Although domestic policies largely shape the debt profile, external factors cannot be discounted. The overlap has already become apparent in this section. The thesis will now turn to those factors which were beyond the control of the rescheduling countries and had -- at least in the 1980s -- a decisive impact on the precipitation of the debt crisis.

2.2 External Factors

The previous discussion has already revealed the interaction between internal and external causes of the debt problem. The external factors will now be isolated for analysis. The external sector in Latin America continues to expand and contract according to the international business cycle. Since the 1970s those up and down movements have been reinforced by the volatile capital flows to the region.

The following analysis will focus on five interrelated aspects of external vulnerability: (1) the commodity concentration of exports, (2) developments in commodity prices, (3) export growth, (4) protectionism and (5) economic policy in the OECD, mainly in the USA, with its impact on interest rates and the exchange rate.

2.2.1 Commodity Concentration of Exports

Although the World Development Reports bear evidence of the structural changes in Latin America during the last three decades, dependence on external markets remains significant. The external sector has actually increased its relative importance. The ratio between the combined value of exports and imports and GDP has been growing from 1970 to 1980 [44].

Depending on the size of the internal market and the export structure, Latin American countries vary in their ability to absorb external shocks. Two parameters which influence the absorptive capacity of shocks are the export destination and commodity composition.

All countries studied export the bulk of their goods and services to the OECD countries. In 1983, all but three of the rescheduling countries conduct 60 per cent of their export business with the OECD countries [45]. Despite a decrease compared with the 1960s, for the smaller countries plus Mexico and Peru the figure still ranges between 70 and 86 per cent.

The growth path is, thus, essentially set by OECD demand.

Studies have calculated that exports of non oil developing countries expand by $\frac{1}{2}$ to 3 percentage points with one percentage point additional OECD growth [46]. Therefore, a recession in the OECD countries has a multiple negative effect on Latin American exports. Most countries are not in a position to redirect their trade in the wake of a recession. Only Argentina has expanded its trade ties with East European countries, especially the Soviet Union. However, this appears to be the result of political circumstances (for example, U.S. grain embargo).

In the other realm, the structure of exports, only Argentina, Brazil, Jamaica and the Dominican Republic succeeded to augment the share of manufactured exports to total exports by at least 14 percentage points [47]. In 1982, Jamaica had even increased this share to 58 per cent of total, from 31 per cent in 1965. However, the diversification did not circumvent the country's balance of payments problems.

In all the rest of the countries studied, primary commodities continued to be the major revenue source. They generated more than 60 per cent of total revenues. The reliance on a

single commodity was particularly marked in the oil exporting countries of Ecuador, Mexico and Venezuela. In 1982, petroleum exports accounted for 64 to 97 per cent of their total export earnings [48]. Chile (copper), Guyana (bauxite) and the Dominican Republic (sugar) also relied heavily on a single commodity, albeit to a lesser extent (40-50 per cent).

Table 11 in the Appendix indicates how much one, two or three commodities contributed to the total export revenues. The dependence on two commodities is still formidable in the Central American countries, where both products make up 50 and more per cent of total earnings. The fall in commodity prices combined with political uncertainty and guerilla warfare has depressed exports in the three countries and weakened the Central Common Market. Ultimately these factors, plus high interest charges, prevented them from servicing their debt.

2.2.2 Commodity Prices and Terms of Trade

The concentration of exports has been strong in sugar, coffee, copper, and petroleum. The price developments of these four commodities have been studied for the period between 1977 and 1983. Chart 2.10 shows that between 1978 and 1980 all four indices were rising but from 1980 to 1982 recorded a decline of about 30 per cent in copper and coffee prices and a 77 per cent drop in the price of sugar. This sharp fall in the sugar price was sufficient to decisively influence the debt crisis in Guyana, the Dominican Republic and Cuba. Although the official

petroleum price increased until 1982, the world oil glut had already forced the price down in the spot markets since 1981. The price movements in the chart confirm the parallel behavior of commodity prices with the economic situation in the OECD countries. Whenever there is a recession, prices in commodity markets fall and rise during recovery phases.

Chart 2.10 : Indices of Annual Average Commodity Prices,
1977-1983 (1980 = 100)

Source: Appendix, Table 12

Commodity prices have a strong impact on the export earnings but can they trigger a debt crisis? Such an interpretation would be incorrect. First, commodity prices always fluctuate and at times strongly. There are more country cases which did not reschedule despite falling commodity prices than there were

cases that did. One indicator in this regard entails drawings under the IMF Compensatory Financing Facility compared to the number of reschedulings. Second, rising commodity prices do not protect against reschedulings. As Ecuador, Mexico, Peru and Venezuela have shown, the oil price was still over the 1980 level when the debt crisis was precipitated. Third, a rising or falling trend of prices is not critical for a debt crisis. What counts is the perception whether the trend is permanent or temporary. Accordingly, plans are based on these perceptions or expectations. With regard to petroleum, these expectations turned out to be erroneous. Therefore, only the unanticipated shocks in prices will have a contributing impact on the debt servicing capacity. Four, the negative trend in prices and its effect on the trade balance can be offset by international reserves and foreign borrowing. For example, the terms of trade of Latin America deteriorated by 9.5 per cent in 1978 vis-a-vis the preceding year [49]. The availability of offsetting variables did not affect the debt service capacity. Their absence in the 1980s aggravated the debt burden, when the terms of trade declined 5.7 per cent in 1981, 5.2 per cent in 1982, and 1.5 per cent in 1983, always compared to the preceding year.

The terms of trade had different repercussions in individual cases than in the aggregate. In particular, the sugar and copper exporting countries saw a drop in their terms of trade by up to 30 per cent between 1980 and 1982. Table 13 in the Appendix summarizes the development of the terms of trade between 1979 and 1983. Leaving aside the oil exporters, the

other 11 rescheduling countries as a group experienced a drop in their terms of trade in the amount of 20 per cent between 1980 and 1982, the year the international recession reached its trough. The ensuing recovery slightly improved the terms of trade of the countries studied.

2.2.3 Export Growth

The export performance of a borrowing country is of utmost importance for the repayment of a foreign loan. As the American-Austrian economist F. Machlup has succinctly shown in a simple model that analyzed how countries with foreign debt should repay, a country has to generate a surplus in its trade balance in order to pay back its external loans. Despite the simplicity of the model and its assumptions, Machlup concludes that the exports reflect the "real" payment of the loan [50].

Although loans usually get rolled over instead of repaid, export growth is pivotal for debt service. In order to maintain a constant relative debt burden, the Brazilian economist Simonsen has demonstrated that export revenues should be increasing at a rate as least as rapidly as that of interest [51]. This criterion was almost never met in the 40 cases studied. Sluggish demand, adverse terms of trade, overvalued exchange rates, and political events caused declines in export growth rates at a time when they were most needed. In nominal terms, almost all 15 countries experienced negative export growth one year before their first rescheduling. Mexico and Chile (1965) were the only cases whose exports continued to grow. The double reschedulers, in general, succeeded in boosting exports in the wake of a real devaluation.

Chart 2.11 compares export performance with the typical interest rate on a Latin American loan, the London interbank offered rate (LIBOR) plus one per cent, in nominal and real terms. In nominal terms, the region was able to meet the Simonsen criterion until 1980. The drop in export earnings in 1978 could easily be offset by external borrowing. In the absence of new net lending and in the wake of the sharp fall in exports from 1980 to 1982, it is clear that the debt situation became explosive. The picture changes only slightly when one observes the interest rates adjusted by the OECD/GNP deflator and the real export growth. The latter one has been split into two rates, one for the exports of the higher middle-income countries (EHMICs) and one for the exports of the lower middle income countries (ELMICs). The unweighted average growth rate for EHMICs was 7.2 per cent per annum between 1973 and 1983, and for ELMICs 0.6 per cent.

Chart 2.11 : Export Growth and Interest Rates, 1977-1983

Note: The interest rate is the London interbank offered rate on three-month U.S. dollar deposits plus one per cent spread.

Sources : IMF : World Economic Outlook, Washington, D.C., 1985, pp 213, 217

World Bank: World Development Report, Washington, D.C., 1985, pp 190-191

The lower mark for ELMICs may explain why those countries were among the first which had to reschedule between 1979 and 1982, since the real interest rate exceeded the rate for ELMICs as early as 1978. Therefore, Bolivia, Jamaica, and Guyana had to request a debt renegotiation, because their respective exports were declining and could not sustain the debt burden. This suggests that the contraction of external debt in those countries was inconsistent with their export capabilities. It seemed just a matter of time until their balances of payments deteriorated to the point of crisis.

For EHMICs, the debt strategy was different. Their real export growth exceeded the real interest rate until 1980. However, with rising real interest, combined with a rapid build up of short term debt and decline of real exports between 1980 and 1982, their balances of payments' situation became also untenable. From the charts, it appears that it was not the EHMIC's but rather the unprecedented high real interest rates that incapacitated the debt strategy.

2.2.4. Protectionism

The need to boost exports has been sufficiently demonstrated above. It has been reinforced by the constraint in lending. This has necessitated a net transfer of capital from Latin America to the creditor countries, which is achieved by a surplus of exports over imports. However, Latin America is challenged by an export constraint, protectionism. If OECD countries and the USA, in particular, are not opening their

markets further to exports from the region but are actually introducing new barriers, how will these countries ever be able to honor their debt obligations in full?

Although the current situation is not as perilous as during the 1930s, it nevertheless is reminiscent of a statement made by the League of Nations in 1932:

When the great creditor countries reduce their exports of capital...all their debtors must meet their obligations either in goods or in gold, instead of by fresh borrowing. Before this extraordinary situation had fully developed, however, a further check was imposed upon the capacity of the debtor countries to pay their external obligations. The increased export surpluses which they placed upon world markets caused concern in the importing creditor countries which thereupon imposed higher tariffs and supplemented them by additional restrictions on imports. These ensued, in consequence, an enormous shrinkage in ~~import~~ trade and the logical consequence of this shrinkage has been a series of moratoria, suspensions of payments and stand still agreements as a result of which the credit of many debtor countries has been gravely impaired [52].

Protectionist concerns were absent in the reschedulings before 1980. The severe recession from 1981 to 1983 has again lifted protectionism to prominence. It may be considered as one of the aggravating factors of the debt problem.

2.2.5 Economic Policy in the OECD Countries

Although the previous four external factors have been influenced by the OECD countries, the impact of OECD monetary and fiscal policy on the region was even stronger. Since 1979, industrial countries led by the U.S. Federal Reserve Board have adopted anti-inflation policies. The primary goal has been to break entrenched inflationary expectations. Inflation was brought down from a peak of 9.2 per cent in 1980 to 4.9 per cent

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in 1983 [53], at the expense of higher real interest rates and much higher unemployment of labor and capital.

Two related instruments were supposed to accomplish this reduction, monetary and fiscal policy. It appears, however, that the restrictive monetary policy did all the work. The commitment by OECD countries to cut their fiscal deficits was not implemented. On the contrary, the seven major industrial countries increased their central government deficits measured as a percentage of GNP from 3.5 percent in 1980 to 5.7 per cent in 1983. The U.S. government fared even worse. It increased its deficit from 2.4 to 5.8 per cent of GNP in the same period [54]. In order to finance the U.S. deficit, which is staggering in absolute terms, the U.S.A. had to attract foreign savings which, in turn, require higher real interest rates than elsewhere. Thus, the upward pressure on interest rates was caused by the monetary authorities as well as by the growing fiscal imbalance.

As many foreign loans are extended on a variable interest basis, the surge in real interest resulted in a surge of the interest payment burden. Interest charges on external public debt measured as a percentage of GNP nearly doubled between 1980 and 1983 from 1.6 to 3 per cent [55]. These ratios, moreover, underestimate the total interest burden as short term and non-guaranteed debt are not included. The additional interest service over the "traditional" real rate of two to three per cent, was substantial in individual cases. For example, "excess" interest cost for Brazil amounted to U.S.\$6 billion between 1979 and 1982 [56].

Chart 2.12 : Financial Transfers, 1979-1984¹⁾
(in billions of U.S. dollars)

1) Seven countries studied: Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela

Source: IDB: 1985 Report, Washington, D.C., 1985, p. 18

Chart 2.12 illustrates that the increasing interest charges could be offset by net external borrowing until 1982 or one year earlier if capital flight is taken into account. The widening gap between unsatisfied financial requirements and interest obligations contributed to a large extent to the deterioration and ultimate precipitation of the debt crisis.

The second consequence of high real interest rates in the U.S. was an appreciation of the U.S. dollar. Despite the growing U.S. current account deficit, the U.S. effective

exchange rate appreciated by over 50 per cent between 1980 and 1985 as can be seen in Chart 2.13. The fiscal imbalance, the rising investment demand in the U.S. and the strength of its economy may partially explain the upward pressure of the dollar.

Chart 2.13 : Dollar Exchange Rate, 1980-85
(Indices, average value for 1974-83=100)

Source: IMF: World Economic Outlook 1985, p34

For Latin American debtors, this development was two sided. The positive effect was a growth in U.S. imports and hence an expansion of Latin American exports. On the negative side, since external debt is denominated in U.S. dollars, its high value adds to the debt burden. Furthermore, the huge U.S. trade deficit has bred protectionist pressures on Capitol Hill. It is necessary to weight both factors in order to determine whether the high U.S. dollar has been "bad" or "good" for Latin America.

2.3 Conclusion

Does the previous analysis of the 40 cases show common characteristics that determine the origins of the debt problem? One can answer this question in an affirmative, albeit qualified manner. The answer is affirmative, because the factors mentioned above are manifested in each of the 15 countries studied and have influenced their debt servicing capacity. The answer is qualified because the factors analyzed are those which contribute to a balance of payments crisis. The IMF Stand-By and Extended Fund Arrangements with the region were concluded six times more often than rescheduling arrangements.

Interestingly, among the reschedulers were countries which had pursued completely different economic policies, be they interventionist, laissez-faire or socialist. For this reason, the myriad of economic factors such as fiscal, monetary, and exchange rate policies as well as developments in commodity markets are only partially explanatory. What the analysis in this chapter indicates is that external debt management has not been integrated into economic policy making. The deterioration of the debt portfolio confirms that international capital has bypassed domestic political and economic considerations to the extent that it presented itself and was taken as a panacea for everything. As much as an overdose leads to distortions, expressed in a postponement of adjustment, the withdrawal of funds results in collapse. The next chapter will deal with this volatility of capital, by analyzing the changes of capital flows to Latin America and their impact on reschedulings.

NOTES

1. Note that a country plus a year, e.g., Argentina (1956), refers to a single case which rescheduled in the year indicated.
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10. See also Tanzi, V., Fiscal Disequilibrium, op. cit., p. 1080.
11. Ibid., pp. 1075, 1080.
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13. IDB, 1985 Report, ibid., p. 407.
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20. IDB, 1982-1985 Reports, op. cit., see country summaries: IMF Annual Report, Washington, D.C., 1962, p. 149; IDB, European Financing of Latin America's Economic Development, Washington, D.C., 1966, p. 4; Bittermann, H.J., The Refunding of International Debt, Durham, N.C.: Duke University Press, 1973, p. 113.
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43. See Appendix, Table 10.
44. IDB, 1982 Report, op. cit., p. 24.
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CHAPTER THREE

THE FREQUENCY OF RESCHEDULINGS

If the origins of debt reschedulings are similar to those of countries which encountered balance of payments problems and, subsequently, adopted IMF adjustment programs, what is the distinguishing characteristic between rescheduling and non-rescheduling countries? The answer has to be sought in the role of international capital. The changes that have occurred in the international financial system, particularly over the last 15 years, have decisively influenced the external debt situation in the region.

Since the number of reschedulings has significantly increased over the last 30 years, two explanations will be tested: One proposition holds that the frequency of reschedulings is an indicator of the changing forms of capital flows to Latin America. The second proposition argues that the frequency of reschedulings is the consequence of the previous reschedulings. This would mean that the goals for a successful rescheduling, spelled out by the Development Committee, could not be achieved by one single arrangement.

Intuitive proof for both propositions is evident from the data. The change in capital flows is revealed in the change of rescheduling fora. In the 1950s, 1960s and until 1975, all debt restructurings took place with official creditors in the Paris or The Hague clubs. Since then commercial bank restructurings have begun to dominate the debt scene. In the 1980s, official

reschedulings accompany the larger commercial reschedulings and are no longer dominant as can be seen from the next table.

Table 3.1: Categorization of Cases, by Official and Commercial Reschedulings (1)

Time	Official	Commercial	Cases
1950s	1		1
1960s	7		7
1970s	4	4	8
1980-84	7	24	31
Total	19	28	47

1. The larger number of cases is due to official and commercial reschedulings in the same year by Brazil (1983), Costa Rica (1983), Ecuador (1983), Jamaica (1984), Mexico (1983) and Peru (1983, 1984).

The tentative evidence for the second proposition stems from the fact that nine out of 15 countries, involving 75 per cent of the cases, went through several, usually two, debt reschedulings over a three year period after the first agreement.

3.1 Proposition One: Frequency as Indicator for Changing Capital Flows

How far is the frequency of reschedulings an indicator for changes in capital flows to Latin America? After having presented the intuitive proof, four hypotheses attempt to verify this proposition.

The first hypothesis argues that the 1950s were dominated by foreign direct investment. Therefore, debt service was low and only one country had to renegotiate its debt. The second

hypothesis states that during the 1960s official flows were the main source of capital to Latin America. Although the debt was contracted at a fixed interest rate, domestic macroeconomic policies could put the country "off track" with regard to debt service. Four countries experienced such problems during the 1960s. The third hypothesis argues that the 1970s were dominated by a surge in commercial bank lending. Loans were extended at variable interest and their maturity was usually shorter than official loans. Changes in the terms could, thus, seriously hamper the viability of the balance of payments as well as an economic policy that was incompatible with foreign borrowing. The switch from official to commercial lending as the main source of capital to the region was manifested in the reschedulings. The Paris Club subsided in importance while commercial bank restructurings emerged. Although reschedulings increased only by one compared to the 1960s, the 1970s demonstrate that reschedulings were not the only option left to countries with debt problems. Latin America was able to continue borrowing and postpone adjustment because the creditors were willing to continue lending. The fourth hypothesis argues, therefore, that the dominance of commercial loans has made the region more vulnerable to changes in capital flows. This dependence on banks' behavior reinforces the debt servicing problems, when lending is interrupted and contracted. As a result, countries have no option but to request a rescheduling.

In the following discussion, capital from official creditors

comprises multilateral loans from international organizations such as the World Bank and IDB, and bilateral loans from governments and their agencies, such as the EXIM Bank in the U.S.A. Capital from private creditors comprises suppliers' credits, loans from commercial banks, and publicly issued and privately placed bonds (11).

3.1.1 Hypothesis One: Direct Investment as Main source of Capital During the 1950s

During the 1950s, foreign direct investment was the principal source of external capital to the Latin America. It is argued that for this reason rescheduling could seldom occur. In fact, it occurred on only one occasion.

Most foreign investment, particularly from the U.S.A., was concentrated at that time in petroleum and other resource industries such as copper. Since the bulk of the production of those commodities is exported, profits will likely fluctuate according to the movements in international commodity markets. Therefore, the repatriation of dividends poses a minor problem to the balance of payments, as the demand for foreign exchange for the repatriation of profits tends to fall with a decrease in export earnings and to rise when they increase. Moreover, one can expect that corporations will reinvest part of their profits during a boom phase. The repatriation of dividends, thus, does not necessarily pose a permanent "charge" on foreign exchange earnings as debt service does. For this reason, foreign direct investment does not make the balance of payments more vulnerable

as an indebtedness strategy is capable of doing.

As financial data on the 1950s are not comprehensive and detailed, one cannot identify the capital movements according to the source. Instead, one can solely work with the statistics of the IMF Balance of Payments Yearbook which distinguishes capital movements according to the destination.

Table 3.2: Latin America (excluding Cuba): Capital Movements, 1951-60 (millions of U.S. dollars)

	Net Direct Invest- ment (1)	Long Term Capital (2)	Net Official Trans- fers(1) (3)	Private Short Term Capital (4)	Sub Total (1-4)	Gold Foreign Assets & Net IMF Position (5)	Total (1-5)
1951-55	1,625	755	145	105	2,630	900	3,530
Average	325	151	29	21	526	180	706
1956-60	4,360	1,305	535	230	6,430	1,115	7,545
Average	872	261	107	46	1,286	223	1,509

1. Especially donations.

Source: IMF: Balance of Payments Yearbooks, various issues.

Table 3.2 indicates that foreign direct investment accounted for 66 per cent of net capital inflow, excluding balance of payments loans, in the decade 1951-1960. One derives almost the same figure when the ratio between net foreign investment and the increase in stock of external public debt is calculated. Net foreign investment amounted to U.S.\$6,373 million between 1950 and 1960. Although no reliable data are available on external public debt between 1950 and 1955, it can be assumed that external debt in Latin America totaled around U.S.\$2.5 billion

in 1950 [2]. In 1960, external debt stood at U.S.\$6.613 million [3]. Thus, the stock of debt had increased by U.S.\$4.113 million. The ratio was 64.5 per cent for the period 1950-1960.

Long term capital made up only 23 per cent, of which the World Bank, in turn, provided about 28 per cent [4]. As can be seen from Table 15 in the Appendix, four countries Argentina, Brazil, Mexico, and Venezuela accounted for 30 per cent of total investment between 1951 and 1960 and Chile, Colombia and Peru for most of the remainder.

There is a myriad of reasons why foreign direct investment was the prevailing source of capital in the 1950s.

First, for at least one decade after the Second World War, the U.S.A. was the only country which could provide financial resources to the rest of the world. European reconstruction received prime attention, best manifested in the Marshall Plan. As a result, the bulk of external debt, namely two-thirds of total, was concentrated in Europe, while 13 per cent of total was in Latin America [5].

Second, the import substituting industrialization strategy was at its peak during this decade. The political element of this inward looking policy was the mobilization of indigenous resources and the lessening of external vulnerability. From a political point of view, it might be questioned whether Latin America would have embarked on an indebtedness strategy similar to the one in the 1970s, even if the financial resources had been available. Furthermore, it seems that the import substitution strategy would not have been consistent with a debt-strategy, since the anti-export bias in the former could

have jeopardized the debt servicing capacity of a country and hence its credit worthiness abroad. On the other hand, direct foreign investment would result in a certain degree of foreign interference. However, the supply of the needed technology, managerial skills and marketing know-how by the multinational corporations could offset the negative aspect of foreign investment.

Third, Latin America did not receive much of the development assistance (ODA) which was mainly granted to colonies or just newly independent states in Africa and Asia. This fact is well documented in the flow of financial resources from OECD countries to LDCs and multilateral agencies [6]. Between 1950 and 1960 official transfers amounted to 34 per cent of total OECD flows, but they constituted only 7.5 per cent of capital inflows to Latin America. Since sufficient official and private loans from OECD countries were not forthcoming, the region had to rely heavily on foreign direct investment as the major source of external capital.

Fourth, the access to foreign capital markets was barred as long as the countries which had defaulted in the 1930s had not settled their defaults. The U.S. Congress had passed legislation regulating foreign borrowing in the wake of the defaults. The main law, the Johnson Act (1934), prohibited loans to governments whose securities were still in default [7]. Although Latin American countries had settled their defaults by the beginning of the 1950s, their creditworthiness had suffered and as a consequence borrowing was rendered more difficult.

Fifth, since the principal source of liquidity was the U.S.

dollar which was in short supply at this time, lending was subsequently geared mainly to short-term trade financing. Therefore, the early reschedulings always involved suppliers' credit. In the context of the dollar shortage, it should be remembered that the European currencies were inconvertible until 1958 which posed an additional impediment for international trade and finance.

~~These five points were the main constraints on foreign~~
borrowing in the 1950s. The Cuban revolution caught the U.S. Administration by surprise. The new Kennedy Administration stepped up efforts to contain the revolution spreading throughout Latin America. Official capital flows were one tool in achieving this goal.

3.1.2 Hypothesis Two: Official Flows as Main Capital Source During the 1960s

The second hypothesis contends that official capital flows became the major financial source to Latin America as direct foreign investment decreased in relative importance. Since official loans are usually extended on medium and/or long term, the countries' debt profile did not deteriorate and hence the risk for debt problems was contained.

As can be seen from the next chart, the only potential peril for debt servicing problems could come from suppliers' credit.

These made up, on average, 22 per cent of external public debt between 1960 and 1970, although this kind of finance began to decline during that decade. The share was almost cut in

half between 1962 and 1970. As mentioned before, reschedulings in the 1960s always involved suppliers' credits whose bunching was part of the debt problem. Despite the importance of official credit, four countries had to renegotiate their debt on seven occasions.

Chart 3.1 : Structure of External Public Debt in Latin America, 1960-1970 (in per cent)

Source: IDB 1985 Report, Washington, D.C., 1985, p. 426

The changes in official flows took place in the wake of the Cuban Revolution. Alarmed by a possible domino effect, the U.S. Administration launched a series of foreign policy initiatives toward the region. For example, the Alliance for Progress was created, the Inter-American Development Bank, the first regional bank of its kind, began its operations in 1960, and the region could expect more concessional financial flows through bilateral channels such as the U.S. Agency for International Development (AID) or multilateral institutions such as the International Development Association (IDA), also founded in 1960.

The changes were marked when one compares the 1956-60 period with the one between 1961 and 1963 with regard to long-term capital and net direct investment.

Chart 3.2 : Net Direct Investment and Long Term Capital Flows to Latin America, 1956-60 and 1961-63 (in millions of U.S. dollars)

1) Annual Averages

Source: IDB: European Financing of Latin America's Economic Development, Washington, D.C., 1966, p. 56

Whereas direct investment between 1961 and 1963 was a mere 26 per cent of the 1956-60 period, long term capital more than doubled in the comparable period. Although during the decade direct investment remained an important source of capital to the region, averaging 25 per cent of total flows, it had clearly surpassed its zenith of the 1950s. One can identify three explanatory factors for this development.

First, the decline was a result of a shift in U.S. investments toward Europe which had already begun in the 1950s. The formation of the European Economic Community reinforced this trend. For example, between 1959 and 1964, the U.S. investments in Europe grew by 127 per cent compared to 25 per cent in Latin America [8].

Second, several countries - for example, Argentina, Chile and Cuba - wanted to regain control over their domestic industries. This nationalistic mood was translated in the nationalization of selected industries and in restrictive legislation concerning foreign direct investment. The critical attitude toward multinational corporations retarded the growth of investment in Latin America. As a result, the U.S. direct investment position in Latin America augmented only by 21 per cent from U.S.\$8.1 billion in 1957 to U.S.\$9.8 billion in 1966, in contrast to the 81 per cent leap from U.S.\$4.6 billion in 1950 to the level of 1957. The sluggish growth also affected the distribution of U.S. investment abroad. The Latin American share fell from a peak of 37.7 per cent in 1950 to 31.7 per cent in 1957 to 18.8 per cent in 1966 (9).

Third, direct investment tend to be concentrated in the industrial countries, because investment is mainly directed to production for the local and regional market. Since those markets are largest in the OECD countries, direct investment tended to remain largely within the OECD (10). This point entails, however, another objection to direct investment. Multinational corporations mainly invest in mining and manufacturing in LDCs, whereas there has been an urgent need for infrastructure investments including roads, schools and hospitals. In order to finance these projects, the public sector in LDCs expanded and resorted to external borrowing.

This general trend was temporarily interrupted at the end of the 1960's when a rapid expansion of multinational corporations

in LDCs took place. Between 1968 and 1971 foreign direct investment recovered sharply, averaging 37 per annum of total net flows [11]. With the multinationals which were involved in manufacturing and mining, international banks and trading companies followed in order to finance and service them.

The expansion of multinationals was only one out of four major changes that influenced international capital inflows at the end of the 1960s. The others were (1) the growth of the Eurocurrency market, (2) the shifts in official aid programs, and (3) the acceleration of world trade.

The growing importance of the Eurocurrency market was greatly stimulated by U.S. regulations on banking. The outflow of private capital from the U.S. had contributed to a growing balance of payments deficit, which the U.S. government attempted to redress by imposing capital-control legislation in the second half of the 1960s. The best known measure was the Voluntary Foreign Credit Restraint Program. It was introduced in 1965, made mandatory in 1968 and abandoned in 1974, when it had failed to yield the desired results. On the contrary, this program further encouraged U.S. banks to open branches abroad. Growing demand for financial services by multinationals supported this expansion. Subsequently, lending by the U.S. branches soared during the second half of the 1960s. Between 1960 and 1964 their lending grew, on average, by 18.5 per cent per annum, but reached 37.5 per cent between 1964 and 1972 [12].

Two other measures -- Regulation Q which put interest ceilings on domestic savings deposits, and Regulation D with

regard to reserve requirements which U.S. banks had to hold and did not yield any interest -- resulted in a diversification of funds to offshore branches. Therefore, the number of overseas branches of U.S. member banks in Latin America increased by 150 per cent from 72 in 1965 to 182 in 1970 [13].

When many Latin American countries reached the stage of semi-industrialization, they achieved credit standing in private capital markets. At the same time, the U.S.A., which was also facing a growing balance of payments deficit, curbed its concessional flows to the region in the second half of the 1960s. For example, the net disbursements by AID declined from US\$440 million in 1966 to US\$189 million in 1971 [14].

Bilateral grants were reduced by 36 per cent during the same period. As a consequence, official flows were decreasing in importance at the end of the 1960s.

3.1.3 Hypothesis Three: Commercial Lending as Dominant Force During the 1970s

The third hypothesis contends that commercial lending has become the main source of capital to Latin America. Chart 3.3 shows the development of net capital flows to Latin America and the leading role that private capital assumed during the decade.

Chart 3.3: Shares of Official and Private Capital Flows and Net Foreign Direct Investment in Latin America, 1961, 1966-1983 (in percentages)

Source: IDB: External Financing of the Latin American Countries, Washington, D.C., 1984, Table 5

The switch from non debt creating flows (direct investment) in the 1950s and partly the 1960s to debt creating flows first in the 1960s by official creditors, and later primarily by private creditors, has had major repercussions on Latin American debt servicing capacity. Since the terms of official and private lending can substantially deviate from each other, the vulnerability of the balance of payments has increased through this change. The harder terms of commercial loans do not adversely affect the country's debt servicing capacity as long as the country disposes of offsetting variables such as reserves or continued and sufficient access to capital markets.

Despite the dominance of commercial lending, the decade was characterized by a build up to the wave of reschedulings in the 1980s. The 1970s were spared from many reschedulings. Compared

to the 1960s, the number increased by one to eight cases. The novelty was the renegotiation of four cases with commercial bank consortia. One explanation why rescheduling exercises did not significantly increase was the availability of off-setting variables. Due to high international liquidity, Latin American countries were able to borrow in order to balance their public sector and current account deficits without making the necessary adjustments.

This indebtedness strategy was possible as a result of the surge of international lending which began at the end of the 1960s and accelerated the following decade. One can identify seven factors which facilitated and stimulated the expansion of international lending: (1) recycling of OPEC surpluses, (2) commodity boom in the beginning of the 1970s, (3) diversification of bank portfolios, (4) financial innovations, (5) introduction of the cross-default clause, (6) a new approach toward non-guaranteed debt, and (7) abolition of U.S. controls on capital exports [15].

First, the quadrupling of oil prices in 1973 triggered the recycling of OPEC surpluses by the Eurocurrency market. It was mainly these resources that financed the indebtedness process in Latin America. The domestic savings in OECD countries did not significantly contribute to the net flow to oil importing LDCs. Between 1974 and 1981, the IMF estimated that only about 3/4 of 1 per cent of the aggregate national savings of OECD countries consisted of net lending abroad, compared to about 2 1/2 per cent during the preceding six years [16].

Second, the commodity boom at the beginning of the 1970s stimulated external lending. Latin American countries were perceived as a good risk since commodity prices were soaring.

Third, commercial banks reinforced their efforts to diversify their portfolios. Lending expanded to LDCs, because, in the first half of the 1970s, OECD loan demand was sluggish and their profitability low. On the other hand, banks could charge higher spreads for loans to LDCs and in this way increase their profits. Studies show that, for example, the 12 largest U.S. banks derived about half of their earnings from external operations, in which the LDC borrowers were the most profitable ones [17]. Since 1974, the volume of lending rather than the spreads produced the profits. This is evident from a comparison between spreads above LIBOR on loans to industrial countries and to non-oil LDCs. The difference between rescheduling and industrial countries was less than one percentage point in the period 1974-80 [18]. Therefore, a study by Folkerts-Landau suggests that "the institutional evolution of the international bank loan market has been a movement away from pricing to offset the expected risk of outright default, to a new system where rates on syndicated international credits reflect only the (lower) expected cost of rescheduling. This, in turn, has led to lower and less variable spreads than those existing even in well-developed domestic financial markets" [19].

Fourth, two major financial innovations greatly facilitated lending to Latin America and other LDCs: the creation of the "roll-over" credit and syndicated lending [20]. Both

innovations supported banks in minimizing the risk of lending long term. The "roll-over" credit is a loan which is granted on a variable interest rate, usually LIBOR plus a premium. The interest rate is adjusted every three or six months to the market conditions. It protects the banks more than a fixed interest rate, especially during inflationary times. On the other hand, borrowers can gain also, as can be observed in the 1970s, when the real interest rate was negative for some years. However, the unprecedented high real rates in the 1980s show the risks inherent in loans extended on variable interest.

Chart 3.4 : Proportion of Disbursed Public Debt: Concessional and Variable Interest Loans, 1971-1983 (in percentages)

Source : World Bank: World Debt Tables, 1981-1985 Editions, Washington, D.C., 1981-1985

With the breakdown of the Bretton Woods system, many relatively stable economic relationships, such as exchange rates and interest, began to fluctuate. As a consequence, loans with variable interest increasingly replaced fixed interest rate loans. In Latin America, the share of variable interest rate loans as part of total public external debt increased from 7.4 per cent in 1971 to 57.5 per cent in 1980 and to 66.1 per cent in 1983 [21]. In particular, the large debtor countries, Brazil, Chile, Mexico and Venezuela, relied more than 66 per cent on this kind of financing.

Concurrently, concessional loans which are those with a grant element of 25 per cent or more, declined from 26 per cent of disbursed public debt in 1971 to six per cent in 1983 for Latin America. In seven rescheduling countries, the share of concessional loans decreased by more than 20 percentage points. Among those countries was Brazil which reduced its reliance on concessional credit from 35.8 per cent in 1971 to a mere 2.4 per cent in 1983 [22]. The declining share of concessional finance for the region is as much a sign for the maturing of the Latin American economies as the consequence of a stagnant portion of about 10 per cent of total net ODA to the region [23]. Since Latin America has had a large financial absorptive capacity, "roll-over" credits could fill the gap.

The second innovation, syndication, is the organization of a loan to which many lenders subscribe. As a large number of banks participate, the risk and exposure of one single bank is reduced. This made it attractive also for smaller banks to

enter the international banking scene and participate in loans to Latin America.

Fifth, syndication was supported by the introduction of the cross default clause, i.e., a country may be considered in default on all its loan agreements if it defaults on any of them. As a consequence, loans are immediately due. Thus, if a borrower becomes delinquent on a syndicated loan, all participating banks would be affected. In case of default, a country's creditworthiness would be impaired for years. For this reason, reschedulings have also acquired such an importance in forestalling default.

Six, the cross-default clause made it possible to view private non-guaranteed debt in a different light. When private borrowers face debt servicing difficulties, LDC governments have transformed external private debt into publicly guaranteed debt. Those difficulties are frequently caused by a foreign exchange shortage. Therefore, commercial banks are more concerned with a country's debt servicing capacity rather than the ability of the private borrower to honor his obligations. Lending institutions have, thus, not discriminated against private and public borrowers within one country. The differences in lending rates have usually been less than 50 basis points [24].

Seven, two legal developments in the U.S. removed, in part, the cause of the low levels of credit granted to LDCs. The abolition of U.S. controls on capital exports, such as the Mandatory Credit Restraint Program in 1974, gave additional

impetus to the lending process. The Foreign Sovereign Immunities Act of 1976 created a better legal framework for dealing with sovereign immunity. The interpretation of immunity is now more restricted than it was before [25]. As a result, it is argued that "international banking markets generally proved better equipped to deal with the risk of lending to sovereign borrowers than the markets for foreign bonds and direct investment" [26].

These seven points explain the main reasons behind the surge of bank lending. As Chart 3.3 indicates, official lending and particularly ODA could not keep up with the borrowing needs of Latin America. Furthermore, the low real interest rates during most part of the 1970s stimulated the indebtedness strategy. Direct investment decreased relatively in importance vis-a-vis bank lending, but still contributed on average 22.3 per cent to the total net capital outflows to Latin America between 1971 and 1980.

The potential dangers of a heavy reliance on commercial banks were recognized at the end of the 1970s, but were ignored in the absence of an alternative -- apart from adjustment. With the reversal of commercial lending policies toward the region by 1982, new lending came forth only in combination with an I.M.F. stabilization program.

3.1.4 Hypothesis Four: The Curtailment in Commercial Lending in the 1980s

The last hypothesis contends that the strong contraction of commercial lending has aggravated the debt servicing problems and forced countries to reschedule on an unprecedented scale. "Underlending" by banks resulted in a net transfer of resources from Latin America to its creditors.

Table 3.3: Latin America: Net Disposable Financing After Payments of Profits and Interest, 1978-83 (in billions of U.S. dollars)

Year	Net Inflow of Capital (1)	Net Payments of Profits and Interest (2)	Net Disposable Financing (3)=(1)-(2)
1978	26.1	10.2	15.9
1979	28.6	13.6	15.0
1980	30.0	18.0	12.0
1981	37.7	27.7	10.0
1982	19.2	37.6	-18.4
1983	4.4	34.5	-30.1

Source: CEPAL, Preliminary Overview of the Latin American Economy During 1984, No. 409/410, Jan. 1985, p. 16.

Table 3.3 shows the decline of net disposable financing to the region from 1978 to 1981. Since then, net receipts turned to net transfers from the region. The net inflow of capital decreased by 49 per cent from 1981 to 1982 and again 77 per cent from 1982 to 1983. Concurrently, interest obligations soared. In the absence of net capital inflows to roll over debt, there remained no alternative but to reschedule. As a consequence, in the period between 1980 and 1984 24 commercial and seven

official reschedulings took place.

Two events in 1982 precipitated the abrupt change in lending to Latin America: the Falkland/Malvinas war and the Mexican financial crisis in August. The change proved the fallacy that the roll over mechanism is an automatic process, and that short term borrowing could sustain Latin American economies.

Commercial banks reduced their lending not so much through the price mechanism but through credit rationing. This contraction was reinforced by a desire to reduce LDC exposure in banks' portfolios and by herd behavior on the side of the bankers.

As has been mentioned in the previous section, the interest rate did not significantly discriminate between borrowers from industrial and developing countries. Therefore, it is suggested that the interest rate is not the decisive instrument in allocating funds to LDCs. It is rather credit rationing which is based on a country's creditworthiness [27]. Apart from political considerations, Kapur [28] identifies four indicators of economic performance which influence bankers' perceptions of a creditworthiness, (1) current level and expected growth of exports, (2) the overall growth performance, (3) the projected change in the debt service ratio, and (4) the banks' exposure to and involvement in a country. The first three indicators have been discussed in the previous chapter and showed generally a deterioration in their values over a five year period before rescheduling. Nevertheless, commercial bank loans kept on being made. This can be explained by the changing perceptions toward lending to Latin America as well as by the greater "tolerance

2

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level" of commercial banks in dealings with LDCs (29). Moreover, in the 1970s, the risk factor reflected in the spread over LIBOR was not anymore so apparent in the Euroloans as it is in the bond market or even with direct investment. This can be explained by the changing conditions in international capital markets. The 1950s and 1960s may be characterized as a suppliers' market with regard to international capital for LDCs. With the first oil shock and the necessity to recycle OPEC surpluses the market changed to a buyers' market, thus in favor of the debtors. An indication of the prevalence of such a market was the negative real interest rates in Eurocurrency loans during most part of the 1970s. Since 1979, when tight monetary policies were adopted to combat inflation in OECD countries and high real interest rates were prevailing in the international capital markets lenders regained the upper hand with regard to LDC credit. The market switched back to a sellers' market.

This change also affected credit policy. During the 1970s, LDCs, and particularly Latin America, were major customers with respect to the Eurocurrency market, when OECD credit demand was sluggish. However, the strong recovery of the U.S. economy since 1982 and later, to a lesser extent, that of the Western European economies has attracted financial resources which are urgently needed in Latin America. It would be interesting to investigate whether there also exists a "crowding out" effect on a global scale, where OECD investment and loan demand substitutes LDC loan demand, leaving the latter, relatively speaking, empty handed. The large U.S. fiscal

deficit and the need to attract foreign savings to the U.S.A. have certainly reinforced the shift of emphasis to lending to industrial countries.

OECD economic performance is only one out of a host of factors which have contributed to the sharp curtailment in lending to Latin America. At least seven factors are worth mentioning, all of which are interrelated.

First, the previous chapter already underlined the political climate in many Latin American countries, which has not always been conducive to increased lending. This is especially true in the 1980s when OECD and particularly U.S., investment demand grew while lending to Latin America began to fall as the region fell to its deepest recession since the 1930s and rescheduling has become the order of the day. In this context, one of the two goals set by the Development Committee, the reestablishment of creditworthiness for a rescheduling country, has become more difficult to achieve. Bankers not only assess the country itself but compare its performance with others. Even if Latin American countries do well but not as well as OECD countries, lending to the region remains uncertain, since banks have better opportunities to allocate their sources than in Latin America. As a consequence underlending, relative to need, will persist in the coming years.

Second, the reduction of lending came in the wake of a reassessment of banks' exposure to a country and/or region. The inventory of exposure to Latin America showed a high, and for banks, undesirable loan/capital ratio. This ratio has been

increasing during the 1970s and reached 163 per cent for the nine major U.S. banks in 1982 with regard to five Latin American countries.

Table 3.4 Exposure as Percentage of Capital, Nine Major U.S. Banks, End-1982

Bank	Argentina	Brazil	Mexico	Venezuela	Chile	Total	Capital (bill. U.S. \$)
Citibank	18.2	73.5	54.6	18.2	10.0	124.5	5,989
Bank of America	10.2	47.9	52.1	41.7	6.3	158.2	4,799
Chase Manhattan	21.3	56.9	40.0	24.0	11.8	154.0	4,271
Morgan Guaranty	24.4	54.3	34.8	17.5	9.7	140.7	3,107
Manufactures Hanover	42.5	77.7	66.7	42.4	28.4	262.8	2,592
Chemical	14.9	52.0	60.0	28.0	14.8	169.7	2,499
Continental Illinois	17.8	22.9	32.4	21.6	12.8	107.5	2,143
Bankers Trust	13.2	46.2	46.2	25.1	10.6	141.2	1,895
First National Chicago	14.5	40.6	50.1	17.4	11.6	134.2	1,725
All Nine Banks	19.7	55.8	49.0	26.5	12.0	163.0	28,970

Source: Cline W.R.: International Debt and the Stability of the World Economy, Washington, D.C., 1981, p. 34

The exposure to those five countries exceeded 100 per cent for all banks. However, their share of total bank loans is far more modest, less than 15 per cent [30]. On the other hand, foreign lending has contributed significantly to profits, particularly during the 1970s. In case of the nine U.S. banks between 1970 and 1976, net earnings from international operations grew at an annual rate of 30 per cent while domestic earnings stagnated. For example, in 1976 more than 52 per cent of total earnings stemmed from international operations in which the LDCs proved to be the more profitable [31]. However, the wave of reschedulings in the 1980s have reduced those earnings and made it necessary to diversify out of LDC loans.

Third, the heavy exposure to Latin America had made the major U.S. banks more vulnerable with regard to fluctuations in earnings. Since the debt servicing problems could have had an adverse effect on the price of bank stocks, banks had to redefine their lending policies toward Latin America and other LDCs. Quality rather than quantity of loans has again become the tenet of LDC lending.

~~Fourth, as much as default probabilities were underestimated~~ in the 1970s - reflected in the lower spreads over LIBOR - they are now overestimated [32]. This seems to be a well known psychological phenomenon which can also be observed in the exchange rate market where adjustments and uncertainties cause overshooting until market balances around its equilibrium position.

Fifth, another psychological factor is herd behavior on the part of banks. Lending institutions have a similar outlook and actions by one bank are quickly followed by others. For example, during the 1970s syndicated loans pulled along smaller banks in the lending process to Latin America. There was maybe even excessive competition in order to participate in those lending operations. In this way, banks greatly stimulated the external debt strategy in Latin America. The overreaction in reverse is apparent since 1982, when banks have attempted to reduce their exposure to Latin America, thereby exacerbating the situation still further. In this respect, banks have to assume part of the responsibility for the current situation in Latin American countries for "imprudent borrowing is usually

impossible without imprudent lending" [33].

Sixth, the tacit assumption that the OECD governments would come to the aid of the banks proved to be erroneous. Political opposition mounted against a "bailout" of the commercial banks, particularly the large ones. Therefore, the leading U.S. banks are pushing the smaller banks to stay in the lending process called involuntary lending - to Latin America. This would strengthen the larger banks politically and financially too, as they would not need to extend their exposure to Latin America due to a withdrawal by smaller banks.

Seventh, instead of bailing out banks, the U.S. Congress has introduced new regulatory arrangements in the International Lending Supervision Act of 1983. Among the important reforms were: (1) establishment of prudential reserves against certain international assets; (2) an increase in the requirements for disclosure of large concentrations of international lending at banks, which should tighten market discipline in bank behavior; (3) an increase in the frequency of U.S. bank reporting on country exposures to supervisory authorities; (4) the adoption of tightened policy guidelines for the capital adequacy of large U.S. banks, and (5) the adoption of regulations for accounting for fees on restructured international credits [34].

To sum up, in the 1980s Latin America was adversely affected by the changing conditions in international capital markets, a psychological overreaction by bankers, and new regulatory measures in OECD countries. It culminated in a mood of disillusionment about Latin America. It seems that the region

is incapable of being freed of alternating waves of optimism and disillusionment which only reinforce the procyclical nature of capital flows. History seems to repeat itself when one reads a paragraph in a 1937 report by the Royal Institute of International Affairs:

The history of investment in South America throughout the last century has been one of confidence followed by disillusionment, of borrowing cycles followed by widespread defaults, and of a series of alternating repudiation and recognition of external debt [35].

3.2. Proposition Two: The Frequency of Reschedulings as a Consequence of Previous Reschedulings

Rescheduling exercises appear not to solve the problem to which they are directed the first time. Instead, the country usually goes through several "rounds (two or three) over a three year period following the first arrangement.

Table 3.5: Countries with Two or Three Reschedulings over a Three Year Period

	1960s	1970s	1980-84
Argentina	1962-1965		
Brazil	1961-1964		1983-1984
Chile		1972-1974-1975	
Ecuador			1983-1984
Guyana			1979-1982-1984
Jamaica			1979-1981-1984
Mexico			1983-1984
Nicaragua			1980-1981-1982
Peru	1968-1969	1978-1979	1983-1984

From Table 3.5, it is evident that most countries have to reschedule at least twice within a three year period in order to manage the external debt problem. Only in very few cases (Argentina, 1956, 1976, Chile, 1965), a single agreement proved

to be sufficient. The cases in the 1980s which did not reschedule twice will probably renegotiate their debt again in 1985 or 1986.

The repeated reschedulings prove that the two objectives for a successful rescheduling set by the Development Committee cannot be achieved at the first time. It is clear that creditworthiness and adjustment are medium and long-term concepts which are not adequately addressed in the reschedulings. A rescheduling agreement offers a short-term solution to a long term problem. The time horizon of creditors as well as debtors is to blame for this error.

The problem of the debtor country lies in its entrenched economic and political structures. Economic policy making is complicated in many Latin American countries where the institutionalization - i.e., the accommodation of the demands and conflicts of the various interest groups through formal and informal institutions -- has lagged behind their economic modernization [36]. As a result governments face tough decisions in the event of reschedulings but lack the political strength and often legitimacy to implement the policies stipulated by the IMF. The question at stake is whether a country can comply with an IMF stabilization program without jeopardizing the stability of the political system.

Stabilization processes involve temporary sectoral imbalances. Economic adjustment is not instantaneous but due to limited mobility and rigidities in certain markets takes place with time lags in various markets. Bearing in mind that market

economies are inherently unstable and do not necessarily tend to their equilibrium positions, the establishment of economic and political stabilization is hard to attain as some imbalances will always remain. The magnitude of these imbalances determines whether or not the system can correct them or whether the system gets unravelled. The description of the political changes in the previous chapter only underlines the explosive situation in many rescheduling countries.

Another reason why double reschedulings occur can be found in the inconsistency of targets. Whereas the IMF and the reschedulings focus on a limited number of targets and employ the same number of instruments to their targets, the governments involved have many political and economic targets. These targets not only frequently contradict each other (e.g., real wage increases and reduction of inflation) but should be achieved by a smaller number of instruments. Economic instruments have to achieve economic and political targets because the latter cannot be quantified and are approached by indicators. For example, the limits on wage increases might serve the target of controlling inflation but violate the political target of national unity, as trade unions will attempt to resist cuts in real wages. The possible demonstrations and strikes might even jeopardize the target of increased investment and growth. Governments, thus, have to direct their policy in such a way as to minimize economic trade offs and trade offs between economic and political targets. For this reason, IMF stabilization programs can hardly ever be implemented in full

since politicians base their decisions on what is politically feasible. As a consequence policy making is oriented toward the short term rather than long term.

Creditors, on the other hand, also adopt a short-term view. They agree on a rescheduling arrangement only when the country involved has worked out an adjustment program with the IMF.

Since they know that those programs are hard to implement, and often cancelled, creditors prefer a short term agreement. In case of a longer term agreement, they could lose their indirect leverage of insisting on an IMF program. Furthermore, there is no interest on the side of the creditors to let debt reschedulings become institutionalized through longer term arrangements. However, it is precisely the reluctance of creditors to take a longer term view of the debtor countries, which also creates economic as well as political uncertainty in those countries. The local politicians can only govern ad hoc since they do not know how they will manage their economies without a sufficient inflow of capital. Both lenders and debtors are caught in a catch 22 situation with respect to political stability and capital inflow. It was not until 1984 that creditors realized that a short term approach would be self-defeating, since rescheduling would otherwise become an annual exercise. The Mexican multi-year rescheduling in 1984 set the stage for a longer term restructuring. If this approach is widely applied, it could foster an economic and political climate in those countries more conducive to resolving their indebtedness problems.

In conclusion, the frequency of reschedulings has affirmed

the potential dangers of the different kinds of external capital which are low for direct investment and official loans but high for commercial loans. Therefore, the shift toward commercial borrowing has made the region more susceptible to shocks in the international system. As a consequence, the positive correlation between the number of reschedulings and the changing capital flows underlines the urgent need for coordinated debt management and the anticipation of possible adverse movements in interest rates.

The repeated reschedulings are furthermore a result of the short-term outlook taken by private creditors, the IMF, and debtors. A first step to correct this deficiency could be the introduction of a multiyear rescheduling as a general rule.

In the next chapter, the terms and characteristics of rescheduling arrangements will be analysed. They also reveal why reschedulings took place so frequently.

Footnotes

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CHAPTER FOUR

TERMS AND CHARACTERISTICS OF RESCHEDULINGS

In this chapter, the analysis will be focused on the rescheduling arrangements themselves. The previous chapters have already documented the changes of international capital markets which resulted in a replacement of official creditors by private banks as the main supplier of capital to Latin America. This shift has also affected the debt renegotiations. Until the mid-1970s, rescheduling exercises took place only within official creditor clubs. Since then, the debt restructurings with commercial banks have become dominant. For this reason, the following analysis will differentiate between official and commercial bank reschedulings.

4.1 Multilateral Debt Renegotiations with Official Creditors

Reschedulings are conducted multilaterally within the framework of creditor clubs such as the Paris Club or the Hague Club. These two clubs were established in the mid-1950s, when European currencies were still inconvertible. In order to increase the transferability among them, Brazil convened with European creditors in the Hague Club and Argentina in the Paris Club. Under the club arrangements, the member states agreed to accept payments in any of the members' currencies with regard to transactions by Argentina or Brazil. Apart from the purpose of multilateralizing payments, the Paris Club served also as forum for the renegotiation of the Argentine public external debt in

1956. When the external convertibility was reestablished by European countries in 1958, the clubs - predominantly the Paris Club and on two occasions the Hague Club - became forums for multilateral debt reschedulings by LDCs (1, *).

In the Latin American context, 19 official reschedulings have taken place between 1956 and 1984. Most cases were renegotiated under the auspices of the Paris Club. The Hague Club hosted the two earlier reschedulings by Brazil, and creditor groups settled the Mexican and, twice, the Peruvian debt.

Although all clubs operate on an informal basis, in the Paris Club certain "rules" or standard features have emerged over time. Creditors are concerned that the Paris Club might become a formal institution for debt renegotiations and, hence, will lose its ad hoc character. Despite the existence of a small secretariat in the French Treasury, the creditor countries insist that the Paris Club should be convened only under exceptional circumstances. Accordingly, a situation is considered "exceptional" when a debtor country faces severe balance of payments problems, and has accumulated arrears to the point where default is imminent. If the economy of a debtor country is in such critical condition, creditors are willing to renegotiate the public portion of the external debt on an ad hoc basis, thus on relatively short-term and case-by-case. This approach should serve as a disincentive for lax debt management and an economic policy which is incompatible with the external contractual obligations.

In the absence of a formal framework, some flexibility is added in the negotiations. Creditors can consider the specific economic as well as socio-political problems of the country concerned. This may work to the advantage of a debtor, but sometimes to the detriment. It depends largely on the creditors' perceptions of the debtor's political situation that influences the rescheduling arrangement. For example, the three Chilean reschedulings in the 1970s were overshadowed by political issues. The conclusion of the first agreement was protracted by the compensation issue for the expropriation of the U.S. copper industries [2]. After the overthrow of the Allende government, some European creditors refused to participate in the Paris meetings because of the human rights abuses by the military government of General Pinochet [3].

Despite the "informality" of the club, certain procedures have become standardized. When a country encounters debt servicing problems, it usually requests a debt restructuring within the Paris Club. In general, a senior official of the French Treasury chairs the meetings which are not only attended by the creditors and debtor but also by observers from international organizations such as the IMF, World Bank, OECD or UNCTAD (United Nations Conference on Trade and Development). These observers, especially the IMF, are frequently asked to prepare a report on the economic situation and prospects of the debtor country. In this way, the debtor and an independent third party present an assessment of the economy to the creditors.

The creditor countries go united into the negotiations with a common position. This approach is well summarized by the policy of the U.S. government toward multilateral reschedulings. In a January 1978 decision of the National Advisory Council on International Monetary and Financial Policies, the following principles were stated:

1. Debt-service payments on international debt should be reorganized on a case-by-case basis and only in extraordinary circumstances where reorganization is necessary to ensure repayment. Debt relief should not be given as a form of development assistance.
2. When a reorganization involving government credit or government-guaranteed credits takes place, the United States will participate only if:
 - (a) the reorganization agreement incorporates the principle of non-discrimination among creditor countries, including those that are not party to the agreement.
 - (b) the debtor country agrees to make all reasonable efforts to reorganize unguaranteed private credits falling due in the period of the reorganization on terms comparable to those covering government or government-guaranteed credits.
 - (c) the debtor country agrees to implement an economic program designed to respond to the underlying conditions and to overcome the deficiencies which led to the need for reorganizing debt-service payments.
3. The amounts of principal and interest to be reorganized should be agreed upon after a thorough analysis of the economic and the balance of payments prospects of the debtor country.
4. The payments that are reorganized normally should be limited to payments in arrears and payments falling due not more than 1 year following the reorganization negotiations [4].

The U.S. position, which is similar to that of the other creditors, serves as the basis for the negotiations. The outcome of the Paris Club meetings is written down in the

"Agreed Minutes" which specify:

1. types of debt to be consolidated.
2. "cut-off" date.
3. consolidation period.
4. repayment terms (grace, maturity, interest).
5. commitments of the debtor country.

The Agreed Minutes are not a legally binding document. The representatives of the participating creditors only recommend to their respective governments the implementation of bilateral agreements in accordance with the Agreed Minutes. Thus, it is not until the bilateral arrangement is signed that the rescheduling becomes effective. In general, several months elapse between the Paris Club and the bilateral agreement.

The following analysis will be confined to the Agreed Minutes whose terms have often been made public. On the other hand, bilateral agreements are considered confidential and, therefore, information on the final terms is lacking in most cases. Before the content of the 19 Agreed Minutes is examined in detail, Table 4.1 summarizes its main terms.

4.1.1 Coverage of Debt Rescheduled

The reschedulings under review have covered a variety of debt obligations. They included publicly guaranteed loans and credits extended by official agencies as well as by governments [5]. Loans owed to multilateral financial institutions are not considered for debt relief. For example, the World Bank interprets default in a very narrow sense, i.e., default

TABLE 4.1: Summary of Terms of Official Multilateral Debt Reschedulings, 1956-1984

Debtor Country ¹	Date of Agreement MO/DAY/YR	Type of Debt ²	Consolidation Period (Yrs)	Rescheduled Amounts		Repayment Terms	
				(US\$)	(Per Cent)	Grace (Yrs.)	Repayment (Yr)
Argentina I	5/30/56	FIA	Arrears as of 6/30/56	500	100	0	9.5
Brazil I	5/24/61	PI	4.6	300	35-80	0.5	6.0
Argentina II	10/26/62	P	2.0	270	50	0	6.0
Brazil II	7/01/64	PI	2.0	200	70	2.0	6.0
Chile I	2/24/65	P	2.0	90	70	2.0	6.0
Argentina III	6/26/65	P	1.0	76	60	2.0	6.0
Peru I	9/27/68	PI	1.5	58	75-95	1-1.5	6.0
Peru II	11/19/69	PI	2.0	70	75	1.0	6.0
Chile II	4/19/72	PI	1.2	181	70	2.0	6.0
Chile III	3/25/74	PI	2.0	406	80	2.0	6.0
Chile IV	5/06/75	PI	1.0	230	70	2.0	6.0
Peru III	11/03/78	PI	1.0	420	90	2.0	6.0
Costa Rica I	1/11/83	FIA	1.5	200	85	3.8	6.5
Mexico I	6/22/83	PA	0.5	2,000	90	3.0	6.5
Peru IV	7/26/83	PI	1.0	466	90	3.0	6.5
Ecuador I	7/28/83	PI	1.0	142	85	4.0	6.5
Brazil I	11/23/83	FIA	1.6	2,695	85	4.0	6.5
Peru V	6/05/84	PI	1.3	704	90	4.9	6.5
Jamaica I	7/16/84	EIA	1.3	105	100	3.0	6.5

1. Roman numerals indicate, for each country, the number of debt rescheduling in the period beginning 1956.

2. P - Principal; I - Interest; A - Arrears.

3. Grace and repayment are defined to begin at the end of the consolidation period.

Sources: (*); Brau, E. and Williams, R.C., Recent Multilateral Debt Restructurings with Official and Bank Creditors, Washington, D.C., 1983, p. 16; World Bank, Multilateral Debt Renegotiations, 1956-1968, Washington, D.C., 1969, p. 4; Crowe, Brian G., International Public Lending and American Policy, in Aranson, E.D. (ed.), Debt and the Less Developed Countries, Boulder, 1979, pp. 38-39; Buttermann, H.V., The Refunding of International Debt, Durham, 1973, pp. 112-116, 122-126, 131-133, 181-184.

constitutes any interruption of contractual obligations. Therefore, if the World Bank declares a country in default, it would force the borrower into default to all its creditors under the cross-default clause [6]. Previously rescheduled debt is also excluded from being restructured. However, there are exceptions to this rule: Brazil (1964) and, in recent years, some African cases have been allowed to consolidate their previously rescheduled debt in successive agreements. In the Appendix Table 17 provides a detailed overview of the types of debt which was rescheduled in the 19 Latin American cases.

With regard to maturity, principal and interest on medium- and long-term debt falling due in the consolidation period were subject to renegotiation. In several cases - Argentina (1956), Costa Rica (1983), Mexico (1983), Brazil (1983) and Jamaica (1984) - arrears were consolidated. Although most other cases also had accumulated arrears at the time of the Paris Club meeting, they were usually settled in a commitment by the debtor country to eliminate the arrears within a specified period of time or outside of the Paris Club through refinancing.

Short-term debt is excluded from rescheduling because its inclusion could have adverse effects on the trade financing by the debtor country. However, this tenet also knows its exceptions, albeit rare. As a general rule, current maturities of short-term debt are not rescheduled [7]. On the other hand, Mexico (1983) could renegotiate its short-term debt in arrears.

Table 4.2 describes which debt was covered in the rescheduling cases of the 1980s.

Table 4.2: Coverage of Debt: 7 Cases, 1983-84

Country	Medium- and Long-Term Debt				Short-Term Debt	
	Current Maturities		Arrears		Arrears	
	P(1)	I(2)	P	I	P	I
Costa Rica	Yes	Yes	Yes	Yes	No	No
Mexico	Yes	No	Yes	Yes	No	Yes
Peru	Yes	Yes	No	No	No	No
Ecuador	Yes	Yes	No	No	No	No
Brazil	Yes	Yes	Yes	Yes	No	No
Peru	Yes	Yes	No	No	No	No
Jamaica	Yes	Yes	Yes	No	No	No

1) P = Principal; 2) = Interest.

Source: (*).

Due to the long period of observation, the absolute amounts rescheduled lose their comparative value. If one classifies them, nevertheless, one observes that the size of consolidation ranged in almost two-thirds of the cases between U.S. \$200 and 500 million.

Table 4.3: Amounts Rescheduled in 19 Multilateral Agreements

Number of Reschedulings	Amounts (in millions of U.S. Dollars)
4	less than 100
5	less than 201
7	less than 501
3	502 or more
19	

Sources: World Bank, Multilateral Debt Renegotiations, op. cit., p. 4; Hardy, C., Rescheduling Developing-Country Debts, op. cit., pp. 4-9; Brad, E. and Williams, R.C., Multilateral Debt Renegotiations, op. cit., p. 16; (*).

The consolidated debt was held by five to 20 creditors. While in earlier reschedulings - during the 1950s and 1960s - seven creditors, on average, participated in the Agreed

Minutes, the number of participating creditors has averaged 13 in the cases of the 1970s and 1980s. This has been the result of two developments. First, in the earlier reschedulings, more creditors attended, on average 11, than actually participated in the final agreement. In the more recent cases, the attending creditors, in general, signed also the document. Second, the so-called "de minimis" clause - i.e., the stipulation that creditor countries whose eligible claims are less than a specified amount, are excluded from the rescheduling arrangement [8] - has been lowered. For example, in the Peruvian case (1968), the limit was set at U.S.\$2 million, whereas in most agreements since 1983 the limits were lower than U.S.\$500,000 [9].

A comparable measure for debt relief is the percentage of the eligible amount rescheduled, which is summarized in the following table.

Table 4.4: Proportion of Debt Rescheduled

<u>Number of Reschedulings</u>	<u>Percent of Eligible Amount Rescheduled (%)</u>
1	50 or less
9	60 - 80
7	85 - 95
2	100
<u>19</u>	

Sources: (*), World Bank, Multilateral Debt, op. cit., p. 4.

In the earlier reschedulings, the proportion of debt rescheduled was usually less than 75 per cent, with Argentina (1956) being the exception. This pattern did not change during

the 1970s. However, in the seven reschedulings of 1983-84, the percentage ranged between 85 and 100. This increase has to be interpreted with caution, since this positive development for the debtor is deceptive. If, namely, the rescheduled amounts are related to the total outstanding medium- and long-term debt of the countries studied one year prior to rescheduling, this increase pales into insignificance. Although the reschedulings before 1980 did not reach the high proportions of coverage in the 1980s, the amounts consolidated did constitute generally a higher proportion of total outstanding debt. Between 1956 and 1980, creditors agreed to restructure amounts in excess of eight percent of total outstanding debt in 58 per cent of the cases - in comparison to 12.5 per cent in 1980. On the other hand, during the 1980s, 88.5 per cent of the cases renegotiated amounts equal to or less than eight per cent of total outstanding debt [10].

Although this result is also a reflection of the changes in the structure of Latin American debt, creditors could raise the proportion of coverage to 100 percent. This move could give some additional relief to the debtor country without departing from creditors' policy toward reschedulings. It would actually be a return to the general practise before 1980, when a larger percentage of rescheduled amounts relative to total outstanding debt was covered by the Agreed Minutes.

4.1.2 Cut-Off-Date

The extent of debt relief is partially determined by the cut off date, i.e., the date before which loans must have been contracted in order to qualify for consolidation. The shorter the time period between cut-off date and the beginning of the consolidation period, the larger will be the amount of debt service eligible for renegotiation [11].

The reschedulings in the 1960s show the smallest discrepancy between cut off date and consolidation period. This interval was larger in the recent reschedulings, ranging between 3 and 16 months. In the 1980s, the cut-off date is usually maintained in a successive rescheduling agreement. Therefore, the Peruvian case (1984) shows a lengthened interval of 16 months. However, the practice to keep the cut off date unchanged for repeated reschedulings cannot be observed during the 1960s and 1970s.

Table 4.5: Interval between Cut-Off Date and Consolidation
Period (in months)

Interval					
Cases	0	1-2	3-7	8-16	Cases
1960s	5	1	1	-	7
1970s	1	-	-	1	2
1980-84	1	-	5	1	7
Total	7	1	6	2	16

Source: World Bank, Multilateral Debt Renegotiations, op. cit., p. 4; (*).

From Table 4.5, it is apparent that the significant lengthening of the interval occurred in the 1980s compared to the 1960s. This shift means a deterioration of the terms granted in the recent reschedulings. It is not clear what may have motivated creditors to make or to have made this change. However, with respect to the considerable economic and social costs of the adjustment process in debtor countries, official creditors may reconsider this policy change and return to the shorter intervals practised in the 1960s.

4.1.3 Consolidation Period

The consolidation period, i.e., the period in which debt service to be rescheduled, has fallen or will fall due, is another measure of debt relief [12].

Table 4.6: Length of Consolidation Period (in years)

Consolidation

Period (yrs)	Less		Between 1.1		Over	
Cases	than 1	1	and 1.99	2	2	Cases
1960s		1	1	4	1	7
1970s		2	1	1		4
1980-84	1	2	4			7
Total	1	5	6	5	1	18

Source: World Bank, Multilateral Debt, op. cit., p. 4; (*).

In the majority of cases, the consolidation period did not exceed two years. The experience of Latin American countries was similar to reschedulings by other LDCs. Out of 82 LDC cases

under review between 1960 and 1984, more than 50 per cent of the cases agreed on a consolidation period of one year, and about 30 per cent on a period of one to two years [13, *].

If one makes a comparison over time, one notices a shift to shorter consolidation periods since the 1960s, whereas the earlier reschedulings showed, in their majority, a consolidation period of two to five years. In recent reschedulings, such long periods were never granted. Two main reasons are responsible for this development. First, as has been pointed out, U.S. and creditors' policy is targeted toward shorter term consolidation periods [14]. Second, in the Agreed Minutes, the provision of "conditional further rescheduling" has been replaced by the "goodwill clause". The former refers to a stipulation that obligations falling due in a specified future period would automatically be rescheduled without another Paris Club meeting and on the same terms spelled out in the first Agreed Minutes. This provision was generally made conditional upon the adoption of an IMF adjustment program. The "goodwill clause" is more constrained than the former and refers only "to the creditors' willingness to consider further debt relief in the future, subject to fulfillment by the debtor country of specified conditions" [*]. Although this clause was seldomly incorporated in the Paris Club agreements prior to 1980, it has now become a standard feature [15]. The goodwill clause links a further rescheduling to more conditions than those demanded in the 1960s. The conditions are myriad. The debtor has to agree to one or more points, among them (1) to continue to have an IMF

program in place, (2) to conclude and comply to a new IMF program, (3) to establish effective arrangements with banks and other creditors, (4) to comply with all conditions spelled out in the present Agreed Minute, and (5) to comply with the most-favoured nation and initiative clause [1]. However, recent practice shows that certain countries went through their second or third round of rescheduling without implementation of the above mentioned conditions. This suggests that repeated reschedulings do not depend on the "goodwill" of the creditors but on the necessity to forestall default, in which the creditors have a high stake. Moreover, the "goodwill clause" could be dropped, if creditors are willing to consider longer consolidation periods in the Agreed Minutes.

The cumulative consolidation period - due to successive reschedulings - ranged from a half year in the case of Mexico to over eight years in the case of Brazil. On average, the countries studied were granted a consolidation period of 1.6 years [16]. This period is, however, too short to guarantee an adequate adjustment. As a consequence, reschedulings tend to be repeated. This deficiency was already identified by the Pearson Commission, when it criticized the short-term consolidation.

This "short-leash" approach involves heavy costs in terms of uncertainty, pre-emption of scarce management and professional skills, and the inability of the debtor to formulate long-term plans and policies. When relief is given, it should be provided for an adequate period to avoid a rapid succession of debt relief negotiations. We recommend that debt relief operations avoid the need for repeated reschedulings and seek to re-establish a realistic basis for development finance [17].

This recommendation was revived with new life when Mexico

concluded a pluriannual rescheduling with its creditor banks in 1984. The idea that a multiyear approach should also be extended to the Paris Club, was supported by the heads of state of the seven leading industrial countries. In their final communique of their meeting in London they stated:

...in cases where debtor countries are themselves making successful adjustment efforts to improve their position, encouraging more extended multiyear rescheduling of commercial debts and standing ready where appropriate to negotiate similarly in respect of debts to governments and government agencies [18].

With the political support guaranteed, this proposal waits now to be implemented in successive Agreed Minutes.

4.1.4 Repayment Terms

The repayment terms refer to grace, maturity, and interest. These terms stipulated in the Agreed Minutes have differed according to the types of debt consolidated and to the severity of the balance of payments situation. The variations refer mainly to the grace and repayment periods. Although the maturities - grace and repayment period - of the 19 cases studied averaged 7.2 years, there occurred a noticeable shift within their composition.

Table 4.7: Grace and Repayment Periods of 19 Reschedulings

Number of Reschedulings	Grace Period (in years)	Number of Reschedulings	Repayment Period (in years)
2	0	4	2.5-3.5
3	1 or less	11	4-5
7	2		
6	3-4	4	6-7
1	5 or less	1	9
19		19	

Source: World Bank, Multilateral Debt, op. cit., p. 4; Crowe, Brian, G., International Public Lending, op. cit., pp. 38-39; (*).

Whereas before 1980 the grace period lasted between one and two years, it has been extended to a minimum of three years in the 1983-84 reschedulings. Concurrently, the repayment period was reduced to less than five years, while the earlier reschedulings showed an average amortization of 5.7 years. The larger grace periods represent additional debt relief for the debtor country in the short run.

The extension of grace was also manifested in the "backloaded" repayment schedule, i.e., schedule where most rescheduled obligations fall due in the latter part of the repayment period [19], and has been generally applied in the Latin American context. However, this approach includes all payments subject to debt consolidation. Thus far, we have only referred to the formally rescheduled portion.

The rescheduling is generally broken down into three parts. First, the already mentioned formal portion is that which constitutes between 50 and 100 per cent of the eligible amount. Second, the downpayment portion represents the amount to be paid during the consolidation period. Third, the remainder is an unconsolidated portion which is usually also postponed and redeemed over a one to two year period [20, *]. Since creditors do differentiate between a rescheduling of current maturities and arrears, the repayment terms for the latter have been more stringent than for the former. In Appendix, Tables 19 and 20 recapitulate the repayment schemes of rescheduled maturities and arrears. In order to document this different treatment, the following chart illustrates three case studies.

Chart 4.1: Repayment Schedule of Three Countries (in per cent of total repayments)

Source: Appendix/Tables 19 and 20

One new development occurred in 1984. In the Jamaican case, the terms distinguished between principal and interest to be rescheduled [2]. As a result, the bulk of interest had to be repaid in the first two years after the agreement, whereas the bulk of principal could be redeemed in the second half of the repayment period.

Since the debtor countries under review faced a serious foreign exchange crisis, the rationale for a downpayment may be questioned. For the sake of debt relief, the downpayment portion should be kept as low as possible, and, if it cannot be entirely dropped, creditors might consider the extension of a "bisque clause" with regard to the downpayment. This clause, which was granted by the United States and Canada on postwar loans to the United Kingdom, entitled the borrower to postpone the contractual obligations for a short period of time in case of balance of payments problems [21]. The deferment of payments at the option of the debtor could add some flexibility to the

debtor government in managing its foreign exchange problems. A similar idea was also included in the Indonesian rescheduling of April 1970 [22]. The extension of this potential relief, however limited, should be considered in the face of the heavy debt service obligations by the debtors studied.

Apart from grace and repayment period, the interest rate is another determining factor of the terms. The interest on rescheduled debt is rarely determined or even recommended in the Agreed Minutes. The multilateral arrangements usually stipulate that the interest on deferred payments is "to be determined in the bilateral agreements" or "to be determined on the basis of the appropriate market rate" [21].

Since information contained in the bilateral agreements is considered Confidential, comprehensive data on interest charges are lacking. Thus, a comparison is impossible. Moreover, even the availability of data would make a comparison a dubious exercise. For example, suppliers' credits have been extended on relative low interest but were tied to the purchase of goods which could have been bought more cheaply elsewhere. Therefore, the effective rate of interest may have been higher, if one takes into account the tying of loans as well as other charges [23].

4.1.5 Most-Favored Nation and Initiative Clauses

Two non-discrimination clauses are frequently incorporated in the multilateral agreement. One is the most-favored nation (MFN) clause which stipulates that "the debtor country will accord to each of the participating creditor countries a treatment not less favorable than that which it may accord to any other creditor country for the consolidation of debts of a comparable term" [*]. This MFN provision has been included in all but three cases - Brazil (1961), Peru (1968 and 1969).

However, the MFN clause does not rest on reciprocity, i.e., debtors may not expect equal treatment from creditors when they request a rescheduling. The history of reschedulings has shown that political deliberations have been of decisive importance in determining the extent of debt relief. For example, expropriation issues in Peru (1968/69) and Chile (1972) and economic uncertainty in those debtor countries protracted the debt renegotiations. Hence, concessions by the creditors were not forthcoming.

The second provision, the "initiative clause", was introduced in the Agreed Minutes in the 1970s and reads as follows:

In order to secure comparable treatment of public and private external creditors on their debts, the Delegation of (the debtor country) stated that their Government will seek to secure from external creditors, including banks and suppliers, rescheduling or refinancing arrangements on terms comparable to those set forth in this Agreed Minute for credits of comparable maturity, making sure to avoid inequity between different categories of creditors [*].

This clause was included as a response to the growing importance of commercial banks in financing Latin American

needs. Therefore, since the end of the 1970s, the "initiative clause" has been a standard feature of virtually all Agreed Minutes.

4.1.6 Linkage with an IMF Stabilization Program

Apart from the obligation entailed in the Agreed Minutes, the debtor country commits itself to carry out additional "undertakings". As the examination of the origins of reschedulings has shown, the debtor country generally faces a severe balance of payments crisis at the time of the Paris meeting. It is, therefore, insufficient to extend debt-relief without addressing the underlying causes of the debt-problem. Debt-relief in the form of a rescheduling agreement can only then contribute to the improvement of the balance of payments and hence economic situation of the debtor country, if its government implements the necessary adjustment with regard to fiscal, monetary and exchange policies.

Since the early reschedulings - except Argentina (1956) - the debtor country was required to draw under an upper-tranche credit program of the IMF. Thus, the creditors made the rescheduling conditional upon the conclusion of an IMF supported adjustment program. In virtually all cases IMF programs were in place before the bilateral agreements. An exception was Chile (1972) when its government rejected the prerequisite of an IMF program and it submitted instead a policy declaration which was finally accepted by the creditors.

The IMF Stand-By programs are usually of short-term duration

as are the rescheduling arrangements. On the other hand, adjustment is considered a medium- to long-term process. Therefore, the problem arises how this approach can reconcile long-term adjustment with short-term instruments. This inconsistency leads to repeated reschedulings and contributes to economic and political uncertainty in the debtor-country.

This problem will become more pronounced if multiyear reschedulings are widely applied and also extended to Paris Club agreements. Creditors have either to sacrifice their principle that an IMF program has to be in place during the implementation of the Agreed Minutes, or to resort to other means such as enhanced country surveillance and new safeguard clauses if they want to retain a certain degree of influence on the debtor's economy.

In conclusion, as much as the adjustment is a necessary condition for the rescheduling, it should not diminish the prospects of growth. The Pearson Commission, some years ago, pointed to this issue when it stated:

Another requirement for sensible debt rescheduling is a better balance between the quest for stabilization and the quest for growth. Some debt rearrangements in the past have stipulated that the debtor governments agree to a stringent program of economic stabilization. Even when greater monetary and fiscal restraints are appropriate, the resulting program has often not been sufficiently dynamic. Generally these agreements have emphasized restraint on government spending and credit policies and neglected the need to mobilize domestic resources more effectively, generate new export earnings, and sustain sound development outlays [24].

4.1.7 Degree of Debt Relief

Since the rescheduling arrangement constitutes only one aspect of a comprehensive program of economic adjustment, it is difficult to assign the improvement or even deterioration in certain economic measures (e.g., unemployment) solely to the debt restructuring. Moreover, the relevant measures of the importance of debt relief - such as debt relief as a percentage of imports, exports, current account deficit or debt service [25] - are deficient. Due to price distortions and import and export restrictions, they tend to fluctuate considerably prior and after the renegotiations so that an "objective" judgement becomes almost impossible.

In 1976, the IMF conducted a study investigating the effects of reschedulings (including Latin America) and concluded that "in about four-fifth of the cases in which stand-by arrangements were associated with debt renegotiations, there was an improvement in the overall balance of payments performance, while in about two-thirds of the cases the current account performance improved" [26].

If the analysis of debt relief extends beyond the balance of payments, one has to consider its impact in conjunction with the effects of the adjustment policies on employment, investment, and other economic variables. The outcome of the cost-benefit analysis with regard to rescheduling and adjustment becomes less clear. The positive effect of debt relief - e.g., lower debt-service ratio - confronts the negative impact on

employment, real wages, and investment. It depends on the time span of observation whether a rescheduling is judged as "success" or "failure". However, it appears that creditors assess the rescheduling in a narrower sense, that is, with regard to its short-term effects on the balance of payments. Therefore, the agreement is often deemed to be performing satisfactory. On the other hand, debtor countries examine reschedulings in a broader sense, thus with respect to the whole economy, and are less sanguine. Their main complaint aims at the neglect of development and growth criteria in the Agreed Minutes.

If debt relief is still more narrowly defined, i.e., restricted to the Agreed Minutes themselves, then the preceding analysis has revealed variations in the extent of debt relief. Those variations leave room for improvement which has been

indicated in various subsections. Therefore, official creditors may contemplate the implementation of the following suggestions:

- (1) Coverage: 100 per cent coverage of eligible debt to be consolidated.
- (2) Cut-off date: shorter intervals between cut-off date and the beginning of the consolidation period.
- (3) Consolidation period: return to longer consolidation periods and introduction of multiyear reschedulings with official creditors.
- (4) Repayment terms: Elimination of the downpayment and if not possible, introduction of a "bisque clause" for the downpayment.
- (5) Longer-term adjustment programs.

4.2 Commercial Bank Reschedulings

The Paris Club reschedulings of the last few years covered only a part of the total debt falling due in the consolidation period. In the 1980s, over 80 per cent of Latin America's external debt has been contracted with private banks [27]. For this reason, commercial banks have become the main source of debt relief.

Between 1976 and 1984, Latin American countries have renegotiated their debt with commercial banks on 29 occasions. The bulk of agreements were reached in 1983 - 9 cases - and in 1984 - 10 cases.

The approach of bankers toward rescheduling is similar to the one taken by official creditors. Thus, the guiding principles are a case-by-case approach, ad hoc treatment indicating the exceptional economic circumstances in the debtor country, and generally an IMF adjustment program.

However, Paris Club and private bank reschedulings differ in their institutional setting. Whereas in the Paris Club a small number of creditors - up to 20 - negotiates with the debtor country, the bank debt restructuring involve a large number of creditors. For example, large debtors such as Brazil and Mexico have to settle their debt with over 1000 banks. Even smaller debtors, like Bolivia, owe payments to about 100 banks. For this reason, it is imperative to organize the banks prior to the debt renegotiations. Depending on the number and size of the creditors, a coordination or steering committee is established in order to conduct the negotiations on behalf of all creditors.

Sometimes creditors together with the debtor country form a complete set of task forces. But the Brazilian experience has proven that such an approach is inefficient because of the overlapping and even conflicting responsibilities of the sub-committees [28].

The large number of creditors involved in the debt restructuring obviously complicates the rescheduling. In order to streamline the priorities and interests of, say, 400 from 15 to 20 countries, it requires time-consuming negotiations among banks prior to the meetings with the debtor country.

Differences among banks have particularly surfaced with respect to continued lending and the evaluations of the need and economic prospects of the borrower.

For the sake of clarity, the following analysis will again be preceded by a summary of the terms of commercial bank reschedulings between 1976 and 1984.

4.2.1 Coverage of Debt Rescheduled

For commercial bank reschedulings, two objectives have been established which determine, in part, the extent of coverage:

- (1) equitable burden-sharing among creditors, and
- (2) containment of the damage to the creditworthiness of the debtor country [*].

The first objective is meant to prevent banks from reducing their exposure to the debtor country. This "sharing clause" has been reluctantly accepted by smaller, especially U.S., banks.

Table 4.8: Summary of Terms of Commercial Bank Reschedulings, 1976-1984

Debtor Country	Date of Agreement	Type of Debt	Consolidation Period (Yrs)	Rescheduled Amounts (US\$)	Percent	Fees (%)	Grace (Yrs)	Maturity (Years)	Spread over LIBOR (%)
Argentina	1976	P	0.5	991	...	...	...	...	...
Peru	Jan. 1979	P	2	821	90	...	2	5	1 7/8
Guyana	1979	P	...	29	100	...	...	...	...
Jamaica	April 1979	P	2	126	68	...	2	5	2
Nicaragua	Dec. 1980	PI	Accumulated Arrears	582	100	...	5	11-12	3/4 - 1 1/4
Bolivia	April 1981	P	2	412	80-90	...	2-3	3.5-6	2 - 2 1/2
Jamaica	June 1981	F	2	103	100	...	2	5	2
Nicaragua	Dec. 1981	PI	Accumulated Arrears	188	100	...	5	10	3/4 - 1 1/4
Nicaragua	March 1982	PI	Accumulated Arrears	102	100	...	5	10	3/4 - 1 1/4
Guyana	June 1982	F	1.1	14	100	...	...	...	2 1/2
Brazil	Feb. 1983	F	1	4,532	100	1.50	2.5	8	2 1/2
Chile	July 1983	P	2	3,400	100	1.25	4	8	2 1/8
Costa Rica	Sept. 1983	F	2	1,240	97-100	1.38	3.25	6.5-7.5	2 1/2
Cuba	Dec. 1983	F	2.33	128	100	1.25	...	5.5	2 1/2
Dominion Rep.	Dec. 1983	P	1.1	500	95	1.25	1	5	2 1/2
Ecuador	Oct. 1983	P	1	1,635	93-100	1.00	...	4-7	2 1/2
Mexico	Aug. 1983	F	0.33	23,625	100	1.00	4	4	1 1/4
Peru	July 1983	P	1	300	100	...	...	...	2 1/2
Guatemala	July 1983	P	...	800	90	1.25	...	...	...
Argentina	Dec. 1983	P	...	3,241	100	...	...	...	...

Table 4.8 (continued): Summary of Commercial Bank Reschedulings, 1976-1984

Debtor Country	Date of Agreement	Type of Debt ¹	Consolidation Period (Yrs)	Rescheduled Amount (US\$)	Fees ² (%)	Grace (Yrs)	Maturity (Yrs)	Spread over LIPOR (%)
Bolivia	Jan. 1984	F	1.75	536	...	4	...	...
Brazil	Jan. 1984	P	1	5,350	1.0	5	9	2
Ecuador	Dec. 1984	P	5	4,980	-	3	12	1 3/8
Guyana	July 1984	P	Extension of Payment	42	...	-	-	2 1/2
Honduras	Dec. 1984	P	2	368	...	2	10	1 1/2 - 1 7/8
Jamaica	June 1984	P	1.75	164	...	-	5	2 1/2
Mexico	Sept. 1984	P	6	48,700	-	-	14	7/8 - 1 1/2
Peru	Feb. 1984	P	1.33	1,415	0.75	5	9	1 5/8
Venezuela	Sept. 1984	P	6	20,750	-	-	12.5	1 1/8

Note: Three dots (...) indicate lack of data.

1. F - Principal; I - Interest

2. Fees are calculated as a percentage of the total amount reduced.

Sources: (*) Brau, E. and Williams, R.C., Recent Multilateral, op. cit., pp. 35-40; ECLA, Adjustment Policies and Renegotiation of the External Debt, Washington, D.C., 1984, p. 20; World Development Report, Washington, D.C., 1985, p. 28; World Bank, World Debt Tables, 1984-1985 Edition, Washington, D.C., 1985, pp. xvi-xvii.

They play only a subordinate role in the negotiations but their further participation is essential in order to prevent the debt problem becoming exclusively a "big bank" issue. The concern for cohesiveness among banks has yielded the advantage for the debtor that the steering committees attempts to define the coverage as broadly as possible in order to include all bank debts.

The second objective should minimize the damage caused by the rescheduling and, hence, to the prospects of regaining access to the international capital market by the debtor country. For this reason, creditors have excluded interest payments falling due or in arrears. Since official bank regulators have to reclassify loans which are not performing, the adverse impact of such measure would lead to a further reduction or even cessation of new lending to the country concerned. In our sample, there was only one exception, Nicaragua; where interest in arrears was included in the three arrangements between 1980 and 1982. This concession has, however, limited Nicaragua's ability to borrow anew from commercial banks.

The main form of incorporating interest in a debt consolidation is a refinancing of a portion of the outstanding interest commitments. According to ECLA, "in this way the banks have introduced a de facto rescheduling of interest payments," since they are capitalizing a portion of their income under this heading until the countries are able to recover their external payment capacity [29]. This alternative form has gained

considerable importance in recent years when interest payments constituted a heavy burden to the debtor countries due to the high real rates in the OECD countries.

In all reschedulings reviewed here, public and/or publicly guaranteed debt was subject to renegotiation. Obviously, all public and publicly guaranteed debt which had already been covered by the Paris Club, was excluded. In about 35 per cent of the cases, countries had concluded or requested a Paris Club rescheduling. Apart from the public sector, debt obligations owed to the private sector were considered for debt relief in about 25 per cent of the cases.

With regard to maturity, most debt referred to medium- and long-term debt. However, short-term debt, mainly public and non-trade related, was included in about 30 per cent of the cases. Banks resent this development because they did not intend to commit themselves in the medium or long-term to the debtor countries. Nevertheless, they had to accept the conversion of short-term into medium-term debt, such as in the case of Chile (1983). However, in order to avoid a negative impact on trade financing, short term trade related credits have been handled differently. They have either been rolled over - e.g., Brazil (1983-84), Chile (1983), and Ecuador (1983) - or the rescheduling agreement included a trade credit maintenance facility - e.g., Argentina (1984) and Ecuador (1984) [*].

The amounts of debt rescheduled are estimated at U.S.\$145 billion for the 29 cases. Whereas these amounts were relatively modest prior to 1983, they almost exponentially grew in 1983 and

1984. Therefore, the Paris Club arrangements appear insignificant in comparison with the bank restructurings. Commercial banks stretched out payments due to the amount of U.S.\$142 billion in 1983-84, while official creditors consolidated about US\$6.3 billion. In other words, more than 95 per cent of the rescheduled debt in 1983-84 was attributed to commercial banks, the remainder belonging to official creditors.

The large debtors - Argentina, Brazil, Mexico and Venezuela - accounted for 87.5 per cent of the total amount consolidated. The multiyear reschedulings of 1984 particularly have reinforced the preponderant position of the large debtors. They attract the attention of the creditors, whereas the smaller debtors play a rather subordinate role. But as has already been stressed, equal treatment of creditors (MFN clause) does not know its counterpart in a equal treatment of debtors. Since smaller debtors simply lack the bargaining power, their deals with creditors are often less favorable than the ones of the larger debtors [30]. For example, if one relates the rescheduled amounts to the debt outstanding one year prior to rescheduling, one observes that this ratio was for the large debtors - except Brazil - never below the 30 per cent. On the other hand, most smaller debtors showed a ratio of 20 per cent or less. Although Brazil was also in this lower group, this country has at least the prospects that it will be granted a multiyear rescheduling which, in turn, will raise its ratio.

The size of consolidation, expressed in percentages, has also been higher than in the Agreed Minutes. Prior to 1983,

full coverage was granted in the majority of cases. The rest of the cases covered, between 80 to 98 per cent of eligible debt to be consolidated, with the bulk concentrated in the 90 per cent range. In 1984, however, creditors allowed a 100 per cent coverage for all cases.

4.2.2 Consolidation Period

As stated earlier, the length of the consolidation period determines partially the extent of debt relief. The period may cover those periods in which the debtor country accumulated arrears and/or in which future amortization payments will mature (31).

About one-third of the cases had to consolidate arrears or requested a formal deferral. The latter is treated as a "rescheduling in its broadest meaning". Argentina (1976) worked out a six month deferral with its creditors. Guyana has deferred its payments four times since June 1982. Since the Guyanese authorities always post-pone the payment of the same amount which was deferred before, plus the amount due in the next half year or period, the deferments in this study refers only to the first (1982) and last (1984) rescheduling.

Table 4.9: Length of Consolidation Period (in Years)

<u>Number of Reschedulings</u>	<u>Consolidation Period</u>
5	1.0
5	1.1-1.99
8	2.0
2	2.1-2.5
4	4.0-6.0
24	

Sources: Brau, E. and Williams, R.C., Recent Multilateral, op. cit. pp. 35-40; (*); IDB, 1984-1985 Reports, country summaries.

Table 4.9 shows that in 75 per cent of the cases the duration of the consolidation period ranged between one and two years. The average consolidation period in 1983 was 1.6 years which corresponds exactly with the average value in Paris Club agreements. The same criticism of the short consolidation period, expressed in the Agreed Minutes, is also valid for commercial bank reschedulings. However, banks have recognized that this short-run approach toward rescheduling has only added to considerable uncertainties about developments in the external environment and the adjustment process of the debtor country.

Prior to 1984, the steering committees did not design medium-term plans for debt service obligations. As a consequence, the terms of reschedulings contributed to a bunching of the debtor countries' amortization payments (*). In order to redress this deficiency, commercial banks have introduced multiyear rescheduling packages for selected debtors. A condition for a long-term stretching out of payments is the satisfactory implementation of an IMF supported program. In 1984 Ecuador, Mexico and Venezuela concluded in principle a pluriannual rescheduling. Debt service falling due between 1985 and 1988 (Venezuela), 1989 (Ecuador), and 1990 (Mexico) will be stretched out over a 12 to 14 year period.

The extension of those consolidation periods in 1984 was also reflected in the average duration which has lengthened to almost three years in 1984. However, this positive result should not overlook the fact that the smaller debtors have not yet benefitted from this change.

4.2.3 Terms of the Rescheduling Arrangements

The terms, which comprise grace, maturity, interest rate, and commissions, have varied considerably among rescheduling agreements. Creditors granted different terms over time and discriminated between smaller and larger debtor countries.

The first component, grace and maturity, is categorized in the following table.

Table 4.10: Grace and Maturity in Bank Rescheduling Agreements

<u>Grace</u>		<u>Maturity</u>	
<u>Cases</u>	<u>Years</u>	<u>Cases</u>	<u>Years</u>
4	0 - 1	5	5
7	2	9	5.5 - 8
5	2.5 - 3	6	9 - 10
4	3.2 - 4	4	11 - 14
5	5	—	
25		24	

Note: Information is lacking for all 29 cases, hence the smaller numbers 25 and 24, respectively.

Sources: Brau, E. and Williams, R.C., Recent Multilateral, op. cit., pp. 35-40; (*); IDB, 1984-1985 Reports, country summaries.

The grace periods have been relatively evenly spread between zero and five years for the 25 cases studied. A trend toward longer grace periods as could be observed for the Paris Club agreements was not evident. However, as a result of the multiyear reschedulings, a trend toward longer maturities has been marked. The larger debtors received, at least in their

second round, maturities on their rescheduled debt between nine and 14 years. On the other hand, the smaller debtors such as Bolivia, Costa Rica, Dominican Republic, and Jamaica, had to amortize their obligations between five and eight years. The only small debtor which creditors granted relatively favourable grace and maturity, was Nicaragua. This country had to redeem its rescheduled debt within five to seven years after the end of a five year grace period. The Nicaraguan reschedulings were unique, for they were "largely based on development criteria as is reflected in the fact that they included lengthy postponement of a considerable proportion of interest payments and unusually long maturities [32]. These criteria were not applied in the subsequent first "wave" of reschedulings in 1983. On the contrary, one could identify a deterioration of the terms in all rescheduling exercises. Interestingly, the 1983 agreements showed a high degree of similarity with each other. ECLA partially explains this feature by the series of events concerning the debt problem in 1982.

This process began and took place most rapidly in Mexico, due to the urgency of solving the problems of such an important borrower. That country also had the tradition of being one of the banks' best clients. Since the banks contend that rescheduling terms are determined on a risk basis, the agreement reached with Mexico established a sort of "floor", or lower limit, for the terms of other rescheduling exercises. These "floor" terms were similar to the least favourable terms of the 1970s. As a result, the latter, which at one time were an exception affecting only a few countries, ended up by extending to practically all of Latin America [33].

This similarity in terms is interpreted by ECLA and others as a monopolistic or cartel like behavior on the side of the

banks [34]. Although the terms of the 1983 agreements do indeed not deviate significantly from one another, this suggestion appears to be unfounded. If, namely, banks behaved like a cartel, they would have continued this policy beyond 1983. However, they did not. In fact, banks recognized that their short-term approach toward rescheduling was inadequate and would perpetuate the debt problem. As a novelty, three pluriannual reschedulings were concluded with Ecuador, Mexico and Venezuela. This approach should facilitate a return to a more normal debtor-creditor relationship and add more certainty about future debt service obligations.

As example for a multiyear rescheduling, the Mexican agreement will be taken. The Mexican authorities arranged with its creditor banks to stretch out amortizations falling due between 1985 and 1990 over a 14 year period. In this period, US\$48.7 billion has to be discharged. Although no grace was granted, the repayments begin modestly, i.e., they will range between US\$0.5 and 1.2 billion per annum through 1988. Thereafter, the amortization will increase steadily to a maximum amount of U.S.\$6.1 billion in the final year [35,*]. In the next chart, the impact of Mexico's multiyear rescheduling on its external debt profile is illustrated. It compares the situation before and after the restructuring. The debt relief which is calculated as the difference between the original and new amortizations, reaches U.S.\$40.5 billion in the first six years of the agreement.

Chart 4.2 : Mexico's Multiyear Rescheduling of External Public and Publicly Guaranteed Debt:
Impact on the Amortization Profile and the Debt Relief (In billions of U.S. dollars)

Sources: (*) World Bank: World Debt Tables, 1984-85 Edition, Washington, D.C., 1985, pp. xv-xvii.

Creditor banks make the conclusion of a multiyear rescheduling package contingent upon the successful implementation of an adjustment program which has already yielded noticeable results. The countries which have thus far been considered for such a deal have either a diversified economic structure and/or possess large oil reserves. It remains to be seen whether this new approach will be restricted to the larger more advanced Latin American countries or also be extended to the smaller, less diversified debtors.

The second component, interest, is based on LIBOR or the U.S. prime, depending on the creditors' option. Then, a spread over LIBOR or the U.S. prime is determined.

The spread, which has varied among debtors, has triggered a wave of criticism. How do banks justify the spread and how do the borrowers view it?

The position of the banks is somewhat ambiguous because it has been changing with the market situation. According to Mr.

Wallich of the Federal Reserve, the spread should be composed of three elements: (1) the risk premium to cover losses, (2) the contribution to the bank's cost of capital related to the loan, and (3) the overhead operating costs involved [36]. However, these criteria were largely ignored in the borrowers' market of the 1970s. As a result, spreads were reduced to a minimum and were almost equal for all borrowers. Already in 1978, Mr. Wallich pointed out that "a spread of 1 per cent, which had for a while to be a minimum spread, hardly provides a well-capitalized bank with an adequate return on capital and a reasonable risk premium - leaving nothing left to cover operating costs" [37]. This was realized too by banks when the first reschedulings appeared on the horizon in the beginning of the 1980s. Banks responded by increasing the spreads again.

As much as in the 1970s the risk premiums were too low or underestimated, in 1983 they were too high and over-estimated. Perhaps the high spreads of 2.1 to 2.25 per cent in 1983 can be better explained by psychological factors rather than by monopolistic behavior on the part of the banks. The wave of debt renegotiations of that year was unprecedented in the financial history since World War II. The uncertainty was reflected in an overreaction by banks charging high spreads and commissions for the rescheduling exercises and new loans. This somewhat short-sighted approach was not only an attempt to compensate for the low premiums of the 1970s but also to keep all banks, particularly the smaller U.S. ones, in the lending process.

The shortcomings of this first round of reschedulings became quickly salient. First, as has been argued in the previous chapter, credit rationing rather than spread is the decisive instrument of allocating funds to debtor countries. The sharp curtailment in lending to the region confirms that the high spreads in 1983 were not an incentive to continued lending but almost a disincentive as they indicated the diminished credit worthiness of the debtor countries. Second, the higher spreads and commissions damaged the reputation of banks in the debtor countries. Banks actually made profits of the rescheduling exercises instead of showing concern about the longer-term recovery prospects of the debtors. Therefore, the first round of reschedulings was not conducive to calming down public resentment in debtor countries against international banks and foreign interference.

Moreover, debtor countries argue that their governments recognize their debt obligations and are prepared to honor them. Therefore, a risk premium in form of higher spreads is superfluous. This point was voiced by former economics minister Grinspun of Argentina, when he stated:

Starting in 1982, the external debts of many countries have been rescheduled and in some cases the mark up on commercial lending have been reduced by approximately one point. But it must be noted that this slight decrease has applied to margins and commissions that had reached levels that were both excessively high and unsustainable, allegedly based on a concept of country risk that we cannot accept, since the legal continuity of national state guarantees final payment of all sovereign debt assumed. Countries constitute sovereign entities, not risks [38].

The widespread criticism of the hard terms in the 1983 reschedulings was addressed by the international financial

community. One measure in response was the elimination of the more costly prime option in virtually all 1984 reschedulings, with Argentina, Brazil and Peru being the only exceptions [39]. Whereas in all but one case in 1983 the spreads were two per cent over LIBOR, the 1984 restructurings showed a picture in reverse. In only two cases - out of nine - were the spreads in excess of two percent over LIBOR. The remainder renegotiated their debt with a spread between one and two per cent. The next table categorizes the cases of which information is available.

Table 4.11: Spread over LIBOR (in percent)

<u>Spreads (%)</u>	<u>Cases</u>	<u>Sub-classification</u>
1.25 or less	4	(before 1983: 2; 1984: 2)
2 or less	10	(before 1983: 4; 1983: 1; 1984: 5)
2.25 - 2.5	11	(before 1983: 1; 1983: 8; 1984: 2)
	25	

Sources: Brau, E. and Williams, R.C., Recent Multilateral, op. cit., pp. 35-40; (*); IDB, 1984-85 Reports, Country summaries.

Although Table 4.11 confirms the softening of rescheduling terms with regard to spread, it does not reveal the beneficiaries. Apart from 1983, when all debtors received similar terms, the other years show some certain differences between larger and smaller debtors. The Nicaraguan reschedulings are the exception as Table 4.8 has indicated. In 1984, the banks accepted lower spreads over LIBOR for Argentina, Ecuador, Mexico and Venezuela. On the other hand, the smaller

debtors and Brazil were not given similar terms but their spread laid between 1.5 and 2.5 per cent over LIBOR. As can be expected, creditors will settle the Brazilian debt on a pluriannual basis, and thereby, reduce the spread too. However, the limited bargaining power of smaller debtors may leave them with less favorable terms than the ones granted to the large debtors.

The last component, which has been closely linked to interest charges, forms the rescheduling fees. These fees or commissions are charged by banks for rescheduling commercial bank debt and were paid at the conclusion of the agreement. They are calculated as a percentage of the total amount rescheduled. In addition to these commissions, banks may charge the debtor to pay for other costs. Since these additional charges are not reported, they cannot be quantified. Therefore, the reported fees are frequently an approximation of the total real ones [40].

According to a study conducted by Mendelsohn in 1982/83, rescheduled LDC debt was "yielding banks about two per cent a year more than the terms on which most of that debt was originally contracted" [41]. The same report estimates that banks might have earned about U.S.\$1.75 billion a year on the U.S.\$90 billion of LDC debt which was restructured between mid-1982 and mid-1983 [42]. If this calculation is correct and applied to the Latin American bank reschedulings, banks may have received around U.S.\$1 billion in commissions and higher spreads.

In 1983, fees ranged between 1.25 and 1.5 per cent with Mexico - one per cent - being the only exception. As mentioned above, the extra surcharges were generally criticized. In order to discourage the charge of upfront fees, a new U.S. bank regulation stipulates that such fees have to be amortized over the life of a loan [43]. Since upfront fees were used to improve the profits of banks in the short-run, the new rule has made this accounting technique redundant.

For 1984, information on fees is available for six cases. Creditors charged Brazil and Peru 0.5 per cent less than in the previous rescheduling. But banks entirely waived the commissions for multiyear restructurings as well as for Argentina. This policy change suggests that commissions are not necessarily needed.

4.2.4 IMF and New Lending

Commercial banks, like official creditors, require debtor countries to draw under an upper-tranche credit facility of the IMF. Since the Peruvian experience in 1976, when that country and commercial banks worked out a stabilization program without IMF participation [44] which failed, banks have been extremely reluctant to settle debts without an IMF program. In our sample, there were several exceptions to this rule. For example, Nicaragua (1980/81/82) managed to do without an IMF adjustment program. Neither did Cuba, which is not a Fund member, nor Guyana whose debt is only deferred but not formally rescheduled.

The financial developments of the 1980s have changed the IMF - commercial banks relationship into an interdependence. The previous chapter discussed seven factors which were responsible for the sharp contraction of bank lending to the region. It is, however, the second objective for reschedulings outlined by the Development Committee - "the promotion of the restoration and enhancement of financial flows through adjustment policies" which has made an IMF program conditional upon new net lending and vice versa. This makes a rescheduling sometimes a "lender's trap", i.e., banks must lend new money in order to shore up the quality of their outstanding claims to debtor countries [45].

In 1983-84, seven Latin American countries tied their rescheduling arrangements to new loan commitments by the participating banks. This concerted action "forced" all banks to increase equiproportionally their exposure to a rescheduling country. This so-called involuntary lending was resisted particularly by smaller banks which wanted to reduce rather than increase their exposure. The IMF, in turn, waited until banks had organized a "critical mass" of loan commitments until it gave its final approval to an adjustment program. These commitments fell only twice short of expectations when the actual disbursements were lower than the commitments. The following table gives an overview of the concerted lending operations in 1983-84.

Table 4.12 shows that none of the Central American countries and other small debtors were extended new net funds. Attention is obviously directed to the larger debtors. However, this does

Table 4.12: Concerted Lending: Commitments and Disbursements,
1983-84 (in millions of U.S. dollars)

Debtor Country	1983		1984	
	Commit- ments	Disburse- ments	Commit- ments	Disburse- ments
Argentina				
Medium-term loan	1,500	500	3,700	-
Trade deposit facility	-	-	500	-
Brazil				
Medium-term loan	4,400	4,400	6,500	6,500
Chile				
Medium-term loan	1,300	1,300	780	780
Ecuador				
Medium-term loan	431	431		
Mexico				
Medium-term loan	5,000	5,000	3,800	3,800
Peru				
Medium-term loan	450	250	-	100
Uruguay	240	240		

Source: (*)

not mean that the small debtors can do without new net funding.

The Declaration of Quito was specific with regard to new net financial flows to the region, when it stated:

The maintenance of a net, adequate and increasing flow of new public and private financial resources for all the countries of the region as an essential component of external debt renegotiations and as a guarantee of social and economic development, should be assured by granting additional commercial and financial credits (46).

In conclusion, commercial banks granted better terms in the 1984 reschedulings. The extent of debt relief could further be improved if the following recommendations are implemented, in full, including:

- 1) Multiyear rescheduling arrangements to all debtor countries.
- 2) Reduction of spreads over LIBOR.
- 3) Elimination of rescheduling fees.
- 4) No discrimination between smaller and larger debtor countries.
- 5) Maintenance of credit lines and additional new net lending.

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10. See Table 4.1 and Appendix, Table 8.
11. Brau, E. and Williams, R.C., op. cit., p. 18. In our sample of 19 reschedulings, of which data could be gathered for 16, the cut off date was between 0 and 16 months before the beginning of the consolidation period.
12. Ibid., pp. 18-19.
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14. See point 4 of the U.S. decision on reschedulings in 1978.
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CHAPTER FIVE

ALTERNATIVE APPROACHES TO RESCHEDULING

The shortcomings analyzed in the previous chapter have resulted in the allegation by critics that rescheduling is a "muddling through" strategy, a method without an end. On the other hand, rescheduling has been praised as a highly sophisticated approach toward problem-solving. This contradiction is best explained in an article by Lindblom on "The Science of Muddling Through" [1]. According to him, too much emphasis is placed in decision-making policy on the so-called rational-comprehensive method where there is clarity of values and objectives, a means-end relationship and a comprehensive analysis. In practice, however, this method is seldomly applied. Decisions are essentially based on incrementalism or successively limited comparisons of values. In this way, creditors make choices between marginal values - for example, the reestablishment of the debt-servicing capacity and long-term adjustment - when they renegotiate the external debt of a country. It is this process of incrementalism which determines the outcome of reschedulings.

Therefore, critics have different values or objectives in mind when they outline the deficiencies of "standard" reschedulings and put forward new proposals. Frequently, their proposals do not reject the rescheduling process but more the way it is conducted. Especially, the time-horizon is a main issue.

The proposals range from longer-term restructurings to institutional changes to repudiation. Moreover, the various forms of debt relief are often accompanied by proposals concerning the reform of the international financial system.

One can categorize the alternative formulas to rescheduling in four different forms. They appear mostly in some kind of combination and will, therefore, be presented in the context of a concrete proposal.

- 1) Conversion of debt into long-term bonds
- 2) Debt-service in connection with economic performance
- 3) Reforms within multilateral financial institutions and commercial banks
- 4) Debtor cartel and the repudiation issue.

The proposals presented below are far-reaching. The central question arises as to which country should be eligible for debt-relief. Thus far, those LDCs qualify for rescheduling which actually are experiencing debt-servicing problems. However justified this policy may be in such cases, the question remains whether or not other LDCs - which have taken out loans on similar terms but conducted a different economic policy that enabled them to service their debt on schedule - should also qualify for debt relief. If domestic economic policies are, to a large extent, responsible for the debt-servicing difficulties, then the debt-relief might be perceived as a reward for economic mismanagement of the LDC concerned. On the contrary, LDCs which pursued an economic policy consistent with foreign borrowing, are in fact penalized, since they cannot expect a renegotiation.

of their external debt because there is no need. This seems to be unfair at first glance but the criterion for debt relief - i.e., debt service and balance of payments problems - should be maintained. The LDCs which receive some sort of debt relief have to go through an adjustment process that can be costly in terms of unemployment and economic stagnation. Moreover, the creditworthiness of those countries will suffer and, as can be observed, new lending is not sufficiently forthcoming. On the other hand, LDCs without debt-servicing problems may expect more favourable terms and sufficient amounts in their new borrowing operations.

The first three blocks of proposals restrict eligibility to the actual rescheduling cases. The last proposals are less clear in this respect.

5.1 Conversion of Debt into Long-Term Bonds

Debt restructuring will involve costs on the side of the borrower or of the lender or both. Debtor countries argue that they are asymmetrically bearing the burden of the rescheduling. The borrowing country has to accept an austerity program, whereas banks have actually improved their earnings by charging front-end rescheduling fees. The debtor countries demand that there should be an equal burden sharing, since both creditors as well as debtors have been responsible for the debt problem.

The commercial lending institutions could absorb some of the costs arising from the debt problem by reducing their amortization claims vis a vis the debtor countries. This

writing down option has been presented in various proposals.

Their common features are the conversion of parts of the accumulated debt into long-term obligations, the trading of LDC loans at a discount, and the establishment of an international institution which organizes the conversion and rescheduling.

The Declaration of Quito of January 13, 1984, urged that possibilities of such conversion should be explored. In this context three proposals deserve attention.

Kenen Proposal [2]

This plan builds on the premise that "it must reduce LDC's debt burden so that they do not have to pursue domestic policies that jeopardize internal stability and interfere with worldwide recovery. It must permit the banks to go on lending because LDCs must go on borrowing" [3].

Kenen proposes the establishment of a new institution, the International Debt Discount Corporation (IDDC) which would issue long-term bonds to the banks in exchange for the LDC debts. The bonds would be traded at a 10 per cent discount. Therefore, banks would receive 90 per cent of the amortization of their LDC loans. They would have to absorb this 10 per cent devaluation of their assets out of their profits and/or capital base. Kenen did not calculate the possible losses for the banks. Critics, like Cline, contend that this 10 per cent discount would mean a significant cut in the capital base of the large banks, up to 30 per cent [4].

If one assumes that this discount would not jeopardize the banks' viability, the IDDC could reschedule the LDC debt on a long-term basis. By using the 10 per cent extracted from the banks, the IDDC could charge lower interest rates and grant longer grace periods. Thus, the discount is reflected in the balance sheets of the banks - where they will have a low-risk, long-term asset at a lower return - whereas for LDCs it is turned into a reduction of the debt service.

Weinert Proposal [5]

Weinert suggests that banks should swap their LDC loans for World Bank bonds. Because of its expertise, the World Bank and not a new organization should ~~emit~~ issue these bonds, which will be traded at their face value, but the interest rate would be below the commercial rate. Instead of the immediate 10 per cent loss in the Kenen proposal, the banks could gradually absorb the losses caused by lower returns. The lower interest on the bonds enables the World Bank to reschedule LDC loans on a long-term basis.

The Weinert proposal also includes characteristics of other relief forms: reduction of interest charges and debt service in connection with economic performance. The interest rates on the bonds would depend on the country's capacity to pay, although they would never exceed the commercial rate. Interest would be fixed on an annual basis and would be calculated with a formula which takes into account export volumes and the terms of trade. The debt service would, thus, be linked with a country's export performance.

Rohatyn Proposal [6]

This plan is similar to the conversion of New York City's short-term debt into long-term debt by the Municipal Assistance Corporation during the 1970s.

Rohatyn proposes that the IMF, the World Bank or a new institution should convert LDC debt into long-term (15 to 30 years), low interest-yielding bonds. Moreover, the repayment obligations should be linked with the economic situation in the LDC concerned. Therefore, the repayment schedule should be organized in such a way that the debt service ratio does not exceed 30 per cent per annum. This solution constitutes a long-term rescheduling in association with an upper-ceiling for debt service. The banks, however, will incur losses due to the lower interest of bonds. Rohatyn does not specify who - the banks' stockholders or the taxpayer - will pay for these losses.

These three proposals demand a conversion of LDC debt into bonds which is an old idea dating back to the Dawes Plan concerning the German reparation payments and, more recently, to the plan to rescue New York City from bankruptcy. The benefits of this solution are the lower interest charges and the long-term repayment period. These two aspects are appealing but should not distract from the problems involved in such an approach. First, the important difference with the past experience is that debt or reparation conversions have taken place only on a case-by-case basis and never across the board. Second, the conversion of short-term debt into long-term bonds might have adverse effects on short-term trade financing by

banks. Third, the potential losses of banks have to be quantified before the conversion, for they may have a serious impact on banks' stocks. The losses are certainly not conducive for continued lending. However, banks are capable of absorbing these losses as they already tacitly swap their LDC loans at a discount [7]. Although the market's volume is relatively small - about U.S.\$3 billion in 1984 - compared to total LDC debt, it offers banks an opportunity to reduce their exposure to certain LDCs. Banks object that this secondary market for LDC debt would become institutionalized as the proposal suggests. In this case, the bank regulators may require higher loan-loss reserves because certain LDC loans are not worth their face value. Moreover, tighter regulation on LDC debt may discourage smaller banks from staying in the lending process. Therefore, banks seem to favour an informal discount market for LDC loans rather than a formal approach to LDC relief in the form of bonds. Fourth, the participation of the World Bank in conversion operations may affect its good creditworthiness. As a result, the credit standing of the World Bank could fall in the bond market. For this reason, international institutions such as the World Bank or IMF should not become instruments for bailing out commercial banks or for representing their interests. Fifth and finally, these proposals focus on the banks' existing loans rather than the necessity for new net lending to LDCs. In neither proposal is there a clause for continued lending. It is even argued that the losses incurred by banks through conversion might result in a withdrawal from

international lending to LDCs [8].

5.2 Debt Service in Connection with Economic Performance

The Declaration of Quito of January 13, 1984 urged that "mechanisms should be explored to stabilize over time the amount of resources annually allocated to debt servicing in accordance with the payments profile of each country". In this context, two sets of proposals have dominated the discussion. One set links the debt service to a certain percentage of a country's export earnings. The other set aims at the stabilization of interest obligations through various schemes.

Although the idea of linking payments to export revenues was, in principle, endorsed by the Cartagena Group - i.e., group of all major Latin American debtor countries - it was never implemented until the new president of Peru, Garcia Perez, took office in July 1985. In his inaugural speech, he announced that Peru would limit debt payments to 10 per cent of its export earnings [9]. The immediate effect of such a policy is the greater availability of foreign exchange for necessary imports. Concurrently, however, the prospects of obtaining new loans are diminished, since U.S. bank regulators require banks to set aside reserves when they do not receive interest payments after 90 days. Meanwhile, the not fully performing Peruvian loans have been downgraded to "value impaired". Therefore, the linkage proposal is appealing only if changes in U.S. regulatory rules are made. These changes are unlikely, however, to take place. On the contrary, bank supervision has been tightened so

that it remains doubtful if this linkage approach will yield positive results in the long run.

Exchange Participation Notes [10]

Another proposal which links debt service with a country's capacity to pay, focuses on the trading of LDC debt for so-called exchange participation notes (EPNs). These EPNs entitle the holder to receive a certain share of the country's annual export revenues. They refer only to the country's amortization payments. Interest would be paid according to the original schedule. However, in the 1980s, it was exactly the high level of real interest which significantly contributed to the outbreak of the debt crisis. Therefore, this scheme would provide only limited relief. Another problem of the EPNs is the annual assessment of the debtor's capacity to pay. In this way, the repayment period becomes a variable and, thus, depends entirely on the economic prospects of the country concerned. This uncertainty of the EPNs' maturity does affect its face value. If banks intend to trade EPNs, they have probably to sell these notes at a discount and incur certain losses. For this reason, this scheme may be a disincentive for continued lending [11].

The other set of proposals deals with the stabilization of the interest obligations through compensation schemes and trading caps on interest.

Mexican Proposal [12]

The reduction of interest obligations can also be indirectly achieved. The Mexican Government has proposed a liberalization of the IMF Compensatory Financing Facility (CFF) with respect to interest payments. Countries which face real interest charges in excess of two per cent, should be eligible to draw under the expanded CFF scheme. This would bring temporary relief to those LDCs which have contracted the bulk of their debt at variable interest.

The lack of IMF resources will currently not permit an inclusion of an interest compensation scheme into the CFF. For example, the potential claims of non-oil LDCs on the CFF with regard to interest stabilization would have ranged between US\$10 and 20 billion annually during the period 1981-84 [13].

If this interest facility cannot be financed out of the Fund's ordinary (quota) resources, the credit lines under the General Arrangements to Borrow (GAB), which total SDR 17 billion, may be activated. Under the reformed GAB, the IMF can also tap GAB for lending operations to nonparticipants (i.e., all LDCs) through a "crisis fund", albeit under more restrictive conditionality [14]. However, the GAB has to be amended in order to facilitate exclusive drawings under the CFF which is currently only permitted in conjunction with an adjustment program.

RIAC Proposal [15]

This scheme suggests that banks trade temporary caps on interest rates. The system of a reimbursable, interest-averaging cap (RIAC) would postpone payments on interest, if interest rates exceed a certain level. Unlike the Mexican proposal, where the debtor country could expect a compensation for excess interest, RIAC adds the interest in excess to the principal. Although the debt would increase in this way, it would relieve LDCs from a rising debt service in the event of increasing interest rates. This system should be appealing to banks, since they would not incur losses with RIAC.

However desirable the Mexican and RIAC proposals may be, the international financial community does not appear to intend to introduce such schemes. Creditors have been satisfied the way rescheduling has worked thus far and do not feel a need for change and additional debt relief.

5.3. Institutional Changes in the International Financial System

Institutional changes in international financial institutions do not substitute reschedulings or offer an alternative to them but complement them. This section will refrain from a detailed discussion of the pros and cons of new or restructured financial institutions, as it would go beyond the scope of this thesis. Instead, the major issues will be briefly presented.

Since reschedulings constitute only a small fraction of international financial relations, the renegotiation of external

debt is frequently addressed in a wider context. Three aspects of financial problems by LDCs receive predominant attention:

- (1) the strengthening of multilateral financial institutions,
- (2) improved information about borrowing countries, and (3)
- establishment of new agencies to deal with LDC debt.

The first aspect focuses on changes within the IMF, World Bank, and IDB. The Cartagena Group has proposed that these institutions should receive a greater volume of resource and increase their lending capabilities. With this proposal, the availability of new lending from abroad should be guaranteed. Since commercial banks are reluctant to increase their LDC exposure, debtor countries hope that multilateral institutions can partly fill the gap.

The debate on possible reforms of the IMF has centered around three issues: (1) increase of quotas, (2) conditionality, and (3) new financing facilities such as an extended CFF. The quinquennial reviews of the quotas and their subsequent increases (except 1951 and 1956) were not kept in line with the growth rate of world trade and inflation. Therefore, the quotas covered a steadily declining percentage of world trade, falling from 10 percent in the 1950s and 1960s to four per cent in the 1980s [16]. A reversal of this trend and a return to a 10 per cent ratio would require a significant increase of quotas at the next review. However desirable such an increase would be in strengthening the IMF role and its lending capacity, it is unlikely that such quota increase would pass the U.S. Congress. Already the last quota review stirred opposition because it was

argued that this measure would be a bailout for banks [17]. This argument, however, has been invalidated as the IMF has successfully forced banks to continue lending instead of becoming a substitute for bank lending.

Many proposals have been put forward to increase IMF resources, ranging from an increase of quotas to a special issue of SDRs, confined to LDCs [18]. Their common purpose is the increase in LDC liquidity in order to "fill the gap before major damage is done to development and to international credit" [19].

Since new net lending to LDCs has fallen sharply, the logical sources for long-term credit are the World Bank and the regional development banks. In order to increase their lending capacity, new funds have to be committed to them. If, however, the allocation of new resources to those organizations is not forthcoming or sufficient, one might contemplate a change in their lending/capital ratio. For example, the Brandt Commission has proposed a change of this ratio from currently 1:1 to 2:1 [20]. Again, the mood in the U.S. Congress will not allow a realization of those changes in the near future. One option which has been actively promoted by the World Bank and the regional development banks, is co-financing. This form of finance taps private source for long-term projects or adjustment.

The second aspect, the need for improved information on LDC debt, was addressed immediately after the outbreak of the debt crisis in 1982, with the establishment of the Institute for

International Finance (IIF). The main objectives of the IIF are the improvement of information among creditors, the exploration of institutional arrangements including the strengthening of the inter-bank market and encouragement of equity flows to LDCs, and the examination of new debt instruments such as the conversion of debt into bonds [21]. The expectations about the effectiveness of the IIF are mixed for two reasons. First, the debt servicing difficulties of several Latin American countries are partly explained by the accumulation of short-term debt. However, information on short-term credit is not readily available. It remains to be seen if the IIF can solve this problem and can provide better information than the IMF, World Bank or BIS. Second, it has been questioned whether additional information will add to improved decision-making in LDC lending. Mendelsohn argues that there is more need for judgement rather than more statistics [22].

The third aspect, the establishment of new agencies, raises more questions than it provides answers. The main purpose of the new agencies are either the organization of the conversion of the LDC debt or the provision of continued lending to LDCs.

Apart from the proposals put forward by Kenen, Ronatyn, and Weinert, three other proposals are interesting in this context which essentially focus at LDC funding rather than rescheduling.

Bolin and Del Canto propose the establishment of an Export Development Fund which would extend long-term loans (up to 15 years) and obtain its funds by floating 8 to 14 year notes in the Euro dollar market [23]. Lord Lever argues that a central,

agency should be set up by the export credit agencies of the OECD countries. This agency would maintain a continuous flow of credit to LDCs. It would notify central banks of LDCs that individual export credit agencies would insure bank lending to cover current account deficits. The recommendations made by the central agency would be based on the advice of the IMF which would work in close cooperation with this agency [24].

A similar close cooperation is suggested in the plan of Meissner. He argues that private banks themselves should set up a Global Reserve Bank which would provide balance of payments loans to LDCs in conjunction with the IMF and World Bank. His "reform without governments" is based on the realistic assumptions that (a) the OECD countries are not sufficiently helping LDCs because of political reasons and ignorance and (b) the IMF and World Bank will not be adequately funded [25].

Despite the attractiveness of the new agencies to guarantee new net funds to LDCs, the key question is whether it will work in practice. Other related questions are open to debate such as: How will the bond market react to the Bolin/Del Canto proposal?; What impact will those agencies have on continued lending to LDCs?; What incentive remains for private banks for new lending?; Are creditors and debtors willing to cooperate?; Will a new agency be able to solve the debt problem or is the problem not more complex? The question will be left unanswered, since an adequate response would require a thorough analysis of international financial institutions and their deficiencies.

5.4 Debtor Cartel and the Repudiation Issue

Since the outbreak of the debt crisis in 1982 the idea of a debtor cartel has been discussed as a potential opportunity to coerce industrial countries into concession with regard to debt. Although this notion has been officially rejected by most Latin American governments, it has attracted public appeal in the debtor countries.

Ideally, a debtors' cartel should renegotiate the total Latin American debt - or LDC debt, depending on whether a region or all LDCs participate in the cartel - on behalf of the respective governments. This organization could further enhance the economic and, especially, political integration process among LDCs. A sense of solidarity is palpable, when one observes the series of high level summits on the external debt in Latin America. The perceived financial threat has been expressed by forceful statements such as "debt has to be paid by money, not by hunger" (Brazilian President Sarney) or "...payment of that debt is an economic impossibility, a political impossibility. You practically have to kill the people to force them to make the sacrifices required to pay that debt. Any democratic process that tries to impose those restrictions and sacrifices by force will be ruined" (Cuban President Castro) [26].

Despite the rhetoric and the justified concern about social peace in the debtor countries, a debtors' cartel is not likely to be established for several reasons.

First, it will be in the interest of creditors to prevent

such a collusion. They may be better off in granting concessions or even writing down part of their LDC claims than provoking the establishment of a cartel. The introduction of multiyear reschedulings may be seen as a step in avoiding a confrontational stand between debtors and creditors.

Second, joint action would not necessarily improve the situation of an individual debtor. For debtors which have a better creditworthiness than other LDCs, their credit rating may suffer as a consequence of their participation in the debtors' cartel. It remains doubtful if self-interest is subordinated to international solidarity.

Third, since the agreement on a common approach toward creditors will be a tedious and time-consuming negotiation process, debtors have to seek "bridging" arrangements with creditors until the debtors' cartel renegotiates LDC debt on a "global" basis. It appears unlikely that due to their ideological, economic, and geographic diversity debtors will produce a debt-renegotiation formula which will accommodate all individual interests. Moreover, creditors will be reluctant to support those "bridging" solutions and, if they do accept, they will probably reschedule on harder terms.

Fourth, the establishment of a debtors' cartel will have adverse effects on the capital flows to Latin America and other LDCs. Even the potential formation of a cartel may increase the uncertainty and create a climate that limits further lending to the region.

Fifth, and finally, the general rejection of a debtors'

cartel by official Latin American authorities indicates that the negative impact of such a move outweighs the benefits. Otherwise, the creation of a cartel would have seriously been deliberated.

The debtors' cartel has been mentioned in the context of the repudiation of debt. However, individual rather than collective cancellation of debt is a possibility, depending on which definition of default is used. The broader definitions range from temporary repayment interruptions to rescheduling to "non-fulfillment by a debtor of any clauses of a loan contract" [27]. Here, preference is given to the narrower definition provided by Cline, who considers a default an "outright repudiation and extended, unilateral moratorium" [28].

There is ample reason to assume that the costs of such a default far outweigh the benefits. Benefits can only be expected from the total liquidation of the external debt in case of an outright repudiation, and from the temporary suspension of debt-service payments, in case of a moratorium.

The decision to repudiate debt would amount to a revolution in the defaulting country. The international response to the repudiation would likely be a seizure of the foreign assets of the defaulting country. This move, however, affects the interests of the elites which basically hold those foreign assets. For this reason, one may expect strong opposition from these groups against a repudiation. They have to be deprived of their power in order to make a repudiation possible. This would imply an overthrow of the political system, as the Cuban case has proved.

The defaulting country will probably retaliate, in turn, by seizing the foreign assets in its country. Thus, the net benefit or loss depends on whether or not the sum of liquidated external debt plus expropriated investments will exceed the sum of the seizure of the foreign assets held by defaulting country and the foregone future inflow of loans and foreign direct investment.

Moreover, the defaulting country may be cut-off from any supply of capital. With the denial of short-term credit which is essential for trade financing, a country faces economic isolation at least in the short run. Then, it will depend on its reserves if it can maintain its import requirements. In the medium run, it will depend on the ability of the defaulting country to redirect its trade to other country groups. In the case of many LDCs which mainly trade with OECD countries, it may mean an alignment with the socialist planned economies.

However, even a unilateral moratorium can seriously impair the country's reputation in the long-run. As North-South relations are already strained, this move would further contribute to the disillusion of commercial banks with the LDCs, eventually culminating in a financial "delinking" by the North.

Although outright default is dismissed by most experts, "default by attrition", i.e., default which is tacitly tolerated by creditors, has been observed in several small debtors [29]. Bolivia has suspended payments to commercial banks; Nicaragua has become the first country ever to fall in arrears to the World Bank [30]. This country's and Peru's debt have been

declared "value impaired" by U.S. bank regulators. Although the consequence for these countries will not escalate to a seizure of their assets abroad, their credit rating will drop and, hence, their access to new funds will almost dry up. This "penalty" can be extended the more a debtor country applies "default by attrition" tactics. Perhaps the negative consequences of default have contained widespread default in the 1980s. As a study by Eaton and Gersovitz has summarized:

The existence of penalties activated automatically by default can play a valuable role in stabilizing international lending. If borrowers know that retaliation will occur and if the penalties are sufficiently severe, defaults can be deterred. In this situation, lenders may be better off, since they have an opportunity to lend not otherwise available. Borrowers may also be better off, since they can borrow funds that lenders would not otherwise be willing to lend. In effect, the potential penalty serves as a form of collateral for a LDC that it cannot otherwise give. It may well be that the larger the penalty - the better off is the borrower [31].

5.5 Conclusion.

The previous section on the debtors' cartel has explained why this scenario is unlikely to take place. On the other hand, the other approaches present possible answers to address the debt problem. However, there are two obstacles which will prevent their realization in the near future. First, several proposals would require changes in bank regulations if the debtor countries are to be protected from the negative consequences of debt conversion or linking debt service with economic performance. Second, the general mood in the U.S. Congress and the banks does not indicate that they are prepared to make additional concessions to the debtor countries, apart from rescheduling.

Finally, the "standard" reschedulings or the just discussed proposals, presented in Sections 5.1-5.3, can only then be deemed "successful", if other external factors are conducive to the restoration of the debt servicing capacity. The solution of the debt problem requires the sustained growth in OECD countries and LDCs themselves. Unless this growth accompanies rescheduling exercises, the recovery prospects of the debtor countries remain gloomy.

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According to Cline an extra 1 per cent interest costs the non-oil LDCs \$3.8 billion a year. Assuming a real interest ceiling of 3 per cent, potential claims were calculated as follows:
	1981	1982	1983	1984
LIBOR(%)	8.1	6.0	4.7	6.7
"Excess" real interest (%)	5.1	3.0	1.7	3.7
Claims (US\$)	19.4	10.8	6.5	13.1
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CHAPTER SIX

Conclusion

The analysis of the origins, frequency, terms and characteristics of reschedulings has shown some major shortcomings among which:

Reschedulings do not pay adequate attention to the adjustment process and economic growth.

Reschedulings are not successful in reestablishing the creditworthiness of a country and hence in restoring sufficient new lending in the short run.

Reschedulings tend to be repeated, indicating its short term perspective.

Reschedulings have undoubtedly played a crucial role in averting default and in mitigating the debt crisis. However, this does not mean that they cannot do better.

The alternative proposals to rescheduling focus mainly on the technical aspects of stretching out the repayment schedule through various means and on the strengthening of financial institutions. Their aim is to move beyond a "crisis management" of debt which is costly for creditors and debtors. However, what they have in common with the "standard" rescheduling process is the implicit disregard of the growth aspect.

In order to facilitate the repayment of the external debt as well as the adjustment in the countries involved, it is imperative that their economies achieve sufficient growth in GDP. Therefore, reschedulings should be explicitly linked to

the growth objective.

Economic development and growth depend largely on capital. Although Latin America finances 80 to 90 percent of its investments out of its own savings, the remainder has to be supplemented by external sources. In an article by Borin and Del Canto, the necessity of external capital for economic development was succinctly expressed: "No nation has yet moved from "underdeveloped" to "industrialized" without steadily increasing flow of credit....To be "developing" is to be in debt" [1]. For this reason, a continuous flow of capital to the region and to rescheduling countries in particular is the only solution possible, if those countries are to be pulled out of recession and of the vicious circle of reschedulings. In this context, the German experience from Versailles to the Hoover Moratorium and all its consequences should be a strong reminder of this vicious and finally fatal circle.

As a conclusion, an alternative approach is suggested, a rescheduling with growth strategy. How should this be realized?

First, this proposal is a supplement and not a substitute to new lending. Commercial banks should continue their lending to the region at their current size which is rather small compared to the 1970s.

Second, creditors should agree on a multiyear approach toward official and commercial banks' reschedulings as a general rule. Moreover, they should consider implementing some of the recommendations made in Chapter Four. Official creditors should (a) extend the coverage of eligible debt to be consolidated to

100 per cent, (b) reduce the time-span between cut-off date and the beginning of the consolidation period, (c) lengthen the consolidation period, and (d) possibly eliminate the downpayment.

Commercial banks, in turn, should (a) reduce the spreads over LIBOR, (b) eliminate rescheduling fees for all debtors and (c) not discriminate between smaller and larger debtor countries.

Since the recommendations should contribute to a longer-term debt relief, it will be crucial that the economic adjustment programs also adopt a longer term outlook.

Third, the debt service should be partly paid in local currency. The purpose of this facility is twofold. First the creditors will receive their claims in full, because the foreign exchange constraint of the debtor country is removed. The debt service in local currency is paid to an official agency, usually the Central Bank, which assumes responsibility for the external debt obligations. This agency, in turn, renegotiates the external debt service according to the transfer capacity of the country. The debt service in local currency is honoured by the original borrower on the normal schedule. In this way, the banks do not need to reclassify and downgrade their loans to rescheduling countries and, hence, suffer losses. This method has already been applied in various cases. For example, the Mexican government assumed responsibility for the foreign exchange liabilities of the private sector to foreign creditors. As a result, U.S. bank supervisory authorities

considered Mexican private-debt as "performing" loans [2]. Second, for the debtor countries, the debt service ratio would decrease even further than after a "standard" rescheduling. This means additional relief to the balance of payments and an opportunity to increase foreign exchange reserves. The notion that a portion of the external debt liabilities can be paid in local currency is not new. The Turkish (1959) and Ghanaian (1966) reschedulings included options to the creditors to accept part of the debt service in local currency to be invested in the debtor's country [3]. New in this proposal is that this option should become a commitment by creditors and standardized in successive agreements.

Fourth, the debt service in local currency should stay in the country and serve as an "engine for growth". This "recycled" debt service should promote investment and hence growth. The debt service portion in local currency should be allocated to a fund within the leading domestic investment bank or a bank chosen by the creditors. The creditors--possibly in cooperation with the investment bank--will employ this money for financing of domestic investment projects or equity investment in local companies.

This infusion of "recycled" money would contribute to growth and concurrently to a restoration of confidence and creditworthiness of the debtor country. Moreover, this method will assist the debtor country in switching part of the debt-creating source to a non-debt creative source of finance. This proposal can be a positive sum game. The debtor country

gains as it will recover sooner from the recession. The creditors, particularly commercial banks, gain as they would diminish losses which they have already incurred on loans made to those countries.

The "recycled" money guarantees the creditors a fair return on investment which can be repatriated or reinvested. Moreover, creditors and debtors could agree in their rescheduling package to a gradual repatriation of the investments by selling off shares during the life time of the multiyear accord (10-15 years).

Another opportunity for banks is the sale of shares of those investments, with their guarantee, in their home countries. By selling those shares to the public they would indirectly receive the other part of the debt service in the currency it was supposed to be made. This should make the proposal also attractive to banks.

This new approach toward rescheduling may be a non-starter as so many other proposals were in the past. However, one should keep in mind that unless all parties seek a politically, economically and financially feasible solution, there will be no end of reschedulings in this decade and perhaps beyond.

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APPENDIX

Table 1 Government Deficits as a Percentage of GNP

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Table 1 : Government Deficits as a Percentage of GNP over 5 Year Period before Rescheduling¹⁾

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Argentina	1956	...	...	...	...	...	...
Brazil	1961	2.5	3.2	2.3	2.4	3.9	0.7
Argentina	1962	...	...	...	...	...	...
Brazil	1964	4.0	5.3	5.2	3.9	3.2	2.3
Chile	1965	3.3	2.9	2.9	4.1	3.2	3.2
Argentina	1965	...	...	...	...	...	...
Peru	1968	3.1	4.3	4.3	3.5	2.1	1.2
Peru	1969	4.1	3.1	4.3	4.3	3.5	2.1
Chile	1972	2.2	8.3	0.7	0.3	0.9	0.7
Chile	1974	5.4	7.6	10.2	8.3	0.7	0.3
Chile	1975	7.5	10.6	7.6	10.2	8.3	0.7
Argentina	1976	5.9	12.2	6.4	5.6	2.8	2.6
Peru	1978	5.3	7.7	6.4	5.5	3.2	3.9
Peru	1979	5.6	5.1	7.7	6.4	5.5	3.2
Guyana	1979	...	...	...	...	...	...
Jamaica	1979	12.7	17.4	14.8	15.8	7.8	7.5
Nicaragua	1980	6.0	6.9	8.5	4.4	4.1	6.0
Bolivia	1981	6.2	8.0	7.5	4.0	5.2	...
Jamaica	1981	17.3	22.3	16.3	17.4	14.8	15.8
Nicaragua	1981	6.2	7.1	6.9	8.5	4.4	4.1
Nicaragua	1982	7.8	12.3	7.1	6.9	8.5	4.4
Guyana	1982	30.1	37.3	30.8	22.1	...	...
Brazil	1983	-0.3	-0.1	-0.1	-0.1	-0.2	-0.3
Chile	1983	-2.2	2.3	-2.7	-5.6	-5.0	0.1
Costa Rica	1983	5.2	3.0	3.2	7.8	7.0	5.1

(continued)

Table 1 (continued) : Government Deficits as a Percentage of GNP

Country	Year of		5-Year						
	Rescheduling	Average	-1	-2	-3	-4	-5		
Dominican Rep.	1983	3.2	3.2	2.6	-2.7	5.9	1.5		
Ecuador	1983	2.6	4.8	5.1	1.5	0.7	1.2		
Mexico	1983	6.5	16.3	6.9	3.2	3.4	2.7		
Peru	1983	3.5	4.0	5.0	2.9	0.6	5.0		
Uruguay	1983	2.3	9.2	1.5	-0.1	0.1	0.9		
Argentina	1984	8.2	12.2	19.3	3.7	0.6	0.4		
Bolivia	1984	8.8	14.2	7.5	6.6	8.0	7.5		
Brazil	1984	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2		
Ecuador	1984	2.7	1.6	4.8	5.1	1.5	0.7		
Guyana	1984	32.6	38.2	34.5	37.3	30.8	22.1		
Honduras	1984	4.3	6.6	7.3	2.9	3.0	1.9		
Jamaica	1984	16.5	15.6	13.6	14.5	22.3	16.3		
Mexico	1984	7.6	8.3	16.3	6.9	3.2	3.4		
Peru	1984	4.3	9.1	4.0	5.0	2.9	0.6		
Venezuela	1984	1.8	1.5	5.4	2.2	0.6	-0.9		

1) The deficit or the surplus of the central government is calculated as the difference between revenue received on the one hand, and expenditure and lending minus repayments, on the other (with sign reversed).

Sources : IMF International Financial Statistics, Yearbook 1983 and August issue 1985

Table 2 : Average Annual Growth in Money Supply over 5 Year Period before Rescheduling
(per cent)

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Argentina	1956	18.6	17.5	16.4	24.0	13.8	21.3
Brazil	1961	31.2	38.0	42.0	21.9	32.2	22.2
Argentina	1962	28.5	11.4	28.6	43.0	42.8	16.6
Brazil	1964	51.6	64.1	63.4	50.5	38.0	42.0
Chile	1965	34.2	64.6	34.4	28.2	12.7	31.1
Argentina	1965	21.0	41.2	17.5	5.4	11.4	29.5
Peru	1968	18.7	8.0	15.0	24.7	37.1	8.7
Peru	1969	20.4	17.1	8.0	15.0	24.7	37.1
Chile	1972	47.7	99.3	53.0	36.4	25.6	24.1
Chile	1974	110.8	264.4	100.9	99.3	53.0	36.4
Chile	1975	166.6	315.5	264.4	100.9	99.3	53.0
Argentina	1976	62.1	89.2	67.3	80.2	42.4	31.5
Peru	1978	47.8	44.6	76.6	51.1	41.4	25.2
Peru	1979	53.9	55.7	44.6	76.6	51.1	41.4
Guyana	1979	-25.5	-4.8	24.3	11.4	55.3	31.5
Jamaica	1979	21.1	17.7	37.8	2.4	20.2	27.3
Nicaragua	1980	17.8	68.0	-7.2	6.2	25.4	-3.5
Bolivia	1981	24.6	38.4	33.8	13.5	20.9	36.5
Jamaica	1981	20.2	35.4	7.5	17.7	37.8	2.4
Nicaragua	1981	29.4	54.6	68.0	-7.2	6.2	25.4
Nicaragua	1982	28.7	21.7	54.6	68.0	-7.2	6.2
Guyana	1982	8.7	5.0	12.6	-3.2	4.8	24.3
Brazil	1983	62.5	82.0	65.2	75.1	51.6	38.7
Chile	1983	44.3	-5.5	23.4	62.6	75.1	51.6
Costa Rica	1983	29.2	67.5	40.1	8.5	10.8	19.1

(continued)

Table 2 (continued) : Average Annual Growth in Money Supply

Country	Year of Rescheduling	5-Year Average							
		-1	-2	-3	-4	-5			
Dominican Rep.	1983	11.4	10.7	1.6	17.1	11.6	15.9		
Ecuador	1983	20.6	21.6	21.7	26.2	20.3	13.3		
Mexico	1983	36.1	43.8	36.8	31.1	31.4	67.2		
Peru	1983	49.4	33.7	43.4	71.1	59.6	39.2		
Uruguay	1983	43.6	-0.8	33.9	38.9	93.1	53.0		
Argentina	1984	156.4	287.8	193.1	53.9	115.8	131.4		
Bolivia	1984	77.4	198.9	120.6	15.1	38.4	13.8		
Brazil	1984	71.8	85.1	82.0	65.2	75.1	51.6		
Ecuador	1984	22.4	22.3	21.6	21.7	26.2	20.3		
Guyana	1984	11.6	24.2	19.2	5.0	12.6	-3.2		
Honduras	1984	10.0	13.4	3.1	8.5	7.3	17.7		
Jamaica	1984	12.1	7.8	18.7	7.8	18.5	7.7		
Mexico	1984	37.4	43.8	43.8	36.8	31.1	31.4		
Peru	1984	56.6	75.4	33.7	43.4	71.1	59.6		
Venezuela	1984	10.9	11.6	9.9	11.4	14.1	7.4		

Source : IMF International Financial Statistics, various issues

Table 3: Inflation : Average Annual Increase in Consumer Prices Over 5 Year Period Before Rescheduling
(per cent)

Country	Year of Rescheduling	5 Year Average	-1	-2	-3	-4	-5
Argentina	1956	14.9	12.5	4.0	4.2	39.1	...
Brazil	1961	20.2	29.7	39.7	16.0	21.9	35.2
Argentina	1962	42.3	14.0	27.3	113.7	31.6	24.7
Brazil	1964	55.1	91.6	71.0	51.1	32.4	29.6
Chile	1965	23.5	28.8	46.0	27.3	9.2	6.0
Argentina	1965	23.1	22.1	24.0	28.1	14.0	27.3
Peru	1968	10.2	9.8	9.2	16.1	9.9	5.8
Peru	1969	12.8	19.0	9.8	9.2	16.1	9.9
Chile	1972	25.6	19.2	33.0	30.6	26.3	18.8
Chile	1974	102.7	353.6	77.3	19.2	33.0	30.6
Chile	1975	197.6	504.7	353.6	77.3	19.2	33.0
Argentina	1976	108.4	182.3	23.3	61.2	57.9	35.0
Peru	1978	24.3	38.1	33.5	23.6	16.9	9.5
Peru	1979	34.0	57.8	38.1	33.5	23.6	16.9
Guyana	1979	11.6	15.3	8.2	9.0	8.0	17.4
Jamaica	1979	19.5	34.9	11.2	9.8	17.3	24.4
Nicaragua	1980	16.7	48.1	4.6	11.4	2.8	...
Bolivia	1981	18.0	47.2	19.7	10.4	8.1	4.5
Jamaica	1981	22.4	27.1	29.1	34.9	11.2	9.8
Nicaragua	1981	20.4	35.3	48.1	4.6	11.4	2.8
Nicaragua	1982	24.7	23.9	35.3	48.1	4.6	11.4
Guyana	1982	16.0	24.7	14.0	17.7	15.3	8.2
Brazil	1983	75.6	98.0	105.6	82.8	52.7	38.7
Chile	1983	27.6	9.9	19.7	35.1	33.4	40.1
Costa Rica	1983	32.1	90.1	37.1	18.1	9.2	6.0

(continued)

Table 3 (continued): Inflation

Country	Year of		5-Year				
	Rescheduled	Average	-1	-2	-3	-4	-5
Dominican Rep.	1983	8.9	7.6	7.5	16.8	9.2	6.0
Ecuador	1983	12.9	16.3	13.0	13.1	10.3	11.7
Mexico	1983	29.8	58.9	27.9	26.4	18.2	17.4
Peru	1983	64.7	64.4	75.4	59.2	66.7	57.8
Uruguay	1983	45.6	19.0	34.0	63.5	66.8	44.6
Argentina	1984	174.7	343.8	164.8	104.5	100.8	159.5
Bolivia	1984	99.6	275.6	123.5	32.1	47.2	19.7
Brazil	1984	96.2	142.0	98.0	105.6	82.8	52.7
Ecuador	1984	20.2	48.4	16.3	13.0	13.1	10.3
Guyana	1984	17.9	14.9	18.5	24.7	14.0	17.7
Honduras	1984	11.5	9.5	9.9	10.2	15.6	12.5
Jamaica	1984	17.3	11.6	6.8	12.5	27.0	28.8
Mexico	1984	46.6	101.8	58.9	27.9	26.4	18.2
Peru	1984	75.4	111.2	64.4	75.4	59.2	66.7
Venezuela	1984	13.2	6.2	9.5	16.2	21.5	12.4

Source: IMF International Financial Statistics, various issues

Table 4 : Current Account Deficits as Percentage of GNP over 5 Year Period before Rescheduling ¹⁾

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Argentina	1956	2.0	5.3	-0.8	-3.7	5.7	3.4
Brazil	1961	2.4	4.0	2.9	2.7	2.2	---
Argentina	1962	3.0	4.3	1.8	-0.1	4.7	4.1
Brazil	1964	2.6	1.0	3.2	2.0	4.0	2.9
Chile	1965	4.8	2.9	5.3	6.2	6.3	3.3
Argentina	1965	1.3	-0.2	-1.8	2.6	4.3	1.8
Peru	1968	3.3	5.7	4.7	3.5	-0.4	2.8
Peru	1969	2.8	0.5	5.7	4.7	3.5	-0.4
Chile	1972	1.1	1.9	1.2	-1.4	2.5	1.1
Chile	1974	1.7	2.7	4.0	1.9	1.2	-1.4
Chile	1975	2.5	2.7	2.7	4.0	1.9	1.2
Argentina	1976	0.8	3.4	-0.2	-1.7	0.9	1.4
Peru	1978	6.7	6.9	8.3	10.2	5.7	2.6
Peru	1979	6.6	1.7	6.9	8.3	10.2	5.7
Guyana	1979	13.9	6.3	22.8	33.4	4.6	2.2
Jamaica	1979	5.5	2.0	1.3	10.5	9.8	3.8
Nicaragua	1980	7.3	12.1	1.3	8.9	2.2	12.1
Bolivia	1981	5.0	2.4	8.3	8.9	3.6	1.9
Jamaica	1981	5.3	6.7	6.1	2.0	1.3	10.5
Nicaragua	1981	8.6	18.5	12.1	1.3	8.9	2.2
Nicaragua	1982	12.2	20.3	18.5	12.1	1.3	8.9
Guyana	1982	21.1	36.2	23.4	16.9	6.3	22.8
Brazil	1983	4.7	6.0	4.4	5.2	4.5	3.4
Chile	1983	9.1	10.4	14.9	7.3	5.9	7.2
Costa Rica	1983	14.1	13.6	17.6	14.4	14.4	10.6

(continued)

Table 4 (continued) : Current Account Deficits as Percentage of GNP

Country	Year of									
	Rescheduled	Average	-1	-2	-3	-4	-5			
Dominican Rep.	1983	7.0	5.8	5.8	10.4	6.2	6.7			
Ecuador	1983	7.8	9.2	7.6	5.7	6.9	9.5			
Mexico	1983	4.3	3.6	6.0	4.5	4.1	3.1			
Peru	1983	2.4	7.7	8.0	-0.3	-5.3	1.7			
Uruguay	1983	4.2	2.4	4.2	7.1	4.9	2.5			
Argentina	1984	3.2	4.0	4.3	4.0	3.1	0.5			
Bolivia	1984	4.0	3.0	1.7	4.6	2.4	8.3			
Brazil	1984	4.7	3.4	6.0	4.4	5.2	4.5			
Ecuador	1984	6.0	0.8	9.2	7.6	5.7	6.9			
Guyana	1984	29.4	37.6	33.1	36.2	23.4	16.9			
Honduras	1984	10.3	7.9	8.8	12.1	13.5	9.3			
Jamaica	1984	9.8	10.8	13.2	12.0	6.7	6.1			
Mexico	1984	2.9	-3.8	3.6	6.0	4.5	4.1			
Peru	1984	3.1	5.3	7.7	8.0	-0.3	-5.3			
Venezuela	1984	-2.9	-6.2	6.2	-5.9	-7.9	-0.7			

1) The current account deficit is the net total of balances on goods, services, and private transfers, as defined in the IMF's Balance of Payments Statistics (with sign reversed)

Sources : IMF International Financial Statistics, various issues

World Bank: World Debt Tables, 1981-1985 editions

Table 5 : Current Account Financing of the Western Hemisphere, 1977-84.
(in billions of U.S.dollars)

	1977	1978	1979	1980	1981	1982	1983	1984
Current Account Deficit ¹⁾	11.6	19.4	21.7	29.3	43.1	42.1	11.7	5.5
Capital Outflows ²⁾	5.9	5.6	4.5	18.9	28.6	28.2	9.3	2.6
Financing Requirement	17.5	25.0	26.2	48.2	71.7	70.3	21.0	8.1
Relatively Stable Flows	5.5	7.4	10.0	11.0	12.6	15.3	15.7	12.1
Non-Debt Creating Flows ³⁾	2.8	4.9	7.2	6.8	8.3	10.2	4.6	5.0
Long-Term Borrowing from Official Sources	2.7	2.5	2.8	4.2	4.3	5.1	11.1	7.1
Use of Reserves ⁴⁾	-4.8	-8.0	-11.2	-3.5	1.3	16.2	-2.3	-10.5
Reserve Related Liabilities ⁵⁾	-0.4	-0.2	-0.1	1.8	1.4	9.1	7.1	4.2
Other Borrowing ⁶⁾	17.1	25.8	27.6	39.0	56.4	29.7	0.4	2.3

Source : IMF World Economic Outlook April 1985, p 253

- 1) Net total of balances on goods, services, and private transfers, as defined in the IMF's Balance of Payments Statistics (with sign reversed)
2) Recorded assets transactions, which pertain mostly to export credits, and errors and omissions, which are taken to be a measure of capital flight
3) Comprises (i) official transfers, (ii) net direct investment flows, and (iii) SDR allocations
4) Minus (-) sign indicates an increase
5) Comprises short-term borrowing by monetary authorities from other monetary authorities (IMF, BIS)
6) Comprises short- and long-term borrowing from private creditors

Table 6 : Capital Flight from 10 Latin American Countries, 1977-83
(in millions of U.S. dollars)

	1977	1978	1979	1980	1981	1982	1983	Total
Argentina	—	1,510	—	2,299	8,671	4,931	1,960	19,371
Bolivia	219	85	62	260	384	188	72	1,270
Brazil	628	127	—	341	418	645	943	3,102
Chile	13	128	12	—	—	737	400	1,290
Ecuador	50	126	22	68	442	225	93	1,026
Mexico	1,657	635	1,115	3,770	8,593	8,755	8,328	32,853
Nicaragua	84	238	306	165	37	66	46	942
Peru	43	13	—	187	4	—	490	737
Uruguay	—	7	53	—	162	1,265	627	2,114
Venezuela	453	316	—	3,101	4,899	7,587	296	16,652
Total	3,147	3,185	1,570	10,191	23,610	24,399	13,255	79,357

Source : IMF International Financial Statistics, August 1985 (for data on "Errors and Omissions")

IDB 1984 and 1985 Reports (for data on private short-term capital outflows)

Capital flight is defined as the sum of the negative entries in the "errors and omissions" item of the country's balance of payments and the recorded outflows of private short-term capital.

Note that the negative signs are reversed.

Table 7 : International Reserves as Equivalent Months of Imports over 5 Year Period before Rescheduling

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Argentina	1956	5.5	4.7	6.5	8.0	4.3	4.2
Brazil	1961	4.0	2.9	3.2	4.1	3.8	6.0
Argentina	1962	3.1	3.1	5.0	3.4	1.2	2.6
Brazil	1964	3.1	2.5	3.1	3.8	2.9	3.2
Chile	1965	1.8	1.8	1.6	1.6	1.4	2.4
Argentina	1965	2.8	1.7	3.4	1.0	3.1	5.0
Peru	1968	2.5	1.3	1.8	2.9	3.4	2.9
Peru	1969	2.1	1.2	1.3	1.8	2.9	3.4
Chile	1972	2.5	2.0	3.4	3.4	2.1	1.4
Chile	1974	2.4	1.9	1.5	2.0	3.4	3.4
Chile	1975	2.0	1.4	1.9	1.5	2.0	3.4
Argentina	1976	3.5	2.1	4.9	6.3	2.7	1.4
Peru	1978	3.1	2.0	1.7	2.0	5.0	4.6
Peru	1979	2.7	2.8	2.0	1.7	2.0	5.0
Guyana	1979	1.6	2.1	0.8	0.8	3.1	2.5
Jamaica	1979	0.9	0.6	0.5	0.3	1.0	1.9
Nicaragua	1980	2.2	3.0	0.9	2.0	2.6	2.3
Bolivia	1981	4.4	5.4	5.0	3.6	4.7	3.5
Jamaica	1981	0.6	0.8	0.6	0.6	0.5	0.3
Nicaragua	1981	1.9	0.8	3.0	0.9	2.0	2.6
Nicaragua	1982	1.6	1.2	0.8	3.0	0.9	2.0
Guyana	1982	0.8	0.1	0.3	0.5	2.1	0.8
Brazil	1983	3.3	1.2	2.3	2.3	4.1	6.8
Chile	1983	4.8	4.1	4.5	5.9	5.4	4.0
Costa Rica	1983	1.4	2.0	1.0	1.2	1.2	1.8

(continued)

Table 7 (continued) : International Reserves as Equivalent Months of Imports

Country	Year of		-1	-2	-3	-4	-5
	Rescheduled	Average					
Dominican.Rep.	1983	1.6	1.1	1.6	1.5	2.1	1.6
Ecuador	1983	3.0	1.5	2.4	4.1	3.6	3.5
Mexico	1983	1.4	0.6	1.3	1.5	1.7	1.8
Peru	1983	4.8	4.0	3.4	6.8	7.2	2.8
Uruguay	1983	11.7	8.8	9.2	12.5	15.0	13.2
Argentina	1984	6.3	2.8	4.5	3.7	7.0	13.3
Bolivia	1984	5.2	3.2	6.4	3.8	5.4	5.0
Brazil	1984	2.3	1.8	1.2	2.3	2.3	4.1
Ecuador	1984	3.0	3.4	1.5	2.4	4.1	3.6
Guyana	1984	0.3	0.2	0.3	0.1	0.3	0.5
Honduras	1984	1.5	1.3	1.4	1.0	1.5	2.4
Jamaica	1984	0.6	0.5	0.7	0.5	0.8	0.6
Mexico	1984	1.5	2.5	0.6	1.3	1.5	1.7
Peru	1984	5.2	4.6	4.0	3.4	6.8	7.2
Venezuela	1984	8.8	10.7	6.0	7.6	9.4	10.2

1) International reserves comprise gold, foreign exchange holdings plus the reserve position in the IMF at end of year. Imports comprise imports of goods and services during the year.

Sources : IMF Annual Report 1986, p 13

World Bank : World Debt Tables, 1981-1985 Editions

Table 8 : Disbursed Outstanding Debt : Size and Change over 5 Year Period before Rescheduling¹⁾
(in millions of U.S. dollars and per cent)

Country	Year of Rescheduling	5 Year Average	-1-	-2-	-3-	-4-	-5-
Argentina Debt	1956		600				
Brazil Debt	1961		2,420	2,024	1,821	1,509	1,439
% Change		12.1	19.6	11.1	20.7	4.9	4.2
Argentina Debt	1962		2,272	1,924	1,565	1,382	1,279
% Change		15.6	18.1	22.9	13.2	8.0	
Brazil Debt	1964		3,020	2,975	2,664	2,420	2,024
% Change		10.8	1.5	11.7	10.1	19.6	11.1
Chile Debt	1965		1,286	1,228	1,030	862	622
% Change		20.5	4.7	13.7	25.3	38.6	20.1
Argentina Debt	1965		2,393	2,569	2,491	2,272	1,924
% Change		9.4	-6.8	3.1	9.6	18.1	22.9
Peru Debt ²⁾	1968		623	524	385	261	249
% Change		20.4	18.9	36.1	47.5	4.8	-5.3
Peru Debt ²⁾	1969		701	623	524	385	261
% Change		24.0	12.5	18.9	36.1	47.5	4.8
Chile Debt	1972		2,574	2,627	2,440	2,038	1,752
% Change		10.3	-2.0	7.7	19.7	16.3	9.7
Chile Debt	1974		3,177	2,963	2,574	2,627	2,440
% Change		9.5	7.2	15.1	-0.0	7.7	19.7

(continued)

Table 8 (continued): Disbursed Outstanding Debt

Country	Year of Rescheduling	5 Year Average	-1	-2	-3	-4	-5
Chile	1975		4,325	3,177	2,963	2,574	2,727
Debt			36.1	7.2	15.1	-2.0	7.7
% Change		12.8					
Argentina 2)	1976		3,121	3,247	2,783	2,375	2,151
Debt			-3.9	16.7	17.2	10.4	14.9
% Change		11.1					
Peru 2)	1978		4,710	3,666	3,021	2,221	1,442
Debt			28.5	21.4	36.0	54.0	36.7
% Change		35.3					
Peru	1979		6,125	5,194	3,836	3,251	2,381
Debt			17.9	35.4	18.0	36.5	54.0
% Change		32.1					
Guyana 2)	1979		439	398	364	291	214
Debt			10.3	9.3	24.8	36.3	29.7
% Change		22.1					
Jamaica 2)	1979		1,050	945	886	690	529
Debt			11.1	6.7	28.4	30.6	51.5
% Change		36.0					
Nicaragua 2)	1980		1,127	985	864	661	598
Debt			14.5	13.9	30.7	10.4	29.7
% Change		19.8					
Bolivia 2)	1981		2,195	1,880	1,692	1,375	1,047
Debt			16.8	11.1	23.0	31.3	31.0
% Change		22.6					
Jamaica 2)	1981		1,396	1,176	1,050	945	886
Debt			18.7	12.0	11.1	6.7	28.4
% Change		15.4					
Nicaragua 2)	1981		1,693	1,127	985	864	661
Debt			50.1	14.5	13.9	30.7	10.4
% Change		23.9					
Nicaragua 2)	1982		2,085	1,693	1,127	985	864
Debt			23.2	50.1	14.5	13.9	30.7
% Change		26.5					

(continued)

Table 8 (continued): Disbursed Outstanding Debt

Country	Year of Rescheduling	5 Year Average	-1	-2	-3	-4	-5
Guyana 2)	1982		647	554	496	439	398
Debt			16.8	11.6	13.1	10.3	9.3
% Change		12.2					
Brazil	1983		73,034	64,625	56,499	51,479	46,347
Debt			18.0	14.4	9.8	11.0	31.9
% Change		16.0					
Chile	1983		13,959	12,636	9,418	7,548	5,925
Debt			10.5	34.2	24.8	27.4	22.7
% Change		23.9					
Costa Rica 2)	1983		2,469	2,252	1,701	1,305	951
Debt			9.7	32.4	30.4	37.2	30.2
% Change		28.0					
Dominican Rep.	1983		1,913	1,636	1,478	1,198	1,074
Debt			16.9	10.7	23.4	11.6	17.7
% Change		16.1					
Ecuador 2)	1983		3,919	4,221	3,329	2,630	2,251
Debt			-7.1	26.7	26.6	16.8	96.9
% Change		32.0					
Mexico	1983		58,441	52,339	40,871	37,330	32,380
Debt			11.6	28.0	9.5	15.3	21.1
% Change		17.1					
Peru	1983		8,522	7,484	7,547	6,497	6,125
Debt			13.8	-0.7	16.1	8.0	17.9
% Change		10.6					
Uruguay	1983		1,907	1,675	1,339	1,118	861
Debt			13.8	25.1	19.7	29.8	5.1
% Change		18.7					
Argentina	1984		36,945	28,189	22,760	16,889	14,044
Debt			31.0	23.8	35.6	19.5	23.0
% Change		30.8					
Bolivia 2)	1984		2,969	2,555	2,509	2,195	1,880
Debt			16.2	1.8	14.3	16.8	11.1
% Change		12.0					

(continued)

Table 8 (continued) : Disbursed Outstanding Debt

Country	Year of Rescheduling	5 Year Average	-1	-2	-3	-4	-5
Brazil	1984						
Debt			79,580	73,034	64,625	56,499	51,479
% Change		11.4	8.9	13.0	14.4	9.8	11.0
Ecuador 2)	1984						
Debt			6,239	3,919	4,221	3,329	2,630
% Change		24.4	59.2	-7.1	26.7	26.6	16.8
Guyana 2)	1984						
Debt			663	661	647	554	496
% Change		8.8	0.3	2.0	16.8	11.6	13.1
Honduras	1984						
Debt			1,766	1,534	1,399	1,376	918
% Change		18.6	15.2	9.6	19.0	28.2	20.8
Jamaica 2)	1984						
Debt			1,950	1,847	1,537	1,396	1,177
% Change		13.3	5.6	20.1	10.1	18.7	12.0
Mexico	1984						
Debt			75,470	58,441	52,339	40,871	37,330
% Change		18.7	29.1	11.6	28.0	9.5	15.3
Peru	1984						
Debt			10,235	8,522	7,484	7,541	6,497
% Change		11.1	20.1	13.8	-0.7	16.1	6.0
Venezuela	1984						
Debt			26,721	25,923	19,940	14,726	12,320
% Change		23.7	3.0	30.0	35.4	19.5	30.5

1) Disbursed outstanding debt includes all public, publicly guaranteed, and private non-guaranteed debt, except where specified otherwise.

2) Debt figures refer only to public and publicly guaranteed debt

Sources : D. Avramovic: Latin American Debt, Journal of World Trade Law, Vol 4, No. 2, 1970, p 122

Banco Central de Chile: Economic Report of Chile 1983, Santiago 1984, p 90

IDB: External Debt and Economic Development in Latin America, Washington, D.C., 1984

IDB: External Public Debt of Latin American Countries, Washington, D.C., 1984

World Bank: World Debt Tables, 1981-1985 Editions, Washington, D.C.

Table 9 : Short-Term Debt, 1977-1983
(in millions of U.S.dollars)

Country	1977	1978	1979	1980	1981	1982	1983*
Argentina	1,295	2,400	5,672	10,285	9,604	7,782	9,775
Brazil	n.a.	n.a.	n.a.	8,900	10,600	13,506	12,602
Chile	691	741	977	1,671	2,989	3,338	1,700
Mexico	376	1,071	3,193	11,766	22,654	22,425	9,994
Peru	1,006	1,069	621	1,299	1,363	1,580	1,174
Venezuela	5,977	6,862	11,380	12,774	9,360	6,000	6,994
Latin America	14,482	20,505	36,328	55,139	65,238	68,588	51,094

1) Disbursed debt with a maturity of less than a year

* preliminary data

Source : IDB: External Debt and Economic Development in Latin America, Washington, D.C. 1984

Table 10 : Debt Service Ratio 5 Years before Rescheduling¹⁾

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Argentina ²⁾	1956	2.3	2.3	1.8	1.4	2.2	3.3
Brazil	1961	25.9	36.8	32.3	26.8	18.9	14.6
Argentina	1962	14.0	22.3	22.0	16.0	12.4	7.4
Brazil	1964	32.4	30.5	32.9	29.2	36.8	32.3
Chile	1965	20.6	20.8	19.1	23.9	23.3	16.0
Argentina	1965	19.4	20.5	24.6	18.3	22.3	11.2
Peru	1968	8.5	11.1	9.8	6.7	5.8	8.9
Peru	1969	9.6	14.6	11.1	9.8	6.7	5.8
Chile	1972	17.6	21.2	18.3	15.9	19.8	12.6
Chile	1974	15.2	10.9	9.9	21.2	18.3	15.9
Chile	1975	14.4	11.9	10.9	9.9	21.2	18.3
Argentina	1976	19.5	22.0	16.8	17.7	20.5	20.3
Peru	1978	27.0	30.5	25.9	25.3	23.0	30.5
Peru	1979	27.2	31.1	30.5	25.9	25.3	23.0
Guyana	1979	9.6	15.8	11.9	11.2	4.3	4.8
Jamaica	1979	11.3	16.9	14.8	11.9	6.9	6.1
Nicaragua	1980	11.9	7.9	13.5	13.9	12.2	12.3
Bolivia	1981	29.5	27.2	31.4	50.5	21.5	17.0
Jamaica	1981	14.8	14.1	16.4	16.9	14.8	11.9
Nicaragua	1981	12.7	16.2	7.9	13.5	13.9	12.1
Nicaragua	1982	15.9	27.8	16.2	7.9	13.5	13.9
Guyana	1982	19.0	21.5	16.9	29.0	15.8	11.9
Brazil	1983	35.6	43.0	33.6	34.5	36.2	31.0
Chile	1983	27.7	20.0	29.6	21.9	26.5	40.7
Costa Rica	1983	18.3	12.0	16.4	16.8	23.0	23.3

(continued)

Table 10 (continued) : Debt Service Ratio 5 Years before Rescheduling

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Dominican Rep.	1983	16.4	22.7	15.3	11.9	21.4	10.7
Ecuador	1983	28.0	40.3	30.8	18.7	38.3	12.0
Mexico	1983	41.9	33.0	27.6	31.9	62.2	54.9
Peru	1983	33.1	36.4	44.9	30.9	22.3	31.1
Uruguay	1983	18.3	13.4	10.0	12.4	10.0	45.9
Argentina	1984	19.8	24.0	24.1	18.2	17.8	14.8
Bolivia	1984	28.7	30.5	28.3	26.2	27.2	31.4
Brazil	1984	35.2	28.7	43.0	33.6	34.5	36.2
Ecuador	1984	32.1	32.5	40.3	30.8	18.7	38.3
Guyana	1984	22.1	24.6	18.5	21.5	16.9	29.0
Honduras	1984	13.9	14.9	18.9	12.8	10.1	12.6
Jamaica	1984	18.3	15.4	18.9	26.5	14.1	16.4
Mexico	1984	38.1	35.9	33.0	27.6	31.9	62.2
Peru	1984	30.8	19.6	36.4	44.9	30.9	22.3
Venezuela	1984	12.9	15.0	16.0	10.6	13.3	9.5

1) Debt service ratio : amortization and interest payments on public external debt to exports of goods and services.

2) Estimates

Sources: Avramovic, D.: Economic Growth, and External Debt, Baltimore, 1964, p. 46

Canto, J. del: Brazil: Economic Growth, Washington, D.C., 1981, p. 160

IMF: Balance of Payments Yearbook, Vol 7 and 13

World Bank: External Medium and Long Term Public Debt-Past and Projected Amounts Outstanding

Transactions and Payments, 1956-1967, Washington, D.C. 1967, Table 4

World Bank: World Debt Tables, 1981-1985 Editions, Washington, D.C., 1981-1985

Table 1P : Main Primary Exports as Percentage of Total Export Revenues

Country	Product(s)	1970-74	1978-83
Argentina	Beef	13.3	6.7
	Maize	13.9	9.4
		27.1	15.1
Brazil	Coffee	20.2	9.8
	Sugar	10.6	3.7
	Soybeans	9.5	8.1
		30.3	21.6
Chile	Copper	62.3	47.5
Costa Rica	Coffee	27.9	25.5
	Bananas	26.5	23.5
		54.4	49.0
Dominican Republic	Sugar	48.1	48.3
	Coffee	9.3	10.6
		57.4	58.9
Ecuador	Petroleum	40.9	55.4
Guyana	Sugar	35.2	32.0
	Bauxite	28.2	41.4
		63.4	73.4
Honduras	Bananas	40.0	27.8
	Coffee	15.5	23.8
		55.5	51.6
Jamaica	Sugar	11.1	6.3
	Bauxite	25.3	23.4
		36.4	29.7
Mexico	Petroleum	1.6	65.3
Nicaragua	Coffee	14.5	29.8
	Cotton	26.5	20.5
		41.0	50.3
Peru	Fishmeal	20.4	23.1
	Petroleum	0.3	13.7
	Copper	18.6	13.5
		39.3	50.3
Uruguay	Beef	34.0	16.7
Venezuela	Petroleum	61.8	56.8

Note: Commodities are defined in terms of the U.N. Standard International Trade Classification, Revision 2, as follows: Beef: 011.1; Maize: 044; Bananas: 057.3; Sugar: 061.1; Coffee: 071.1; Fishmeal: 081.4; Soybean: 222.2; Cotton: 263.1; Copper: 287.1; Bauxite: 287.3; Petroleum: 333.

Sources: IDB: 1982 Report, Washington, D.C., 1982, pp. 398-400
IDB: 1985 Report, Washington, D.C., 1985, pp. 433-434

Table 12 : Indices of Annual Average Commodity Prices, 1977-1983
(1980=100)

	<u>Sugar</u>		<u>Coffee</u>	
	<u>Index</u>	<u>Price</u>	<u>Index</u>	<u>Price</u>
1977	28	17.9	117	535.7
1978	27	17.2	80	364.4
1979	27	17.1	86	393.8
1980	100	63.1	100	458.3
1981	81	51.1	78	358.4
1982	23	14.8	68	311.9
1983	30	18.7	67	309.4

	<u>Copper</u>		<u>Oil</u>	
	<u>Index</u>	<u>Price</u>	<u>Index</u>	<u>Price</u>
1977	60	130.9	43	12.4
1978	63	136.5	43	12.7
1979	91	198.5	47	13.6
1980	100	218.2	100	28.7
1981	80	174.2	114	32.6
1982	68	148.1	116	33.4
1983	73	159.1	101	29.1

Note: Prices refer for sugar to the free market (cts/kg), for coffee to the Brazilian sor (cts/kg), for copper to the London Metal Exchange price (cts/kg), and for oil to Saudi Arabian Light* (\$/bbl).

Sources: IDB: 1982 Report, Washington, D.C., 1982, pp. 396-397

IDB: 1985 Report, Washington, D.C., 1985, p. 432

Table 13 : Net Barter Terms of Trade, 1979-1983 (1980 = 100)

Country	1979	1980	1981	1982	1983
Argentina	102	100	102	90	91
Bolivia	77	100	84	76	84
Brazil	114	100	85	84	92
Chile	120	100	79	74	90
Costa Rica	97	100	90	88	95
Dominican Rep.	83	100	125	82	85
Ecuador	70	100	97	98	114
Honduras	100	100	83	81	87
Jamaica	107	100	89	85	90
Mexico	77	100	110	106	105
Nicaragua	103	100	70	64	67
Peru	99	100	94	89	109
Uruguay	119	100	91	80	81
Venezuela	67	100	119	112	103

Sources: World Bank: World Development Report, Washington, D.C., 1984, pp. 234-35, and 1985, pp. 190-91.

Table 14 : GDP Growth at Constant Prices over 5 Year Period before Rescheduling (in percent)

Country	Year of		-1	-2	-3	-4	-5
	Rescheduling	5-Year Average					
Argentina	1956	6.8	15.9	5.1	6.8	-14.1	20.4
Brazil	1961	...	...	...	...	...	...
Argentina	1962	1.4	7.4	0.0	8.1	- 3.3	- 5.3
Brazil	1964	...	...	...	...	...	...
Chile	1965	5.1	4.7	4.9	4.5	6.1	5.3
Argentina	1965	1.5	- 2.4	- 3.7	- 0.9	6.9	7.4
Peru	1968	5.5	3.5	7.1	5.1	6.9	4.7
Peru	1969	4.5	0.0	3.5	7.1	5.1	6.9
Chile	1972	3.8	9.0	1.4	3.3	2.9	2.5
Chile	1974	1.4	- 5.6	- 1.2	9.0	1.4	3.3
Chile	1975	0.9	1.0	- 5.6	- 1.2	9.0	1.4
Argentina	1976	3.6	- 1.6	6.8	5.4	3.1	4.5
Peru	1978	3.7	- 1.2	3.1	3.3	6.9	6.2
Peru	1979	2.1	- 1.8	- 1.2	3.1	3.3	6.9
Guyana	1979	5.0	4.8	0.0	2.9	10.4	7.0
Jamaica	1979	-2.6	- 0.4	- 1.7	- 6.1	- 0.6	- 4.2
Nicaragua	1980	-3.6	-26.4	- 7.9	7.5	5.8	2.9
Bolivia	1981	3.2	0.6	1.8	3.3	4.2	6.0
Jamaica	1981	-3.0	- 5.4	- 1.5	- 0.4	- 1.7	- 6.1
Nicaragua	1981	-2.2	10.0	-26.4	- 7.9	7.5	5.8
Nicaragua	1982	-2.3	5.3	10.0	-26.4	- 7.9	7.5
Guyana	1982	-1.1	4.5	1.9	- 0.6	4.8	0.0
Brazil	1983	3.5	0.9	- 1.6	7.7	6.4	4.8
Chile	1983	3.1	-14.1	5.5	7.7	8.3	8.3
Costa Rica	1983	0.1	- 6.9	- 4.5	0.7	- 1.9	6.3

(continued)

Table 14 (continued) : GDP Growth at Constant Prices over 5 Year Period before Rescheduling

Country	Year of Rescheduling	5-Year Average	-1	-2	-3	-4	-5
Dominican Rep.	1983	3.7	1.7	4.0	6.1	4.5	5.3
Ecuador	1983	4.5	1.7	3.9	4.9	5.3	6.6
Mexico	1983	6.6	- 0.5	7.9	8.3	9.1	8.2
Peru	1983	1.9	0.9	3.0	2.8	4.3	-1.7
Uruguay	1983	-0.2	- 9.4	1.9	6.0	6.2	6.3
Argentina	1984	-0.4	1.3	-5.7	-5.9	1.1	7.1
Bolivia	1984	-1.1	- 7.7	-8.7	0.6	1.8	3.4
Brazil	1984	1.9	- 3.2	0.9	-1.6	7.2	6.4
Ecuador	1984	2.5	- 3.3	1.7	3.9	4.9	5.3
Guyana	1984	-3.2	- 9.6	-12.4	4.5	1.9	-0.6
Honduras	1984	1.6	- 0.5	- 1.7	0.5	2.8	6.8
Jamaica	1984	-0.5	1.8	0.7	-0.0	-5.4	-1.5
Mexico	1984	3.9	- 5.2	- 0.5	7.9	8.3	9.1
Peru	1984	-0.2	-11.8	0.9	3.0	-0.8	4.3
Venezuela	1984	-0.7	- 3.5	0.6	0.4	-1.7	0.8

Source : IMF : International Financial Statistics, various issues

Table 15.: Net Foreign Direct Investment in Latin America, 1950-1960 (in millions of U.S. dollars) ¹⁾

Country	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
Argentina	...	5.3	7.0	6.2	4.5	3.8	62.8	69.6	120.1	245.0	333.4
Bolivia	...	...	...	...	1.0	2.6	3.0	6.9	16.6	20.5	16.5
Brazil	39.0	63.0	94.0	60.0	51.0	79.0	140.0	238.0	226.0	245.0	138.0
Chile	- 4.8	36.0	53.8	56.5	-54.0	1.6	32.9	45.6	46.5	54.3	29.0
Colombia	1.1	4.9	15.4	6.3	39.9	0.5	12.0	4.1	- 0.8	0.9	2.5
Costa Rica	0.6	2.4	1.4	0.2	0.9	2.8	5.6	0.3	0.6	7.6	1.6
Dominican Rep.	1.0	7.7	2.3	-7.5	6.4	1.1	5.1	-20.2	21.7	17.6	- 3.9
Ecuador	1.4	2.0	1.0	6.6	6.6	3.0	8.8	6.3	6.3	4.5	5.0
El Salvador	--	- 0.1	--	--	--	0.2	- 1.6	- 1.6	0.6	--	--
Guatemala	1.5	- 0.5	- 1.6	- 2.1	- 1.5	3.7	6.8	17.7	14.8	19.3	16.8
Haiti	4.7	6.2	4.7	5.7	2.4	2.1	2.7	-3.5	- 1.9	1.2	3.6
Honduras	0.1	12.0	15.6	8.7	2.5	1.9	0.2	2.9	- 4.9	-2.6	- 7.5
Mexico	86.5	123.8	63.3	40.9	104.6	111.8	118.0	131.6	100.3	81.2	- 7.6
Nicaragua	2.0	1.0	2.0	2.0	2.0	2.0	2.1	2.9	2.4	1.2	1.7
Peru	- 8.2	30.2	50.3	37.4	28.1	24.2	49.0	83.7	94.4	66.2	1.1
Uruguay	20.0	10.0	40.0	...	...	-10.0	20.0	...	...	...	...
Venezuela	16.5	- 0.1	155.0	169.2	43.8	- 4.1	592.0	980.0	86.1	49.0	-134.2
Total	161.4	303.8	504.2	390.1	238.2	226.2	1,059.4	1,564.3	728.8	810.9	396.0

Note: Three dots (...) indicate lack of data.

1. The entries are estimated of the net inflow (credit) or outflow (debit) of foreign private long-term capital, for the most part in the form of direct investment. If necessary, data are converted to dollars.

Source: IMF : Balance of Payments Yearbook, several issues.

Table 16: Latin America: Structure of the External Public Debt, by Type of Creditors, 1960-1983
(Percentages)

Year	Private				Official			Disbursed Portion	Undisbursed Portion
	Suppliers	Banks ²	Bond Issues	Nationalization	Total Private	Multi-lateral	Bilateral		
1960	23.9	16.4	8.1	1.2	49.6	12.9	37.5	81.0	19.0
1961	25.0	14.2	8.1	0.9	48.2	15.3	36.5	74.6	25.4
1962	31.6	11.5	8.0	0.7	51.8	15.8	32.4	79.1	20.9
1963	29.0	11.2	7.7	0.5	48.4	18.5	33.1	75.2	24.8
1964	25.6	13.1	7.2	0.8	46.7	19.8	33.5	76.3	23.7
1965	20.2	12.0	7.5	1.0	40.7	22.5	36.8	76.8	23.2
1966	19.5	10.5	7.7	1.6	39.3	23.4	37.3	75.5	24.5
1967	17.2	11.1	6.1	4.4	38.8	22.1	39.1	74.2	25.8
1968	17.4	12.0	6.7	3.4	39.5	22.8	37.7	73.2	26.8
1969	16.7	18.3	6.6	2.1	43.7	24.0	32.3	75.0	25.0
1970	16.9	19.5	5.9	2.4	44.7	24.3	31.0	75.7	24.3
1971	16.3	22.5	5.6	2.4	46.8	24.5	28.7	73.8	26.2
1972	14.6	26.1	5.4	1.9	48.0	24.3	27.7	74.2	25.8
1973	12.9	32.6	4.6	1.4	51.5	22.7	25.8	73.8	26.2
1974	11.9	37.7	4.0	2.0	55.6	20.0	24.4	75.0	25.0
1975	10.7	42.5	3.7	1.4	58.3	20.1	21.6	75.9	24.1
1976	9.0	46.0	3.6	2.3	60.9	18.8	20.3	76.0	24.0
1977	8.0	50.0	5.8	1.3	65.1	17.4	17.5	76.2	23.8
1978	7.1	52.7	6.9	0.9	67.6	16.5	15.9	78.2	21.8
1979	6.8	56.0	6.2	0.6	69.6	16.7	13.7	77.9	22.1
1980	6.1	55.3	7.1	0.3	68.8	17.2	14.0	80.4	19.6
1981	5.7	56.7	6.7	0.3	69.4	17.5	13.1	80.4	19.6
1982	5.0	59.8	4.9	0.1	69.8	17.8	12.4	81.5	18.5
1983	3.8	65.0	3.5	0.1	72.4	16.2	11.4	84.7	15.3

¹ Including the undisbursed portion at year end

² Includes also private institutions other than commercial banks

Source: IDB: 1985 Report, Washington, D.C., 1985, p. 426

Table 17 : Debt Subject to Consolidation in Official Reschedulings

Argentina	1956	: Medium-term commercial debts of the public and private sectors.
Brazil	1961	: Interest and principal payments due on medium-term suppliers' credits contracted before June 1961
Argentina	1962	: Principal payments due on suppliers' credits with a maturity of over 6 months contracted on or before October 24, 1962.
Brazil	1964	: Interest and principal payments due on medium-term suppliers' credits with a maturity of over 6 months contracted before Dec. 31, 1963, including those credits already consolidated in 1961.
Chile	1965	: Guaranteed suppliers' credits...under which principal payments are due over a period of more than 6 months, and governmental loans.
Argentina	1965	: Commercial credits guaranteed by the public authorities of the creditor countries and government credits with a maturity of over 180 days and contracted before Dec. 31, 1964.
Peru	1968	: Interest and principal payments due on Peruvian Government and Government guaranteed suppliers' credits with a maturity of 1-12 years, contracted before June 30, 1968.
Peru	1969	: Same coverage of types of debt as in 1968, but credits had to be contracted before Oct. 1, 1969.
Chile	1972	: Interest and principal payments due on: (a) officially guaranteed commercial credits contracted before Jan. 1, 1971, and (b) loans by governments or government agencies of less than 40 years maturity concluded before Jan. 1, 1971.
Chile	1974	: Same coverage of types of debt as in 1972, but loans of type (a) had to be contracted before Dec. 31, 1973. Excluded are all loans which have been rescheduled before.
Chile	1975	: Same coverage of types of debt as in 1974, but loans of type (a) had to be contracted before Dec. 31, 1974. Excluded are all loans which have been rescheduled before.
Costa Rica	1983	: Interest and principal payments due on official and officially guaranteed credits with a maturity of over 1 year contracted before July 1, 1982. Interest and principal in arrears on credits mentioned above.

(continued)

Table 17 (continued) :Debt Subject to Consolidation

Mexico	1983	: Principal payments due on official and officially guaranteed loans with a maturity of more than 1 year contracted before Dec. 20, 1982. Excluded are loans which have been guaranteed by the Mexican Government. Interest and principal in arrears on loans mentioned above.
Peru	1983	: Interest and principal payments due on official and officially guaranteed loans with a maturity of more than 1 year contracted before Jan. 1, 1983. Exclusion of debt service due as a result of the re-scheduling in 1978.
Ecuador	1983	: Interest and principal payments due on official and officially guaranteed loans with a maturity of more than 1 year contracted before Jan. 1, 1983.
Brazil	1983	: Interest and principal payments due on official and officially guaranteed loans with a maturity of more than 1 year contracted before March 31, 1983. Interest and principal in arrears on loans mentioned above.
Peru	1984	: Same coverage as 1983, but exclusion of debt service due as a result of the reschedulings in 1978 and 1983.
Jamaica	1984	: Interest and principal payments due on official and officially guaranteed loans with a maturity of more than 1 year contracted before Oct. 1, 1983. Interest and principal in arrears on loans mentioned above.

Sources : (*), World Bank: Multilateral Debt Renegotiations, 1956-1968, Washington, D.C., 1969, p. 8.

Table 18 : Official Debt Reschedulings, 1964-1984 : Cumulative Consolidation Period

Country	Consolidation Periods for Current Maturities Under Successive Agreements (Years)					Cumulative Number of Years	Number of Agreements
	I	II	III	IV	V		
Argentina	2.0	1.0				3.0	3
Brazil	4.6	2.0	1.6			8.2	3
Chile	2.0	2.2	2.0	1.0		7.2	4
Costa Rica	1.5					1.5	1
Ecuador	1.0					1.0	1
Jamaica	1.25					1.25	1
Mexico	0.5					0.5	1
Peru	1.5	2.0	1.0	1.0	1.25	6.75	5
							18

Sources: (*), Table 4.1

Table 19 : Repayment Schedule of Rescheduled Amounts, 1956-1984 (in per cent of total payments subject to rescheduling)

Country	Year of Agreement	Calendar Years Following the Rescheduling									
		1	2	3	4	5	6	7	8	9	10
Argentina 1956	----	11.1	11.1	11.1	11.1	11.1	11.1	11.1	11.1	11.1	
Brazil ²⁾ 1961	....	....	....	....	....	18.0	18.0	18.0	18.0	18.0	8.8 ¹⁾
Argentina ²⁾ 1962	....	....	....	5.0	15.0	20.0	20.0	20.0	20.0		
Brazil 1964											
Mat. due 1964	15.0	15.0	----	14.0	14.0	14.0	14.0	14.0	14.0		
Mat. due 1965		15.0	15.0	----	14.0	14.0	14.0	14.0	14.0		
Chile ²⁾ 1965											
Mat. due 1965	....	....	....	20.0	20.0	20.0	20.0	20.0	20.0		
Mat. due 1966	....	....	....	....	20.0	20.0	20.0	20.0	20.0		
Argentina ²⁾ 1965	....	....	....	15.0	20.0	20.0	20.0	20.0	25.0		
Peru ^{2,3)} 1968	....	....	....	25.0	25.0	25.0	25.0	25.0			
Peru ²⁾ 1969	....	....	....	14.5	25.0	25.0	25.0	12.5			
Mat. due 1970	....	....	10.0	20.0	35.0	35.0					
Mat. due 1971	....	....	....	10.0	20.0	35.0	35.0				
Chile 1972	5.9	24.1	----	10.8	10.8	10.8	10.8	10.8	10.8	5.2	
Chile 1974	5.0	5.0	10.0	11.4	11.4	11.4	11.4	11.4	11.4	11.4	
Costa Rica 1983	5.0	5.0	5.0	----	18.5	17.0	17.0	17.0	17.0	8.5	
Mexico 1983	10.0	----	----	15.0	30.0	30.0	15.0				
Peru 1983	3.3	6.7	----	----	18.0	18.0	18.0	18.0	18.0		
Ecuador 1983	5.8	9.2	----	----	17.0	17.0	17.0	17.0	17.0		
Brazil 1983	1.5	3.5	4.0	3.0	3.0	----	21.3	21.3	21.3	21.3	

(continued)

Table 19 (continued) : Repayment Schedule of Rescheduled Amounts, 1956-1984

Country	Year of Agreement	Calendar Years Following the Rescheduling									
		1	2	3	4	5	6	7	8	9	10
Peru 1984	2.7	7.3	---	---	---	---	22.5	22.5	22.5	22.5	22.5
Jamaica 1984											
Principal	---	---	---	---	20.0	20.0	20.0	20.0	20.0	20.0	
Interest	40.0	10.0	---	---	10.0	10.0	10.0	10.0	10.0	10.0	

Note: Mat.= Maturities

Four dots (....) indicate lack of data.

1) In 1961 the creditors agreed to distribute the last four installments over five years until 1966.

2) Percentages refer only to the effective rescheduling portion. The downpayment and/or the unsolidated portion are not included.

3) Peru was granted two possibilities to repay.

Sources: (*)

Table 20 : Repayment Schedule of Arrears: Selected Cases (in per cent of total arrears due)

Country	Year of Agreement	Calendar Years Following the Rescheduling				
		1	2	3	4	5
Brazil 1964	-----100					
Argentina 1965	60.0	40.0				
Costa Rica 1983	7.5	7.5	10.6	21.3	21.3	10.6
Mexico 1983						
Short-Term	5.0	5.0	30.0	60.0		
Medium-Term	10.0	-----	-----	15.0	30.0	15.0
Brazil 1983	-----	66.7	33.3			
Jamaica 1984						
Principal	-----	20.0	20.0	20.0	20.0	20.0
Interest	50.0	50.0				

Sources: IDB: European Financing.....op.cit. pp.102,104

(*)

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