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"MILLENNIAL DEBT AND DEVELOPING COUNTRIES: A NEW KIND OF DEBT?"

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Abstract

Although the 'debt crisis' no longer threatens the international financial system, many low and middle income countries are still struggling with large debt overhangs. This paper explores the notion of "millennial debt" held by developing countries, highlighting the primary reasons behind the persuasiveness of the external indebtedness problem in the Latin American region at the turn of the new century. For Latin America, the root causes of indebtedness lie deep within the structure of the modern economy marked by dependent and unequal economic relationships between nations, and the impact of certain external factors: - a dramatic fall in commodity prices (including oil) and contraction in world trade; the global recession (1981-82) and sharp increases in floating interest rates; the pursuit of expansionist policies and capital flight from Latin America; and increasing protection in the developed world against Third world exports.

Developing countries, especially those in Latin America tried to take responsibility for their indebtedness by adopting strict reform measures, mainly in the form of structural adjustment programmes. However, external debt in Latin America has accumulated gradually over a long period of time standing at an incredible $2.3 trillion in 1997 and a debt-to-exports ratio of close to 2000. At the beginning of the new millennium, several new factors (along with some of those present in the 1980s now explain the state of debt affairs: - a more difficult and deteriorating international economic environment characterized by weaker-than-anticipated commodity prices, reduced world trade volumes, and capital flows along with increased exposure to financial crises and other external shocks arising from increased interdependence of economies in the global environment.

The paper concludes that Latin American countries now face a 'new' kind of debt characterized by shorter maturity dates, mainly held by private creditors. These economies must, therefore, take full advantage of the various debt relief initiatives now available to make more evident the slight improvements that have occurred. Nonetheless, the presence of large stocks of debt has clearly become a disaster for the peoples living in this part of the Third World. The success of their efforts will, however, require the cooperation and commitment of both worlds - developed and developing. Without this, the human achievements recorded so far may be lost.

Millennial Debt and Developing Countries: A New Kind Of Debt?

Introduction

Everyone is aware of the global international debt crisis. While sometimes referred to as the Third World debt crisis, in our interdependent world, it affects everyone. Whereas, in the past it used to be a concern for specialists in trade and financial matters, this phenomenon has acquired a universal dimension. Preoccupation with external debt issues is now shared by political leaders, economists, business persons, international organizations. Working people throughout the developing world have also become interested being very conscious of the impetus of the debt crisis, and the burden it places on their lives.

The early years of the 1980s witnessed a massive debt explosion which had its epicenter in the Latin America region[1] . According to Jacobo and Hilda Schatan (1985) this phenomenon is only one of the more visible manifestations of a profound crisis which affected the Latin American region for a long time. They note further, that this crisis of the Latin American external sector is not an isolated phenomenon associated with conjunctural problems of the world economy. On the contrary, it expresses the end of a whole system of international relations. Moreover, the Latin American crisis is deemed to have its own roots; although exacerbated by external factors, it does not stem exclusively or mainly from these (Schatan et. al.,1985:1).

Concerning such internal roots, the economic crisis can be conceived of as the crisis of the development pattern followed by Latin American societies, as well as the crisis of their basic values. The development pattern was characterized essentially by a strategy of rapid economic growth associated for a long time, in several of the Latin American countries, with a scheme of export-led industrialization. These approaches resulted in a mixture of plunder and self-destruction carried out by means of the apparently harmless instruments of the international market (Schatan et. al.,1985:70).

Shortly after the debt crisis exploded in the 1982, Latin American governments began to react, trying to find some way out of the situation facing them. The central causes have been well analyzed and several attempts - economic and political - have been made at finding solid and enduring solutions, not just the cosmetic ones proposed by the international leadership.

Today, burgeoning external debt continues to be one of the major, if not the major problem facing developing economies. High levels of external debt, like a silent war, have pervaded the decade of the nineties tearing down

[1]The term Latin America refers to the group of severely indebted low and middle income economies of Central and South America. There will be a heavy focus on the larger economies in the region , and especially the six largest ones sometimes referred to as the 'big six': Argentina, Brazil, Chile, Mexico, Peru and Venezuela.

entire economic structures and throwing development in reverse, and are still with us as we enter a new millennium. This "millennial debt", in my characterization refers to the debt overhang that persists at the turn of the new century and which has developing countries still trapped in its web.

Specifically, it is the total debt stock and components held by Latin American countries during the latter half of the 1990s (1994 -1999). The debt stock and its components refer to both short and long term debt (held by debtors), private non-guaranteed debt, and public and publicly guaranteed debt (held by creditors). Debt ratios, a useful short-cut to assessing a country's/region' debt situation are the main tools for assessment used in this paper. For example, evidence on the debt overhang is provided by the debt-to-GNP ratio, which for the Latin American region stands at around 46 percent. Since external debt has to be serviced in foreign exchange, the debt-to-export ratio (200-250 percent in Latin America) is a measure of the feasibility of repayment. However, this measure does not capture the degree of concessionality (in terms of grace periods or sub-market interest rates) in the debt stock. The net present value of debt-to exports account for the grant element in the debt. The cash flow situation is indicated by the debt-servicing-to-exports ratio- probably the most important single indicator. In 1999, the Latin American region spent, on average, 35 percent of its export earnings servicing debt (liquidation of the principal and accumulated interest). However, because of the widening gap between due and actual payments between the 1990s, this ratio has moved back to the levels existing in the 1980s (25-30 percent).

Indeed, the question could be asked, what has led to the persistence of this untenable situation? In the following pages of this paper, I will explore, albeit very briefly and in a preliminary way, a few of the more fundamental and interesting aspects of this continuing problem, especially in the Latin American region. Some mention will also be made of the Caribbean region at times since the data was often grouped and presented in that manner. In very broad terms, the paper reviews why there is such monstrous debt in developing countries in Latin America. What originated it and how? Which are the forces and ideologies that have sustained and aggravated this condition of indebtedness and that are responsible for the long term consequences now visible? Are these factors the same ones that led to the crisis in the 1980s? If not, what are the differences? Has the impact of these factors changed the stock or component of debt in Latin America? In what ways? Finally, what are some of the option available for further debt as we enter a new millennium?

Before proceeding with any further analysis, it is necessary to stress some of the more important limitations of the present exploration. There are many gaps to fill; many assumptions and conclusions that are highly debatable; data that are lagged and figures that may or may not be sufficiently precise; arguments that are neither complete nor irrefutable. I wish to note, however, that my aim in this presentation is a modest one: a wish to contribute some ideas, reflections and preoccupations that may be useful for much-needed in-depth study and discussion of the matters referred to above.

The Indebtedness Problem Of The 1980S: How It All Began

Many people know what it feels like to owe money, even if only to a cooperative society for a loan or a building society for a mortgage. But it's a different matter, altogether to be to be deeply in debt and unable to repay it. And even worse to be in that situation if someone else ran up the debt and left you to carry it. Similarly, nations borrow money abroad in order to cancel their deficits in current accounts, to expand or initiate new development projects, and, in general to supplement their internal savings deficiencies and to maintain or increase their international monetary reserves.

Kojn (1984) noted that both governments and private enterprise borrow as a temporary measure, in response to an unavoidable need at a given moment, thinking, at times, very naively of course that such a need will cease to exist after a certain period of time. In a majority of cases, it is also assumed that such external loans will not only produce (through the investments made with them) the foreign currency needed to repay the loans, but that they will also contribute to the self-sustained economic growth of the debtor countries, a process that will make further borrowing unnecessary (Kojn,1984:9).

In the case of developing economies, it is not clear whether the thinking of the governments mirrored the above, since reality has proved otherwise. Far from being a temporary phenomenon, foreign indebtedness has become a true addiction from which debtor countries do not have the capacity to to escape. As in the case of drug addiction, the doses have become larger and larger. In Latin America, a number of factors have been viewed as being responsible for the debt crisis. However, I will review some of the main factors which explain the causes of the crisis in that region.

(1) Role of the Government :United States of America and Latin America

The majority of the creditors prior to the early 1970s were foreign governments and international financial institution such as the International Monetary Fund (IMF), the World Bank and regional development banks. However, during the late 1970s and early 1980s, commercial banks began playing a larger role in international lending issuing general purpose loans to developing countries to provide balance of payments support and the expansion of export sectors (Todaro, 1997:506-507).

With its great natural resources and skilled workforce, in comparison with other areas of the developing world and with growth rates averaging nearly 7 percent, Latin America seemed like a golden prospect in the 1970s. Western banks took the lead in lending to Latin America and the region accounted for two-thirds of the value of all commercial loans to developing countries (Kojn, 1984:10). But according to Jubilee 2000 Coalition, the global debt crisis was born in the United States of America in the 1960s.

The US government had spent more money than it earned and to make up for this, decided to print more dollars. This led to a fall in the value of the world's stocks of dollars. This was bad news for the major oil-producing countries whose oil was priced in dollars. The money they made from exports now bought less. So in 1973, they hiked their prices. This caused them to make huge sums of money which they deposited in Western banks -- mainly USA and Canada. However, as interest rates plummeted, the banks were faced with an international financial crisis. Faced with great liquidity, they lent out the money fast, in wild competition to export capital to stop the slide, turning to Third World economies to which were doing well but which wanted money to maintain development and to meet the rising costs of oil.

The banks lent lavishly to the avid Latin American market, following aggressive strategies to dispose of their excess liquidity and without much thought about how the money would be used or whether the recipients had the capacity to repay it. Third World governments were pleased to take advantage of the loans at very low interest rates- below the then rate of inflation. and so accepted these changes under the influence of the aggressive marketing techniques employed by the banks which included attractive offers that appeared to be to their benefit, without realizing the grave harm that they would suffer in the future. What appeared in the first instant to be a technical innovation became a real trap, since any increase in the interest rate would apply to the total outstanding debt and not only to new loans. In the case of several Latin American countries with stable exchange rates, the considerable difference between domestic interest rates and the international ones made it profitable to borrow dollars abroad to convert them, for example, to Chilean or Mexican pesos and lend the resulting sums in Chile/Mexico at rates were substantially higher. In the case of Chile, for example, many leading firms were leading firms were established in 1977/78 to carry out such operations, which, at certain times, were yielding a rate differential of three or four percentage points per month (Kojn,1984:15).

However, in a second period, starting shortly before the advent of the Reagan Administration in the USA (January, 1981), the above situation changed completely. Alongside a world economic recession, inflation became increasingly acute in the USA and other industrial nations, and rates of interest escalated. In order to diminish the risks associated with these operations, private banks decided to change the terms and conditions of granting the loans, shifting from fixed interest rates to floating interest rates due at first to inflation then to tight monetary policies.

(2) Fall in Primary Commodity Prices

Inflation in the middle to late 1970s resulted in several countries revaluing/devaluing their currencies. This led to higher prices for exports which in turn led to the belief that higher export revenues were permanent. However, the world economic recession at work in the early eighties in the central nations motivated sharp drop in prices of raw materials exported by Latin American countries precisely at the time when the financial charges due as interest payments became heavier, and when the flow of fresh capital to the region began to slacken. This resulted in

severely reduced export revenues which were unable to finance the outstanding amortization amounts that had now fallen due.

(3) Capital Flight from Latin America to the rest of the World

Maintaining internal structures based on a high degree of economic concentration favored the processes of "dollarization", of importing superfluous goods and of capital flight. In particular, the military regimes which ruled in Latin America favored massive imports of armaments, which were generously financed with foreign loans. Also, the claim was made that employment could be created through an expansion of the industrial base, and that the living standards of the majority of the population could be improved through adequate provision of food, health, etc., without modifying the basic structures of economic power. These processes were reinforced by acute inflation and in some countries by keeping overvalued exchange rates. Moreover, income distribution led to further spending and increased flight of private capital. Latin American nations abruptly had to compress their imports to be able to continue paying their debt services, and for the first time the region became a net capital exporter. Fully 62 percent of Argentina's and 71 percent of Mexico's debt growth were estimated to have resulted from capital flight. In fact, some researchers have argued that the 1985 level of Mexican debt would have been $12 billion rather than the actual $96 billion were it not for the huge private capital flight(Todaro, 1997:513).

(4) Latin America's pursuit of Expansionist Economic Policies and Political Turmoil in the Region

The pursuit of very high economic growth rates, the expansionist policies applied in the region, as well as the escalation of interest rates, led to an ever increasing cost of financial capital, by causing annual debt services to be absorb higher proportions of export earnings. This led to additional borrowing from OECD commercial banks so that imports of all kinds (chemicals, foodstuffs, capital goods) could continue after the payment of debt services. But world recession and the political/capital turmoil of Argentina's war with Britain over the Falkland Islands (March - June, 1982) suddenly made the region look like a bad bet. Bankers cut back on new lending to Argentina, and the rest of Latin America also became suspect. Mexico crashed under the strain of too much debt and inadequate financial resources in the latter half of 1982 after President Jose Lopez Portillo got his party safely past the July 1982 elections. Later in 1983, the roof collapsed in Brazil, Chile, Argentina, Venezuela and Peru. Latin America as a region was in deep debt.

Evidence Of The First Crisis In Latin America

By 1983, the external indebtedness crisis in Mexico had acquired full force, followed by similar crises in other Latin American countries, as well as in other regions of the world. The following signs provide evidence of the terrible problem at hand.

(1) Inability to Service the External Debt (pay interest and the principal)

Table 1: Latin America :Total Outstanding and Disbursed Debt at the end of year 1970-1985[a]

Year	Total Debt ($billion)	Debt with Official Sources ($billion)	Debt with Official Sources (% of total debt)	Debt with Private Sources ($billion)	Debt with Private Sources (% of total debt)
1970	23	8	36	15	64
1971	26	9	36	17	64
1972	30	10	34	20	66
1973	40	12	28	28	72
1974	56	14	25	42	75
1975	75	16	22	59	78
1976	98	18	18	80	82
1977	116	21	18	95	82
1978	151	25	16	127	84
1979	182	27	15	157	85
1980	223	31	14	198	86
1981	278	34	12	246	88
1982	318	40	12	278	88
1983	344	51	15	293	85
1984	360	57	16	303	84
1985	368	65	18	303	82

(a) includes Argentina, Bolivia, Brazil, Colombia, Costa Rica, Chile, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Dominican Republic, Uruguay and Venezuela. Estimates comprise long, medium, and short tem debts and debts with financial institutions that report to the Bank for International Settlements that are not officially guaranteed. Debts with other financial institutions and export loans are excluded. All short term debts are presumed to be with private sources.

Source: CEPAL, on the basis of data from the World Bank, Bank for International Settlements, Inter-American Development Bank.

Figures show with dramatic clarity the development of the indebtedness process since the early 1980s, in Latin America, as at that time it was among the major debtors of the world. World Bank data in Table 1 for nineteen (19) Latin American countries show a global debt level at around $370 billion in 1985. If Cuba and the other Caribbean nations are included, the total stretched beyond the $380 billion mark, that is almost one half of all the Third World's foreign debt at that time Fifteen years earlier, the Latin American debt had been only $23 billion, by 1977 it had passed the $100 billion mark and by 1983, it was close to $350 billion.

Table 2: Latin America :Total Outstanding and Disbursed Debt at the end of year in selected countries

Countries	1978	1980	1981	1982	1983	1984
Argentina	12.5	27.2	35.7	43.6	46.5	49.0
Brazil	52.5	68.4	78.6	87.6	96.5	102.4
Chile	6.7	11.7	15.5	17.2	17.4	18.4
Mexico	33.9	50.7	74.9	88.3	92.1	95.9
Peru	9.3	9.6	9.7	11.1	12.4	13.3
Venezuela	16.4	26.5	28.4	30.5	33.5	31.3
Other countries	19.8	29.0	34.9	40.1	45.6	49.4
TOTAL	**150.9**	**222.5**	**277.7**	**318.4**	**344.0**	**359.7**

Source: CEPAL Statistical Yearbook, 1985.

Table 1 also shows that most of the increment in total indebtedness came from commercial loans, which went up twenty-fold between 1975 and 1985; official credit instead moved up slowly with an eight-fold increase during the fifteen years.

Table 3: Latin America: Relationship between External Debt and Exports of Goods and Services

(Index: Exports =100)

Item	1977	1979	1981	1982	1983	1984[b]
Latin America	**191**	**202**	**213**	**309**	**338**	**317**
Argentina	125	192	271	338	365	---
Brazil	252	297	255	341	345	---
Chile	188	158	226	289	317	---
Mexico	341	248	232	253	270	---
Peru	294	175	205	234	238	---
Venezuela	106	154	137	172	134	---

b: Country figures not available for 1984 not available.

Source: CEPAL, various publications. Reproduced from Schatan and Schatan, 1985:12.

Table 2 shows that by the end of 1985, only six countries were responsible for more than four-fifths of the Latin American debt, bearing the heaviest burden in total debt servicing according to OECD data: Brazil $105 billion; Mexico $100 billion; Argentina $50 billion; Venezuela $35 billion; Chile $22 billion; and Peru $14 billion. The ratio of debt-to-exports also jumped considerably from 1.9 to 1 in 1977 to 3.2 to 1 in 1984 according to data from the

Economic and Social Commission (CEPAL), and in several countries, the external debt grew much more rapidly than did their exports. This resulted in a trebling of the debt to export ratio for Argentina and the doubling of that for Chile in just five years. (See Tables 2 and 3). The external debt also grew disproportionately in relation to the Gross Domestic Product (GDP) in a number of Latin American countries reaching levels that can be considered as truly unbearable. This is shown in Table 4.

In the case of Argentina, this ratio went up from 15 percent in 1977 to over 40percent in 1983; in Chile and Venezuela such ratio went up from around 35 percent to a staggering 60 percent during the same period. For the region as a whole, the situation appeared slightly better, although by 1985 the average ratio had climbed to over 43 percent, one-fifth higher than that recorded for 1983. The last four or five years of the decade of the eighties witnessed a serious aggravation of the Latin American foreign debt situation. The external borrowing policies applied by the nations led to large increases in foreign capital reserves absorbing an ever growing proportion of the export earnings of the region.

Table 4: Latin America: Relationship between External Debt and Gross Domestic Product

(Index: GDP =100)

Item	1977	1979	1981	1982	1983	1984	1985
Latin America	23.9	28.4	32.2	33.7	35.7	42.7@	43.2@
Argentina	14.7	26.2	38.4	39.7	41.1	---	---
Brazil	22.3	25.7	26.5	28.5	31.6	---	---
Chile	34.8	37.8	47.6	60.9	60.2	---	---
Mexico	23.4	24.0	30.2	31.5	33.0	---	---
Peru	36.9	35.0	31.0	33.6	40.8	---	---
Venezuela	36.4	63.9	66.1	65.3	61.8	---	---

--- Country figures for 1984 and 1985 not available.

@ Estimated figures.

Source: CEPAL, various publications. Reproduced from Schatan and Schatan, 1985:13.

(2) Need to Stabilize Economic Fundamentals and Renegotiate Debt

When Mexico defaulted on its debt repayments in 1982, the whole international credit system was threatened. Mexico owed huge sums of money to banks in the USA and Europe and they did not want to lose it. So they banded together and got the support of the International Monetary Fund for a scheme to spread out or reschedule the debts. Since then the IMF and World Bank – the two main international financial institutions – have been involved in lending money and rescheduling debt in countries which, like Mexico, could not pay interest on their loans. But their rescheduled loans added to the debt burden and came with conditions.

The most popular scheme chosen is known as Structural Adjustment Programmes (SAPs) which required Latin American governments to agree to impose very strict economic programmes in their countries in order to reschedule their debts and/or borrow more capital. SAPs consist of measures designed to help a country repay its debts by earning more hard currency – increasing exports and decreasing imports, and usually have to:

- spend less on health, education and other social services. The result is that citizens pay for them via taxes but must go without these essential services.
- devalue the national currency, lowering export earnings and increasing import costs.
- cut back on food subsidies with the result that prices of essential will soar.
- cut jobs and wages for workers in the public sector – government, industries and services.
- encourage privatization of public industries and services, including sale to foreign investors.
- take over small subsistence farms for large-scale export crop farming instead of staple foods. So farmers left with no land to grow in their own food and few are employed on large farms.

In a few countries the SAPs appear to have had some good effect, at least for some time; but in most cases, particularly in Latin America, have worsened the economic situation with the poor being the hardest hit. Included are the loss of buying power due to inflation and the elimination of subsidies; emigration to work in another country because of the lack of jobs at home; higher taxes and cutbacks in government expenditure on health, education and other social services; and exacerbated environmental problems.

Continuing Indebtedness In Latin America In The1990S And Beyond

By the beginning of the nineties, the Western governments could safely declare that their debt crisis was over. Bank savings were secure once more and the media turned its attention to more pressing matters. But in Latin America, and especially in Africa, the struggle with the burden of escalating external debt still goes on. The approach to solving the external payments crisis in Latin America has created some devastating side effects, particularly for the lower income groups in Latin America. The level of debt and debt servicing during the 1990s covered approximately 17 percent of the debt payments due. The unpaid balances plus high fees for the privilege of rescheduling debt payments were added to the existing debt. During this same period the price of Latin American exports relative to the prices of imported goods declined by 30 percent. As a result, by 1997, Latin American debt

to exports ratio was about 256 percent. In several cases, exports could not be increased by such a large percent and the capacity to import declined in a number Latin American countries. The reduced level of imports caused shortages of fuel, spare parts and other essential goods which contributed to a massive slide back into poverty.

Further, capital formation as a percentage of GDP declined, and with less capital to work with, the rate of growth of production of all goods declined dramatically, even being negative in several countries. For example, overall output in the region was stagnant in 1999 for the first time since 1990 with eleven countries experiencing negative per capita growth. The average living standard of the people has been reduced to levels evident some 20 to 30 years ago. The number of families unable to meet their basic needs doubled during the decade of the eighties and have almost doubled again in the nineties. The human toll of this poverty is evident among lower income groups with wage earners bearing the heaviest burdens.

What is responsible for this worsening situation? This section of the paper seeks to highlight these factors and their attendant impacts on Latin America's ability to cope with its external debt problems at the turn of the century.

(1) A More Difficult and Deteriorating External/International Economic Environment

During the latter part of the 1990s, there have been important improvements in the condition of many developing economies, especially the Asian crisis countries. However, the external environment facing most of the others has continued to deteriorate, reflecting weaker-than-anticipated commodity prices, reduced world trade volumes, and capital flows. The average price of non-energy commodities is down 6.3 percent; the year-on-year world trade volumes in the last quarter of 1998 is estimated at near zero and the 1999 forecast for growth in world trade has been cut from 5.7 percent to 4.2 percent External finance too remains tight, with access largely restricted to the most credit-worthy borrowers, and at much higher spreads (World Bank, 2000:6).

This deteriorating environment has also brought domestic weaknesses into sharper focus, including chronic fiscal deficits in several large developing countries in Latin America. In fact, growth prospects are down for all developing countries, but the downward revisions are especially pronounced for oil exporters and Latin America (World Bank, 1999:8). Aggregate GDP growth in Latin America and the Caribbean fell from 5.1 percent in 1997 to 2 percent in 1998 largely owing to a deterioration in the external environment. Export growth slowed and contractionary macroeconomic policies were adopted in the face of diminished access to foreign borrowing (World Bank, 2000:159). This no doubt will further reduce the region's ability to import needed resources for production and growth and for debt servicing.

(1) Increased Interdependence of Economies and the Effects of Contagion

During the 1970s, the larger economies in the Latin American region had just started to play a larger role in the global economy mainly because of the need to supply much needed raw materials and other essential goods to the

developed world continues. Today, most of these economies have also become increasingly interconnected with each other, both intra-regionally and extra-regionally in the global environment, some establishing their own financial capital markets and/or have been trading extensively in established capital markets. This increased interdependence, however, has its positives and negatives in terms of its impact on continuing debt in the region.

For example, the exchange rate crisis in Brazil in 1998 resulted in a near complete loss of investor confidence in the authorities' ability to implement the original IMF-backed fiscal adjustment programme. This forced the Brazilian government to allow the **real** to float in early January of 1999 with the currency losing about one-third of its value against the US dollar. In an effort to stabilize the exchange rate and prevent the resurgence of inflation, interest rates were raised to 45 percent. The crisis in Brazil had devastating effects on its own economy (Brazil had a relatively short-lived recession) as well as on those of other countries in the region.

The effects on the rest of Latin America were, however, considerable and worked through multiple channels. First, direct trade links are strongest in Latin America are strongest as shown in Table 5, and according to World Bank data MERCOSUR countries were hardest hit. Argentina, for example, had its second major recession in four years, due in large part, to the collapse of the Brazilian imports, low grain prices and high real interest rates – a result of diminished investor confidence at the height of the Brazilian devaluation. Gross Domestic Product also fell in Venezuela in the third quarter of 1998, and in Chile in the fourth quarter of 1999-- Chile's first decline since the mid-1990s. In Peru GDP was flat in the fourth quarter. Given the fragile conditions of world oil markets at present, downward price pressures would be likely to continue, adversely affecting the much needed export earnings of the region's principal exporters -Venezuela, Mexico, Ecuador and Columbia. The smaller, more open economies such as Paraguay and Uruguay are expected to be hit harder (World Bank, 2000: 205).

Table 5: Shares of Exports and GDP for Brazil and Latin America, 1997 (Percent)

	Brazil		Latin America	
Exporter Group	Exports	GDP	Exports	GDP
World	1.0	0.2	5.2	1.0
Latin America	4.8	0.8	19.1	3.0
Argentina	25.9	2.2	34.1	2.9
Mexico	0.9	2.7	2.7	0.6

Note: Export Shares in percent, and share of exporting country or group GDP.

Sources: IMF, Direction of Trade Statistics and World Bank data.

Second, weaker prices in several commodities in which Brazil is an important supplier or consumer also affected several developing countries within and outside of Latin America itself. Brazil has a large world export market share in iron ore and steel (29 percent); coffee (23 percent); and soya beans (22 percent). Export receipts declined

in tandem with reduced capital flows to the region as prices for key exports (coffee, metals, minerals, oil and sugar) fell. The Brazilian devaluation, for example, was estimated to cause Arabica coffee to fall 15 to 20 percent below pre-crisis levels. Further, although Brazil and the broader Latin American region account for only 2.5 percent and 6.5 percent of world oil consumption, respectively, they have constituted 10 percent of the growth in demand over the 1990-1996 period.

(1) Reduced Foreign Capital Flows to the Region

In 1998, all of the large Latin American countries adopted restrictive monetary and fiscal policies to adjust to reduced foreign capital flows. Brazil, the first and hardest hit, increased interest rates to about 50 percent in September and real interest rates hovered at around 30 to 35 percent in the latter part of the year. Real interest rates also remained high in a number of the other countries – 15 to 20 percent in Columbia and Mexico; 10 percent in Peru and Venezuela; 7 to 8 percent in Argentina and around 4 to 5 percent in Chile. Naturally, investment slowed markedly with a sharp decline in industrial production and a deterioration in business confidence.

Following increased debt service commitments (estimated at $65 billion), a widening of the current account deficit by roughly $20 billion (up from $67 billion to $97 billion), and a draw down of reserves in the region's largest economies, import volumes began to plummet toward the end of 1998. Though there has been a modest recovery in the private capital flows, this has, however, been largely inadequate in a region whose refinancing needs are large. The market too has become less receptive since the Brazilian crisis and borrowing is confined to the best sovereign borrowers.

(1) Increased borrowing and a drastic change in the maturity structure of bank lending flows.

Developing country indebtedness continued its surge started in the 1970s and 1980s, through the 1990s and into the twenty-first century. World Bank data show that the total debt of developing countries rose around 60 percent from around $1.5 trillion in 1990 to $2.3 trillion in 1997. In Latin America, the stock of long term debt also increased from $559 billion in 1997 to $649 billion in 1999. However, the total debt-to-GNP ratio has remained virtually flat since 1988, whereas the debt -to-exports ratio has declined sharply since the mid-1980s until 1997. The region's average debt-to-exports ratio fell from 256 percent in 1990 to 191 percent in 1997, and the debt-to-GNP ratio from 45 percent in 1990 to 36 percent in 1997. However, these indicators increased again from 1997 to 1999 owing to slower growth in output and exports and an increase in total external debt (World Bank,1999:156, 159). These statistics indicate little or no change in Latin America's indebtedness status and even a reduced ability to generate the levels of output for export that will adequately service this debt and foster growth in the region. This is very depressing state of affairs. Already high levels of debt are making more difficult region to extricate itself from a state of pure misery cause in large part by the presence of this same debt.

But far more remarkable than the increasing total stock of external debt, has been change in the maturity structure in bank lending flows to the region. In the 1990s, bank lending flows to many developing countries shortened with the fastest growth in short term debt occurring in East Asian countries followed by Latin America. (World Bank, 2000: 77). Latin America recorded the second fastest growth in short term debt for the period 1990 to 1997, though larger additions to reserves helped hold down the ratio of short term debt to reserves.[1] During that period Latin America and the Caribbean received 31 percent of short term debt flows to developing countries. Of this amount, Brazil received 10 percent and Mexico 8 percent.

This trend continued into 1998 with short term lending by international banks increasing rapidly despite a falling share of their lending in total private debt flows (See Table 6) and despite flat or declining ratios of indebtedness to exports and GNP. This was different from the 1970s when borrowing from international banks was the main source of private capital flows to developing countries, and bank lending rose sharply in the years of oil price increases as international banks recycled petro-dollars from oil exporting to oil importing countries.

Table 6: Short-term Debt of Developing Countries and Latin America, 1986 -1998 $US (bn.)

Items	1986	1990	1994	1995	1996	1997	1998
Short term debt (GDF definition)	154.2	244.6	360.5	424.4	460.8	469.3	411.9
Short tem debt as a percentage of total debt (GDF definition)	14	17	18	20	21	20	16
Short term claims by BIS reporting banks (BIS definition)	159.9	175.6	293.9	351.9	410.6	454.1	369.1
Short term debt (BIS) as a percentage of total debt	14	12	15	16	18	20	15
Latin America and Caribbean	19	14	17	17	19	22	20
Short tem debt as a percentage of reserves	198	119	91	91	88	91	68
Latin America and Caribbean	257	143	101	86	84	91	93

Note:- The Global Development Finance (GDF) definition uses the original maturity concept of short term debt, while the Bank for International Settlements (BIS) uses remaining maturity. The GDF estimates of short term debt includes suppliers' credit. Short term international debt is defined as all cross border debt that has less than or equal to one year of maturity. The BIS uses the remaining maturity concept by which all cross border debt becomes due within the year it is counted as short term debt. This includes liabilities with an original maturity of one year or less plus repayments falling due within the next 12 months on .liabilities with an original maturity of more than 1 year. This concept is useful in evaluating a country's total short term external payments obligations , i.e., its liquidity position. The GDF definition comprises all cross border liabilities with an original maturity of one year or less, a definition which highlights the amount of short term debt contracted at the margin. It

[1]East Asia and Pacific where the fastest growth in short term debt occurred received 45 percent of short term debt flows to developing countries.

also includes trade credits reported by the OECD.

Source: World Bank and Bank for International Settlements, 2000.

Short-term debt also rose relative to other critical variables indicating liquidity and debt servicing capacity, namely exports and reserves. The ratio of short-term debt-to- exports in developing countries increased from 21 percent to 27 percent during the 1990 to 1997 period. While the ratio of short-term debt to reserves remained relatively stable in the 1990s but, due to larger additions in reserves, it remained close to 1, the critical safe threshold for borrowing.

A combination of factors - on both the lenders' and borrowers' sides - caused this rapid build up in short-term bank lending. First, the recession of the early 1990s and lower interest rates in industrial countries encouraged international banks to lend more short-term to developing countries. Source-country policy factors such as capital adequacy regulations tended to favor short term lending by banks, and international rescue efforts (as in Mexico in 1994) tended to give precedence to short term banking claims. In developing countries themselves, cyclically rapid growth in the 1990s (in East Asia in particular) contributed to rapid growth in short-term financing that was linked to unsustainable domestic asset booms.

The growth in short term debt of developing countries also reflected the fact that international banks were lending more short term even as were reducing their overall loan portfolios to developing countries as well as their own exposure in terms of their capital at risk (World Bank, 2000:79). High levels of short-term debt increases developing countries' vulnerability to financial crises. The risk of crisis also appears to rise with the share of short-term borrowing by domestic banks. The interaction of deteriorating fundamentals (such as over-valued currencies and excessive public borrowing) and high levels of short-term debt appears to have played a significant role in recent crises. For countries with open capital accounts and high levels of financial intermediation, the level of broad money, and high levels of short-term domestic debt, relative to international reserves, is also important because of the potential for capital flight.

Short-term bank lending to developing countries has also been observed to be pro-cyclical, rising during favorable times and reversing more sharply in times of adverse shocks. This pattern is observed across cyclical domestic demand shocks as well as external terms of trade shocks. While the pro-cyclical response to external borrowing can substantially accentuate the impact of the shock , the evidence contradicts conventional wisdom that external financing may help countries smooth consumption or temporarily adjust to economic shocks. While longer term debt may also be pro-cyclical, such response is more pronounced in the case of short-term debt (World Bank,2000:159). No one knows whether the trend of increasing short-term flows to developing countries will last since debt due to private creditors fell by about $2.7 billion in 1999. This was, however, offset by a rise in debt from official sources reflecting increased support by multilateral institutions.

A New Kind Of Debt?

From the foregoing discussion, it is clear that the Latin American region has been caught in the throes of an ever increasing debt burden. In the 28-year period 1970-1997, the external debt of developing countries grew from $68.4 billion to just over $2.7 trillion, an increase of more than 2300 percent. Debt service payments increased by 2118 percent to exceed $220 billion by the mid-1990s.

It is also clear that coupled with some of the factors at play during the 1980s like falling interest rates, weaker-than-anticipated world commodity prices, reduced capital flows, excessive borrowing to finance economic growth continued while Latin America's indebtedness problem worsened. In Latin America, debt indicators have worsened as aggregate dollar-based GNP due to depreciating currencies and weak growth. The ratio of external debt-to-GNP rose to 46.2 percent, the highest level for this decade and second only to Sub-Saharan Africa. Though the ratio of debt-to-exports fell from 211 percent in 1998 to 195 percent in 1999, it remains above the 1997 levels. Debt service as a share of exports rose to more than 35 percent, the highest level for the 1990s (World Bank, 2000:197).

There are, however, some additional factors at work during the 1990s. Especially, it should be noted that the basic structure of debt in the region has changed dramatically, and in this sense one can conclude that the region faces a "new " kind of debt – large stocks of debt with shorter maturity dates and an ever expanding potential for plunging the region into financial crisis. World Bank data confirm this association between excessive growth in short term banking debt and subsequent financial crisis. In both cases, there was a rapid shortening of maturities of international bank lending to developing countries prior to the crisis. There were also important differences however. Whereas the surge in short term lending in the 1970s, to a large extent reflected the recycling of petro-dollars that could not find higher returns in industrial countries; in the 1990s in contrast, the cyclical downturn in interest rates in industrial countries was only one of the driving forces behind the surge in lending. Second, lending in the 1970s was primarily from private banks to the public sector in developing countries for the purpose of financing fiscal deficits and state enterprises. The short term debt of the 1990s, on the other hand, went primarily to the private sector in developing countries and was largely intermediated by local commercial banks. Third, whereas in the 1970s international banks became highly exposed in terms of capital at risk in their lending to developing countries, international banks in the 1990s carried much less risk capital exposure. This was largely the result of their divestment of such risks during the 1980s, but also because of BIS prudential banking regulations and in part, the substitution of bonds, equity and foreign direct investment flows for bank loans.

The debt is also "new" in that it exposes the domestic banking systems to significant currency and liquidity risks through their short-term borrowing in foreign currency and their onward-lending to domestic corporations to finance longer term investments. Though the stock of debt is mainly in the form of commercial bank debt (a similarity with the 1980s), there has also ben a rise in debt from official sources reflecting increased support for countries in crisis; a departure from the position towards the end of the 1980s when international financial institutions such as the

International Monetary fund (IMF) and the World Bank held developing countries responsible for the repayment of their own debt, and tried hard to keep multilateral debt relief off the debt relief agenda.

Options For Further Debt Relief

Despite growing debt, Latin America needs take certain safeguards in order to reduce its vulnerability to financial crises and similar external shocks, as well as to extricate itself from the stranglehold of ever increasing external debt obligations. There is not enough space to go into all of the possible solutions to the external debt crisis in Latin America. Nonetheless, it is worth discussing some of the major ones.

(1) Adopt a Strategic Approach to Debt Management

Having noted that developing countries are particularly exposed to the volatility of global markets because of their large stock of foreign currency liabilities, there is cause for concern that 70 percent of sovereign borrowers do not hedge their interest on their exchange rate exposures. This was revealed by World Bank data from a recent survey. It was also shown that outstanding external public and publicly guaranteed liabilities of developing countries are currently more than two and a half times their international reserves. Sixty percent of these liabilities are at floating interest rates and 20 percent of overall liabilities (including those of the private sector) are short-term, with a maturity of less than 1 year.

Latin American countries need to adopt a more strategic approach to managing the region's debt, following the lead of Argentina, Brazil and Colombia. In fact, the arguments in favor of active liability management are compelling: diversifying the portfolio, improving credit ratings, and making timely debt service payments all lead to lower borrowers costs. While each borrower is unique and driven by a different set of risk preferences, there are several common principles that govern this type of debt management and the adoption of such an approach has several advantages.

The primary goals of a strategic approach to debt management are:-

(i) improving credit ratings, limiting the impact of volatility in global markets, maintaining access to international capital markets, and minimizing borrowing costs.

(ii) The countries using this strategy need to be acutely aware that the perception of creditworthiness by foreign investors plays an important role in determining the availability, cost and sustainability of capital. They must also understand the importance of communicating with the markets and the need to regularly make information available, not only about the general economic situation of the country, but also its current financial situation and its policies, to attract investors.

(iii) To cushion the impact of market shocks and avoid the need to issue debt when the markets are unfavorable, liquid reserves are maintained at a level equivalent to one-quarter to one-third of annual external financing requirements.

(iv) The vulnerability to large stocks of short-term debt , which was a distinctive feature of the Russian crisis, and which is now a feature in Latin America is addressed, greatly reducing the rollover risk. Argentina has been particularly successful in this as short term debt accounts for just 3 percent of total debt , or less than 1 percent of GDP.

(v) The sources of financing are diversified so as to increase the number of both domestic and foreign investors that hold the external debt and thereby improve the opportunity for access to all markets.

(vi) The use of guarantee schemes is restricted so that the level of external contingent liabilities is constrained and the likelihood of the government having to absorb significant voloumes of "private" debt is absorbed (World Bank:1999:85).

2. Seek out more opportunities for Debt Forgiveness, especially write-offs

In considering possible lines of action, official bilateral debt and multilateral debt are best considered separately. Taking bilateral debt first, the possibilities include:-

(i) Increasing the percentage of debt reduction available on non-concessional debt from the Naples maximum of 67 percent. President Clinton must have realized the need for this when in a speech to finance ministers and central bankers at an annual meeting of the International Monetary Fund and the World Bank, he pledged to forgive all (100 percent) non-concessional debt owed to the United States by 36 of the world's poorest countries.
Simply put the President noted that "unsustainable debt is helping to keep too many poor countries and poor people in poverty". The United States in good conscience could not ask impoverished nations to choose between making interest payments on their debt or investing in their children's education. Poor countries owe the United States some $5.7 billion, including $21 billion from so-called concessional loans granted at interest rates of 1 percent or less, and $3.6 billion from non-concessional loans extended at market rates. The relief is hinged on promises that the money saved on debt payments would be well-spent alleviating poverty at home (Hunt, 1999:5). Some of the Latin American countries that will benefit from this initiative include Bolivia, Honduras and Nicaragua. Other Latin American countries should seek this form of debt relief, widely believed to be the most effective way to break the shackles of poverty, hunger and disease burdening millions in poor countries. Other developed countries should also make it their highest priority to share their prosperity with needy nations not only through debt forgiveness but through trade, technology and investments in education and healthcare. .

(ii) **Dealing with accumulating arrears to non-Paris Club creditors** through buy-backs and swaps, following the example of commercial debt deals or by offering non-Paris Club creditors equivalent relief on their own debts in return for writing off their loans. During 1999, major progress was made in debt reduction in Latin America through the Brady exchange and buy back operations. Seven debt restructuring agreements between debtor countries and their commercial bank creditors were concluded, restructuring $7.1 billion in debt and reducing outstanding debt by $2.7 billion.

Among low income countries, Guyana bought back $55.9 million at an average price of 9 cents per dollar of the

principal debt (pipeline debt)[1] in a deal; supported by the IDA Debt Reduction Facility. Some $34.4 million of eligible commercial bank claims was extinguished. Other Latin American countries benefitting from this facility were Argentina which swapped $129 million of Brady Bonds; $84.1 million of discount bonds; and $45 million of par bonds, Brazil, Mexico and Uruguay. Brazil in 2 swap operations retired $4.2 billion of Brady Bonds. The first resulted in savings of about $1.7 billion, and the second when Brazil issued a $2 billion 10-year global bond in exchange for 42.7 billion of Brady Bonds, net present value savings was $200 million, and an added $570 million was released in collateral. Mexico retired some $1035 million of Brady bonds; and Uruguay swapped $96 million of Brady Bonds for $85 million of 30-year global bonds at an interest rate of 195 basis points above the US Treasury Rate resulting in net present value savings of more than 410 million (World Bank, 2000:157-157).

(iii) Widening the scope of Paris Club negotiations by finding ways of bringing non-Paris club creditors within collective negotiations or of securing their agreement to provide the debt reductions comparable with those agreed by the Paris Club (ODI, 1995:4).

(iv) **Reducing the costliness to debtors of institutional arrangements.** Ideas here include simplifying the negotiation of the bilateral agreements which follow a Paris club agreement; shifting the forum for debt discussions to donor meetings which can take a comprehensive view of a country's need for financial assistance, including aid and debt relief.

With respect to **multilateral debt**, the options can be summarized as follows: (a) continuing to refinance past loans on more concessional terms, subsidized from bilateral resources and augmented by special bilateral assistance in difficult cases. (b) same as for (a), but with greater use by the principal multilaeral creditors (IMF and World bank) of their own resources to subsidize refinancing, as in the HIPC Initiative which was adopted to provide debt relief that is "broader, deeper and faster". This new framework has a number of changes which will benefit debt-strapped countries: lowering the maximum ratio of net present value of debt to exports to a fixed level of 150 percent; lowering the ratio of net present value of debt to fiscal revenue to 250 percent, the export to GDP ratio to 30 percent, and the public revenue to GDP ratio to 15 percent (all levels viewed as more sustainable ones). The Enhanced HIPC Initiative also promises to achieve better results in poverty reduction than d id past debt relief programmes. However, this initiative requires the review of all countries for debt relief as well as the support of all donors to maintain new aid flows alongside debt relief (the principle of "additionality") to the poorest countries. If there is any initiative that requires more than lip service, this may be it.

(c) abandonment of the "preferred creditor" status of multilateral creditors, making their past loans eligible for rescheduling or write-off (ODI, 1995:4).

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[1]Pipeline debt for Guyana consists of debt under the External Payments Deposit Scheme (EPDS). The scheme required all requests for foreign exchange for payment of commercial arrears to be deposited with the central bank in equivalent Guyana dollars (World Bank, 1999:157).

Conclusion

The debt crisis of the 1980s has come and gone in the high-income countries. However, its effects linger on as a cancer in Latin America and other parts of the developing world. Though it is difficult to undo what this crisis has imposed on peoples in these parts of the world, it is necessary for all involved to continue to work diligently for the success of the structural changes that have started and which will, over time, reduce the extent of the ongoing burden. The sooner steps are taken to resolve it, the more stable our world would be.

Meanwhile the affluent world must take major responsibility in assisting the poor out of this dilemma. Developing countries continue to struggle on the economic front and it is striking to note that so many of them countries especially in Latin America have looked at their future and have decided to continue to bear the economic costs and burdens of long-term macro-economic structural adjustment and other reforms. One must applaud this current willingness to accept further costs of adjustments.

However, the determination of these countries deserves an equal commitment by external donors. Although creditors have provided increasingly concessional terms for the severely indebted countries, they have not fully come to terms with their limited debt servicing capabilities. The latest Naples terms have been designed to facilitate final debt-stock reduction but these do not provide the desired exits from the rescheduling process. There is still a need for greater debt relief on a case-by-case basis.

However, this is not a panacea for poor indebted countries. Reductions in outstanding claims would release resources and improve the investment climate. Bit it is domestic policy which in the end holds the key to their future prospects. Specifically, alongside measures to reduce total external indebtedness, there must be a greater understanding of the links between capital surges and crisis to assist countries in managing attendant risks of doing business in the global arena. There must also be increased interest in policy measures designed to improve the safety and soundness of domestic banking policies. Finally, the threat of future crises should focus the attention of governments on building and adequately funding domestic safety nets for the poor. There is reason to hope that developing countries will finally realize more of the promised benefits of access to global capital markets, while suffering fewer of the associated risks.

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