EUROPEAN PARLIAMENT

EUROPEAN PARLIAMENT DELEGATION

for relations with

THE UNITED STATES

24th Meeting of Delegations

7 - 9 January 1985

BRUSSELS

INFORMATION NOTE

on

The Latin American Debt Problem

drawn up by the

Directorate-General for

Research and Documentation

DIRECTORATE-GENERAL FOR COMMITTEES
AND INTERPARLIAMENTARY DELEGATIONS

19 December 1984

PE 94.636

The Latin American Debt Problem

The Debt

At the end of 1983, the total external debt of Latin American countries amounted to $ 336 bn, or nearly half of the total LDC debt estimated at $767 bn. The main debtor countries were Brazil ($94 bn), Mexico ($91 bn), Argentina ($43 bn) and Venezuela ($35 bn). After the double-digit growth rates of Latin American debt in the 1970s, total external debt increased only by 5% in 1983 and is projected to rise by scarcely more in 1984 (Table 1)

The underlying causes of the debt problem can be listed broadly as follows :

- External events, such as stagnation in the OECD area, high US interest rates, reduction in commodity prices, which led to extremely high debt-to-export ratios for the Latin American countries (Table 2).

- Domestic policies in Latin America, such as import substitution, exchange and interest rates, political uncertainties which hindered the export sector and triggered massive capital flight from the region.

- The relative ease with which Latin American countries and LDCs in general were able to obtain financing from commercial banks and the ensuing failure to assess properly debt-servicing capacity of the of the borrower countries (Table 3)

Mexico and Argentina ran into difficulties in mid-1982, after which the crisis spread to several countries.

Improvement

In the past two years, a number of major debtor countries have made progress, not only towards resolving their own debt problems, but also towards defusing the crisis atmosphere prevalent two years ago, concerning the LDC ability to service debts out of actual or prospective exports (Table 3).

The greatest improvements have been registered by the two largest debtor countries, Brazil and Mexico. Growth in industrial countries, especially the United States, has made it possible for debtor countries to expand exports and increase surpluses on merchandise and non-interest services.[1] The trade surpluses of Mexico and Venezuala may be sufficient to cover all their interest obligations and Brazil's interest payments coverage should exceed 80% (Table 3).

The region's external adjustment has been remarkably fast, at first through import cutbacks and import substitution, and helped subsequently in 1984 by strong US demand.

The import cutbacks were accompanied by reductions in economic activity and living standards. For some countries these reductions rivaled those of the 1930s, and they still pose significant political and social risks.

Economic growth has resumed in Latin America, although within a modest range of 1% to 3%. For 1985, a higher economic growth is forecast averaging about 3.5%, with Brazil achieving perhaps 5% (Table 5).

Another area of improvement is reduced capital flows. Capital flows was a major factor in the rapid build-up of external debt in several countries - notably Argentina, Mexico and Venezuela. Given the fact that foreign commercial banks will not extend substantial new loans for some years to come, it is important for sustaining economic growth to find other than bank funds, especially the large amounts of assets abroad belonging to their own residents.

----

1) Almost 85% of Latin American export increase went to the US market (Table 4).

The combination of improved trade surpluses and reduced capital flows has enabled Mexico, Brazil and Venezuela to build up their foreign exchange reserves; these three countries can look forward to a recovery of their real per capita incomes to pre-crisis levels within five years, provided that export performance remains good and debt growth is limited.

Rescheduling

Several rescheduling operations have taken place in 1984 between international banks and debtor countries, which implement adjustment programmes. This was done case by case, applying the, so-called, 'Philadelphia' formula[2], which was drafted at the 5 June 1984 bankers meeting in Philadelphia and which was taken up at the London Economic Summit, 7-9 June. The Latin American debtors met several times in Quito (January), Cartagena (June) and Mar del Plata (September). A 'debtors' cartel did not emerge, because the magnitude, composition and terms of the debts vary from one country to another. The debt issue, however, has been 'politicised' and debtor countries of the region now have periodic consultations on debt problems.

Debt restructuring took place with Mexico on more favourable terms to the borrower with an option for non-US banks to switch partially their dollar denominated loans into another convertible currency. Mexico has agreed to the monitoring of economic performance by the IMF. A similar debt refinancing for Argentina was announced in December 1984 with possible IMF and US Treasury standby or bridging loan facilities.

An agreement on multi-year rescheduling has also been reached in principle with Venezuela (without IMF programme), and Brazil is expected to begin talks on a multi-year arrangement soon.

Problem Countries

- Argentina's debt-to-export ratio of 405% is the highest concerning LDC debtor countries; fiscal, monetary and wage policies have led to hyper-inflation (550%) and discouraged investment in export-

----

2) The 'Philadelphia' formula, applied to Mexico first, involves rescheduling the maturities of several years, with lower interest rates, longer repayment periods and monitoring by the IMF.

orientated and other productive activities. Much will depend upon the economic programme for 1985 and on the creditor banks' financing package, which has to bring interest and trade payments up to date.

- Peru's access to IMF financing has been interrupted because the public sector deficit has far exceeded IMF targets. Peru suspended interest payments last June. It is unlikely that it will resume them before the general elections of 15 April 1985.

- Colombia has pursued expansionary domestic policies at a time of reduced export earnings. Its foreign exchange reserves have been eroded and debt-servicing difficulties will be difficult to avoid.

- Chile's austerity programme, in compliance with the IMF, has not resulted in improvement of the balance of payments. Its current account deficit has been widening during 1984, partly because of weak copper prices.

Outlook

Economic model simulations appear to indicate that OECD economic growth is the most important factor for Latin American export growth. An increase in the United States interest rates of 2% would contribute to a current account deterioration of all LDCs of about 6 to 7 bn dollars.[3] Such a rise in interest rates, however, does much less damage than a similar percentage point drop in the OECD growth rate.

Oil prices are significant for individual countries (Mexico, Venezuela, Colombia), but the benefits for some countries are offset by losses for the others.

The effects of a possibly depreciating dollar appear to be ambiguous and to be different from one country to another.

----

3 Commission of the European Communities, Annual Economic Review 1984-1985, November 1984, Ch. 2 p. 26-29

Latin America's long-term growth potential does not only depend on industrial countries' demand, but also on domestic policies aimed at creating a favourable climate for investment and exports.

References

Morgan Guaranty, World Financial Markets

- October/November 1984, "The LDC debt problem - at the mid-point".
- August 1984, "Currency diversification for LDC external debt".
- July 1984, "Stabilization policies in Brazil".
- May 1984, "Mexico: progress and prospects".
- September 1983, "International debt: progress report and the tasks ahead".
- June 1983, "Global Debt: Assessment and long-term strategy".
- February 1983, "Global Debt: Assessment and prescriptions".

Latin America Weekly Report

- 7 December 1984, Finance Argentina, Peru, Colombia, p. 7.
- 16 November 1984, Finance, Peru, p. 5.
- 7 September 1984, Debt Posturing, p. 1.
- 3 August 1984, Finance Mexico - DM as hedge against dollar, p.5.
  Region's allies in US Congress, p. 9.
- 29 June 1984, Cartagena, p. 1.
- 15 June 1984, Philadelphia, p. 1.
- 2 June 1984, Debtors' Cartel, p. 1.

The Economist

- 15 December, Argentina, p. 52; Peru, p. 65.
- 8 December, Argentina, p. 89.
- 17 November, Chile, p. 86.

Table 1

Gross external debt (billions of dollars, at end of year)

	1983	1984 (forecast)
Argentina	43.4	45.0
Brazil	93.6	102.0
Chile	18.6	20.5
Colombia	11.2	11.7
Ecuador	6.9	7.1
Mexico	90.6	94.9
Peru	12.8	14.0
Venezuela	34.9	35.0
Sub-total	312.0	330.2

Table 2

Debt-to-export ratios (gross external debt as percent of exports of goods and services)

	1983	1984 (forecast)
Argentina	435	405
Brazil	366	331
Chile	375	394
Colombia	247	259
Ecuador	246	241
Mexico	317	293
Peru	312	338
Venezuela	203	192
Sub-total	327	310

Table 3

Interest payments coverage(percent of interest payments on external debt covered by surpluses on trade in goods and non-interest services)

	1982	1983	1984 (forecast)
Argentina	52	55	67
Brazil	- 30	33	81
Chile	0	41	13
colombia	-153	-188	- 89
Ecuador	- 47	85	73
Mexico	57	156	132
Peru	- 58	5	25
Venezuela	- 17	208	110
Sub-total	5	86	87

A negative number indicates a deficit on trade and non-interest services.

Table 4

Industrial-country imports from Latin America

	$ billion	% growth
United Stages	9.74	27.8
Canada	0.14	4.5
Japan	1.07	17.5
France	0.15	4.7
W. Germany	0.95	19.6
Italy	- 0.60	- 16.0
United Kingdom	0.17	9.5

Changes in annualised value of imports 1984 year to-date, versus second half 1982.

Table 5

Real GDP growth (percent per annum)

	82/83	1984	1985 (forecast)
Argentina	- 1.3	3.0	2.0
Brazil	- 1.1	2.5	5.0
Chile	- 7.8	5.5	1.0
Colombia	0.9	2.0	1.0
Ecuador	- 0.8	1.0	3.0
Mexico	- 2.6	1.5	4.2
Peru	- 5.8	2.0	3.0
Venezuela	- 2.1	1.0	3.0
Everage	- 1.9	2.2	3.7

Table 6

Current account balances (billions of dollars)

	1981	1983	1984 (forecast)
Argentina	- 4.7	- 2.4	- 2.0
Brazil	-11.7	- 6.9	- 2.3
Chile	- 4.7	- 1.1	- 2.0
Colombia	- 1.9	- 2.7	- 2.2
Ecuador	- 1.0	- 0.1	- 0.2
Mexico	-12.5	5.5	3.9
Peru	- 1.6	- 0.9	- 0.8
Venezuela	4.0	3.7	0.5
Sub-total	-34.3	- 4.8	- 5.0

Source : Morgan Guaranty, World Financial Market, October/November 1984.