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Situation, Politics and Outlook of the Latin American Debt Permanent Secretariat, Latin American Economic System

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Situation, Politics and Outlook of the Latin American Debt Permanent Secretariat, Latin American Economic System

[The following document was prepared by SELA's Secretariat for the First Workshop Seminar Update on the Latin American Parliament SELA, held on July 9, 1997, at SELA's headquarters in Caracas Venezuela, within the cooperation framework established between both institutions.]

I. The Foreign Debt Situation.

A. THE DEBT VOLUME.

In 1996 the total debt paid by the 22 Latin American and Caribbean countries exceeded $600,000 million, that is, $60,000 million more than in 1994 (see Table 1). In truth, such increase was small compared with 1995 debt volumes, however these already reflected an increase over 1994 figures. This rise was due mainly to the increase in Mexico's debt following the 1994 financial crisis and, to a lesser degree, to Argentina's official and Brazil's private debt. A comparison with debt volumes of 20 years ago reveals that during that period the volume of the debt increased by 8.8%, making the foreign debt the region's main financial problem. On the other hand, in the five year period 1990-1994, twenty Latin American and Caribbean countries paid $174,000 million in interest on the debt.

In 1996 the relation between total interest produced and exports of goods and services for Latin America and the Caribbean as a whole was 14.5%, which is an improvement over the 23.5% percentage registered in 1990. However, this is due mostly to the growth in exports than to a decrease in debt servicing obligations.

B. FOREIGN DEBT STAGES.

An analysis of Latin America's and the Caribbean's long term debt reveals that it has unfolded along several stages during which the nature of foreign loans changed considerably.
Table 1. Latin America and the Caribbean: Total external debt payments\textsuperscript{a} (in millions of dollars) and the relation between total interest produced and exports of goods and services.

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From 1930 to 1975 Latin America received few international loans. Beginning in 1975 three stages can be detected which are the direct predecessors of the current foreign debt situation.

The first stage covers from 1975 to 1981 and it was characterized by the oil crisis, the recycling of petrodollars, the recession in developed countries and, up to the end of 1979, low international interest rates. As a consequence of this, Latin American countries had easy access to sizable and inexpensive loans from transnational commercial banks. Such loans were used differently depending on the country: Brazil, for example, used them to finance important industrial investments and Argentina financed capital flight. Beginning in 1980, interest rates increased enormously, exchange rates became overvalued in several countries, and the foreign debt of governments and the private sector grew excessively. This period ends with Mexico's 1982 crisis. When that country ceased to honor its debt servicing obligations, the voluntary flow of capital came to an end.

The second stage is that of the "lost decade" and covers 1982 to 1990. Its typical features were the change in the United States' monetary policy, world recession, and the deterioration of the terms of trade in Latin America and the Caribbean. It was marked by very high interest rates and drastic adjustment programs. In several cases banking crisis, devaluation and inflation took place (including hyperinflation in Argentina, Bolivia, Brazil, Nicaragua and Peru). During that period Latin America transferred abroad $220,200 million and between 1981 and 1990 the per capita gross national product accumulated fell was 7.5%.

The third stage began in 1991 and is marked by the renewed flow of capital to Latin America and the Caribbean. It resulted in a significant increase in the availability of foreign currency. In some cases, the overvaluation of local currency and the risks of volatility created some inconveniences. The low interest rates in the USA, which stimulated the flow of capital toward "emerging markets" and the trade and financial liberalization, as well as the privatization process in several Latin American markets, contributed to this process. The Mexican and Argentine crisis of 1994 and 1995 affected the situation significantly, however, the net transfer of resources continued, even if with much lower amounts than those of the previous period (between 1994 and 1996 an average of $13,000 million were transferred, compared with $29,000 million transferred annually between 1992 and 1993).
Table 2. Latin America and the Caribbean: Long Term Debt (in millions of dollars).

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<tr>
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The third stage effected a change in the main economic agents which today are the institutional investors (pension funds, insurance agencies, etc.); and high interest rates and the strength of the external sector determined capital movement. As Table 2 indicates, in the case of public debt with public security, the financial claims of commercial banks fell abruptly (between 1990 and 1995 these fell from $102,000 million to $34,000 million) and bonds increased from $76,000
million in 1990 to almost $200,000 million in 1996. Also, during that same period nonguaranteed private debt grew at a much higher rate than official debt and in 1996 outstanding amounts were made up in equal amounts by bonds (previously almost non-existent) and debts to banks.

The changes in the structure of long term debt are clearly evident in Table 3. In both the public debt and publicly guaranteed debt and the non-guaranteed private debt, bonds increased strongly and the role of commercial banks decreased considerably.

II. Debt Policies.

A. SELA's Plan.

The problem of foreign debt is one of the issues that determines the global economic policy of Latin American countries and as such it is one of SELA's constant preoccupations. During one of the most serious moments of the debt crisis, SELA convened a Regional Conference on Foreign Debt, held in June 1990 in Caracas, which produced a proposal to deal with this problem. This proposal stated that, bearing in mind each country's situation, the nominal value of all mid- and long-term debt principal with commercial, should be reduced substantially. To this end, the value of the debt in secondary markets, each country's development objectives and its payment capacity should be taken into account; payment of overdue debt would receive a similar treatment. As opposed to the numerous proposals originating from creditor countries, SELA's plan did not envision any conditionality aspect regarding countries "internal economic policies." Even though the proposal was approved by the governments participating in the Conference, it was never put into effect.


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aIncluded in the "Commercial Banks" heading.
B. THE BRADY PLAN.

Finally, the Brady Plan was adopted. It was announced in March 1989 and was carried out through individual agreements between the debtor country and creditor banks. In the agreements signed, creditor banks agreed to reduce or restructure at lower interest rates a developing country's outstanding debt, as long as that country initiated a macroeconomic adjustment program which generally included structural reforms. Banks selected the restructuring modality from a menu established in the agreement between the debtor government and the creditor banks. To facilitate its fulfillment, financing for collateral was made available by official or multilateral sources (IMF, World Bank, IDB and official donors, particularly Japan).

As a result of the Brady Plan the nominal value of the debt with commercial banks decreased through buybacks (as in the case of Costa Rica, Uruguay and Venezuela) and discounts, and its weight was reduced with bonds exchanged at their face value and with discounts on interests (as in the case of Argentina, Mexico and Venezuela). Nevertheless, in some cases debt increased with the new currency. In brief, in the aforementioned countries following the Brady Plan, the foreign debt decreased by one-third with regard to the nominal values (without counting costs), but increased by close to a quarter if the values of the bonds in secondary markets are taken as reference.

Presently, the Brady bonds are beginning to be replaced by other discount transactions, without collateral and with high interest rates. These involve interesting operations for the release of part of the zero coupon bond, due to the discounts that may be obtained, and to the commissions they originate for participating agents.

Between January and September 1996, Mexico replaced $3,600 million worth of collateralized Brady bonds with instruments without collateral and with high interest rates, with an average 22% discount. The difference between the nominal value and market values ($800 million) and the proportional discount of the Brady bonds collateral ($400 million) resulted in a $1,200 million savings. The two operations—for $2,400 million and for $1,200 million—have interest rates of 11.5% and 445 basic points over US Treasury rates, respectively.

C. RESTRUCTURING OF THE OFFICIAL DEBT.

During the last decade, several official debt (negotiated in the Paris Club) restructuring plans have been devised with a view to ease payments due by low-income and, in some cases, middle-income countries. This was the mandate of the Toronto (1988), the extended Toronto (1991) and the Naples (1994) meetings, which dealt with lower income countries. The low- and middle-income, highly-indebted countries were considered in the Houston meeting (1990). In September 1996, the Paris Club countries agreed on the Lyon terms according to which up to 80% of the bilateral debt of poorer indebted countries would be canceled.

D. RECENT NEGOTIATIONS.

During recent years Nicaragua, Honduras, Panama, and Peru renegotiated their foreign debt.

In December 1995, Nicaragua bought back 81% of its debt with commercial banks at 8% of its nominal value. In 1996, the Russian Federation canceled 90% of its bilateral debt in rubles, which amounted to $3,300 million. Likewise, Mexico ($1,000 million) and Germany canceled their debt.

Honduras and Guyana restructured their official debt within the Paris Club, according to the terms agreed upon in Naples which allowed for a 50 to 67% reduction of their bilateral debt.
In April 1996, Panama restructured $3,900 million of its debt with commercial banks, including $1,900 million in back interest. A menu of discount bonds or at a par bonds with reduced interest was established. The United States Treasury’s zero coupon bonds serve as collateral to at a par and discount bonds.

Peru negotiated its official debt in the Paris Club (July 1996) and with the Russian Federation (December 1996), as well as its commercial debts. In the negotiations with the Paris Club, Peru received the treatment granted to highly indebted middle-low income countries. It restructured payments on $5,000 million, with the totality of amortizations and interests accrued between April and December 1996, 85% accrued in 1997, and 50% or 60% corresponding to 1998. The Russian federation canceled 84% of the $1,000 million Peru owed it in due debt and interests. As for the agreement reached with commercial banks, it restructured payments on $8,000 million, which included $3.8 million in due interests. The agreement includes a buy back option for $2,483 million at 38 cents per dollar.

Currently, the HIPC initiative (for highly indebted developing countries) is being applied. This is based on international support for the reduction to sustainable levels of the foreign debt. In its application, the initiative envisions that sustainability may be obtained at three levels. In the first phase, the Paris Club grants a debt restructuring plan along the terms agreed in Naples (up to 67% reductions), the other bilateral and commercial creditors grant a similar treatment and multilateral organizations support the adjustment programs. If this were not enough to insure sustainability, reductions would reach up to 80% and donors and multilateral institutions would increase their support. The World Bank established an HIPC Trust Fund and endowed it with $500 million as an initial contribution to the initiative. The IMF will participate through a special extended structural adjustment facility. The Paris Club has agreed to go beyond the Naples terms and offer reductions of up to 80% of the debt. The World Bank and the IMF have estimated that the full implementation of the initiative will represent a $5,500 million debt reduction. Forty-one countries could benefit from this initiative, and, in principle, four of these countries are Latin American: Bolivia, Guyana, Honduras and Nicaragua.

III. Outlook on the Foreign Debt.

The foreign debt will continue to be one of the main problems of global finances, economy and politics. However, it is probable that important changes will occur in debt treatment, if current trends consolidate, or if changes occur in the political decisions of debtor and creditor countries.

A. THE POLICIES OF CREDITOR COUNTRIES.

Today, creditor countries’ and the IMF’s policies are more flexible than in the past. This is perhaps due to four main issues. In the first place, the bulk of the debt is in bonds and therefore the most important creditors are the bond holders, who are mostly institutional investors (pension funds, insurance companies, mutual funds, trust funds, etc.). Commercial banks’ percentages are decreasing (between 1980 and 1996 their quota fell from 63% to 18%, while bonds increased from 5% to 47%). This change in the nature of the creditors may have important political consequences. When the debt was with banks, a generalized default on payments could cause the international financial system to crash. Today, even though institutional investors are a fundamental part of that system, their hold-
ings are sufficiently diversified and fluid as to withstand the fall of one title. Another change is the end of the privatization process in the majority of Latin American countries (with the exception of Brazil), in which external creditors played an important part. The third factor is the worsening of social conditions following the adjustment programs, which could become even more serious if countries must allocate a substantial portion of their income to debt payments. A fourth issue is that for commercial banks foreign debt operations (such as reconvertions, buy backs and advance payments) represent an importance source of new commissions, given the high amounts they refer to.

The IMF appears to have adopted a more flexible stance, perhaps due to the above mentioned factors. It is possible that once adjustment programs are monitored in details and the ownership of public enterprises becomes private, those processes may not exert much influence. Causes may weaken or disappear once consequences acquire their own dynamics. The IMF itself raises the possibility of an "involuntary restructuring" of the foreign debt when the debt servicing capacity has deteriorated to such an extent that there are few possibilities that an economic adjustment program with official financing may reinstate financial stability with a certain speed, even with a drastic compression of domestic absorption and a substantial devaluation. Countries, then, may resort to an involuntary restructuring of their external debt. Such restructuring may involve a lengthening of time limits and interest rates reductions, or debt reduction operations. This process "is necessarily ad hoc and with uncertain results." It foresees a struggle between bond holders and debtor countries: bond holders may seek compensations on an individual or coordinated basis, by attempting to appropriate debtors' assets or threatening to break their trade and payments system. However, from the point of view of debtors, there may be sound economic and political reasons for an involuntary restructuring based on economic estimates that foresee greater financial costs in the future, against a ratio and deep internal economic adjustments.

B. The Policies of Debtor Countries.

To the extent that debtor countries have access to new loans and several national currencies are overvalued, it is unlikely that countries will adopt questioning measures. The situation could change if capital flows revert or decrease, as occurred during the second half of 1980 when serious fiscal and external crisis caused significant difficulties in several countries.

In the 1980s, negotiations on the foreign debt were carried out at the bilateral level. Creditors exerted great pressure in order to avoid joint action by debtor countries. In turn, many debtors believed they were better off negotiating separately. As a result, creditors, who did join efforts ended up dictating policies.

Debtor countries now face the possibility of improving their negotiating position, either in multilateral fora or through market prices debt buy-back strategies. Pressure could be exerted in international fora to obtain better conditions. One possibility would be an extension to other countries of the Naples or Lyon terms in the Paris Club, and HIP terms with commercial banks. Moreover, market prices buy-back strategies could be explored, considering that bonds' prices depend to a great extent on debtor countries' policies.

In summary, the relative importance of the main agents (bondholders and commercial banks) has changed, the outlook of developed countries and multilateral financial institutions is different, creditors have dispersed, and international liquidity has increased. A new outlook exists, therefore, regarding the foreign debt which could allow for new proposals.