Latin America's Debt:
Deepening Underdevelopment

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The debt crisis continues to constrain economic growth and development in Latin America. Peadar Kirby, a journalist specialising in Latin American affairs, examines the human cost for the people of Argentina, Peru and Brazil of the debt crisis, the role of industrialised nations and their response to appeals for debt relief.

Introduction

> "For the majority of the continent's poor the problem is not the debt; it is their countries' overall political and social structures . . . The question is not whether to pay the debt; it is how non-payment might influence political and economic structures. What the people of Latin America really need are concrete alternative economic programmes and policies." – Dr. Javier Iguiñiz, economics professor at Lima's Catholic University.[1]

When Mexico suspended payments on its foreign debt in August 1982, the developed world's bankers held their breath fearing a collapse of the world financial system. In the intervening five years most Latin American countries have lurched from crisis to crisis, finding no solutions that might permit sustained economic growth. Yet, for the world's large banks, multilateral lending agencies and major creditor governments the fears of August 1982 have receded; if no lasting solutions have been found, at least the major banks have ensured not just their survival but also their profits. As the Massachusetts Institute of Technology economics professor, Rudiger Dornbusch, has put it: "Today, real wage cuts in debtor countries assure the trade surpluses and dollar earnings that keep bank stockholders in the black."[2]

For the countries of Latin America and the majority of their peoples, the foreign debt crisis is yet another symptom of their continuing failure to find a model of sustained development to satisfy the basic needs of more than a small elite. The very response of the debtor countries themselves is an eloquent reminder of this failure. They had the potential, through a co-ordinated debt repudiation, to cause severe damage to an international economic order which has increasingly impoverished them. Yet, they baulked at such a move, partly because they feared it could make their situation even worse. Back in the 1930s, however, with debts which were not eating up as high a percentage of export earnings as are those today, many Latin American governments did unilaterally suspend payments. Their more cautious response on this occasion indicates their greater integration into the international economy but also the failure to fashion a model of development in the light of which they could evolve a coherent debt strategy, containing the social damage caused by debt repayments and limiting their negative impact on economic development.

The greater dependence of the region today is indicated by the political and economic dominance of the United States. The commercial banks, no matter how large, can only threaten a cutoff of further loans and credits as a way of ensuring their debts are serviced. In recent years, most debtor countries would have saved far more by debt repudiation, at least in the short-term, than they gained through new loans. When backed by the political will of the US administration, however, the banks and the multilateral agencies are in a far more powerful position not only to demand their debts be paid back, but even to dictate to their debtors the internal economic policies they must implement as a condition for debt rescheduling. This remains true notwithstanding the measures being taken by major creditor banks to protect themselves against defaults. Furthermore, local elites, who have often benefitted from their countries' indebtedness, have been extremely reluctant to challenge their creditors. In this sense, the debt issue has from the very beginning been a political rather than a financial problem, an expression of power relationships at a world level.

Conventional view

According to the conventional view, the fundamental cause of Latin America's $370bn debt lies in the growing fiscal deficits incurred by these countries in the 1970s as governments resorted to high levels of foreign borrowing to ride out the effects of the international oil price rises in 1973 and 1979. (Even in itself, this analysis overlooked the fact that two of Latin America's four largest debtors, Mexico and Venezuela, are major oil exporters while a third, Argentina, is almost self-sufficient in oil.) The austerity programmes imposed by the International Monetary Fund (IMF) on almost all the region's debtors as a condition for further loans, involved measures such as reducing government spending, opening the economy to foreign competition and cutting back on local consumption in order to reduce imports and improve the competitiveness of exports.

Creditor banks and the multilateral agencies, with the firm backing of the Reagan administration, have followed a consistent strategy of country-by-country rescheduling deals. Viewing it as a series of individual book-keeping problems rather than as a regional political and economic problem, the banks have traded slightly easier repayment terms for the implementation of IMF austerity programmes by the debtors. Since the Mexican default in 1982, the number of debt reschedulings has increased enormously. From an average of some five per year between 1975-80, it jumped to around 30 per year between 1982-86. The faithful implementation of the IMF economic programmes imposed as part of these reschedulings led, as expected, to a catastrophic downturn in the region's economies, especially in 1983. According to IMF figures, per capita GDP in Latin America and the Caribbean fell by 7.5 per cent between 1980 and 1985.[3] Focussing on the balance of payments, however, supporters of these harsh measures pointed to a sharp upward trend in the region's trade balance, from a $6bn deficit in 1982 to a $22bn surplus in 1983. Real economic growth in the domestic economies would follow, they argued.

By 1985, such optimism was on the wane as evidence of continued stagnation among the debtor countries could no longer be blamed either on domestic policies or on unfavourable international conditions since growth in the OECD countries had picked up. For most countries, their trade surplus indicated not an export-led growth but rather the depth of their recession as they cut back on all but the most essential imports. These fell by almost 40 per cent between 1981 and 1983.[4] Far from curbing inflation, countries implementing IMF programmes experienced higher rates than before or higher than countries not implementing such programmes. Furthermore, studies have pointed to the effects of IMF programmes in redistributing income away from lower-income groups and towards the dominant elites.[5]

The human cost

The burden of repaying the region's huge foreign debts has fallen on the people. According to a January 1987 report by the UN Economic Commission for Latin America and the Caribbean (ECLA), the well-being of Latin Americans has deteriorated "to a point that could not have been imagined a few years ago, both because of its depth and the broad social spectrum affected." ECLA singled out the burden of debt repayments as the most important element impeding recovery.

A similar diagnosis dominated the deliberations of the 1,200 delegates who came together in Havana in July 1985 for the most representative gathering ever assembled to discuss the regional debt problem. They came from every Latin American country and represented a wide spectrum of opinion – conservative to radical political parties, trade union and peasant organisations, church leaders and academics, businessmen and journalists. The concerns which brought them together were well articulated in a letter sent to the conference by the Catholic archbishop of São Paulo in Brazil, Cardinal Paulo Evaristo Arns. Read out at the beginning of the four-day conference by the cardinal's representative, Frei Betto, the letter was again read out to the delegates at the closing session by President Fidel Castro himself.

Among other points, Cardinal Arns stressed:

> "There is no realistic way in which the Latin American and Caribbean people can assume the weight of paying the colossal debt incurred by our governments. It is not even possible to continue paying high interest rates at the expense of sacrificing development and well-being.
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> The problem of the debt is not just financial, but fundamentally political and it must be faced as such. What is at risk here are not the accounts of international creditors, but rather the lives of millions of people who cannot suffer the permanent threat of regressive measures and unemployment which bring misery and death."

For Latin Americans, the foreign debt burden is but the most serious symptom of recent development policies which have devastated their economies. These were implemented in country after country, usually under extreme right-wing military dictatorships in the late 1970s. Designed to re-structure local economies through opening them to free-market forces, their impact in different countries was aggravated by high military spending and, in some, failure to devalue. Following attempts in the 1960s to build up a diversified manufacturing base through an import substitution strategy, the application of radical free-market policies all but destroyed the fragile gains of the earlier period. The incoming civilian governments of the 1980s, therefore, inherited not only huge foreign debts, but, severely weakened economies in many cases. Furthermore, the already impoverished majorities were being forced to bear the burden. The differing experiences of Argentina, Peru and Brazil illustrate this.

Argentina

Argentina had been an early leader among Latin American countries in building up a protected manufacturing base in the post-War period. By the 1960s, this policy had run out of steam as falling receipts from its agricultural exports were not sufficient to support a largely inefficient local industrial sector. In a bid to diversify exports, the economy was opened to foreign investment. The country lurched through continuous unrest under numerous military governments until the 1976 takeover when the then military government determined on a policy of 'national reconstruction'. The Harvard-trained economist Martinez de Hoz was made Minister of Finance. In a bid to stabilise the notoriously unstable *peso* and to make Argentine industry more efficient, he embarked on a policy of radical, overnight liberalisation of the trade regime accompanied by severe wage freezes and military control of the powerful trade union movement.

The result was catastrophic. Local industry proved unable to compete against cheaper foreign imports while the reduction in state incentives for both industrial and traditional exports brought these almost to a standstill. By April and May 1980 a wave of bankruptcies had hit major industrial firms and banks. Real wages were estimated to have fallen by 50 per cent, severely reducing local demand. Furthermore, the government's policy of delayed devaluations and high interest rates fuelled financial speculation which further hit industrial investment. As one study of the period has concluded: "Argentina became indebted to finance with foreign currency a policy of economic openness that resulted in the massive destruction of its productive capacity and the disintegration of its industrial production . . . a massive desubstitution of imports; and the loss of foreign markets for its exports."[6]

When the military took power in 1976, the country's foreign debt was \$8.9bn; by the time they relinquished it in 1983, it was \$46bn. Most of this increase came in the 1978-81 period, at the height of Martinez de Hoz's tenure of office. The borrowed money went to pay for increased imports, the huge surge in luxury tourism abroad by the elites and to service the existing debt. Furthermore, as recent studies have shown, substantial amounts left the country again in capital flight (cf below: "Exporting Capital").

For a country that boasted of its high living standards and liked to compare itself with the developed world, Argentina has suddenly had to admit to poverty levels equal to those of its neighbours. Government figures published in 1986 showed that production had fallen to 1973 levels while the National Census and Statistics Institute reported that 30 per cent of all Argentine familes are unable to satisfy their basic needs and 40 per cent of children under two years lack adequate nourishment.

Peru

In Peru it was the elected civilian government of Fernando Belaunde

Terry (1980-85) which implemented similar free-market policies, opening the Peruvian market to international competition, and inviting foreign capital on advantageous terms. These policies soon produced dramatic results which were further aggravated by the 1982-83 international recession. The ending of import bans and quotas and the reduction of tariffs opened the local market to a flood of imports, particularly machinery and industrial raw materials but also luxury consumer goods.

Manufacturing industry, which accounts for over 20 per cent of GDP, saw its output fall by more than a fifth between 1981 and 1983 and by 1984 it was operating at only 40 per cent of capacity. The impact of liberalisation plunged the textile industry, traditionally the backbone of Peruvian industry, into its worst crisis ever. Meanwhile despite generous tax incentives, multinational investment increased only briefly and by 1984 more dollars were being repatriated from Peru than were entering in new investment. The more profitable sectors of state-owned industry were converted into mixed enterprises (in some cases with the owners who had been expropriated by the 1968-80 military government) while the rest was starved of public investment. With the deregulation of the financial sector, currency speculation became the most profitable sector of the Peruvian economy. Continuing devaluations of the *sol* coupled with high domestic interest rates due to growing inflation ensured huge profits for banks and finance houses who could transfer capital from *soles* to dollars as suited them.

Under Belaunde the Peruvian debt burden became unsustainable. He inherited a debt of $9.6bn, most of it borrowed by the military government to pay for their ambitious development projects. Some 30 per cent of it, however, had gone into defence spending. Instead of cutting back on foreign borrowing, Belaunde put the country further in debt, looking for loans of $4bn in 1981 to finance his pet projects (chief among which was a road through the Peruvian jungle). Badly hit by a fall in world prices for the country's traditional raw materials exports as well as by the impact of the government's own policies on Peruvian industry, Belaunde had to resort to the IMF in early 1982. The Fund's austerity policies further deepened the recession. This proved completely counter-productive as tax revenue fell by one third in 1983, more than cancelling out any benefits resulting from the IMF-dictated government spending cuts. Despite negotiating the postponement of debt repayments with creditor banks and OECD and socialist governments in 1983-84, the administration had to return to the IMF in late 1983. Following long months of negotiations, an 18-month emergency stand-by package was agreed, involving an even more severe austerity programme. By the time the Belaunde government left office in July 1985, the debt had grown to almost $14bn while repayments due on it were estimated to equal 160 per cent of export earnings for that year.

It was ordinary Peruvians who bore the brunt of the government's economic policies and its desperate attempts to maintain repayments on the foreign debt. The impact of austerity measures in 1983 alone led to a 20 per cent fall in real wages that year. A World Bank report in 1985 concluded that "the overwhelming majority of Peruvians are markedly worse off than in 1970," laying the blame for this on "economically damaging reforms, and unsatisfactory economic management." Yet it is the poor who have suffered the most: the poorest 25 per cent have seen their income fall twice as much as those of the richest 10 per cent. Fr. Tom Burns, a US missionary priest working in a Lima shantytown who has testified before a US Congressional committee examining the debt problem, has written of the situation in Peru: "For the poor, 'austerity' has meant desperation . . . Between 1973 and 1983 the average fully employed worker lost close to 60 per cent of his or her buying power. Simultaneously, the number of fully employed workers dropped from 50 to 37 per cent of the workforce, and the unemployment rate increased to 8.8 per cent. As a result, in 1983 the average bread-winner was supporting eight others, as opposed to six in 1973, on a real income that had declined by 60 per cent."[7] Alongside the drop in the fully-employed workforce, which refers to workers with full-time jobs, the masses of underemployed have swelled as is evidenced by the huge numbers of street-traders who throng Lima's streets.

Brazil

During their long years governing Brazil (1964-85), the armed forces also radically restructured the economy, contracted the world's largest foreign debt and placed a severe burden on the majority of Brazilians. But far from destroying the country's fragile industrial base, the military's policies led to the growth of protected manufacturing sectors with heavy state involvement. The fruits of this policy can now be seen in the fact that Brazil is the capitalist world's eighth largest economy and the world's fifth largest exporter of arms. So successful has Brazil been in building up a local small-computer industry, through reserving the local market for wholly-owned Brazilian firms, that President Reagan has threatened retaliatory action if Brazil does not change the law and allow in US firms to compete in its lucrative internal market.

The cost of this policy for Brazil has been massive foreign indebtedness, made worse by the fact that the country depends heavily on imported oil and was therefore badly hit by the 1973 and 1979 international oil price rises. The country's buoyant growth rates of around 8 per cent in both 1985 and 1986, as well as its large trade surplus in both those years, however, place Brazil in a far more healthy position in terms of servicing its debt. Erratic domestic policies, as with the *Plan Cruzado* in 1986 which led to a consumer boom and severely reduced the country's trade surplus at the end of last year, are causing debt servicing difficulties. While not inconsiderable, the underlying strengths of the Brazilian economy look likely to enable current setbacks be overcome. Despite such difficulties, Brazil remains the only regional economy to emerge in a strong position from the years of military rule.

The main similarity between Brazil and its regional partners is that its restructured economy enriches a small elite at the expense of the majority of Brazilians. Even the government today admits the social consequences of the so-called 'Brazilian miracle,' as Bishop Mauro Morelli told me recently. "Our Minister of Finance has said on TV that there are six million children in Brazil starving, in an extreme condition of want. Public officials have declared that altogether we have 37 million children who are suffering some kind of severe need. Out of these some say there are seven or eight million running wild, loose on the streets who have no names, no family, no ties whatsoever," said the bishop. Meanwhile the clearest link between the debt and poverty is seen from the government's policy of exporting food to earn the foreign exchange needed to maintain debt payments. Brazil is the world's fourth largest food exporter while it is sixth on the list of countries with problems of malnutrition. This means that while production of foods like soyabeans, coffee or oranges for export has been rising, it has been at the expense of foods like rice, beans or yucca for local consumption.

Broadening the agenda

This social impact of the region's debt crisis, deepened yet further by the imposition of IMF austerity programmes, has forced the new wave of elected civilian governments to challenge the conventional analyses and resultant prescriptions forced on them by their creditors. From mid-1984, the region's eleven most indebted countries have come together in the Cartagena Group, seeking a regional solution to the crisis and focusing attention on the developed world's responsibility for it. The very fact of coming together at all in what many bankers feared could become a 'debtors' cartel', in itself challenged the case-by-case approach through which their creditors hoped to avoid a concerted challenge.

But it also marked a historical new willingness by the Latin American countries to examine the sharply deteriorating terms of the region's integration into the world economy.

One major factor in the increase in Latin American indebtedness in the 1970s was the flow of 'petrodollars' from the newly rich Middle Eastern sheiks into the world's large commercial banks. These banks, in turn, lent it on highly advantageous terms to developing countries who up to then had borrowed mainly from governments or from their multilateral agencies. Unlike the low, fixed interest rates given by the latter, however, the private banks lent at market rates. The steady rise in US interest rates and in the dollar itself due to the policies of the Reagan administration in the early 1980s, therefore, added substantially to Latin America's debt burden and was a major reason for the emergence of the present crisis. The US prime lending rate rose from 11 per cent in early March 1984 to 12.5 per cent in May and up to 13 per cent in late June.[8] Each rise of one per cent added approx. $2.5bn to the region's annual debt bill, then running at around $30bn. Again and again the Cartagena countries called for urgent action to stabilise and reduce interest rates to levels closer to their historic averages, and proposed measures to modify their impact on the level of debt repayments.

More significant, however, has been the emphasis at Cartagena Group meetings on the need for economic growth among debtor countries as the only way out of the debt trap. It is this which has brought to the centre of the debt debate in Latin America issues such as falling international commodity prices and growing protectionism in the developed world, since these are seriously inhibiting growth among debtor countries. These factors have more than offset any benefits from falling interest rates and the weakening dollar since 1986.

The debt crisis has been exacerbated by the sharpest drop in commodity prices such as sugar and cotton, tin and copper, wheat, maize and rice, since the second World War; prices have halved in real terms since the late 1970s and are now at their lowest levels since the 1930s. As most Latin American countries depend on one export commodity for over 50 per cent of their export earnings – Mexico, Venezuela and Ecuador on oil, Chile on copper, Bolivia on tin – this means they must increase production substantially simply to maintain 1970s income levels. While many different causes lie behind this crisis in commodity prices, commentators see little hope of any substantial improvements in the short-term.

Adding to Latin America's export problems has been the steady growth of protectionism in the United States and the EEC through such measures as quotas and quality standards. As well as finding traditional markets increasingly closed to them, Latin American producers are having to compete with subsidised US and EEC products, thereby undercutting the one competitive edge they had, lower production costs. For example, senior politicians in Uruguay have pointed out to me how these policies have severely damaged the basis of their country's traditional economic prosperity. Not only has the EEC closed off their traditional markets to them but it is able to sell subsidised products more cheaply to Brazil than can Uruguay, thus undercutting what should be the latter's natural market.

The debt crisis has, furthermore, led to a collapse in investment in the region. Private investors have been driven away by the serious economic downturn while bank loans have declined to the minimum necessary to roll debts over and maintain the fiction that they are still being serviced. From the middle of 1984 to March 1986, exposure for the nine major U.S. banks in Latin America fell by $1.6bn. Overall investment has declined by some 30 per cent compared to the late 1970s. Coupled with cutbacks in government spending, this adds up to a severe deterioration in the region's productive infrastructure which is bound to have lasting long-term effects.

Exporting capital

The end result of this spiral of decline provides the most ironic revelation of the ultimate beneficiary of the North-South interrelationship. For, with net resource transfers to Latin America falling from $49bn in 1981 to $4bn in 1985 while outflow in the form of profit repatriation and debt repayments steadily grew from $27.8bn in 1981 to $36.7bn in 1985, the region became a net capital exporter to the developed world. This net outflow has totalled more than $100bn over the past four years, more than the total net receipt of resources over the previous decade.

The Cartagena Group has made action on these structural imbalances by the developed world an essential part of the debt agenda. For example, the final declaration of the Montevideo meeting of the group in December 1985 demanded a reduction in interest rates and bank profit margins, limits on the net transfer of capital out of the region, a substantial increase in funds from multilateral development agencies, the elimination of protectionist measures by developed countries and a policy which would make debt repayments dependent on economic growth within debtor countries rather than on the implementation of free market policies. An example of the implicit free-market ideology inherent in the creditors' prescriptions is given by Fr. Peter Henriot of the Washington DC-based Centre of Concern. He points out that IMF programmes always ask for such things as labour code reforms or price increases for agricultural goods. "There are no demands for land reform, for attacks on domestic production monopoly, for international steps to limit the flight of capital or the financial machinations that accompany the international drug traffic."[9]

In part to deflect attention from this wider agenda, creditor banks have drawn attention to the issue of capital flight. According to a 1986 study by Morgan Guaranty Trust Company of New York, this legal or illegal expatriation of badly needed foreign exchange by private citizens in many Latin American countries constitutes a large part of the debts of Argentina, Mexico and Venezuela. If these large sums had not been spirited abroad, the study suggests, Argentina's debt would now be $1bn instead of $50bn, Mexico's would be $12bn instead of $100bn and Venezuela would be $12bn in the black instead of $30bn in the red. The US Federal Reserve Board estimates that over one third of the $252bn increase in the foreign debts of Argentina, Brazil, Chile, Mexico and Venezuela between 1974 and 1982 went into buying assets abroad or was deposited in foreign bank accounts.

In drawing attention to the extent of capital flight, banks pointed the finger back at debtor countries, urging them to take stronger measures to stem this flight. Furthermore, they justified their reluctance to lend more by arguing that this would simply fuel capital flight. But the argument is double edged as capital flight has now been exacerbated by the debt trap itself. At the very time debtor countries are most starved of funds, their elites are most determined to keep their private assets outside the country. And, as MIT economist Dornbusch has pointed out, the elimination of the withholding tax on non-resident holdings in the United States has facilitated capital flight. "Our banks are the chief vehicles for and beneficiaries of the capital flight," he said.

Garcia's stand

While the eleven Cartagena Group countries continued to encounter difficulties in coordinating and presenting a coherent agenda, the young and dynamic President Alan Garcia who took power in Peru in July 1985 gave more accurate voice to the feelings of many Latin Americans. Addressing the UN General Assembly in New York in September 1985, he presented the debt as "a conflict between the poor South of our American continent and the industrial, imperialist, and financial North." He described IMF letters of intent as "letters of colonial submission to the prevailing injustice. While the richest countries close their borders, we must open ours, destroying our industrial facilities and indebting ourselves to continue to buy from foreign industry".

He continued:

> "We say the International Monetary Fund does not have the moral authority to preach austerity in our country because during the seventies when it was necessary to place petrodollars in credits for poor countries, it promoted indebtedness. In those years, it was an accessory to waste, unproductive investment and the growth of public administration.
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> "The IMF also only demands austerity from the poor countries, favouring the most powerful nation on earth. Since the non-convertibility of the dollar was declared in 1971, the USA is the only country that can indefinitely issue currency to cover its own deficits. What has been the IMF's role in adjusting the American economy?"

Saying that "the Peruvian government has been elected by the people, and not by some financial cartel to satisfy its appetities," President Garcia characterised the basic option facing his country as "debt or democracy." He announced that his administration would reject the IMF as an intermediary between Peru and its creditors and would limit its debt repayments to 10 per cent of the country's export earnings. The initial results of this policy and the reactivation programme accompanying it, have been to reverse Peru's long economic decline. Domestic economists, however, wonder how sustained will be the reactivation.

Peru's move is the closest Latin America has come to challenging in any radical way the debt strategy followed by the banks, with the backing of the multilateral agencies and the US administration. As a result it has been declared ineligible for further loans. President Garcia has sought wider regional backing for his stand, cultivating President Raul Alfonsin in a particular way since the Argentine administration had, on a number of occasions, appeared willing to adopt a more radical stand. Bolivia, which had been the first country to declare a moratorium in a situation of absolute inability to pay in 1984, returned to the fold with a change of government in 1985 and began repayments again. The closest Garcia got to support from the region was a declaration from the Cartagena Group that every country was free to take whatever measures it deemed necessary to achieve economic growth. Ultimately, however, the international bankers can live with the Peruvian decision since its $14bn debt is insignificant compared to the large debtors; what was feared more was that it might prove an attractive precedent to the latter.

In February 1987 Brazil sent shock waves through the international financial system with its decision to declare an indefinite moratorium on half of its $106bn debt, the world's largest. The shock proved short-lived, since it quickly became obvious that far from challenging its creditors, it was simply establishing a bargaining position to force them to grant it new loans. Brazil has for long been pushing for a debt strategy that would involve, in the words of its former Finance Minister, Dilson Funaro, "mechanisms to resolve the crisis and not just formulas to administer it." But, while threatening action such as limiting repayments to 2.5 per cent of GDP, the country has stopped short of adopting a unilateral strategy and risking future loans.

'Divide and conquer'

Undermining the emergence of a debtors cartel, has been a clear strategy by the private banks and the IMF to pursue a 'divide and conquer' strategy. By offering ever more advantageous rescheduling terms to cooperative debtor countries while simultaneously threatening dire consequences on those who unilaterally limited their repayments, the creditors have managed to avoid the emergence of a concerted challenge to their strategy. The failure of this approach to offer any lasting solution to the problem, or even to facilitate a country's ability to service its debt, is well illustrated by Mexico's experience. As the country which, among the large debtors, has most faithfully followed its creditors' advice, it ended up in early 1986 in a worse crisis than it was in when it first declared its inability to pay in 1982.

Faced with this failure, the banks have been forced to adopt a new flexibility. This was evidenced by their willingness to conclude a rescheduling agreement with Brazil in 1986 without the intermediary of the IMF, and by agreements with Mexico in 1986 and Argentina in early 1987 which were both hailed as marking a new breakthrough. These offered substantially lower repayment terms and longer spreads than any previous agreements and, in Mexico's case, even built in a provision promising further loans in the event of a further drop in international oil prices, Mexico's main export. An agreement with Chile just days after Brazil's partial moratorium was announced in February, allowed for annual instead of half-yearly repayments, a further sign of greater creditor flexibility.

The Baker Plan, announced in October 1985 by the US Treasury Secretary, was seen by debtors as marking a new recognition that debt repayment demanded measures to stimulate economic growth, something the austerity packages up to then had not achieved. In itself, however, it marked no radical departure; all it did was to promise some \$30bn in new loans, most of it from the commercial banks. Furthermore, this new lending was designed to facilitate countries to make necessary structural adjustments through implementing free-market policies. Even this meagre promise, regarded with scepticism by many debtors, has been slow to materialise. In the case of the Mexican agreement, regarded as the first substantial result of the Baker Plan, some 100 of its 600 creditor banks proved so reluctant to loan yet more money that it took nine months to persuade them all.

Major pressure by the US Treasury Secretary and his former colleague in the Federal Reserve, Mr. Paul Volcker, have failed to persuade the banks substantially to increase their lending. Already smaller banks have been selling their loans at a loss and turning the problem over to the larger ones. Between 1982 and 1986, loan exposure to Latin America by smaller banks fell by 17 per cent. The larger banks have also been playing safe, reducing their exposure. The capital and reserves of the 24 largest US banks now almost equal their loans whereas in the early 1980s they came to only about half. But while the large banks seek to safeguard themselves against any default, they also continue to benefit from the massive inflow of debtors' funds and from capital flight. Citicorp, the US bank with the largest exposure in Latin America, made a 25 per cent return on those loans last year, making them more profitable than those to any other region outside North America itself.

Debt relief

As the Baker Plan is widely perceived both among debtors and creditors to have ground to a halt, more attention is being paid to a plan proposed by Senator Bill Bradley, a New Jersey Democrat, for partial debt relief. This, it is envisaged, would offer partial relief both of interest and of principal as well as new loans, but would maintain the case-by-case reschedulings which have characterised the creditors' handling of the debt. The financial world was further shaken into reality by the surprise decision of Citicorp at the end of May 1987 to increase its loan reserves by \$3bn, a move quickly followed by Chase Manhattan and National Westminster Bank in Britain. While commentators differ as to the precise implications of this dramatic development, they are agreed that it shakes the financial world into a new awareness of the seriousness of the debt problem. More than offering new relief to hard-pressed debtors, it looks set to boost such mechanisms as debt-equity swaps, giving even more control to banks over key sectors of debtor countries' economies. Furthermore, it underlines the fictional nature of most Latin American debtors' seeming solvency, achieved only through constant reschedulings. Other initiatives aimed at easing the problem include Japan's proposal to set aside $20bn in new loan funds for indebted countries and discussions in the United States of a new 'Marshall Plan' for these countries.

All these moves, however, simply underline the extent to which the agenda put forward by the debtor countries themselves has been avoided by the developed world. Appeals by Latin American presidents to the industrialised countries' annual economic summits for consideration of these wider dimensions of the issue have met with no effective response. The "constructive dialogue among creditor and borrowing countries" asked for by the presidents of Argentina, Brazil, Colombia, Ecuador, Mexico, Peru and Venezuela in a letter to the 1984 London economic summit has never taken place nor is there any likelihood of that happening as long as Mrs. Thatcher and President Reagan insist that the only solution to the debt problem is through reduced government spending and economic restructuring.

The outlook for Latin America is grim. Confronted by the firm determination of their creditors to ensure their own survival at all costs and by the staunch refusal of powerful governments, especially the US and British governments, to consider any wider reforms in the international economic order, the debt problem looks set to continue indefinitely, undermining the fragile democratisation of Latin America.

Footnotes

1. Interview with Iguiñiz in *Latinamerica Press*, March 29th, 1984.
2. R. Dornbusch, 'Dealing with Debt in the 1980s' in *Third World Quarterly*, July 1985, p.533.
3. *South*, January 1987, p.39.
4. IMF "World Eeonomic Outlook", April 1985, Table 24.
5. M. Pastor, Jr, 'The Effects of IMF Programs in the Third World: Debate and Evidence from Latin America', in *World Development*, Vol. 15, No. 2, 1987.
6. M. Diamond and D. Naszewski, 'Argentina's Foreign Debt: Its Origin and Consequenees', in *Politics and Economics of External Debt Crisis: The Latin American Experience*, Boulder and London, Westview Press, 1985, p.249.
7. T. Burns, 'Debt Crisis: It is the Poor Who Pay' in *Latinamerica Press*, March 29th, 1984.
8. R. Roett, 'Latin America's Response to the Debt Crisis' in *Third World Quarterly*, April 1985, p.233.
9. P. Henriot, 'International Debt, Austerity and the Poor,' unpublished paper, 1986, p.19.