UNITED NATIONS

ECONOMIC COMMISSION
FOR LATIN AMERICA
AND THE CARIBBEAN - ECLAC

1945-1985

Distr.
LIMITED

LC/L.332(Sem.22/2)/Add.1
26 April 1985

ENGLISH
ORIGINAL: SPANISH

Expert Meeting on Crisis and Development in Latin America and the Caribbean

Santiago, Chile, 29 April - 3 May 1985

CRISIS AND DEVELOPMENT: THE PRESENT SITUATION AND FUTURE PROSPECTS OF LATIN AMERICA AND THE CARIBBEAN

Volume II

THE ONSET OF THE CRISIS AND THE ECONOMIC POLICY RESPONSE: EFFECTS AND OPTIONS

85-4-560

CONTENTS

Page

I. THE ECONOMIC CRISIS 1981-1984 1

A. MAIN DIMENSIONS 1

B. EXTERNAL CAUSES 4

1. The international recession and the fall in the terms of trade 4
2. The high cost of external credit 5
3. The fall of the net capital inflow and the negative transfer of resources 5

C. INTERNAL CAUSES 7

1. The excesses of the policy of external indebtedness 7
2. The excessive expansion of domestic expenditure 9
3. Stabilization policies and the exchange-rate lag 10
4. The liberalization of the financial system and the rise in real interest rates 12

II. THE ECONOMIC POLICY REACTION 15

A. ADJUSTMENT POLICIES AND THE ADJUSTMENT PROCESS 15

B. THE RENEGOTIATION OF THE EXTERNAL DEBT 18

1. The first round of reschedulings 18
2. The second round of reschedulings 20
3. The third round of reschedulings 22
4. The process of rescheduling: achievements and insufficiencies 23

III. OVERCOMING THE CRISIS 26

A. REACTIVATION, ADJUSTMENT AND GROWTH: CONDITIONS AND POSSIBILITIES 26

1. The starting point 27
2. External conditioning factors 29
3. Adjustment policies 32

a) Exchange, tariff and export-promotion policies 33
b) Price and subsidy policies 35
c) Investment policies 37

Page

B. PRICE STABILIZATION AND THE EXPANSION OF PRODUCTION: RELATIONS AND POLICIES 39

1. The challenge of inflation 39
2. Lessons of the recent past 41

a) Why traditional stabilization programmes are a failure 41
b) The failure of traditional programmes: analytical implications 43

3. A programme of stabilization with expansion: basic lines 45

a) Simultaneous slackening of the growth rate of key prices 45
b) Consistency between the policy on key prices and monetary and fiscal control 46
c) Correction of price lags 46
d) Graduality versus shock 47

4. An expansive stabilization programme: instrumental aspects 48

a) The control of the nominal aggregate demand 48
b) Price and income policies 49

Notes 52

ANNEX: Statistical tables and figures 57

I. THE ECONOMIC CRISIS 1981-1984

A. MAIN DIMENSIONS

Since 1981 Latin America has suffered its most acute, prolonged, polyfaceted and widespread economic crisis since the great depression of the 1930s.

Viewed in historical perspective, one of the central and unusual traits of the crisis has been the large number of varied characteristics of the economies of the region which, in greater or lesser degree, have suffered its consequences. Another peculiar --and certainly no less alarming-- feature has been the magnitude of the deterioration exhibited simultaneously and persistently by most of the chief economic indicators. In fact, along with the decline in production, there was a fall in employment in most of the countries and a drop in real wages. At the same time inflation went up and the problems of the external sector increased and multiplied.

In 1981, as can be seen in table 1, there was a drastic fall in the growth rate of the domestic product, which decreased in absolute terms in 1982 --a phenomenon which had never occurred in the forty previous years-- and declined again, more markedly, in 1983. Although in 1984 there was a halt in this declining trend, the increase in economic activity was slight and hence the per capita product rose less than 1% in relation to the very low level to which it had fallen in 1983. Thus its level was 8% lower than in 1980 and the same as that which had already been reached in the region in 1977.

This unfavourable economic trend was likewise very widespread: in the lapse of the last four years the per capita product fell in 17 of the 19 Latin American countries for which comparable information is available, stagnated in two and rose considerably only in Cuba.1/ Furthermore, this decline reached dramatic proportions in many countries: the per capita product during this period fell by 25% in Bolivia and almost 22% in El Salvador; in Uruguay, Venezuela and Guatemala the decline was close on 16%, and over 11% in Peru, Costa Rica, Argentina and Honduras (see table 2).

Since at the same time there was a sharp and persistent fall in the terms of trade and a considerable increase in net interest payments and remittances of profits abroad, the fall in national revenue --which is a better indicator of existing living conditions-- was even more pronounced than that of the domestic product.

The decline in economic activity had a further and particularly serious effect on capital formation. This, which had shown a vigorous growth between 1970 and 1980, increased very little in 1981 and declined by around 40% in the following two years, with the result that the coefficient of investment fell to its lowest level in the last forty years. Thus, in addition to affecting the current conditions of life, the crisis also reduced the possibilities of a rapid rise in living standards in the immediate future.

As was foreseeable, in view of the high growth rate of the labour force, the decline in economic activity was accompanied by a marked rise in open unemployment rates in most of the countries for which reliable information is available --as can be seen in figure 1-- and by the extension of various forms of underemployment. The negative social effects stemming from the worsening of the employment situation were aggravated, besides, in several countries by a notable fall in real wages. In 1981-1982 these fell by close on 30% in Costa Rica and 20% in Argentina and in 1983 by approximately 20% in Uruguay and Brazil, 16% in Peru and 11% in Chile.

Notwithstanding the increase in unemployment and the fall in wages, and despite the weakening of the inflationary pressures coming from abroad, the rate of price increases went up in most of the Latin American economies during the crisis. In the region as a whole the annual average rate of consumer price variation rose persistently from 27% in 1980 to 163% in 1984 while the weighted rate by population rose between those years from 56% to 184%. Although these rises were greatly influenced by the extraordinary acceleration of inflation in Bolivia --whose annual rate rose from 24% in 1980 to almost 2 200% in 1984-- the growth of inflation in the rest of the region was still considerable. As can be seen in table 3, this is particularly noticeable if the national inflation rates are weighted by the respective populations. In fact, between 1982 and 1984 two out of every three inhabitants of Latin America faced annual price rises of over 100%. This trend continued to increase in 1985. Thus in the first three months of the year inflation rose at an annual rate of 8 200% in Bolivia, 850% in Argentina, almost 225% in Brazil and 130% in Peru. At the same time the rate of inflation remained around 65% in Uruguay and 60% in Mexico, while accelerating in Nicaragua and increasing in Chile and Colombia.

These unfavourable changes on the domestic front were closely linked, especially up to 1983, with others no less negative in the external sector. These were most apparent in the deterioration in the terms of trade, the striking fall in imports, the draining away of international reserves, the frequent and sometimes enormous rises in the exchange rates and, above all, the overwhelming weight of the servicing of the external debt, which forced most of the countries of the region to renegotiate their commitments with the international private banks and with their official creditors.

In 1984, however, there was a favourable turnaround in the situation of the external sector: the value of exports increased, the volume of imports recovered slightly, the fall in the terms of trade was halted, the deficit on the current account was markedly reduced for the second year running and the balance of payments closed with a surplus for the first time since 1980. Nonetheless, these results were mainly due to the notable increase in exports from Brazil and from a relatively small number of other countries and to the very low level of imports which continued in all the economies of the region. Thus in most of them, and despite the advances achieved in 1984, the capacity to import remained very inadequate and continued to be the main restriction on the growth of economic activity and employment.

/The exceptional

The exceptional depth and duration of the present crisis becomes even more evident if considered within the context of Latin American evolution during the postwar period. From this standpoint, the recent economic contraction marked the end of the long stage of growth and transformation which began in most of the Latin American countries after the Second World War and which was characterized by an appreciable degree of economic dynamism, particularly towards the beginning of the past decade (see figure 2).

In addition to marking the end of the long expansive cycle of the postwar period, the acute and varied economic problems which began to appear throughout the region from 1981 signified also the crisis of the development strategy which, in greater or lesser degree, many Latin American countries adopted in the course of the past decade, particularly after the first series of rises in the price of oil. This strategy took advantage of the peculiar conditions created in the world economic sphere after the first oil crisis, particularly in the financial field, to obtain considerable and rapidly increasing amounts of foreign savings. Thanks to the inflow of these resources and also to the intense and persistent increase in the volume of their exports during the period 1976-1980, the region achieved a continuous and significant increase in the volume of its imports. Thus during this period it succeeded in maintaining a rate of economic growth which, although lower than the exceptionally high rate attained during the first half of the past decade, easily exceeded that of the industrialized countries. Indeed, the ready access to external credit not only enabled most of the Latin American countries to cope with the effects of the international recession of 1974-1975 with relative ease, but also made it possible for them to detach to some extent their overall economic evolution from that of the industrialized countries during the following five years.

Nonetheless, the counterpart and intrinsic effect of this situation, which was to some extent unprecedented in the contemporary economic history of the region, was the extraordinary increase in the external debt and the equally rapid growth of the deficits on current account in most of the Latin American countries. Hence in practice the possibility of maintaining a relatively high growth rate was becoming increasingly dependent on the possibility of attracting ever larger amounts of external resources and of continuing the rapid expansion of the volume of exports.

These were the circumstances which exposed Latin America to the full impact of the prolonged and intense recession which began in the industrialized economies in 1980, and confronted the region with the profound changes that have taken place from that year in the international capital markets.

These events affected the development of the region in three outstanding ways. The first and most traditional was the fall in the terms of trade; the second, the spectacular rise in the real level of international interest rates; and the third --and most devastating-- was the abrupt fall in the net inflow of capital. Although, as will be seen, the gestation and magnitude of the crisis in many countries was decisively influenced by the limitations of the economic policies applied, the socio-political conflicts and even natural disasters, the

/peculiar and

peculiar and unprecedented convergence of unfavourable external factors is the chief explanation both of the outbreak, duration and extension of the crisis and of the high cost of the adjustment process and the large number of countries which had to seek the renegotiation of their external debt.

B. EXTERNAL CAUSES

1. The international recession and the fall in the terms of trade

As is well known, midway through the past decade the central economies suffered the worst slump ever experienced in the whole of the postwar period. Although in 1976 their economic activity began once again to expand, it was far from recovering the buoyancy achieved in the earlier period. In addition, the recovery, besides being relatively slight, was characterized by other negative features: on the one hand by the low level of fixed investment, and on the other by the simultaneous and somewhat surprising persistence of rates of unemployment and inflation which were much higher than those that had prevailed up to 1973.

It was largely due to these circumstances that the second series of increases in the price of oil had much more serious effects on the industrialized economies than those of the previous oil crisis and led to a very different response from economic policy. In effect, the recession which began in 1980, although less profound than that of 1974-1975 from the standpoint of its initial impact on the level of economic activity in the industrialized countries, was on the other hand much more prolonged. Moreover, as the proportion of the unemployed in the industrialized countries was much greater at the beginning of the new recession than it had been at the outset of the previous crisis, the stagnation of economic activity was accompanied by the highest unemployment rates recorded in these countries since the great depression of the 1930s.

As in other recessions, the stagnation of economic activity in the industrialized countries had unfavourable effects on their demand for imports and, therefore, on the rate of growth of international trade. On this occasion, however, these effects were more severely felt owing to the resurgence of protectionist practices in the trade policy of many central economies, which became more frequent and more vigorous with the rise in unemployment and the continuance of the recession. In these circumstances the volume of international trade, whose rapid expansion had played a basic role in world economic growth during the postwar period, rose scarcely at all in 1980, stagnated almost completely in 1981, declined by 2% in 1982 and barely recovered its 1981 level in 1983.

For Latin America this evolution of international trade was extremely unfavourable. In view of the marked decline which it provoked in the international prices of most primary products, the terms of trade suffered a continuous and marked decline between 1981 and 1983 and made only a marginal recovery in 1984. In fact, in the four-year period 1981-1984 the fall in Latin America's terms of trade was close on 22%.

/Although during

Although during this period the oil-exporting countries suffered a fall in their terms of trade along with the other economies of the region, the decline was particularly serious for the latter, since in these countries there had been a brusque fall in the terms of trade during the triennium 1978-1980. Hence between 1977 and 1984 the terms of trade of the non-oil-exporting countries fell by almost 38%, so that their average level during 1981-1984 was considerably lower than that recorded during the years 1931-1933, which was the most critical phase of the great depression.

2. The high cost of external credit

No less serious for Latin America were the repercussions of the exceptionally high levels attained in recent years by the rates of interest in the international financial markets.

In fact, as a result of the high priority assigned in most of the industrialized countries to the reduction of inflation, of the emphasis given in this connection to the control of the money supply, and of the high and persistent deficits in the public finances in a number of them, the interest rates rose appreciably in the principal international financial sectors as from 1978. Indeed, in real terms, in the last four years they reached the highest levels ever recorded in the past half century. This represented a radical contrast to the situation prevailing during the crisis of midway through the past decade, when the real interest rate was persistently negative. And since at the same time there was a drastic fall in the Latin American terms of trade, the increase in the real cost of credit which they had to meet was much greater still (see figure 3).

The unusually high interest rates helped to unleash and intensify the Latin American crisis in two main ways. On the one hand, by curbing the recovery of the industrialized economies, they tended to reduce the demand in these countries for Latin American exports. On the other, by raising the servicing of the external debt, they enormously increased the deficit on the current account and, as will be seen further on, they helped to generate a considerable transfer of real resources to the exterior. Thus Latin America's gross remittances of interest rose dizzily from somewhat less than US$ 6.9 billion in 1977 to almost US$ 39 billion in 1984. The decisive effect of the rise in international interest rates on this development is clearly manifest in comparing the growth of interest remittances with that of the external debt. Whereas between 1977 and 1984 the global amount of the debt increased threefold, that of the remittances grew almost fivefold (see table 1).

3. The fall of the net capital inflow and the negative transfer of resources

All in all, and despite the impact of the elements indicated, the fact which contributed most to the intensification of the crisis was the brusque fall in the net capital inflow which occurred in 1982 and became even more marked in 1983. The negative effect of this decline in the procurement of loans and investments was especially notable for three reasons. First, it occurred after a long period

/in which

in which the net inflow of loans grew at a striking rate and not only the evolution of the external sector but also the general functioning of many Latin American economies came to depend very heavily on the continued increase of external finance. Second, it had a procyclical character, since it coincided with the decline of the purchasing power of exports and the sharp downturn in the terms of trade. Third, it was of exceptional magnitude, which, coupled with the very considerable and simultaneous increase in the net interest payments and profits, dramatically reversed the direction of the transfer of resources between Latin America and the rest of the world.

The exceptional dimensions of this process can easily be appreciated in table 4, which shows how the net capital inflow, after increasing markedly and incessantly for almost all the past decade and reaching a record maximum of almost US$ 38 billion in 1981, declined to barely US$ 19 billion in 1982 and to a figure of around US$ 4.4 billion in 1983. Obviously such a violent fall in external credit would have been dangerous in any circumstances, but on this occasion its negative effects were aggravated by the marked increase which took place simultaneously in the net interest payments and profits. Up to 1981 the net volume of loans and investments coming from abroad was far greater than the remittances of interests and profits in respect of returns on foreign capital. The net result of these financial flows was therefore favourable to the region and enabled it to obtain from abroad a real volume of goods and services greater than it would have obtained from the purchasing power of its exports (see figure 4).

This situation changed radically in 1982. In fact, as a result of a new and considerable increase in interest payments and profits --which rose from close on US$ 28 billion to around US$ 38 billion-- and particularly as a result of the drastic reduction of the net capital inflow already mentioned, the balance between the two financial flows became adverse. Consequently Latin America, for the first time in its recent history, had to make a large transfer of real resources to the exterior, to an amount exceeding US$ 19 billion.

The problem intensified in 1983 --a year in which the positive effect of a slight fall in the remittances of interests and profits was more than offset by the new and intense decline in the net capital inflow-- and was only reduced to a small extent in 1984, as a result of the partial recovery of the net inflow of loans and investments.

Thus, during the last three years, Latin America transferred abroad resources amounting to over US$ 70 billion. Nonetheless, this figure --equivalent to almost a quarter of the Latin American exports of goods and services in that period-- underestimates the magnitude of the change brought about by the brusque fall in the net capital inflow between 1981 and 1984 from the standpoint of the region's capacity to import. As can be seen in table 4, in the first of those years the positive difference between the net capital inflow and the payments of interest and profits added to the region's capacity to import a figure equivalent to 9% of the exports of goods and services. In 1984, in contrast, the negative difference between the two financial flows reduced the capacity to import by the equivalent of around 22% of the external sales of goods and services. Hence the

/change produced

change produced by this concept represented a fall of more than 30% in the terms of trade. Adequately to assess the meaning of this figure, it should be noted that the effective fall in the terms of trade during this period was around 14%. Consequently, and in relation to the capacity to import, the negative effects of the fall of the net capital inflow coupled with the increase in the payments of interest and profits were more than double the unfavourable results generated by the deterioration in the terms of trade.

C. INTERNAL CAUSES

As already indicated, the gestation and development of the economic crisis was also decisively affected by elements of an internal character. Undoubtedly the specific nature and relative weight of these factors have varied greatly in the different national experiences. Thus, in some of them --and especially in several countries of Central America-- the most crucial effects have been produced by the profound political changes and the prolonged and grievous civil conflicts which have characterized their recent history. In other countries, the fall in economic activity and the high rate of inflation were accentuated by the effects of droughts, inundations and other natural disasters, which fell with particular force on the agricultural sector and the transport systems. In other experiences, on the other hand, the most important aspects were the negative effects produced by the insufficiencies or excesses of the economic policies applied. Among these, two that had a particular impact were the over-expansionist policies of expenditure in some countries, and the monetary policies based on a liberal opening-up to the exterior, in others. Paradoxically, however, the prolonged application of these two policies, based on very different theoretic and ideological concepts, had a central element in common; namely, their situation of dependence owing to a development strategy excessively linked to external indebtedness.

1. <u>The excesses of the policy of external indebtedness</u>

In essence, this strategy represented the domestic counterpart to, on the one hand, the abundance of international liquidity prevalent between 1974 and 1981 and, on the other, the extremely expansive policy followed during this period by the private international banks in their relations with the semi-industrialized countries.

Strictly speaking, it was the interaction between this attitude of the international banks and the strategy of external indebtedness pursued by numerous Latin American countries that largely permitted the mobilization of the enormous financial surpluses generated in the international system from the time of the first oil crisis. At the same time it was this very interaction which left its distinctive imprint on the economic evolution of many countries of the region during that period. And it was in the end the abrupt change in the attitude of most of the international banks to the viability of development based on this strategy which constituted one of the main decisive elements of the present crisis.

/The main

The main foundation of the strategy of indebtedness was simple and by no means new; namely, the convenience of complementing domestic saving with resources coming from abroad in order to raise investment and the rate of economic growth. However, the attraction and concrete meaning of this facet of development acquired radically different dimensions from midway through the past decade, when the volume of the external resources available in the international capital markets increased and, above all, when the real rate of interest charged for the use of these resources became negative during those years.

The possibilities opened up by this new international financial framework were exploited initially by numerous Latin American countries to palliate the adverse effects of the recession in the industrialized economies and the sudden high rise in the international price of oil on the purchasing power of their exports. Indeed, thanks in part to the procurement of a greater volume of external resources, the region not only maintained a high rate of economic growth amounting to close on 7% in 1974, but it also succeeded in increasing its gross domestic product by around 4% in 1975. Thus the evolution of economic activity in Latin America contrasted markedly with that of the central countries, in which the economy came to a complete standstill during those two years.

Subsequently, and despite the vigorous and sustained expansion of their exports, most of the economies of the region continued to make intensive use of the abundant credit offered by the international private banking system, as a result of which the persistent increase of external indebtedness came to be at the same time a main characteristic and basic requisite of their development processes.

The expansion of external indebtedness thus became a double-edged weapon. On the one hand, it permitted the financing of higher import levels and capital formation, thus contributing in many countries to the maintenance of higher economic growth rates than would have been possible without it. On the other hand, and as a partial result of its own dynamism and also its terms and modalities, the expansion of external indebtedness soon generated the need to make huge and ever-increasing remittances of interest and amortization payments abroad. Thus the real transfer of resources implicit in a given amount of new loans was rapidly declining, while there was a marked growth in the sensitivity of the economy to possible falls in the volume of credit coming from abroad.

This new form of external vulnerability --the scope of which was dramatically revealed in 1982-- was not, however, the only negative effect of the excessive utilization of external indebtedness. An additional consequence, less direct but no less serious, was the decisive support provided by the excessive use of external resources for the application and, especially, for the prolonged maintenance of policies which had a powerful influence on the creation of the crisis, such as those which led to an excessive expansion of domestic expenditure and to a pronounced fall in the real exchange rate.

/2. The

2. The excessive expansion of domestic expenditure

Although the excessive increase of domestic expenditure played a major role in the crises of inflation and the balance of payments suffered by numerous Latin American countries in the 1970s, its incidence was particularly significant in the gestation of the current crisis in some of the oil-exporting nations of the region.

In these countries, the extraordinary rise in the value of their exports caused by the increase in the price of oil and, in some cases, by the vigorous expansion in the volume of external sales, helped to strengthen the balance of payments and at the same time to increase enormously the revenues of the public sector. The exceptional rise in the volume of exports contributed at the same time to an increase in the confidence of the international banks in the prospects of growth in these countries, so that the financial institutions were also more disposed to grant them ample additional resources.

In this context of unprecedented abundance of public and external resources and of favourable expectations regarding the future course of the international price of oil, the development strategy attempted to force an equally extraordinary rate of growth and structural transformation of the economy. The main instrument chosen for this purpose was the expansion of public expenditure, both current and investment, which helped to reinforce the dynamic effects deriving from the external sector.

Stimulated by the expansion of overall demand, production also grew at a rapid rate. However, owing to the inevitable short-term rigidities of supply in some sectors and especially because of the extraordinary expansion of production and domestic expenditure, the volume of imports grew even faster. In fact, despite the notable rise in external sales, the coefficient of imports grew more than that of exports. Nevertheless, the trade deficit could be easily financed, since there was a simultaneous increase in the net inflow of capital. Hence, despite the continuous increase in the said deficit, the international reserves continued to rise and it was not necessary to modify the exchange rate. Even so, the real value of this was declining, since owing to the extraordinary growth of domestic demand inflation was beginning to soar. Additionally, as the inordinate expansion of public expenditure was financed by resources provided by the foreign banks, the external debt also grew at a rapid rate. Thus the possibility that the economy would continue to expand without serious problems of inflation or balance of payments became heavily dependent on the growth of external indebtedness.

As the expansion of this indebtedness depended in its turn mainly on the policies of the banks, which were influenced both by the magnitude of the financial surpluses which they could obtain and by their estimation of the prospects of the debtor countries, the problems implicit in the development strategy selected by these countries began to emerge when, towards the middle of 1981, the ascending trend of the international price of oil came to a halt.

/The threat

The threat posed by this situation was quickly realized by numerous economic agents who decided to transfer their capital abroad in anticipation of a crisis of the exchange rate. Apart from accentuating the fall in the international reserves, this attitude helped to increase the doubts and hesitation of the international private banks, with the result that the inevitability of the exchange-rate crisis became even more apparent.

In these circumstances the economic authorities found themselves forced to make a drastic adjustment to the exchange parity, to make requests for the renegotiation of the payments of the external debt, and to introduce severe adjustment programmes. The immediate results of these measures were the brusque acceleration of inflation, a considerable rise in unemployment, and a perceptible fall in the level of economic activity, particularly in investment expenditure.

3. Stabilization policies and the exchange-rate lag

Inflation --which until the beginning of the past decade had been a serious problem only in a relatively small number of Latin American countries-- tended to spread throughout the region for the first time during the period 1973-1975, and rose again from 1979 onwards. Faced with the need to control inflation --which had often resulted in the main from external factors-- many countries applied stabilization policies which, although they succeeded in moderating price increases, contributed also to the slackening of economic growth.

Nonetheless, it was where monetary policies were in force in the Southern Cone countries --which at the same time adopted strategies aimed at opening up their economies in the commercial or financial fields, or in both, and at modifying the relative roles of State and market, assigning much greater importance to the latter-- that the anti-inflationary policies had the most decisive effect on the development, profundity and duration of the crisis.2/

Even when the decision to apply these policies was essentially based on a theoretical conception as to how to reduce the inflation rate, equilibrate the balance of payments and manage the economic policy in economies freely open to the exterior in the commercial and financial fields, their maintenance for a prolonged period was facilitated by the abundance of external credit available to these countries up to 1981. In effect, the subtantial loans received from abroad not only covered the increasing deficits on their balance-of-payments current account, but also permitted the application of an exchange policy which was chiefly aimed at reducing the inflation rate through its effects on expectations and, in particular, through the restraints imposed on domestic price rises by the free importation of all kinds of foreign products.

Indeed, in some cases these policies achieved the objective of reducing the domestic inflation rate to levels approaching or equal to that of international inflation. Nevertheless, owing in part to the fact that this convergence took longer than was initially foreseen and in part to the fact that inflation was still soaring when the exchange rate began to be used as an instrument of stabilization programmes, these policies provoked a considerable fall in the real exchange rate.

/In its

In its turn, and as was to be expected, this exchange lag had a negative effect on the production of internationally tradeable goods. In the exporting sector, the fall in the real exchange rate, added to the high domestic interest rates, increased the depressive effects caused by the international recession and the decline in the prices of primary products. Its impact, however, was much more adverse in the activities competing with imports, since in these the exchange-rate policy accentuated, instead of compensating, the negative consequences for them of the fall in tariffs. Thus, in parallel with the decline in the growth rate of exports, there was an increase in the number and variety of domestic activities which ceased to be "competitive" and whose share in the satisfaction of domestic demand was replaced by imports. Hence, numerous enterprises had to reduce their level of activity with the ensuing adverse effects on employment. At the same time, the high real cost of domestic credit had an adverse effect on investment, since there were very few activities whose profitability warranted the payment of such high interest rates.

Naturally, and mainly as a result of the aforesaid trends, there was a rapid and persistent increase in the deficit on trade in goods and services. Nonetheless, as there was a continued and abundant inflow of external credit, this imbalance did not result in a loss of international reserves, but was in fact accompanied by an increase in these reserves. Another central and no less important result was the sustained growth of the external debt and, in consequence, of the remittances of interest abroad.

Thus, together with the rise in the trade deficit, the payments on external capital were rapidly increasing, which meant that the equilibrium of the balance of payments came to depend more and more on the continuous expansion of the net inflow of loans and investments. The persistent increase of external finance came to be, at the same time, the basic condition for the maintenance of the exchange-rate policy and therefore for the consolidation of the advances made in the control of inflation.

The use of the exchange-rate policy as an instrument of the stabilization programmes was successively abandoned in the countries in which it was applied between 1981 and 1982, as the adverse trend of external factors increased. In effect, faced with new and sharp falls in the terms of trade and with a brusque drop in the net capital inflow, and in the presence of marked contractions in the domestic levels of production and employment, the governments found themselves driven to a drastic devaluation of their currencies.

As this decision implied the radical modification of a policy which had been repeatedly presented as a basic element of the aforesaid economic strategy, its immediate consequences were very unfavourable. On the one hand, the abrupt rise in the exchange rates was quickly followed by a notable resurgence or acceleration of the inflation rate. On the other hand, it caused dramatic changes in the patrimonial situation of numerous enterprises, and had a specially adverse effect on those which, in the belief that the exchange-rate policy would be maintained, had incurred considerable debts in foreign currency. In their turn, the payment difficulties of these enterprises contributed to the fall in the portfolio of the banks and financial entities. Added to this was the loss of confidence and the uncertainty created both by the abandonment of the exchange-rate policy

/which had

which had long been in force, and the lack of a clear definition of the new policy which would begin to be applied in its place.

In these circumstances the flow of external loans declined still further, while many enterprises with foreign debts decided not to renew their credits abroad, owing to the prevailing uncertainty as to the future evolution of the exchange parity. This increased the fall in international reserves and thus intensified the balance-of-payments crisis and the fall in economic activity and employment.

4. The liberalization of the financial system and the rise in real interest rates

Another domestic phenomenon which helped to create and strengthen the crisis was the abrupt rise in the real rates of interest which followed the reforms of the financial markets introduced in several countries of the region during the second half of the past decade.

The main objectives of these reforms were to eliminate the distortions existing in the assignment of credit and to promote domestic saving through the liberalization of interest rates and the expansion and diversification of the capital markets.

These markets had developed very little up to then in numerous countries, and frequently the interest rates, both passive and active, were fixed by administrative regulations at levels which were normally very low in real terms. Hence the credit market was segmented between those who had more or less easy access to loans granted at low (or even negative) real interest rates and those who had to finance themselves or obtain very expensive credits in the informal sector. In their turn, the low passive interest rates helped to discourage personal saving and to restrict the development of organizations engaged in financial intermediation.

As a result, it was assumed that in liberalizing the functioning of these bodies and allowing the market to determine the rates of interest, the resources obtained by the financial entities would increase and would be assigned more efficiently than in the past. Although it was recognized that for this to happen the real rates of interest would have to rise, it was hoped that their levels would not be much higher than those of the international rates, particularly when the policies of internal financial liberalization were accompanied by a greater financial opening up to the exterior.

In practice, however, following the elimination of various forms of "financial repression", the real domestic interest rates rose to a level much higher than the international rates.

This rise was caused by different factors which, in addition, had a different relative importance in the various countries. In some cases, for example, the liberalization of the financial market coincided with highly restrictive economic policies aimed at curbing inflation. In these circumstances, many enterprises

/raised their

raised their demand for credit to avoid the liquidation of their stocks at the lower real prices imposed by the stabilization policies. Hence the rigidity downwards of the prices of the goods market made the demand for credit increase, thus contributing to the rise in interest rates.

In other cases, the demand for credit by the enterprises expanded on the basis of optimistic expectations as to the future course of the economy, thus contributing to the rise in the interest rate, which remained high despite the non-fulfilment of these expectations, since the accumulated financial costs were so high that new credits had to be obtained to avoid the heavy capital losses which would have resulted from the liquidation of assets to pay the debts contracted.

Moreover, the exchange-rate risk necessarily created imbalances between the domestic and external interest rates, and the difference tended to increase as the lag in the exchange rate and the fall in the value of exports caused by this and by the deterioration in the terms of trade discouraged the entry of capital, thus increasing the probability of a drastic devaluation.

Whatever the causes of the rise in the interest rates, it is certain that as a result of the liberalization of the financial system they rose to a marked degree, in some conntries reaching monthly figures of 2 to 3% in real terms. Naturally, interest rates as high as this were bound to discourage investment and in time affect the solvency of the enterprises and consequently that of the financial system.

Nonetheless, the situation could be maintained as long as expectations regarding the global evolution of the economy were optimistic and the net capital inflows were high. Indeed, mainly as a result of these factors the values of real estate and shares rose at rates similar to or even higher than that of the debt. Finally, however, the increase in the exchange-rate lag, the deterioration in the terms of trade, the fall in the net capital inflow and the pessimistic turnaround in expectations began to undermine the bases of the boom causing a marked fall in the value of assets.

Partly for this reason, many banks preferred to continue extending credit to enterprises which had become insolvent, since in the new circumstances, if the guarantees supporting the loans became effective, they would only have recovered them in part. In no few cases, this trend was reinforced by the fact that the enterprises belonged to the same groups that controlled the banks. Hence, to postpone the moment of acknowledging loss, many banking institutions and enterprises maintained the fiction of renewing loans at very high interest rates, though their payment became increasingly difficult.

Finally, some banks were faced with situations of insolvency. In these circumstances the governments intervened in their support, in order to avoid a crisis of the financial system. But this support called for the expansion of the credit of the Central Bank and thus helped to intensify inflation and forced the State to guarantee the debts incurred by the banks abroad.

/Thus, despite

Thus, despite the need to liberalize the financial system to some extent so that it could grow and diversify, the form in which the reforms were carried out in practice helped in some cases to generate enormously high interest rates and disproportionate levels of internal and external indebtedness, which ended by compromising the creditworthiness of enterprises and banks. In this way, and paradoxically, the measures aimed at promoting the development of the financial system either helped to create its crisis or intensified the flight of capital and the recession.3/

II. THE ECONOMIC POLICY REACTION

As has been seen, from 1981 on Latin America's external context was extremely unfavourable, in both the commercial and the financial areas. In the first place, the drop in the terms of trade traditionally associated with periods of recession in the industrialized economies was unusually large between 1981 and 1983; in addition, only a very small part of this deterioration was cancelled out in 1984 in spite of the marked growth shown by international trade that year. Secondly, the real level reached by international interest rates was extraordinarily high in historical terms. Partly because of this, partly because of the rapid and persistent growth of the external debt up to 1981 and partly because of the large share of the debt which had been contracted at variable interest rates, the impact of the rises in interest rates was much more adverse than in the past.

Because of these changes in the external situation and also because of the inadequate fiscal, monetary, exchange, financial and price policies followed in some countries of the region, the deficit on current account doubled between 1979 and 1981, and in 1981 and again in 1982 was the equivalent of over 35% of the value of exports of goods and services.4/ In addition to this considerable worsening in the disequilibrium in the current account, in 1982 a sudden drop occurred in the net inflow of capital, and the inflationary process accelerated. In these circumstances, many countries began to apply adjustment policies (aimed at reducing the external imbalance) and stabilization policies (aimed at moderating the rate of inflation), and many of them also initiated action to reschedule the servicing of the external debt.

A. ADJUSTMENT POLICIES AND THE ADJUSTMENT PROCESS

The basic objective of the adjustment policies was to reduce current account deficits which could no longer be financed through the net intake of loans and external investments or through a reduction in international reserves. For this purpose, many governments applied, in differing degrees of intensity and through varying means, the two groups of economic policies which are theoretically necessary to operate the adjustment process and which comprise, basically, policies for controlling aggregate demand (fiscal, monetary and income policies) and others which raise the relative price of goods tradeable on the international market (exchange policies, tariff policies or export promotion policies).5/ In some countries these policies were supplemented by public investment programmes and other government measures aimed at directly increasing the substitution of some imports which weighed heavily in the foreign trade deficit.6/

Frequently, adjustment policies were provided for within the framework established in the credit agreements reached with the International Monetary Fund. These agreements included restrictive provisions in the monetary and fiscal area which set limits on the expansion of the net internal assets of the Central Bank and the external and internal debt of the public sector and provided that the government would have to reduce its deficit by raising taxes, increasing the rates charged by public sector enterprises and cutting current expenditure. At the

/same time,

same time, they acknowledged that during the adjustment process it would be necessary to raise the real exchange rate, reduce real salaries and wages and maintain interest rates which were positive in real terms.7/

Of course, the rigour and persistence with which the agreed policies were actually applied varied from country to country. Thus, although the majority of them effected considerable devaluations which initially made it possible to raise the real effective exchange rate very markedly, this later declined perceptibly in some of them (see table 5). It was also not always possible to achieve the targets for reducing the fiscal deficit, and in more than a few cases the share of this deficit in central government expenditure began to increase (see table 6).

The degree to which the policies applied achieved their basic objectives also differed. However, in general much more progress was made in respect of controlling inflation than in respect of reducing the external imbalance. As early as 1982 there was a notable turnabout in Latin America's trade-in-goods balance, which, after showing a deficit of US$ 2 billion in 1981, showed a surplus of over US$ 9.7 billion in 1982. This trend became more marked in 1983, when the trade surplus exceeded US$ 31 billion, and continued in 1984 when the trade-in-goods surplus reached the unprecedented figure of over US$ 38 billion. Primarily because of this rise in the trade balance, the deficit on current account fell dramatically in both 1983 and 1984, amounting in the latter year to US$ 2.1 billion, which was barely equal to 5% of the enormous negative balance of over US$ 40 billion recorded two years before (see table 1).

Because of the way in which it had been achieved, however, this marked reduction in the deficit on current account was very costly in terms of drops in economic activity and employment. Because of the sudden and radical decline in external financing, the adjustment had to be made in an exceedingly short period. For this reason it did not allow for the reallocation of resources, to the extent necessary, from the production of non-tradeable goods to export activities: a process which, precisely because of a real change has been made in the structure of production, can only be carried out in a longer period of time. Up to 1983, the expansion of exports was limited also by the marked decline in the international prices of the majority of the region's main commodity exports and by the drop in the volume of world trade caused by the prolonged recession in the industrialized countries, the increase in protectionist practices of many of them and the loss of dynamism in the OPEC economies. In these circumstances, the value of exports of goods fell markedly in 1982 and stagnated in 1983.

Thus, the spectacular rise of US$ 33 billion shown by the trade balance between 1981 and 1983 was due totally and exclusively to the vertical drop in imports. As may be seen in table 7, their value fell abruptly from nearly US$ 96 billion in 1981 to less than US$ 55 billion in 1983, while their volume contracted by the almost incredible figure of 41% during this brief period of time. The drops in the volume of imports were even greater in Argentina and Chile (where it was halved between 1981 and 1983), Venezuela (which decreased the volume of its imports by 47% in 1983 alone) and, above all, Uruguay (which contracted its real imports by over 63% in the 1981-1983 triennium) and Mexico (which decreased its imports by nearly 67% in the 1982-1983 biennium).

/Although these

Although these colossal drops in imports were in part a reflection of the extraordinarily high levels achieved by external purchases prior to the crisis, they did not affect only external purchases of essential consumer goods and capital goods but also brought about considerable reductions in imports of raw materials and indispensable intermediate goods needed to maintain the level of domestic economic activity. In the last analysis, then, it was not surprising that the domestic product stagnated or even fell in 1982 in many countries, and that another more pronounced decline occurred in 1983.

As mentioned above, this extremely unfavourable trend in Latin America's foreign trade was interrupted in 1984, when, as a result of the recovery of the industrialized economies and, in particular, of the enormous expansion in imports by the United States that year, the volume of world trade rose in a satisfactory way for the first time since 1979. Owing to the impetus provided by this more favourable external situation and also by the higher level registered, as has already been seen, by the effective real exchange rates in many countries from 1982 on, the volume of Latin American exports rose by close to 10%, and their value was slightly higher than that recorded prior to the crisis.

In addition, for the first time since 1981, the increase in exports was accompanied by an increase in the volume of imports. The latter increase was, however, very slight (less than 5%) and was concentrated in a small number of countries (Mexico, Costa Rica, Chile, Ecuador and Uruguay), in the majority of which the volume of imports had dropped enormously in the preceding years. Thus, in spite of the recovery in the volume of imports, this remained very much lower in 1984 than in 1981 in all countries of the region (with the sole exception of Colombia), and in Latin America as a whole, real imports of goods were 38% lower in 1984 than in 1981 (see table 7).

In brief, as a result of the radical drop in the net inflow of capital between 1981 and 1984, the region had to act very rapidly to reduce an external deficit which was much larger than would have been necessary to eliminate in more normal circumstances in its financial relations with the exterior. In addition to making the "normal" adjustment required to correct the excessive deficits on current account which many Latin American countries had incurred in the pre-crisis years, they had to carry out a kind of "overadjustment" to cope with the consequences of the procyclical behaviour of the international commercial banks. Because of this and also because of the external climate since 1983, which was very unfavourable for Latin American exports, practically all the burden of redressing the huge initial external imbalance in barely two years had to be borne by imports, whose violent contraction gave the adjustment a markedly recessive character.

B. THE RENEGOTIATION OF THE EXTERNAL DEBT

1. The first round of reschedulings

For the developing countries, 1982 marked the beginning of a lag in payments on the external debt and of the attempt to renegotiate the terms of servicing that debt. As may be seen in table 8, between 1982 and 1983 thirteen Latin American countries reached preliminary or final agreements to reschedule commitments reachi maturity in 1983 or in the period 1983-1984.8/ In addition, many Latin American countries also requested a rescheduling of their debt with public financial entities, through the so-called "Club of Paris".

The wave of reschedulings began in Latin America in August 1982, when the Government of Mexico formally declared a moratorium of 90 days on amortization payments on the debt of the public sector although interest payments were maintained. Although payment problems had arisen in Mexico even during the first part of that year, they had not become apparent to all the creditors because the country managed to obtain short-term credit to cover the payments due on its medium-term liabilities. However, with the drop in petroleum prices and the rise in debt servicing, the situation got out of hand, and the government was forced to request that the debt be rescheduled. Since Mexico was the second largest customer of the banks in the Third World, with a net debt of US$ 49 billion, which was not much lower than that of Brazil, its problems produced a wave of fear in banking circles since failure to meet its obligations could seriously destabilize the international financial system.9/

In these circumstances, the credit restriction applied by the banks soon extended to the other Latin American countries and resulted in the near paralysis of the flow of loans to the region. According to figures published by the Bank for International Settlements, new net loans by private banks to Latin America (with the exception of Venezuela and Ecuador) dropped sharply from US$ 21 billion in the second half of 1981 to US$ 12 billion in the first half of 1982 and to a bare US$ 300 million in the second half of that year.10/ In addition, the terms on which debts were granted deteriorated seriously.

Naturally, the contraction of the credit market complicated the debt-servicin situation for the remaining borrowers, who were already encountering difficulties in the balance of payments owing primarily to the deterioration in their terms of trade and to the extraordinary high interest rates prevailing in the international financial markets. Thus, at the beginning of 1983, the only important Latin American client of the banks which had managed to forestall a rescheduling was Colombia which has traditionally followed a cautious strategy as regards debts with private banks.

Table 9 contains a summary of the main terms agreed to in the first series of reschedulings of the external debt. As we all know, in these negotiations the banks and the countries have to reach an agreement on the margin to be collected over and above the LIBOR rates, the commissions and the amortization period, both for the rescheduled debt and for new loans. These three factors taken as a whole represent the "negotiated cost" of the debt. This negotiated cost is the main

/determinant of

determinant of the profits made by the banks since the majority of them pay a rate very close to the LIBOR rate for their deposits. On the other hand, for the countries, most of the cost of the debt is represented by the LIBOR rate although as the debt increases, both the cost represented by the margins and commissions and the period of amortization become very high.

The first notable characteristic of the reschedulings carried out during the first round was the similarity in the terms agreed upon between the banks and the various countries (see table 10). In calculating the terms established for amortization payments and new loans for the respective transactions taken as a whole, we see that the margin over and above the LIBOR rate fluctuated between a minimum of 1.95% in the case of Mexico and a maximum of 2.32% in that of Brazil; that the amortization periods varied from six years (Uruguay, the Dominican Republic and Panama) to 8.5 years (Costa Rica) and that commissions ranged from 1.05% (Mexico) to 1.5% (Brazil and Panama). In quantitative terms, the majority of the countries accepted terms close to the top of the scale.

The similarity in terms is explained partly by the way in which the process of negotiating with the banks was initiated. This process began in Mexico and advanced more rapidly there, due to the urgency of solving the problems of such a large borrower. In addition, Mexico was traditionally known to be one of the banks' best clients.

For these reasons and also because the banks maintained that the rescheduled terms are based on the risk involved, the agreement reached with that country in fact established a "floor", or a lower limit, for the terms agreed in other rescheduling exercises. Those terms were, however, similar to the least favourable terms prevailing in the 1970s.11/ Thus, terms which in their day were applied as an exception and only to very few countries, in the end extended to nearly all of Latin America. Thus, a second leading feature of the agreements was deterioration in the terms of the debt.

This deterioration may be examined in two ways. The first takes into account the evolution of terms subject to negotiation, that is to say the margin over and above the LIBOR rate, the amortization period and the commissions. The data relating to these three elements are shown in table 10 and give some idea of the notable deterioration in the terms of the debt. In relative terms, the greatest deterioration occurred in respect of Ecuador and Argentina in that for those countries the negotiated cost of credit rose by 242% and 217%, respectively, by comparison with the terms prevailing in the pre-crisis period (1980-1981). These two countries were followed by Mexico and Panama, which experienced deteriorations equivalent to 181% and 174%, respectively. Some countries, such as Cuba, Costa Rica, Brazil and Peru, showed considerably less deterioration in that the terms to which they agreed were comparable to those applied to the loans they had obtained in the pre-crisis period, which were considerably less favourable than those applied to the countries mentioned above. For example, in 1980-1981 Brazil had negotiated loans with relatively high margins and commissions, partly because it requested longer repayment periods; thus, although Brazil's renegotiated terms were the heaviest, the deterioration represented was comparatively more modest (44%). Cuba is another example of a country whose credit terms prior to the rescheduling were relatively unfavourable (as reflected in short repayment periods) and for that reason their relative deterioration was also much less severe (28%).

The second way of looking at the rescheduled terms is to analyse the financial cost, which depends on the basic LIBOR rate and on the margins and commissions. This approach differs qualitatively from the one described above in that the LIBOR rate is taken into consideration while no account is taken of the amortization periods. In any case, this indicator also suggests that the agreements reached in the first round of reschedulings imposed a heavy burden on the borrowers. On the basis of a basic LIBOR rate of 5% in real terms (the rate prevailing for creditors in 1981-1982), all the countries referred to in table 10, with the exception of Brazil, saw the real financial cost of their credit rise by over 16%. The most notable increases occurred in the cases of Ecuador, Argentina, Mexico and Uruguay and fluctuated between 23% and 28%. On the other hand, in the case of Brazil, since the credit terms agreed in 1980-1981 were already heavy, the rise in the financial cost of the debt amounted to only 9%.

2. The second round of reschedulings

The first round of reschedulings was followed almost immediately by a second round. These reschedulings were necessitated by a number of factors. In the first place, some countries had renegotiated only payments falling due in 1983, to which, in some cases, deferments accumulated in 1982 were added. Since the external sector still showed little dynamism, these countries decided to request the rescheduling of the amortization payments due in 1984. Secondly, there were countries which in spite of having initiated action to restructure their debt during the first round, for one reason or another failed to sign a final agreement. Finally, the private banks agreed to grant "fresh credit", that is to say, credit earmarked for refinancing a certain percentage of the payment of interest on the bank debt, on the basis of a yearly schedule. Thus, countries which had rescheduled payments due in 1983-1984 and those which had requested a year for restructuring had to return to the negotiating table to decide on the amount and the terms of "new" credit for 1984.

The second round of renegotiations had three main general characteristics.

The first of these was the reduction in new bank commitments. Although in 1984 the banks pursued their policy of granting new credit for refinancing part of the interest payments, this contribution fell substantially. For example, Mexico received new credit in an amount of US$ 3.8 billion in 1984 (which represented an increase of 6% in the commitments or exposure of the banks in that country) by comparison with loans for US$ 5 billion in 1983 (which had represented an expansion of close to 8% in their exposure). In the same period, new credit obtained by Chile dropped from US$ 1.3 billion to US$ 780 million, which represented a drop in the growth of bank exposure from 11% to 7%. There was also a decrease in the credit granted to Ecuador, and Peru received no new credit, by contrast with the US$ 450 million which had been granted to it in 1983 (see table 11). The only country which obtained more in new credits than it had the previous year was Brazil (US$ 6.5 billion in 1984 compared with US$ 4.4 billion in 1983). This increase was, however, due to the fact that during the first

/round it

round it had not been possible to maintain the interbank credit lines to that country at the levels established, so that in the second round it was decided to substitute new medium-term credits for the short-term lines.

A number of factors explain the drop in new commitments assumed by the banks. In the first place, the policy of the banks is to restrict their exposure in Latin American countries; in the last analysis, they consider that the amount of new credits associated with the process of renegotiating the debt should gradually decrease. On the other hand, the countries, which are faced not only with the banks' refusal to grant new resources but also with the rigorous targets agreed to with the International Monetary Fund in order to reduce their need for financing, curtailed their imports dramatically. As already mentioned, the result of this was a dramatic decrease in the negative balance on current account and hence, in the need for new loans. Another element which played an important role was that some countries managed to replace some of their bank financing with new disbursements from official international agencies, such as the Inter-American Development Bank and the World Bank.

A second important characteristic of this second round of reschedulings was the decrease in the negotiated cost of credits.

As mentioned above, the first round of reschedulings was characterized by a sudden deterioration in the terms of the debt. In the second round, on the other hand, the countries obtained terms which were somewhat more favourable; in all cases the margins over and above LIBOR and the commissions were lower and the amortization periods longer than in the first round of reschedulings (see table 12). Although the new terms of the debt remained burdensome by comparison with those which characterized the normal credit market in 1980-1981, the relative deterioration in the negotiated terms and the financial cost was much more moderate than that experienced in the first phase of the renegotiation (see columns 7 and 10 in table 13). It is interesting to note that it was countries such as Brazil and Peru, which in the previous round had decided to reschedule only that part of the debt which reached maturity in 1983, which were in the best position to profit from the new situation since the easier terms were applied not only to new credits obtained in 1984 but also to the rescheduled payments due in 1984. Conversely, those countries which had rescheduled their payments due in 1984 during the first round had to comply with the more arduous conditions negotiated on this occasion.

Finally, a third characteristic of the second round of reschedulings was the intensification of the solidarity among the countries of the region with respect to the debt problem. In January 1984, 26 countries of Latin America and the Caribbean participating in the Latin American Economic Conference endorsed the "Quito Declaration" and the "Plan of Action" corresponding to it. In both documents concerted action is proposed for facing up to the crisis, and both advocate the adoption of various measures to reactivate the economies and deal with the external debt. Another demonstration of regional solidarity was the emergency loan for US$ 400 million granted to Argentina by four Latin American governments (Brazil, Colombia, Mexico and Venezuela) and the United States in order to facilitate the payment of the interest which Argentina owed the banks prior to 31 March 1984, the date on which some banks would have had to castigate their loan portfolio in respect of that country. In addition, in May 1984, the Presidents of Argentina, Brazil, Colombia and Mexico, reacting to the persistent rise in international interest rates, made a declaration (later supported by other countries of the region) concerning the dangers of raising the already high cost of the external debt and proposed that a meeting should be held at presidential level to discuss measures for overcoming the problem. All those steps, at both national and regional level, had to enhance Latin America's bargaining power and were to some extent responsible for the banks' decision to soften the terms of the debt in the second round of negotiations.

3. The third round of reschedulings

The trends noted above became more marked during the third round of reschedulings initiated by a number of countries during the second half of 1984. The terms of the preliminary agreements reached between them and their respective banking committees were rather more favourable than those of the agreements entered into previously. Thus, the refinanced payments periods were for a number of years, the periods granted for credit amortization were much longer, the margins collected over and above the basic interest rates decreased and, in the majority of cases, commissions were eliminated.

The first of these "new agreements" was reached between Mexico and its banking committee in August 1984 and was entered into with that country's nearly 600 creditor banks in April 1985. It had characteristics which at that time were unprecedented in the region. Thus, instead of the payments due in respect of one or two years being rescheduled, the amortization payments for the whole of the six-year period 1985-1990 were restructured with US$ 20 billion. In addition, the US$ 23 billion which had already been refinanced in the first round of reschedulings was restructured, and the US$ 5 billion in additional credits granted by the banks in that round was also renegotiated. Thus, the credits renegotiated totalled over US$ 48 billion, the equivalent of nearly two thirds of Mexico's total debt with commercial banks (see table 14). In addition, the period granted over and above the due dates on this loan (14 years) was not only much longer than those agreed to in previous agreements, it was also close to twice as long as the period usually granted prior to the crisis. Moreover, as may be seen in figure 5, the profile of payments due in the period 1985-1990 provided for in the new agreement was much closer to and more compatible with the objectives of external equilibrium and economic growth than that which existed prior to the renegotiation. As for the average margin over and above the LIBOR rate, it fell to 1.1/8, and commissions were not charged (see table 15). In addition, this average margin will be obtained by charging a rate of only 7/8 in the first four years, 1.1/8 in the following five years and 1.1/4 in the last five years.

These favourable changes were partly offset by (and to some extent were also due to) the fact that in the new agreement the banks did not undertake to supply additional credit, for which reason they continued to proceed towards their objective of gradually reducing their relative exposure in Latin America.

The situation was similar in Venezuela, which in October 1984 reached an agreement with its banking committee, the most salient characteristic of which is that it was negotiated without the intervention of the International Monetary

Fund. This agreement covered the refinancing of close to US$ 21 billion for debts maturing in the period 1983-1988 with a repayment period of twelve and a half years. As in the case of Mexico, the margin over the LIBOR rate was 1.13, commissions were not charged and banks did not grant additional new credits.

As a result of these changes and in particular of the much longer extension of the amortization period agreed to, the terms subject to negotiation (margin over LIBOR, commissions and amortization periods) were in fact more favourable in the agreements reached in 1984 by Mexico and Venezuela than in the biennium preceding the crisis, while the real cost of the credit was only slightly higher than in that period (see table 16).

Ecuador also achieved better terms in the preliminary agreement reached with the committee of creditor banks in December 1984. This made it possible to refinance all the credits which would mature in the five-year period 1985-1989 which amounted to US$ 4.3 billion, the equivalent of nearly 90% of its total debt with private international banks. The banks also agreed to supply additional net credit for US$ 350 million. As in the agreement reached by Mexico and Venezuela, the repayment periods of the new credits were much longer than in the pre-crisis period, and commissions were not charged.

Finally, after laborious negotiations, in December 1984 Argentina also reached a preliminary agreement with its banking committee, the main characteristics of which differ to some extent from those of the agreements reached in the initial round of reschedulings. Thus, the refinanced payments due had a duration of four years, and they amounted to the equivalent of slightly more than half Argentina's total debt with commercial banks; in addition, the banks also agreed to grant US$ 4.2 billion in additional net credit. The margin over LIBOR, however, was considerably greater than that provided for in the agreements reached by Mexico and Venezuela, and the banks also charged a commission for the additional credits (see table 16).

4. The process of rescheduling: achievements and insufficiencies

As shown in the preceding sections, in the short time which has elapsed since the Mexican payments crisis in August 1982, the process of renegotiating the external debt has undergone significant changes. Like all complex processes, it has also had positive and negative features. It is, however, clear to see that the labelling of its basic characteristics as favourable or unfavourable depends to a large extent on whether in judging them, account is taken of the point of view of the creditor banks, the Latin American countries or the international financial system as a whole.

Thus, if the process of renegotiating the debt is considered from the point of view of the latter, obviously it has been positive since it helped to stave off the serious threat to its stability and even its viability which the debt crisis originally represented. To grasp the magnitude of that threat, we should bear in mind that in mid-1982 the loans granted by North American banks to the developing countries not members of OPEC amounted to one and a half times the size of their capital and that in the case of the nine largest banks in the United States, this ratio was even higher (2.25). In fact, loans to Brazil, Mexico and Argentina alone were the equivalent of 115% of the capital of those banks.12/

/In these

In these circumstances, if the only alternative to honouring their commitments in the ways and periods agreed to originally open to the debtor countries had been to declare a moratorium (as happened in the 1930s in respect of their debt in bonds), suffering from the effects of the international recession and high interest rates, they would have been forced to opt for the moratorium. In that case, those banks with the biggest loans in the region would have immediately found themselves in a situation of insolvency, which in the end would have also affected the position of other financial institutions. Alternatively, the central banks and the countries' banking authorities would have had to carry out very costly rescue operations of uncertain effectiveness in order to perform their function as lenders of last resort. In either case, the extreme uncertainty or even chaos which would have resulted in the banking systems of the central countries would have resulted in a sudden and prolonged contraction of the international financial system and in a particularly severe reduction in the flows of private loans to Latin America. The process of rescheduling the debt helped to prevent this dramatic chain of events thanks basically to the fact that in practice it provided an intermediate option between the extreme options represented on the one hand by the strict fulfilment of the obligations of the countries towards the banks in accordance with their original repayment schedule (which in the circumstances prevailing since 1982 was impossible) and, on the other, by a unilateral declaration of moratorium.

In general, the process of renegotiating the debt has also been advantageous for the banks and, in particular, for those which have tied up a larger share of their resources in Latin America. It not only allowed them to steer clear of the disasters which would have occurred if some of the large debtor countries had unilaterally chosen to suspend the servicing of their debt, but also meant that in the middle of the crisis they were able to maintain or increase their earnings by collecting higher fees over the basic rates and higher commissions for restructuring.13/

On balance, the process of rescheduling has been much less favourable for the Latin American countries. Although, unlike what had occurred in previous debt renegotiation experiences, the present process included partial refinancing of interest payments, this positive feature was to a large extent offset by the high cost and the insufficient amount of additional credit granted by the banks. As a result of this and of the total eclipse of "voluntary" loans, the external adjustment process, rather than taking place gradually and within a framework of an expansion of production promoted by the reallocation of resources to export sectors and import substitution activities, had to be conducted in a very short period by effecting a radical cut in imports, which was bound to bring on a decline in economic activity and a sudden drop in investments.

In addition, because of the very considerable number of banks involved, the fact that their interests were sometimes opposed and the need to bring their action plans into line with those of the International Monetary Fund and with the needs of the debtor countries, the renegotiation process has been very slow. This, and the fact that in the earlier rounds of rescheduling only debts falling due in one or two years were restructured, meant that in practice the process became a virtually continuous one. In these circumstances, the highest economic authorities in the Latin American countries had to dedicate a disproportionate

/amount of

amount of their time and attention to the rescheduling with the result that other priority activities were neglected and the uncertainty created by the process of restructuring the debt also became a constant element, with adverse effects on the planning of economic policy and the decisions taken by private investors.

Finally, it should be noted that the improvement in the terms of the debt granted in the latest series of reschedulings has so far been of benefit nearly exclusively to those countries which have big debts with the banks and therefore have greater bargaining power. It still remains to be seen whether these terms will be extended to medium-sized and small debtors and also, if that did happen, whether they would make it possible to bring the orderly servicing of external commitments into harmony with the restoration of adequate economic growth in the smaller countries, in which the relative burden imposed by the debt is greater or the terms of trade have deteriorated more pronouncedly in recent years.

/III. OVERCOMING

III. OVERCOMING THE CRISIS

An mentioned before, Latin America has sacrificed three years of growth in order to reduce the enormous external disequilibrium it faced in 1981. Indeed, since that year, not only has economic activity not grown at the average rate of around 5.5% recorded between 1950 and 1980, but it declined during the biennium 1982-1983 and increased only slightly in 1984. As a result of this and of the highly negative evolution of the terms of trade, per capita income was 13% lower in 1984 than in 1980 and in some countries it fell to the levels of a generation ago. Thus, in terms of production and living standards, the cost of the crisis and of the external adjustment has been very high and has been aggravated, in quite a few countries, by unprecedented rates of inflation and the deterioration of the employment situation.

It is therefore essential to apply reactivation and growth policies which, in addition to allowing for a recovery of activity and employment levels, will help adapt the development pattern to the new and more stringent demands resulting from the profound changes that have taken place in the world economy and which will, furthermore, make it possible gradually to overcome the structural weaknesses of the development style that has prevailed heretofore in the region.

This will probably present the greatest economic challenge that the Latin American countries have faced for the last half century. Indeed, in quite a few respects, this challenge can only be compared with the one they faced --and, to a large degree, overcame-- during the critical period between the beginning of the Great Depression and the end of the Second World War. Moreover, the complexity of the problem is increased, in several countries, by the unusual violence of inflation and, in most of them, by the need to maintain, over the next few years, the relative external equilibrium achieved, at the cost of considerable economic and social sacrifices in 1984.

A. REACTIVATION, ADJUSTMENT AND GROWTH: CONDITIONS AND POSSIBILITIES

Strictly speaking, in order for the solution to the current crisis to be a lasting one, it is essential that effective and consistent reactivation, adjustment and stabilization policies be implemented over the short and the medium term and that they be an organic part of development strategies designed to achieve more dynamic, autonomous and equitable long-term growth.14/

The latter condition is not an easy one to fulfil and it does not mean that each time the economic authorities decide to apply measures aimed, for example at reducing inflation or keeping the external disequilibrium under control over the short term, these measures must directly contribute to the achievement of the long-term development strategy objectives, such as allowing for equal opportunities and greater autonomy in the growth process. What it means, rather, is that, taken together, measures adopted to meet short-term policy goals should be compatible with the orientation of the development strategy and facilitate, directly or indirectly, a gradual but steady progress towards the achievement of the objectives of the development strategy.

/It is

It is also obvious that the relative priority assigned to the achievement of recovery in production and employment, external adjustment and stabilization, as well as the decision taken as to what policies should be applied in order to achieve these goals will be different in the different economies of Latin America and the Caribbean; moreover, these priorities and decisions may also change, over time, within a given country, depending on what changes take place on the international scene or in respect of certain domestic political and economic factors.

In general, however, there are three sets of elements which, to different degrees and in different ways, condition the viability, cost and results of adjustment, reactivation and growth processes in the countries of the region. These conditioning factors have to do, in the first place, with the basic characteristics of the domestic economic situation currently prevailing in each country; in the second place, with the external context they will be facing in the near future and, finally --and above all-- with the central orientations and the quality of national economic policies.

1. The starting point

As mentioned before, one of the fundamental features of the recent economic evolution of many countries has been the decline of overall production and, in particular, of levels of activity in the manufacturing industry and in construction.

As was to be expected, this decline went hand in hand, in most cases, with a sharp increase in open unemployment rates and the expansion of different patterns of underemployment. Indeed, in the countries where the economic contraction has been very severe, unemployment has affected not only the less skilled workers, but also significant groups of skilled workers, technicians, professionals and management personnel.

Thus, in many Latin American countries, under-utilization of installed capacity coexists with unemployment and underemployment.

Although it is difficult to calculate exactly the margin of under-utilization of existing production capacity in industry and construction, a preliminary estimate can be made by taking into account the magnitude of the drop in production in these sectors during the crisis. Table 17 shows the estimates made for a selected group of economies of the region, as well as the estimated increases in production that could be attained if it were possible to recover the maximum levels of activity achieved before the crisis began. For the construction sector, these increases would be in the order to 30% in every country considered and would be truly exceptional, around 90%, in Argentina and Uruguay. The increases would be considerably lower and more uneven in the manufacturing industry, which experienced a significant recovery in some countries in 1984. Nonetheless, excep in Costa Rica and Venezuela, the expansion of industrial production that would be reached if pre-crisis levels were recovered would be considerable in all the other countries and quite high in both Peru (20%) and Uruguay (37%).

/As a

As a matter of fact, the above figures represent only a preliminary and very rough estimate of the order of magnitude of under-utilization of installed capacity in the manufacturing industry and in the construction sector in those countries. Indeed, during crises as long and profound as the ones suffered by some of them in recent years, many enterprises halted their activities and quite a few went into bankruptcy or disappeared completely; at the same time, their management personnel and quite a few of their skilled workers chose to emigrate. Moreover, as time goes by, some staff become redundant and some machinery becomes obsolete. All this means that, as the recession continues, it not only reduces production but also brings about a contraction of production capacity.

This is even more likely to have happened in those countries in which the economic contraction was more profound and in which the scanty investments made in recent years may even have been insufficient to compensate for the decline in the stock of capital. This phenomenon may have been offset to a certain degree, however, by the extraordinary growth of imports of capital goods in many Latin American countries during the latter years of the 1970s and, especially, the first two years of the 1980s.15/ This means that in both countries, a considerable part of the imported machinery and equipment arrived, was installed or had recently been put in working order precisely at the time when the crisis began and demand fell; consequently, it was never fully utilized. Hence, it is quite likely that actual production capacity at the end of 1981 was considerably higher than the product actually achieved in 1980 and that the fall in production from 1980 onwards therefore represents an under-estimation of the margin of under-utilization of installed capacity existing in 1984.

Nevertheless, and regardless of what the true figures may have been, there is no question that at the present time, the degree of utilization of available production resources is low in many countries of the region. Consequently, it would be possible, in principle, to achieve significant increases in production without its being necessary beforehand to increase significantly the investment in fixed capital.

This does not mean, however, that such an increase in production can actually be attained over the short term simply by applying measures designed to expand domestic demand. Indeed, a reactivation policy based only on such measures would be hampered by two main factors.

The first of these has to do with the very high rate of inflation that has been reached in not a few countries of the region. Although in theory a stabilization of the level of prices does not necessarily have to lead to a decline in economic activity, in practice, it is difficult to apply policies that will reduce inflation while at the same time raising overall production through the fuller utilization of existing resources induced by an expansion of demand.

All in all, the most serious and general restriction on the application of a reactivation policy based on increasing domestic demand is the balance-of-payments situation. Although in most countries, the current account deficit fell sharply over the last two years, this result was almost entirely due to the phenomenal contraction of imports, the volume of which fell by almost 40% between 1981 and 1984 in the region as a whole. This enormous reduction was also

/accompanied, in

accompanied, in many countries, by a more than proportional reduction of imports of luxury or expendable consumer goods and by a sharp decrease in purchases of capital goods.

Thus, firstly, because of the very small absolute volume of imports; secondly, because of the exceptionally high proportions of imports that consist of purchases of raw materials and intermediate products and, finally, because of the very low level to which the import coefficient has fallen, the countries' import capacity is at this moment the determining factor of and constitutes the fundamental restriction on the overall level of production. Indeed, in a good many of the countries of the region, practically any additional effort to make adjustments in the external sector by decreasing imports would further reduce domestic economic activity. On the other hand, in order to achieve a significant increase in levels of production and income, the level of foreign purchases would have to be increased and this would again aggravate the disequilibrium in the balance of payments. In other words, under the present circumstances, the countries' import capacity must be increased in order to reactivate the economy and, above all, to bring about a sustained renewal of the growth process.

The achievement of this objective, however, depends only partly on policies adopted by national economic authorities; it also depends, to a considerable degree, on external factors that are beyond the control of these national authorities.

2. External conditioning factors

Essentially, four external factors will determine the type of adjustment that can be made and the magnitude of the reactivation that can be achieved in the economies of the region during the remainder of this decade. These factors are: the amount of net external financing available; the real level of international interest rates; the rate of growth of the volume of world trade, and the prices obtained on international markets by the main Latin American export products.

The first of these factors is of fundamental importance. If the countries that still have to complete the external adjustment of their economies had a greater net inflow of loans and investments, the process could be carried out more gradually and, in particular, more efficiently than it has in recent years. If this were the case, it would not be necessary to reduce imports further --with the resulting negative implications this has for levels of production and employment-- but, on the contrary, they could be increased without this causing an increase in the balance-of-payments deficit. Furthermore, if more external financing were obtained, there would be more time for changes in relative prices of tradeable and non-tradeable goods --brought about by real increases in exchange rates and other measures adopted in recent years to reduce the external disequilibrium-- to fulfil their purpose of promoting a shift of resources from sectors producing domestic goods towards export and import-substitution activities. Thus, not only would it be possible to avoid the contractions of economic activity which, under the present circumstances, would be almost inevitable if the volume of imports were to be decreased, but the correction of the external disequilibria would also be more permanent, inasmuch as it would be a result of a true restructuring of the production apparatus. At the same time, as regards the countries that have already reduced their current account deficit to a manageable size, an increase in external financing would make it possible to resume and accelerate the growth process, while preserving the external equilibrium achieved at such a high cost.

As demonstrated by the recent experience of the region, however, it is not only the amount of external financing that matters, but also its cost. Indeed, if real interest rates remain at the current high levels or if considerable surcharges are imposed as external loans are rescheduled or increased, interest payments will continue to be very high. In order to make them, therefore, it would be necessary to maintain or increase the already high surpluses achieved in the merchandise trade, and this would limit the possibility of raising the volume of imports and, hence, the viability and strength of reactivation and economic growth.

In trying to assess the decisive impact which international interest rates have on the situation and prospects of the Latin American economies, it is useful to bear in mind two main facts. In the first place, even though interest rates fell on the international financial markets between mid-1984 and early 1985, in real terms they are still exceptionally high. In the second place --and this is no less important-- increases or decreases in nominal interest rates have a tremendous impact on the import capacity of the Latin American countries and, consequently, on their prospects for reactivation and growth. Inasmuch as the ratio between the debt and exports of goods and services in the region as a whole is approximately 3.2, and around 70% of the debt has been contracted at variable interest rates, each time the interest rates go down (or up) by one point, the effect is equivalent to an increase (or decrease) in the order of 2.25% of the total value of exports.16/ Since, moreover, exports are now more than 40% higher than imports, the latter could be increased (or would have to be reduced) by an even higher amount, without this changing the result of the balance-of-payments current account.17/

If international interest rates were to go down by 3 points --in which case their real value would still be double their average level of the past--, the Latin American countries could increase their total imports by around 10%, without any additional loss of international reserves. For the reasons mentioned above, this would greatly facilitate a resumption of the process of growth. If, on the other hand, this reduction of the interest rates were to occur and it was decided to maintain the current level of imports of goods and services, Latin America's current account deficit would completely disappear and would be transformed into a surplus in the order of US$ 2 billion, which could be used to increase international reserves or to reduce the absolute value of the external debt. In other words, if international interest rates were to go down to the extent assumed, not only would the region as a whole not require additional net financing, but it would have the option of starting to get out of debt. Naturally, the favourable effect of a decline in interest rates could also be used to benefit the countries through variable combinations of the three possibilities mentioned, i.e., increasing imports (greater growth), increasing international reserves (greater stability) and reducing the external debt (greater autonomy).

/The above

The above discussion is not, of course, meant to give either a projection or a prediction of what might happen on the international financial markets, nor is it a recommendation as to what the countries of the region should do if interest rates were to fall as assumed. These data do, however, enable us to appreciate the nature and the order of magnitude of the options which would be open to Latin American countries should this happen. Considering the opposite possibility, they also give a rough idea of the profoundly negative implications of possible increases in international interest rates.

Evidently, the evolution of international interest rates depends on external factors that cannot be changed by the decisions of the Latin American economic authorities. Moreover, recent experience has shown how erratic and unpredictable are the variations in international interest rates. It would not be reasonable, therefore, to rely on the possibility of their falling as the main mechanism for reducing the service of the debt and increasing the countries' import capacity.

That is why it is so important, at this stage, to consider the conditions agreed on in new external-debt-renegotiation agreements, on the one hand, and, on the other, the amount of new credit that the countries of the region are able to obtain, either from private commercial banks or, preferably, from international public financing agencies. Indeed, if the countries of the region manage to obtain a reduction of the various surcharges imposed up to now in external debt renegotiations, and if the net amount and maturities of loans are increased, the countries of the region will be able, in addition to carrying out an adjustment process that is less dramatic and more enduring than the recent one, to put themselves back on the course of growth and begin thus to palliate the profoundly negative impact of the crisis on levels of production and employment and on living standards, without this process leading to a recurrence of unmanageable disequilibria on the balance-of-payments current account.

Nevertheless, in order for the countries to be able to attain satisfactory economic development and to obtain the amounts of external financing necessary to facilitate adjustment and reactivation processes, it is absolutely essential that Latin American exports be increased and diversified and that the prices obtained on international markets rise.

As explained before, during the last three years, many countries of the region adopted measures --such as increasing real effective exchange rates and partially rationalizing their domestic price systems-- which are fundamental to the attainment of this objective. Nonetheless, up to 1983, the effect of these measures was neutralized to a considerable degree by the stagnation of international trade and by the deterioration of the terms of trade. As has also been mentioned, the latter process was especially serious in the non-oil-exporting economies, whose terms of trade had already fallen sharply between 1977 and 1981. Thus, in this group of countries, the level of the terms of trade is now about one-third lower than it was during the period 1950-1970. As a matter of fact, it is highly unlikely that the terms of trade of these economies will be restored in the near future to the level achieved during that 20-year period since, among other things, this would mean that the price of oil would have to go back to pre-1973 levels. Even assuming that the real price of oil were to remain at its current level,

/however, the

however, the non-oil-exporting countries would benefit greatly from a recovery of their real export prices to the average level of the period 1950-1970. Indeed, the recovery would be equivalent to a 30% increase in their terms of trade and this increase would in turn make it possible to finance 70% of their current interest payments or to increase their imports by 40%.

These figures --like the figures on the effect of a reduction in international interest rates-- are given only for purposes of illustration; moreover, the figures will be different for the different non-oil-exporting countries of the region. All in all, however, they do reveal --as do the figures pertaining to interest rates-- the extent to which the origins and seriousness of the crisis have been related to the serious and prolonged deterioration of Latin America's foreign commercial and financial relations and, moreover, the considerable extent to which the solution to the current crisis would be facilitated if the conditions prevailing in international trade and finance were to return to a level similar to that of the historical averages.

3. Adjustment policies

Although it is closely tied in with trends on the external scene, the resumption of a process of sustained growth depends, above all, on domestic economic policies and, in particular, on those which are aimed at increasing the countries' import capacity. As has already been mentioned, the extremely low level to which this has fallen in most countries of the region is now the main factor limiting the application of policies which will make it possible to consolidate and strengthen a short-term recovery of economic activity and subsequently promote a rapid and sustained expansion of production capacity.

Hence the high priority --now and throughout the rest of this decade-- that must be given to measures aimed at promoting exports, substituting imports and reducing the proportion of domestic expenditure that is used for purchasing internationally tradeable goods. These processes will be especially crucial, since in the next few years it is not very likely that the countries will be able significantly to increase their import capacity by attracting a greater net amount of financial resources. Indeed, the commercial banks' policy of gradually reducing their commitments in the region and the continuing high level of the service of the debt suggest that in the next few years financial flows with the exterior will continue to show a negative net result. Consequently, as has been happening since 1982, instead of helping increase import capacity, these flows will tend to reduce it.

Under such circumstances, it is obvious that any attempt to overcome the external restriction to development will have to be based entirely --or, at least, mainly-- on a structural change in the composition of both production and domestic expenditure: as regards production, the proportion represented by tradeable goods (exports and import substitutes) will have to be increased while, as regards domestic expenditure, the aforementioned proportion will have to be reduced.

/a) Exchange,

a) Exchange, tariff and export-promotion policies

In order to promote the reallocation of resources towards the production of tradeable goods while at the same time discouraging, in relative terms, their domestic consumption, policies will have to be applied which will cause the prices of tradeable goods to rise with respect to the prices of non-tradeable goods and services.

In this regard, policies relating to the exchange rate have the most far-reaching effect. Indeed, contrary to the case with tariff policies or export-promotion policies, which encourage the production of one group of tradeable goods at the expense of another, devaluation favours the production (and discourages the domestic utilization) of all these goods as a whole.

That is why it is important, in any programme aimed at reducing or controlling the external disequilibrium, to establish and maintain a high real exchange rate. Hence the importance of the devaluations implemented in recent years in most the Latin American countries which, as mentioned above, made it possible, in most cases, to raise the real effective exchange rate appreciably.

As shown by past experience, however, export and import-substitution activities are sensitive not only to the real level of the exchange rate, but also to its stability. Consequently, in order to encourage structural changes --and hence relatively slow changes-- that entail a long-term adjustment process, it is not sufficient for the real exchange parity to increase for a short time, but rather it must be maintained at the higher level for relatively long periods of time. If this is done, the exchange policy will give producers a clear indication of the real value of foreign exchange over the long term and will encourage them to orient not only their current production but also their investments towards exports and import substitution. In addition, by reducing uncertainty about the future level of the exchange rate, the elimination of sharp and frequent variations in the real exchange rate will reduce the risk of speculation with capital, which tends to have a destabilizing effect on the balance of payments, on economic activity and on price levels.

For the above reasons, significant variations in the real exchange rate should be used only to reduce current account deficits caused by a relatively permanent deterioration of external factors or to correct clear cases of exchange lags. For the above reasons, and because different economic activities have different short-term response capacities, it may be necessary, in situations such as the present one --where overcoming the external restrictions is a basic prerequisite of development--, to supplement a high real exchange rate with temporary tariff surcharges on imports and with subsidies and other measures designed to promote exports. Indeed, the selective use of such instruments makes it possible to encourage export or import-substitution activities that have a greater short-term response capacity. In addition, selective tariff increases also have the advantage of not exerting as general an upward pressure on costs as would normally be produced by devaluation, while, at the same time, they are less likely than devaluation to give rise to or accentuate inflationary expectations.

/Under the

Under the present circumstances, however, in most Latin American economies, export-promotion incentives will probably generate a greater net gain of foreign exchange than tariff surcharges or other measures designed to save foreign exchange by reducing imports. This is due, in part, to the fact that, as a result of the external trade policies applied traditionally --which up to now have placed greater emphasis on saving foreign exchange through import substitution than on gaining foreign exchange through export promotion--, activities aimed at producing for the domestic market are protected by a "total exchange rate" 18/ which is much higher than that received by the export sectors. This is also due, however, to conjunctural factors. Indeed, if one takes into account, in the first place, the enormous drop in the volume of imports that has occurred in almost all Latin American countries since 1982 and the also substantial drop in their import coefficients, it is reasonable to assume that there is only a limited possibility of replacing a significant additional amount of imports over the short term. In the second place, the existence of large margins of idle capacity in the manufacturing industry creates an export potential which could be used if adequately encouraged.19/ Finally, export promotion usually tends to be more productive during periods of international economic recovery and growth (such as the one which appears to have begun in 1984);20/ import substitution, on the other hand, is relatively useful during times of international recession (such as the period 1981-1983).

Although under the present circumstances, export-promotion incentives are probably more effective than measures aimed at selectively restricting imports, the latter can also help attain compatibility between external adjustment and the recovery and growth of domestic economic activity. In general, the contribution of the latter type of measures will be greater in countries where tariff and para-tariff protection for the manufacturing industry is relatively low and even, where there is a greater degree of under-utilization of installed capacity in activities competing with imports, and where the proportion of luxury or expendable imports is relatively higher. In such cases, the imposition of temporary tariff surcharges on imports that can be substituted more quickly and at a lower social cost through the use of existing production capacity and, in particular, on expendable consumer goods, can help to change the composition of imports so that a given amount of them will make it possible to sustain a higher level of domestic production.21/

In general, however, these special temporary incentives to the production of internationally tradeable goods must meet two basic requirements. The first is that they must be selective and favour activities having a highly elasitc short-term supply.22/ The second is that their structure should, in so far as possible, meet the basic criterion of efficiency according to which the cost of gaining a given additional amount of foreign exchange through the expansion of exports must be equal to the cost of saving the same amount of foreign exchange through import substitution. That is why, in theory, incentives granted to exports should be equivalent to the tariff protection granted for import substitution. This means that the export subsidy for a given merchandise should be equal to the tariff rate protecting that merchandise on the domestic market.23/ To the extent that the tariff structure is differentiated --typically, with tariffs being higher for final goods, lower for intermediate manufactures and minimal for raw

/materials--, export

materials--, export incentives should also be differentiated, in order to equalize the incentives offered for export promotion and for import substitution, as well as for different potential exports.

This policy of special temporary incentives for export promotion and import substitution, which is aimed at reducing the trade imbalance, may be supplemented with a policy establishing, for a limited period of time, a financial exchange rate higher than the commercial one, with a view to attracting an influx of new capital and recovering part of the substantial amount of national capital that has gone out in recent years. During this period, the financial exchange rate would be raised more slowly than the commercial exchange rate, so that by the end of the period the two would be equal again. To the extent that the commercial exchange rate were adjusted according to the difference between domestic and external inflation, it would become more appealing to bring capital in from abroad, since anyone who brought in capital would obtain a very attractive interest rate, as a result of the slower increase in the financial exchange rate with respect to the commercial rate.

In essence, the higher temporary financial exchange rate would be, to the capital flows, the equivalent of the tariff surcharge imposed on more expendable or more easily replaceable imports and the special incentives offered for more elastic exports. Thus, all flows of highly elastic foreign exchange, both commercial and financial, would temporarily benefit from the equivalent of a higher exchange rate, whereas less elastic imports and exports would have a lower exchange rate similar to that of the long-term equilibrium.

Depending on individual circumstances, in fact, it could be easier, from the administrative standpoint, to obtain the same result by establishing a single exchange rate that would be higher than the long-term rate and establishing a temporary tax for traditional exports and a very low tariff or no tariff at all (or even a special subsidy) for indispensable imports. The basic principle, however, would remain the same, i.e., to establish a higher effective exchange rate, until such time as the external crisis were resolved, for those items which, over the short term, respond rapidly to price incentives and to provide a lower effective rate for less elastic components.

b) Price and subsidy policies

The increase in exports and in the production of import substitutes that must be achieved in order to manage, over the next few years, to make economic growth compatible with the attainment or preservation of a reasonable external equilibrium does not depend only on exchange, tariff and export-promotion policies. In practice, these increases can also be fostered --although less directly-- by changes in policies pertaining to price controls and fiscal subsidies. Such policies quite frequently tend to keep the domestic prices of internationally tradeable goods --such as most agricultural products, and fuels-- artificially low. Thus, they simultaneously discourage the production of and encourage the consumption of such goods and thus tend to reduce exportable surpluses or increase imports. Thus, the establishment of more realistic prices for these goods and the gradual elimination of subsidies which foster their domestic use can significantly help reduce the external disequilibrium. Such measures often have the additional virtue of

/helping to

helping to reduce the fiscal deficit or the deficits of public enterprises responsible for producing or marketing internationally tradeable goods and thus also eventually help reduce the inflationary pressure originated by the financing of these disequilibria.

Nevertheless, and especially over the short term, readjustments of prices and the reduction or elimination of subsidies can have a negative effect on the distribution of income; this explains why they are constantly postponed. That is why such measures should be applied in such a way as to make a maximum contribution towards restoring the external equilibrium and have a minimum negative effect on the poor. In this respect, it is worthwhile recalling that, although subsidies tend to favour such groups, they are truly progressive when, in relative terms, they benefit the poor more than they benefit other sectors of society. Thus, for example, food subsidies are more progressive than fuel subsidies; consequently, the latter should be reduced earlier and to a greater degree than the former.24/

This differentiated subsidy policy can be applied even in respect of essential goods such as foods, with a distinction being made between imported or exportable foods and those which are produced exclusively for local consumption. The latter are usually produced by small farmers and --because of the relatively high cost of transport or for reasons pertaining to the different structures of preferences-- are not exported. The former, on the other hand, are often produced on medium-sized or large agricultural units. Consequently, both because of its impact on the external equilibrium and because of its social implications, the reduction of food subsidies should be concentrated on products that can be traded on the international market.

In addition, and in order to reduce to a minimum the negative redistributive effect of any subsidy reduction, price subsidies --which lower the cost of the subsidized goods for all who buy them, independently of whether they are rich or poor-- should be replaced, in so far as possible, by direct transfers to the more needy groups.25/ Thus, the effect of the price increase brought about by the elimination of the subsidy would be neutralized, for the poorer groups, by the transfer of income to them; on the other hand, the price increase would discourage consumption of those goods among the medium and higher-income sectors and would encourage their production.

In the same way that this type of change in subsidy policy mechanisms can reduce or even offset completely the possible negative effect that a decrease in the total amount of subsidies would have on income distribution, other changes in the structure and destination of subsidies can also contribute greatly towards achievement of an adjustment that is compatible with recovery and the growth of economic activity. This would be the case, for example, if the resources used to subsidize the domestic consumption of tradeable goods were re-assigned to a programme of subsidies for exports or of incentives aimed at increasing production by increasing the number of shifts worked in industry, particularly in those having an export potential.

The latter option is very important, especially over the short term, because, to the extent that any increase in production and employment has to depend on new

/investments, it

investments, it will necessarily be slow. Nevertheless, given the wide margin of under-utilization of production capacity existing at present in many Latin American economies, it is possible rapidly to increase both production and employment by using existing capital more intensively; an expeditious way to do this is by increasing the number of shifts. Indeed, studies carried out in six countries (Brazil, Colombia, Costa Rica, Chile, Peru and Venezuela) before the current crisis began, show that, on average, the manufacturing industry worked only slightly over one and one-half shifts per day and that, except in Brazil, about two-thirds of industrial enterprises worked only one shift.26/ As a result of the sharp contraction of industrial production in most countries of the region between 1981 and 1983, the number of shifts worked in the manufacturing sector is probably much lower now. Consequently, there is a considerable potential for significantly raising productive employment and, what is more important, for doing so at a cost that is low in terms of new investment. In order to take advantage of this potential, however, it is important to resolve two problems, i.e., that of the marketing of additional production and that of obtaining the additional imported inputs that would be required. As mentioned above, both problems can be solved at once by placing the increase in production abroad; hence the need to link incentives for increasing the number of shifts with a programme for promoting and subsidizing exports.

c) Investment policies

The definitive solution of the external restriction will depend on changes being made in the production structure that will increase the absolute dimension and relative participation of export activities and of those which compete with imports. Although, over the short term, this increased production must be achieved basically through a more intensive use of the installed capacity of the sectors concerned, over the medium term, the real re-allocation of resources that is essential to a growth-oriented adjustment process makes it necessary to expand installed capacity in the sectors producing tradeable goods.

For this reason, and also because of the very low levels to which investment fell in most of the countries during the crisis, it will be essential, over the next few years, to raise the rate of overall capital accumulation and, at the same time, to modify its structure and orientation.

Since two basic objectives of the economic policy for the remainder of this decade will be to reduce or control the external disequilibrium and to raise production and employment levels rapidly and steadily, it will be important, on the one hand, to reduce, in relative terms, those investments which have a high imported content and, on the other hand, to encourage those which require relatively few imports and are labour-intensive. In general, this means, especially in the near future, that investment in machinery and equipment must be increased less than expenditure for construction. Indeed, in most of the Latin American countries, construction has a very low imported content and, on the other hand, generates, directly or indirectly, a large number of jobs. Therefore, an abrupt cut in public works and housing programmes --frequently one of the first measures to be applied in programmes aimed at reducing the fiscal deficit and one which, in fact, was taken in many countries of the region in recent years-- produces very few

/benefits from

benefits from the standpoint of the adjustment --since it only barely reduces imports-- and, on the other hand, has a high economic and social cost, inasmuch as it eliminates the jobs of many workers who cannot easily find employment in export or import-substitution activities. Hence, it is wiser to maintain or initially increase construction expenditure and then reduce it, in relative terms, only gradually, as the decisions adopted in respect of exchange rates and tariffs begin to have their full effect, in order to increase activity in the sectors producing tradeable goods.

Nevertheless, in order for construction expenditure to contribute to the structural adjustment of the economy and not only to the maintenance of employment, changes will have to be made in the way in which it is allocated. Thus, in the selection of public works, preference must be given systematically to those which increase or promote the production of exports and import substitutes (such as irrigation works, hydroelectric dams, the opening up and improvement of roads in agricultural and mining areas, the expansion of ports, etc.), rather than those which only improve the living conditions of certain groups in the larger and usually wealthier cities (such as underground railways, highways and urban modernization, etc.).

In order to achieve an adjustment that is more efficient and less costly from the social standpoint, it will be important, in addition to following the two fundamental principles of giving priority to investments that increase the production of exports and import substitutes and to those which have a relatively low imported content, to give priority to investment projects which produce results over a shorter period and to those for which external financing can be obtained.

Indeed, until such time as the net inflow of capital is recovered and it is necessary to apply a restrictive monetary policy, interest rates will continue to be very high and, consequently, it will be wise to postpone very long-term investment projects; these can be undertaken once the crisis of the external sector has been overcome, when a more favourable financial situation and a more abundant supply of foreign exchange will favour long-term projects having a higher imported content.

Finally, for as long as there is a serious shortage of foreign exchange, priority should also be given to investments for which external financing can be obtained, particularly if it is granted for long terms and at lower interest rates than those charged by the international commercial banks. In addition to having a positive effect on production and employment, such investments have the advantage of increasing the public-sector deficit only in respect of the part covered by the external financing, whereas the latter contributes directly towards reducing the current account disequilibrium.27/

B. PRICE STABILIZATION AND THE EXPANSION OF PRODUCTION: RELATIONS AND POLICIES

1. The challenge of inflation

One of the most serious problems currently being faced by many Latin American economies is that of the extraordinarily high rate of inflation. As already noted, in 1984 the simple average rate of increase of consumer prices reached an unprecedented level of almost 70%, while the average rate weighted by population reached a likewise unprecedented level of 184%. Furthermore, inflation has tended to speed up so far in 1985. Thus, consumer prices increased almost sixfold in Bolivia in only the first three months of the year, while during the same period of time they increased 90% in Argentina, 40% in Brazil and 35% in Peru. As a result, the inflation over the last 12 months in the countries mentioned reached totally unprecedented levels of 8 200%, 850%, 225% and 130%, respectively. In addition, the annual rate of inflation continued to fluctuate around 65% in Uruguay, tended to settle down at 60% in Mexico, and showed an upward trend in Colombia and Chile.

Thus, together with the resumption of the growth process and the maintenance of a suitable external equilibrium, the reduction of inflation is also a priority objective and a basic challenge to the economic policy of a considerable number of Latin American countries.

If reducing inflation necessarily meant provoking a recession --as has tended to occur with the application of traditional stabilization programmes-- this objective would seem almost draconian. This would be particularly so if the magnitude of the recession had to be proportionate to the initial inflation, since at present Bolivia is facing a situation of hyper-inflation, Argentina is nearing such a situation, and Brazil and Peru are suffering from inflation with more than three digits.

Fortunately, there are both empirical and theoretical reasons for asserting that it is possible to reduce inflation significantly while at the same time reactivating the economy. Naturally, both the design and the instrumental management of a programme of stabilization with expansion is a delicate and complex matter. Nevertheless, it is possible. In contrast, insisting on traditional recessive stabilization programmes would be equivalent to automatically condemning those Latin American countries which are affected by sharp inflationary processes to suffer an economic contraction even more acute and prolonged than that which they have already experienced.

Among the empirical reasons why a programme of stabilization with expansion is feasible at the present time, there are three which are of special importance. The first is that, precisely because of the unusual severity of the economic contraction which took place in the period 1982-1983, there is abundant under-utilized production capacity in many countries of the region. The second is that, because of the sharp devaluations carried out from 1981 onwards, the relative increase in the prices of tradeable goods --which normally tends to bring about,

/at the

at the beginning, a speeding up of the inflationary process-- has already taken place; finally, the third reason is that, as a result of the foregoing changes and the existence of an international context which is somewhat more favourable than that prevailing between 1980 and 1983, it is probable that the value of exports will rise more rapidly in the next few years, thus making it possible to increase the volume of imports while maintaining the external equilibrium.

Furthermore, it is worth recalling that in theory the reduction in the growth rate of prices does not necessarily have to cause a recession. On the contrary, if inflation is simply a process where "too much money is chasing too few goods", it is hard to see why, in order to reduce it, it should be necessary to produce still fewer goods, as happens during a recession. The fact that this has indeed happened frequently in practice is attributable to errors in the design or application of traditional stabilization programmes: it is not because such an outcome is theoretically inevitable.

Strictly speaking, from an analytical point of view, reducing inflation "only" calls for slowing down as uniformly as possible the growth rate of the nominal values of certain main variables of the economy such as the exchange rate, the rate of interest and wages. Reducing the intensity of the inflationary process does not call for the reduction of production or for fundamental changes in real variables of the economy. This latter, it is true, represents a feature where the process of price stabilization contrasts with the process of external adjustment, for in so far as such an adjustment makes necessary a sharp turnaround in the trade balance from a deficit to a surplus, it will normally have an unavoidable real cost. This is because --although the adjustment does not require any reduction of production either-- it does in many cases bring with it a drop in the domestic availability of goods and services, which is ultimately the variable conditioning the real standard of living of the population.28/

The above is not a mere theoretical point, but is backed up empirically by certain historical experience. Although they are the exception rather than the rule, there have been programmes of stabilization with expansion. Examples of this were the cases of the abrupt halting of some hyper-inflation situations after the First World War,29/ and in more recent times (1965-1970) the cases of Indonesia 30/ --which managed to bring down its inflation from 1 000% per year to 10% without sacrificing its growth process-- and Uruguay, which reduced its inflation from 125% to 20% between 1968 and 1969 without sinking into a recession.

Of course, examples proving the opposite are abundant, but as already noted they are generally the result of faulty design --both in the case of traditional stabilization programmes and in that of programmes aimed merely at keeping down inflation-- or of unsuitable application.

/2. Lessons

2. Lessons of the recent past

a) Why traditional stabilization programmes are a failure

Why, although this is not intrinsically necessary, have stabilization programmes in the past tended to reduce the product, often very sharply?

It is well known that if it is desired to reduce inflation it is necessary to reduce the growth rate of nominal aggregate demand. This alone is not enough, however, since the slowing of nominal demand may influence either the rate of increase of prices (the desired objective) or the rate of growth of production (the undesirable effect). The question of how to explain to what extent the slowing of demand will affect prices or production constitutes one of the central problems of present macroeconomic theory. In practice, this extent depends both on the policies adopted to achieve the stabilization of price levels and on the inflationary expectations. If the latter are fairly uniform among the different economic agents and, above all, if they coincide with the target inflation implicit in the monetary and fiscal policy, the slowing down of nominal aggregate demand will predominantly affect prices. In contrast, if there is a substantial difference between the inflationary expectations of the public and the target inflation implicit in the monetary and fiscal policy, the slowing down of aggregate demand will also affect production and will cause a recession.

The way that expectations are handled is thus seen to be of fundamental importance. In effect, the failure of most of the anti-inflation programmes carried out in Latin America is due to the fact that they have operated only on demand or only on costs and have neglected or ignored the handling of expectations or have tried to control only some of the variables which influence them.

Naturally, stabilization programmes which sought to reduce inflation through price controls but which did not manage to check monetary expansion were bound to fail, since they attack the symptoms but not the cause of inflation. They temporarily kept down inflation, but only at the cost of internal shortages of supply and/or balance-of-payments crises. In these circumstances, inflation was bound to resurge again after a time, frequently even more strongly than before.

Programmes concentrating exclusively on limiting the expansion of the money supply and reducing the fiscal deficit did not have any success either. This was because although it is theoretically and empirically beyond doubt that it is essential, in order to reduce inflation, to reduce the expansion of the monetary supply too, nevertheless a policy which only achieves the latter objective and does not manage at the same time to control cost pressures runs the risk of causing a recession. Thus, if the inflationary expectations of the economic agents are higher than the target inflation implicit in the monetary policy, prices will be set at a higher level than that which would make it possible to buy the potential production with the amount of money available. In these circumstances, the government will be faced with the dilemma of either maintaining its restrictive monetary policy and thereby provoking a recession, or abandoning its goal of stabilization and effectively ratifying the higher inflationary expectations of the economic agents through a passive monetary policy. It is this crucial dilemma which explains why stabilization programmes which have been centered basically on restricting nominal aggregate demand have frequently brought about a contraction in economic activity or have had to be abandoned after a time. This unfavourable outcome has been particularly common in countries with a long tradition of inflation, since this generates expectations and mechanisms which, although they make "coexistence" with continual rapid price rises more viable from the economic and political points of view, also make it more difficult and costly to apply measures designed to reduce inflation.

This explains the failure of the stabilization programmes which, while with containing demand, "de-indexed" only a single key price. Thus, for example, at various times and in various countries attempts have been made to check inflation by the application of monetary and wage control policies. Since such policies left the other prices (especially those of goods) free and did not take any measures to guide expectations, however, the result was that the decline in inflation was much slower than that of nominal wages, giving rise to Keynesian-type recessions: i.e., due essentially to a drop in real demand. In these cases, the failure of the stabilization programmes has been doubly costly from the social point of view, since as well as reducing the level of economic activity they have caused a deterioration in income distribution.

In still other cases, an attempt has been made to check inflation through exchange rate policy. In order to do this, the exchange rate was readjusted, not as a function of past or present inflation, but in terms of the rate of inflation postulated as a goal for a future period, seeking in this way to reduce the growth rate of prices and costs and, at the same time, to guide and standardize the expectations of the economic agents regarding future inflation. In these cases, the main cause of the failure has been the fact that the prices of goods competing with imports and non-tradeable goods and services went down much more slowly than the rate of devaluation. In practice, and contrary to what might have been expected to happen under the so-called "single price law", imported products tended to be sold initially at prices closer to those charged before the trade liberalization process for their closest domestic substitutes, and not at their long-term value (the international price plus the tariff charges). In other words, at least at the beginning, the convergence between the prices of national and imported goods was in an upward direction (domestic prices) rather than downwards (international prices). Furthermore, the exchange rate lag caused by this tended to generate a substantial disequilibrium in the balance of payments and a decline in economic activity. Both these consequences were initially neutralized through considerable inflows of capital, but the persistent drop in the real exchange rate gradually made the maintenance of the exchange rate policy less and less credible and furthered a situation whereby national products which had to compete on the local market with imported goods were gradually but systematically displaced by the latter. As a result of this, levels of activity and employment dropped and the pressure to devalue increased. Furthermore, as it became evident that the exchange rate policy could not be sustained without massive external indebtedness, the inflow of capital also dropped. Thus, it was eventually necessary to raise the exchange rate sharply, which led to a resurgence of inflation.

/b) The

b) The failure of traditional programmes: analytical implications

Traditional programmes are largely based on erroneous analytical conceptions of inflation. Thus, both the theory which attributes inflation to demand pressures (demand pull) and that which attributes it to the rise in costs (cost push) fail to distinguish adequately between the initial impulse which provokes or accelerates inflation and the mechanism or spiral which keeps the inflationary process going once it has begun. Strictly speaking, the distinction between demand and cost inflation is only relevant for countries with occasional outbreaks of inflation. In contrast, it is almost irrelevant for countries where inflation is persistent. In these, debates centering on these two concepts of the origin of inflation are not only sterile but have led to the application of ill-conceived stabilization programmes. When the inflationary process becomes persistent, it is almost impossible to distinguish between pressures coming from the expansion of demand and those coming from the rise in costs. The most that can be done is to identify phases in which one or the other of these apparently predominates, since in practice the inflationary process becomes a spiral in which both demand and costs continually rise and whose intensity is also decisively influenced by expectations. These expectations influence both demand (for goods and money) and costs (remunerations, interest, exchange rates). Consequently, in order to be successful, the stabilization programme must act simultaneously both on the elements which affect variations in demand and on those which influence the increase in costs, while it must also "guide" or channel expectations. If this is not done, it will be a failure or else will be unnecessarily costly, as most of the stabilization programmes applied in the region have been.

Strictly speaking, if the increase in price levels were due solely to excessive spending, as the "demand pull" theory postulates, it would be impossible for situations of high inflation to exist at the same time as severe recessions, yet this frequently happens in reality. Nor can these situations be convincingly explained by the theories which attribute inflation to the pressures of costs, since although these attribute the recession to rigidities in costs and, in particular, to the inflexibility of the wages paid to the labour force, yet if there is something in the Latin American experience of the last ten years which leaves a strong impression, it is not the rigidity of relative prices, but on the contrary their impressive variation. Thus, the terms of trade have varied by as much as 40% in a single year; the relation between the prices of tradeable and non-tradeable goods --which constitutes a way of measuring the real exchange rate-- has fluctuated in various countries by up to 50% in a single year, and, in relation to wages, the real increases in exchange rates have been even greater, reaching as much as 100%. Likewise, in cases where financial systems have been abruptly liberalized, real interest rates have risen in a short space of time from a negative annual average of 40% to a positive average of over 30%, while as regards the dreaded wage pressures --frequently identified as the exclusive of principal cause of unemployment and recession-- it should be recalled that in various countries of the region real wages have fallen by up to one-third in a single year.

/Thus, the

Thus, the truth is that the really significant rigidity --at least in the countries where inflation is persistent-- is not of an institutional, trade union or political nature, but is due to the inflationary expectations generated by the continuous process of price increases itself. Because of these expectations, all the elements which affect prices and costs --wages, rents, taxes, interest rates, exchange rates, loan repayment installments-- are adjusted either formally (through contracts or laws) or informally (through the market) in anticipation of the future rate of inflation.31/

If the expectations anticipate the level of inflation correctly, they will not give rise to significant disturbances in production or in income distribution, which explains how various countries of the region have "coexisted" for many years with severe processes of inflation without this seriously affecting their economic growth. If the authorities try to reduce inflation more quickly than the economic agents consider possible, however, the programmes of stabilization lose their effectiveness: as already noted, if the expectations are superior to the inflation implicit in the stabilization programme, part of the slackening in nominal aggregate demand will have an incidence on production and tend to generate a recession. This is why the most serious negative effects associated with inflation tend to occur when this accelerates suddenly and during the phase when the authorities are trying to reduce it faster than the public believes possible. Thus, if inflation has come to be persistent, the initial objective of the stabilization policy must be to stabilize the rate of inflation and not freeze the price levels themselves; only subsequently should an attempt be made to slow down the inflationary process.

It is for the same reason that the unemployment caused by stabilization programmes is not due solely or principally to the fact that real wages rise. It is quite true that if nominal wages are readjusted --either through the expectations prevailing in the labour market or because of the existence of a system of formal indexing-- by a larger amount than the increase in price levels foreseen in the stabilization policy, then real wages will rise and tend to generate unemployment (of the neo-classical type), just as the theorists of cost-push inflation fear. However, unemployment and recessions can also be caused when there are declines in real wages, as experience has shown. Thus, if wages are adjusted according to the targeted inflation but the producers have inflationary expectations which are higher than this and they fix their prices in accordance with these, real wages will drop and there will be a reduction in demand for and sales of non-tradeable goods. Consequently, as long as this imbalance in the goods market persists, production will drop and unemployment will rise. This will occur in spite of the reduction in real wages, because in the sectors oriented towards satisfying domestic demand --which normally make up more than half of overall economic activity-- the incentive to dismiss staff because of the drop in sales will be stronger than the tendency to take on more workers because wages are lower.

Thus, in principle, a stabilization programme does not necessarily require that there should be a recession or that there should be a significant variation in real wages, except in two special cases. The first of these is when real wages rise considerably from a level close to their normal, historical or equilibrium values. In such a case, there will be excessive cost pressure which reflects an imbalance in the labour market and will tend to generate a recession and neo-classical-type unemployment. The second case occurs, on the contrary, when real wages drop sharply (unless this drop is to offset a prior excessive rise which had helped to provoke the initial outbreak of inflation). In this second case, the recession would be attributable to insufficient demand and would generate unemployment of the neo-Keynesian type which would reflect an imbalance in the goods market.

3. A programme of stabilization with expansion: basic lines

The foregoing analysis gives rise to four principles which are of fundamental importance for the design of a programme of stabilization with expansion: the need for simultaneous slackening in the growth rates of key prices until they reach the targeted level of inflation; the need for this slackening of key prices to be compatible with the monetary and fiscal expansion; (normally) the need for the correction of some relative prices which may be significantly unbalanced; and the importance of the speed at which it is possible to proceed with the programmes: i.e., the relative merits of gradual and "shock" stabilization programmes.

a) Simultaneous slackening of the growth rate of key prices

As already noted, reduction of the growth rate of the money supply and lowering of the fiscal deficit generally constitute a necessary but not sufficient condition for a stabilization programme. This is because, in practice, the inflationary expectations are not immediately adjusted when restrictive monetary and fiscal policies begin to be applied. At the beginning, the public is skeptical: it wants to see results before believing in the reduction of inflation postulated as a goal by the authorities. This inertia in the adjustment of expectations means that the level of prices is higher than that which would be compatible with the level implicit in the stabilization policy. In such a case, the restriction of nominal aggregate demand tends to have a negative effect on production, and inflation goes down less than was planned. It is for this reason that, if they are to fulfill their objectives and avoid giving rise to a costly recession, stabilization programmes cannot be reduced to the mere control of expansion of the money supply and the fiscal deficit. Measures in these fields must be accompanied by a simultaneous and uniform policy of "slowed-down indexing" which guides or controls the movement of the nominal values of the key variables --wages, the exchange rate, interest rates and prices-- in such a way that these adjust (slow down) to the rate of inflation implicit in the monetary and fiscal policy.

Thus, in contrast with what is proposed in orthodox stabilization programmes, it is necessary in the beginning not to free prices but to control them. At the same time, however, in contrast with what tends to occur with traditional price control systems, the motive for this should not be to keep down inflation but to bring the values of the key variables close to their equilibrium levels as soon as possible.

/b) Consistency

b) Consistency between the policy on key prices and monetary and fiscal control

Nevertheless, just as it is not sufficient, of itself, to control the expansion of aggregate demand through monetary and fiscal policy, it is not sufficient either to impose price controls and to take measures for the deliberate guidance of expectations, for if an expansive monetary and fiscal policy continues to be applied at the same time that prices are controlled, the inflation will be repressed but not eliminated. In such a case, for a certain length of time the inflationary pressures will not manifest themselves in higher prices, but in shortages of supply, in the appearance of black markets, and in balance-of-payments disequilibria, but nevertheless in the end they will lead to a new resurgence of inflation. This means that an essential condition for a successful stabilization programme is to control monetary and fiscal expansion, since this feeds all inflationary processes, although it does not necessarily originally cause them.

Nor is it possible to fix an arbitrary target for the slackening of inflation. This target must be compatible with the monetary and fiscal control that can be really applied. If this is not done, the programme will lack coherence and credibility and the expectations will have the final result of causing prices to rise more than was planned. For example, if the monetary base is equal to 10% of the gross domestic product, if the projected fiscal deficit is 5% of this, and if this deficit can only be financed through credits from the Central Bank, then the monetary base will have to grow by 50% solely in order to cover the public sector imbalance. Thus, unless there were a considerable increase in the demand for money or a very marked growth in economic activity, inflation could not be reduced to much less than 50% per year. A bigger slackening in key prices would not be consistent with the monetary and fiscal programme, and would ultimately end in failure.

c) Correction of price lags

Another real difficulty which has to be faced by stabilization programmes is that in most inflationary processes --except when the level of hyper-inflation is reached-- the movement of prices (although generalized) is not uniform. Thus, it frequently happens that as a result of unsuccessful attempts at stabilization the following items have suffered significant lags compared with other prices: a) the exchange rate (which has a negative effect on the balance of payments); b) tariffs of public services (which thus increase the fiscal deficit); c) agricultural prices (which thus discourage the growth of production of basic foods); d) interest rates (thus hindering the effective assignment of investment and giving rise to large and unjustified redistributions of income from savers to debtors); and e) real wages (which amounts to regressive income distribution and tends to generate a contraction in the sectors of production supplying the domestic market).

Consequently, if the stabilization programme is to be lasting and effective rather than succeeding only in bringing about a transitory reduction in inflation, it is necessary to correct these imbalances in relative prices. Unfortunately, the readjustment of prices which had previously been held back or repressed in comparison with others may be (erroneously) considered by the economic agents as an indicator of probable inflation and not just as a corrective adjustment. If this happens, the inflationary expectations may exceed the inflation target implicit in the monetary and fiscal policy. Therefore, the number and amount of these corrective adjustments must be kept down to the indispensable minimum, since if there are many

/of them

of them or they are very large it will be very difficult to obtain the desired reduction of inflation. For the same reason, too, if the lags in question do not seriously compromise fundamental aspects of the economy, such as the external equilibrium, for example, it may be preferable --especially in the case of very high rates of inflation-- to slow down the rate of increase of all prices uniformly until inflation goes down to more manageable levels, and apply corrective adjustments subsequently. If, in contrast, the lags are very big and their correction cannot be put off, it would appear to be more advisable to correct first of all the biggest lags and only later apply a programme of simultaneous de-indexing of key prices.

d) Graduality versus shock

The speed at which inflation can be reduced depends very much on the monetary or fiscal control which is feasible, the number of key prices which are lagging behind, the size of the relative lag, and the strength of the inflationary expectations. It is precisely because these factors cannot always be controlled strictly that it is advisable for the stabilization process to proceed in a gradual manner, within the limits fixed by the expectations of the economic agents.

In contrast, if it is possible to apply severe monetary and fiscal control and the lags in prices are few in number and small in size, it will be possible to apply a shock treatment without this bringing about a costly recession. This is because, in order to reduce inflation (above all when it is over three digits), it is not essential to make significant changes in the structure of production. What is called for is rather to slow down --in a relatively simultaneous and uniform manner-- the growth rate of the nominal values of a number of key variables, and this can be achieved quickly if severe and coherent monetary, fiscal price and income policies are applied.32/

It is probable, however, that such policies must be accompanied by a semi-confiscatory monetary reform equivalent to the imposition of a one-time direct and progressive task on the owners of money. This may be necessary both in order to increase the credibility of the shock programme and to increase the demand for money and the inflow of tax revenue. It is particularly vital, however, that the set of measures should be adopted in a harmonious and synchronized manner, since it has frequently happened in the past that the shock treatment only checks the increase of certain key variables --usually the money supply and wages-- while other fundamental elements are left untouched or escape from its control, thus tending to give rise to recessive and regressive effects which are both undesirable and avoidable.

Last, but certainly not least, as the success of a stabilization programme --whether it be a gradual or a shock programme-- depends very much on its effect on expectations and on the confidence which it arouses among the economic agents, it is necessary that it should be not only technically coherent but also politically viable, which means that there must be suitable social, political and institutional conditions to enable it to be applied in a stable and lasting manner.

/4. An

4. An expansive stabilization programme: instrumental aspects

a) The control of the nominal aggregate demand

As already said, a basic requisite of an effective stabilization policy is the control of credit and money. In many cases this depends, in its turn, on the speed with which the fiscal deficit can be reduced. This last, however, is not merely a question of will. It is due in part to the fact that, from the fiscal standpoint, inflation constitutes a tax on the owners of money which enables the treasury to "collect" an amount of resources which depends on the quantity of money and the intensity of the inflation. Thus, for example, if at a given point in time money represents 10% of the product and inflation is at a 100% the "inflation tax" would provide the treasury with revenues equal to 5% of the former. To reduce inflation to zero would in this case require the replacement of this source of revenue by a tax which would yield funds amounting to 5% of the product or the reduction of public expenditure by a similar amount. Obviously, neither of these changes can easily be effected in a single year.

Furthermore, owing to the considerable reduction in public expenditure introduced in several countries in recent years, to the fall in the real remunerations of government officials, and to the need to increase public investment, the possibility of introducing further major cuts in government expenditure is limited by social and political considerations. Hence it would be preferable for the inflation tax to be replaced by an increase in tax income or in other revenues of the public sector. However, since the speed with which real fiscal revenues can grow is limited by the administrative capacity of the State and by the reluctance of the public to pay more taxes, the possibility of achieving the goals of monetary control and stabilization will be conditioned by the speed with which these limitations can be overcome.

Although the mechanisms for achieving these objectives may vary considerably from country to country, there are three methods of increasing the revenues of the public sector which have proved particularly effective in the recent experience of Latin America.

The first of these is the automatic indexation of the taxation system, which is especially necessary in countries in which inflation is very intense. In this connection, it should be borne in mind that if the taxation system is not indexed and the legal time-lag between the moment in which the tax is incurred and the moment in which it should be paid is only three months, with an annual inflation of 40% the real tax revenue would fall by 10% for this reason alone.

The second is the control of tax evasion, which frequently reaches major proportions. Hence, in order to increase fiscal revenues, it is preferable to control evasion rather than to introduce new taxes or raise the existing rates --which are often very high, partly because of the extent of the evasion. As a number of recent experiences have shown, evasion can be considerably reduced by a more effective supervision. This requires, apart from the essential condition of a firm political will to enforce tax legislation, the following conditions: a) the radical simplification of the tax system, both as regards the number of taxes and rates and the exemptions and special and discriminatory regulations, since this enormously simplifies tax supervision by the traditional methods and is essential for the strengthening of this supervision by the application of modern computerized control systems; b) the conversion of the tax-revenue services into special divisions within the public administration, endowed with ample means to fulfill their supervisory functions and with a highly qualified and well paid technical personnel; and c) the legal establishment and effective and speedy application of rigorous penalties for tax offenses, which, along with creating a more effective control, will generate in the contributors the widespread conviction that it is economically more rewarding to fulfill their tax obligations than to run the risk of not doing so.

A third method of increasing public revenues is through the fixing and maintenance of realistic prices and charges for the goods and services supplied by public enterprises, some of which are frequently responsible for a large part of the overall public deficit. Besides their contribution to a greater balance between public income and expenditure, the increases in charges and prices have two additional advantages. The first is the speed with which they increase the resources of the State, which is normally much higher than that of the changes in tax legislation; the second is the correction which they introduce into the price system and as was seen, the positive results of this on the adjustment process. In fact, in no few cases the artificially low prices charged by the State enterprises encourage domestic consumption of tradeable goods, thereby contributing to the increase in the external imbalance, whether through greater imports or the reduction of exportable surpluses. Moreover, to ensure that the policy of credit restraint which normally forms part of the stabilization programmes does not create undesirable recessive and redistributive effects, it is important to bear in mind that it is not neutral. Indeed, credit restraint has a disproportionate effect on the sectors particularly susceptible to the variations in interest rates and the availability of credit, such as construction and agriculture, together with the medium-sized and small enterprises, which normally are unable to offer the financial system the same guarantees as the larger productive units. These activities and enterprises are particularly labour-intensive, and therefore a fall in their level of production will tend to produce a disproportionate fall in employment. Thus it is desirable that the application of a restrictive monetary policy should include regulations ensuring the maintenance of the share of these activities and enterprises in the total credit.

b) Price and income policies

As already mentioned, in order to avoid destabilizing contractions in economic activity it is essential that the rate of the nominal changes in the main macroeconomic variables should decelerate simultaneously and be consistent with the inflation goal implicit in the programmes of monetary and fiscal constraint. Nevertheless, there is no sense in controlling the nominal values of wages, interest and exchange rate if there is no similar control over the prices of goods, since the real purpose of these measures is to influence the real levels of wages, interest rate and exchange parity.

/The importance

The importance of guiding or controlling (and not of repressing) the prices of certain goods is all the greater if, to achieve external equilibrium and internal stabilization, it is necessary to correct certain relative prices, as typically happens with the exchange rate and the price of public services. In fact, if no attempt is made to guide the remaining prices towards their new equilibrium, it is probable that, at least at first, the decisions to raise the real exchange rate and the relative prices of public services will create considerable increases in the prices of the remaining goods, mainly owing to the resistance of producers to the reduction in profits that should result from the changes proposed in the relative prices and also because of their tendency to confuse this corrective change with a general upsurge of inflation. On the other hand, it will be more possible to effect this modification in relative prices if the producers see that, through price control, the economic authorities succeed in confining the rises to those goods whose prices were already very depressed.

Of course, it is not a question of reducing inflationary pressures by means of the administrative fixing of artificial prices, or of creating a complex bureaucratic machine to control them. What is needed is a set of relatively simple rules of easy application. In contrast to traditional price control --directed primarily to fixing the prices of agricultural products-- the control should be centered on industrial prices, which are frequently more sensitive to inflationary expectations and to oligopolistic influences. This effort should concentrate on the control of the prices of the leading enterprises, both for reasons of simplicity and because they generally enjoy a certain oligopsonic power over their suppliers, which enables them to pressure these to accept prices in line with those of the products which they process. Moreover, the large enterprises normally use more capital-intensive technologies, which enables them more easily to absorb for a time, through a reduction in their profit margins, the fall in operational income which might be caused by the policy of price control. Another sector in which it might be desirable to guide prices is that which produces certain basic inputs for construction. Indeed, the government programme of public works and housing frequently generates a considerable proportion of the overall demand for these inputs, which enables their prices to be controlled in consonance with the more general objectives of the anti-inflationary policy.

In addition, and to facilitate a stabilization which will avoid the risk of recession, the income policy should likewise try to establish certain general principles with regard to wage adjustments. Thus, to maintain the purchasing power of wages during a process of stabilization, it will be necessary for nominal wages to be increased not only in terms of past inflation but also in relation to expectations and the frequency of wage readjustments should be in line with the rise or fall of the inflation rate.

In periods when there is a slackening of inflation, wage indexation related to past inflation raises the real wage, so that the annual average wage (which is what applies) rises when the inflation rate declines.33/ Hence the indexation of wages in relation to past inflation is a way of ensuring that the future inflation remains the same, or that real wages rise (which, depending on the initial situation, may or may not be desirable). Inversely, if nominal wages are adjusted exclusively to future inflation, real wages will be reduced, even if the inflation objective is achieved and even more so if inflation is not reduced to the extent foreseen.34/

/Consequently, if

Consequently, if the aim is to maintain the real level of wages, these must be readjusted in accordance with both past and future inflation.35/ Even so, there is the risk that, if inflation does not fall as much as foreseen, real wages will decline; or that, if inflation falls more than expected, real wages will rise. Thus a more stable and less risky formula would be: a) to readjust wages in terms of past and projected inflation, and b) to readjust them again when the inflation reaches the level fixed as a goal --whether this happens at the end of 12 months or in a longer or shorter time.36/ This procedure ensures that the average real wage for the period of the readjustment will be the constant real wage postulated as objective.

Finally, the stabilization policy should establish guidelines for the level and evolution of the interest rates. This certainly does not mean that they should be fixed at what would be negative rates in real terms, as has frequently happened in the past, since obviously credit cannot be granted indiscriminately at subsidized rates. In fact, it is common knowledge that a negative real interest rate segments the market between those who have and those who have not access to a credit whose cost has been artificially reduced by the fixing of the interest rate. To take advantage of this cheap credit, the privileged groups tend to overexpand or over-mechanize their installations, or to use their resources in the purchase of assets whose values are depressed by the scarcity of credit, a process which also leads to the concentration of wealth. In addition, the segmentation of the market inhibits the expansion of activities with less access to the banks --usually the small and medium-sized enterprises, which generally use more labour-- thereby forcing them to resort to credits in the informal sector at rates much higher than par. Nevertheless, there are also problems associated with a real interest rate which is much higher than that which would be normal, at least when this is maintained for a long time: it pushes up financial costs and thus contributes to a fall in production. What is more, as has been recently demonstrated in several countries of the region, it is obviously impossible for economies growing at rates of 5 or 6% per year to pay real interest rates of 25 to 30% over a prolonged period without creating a financial crisis.

As the credit market is rapidly adjusted by means of price (the interest rate), the disequilibria in other markets --those of goods, foreign exchange, assets, etc.-- tend to be manifest in the former through absurdly high real interest rates which reflect the imbalances of these other markets but cannot correct them. Hence, while these imbalances remain, a real interest rate will have to be maintained (or "suggested") which is only slighly higher than the international rate, since this is the nearest approximation to the interest rate of equilibrium in the long term.

The logical counterpart of the foregoing is that in such situations credit will have to be rationed by quantity, and not only by price, until the excess demand deriving from the imbalances in the other markets disappears. Meanwhile, it will have to be determined which part of the demand for credit is "legitimate" (that is, deriving from a potential productive capacity which it is expedient to make effective) and which part is "illegitimate" (that is, the result of the desire of the would-be borrower to postpone the liquidation of stocks or assets or the lowering of his prices). Certainly it is not always easy to make this distinction or to carry it out in practice, but it is better to be guided by this than to risk the crisis of the whole financial system owing to the charging of inordinately high real interest rates which obviously cannot be paid save in exceptional or transitory circumstances.

/Notes

Notes

1/ In the period 1981-1984 the overall social product of Cuba --which represents the sum of the gross output of manufacturing, mining, agriculture, transport, communications and commerce increased by 34%. One of the main causes of this outstanding growth was Cuba's very favourable trade relationship with the Soviet Union. On the one hand, this country paid for its purchases of Cuban sugar a much higher price than that of the international market and one which went on multiplying: thus in 1981 the price paid by the Soviet Union was more than double that of the international market, in 1982 it was over four times as high, in 1983 almost six times and in 1984 ten times. Moreover, the Soviet Union sold oil to Cuba at a lower price than that of the world market and allowed it to sell at the international price and in freely convertible currency the surpluses which Cuba succeeded in generating through fuel-saving policies. Thanks to this mechanism and the reduction of fuel consumption, especially in the sugar industry, the value of the re-exported oil rose rapidly and in the biennium 1983-1984 represented around 40% of the total exports of Cuba in convertible currency.

2/ For a recent comparative analysis of these experiences, see ECLAC, Estabilización y liberalización económica en el Cono Sur, Estudios e Informes de la CEPAL, No. 38, Santiago, Chile, 1984.

3/ For two critical analyses of the characteristics and consequences of the financial reforms in Colombia and in the countries of the Southern Cone, see respectively Eduardo Sarmiento, The Failures of the Capital Market: a Latin American View and Joseph Ramos, The Rise and Fall of Capital Markets in the Southern Cone, papers presented to the Seminar on "Financial liberalization and the internal structure of the capital markets", held in Tokyo between 22 and 24 April 1985.

4/ In the 1981-1982 biennium, this figure was even higher (52%).

5/ For a detailed analysis of the way in which these two kinds of policy contribute to the adjustment process, its avoidable and unavoidable cost and its relations with external financing and inflation, see ECLAC, Políticas de ajuste y renegociación de la deuda externa en América Latina, Cuadernos de la CEPAL Series No. 48, Santiago, Chile, December 1984, pp. 95-102.

6/ Probably the most successful example of this type of "structural adjustment" has been the notable reduction in petroleum imports in Brazil, achieved partly by effecting an unscheduled increase in the domestic extraction of petroleum and partly by replacing gasoline and other petroleum products with alcohol and coal. In this respect, see Antonio Barros de Castro, "Ajustamento y Adaptaçao Estructural: A Experiencia Brasileira", Rio de Janeiro, May 1984.

7/ In this respect, see Richard Lynn Ground, "Orthodox adjustment programmes in Latin America: A critical look at the policies of the International Monetary Fund", CEPAL Review, No. 23, August 1984, pp. 45-82.

8/ Jamaica and Guyana also rescheduled their debt with the banks; however, the corresponding data were not available.

9/ The nine largest banks in the United States had loaned Mexico the equivalent of 50% of their capital and reserves, and the largest banks in Japan had considerably more than 50% of their capital on loan in that country. See, "Bottomless debt", The Economist, 11 December 1982 and "The Mexican Schokku", Euromoney, November 1982.

10/ Bank for International Settlements, International Banking Development, third quarter, 1982, Basle, 19 January 1983.

11/ During the 1970s it was not common for countries to exceed margins of 2% over the LIBOR rate, and the margin applied rarely exceeded 2.25%. In addition, margins that high were usually reserved for new borrowers without much experience in international capital markets or for older borrowers without the capacity to service their external debt.

12/ Richard Dale and Richard Mattione, Managing Global Debt (Washington, D.C.: Brookings Institution, 1983) and Morgan Guaranty Trust Co., World Financial Markets, June 1983.

13/ R. Lambert, "New York Banks Show Strong Gains", Financial Times, 19 January 1983.

14/ The guiding principles and essential elements of such strategies are analysed in the Volume III of this document.

15/ Thus, in Mexico, the annual value of imports of capital goods for the period 1980-1981 was 150% higher, on average, than during the five-year period 1975-1979; between these same two periods, imports of capital goods rose by 140% in Chile, 130% in Argentina, 115% in Uruguay, over 100% in Peru and over 90% in Colombia.

16/ Strictly speaking, the effect of a decline in interest rates is more favourable from the standpoint of the balance of payments than the effect of an equivalent increase in exports, since, to the extent that the latter is due to an increase in volume, it will also require some increase in imports.

17/ These figures showing the implications of variations in interest rates for the region as a whole are based on the assumption that they would be maintained for a full year. Naturally, the effect of a decrease (increase) in interest rates would be much more favourable (detrimental) in those countries in which the following are higher: a) the debt/export ratio; b) the proportion of the total debt contracted at variable interest rates, and c) the trade surplus.

18/ In other words, a rate which takes into account not only the level of the exchange rate but also the effect of tariffs and other measures (prior deposits, quotas, prohibitions, etc.) aimed at making imports more expensive or preventing them from entering.

19/ In principle, this capacity could also be used to increased production for the domestic market. This however, would require more imports of intermediate inputs, and these could not easily be financed under the present circumstances. This obstacle would disappear, however, if the additional production was sold abroad.

20/ The strong growth (23%) of Brazil's external sales in 1984 and, in particular, the enormous growth (37%) of manufacturing exports are probably the best example in the region of the potential effectiveness of export-promotion measures when world trade is growing rapidly.

21/ As a matter of fact, the short-term contribution which tariff surcharges can make towards reducing the trade deficit is not the only justification for a differentiated tariff structure. As is well known, tariffs can play a fundamental role in the development process --and have done so throughout history-- by protecting adolescent industries or activities during the early stages of their growth.

22/ Indeed, if special incentives were applied generally and evenly, they would have an effect equivalent to that of an increase in the foreign-trade exchange rate, but their administrative cost would be higher.

23/ The expressions "subsidy" and "tariff rate" are used here solely for the sake of brevity. Strictly speaking, what should be equal are the overall incentives offered for exports in the form of subsidies, tax exemptions, preferential interest rates, etc., and the protection provided for imports in the form of tariffs, quotas, prior deposits, etc.

24/ In order to minimize the impact on the poor of a reduction in fuel subsidies, a direct subsidy could be granted for public transport; this would benefit the poor (especially in the large cities) proportionally more than the rest of the urban population.

25/ Although this principle concerning the efficiency of subsidy policies is always valid, it becomes particularly important when the overall amount of subsidies must be reduced, a measure which may be required when the fiscal deficit must be reduced in order to promote external adjustment and stabilize price levels.

26/ See Daniel M. Schydlowsky, Capital utilization, growth employment and balance-of-payments and price stabilization, Center for Latin American Development Studies, Boston University, December 1976.

27/ For this latter reason, and also because of the high external debt that many countries of the region have, it would be advisable, from a strictly economic viewpoint, to raise, over the next few years, the relative share of foreign investment in total external financing. In assessing such a decision, political criteria of a more general nature must also be taken into account.

28/ The drop in the domestic availability of goods and services will occur whenever the change from a trade deficit to a surplus, as a proportion of the gross domestic product, exceeds the growth rate of the latter.

29/ See in this respect T. Sargent, "The End of Four Big Inflations", NBER Conference Paper No. 90 (National Bureau of Economic Research, New York, 1981).

30/ See G. Papenek, "Comments ..." in W. Cline and S. Weintraub (editors), Economic Stabilization in Developing Countries (The Brookings Institution, 1981).

31/ Naturally, the role played by the rigidity of expectations is even more evident when the process of readjustment of prices and costs is institutionalized through a system of formal indexing, but the rigidity is just as significant and real even when there is no such formal system of indexing.

32/ Among the most novel ways proposed for carrying out such indexing --provided, of course, that it is possible to apply strict monetary and fiscal control and that the lags in key prices are only small-- is that proposed recently by Persio Arida and Andrês Lara Resende in Brazil. This method takes into account the fact that countries with prolonged and very high inflation are probably already using a unit of account which is adjusted daily (for example, the ORTN in Brazil or the UF in Chile) and in which many contracts are already expressed. Arida and Lara Resende propose basically to express all values (wages, interests, rents, ... even eventually the prices of goods themselves) in such a unit of account and to make the prices readjustable according to the average real price (not maximum price) which they had in the period taken as being representative, extending it in each case from one readjustment to the next one. Once this process was completed, the old money which had suffered inflation would be replaced by new money expressed in these readjustable units of account. This would do away relatively painlessly and abruptly with inflation, or at least with the inertial element of inflation. See in this respect Andrês Lara Resende, A moeda indexada: una projusta para eliminar a inflação inercial (Texto para Discussao, 75, PUC), Rio de Janeiro, September 1984, and Persio Arida, "Neutralizar a inflação: (concl.)

32/ (Concl.) uma idea promissora", Economia em Perspectiva, São Paulo (6), September 1984, and the joint paper by these two authors, "Inertial Inflation and Monetary Reform: Brazil" in John Williamson (compiler), Inflation and Indexation, Institute for International Economics, Washington, March 1985, pp. 27-45.

33/ If the nominal wage is 100 during a year, and inflation is at 100%, the annual average real wage is approximately 75: 100 on the first day of the year and 50 on the last. Thus if the nominal wage is double the following year (200), the real wage at the beginning of the year is 100 and, if inflation declines to 50%, the real wage falls to 67 at the end of the year (200:300); that is, the average wage comes to be approximately 83, i.e., 11% higher than in the preceding year.

34/ Continuing the previous example, if the aim is to reduce inflation to 50% in year two (after the inflation of 100% in year one), and if nominal wages are readjusted by 50%, these will rise at the beginning of the year from 100 to 150 in nominal terms and from 50 (100:200) to 75 (150:200) in real terms. If inflation declines to 50%, at the end of year two real wages will be 50 (150:300); that is, on average in year two an average real wage of approximately 63 will have been paid; that is, 16% lower than that of year one.

35/ In the foregoing concrete case, if it is desired to maintain real wages equal to those of year one, and an inflation of 50% is anticipated, nominal wages should be adjusted by 80%, raising them from 100 to 180, so that in real terms they rise to 90 (180:200) at the beginning of the year, to then fall during the course of the year to 60 (180:300) at the end. Thus average real wages for the year will be approximately equal to 75 in year two, that is, they will maintain the real value they had in year one.

36/ In the concrete case of the previous example, wages are readjusted by 80% at the beginning of year two and will be readjusted again when inflation reaches 50%. If it reaches 50% in 12 months, there will be an annual readjustment as before. If the inflation reaches 50% in 10 months, the readjustment will be advanced, since the average wage for the 10 months was already equal to the level of 75 which is the real wage fixed as objective; and it will be postponed, if the prices do not rise 50% until the 12 months are passed.

A N N E X

STATISTICAL TABLES

Table 1

LATIN AMERICA: MAIN ECONOMIC INDICATORS[a]

Indicators	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984[b]
Gross domestic product at market prices (billions of dollars at 1970 prices)	257	271	285	298	318	336	341	338	327	338
Population (millions of inhabitants)	302	310	318	326	334	342	350	358	367	375
Per capita gross domestic product (dollars at 1970 prices)	849	875	897	916	953	982	975	943	893	901
Per capita gross national income (dollars at 1970 prices)	848	875	898	910	951	985	962	912	860	866
Growth rates										
Gross domestic product	3.6	5.7	5.1	4.7	6.5	5.6	1.7	-1.0	-3.1	3.2
Per capita gross domestic product	1.1	3.1	2.5	2.2	3.9	3.1	-0.7	-3.3	-5.3	0.9
Per capita gross national income	-0.5	3.2	2.6	1.3	4.5	3.5	-2.3	-5.3	-5.7	0.7
Consumer prices[c]	57.8	62.2	40.0	39.0	54.1	56.5	56.8	84.5	130.8	184.2
Terms of trade (goods)	-13.5	4.4	6.0	-10.5	4.2	4.1	-9.2	-8.8	-6.2	0.2
Current value of exports of goods	-7.8	16.4	19.3	7.5	34.6	29.4	7.3	-7.9	-0.2	10.2
Current value of imports of goods	6.5	3.8	15.0	13.9	25.8	32.4	7.8	-19.9	-28.6	4.0
Billions of dollars										
Exports of goods	33.6	39.1	46.7	50.2	67.5	87.3	93.8	86.4	86.2	95.0
Imports of goods	39.2	40.7	46.9	53.4	67.1	88.9	95.8	76.7	54.7	56.9
Merchandise trade balance	-5.6	-1.6	-0.2	-3.2	0.4	-1.6	-2.0	9.6	31.5	38.1
Net payments of profits and interest	5.6	6.8	8.2	10.2	13.7	18.0	27.7	37.6	34.5	37.4
Balance on current account[d]	-14.0	-11.0	-11.8	-18.3	-19.6	-28.1	-40.6	-40.7	-9.0	-2.1
Net movement of capital[e]	14.2	17.8	17.0	26.0	28.6	29.7	37.8	19.2	4.4	12.4
Trade balance[f]	0.2	6.8	5.2	7.7	9.0	1.6	-2.8	-21.4	-4.5	10.0
Total gross external debt	76.2	99.7	118.8	150.9	182.0	221.0	275.4	315.3	340.9	360.2

Source: ECLAC, on the basis of official figures.

[a] Product, population and income figures refer to the group formed by the countries includes in table 2, except Cuba (19 countries). Consumer price figures relate to those 19 countries plus Barbados, Guyana, Jamaica and Trinidad and Tobago, except for the years 1982, 1983 and 1984. The data on the external sector relate to the 19 countries mentioned above. [b] Provisional estimates subject to revision. [c] Variation from December to December. [d] Includes net unrequited private transfer payments. [e] Includes long and short-term capital, official unrequited transfer payments and errors and omissions. [f] Relates to the variation in international reserves plus counterpart items.

Table 2

LATIN AMERICA: EVOLUTION OF PER CAPITA GROSS DOMESTIC PRODUCT[a]

Country	Dollars at 1970 prices			Growth rates						Cumulative rate
	1970	1980	1984[b]	1970-1974	1975-1980	1981	1982	1983	1984[b]	1981-1984[b]
Argentina	1 241	1 334	1 177	2.3	-0.1	-7.7	-6.6	1.4	0.9	-11.8
Bolivia	317	382	288	3.0	1.1	-3.5	-11.1	-10.0	-2.2	-24.6
Brazil	494	887	809	8.4	4.1	-3.8	-1.3	-5.3	2.0	-8.3
Colombia	598	824	812	4.2	2.6	0.1	-1.2	-1.1	1.0	-1.5
Costa Rica	740	974	853	4.4	1.7	-4.9	-9.7	-0.3	2.3	-12.4
Cuba[c]	...	...	...	...	...	14.9	2.0	4.6	6.4	30.4
Chile	958	1 045	935	-0.9	2.3	3.9	-15.4	-2.3	4.2	-10.5
Ecuador	413	723	678	8.2	3.3	1.0	-1.1	-6.1	0.1	-6.2
El Salvador	422	433	339	1.8	-1.1	-10.9	-8.3	-2.9	-1.4	-21.8
Guatemala	448	589	498	3.5	2.2	-2.1	-6.2	-5.4	-2.6	-15.4
Haiti	90	114	101	2.2	2.5	-5.2	-4.9	-1.2	-0.1	-10.8
Honduras	313	356	316	0.8	1.8	-2.3	-5.1	-3.8	0.6	-11.3
Mexico	978	1 366	1 295	3.4	3.4	5.1	-3.1	-7.7	0.9	-5.2
Nicaragua	418	337	317	2.0	-5.4	2.0	-4.4	-1.2	-4.7	-6.0
Panama	904	1 174	1 178	2.9	2.7	1.9	3.2	-1.8	-2.9	0.3
Paraguay	383	642	611	3.5	6.3	5.4	-3.9	-5.9	-0.9	-4.8
Peru	659	690	598	1.9	-0.4	1.2	-2.2	-13.2	0.9	-13.3
Dominican Republic	398	601	605	7.0	2.5	1.6	-0.7	1.5	-1.7	0.7
Uruguay	1 097	1 426	1 195	1.1	4.2	1.2	-10.3	-5.3	-3.5	-16.2
Venezuela	1 239	1 310	1 097	1.6	0.3	-3.3	-2.2	-7.4	-4.4	-16.2
Total[d]	709	982	901	4.3	2.6	-0.7	-3.3	-5.3	0.9	-8.6

Source: ECLAC, on the basis of official figures.
[a] At market prices. [b] Provisional estimates subject to revision. [c] Refers to total social product. [d] Average, excluding Cuba.

Table 3

LATIN AMERICA: EVOLUTION OF CONSUMER PRICES

(Variations from December to December)

	1976	1977	1978	1979	1980	1981	1982	1983	1984
Latin America									
Simple average	35.5	23.6	25.4	35.8	27.3	28.8	47.5	66.2	163.4
Weighted average[a]	62.2	40.0	39.0	54.1	56.1	57.6	84.6	130.9	184.2
Simple average[b]	36.9	24.2	26.0	35.3	27.5	29.0	35.6	53.7	67.5
Weighted average[b]	63.6	40.5	39.5	54.2	56.6	58.1	80.9	127.6	151.1
Countries with traditionally high inflation									
Simple average	88.7	50.9	50.7	62.5	49.6	51.9	105.1	154.9	417.8
Weighted average[a]	74.5	47.1	45.7	61.9	65.4	67.6	101.2	157.2	223.0
Argentina	347.5	150.4	169.8	139.7	87.6	131.2	209.7	433.7	683.4
Bolivia	5.5	10.5	13.5	45.5	23.9	25.2	296.5	328.5	2 177.2
Brazil[c]	44.8	43.1	38.1	76.0	95.3	91.2	97.9	179.2	203.3
Colombia[d]	25.9	29.3	17.8	29.8	26.5	27.5	24.1	16.5	18.3
Chile	174.3	63.5	30.3	38.9	31.2	9.5	20.7	23.6	23.0
Mexico	27.2	20.7	16.2	20.0	29.8	28.7	98.8	80.8	59.2
Peru	44.7	32.4	73.7	66.7	59.7	72.7	72.9	125.1	111.5
Uruguay	39.9	57.3	46.0	83.1	42.8	29.4	20.5	51.5	66.1
Countries with traditionally moderate inflation									
Simple average	7.2	9.1	11.9	21.5	15.5	16.5	14.5	15.6	18.1
Weighted average[a]	7.9	8.8	9.8	20.1	15.4	14.1	12.2	16.4	18.5
Barbados	3.9	9.9	11.3	16.8	16.1	12.3	6.9	5.5	5.2
Costa Rica	4.4	5.3	8.1	13.2	17.8	65.1	81.7	10.7	17.4
Ecuador[e]	13.1	9.8	11.8	9.0	14.5	17.9	24.3	52.5	25.1
El Salvador	5.2	14.9	14.6	14.8	18.6	11.6	13.4	14.8	9.8
Guatemala	18.9	7.4	9.1	13.7	9.1	8.7	-2.0	8.4	5.2
Guyana	9.2	9.0	20.0	19.4	8.5	29.1	...	...	...
Haiti	-1.4	5.5	5.5	15.4	15.3	16.4	6.2	12.2	6.1
Honduras	5.6	7.7	5.4	18.9	15.0	9.2	9.4	8.6	3.2
Jamaica	8.3	14.1	49.4	19.8	28.6	4.8	7.0	14.5	31.3
Nicaragua	6.2	10.2	4.3	70.3	24.8	23.2	22.2	32.9	50.2
Panama	4.8	4.8	5.0	10.0	14.4	4.8	3.7	2.0	0.9
Paraguay	3.4	9.4	16.8	35.7	8.9	15.0	4.2	14.1	29.8
Dominican Republic	7.0	8.5	1.8	26.2	4.2	7.4	7.1	9.8	38.2
Trinidad and Tobago	12.0	11.4	8.8	19.5	16.6	11.6	10.8	15.4	13.0[f]
Venezuela	6.9	8.1	7.1	20.5	19.6	10.8	7.9	7.0	18.3

Source: ECLAC, on the basis of official data.
[a] Represents variation by countries, weighted by the population in each year. [b] Excluding Bolivia. [c] Up to 1979, figures represent the Consumer Price Index in the city of Rio de Janeiro: from 1980 onwards, the variation in the national CPI. [d] Up to 1980, figures represent the variation in the Consumer Price Index for manual workers; from 1981 onwards, the variation in the overall national CPI. [e] Up to 1982, figures represent the variation in the Consumer Price Index in the city of Quito; from 1983 onwards, the national Consumer Price Index. [f] Corresponds to variation between November 1983 and November 1984.

Table 4

LATIN AMERICA: NET INFLOW OF CAPITAL, TRANSFER OF RESOURCES AND VARIATION IN TERMS OF TRADE

(Billions of dollars and percentages)

Year	Net inflow of capital (1)	Net payments of profits and interest (2)	Net transfer of resources (3) = (1) - (2) (3)	Exports of goods and services (4)	Net transfer of resources exports of goods and services[a] (5) = (3)/(4) (5)	Variation in terms of trade (6)
1973	7.8	4.2	3.6	28.9	12.5	14.1
1974	11.4	5.0	6.4	43.6	14.7	15.9
1975	14.2	5.5	8.7	41.1	21.2	-13.5
1976	18.2	6.8	11.4	47.3	24.1	4.4
1977	17.0	8.2	8.8	55.9	15.7	6.0
1978	26.1	10.2	15.9	61.4	25.9	-10.5
1979	28.6	13.6	15.0	82.0	18.3	4.2
1980	30.0	18.0	12.0	105.8	11.3	4.1
1981	37.7	27.7	10.0	114.1	8.8	-9.2
1982	19.2	37.6	-18.4	101.9	-18.1	-8.8
1983	4.4	34.5	-30.1	100.5	-30.0	-6.2
1984[b]	12.4	37.4	-25.0	113.0	-22.1	0.2

Source: International Monetary Fund, *Balance of Payments Yearbook*, Various issues, and ECLAC calculations on the basis of official data.
[a] Percentages. [b] Preliminary estimates, subject to revision.

Table 5

LATIN AMERICA: EVOLUTION OF NOMINAL EXCHANGE RATE AND EFFECTIVE REAL EXCHANGE RATE IN SELECTED COUNTRIES

Annual and quarterly averages	Argentina	Bolivia	Brazil	Colombia	Costa Rica	Chile	Ecuador	Mexico	Peru	Uruguay	Venezuela
Nominal exchange rate (units of national currency per US dollar)											
1980	0.2	25	53	47	9	39	25	23	289	9	4.3
1981	0.5	25	93	55	21	39	25	25	422	11	4.3
1982	2.3	99	180	64	39	51	30	56	698	14	4.3
1983	10.5	230	577	79	42	79	46	120	1 625	35	4.3
1984	67.7	2 174	1 848	101	45	99	69	168	3 465	56	7.0
1984											
I	27.8	500	1 141	92	43	88	60	150	2 448	46	5.6
II	41.2	1 786	1 514	97	44	90	66	162	3 024	53	7.5
III	69.3	2 000	2 005	104	44	96	72	174	3 707	57	7.5
IV	132.2	4 411	2 728	111	47	121	77	186	4 681	67	7.5
Effective real exchange rate index, exports[a] (1980 = 100)											
1975	192	97	81	118	107	136	112	104	77	130	117
1976	126	103	78	112	104	117	105	109	81	137	115
1977	164	99	78	102	105	114	99	121	90	136	107
1978	148	103	83	103	107	133	96	114	113	134	107
1979	112	105	93	99	103	119	99	109	107	110	108
1980	100	100	100	100	100	100	100	100	100	100	100
1981	131	70	83	92	143	89	96	90	87	94	91
1982	160	115	80	86	128	105	97	132	86	102	85
1983	155	77	95	87	112	112	102	135	94	138	79
1984	145[b]	56	89	89	...	111	116	114[b]	95	126	112[c]
1982											
I	138	94	84	89	152	93	92	105	83	95	87
II	147	119	79	87	131	96	95	124	84	96	86
III	187	121	77	85	118	111	104	157	86	91	84
IV	159	117	81	85	115	116	98	137	88	124	84
1983											
I	158	108	93	87	111	123	98	147	90	146	82
II	164	83	101	85	109	112	106	135	94	139	80
III	149	59	95	87	112	105	102	132	96	135	78
IV	149	60	91	90	113	109	103	131	95	132	77
1984											
I	154	54	91	90	112[d]	114	111	121	91	130	97
II	136	76	92	88	111[d]	110	115	114	94	133	124
III	135	56	88	88	...	105	120	111	95	119	115
IV	159[e]	39	84	90	...	114	119	107[e]	99	120	...

Source: ECLAC, on the basis of official data from the countries, and International Monetary Fund, *International Financial Statistics*.

[a] Corresponds to average of real exchange rate indexes for national currency vis-à-vis currencies of the country's main trading partners, weighted by the. From 1975 to 1979 these wightings correspond to the average for those years, while from 1980 onwards they correspond to the average for the period 1980-1983. For further information, see the Technical Appendix to the *Economic Survey of Latin America, 1981.* [b] Average January-November. [c] Average January-September. [d] Preliminary estimate. [e] Average October-November.

Table 6

LATIN AMERICA: RELATION BETWEEN DEFICIT AND TOTAL EXPENDITURE OF CENTRAL GOVERNMENT

(Percentages)

Country	1980	1981	1982	1983
Argentina	31.4	43.3	32.2	63.4
Bolivia	45.2	42.0	85.1	84.6
Brazil	36.5	41.5	36.9	25.2
Colombia	6.9	4.6	11.5	20.4
Costa Rica	41.8	24.8	18.8	22.2
Chile	-2.1[a]	4.5	8.2	13.2
Ecuador	20.9	33.8	32.5	22.7
Mexico	16.4	30.3	44.1	30.9
Paraguay	2.6	25.2	6.0	28.8
Peru	12.2	21.4	18.1	38.3
Uruguay	-0.5[a]	0.5	36.4	20.0
Venezuela	0.8	-	4.4	3.4

Source: ECLAC, on the basis of official data.
[a]Surplus.

Table 7

LATIN AMERICA: IMPORTS OF GOODS

	Value			Volume					
	Millions of dollars			Growth rates					
	1981	1983	1984[a]	1981	1982	1983	1984[a]	1982-1983[b]	1982-1984[b]
Latin America	**95 809**	**54 742**	**57 000**	**2.1**	**-18.7**	**-27.2**	**4.9**	**-40.8**	**-37.9**
Oil-exporting countries	**43 005**	**19 117**	**21 830**	**11.6**	**-20.1**	**-41.9**	**12.4**	**-53.6**	**-47.7**
Bolivia	680	482	470	-1.9	-35.3	16.2	-9.9	-24.8	-31.4
Ecuador	2 362	1 408	1 580	-1.3	-7.6	-34.8	12.2	-39.8	-32.3
Mexico	24 038	7 723	10 000	20.5	-43.4	-42.3	26.1	-67.3	-58.7
Peru	3 802	2 723	2 430	15.2	-4.1	-29.2	-14.2	-32.1	-41.7
Venezuela	12 123	6 781	7 350	-0.4	18.8	-47.2	8.2	-37.3	-32.2
Non-oil-exporting countries	**52 804**	**35 625**	**35 170**	**-7.0**	**-17.1**	**-11.1**	**-0.7**	**-26.3**	**-26.8**
Argentina	8 432	4 121	4 270	-12.4	-39.4	-11.3	1.5	-46.3	45.4
Brazil	22 091	15 429	13 940	-13.2	-8.9	-15.3	-4.6	-22.8	-26.4
Colombia	4 763	4 759	4 720	4.3	18.7	-6.1	-3.0	11.5	8.2
Costa Rica	1 090	893	1 000	-24.5	-30.1	7.8	18.8	-24.7	-10.4
Chile	6 513	2 838	3 360	10.9	-39.4	-15.7	16.0	-48.9	-40.7
El Salvador	898	803	870	-4.5	-13.0	-4.4	9.2	-16.9	-8.9
Guatemala	1 540	1 056	1 150	0.0	-21.6	-20.3	3.2	-37.5	-35.3
Haiti	398	352	410	20.9	-21.2	2.0	-6.6	-19.7	-24.0
Honduras	899	761	840	-10.9	-25.0	12.9	-2.3	-15.4	-17.4
Nicaragua	923	778	780	10.7	-25.5	3.7	-1.2	-22.8	-23.8
Panama	1 441	1 246	1 240	6.4	-4.6	-14.9	-14.9	-18.9	-31.0
Paraguay	772	552	580	10.8	-11.2	-19.1	1.1	-28.1	-27.4
Dominican Republic	1 452	1 297	1 220	-7.8	-15.3	4.9	-6.6	-11.1	-16.6
Uruguay	1 592	740	790	-13.9	-29.8	-22.2	8.1	-45.4	-40.6

Source: ECLAC, on the basis of official data.
[a]Preliminary estimates, subject to revision. [b]Accumulated variation.

Table 8

LATIN AMERICA (SELECTED COUNTRIES): RENEGOTIATION OF EXTERNAL DEBT WITH PRIVATE BANKS (FIRST ROUND OF RENEGOTIATIONS 1982/1983)[a]

(Billions of dollars)

Country	Gross bank debt[b] at end of 1982	Renegotiation of debt with private banks					Loans approved during 1982 and 1983			
		Start of nego-tia-tions	Amount			Maturities of re-scheduled amortizations	IMF	BIS[c d]	United States[d]	New credits[e]
			Total	Pub-lic	Pri-vate					
Argentina	22.2	Sep 1982	13.00[f]	6.00	7.00	Sep 1982-1983	2.20	0.50	-	1.10[d], 1.50[g]
Brazil	56.0	Dec 1982	4.80[h]	...	...	1983	6.00	1.20	1.50	4.40
Costa Rica	0.7	Sep 1981	0.62[i]	0.62	-	1982-1984	0.10	-	-	0.23
Cuba	1.0	Sep 1982	0.14[j]	0.14	-	Sep 1982-1983	-	-	-	-
Chile	10.4	Jan 1983	3.46[k]	1.00	2.46	1983-1984	0.88	0.30	-	1.30
Ecuador	4.1	Oct 1982	2.20[l]	1.20	1.00	Nov 1982-1983	0.17	-	-	0.43
Honduras	0.2	Jul 1982	0.12[m]	0.12	-	1982-1984	0.11	-	-	-
Mexico	59.0	Aug 1982	23.70[n]	23.70	-	Aug 1982-1984	3.97	1.85	1.60	5.00
Nicaragua	0.6	... 1982	0.55[o]	0.55	-	...	-	-	-	-
Panama	1.5	... 1983	0.18	...	...	1983	0.26	-	-	0.10
Peru	5.2	Mar 1983	0.38[p]	0.38	-	1983	0.94	-	-	0.45
Dominican Republic	1.0	Dec 1982	0.57[q]	0.15	0.42	1982-1983	0.46	-	-	-
Uruguay	1.2	Feb 1983	0.63[r]	0.63	-	1983-1984	0.46	-	-	0.24

Source: ECLAC, on the basis of official data from the countries and from various national and international sources.

[a] Including countries which during 1982 and 1983 signed definitive or provisional external debt renegotiation agreements with the private banks: excluding the English-speaking Caribbean countries.

[b] Refers exclusively to each country's short, medium- and long-term public and private debt with the private commercial banks that supply information to the Bank for International Settlements. The debt to governments and official agencies is not therefore included, nor the debt with suppliers, nor the debt with those commercial banks which do not transmit information to BIS. In some countries, this last item is significant. In the case of the Dominican Republic, the data correspond to official information.

[c] Bank for International Settlements. [d] Short-term bridge credits.

[e] Credits granted by the international banks as part of the process of renegotiation of the external debt.

[f] Corresponds to public external debt maturities falling within the period September 1982 to December 1983 (US$ 6 billion); to those maturities of the private external debt, protected by Central Bank exchange insurance, which fell due as from November 1982 (US$ 5.5 billion); and to maturities of swaps (US$ 1.5 billion). It should be noted that Argentina did not sign any final agreement on renegotiation of its public external debt during the year 1983. In December 1983 the new government notified its intention to renegotiate a new agreement.

[g] The international banks are waiting to disburse US$ 1 billion until an agreement with IMF is reached.

[h] At the end of 1982 an aplication was submitted to the foreign banks requesting them to grant 1) new loans to the amount of US$ 4.4 billion; 2) refinancing of public and private debt amortizations to the amount of US$ 4.8 billion; 3) maintenance of the short-term loans of US$ 9.6 billion for the financing of foreign trade operations; and 4) re-establishment of the inter-bank credit lines at the levels reached on 30 June 1982 (US$ 10 billion). Points 1 and 2 were accepted in February 1983 and point 3 later; point 4 was never settled.

[i] In September 1983 an agreement was signed providing for the renegotiation of US$ 370 million of arrears and of amortization payments amounting to US$ 250 million which would fall due during 1983 and 1984. A trade credit equivalent to 50% of the interest payments disbursed in 1983 was also granted. The banks also agreed to maintain short-term revolving credits to an amount of US$ 215 million, with a spread of 1 3/4 % over LIBOR.

[j] In August 1982 a request was submitted for deferment of the external debt service payments which were due to be made between September 1982 and December 1983. the Banks also agreed to maintain the short-term credit lines with a spread of 1 1/4 % over LIBOR.

[k] Includes amortization of credits due to be disbursed during 1983 and 1984 (US$ 2 158 million) and the restructuring of short-term financial credits (US$ 1.3 billion). In February 1983 the international banks authorized a moratorium up to April 1983 and then, by successive rollovers, up to January 1984. In the latter month and in February 1984 the definitive debt renegotiation agreements were signed. The maintenance of the short-term loans for the financing of foreign trade operations (US$ 1.7 billion) was also obtained, with a spread of 1 1/2 % over LIBOR.

[l] In September 1983 decrees were signed authorizing the signature of contracts for the refinancing of public and private debt amortizations to the amount of US$ 2.2 billion in the period November 1982 to December 1983. The agreement includes the maintenance of short-term credit lines totalling US$ 700 million with a spread of 1 5/8 % over LIBOR. Between October 1982 and January 1983, by common accord with the creditors, no payments were made against the public debt.

[m] A note of understanding between the government and the creditor banks committee was signed in February 1983, but this agreement did not come into force because the banks refused to contribute new financing equivalent to double the half-yearly interest payments falling due. Until the end of 1983 the government kept up to date with interest payments; the same was not the case with amortization payments on capital.

[n] In August 1982 the international banks authorized a moratorium on public external debt amortization payments for three months, which was subsequently extended until March 1983 and later to August 1983. In the latter month and in September 1983 contracts were signed for the refinancing of public external debt amortization payments totalling US$ 19.83 billion. Later on the amount restructured under the agreement reached US$ 23.7 billion.

[o] During 1982 a renegotiation agreement for this amount was concluded. The terms of the renegotiation are similar to those originally contracted in a debt rescheduling agreement the government obtained in 1980.

[p] In addition short-term credit lines totalling US$ 2 billion were renewed, with a spread of 1.5 % over LIBOR.

[q] In September 1983 an agreement was concluded on the refinancing of US$ 465 million of short-term debt and US$ 100 million of medium- and long-term debt.

[r] Corresponds to 90% of amortization payments on short- and medium-term credits due to be made during 1983 and 1984. In addition, short-term credit lines amounting to US$ 81 million were maintained. At the beginning of March 1983 payments had been deferred for 90 days by agreement with the creditor banks. In July 1983 an agreement was signed with 80 creditor banks.

Table 9

LATIN AMERICA (SELECTED COUNTRIES): TERMS OF RESCHEDULING OF EXTERNAL DEBT WITH PRIVATE BANKS (FIRST ROUND OF RESCHEDULINGS: 1982/1983)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Grace period (years)		Comissions[b]	
	R	AC	R	AC	R	AC	R	AC
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Argentina[c]	2.13	2.50	7.0	5.0	3.0	3.0	1.25	1.25
Brazil	2.50	2.13	8.0	8.0	2.5	2.5	1.50	1.50
Costa Rica	2.25	-	8.5	-	4.0	-	1.38	-
Cuba	2.25	-	8.0	-	3.0	-	1.25	-
Chile	2.13	2.25	8.0	7.0	4.0	4.0	1.25	1.25
Ecuador	2.25	2.38	7.0	6.0	1.0	1.5	1.25	1.25
Honduras	2.38	-	7.0	-	3.0	-	1.38	-
Mexico	1.88	2.25	8.0	6.0	4.0	3.0	1.00	1.25
Nicaragua[d]	[e]	-	12.0	-	5.0	-	-	-
Panama	2.25	2.25	6.0	6.0	2.0	2.0	1.50	1.50
Peru	2.25	2.25	8.0	8.0	3.0	3.0	1.25	1.25
Dominican Republic	2.25	-	6.0	-	2.0	-	1.25	-
Uruguay	2.25	2.25	6.0	6.0	2.0	2.0	1.38	1.38

Source: ECLAC, on the basis of official figures and data from various national and international sources.
[a]Column R refers to rescheduled maturities and column AC to terms for additional credits. [b]Calculated as a percentage of the total amount of the transaction and paid once only at the time of signing the loand contracts. It should be noted that evidence has been found that some commissions were not declared, and consequently the figures could underestimate payments under this head. [c]At the end of 1983 the new Government of Argentina notified its intention to negotiate another debt rescheduling agreements, the terms of which would be better than those included in the present table. [d]Nicaragua is continuing the rescheduling of its bank debt on the terms established in an agreement signed in 1980. [e]Nicaragua pays a maximum rate of 7%; the difference between the interest rate in force and the 7% ceiling will be capitalized.

Table 10

LATIN AMERICA (SELECTED COUNTRIES): DETERIORATION OF TERMS OF INDEBTEDNESS WITH PRIVATE BANKS (FIRST ROUND OF RENEGOTIATIONS, 1982/1983)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Commissions		Deterioration of terms[b] (percentage)	Real cost of credit[c]		
	1980/1981	R*AC	1980/1981	R*AC	1980/1981	R*AC		1980/1981	R*AC	Increase
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Argentina[d]	0.67	2.16	7.5	6.8	1.09	1.25	217	5.82	7.34	26.1
Brazil	1.62	2.32	8.5	8.0	2.01	1.50	44	6.86	7.50	9.3
Costa Rica	1.13	2.25	6.0	8.5	1.23	1.38	28	6.34	7.41	16.9
Cuba	1.00	2.25	5.0	8.0	0.88	1.25	28	6.18	7.41	19.9
Chile	0.91	2.16	7.6	7.7	0.81	1.25	125	6.02	7.32	21.6
Ecuador	0.74	2.28	8.0	6.7	0.97	1.25	242	5.86	7.47	27.5
Honduras	...	2.38	...	7.0	...	1.38	...	...	7.58	...
Mexico	0.65	1.95	7.6	7.6	0.70	1.05	181	5.74	7.09	23.5
Panama	1.09	2.25	8.0	6.0	1.00	1.50	174	6.22	7.50	20.6
Peru	1.12	2.25	8.2	8.0	1.07	1.25	97	6.25	7.46	18.6
Dominican Republic	1.30	2.25	8.1	6.0	0.91	1.25	135	6.41	7.46	16.4
Uruguay	0.98	2.25	9.1	6.0	0.90	1.38	249	6.08	7.48	23.0

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.

[a] The symbol R*AC represents a weighted average of the rescheduled credits and additional credits.

[b] Based on an index of the cost-of-credit components which are subject to negotiation. The following is the formula used:

$$\frac{\dfrac{\dfrac{C_1}{P_1}+S_1}{P_1}}{\dfrac{\dfrac{C_0}{P_0}+S_0}{P_0}} - 1$$

in which: C= Commissions; P= Period; S= Spread over LIBOR, and in which subindex 1 refers to the conditions existing in 1983 and subindex 0 to average terms in 1980-1981. All components of the formula are weighted by the amount of the loan. It should be noted that the deterioration is not in itself an indicator of the quality of a country's negotiation, since it is strongly influenced by the borrower's initial position.

[c] A real annual LIBOR of 5% is assumed and C/P + S are added.

[d] At the end of 1983 the new Government of Argentina notified its intention to negotiate a new external debt rescheduling agreement.

Table 11

LATIN AMERICA (SELECTED COUNTRIES): RENEGOTIATION OF THE EXTERNAL DEBT WITH PRIVATE BANKS (SECOND ROUND OF RENEGOTIATIONS: 1983/1984)[a]

(Billions of dollars)

Country	Gross bank debt[b] at end of 1983	Renegotiation of the debt with the private banks					New credits approved in 1984[c]	Other credits
		Start of negotiations	Amount			Maturities to be rescheduled		
			Total	Public	Private			
Bolivia	1.2	Oct 1982	0.64[d]	0.64	-	1983-1985	-	-
Brazil	71.9	Jun 1983	5.40[e]	...	...	1984	6.50	1.50[f]
Cuba	1.2	... 1984	0.10[g]	0.10	-	1984	-	-
Chile	13.0	Jan 1984	-	-	-	-	0.78	-
Ecuador	4.9	Nov 1983	1.60[h]	...	...	1984	-	-
Mexico	72.6	Mar 1983	12.00[i]	-	12.00	Aug 1982-1984	3.80	1.50[f]
Nicaragua	0.6	Jun 1983	...[j]	...	...	Jun 1983-Jun 1984	-	-
Peru	6.6	Dec 1983	1.56[k]	1.56	-	1984-July 1985	-	-

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.

[a] These data are provisional and subject to revision. The countries included are those that during 1983 did not conclude any formal external debt rescheduling agreement with private banks; others that during 1983 signed definitive or provisional agreements relating only to that year's maturities, and for those of 1984 began a second round of renegotiations; and countries that applied for new credits to refinance interest payments in 1984. Does not include the English-speaking Caribbean countries.

[b] Refers exclusively to each country's short-, medium- and long-term public and private debt with the private commercial banks that transmit information to the Bank for International Settlements. Accordingly, neither the debt with governments of official institutions is included, nor the debt with suppliers, nor the debt with commercial banks that do not transmit information to BIS. In some countries this last item is significant, and the figures could therefore underestimate the share of the banks in total external debt. Note that the coverage as from 1983 is greater than in previous years.

[c] Refers to credits granted by the international banks as part of the renegotiation process.

[d] Includes US$ 416 million of maturities corresponding to the debt rescheduled by the banks in 1981 and US$ 225 million of amortization payments falling due in the period 1983-1985. The Government reached agreement in principle with the foreign banks in mid-1983, but this agreement was conditional on the approval of an agreement with the IMF, and up to March 1985 this had still not been signed. At the end of 1983 it was agreed to pay 50% of the interest. In June 1984, the Government suspended the payment of interest to private international banks.

[e] In November 1983, final agreement was reached on a financing package which includes US$ 6.5 billion provided by the commercial banks, US$ 3.5 billion of refinancing from the "Paris Club" and US$ 2.5 billion of financing from State agencies of the industrialized countries. Short-term lines of trade credit for US$ 10.3 billion and short-term interbank lines of credit for US$ 6 billion also continue to operate.

[f] Lines of credit from EXIMBANK.

[g] Corresponds to US$ 103 million of medium- and long-term amortization payments falling due in 1984. The international banking system also agreed to maintain short-term lines of credit for US$ 370 million at a spread of 1.25% over LIBOR.

[h] In July 1984 a preliminary agreement was reached for the refinancing of US$ 600 million falling due in 1984.

[i] By the end of 1983, on the basis of the FICORCA mechanism, this amount of the private debt with international banks had been restructured.

[j] From June 1983 onwards, Nicaragua ceased for the first time to comply with the payment of interest on its bank debt. In December 1983 agreement was reached for refinancing the outstanding interest which involved the capitalization of 100% of the interest commitments, with payment beginning as from the second half of 1984. In November 1984 the Government stated that it was not in a position to sign a preliminary agreement which had been reached with the private banking system.

[k] Includes the refinancing of US$ 610 million of the medium- and long-term debt and US$ 950 million of the short-term debt.

Table 12

LATIN AMERICA (SELECTED COUNTRIES): TERMS OF RESCHEDULING OF THE EXTERNAL DEBT WITH THE PRIVATE BANKS (SECOND ROUND OF RENEGOTIATIONS: 1983/1984)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Period of grace (years)		Commissions[b]	
	R	AC	R	AC	R	AC	R	AC
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Brazil	2.00	2.00	9.0	9.0	5.0	5.0	1.00	1.00
Cuba	1.88	-	9.0	-	5.0	-	0.88	-
Chile	-	1.75	-	9.0	-	5.5	-	0.63
Ecuador	1.75	-	9.0	-	4.0	-	0.88	-
Mexico	-	1.50	-	10.0	-	5.0	-	0.63
Peru	1.75	-	9.0	-	5.0	-	0.75	-

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.
[a]Column R relates to rescheduled maturities and column AC to terms for additional credits.
[b]Calculated as a percentage of the total amount of the transaction and paid once only on signing the loan contracts. It should be noted that evidence has been found that some commissions were not declared and the figures could therefore underestimate payments under this head.

Table 13

LATIN AMERICA (SELECTED COUNTRIES): DETERIORATION OF TERMS OF INDEBTEDNESS WITH THE PRIVATE BANKS (SECOND ROUND OF RENEGOTIATIONS: 1983/1984)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Commissions		Deterioration of terms[b] (percentage)	Real cost of credit[c]		
	1980/1981	R*AC	1980/1981	R*AC	1980/1981	R*AC		1980/1981	R*AC	Increase
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Brazil	1.62	2.00	8.5	9.0	2.01	1.00	7	6.86	7.11	3.6
Cuba	1.00	1.88	5.0	9.0	0.88	0.88	-7[d]	6.18	6.98	12.9
Chile	0.91	1.75	7.6	9.0	0.81	0.63	51	6.02	6.82	13.3
Ecuador	0.74	1.75	8.0	9.0	0.97	0.88	91	5.86	6.85	16.9
Mexico	0.65	1.50	7.6	10.0	0.70	0.63	60	5.74	6.56	14.3
Peru	1.12	1.75	8.2	9.0	1.07	0.75	34	6.25	6.83	9.3

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.
[a]The symbol R*AC represents a weighted average of rescheduled credits and additional credits. [b]Based on an index of the cost-of-credit components that are subject to negotiation. For the formula used, see table 10. [c]A real annual LIBOR of 5% is assumed and C/P + S are added. [d]Improvement of terms.

Table 14

LATIN AMERICA (SELECTED COUNTRIES): RENEGOTIATION OF THE EXTERNAL DEBT WITH PRIVATE BANKS (THIRD ROUND OF RENEGOTIATIONS: 1984/1985)[a]

(Billions of dollars)

Country	Gross bank debt[b] at September 1984	Renegotiation of the debt with the private banks					New credits[c]	Short-term bridging loans
		Start of negotiations	Amount			Maturity dates of amortization payments to be rescheduled		
			Total	Public	Private			
Argentina	26.1	Dec 1983	13.90[d]	10.40	3.50	1982-1985	4.20	0.50[e]
Brazil	75.3	Nov 1984	...[f]	...	...	1985 - ...	-	-
Chile	13.5	Oct 1984	...[g]	...	...	1985 - ...	1.05[h]	-
Ecuador	4.7	Nov 1984	4.30[i]	...	...	1985-1989	0.35	-
Mexico	73.9	Jun 1984	48.70[j]	48.70	-	1985-1990	-	-
Panama	...	Nov 1984	...[k]	...	-	1985 - ...	...	-
Peru	5.9	Dec 1984	...[l]	...	...	1985 - ...	...	0.40
Uruguay	1.8	Dec 1984	...[m]	...	...	1985 - ...	...	-
Venezuela	26.2	Oct 1982	20.75[n]	20.75	-	1983-1988	-	-

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.

[a] This information is preliminary and is subject to revision. It includes the countries which signed final or preliminary agreements during 1984 for the maturities falling due in 1985 and/or subsequent years and also those countries actively engaged in negotiations with the international banking system to that end. Also includes those countries which did not arrive at any final agreement with the international banking system in previous rounds of renegotiations but which did arrive at such agreement during 1984 (Argentina and Venezuela). Does not include the English-speaking Caribbean countries.

[b] Refers exclusively to the short-, medium- and long-term public and private debt of each country with the private commercial banks reporting to the Bank for International Settlements (BIS). Consequently this does not include debt with governments and official agencies or with suppliers, or with commercial banks not reporting to the BIS. In some countries, this latter item is quite substantial and the figures could therefore underestimate the bank share in the total external debt. It should be noted that as from 1983 the coverage of the information from the Bank for International Settlements is greater.

[c] Refers to credits granted by the international banking system as part of the renegotiation process.

[d] In December 1984, Argentina reached a preliminary agreement with the committee of creditor banks which includes the following points: i) the refinancing of US$ 13.9 billion corresponding to amortization of the external debt in the period 1982-1985 (the total amount includes the renegotiated external public debt mentioned in table 8, since the authorities never reached a final agreement with the private banking system); ii) new loans from the international banking system for US$ 3.7 billion, plus US$ 500 million in short-term trade credits; iii) the continued operation of short-term lines of trade credit for US$ 1.2 billion and short-term interbank lines of credit for US$ 1.4 billion; iv) official credit bodies will disburse US$ 1 billion in additional credits and it is expected that the United States Treasury will provide US$ 500 million until the official credits are available; and v) Argentina undertook to pay off by the end of 1984 nearly US$ 750 million in arrears of interest and to make good in March 1985 US$750 million of a bridging loan agreed in 1982. In December 1983 the Government of Argentina had secured from the international banking system the postponement of all capital and interest payments until 30 June 1984. Between June and November 1984 it paid US$ 560 million in arrears of interest, bringing its payments up to date up to May 1984. In addition, in September 1984 it paid back to the commercial banks US$ 100 million of the emergency loan which it had obtained in March 1984.

[e] At the end of March 1984, the governments of Brazil, Colombia, Mexico, Venezuela and the United States announced that they would be providing financing of US$ 500 million to pay the interest on the external debt of Argentina, of which US$ 300 million were provided by the countries named, US$ 100 million by the commercial banks and US$ 100 million by the recipient government. The loans by the Latin American countries are short-term bridging credits and will be replaced by a credit from the United States Treasury once Argentina reaches agreement with the IMF.

[f] At the end of 1984, the Government tried to negotiate the rescheduling of US$ 51 billion corresponding to the maturities falling due in the period 1985-1991, but the creditor banks only agreed to restructure US$ 37 billion for the period 1985-1990. Preliminary information indicates that the Government asked for the following debt renegotiation conditions: spread of 1.13% over LIBOR repayment term of 16 years, and no payment of commissions. The new government which took office in March 1985 will continue these negotiations.

[g] The international banking system extended to 30 June 1985 the time limit for the payment of amortization commitments falling due in the first half of 1985, while negotiations for the rescheduling of the external debt were going on. New credits for US$ 1 050 million are also being requested.

[h] Credits requested.

[i] In December 1984 Ecuador announced that it had reached preliminary agreement with the committee of creditor banks for refinancing US$ 4.3 billion of its external debt and obtaining US$ 350 million in new credits. It should be noted that this amount includes US$ 2.8 billion falling due in the period November 1982-1984 which had already been rescheduled in the first and second rounds of negotiations (see tables 8 and 11) and US$ 1.5 billion which were originally due to be repaid between 1985 and 1989. Ecuador also obtained the extension for two years of short-term trade credits for US$ 700 million, together with US$ 200 million to settle outstanding payments for imports, and US$ 125 million for financing purchases abroad.

[j] In August 1984, Mexico reached preliminary agreement with the advisory group of creditor banks for the refinancing of US$ 48.7 billion of its external public debt. This amount is made up of the following elements: i) US$ 23.7 billion originally falling due in the period August 1982-December 1984, which had been rescheduled in the first round of negotiations (see table 8); ii) US$ 20 billion which were originally to have fallen due between 1985 and 1990 and which had not been rescheduled; and iii) US$5 billion of additional credits obtained at the beginning of 1983. Since the government is not expected to establish a new agreement with the IMF there will be no element of conditionality after the expiry of the present agreement with the IMF at the end of 1985. In March 1985, final contracts for US$ 28.6 billion were signed with some 600 creditor banks. The rescheduling of the balance has already been agreed, and will be completed shortly.

[k] The postponement of payments falling due in the first half of 1985 was requested while negotiations were going on with the creditor banks.

[l] At the end of 1984, the committee of creditor banks granted a short-term bridging loan for US$ 100 million as part of a financing package in which the governments of Mexico, Venezuela and Spain participated. Since the beginning of 1985, Peru has made monthly payments of arrears of interest to the commercial banks. Thus, by the end of March the outstanding interest had gone down to US$ 135 million. The negotiation on a global rescheduling of the external debt have been put off until the new government takes office next July.

[m] In December 1984, Uruguay asked the committee of creditor banks for permission postpone payments of US$ 100 million due in respect of the external debt in the first half of 1985. Negotiations on the rescheduling of the external debt have been initiated by the new government, which took office in March 1985.

[n] As from October 1982, the international banking system authorized the postponement of payments for three months, and this was subsequently extended on six occasions, the last of these extending up to October 1984. In September 1984, the Government announced that it had reached a direct agreement with its creditors, without the intervention of the IMF, providing for the payment over 12 years of US$ 20 750 million of its external public debt. Payments will begin in the second half of 1985 with US$ 750 million. It should be noted that Venezuela had not signed any agreement with the international banking system in the previous two rounds of negotiations.

Table 15

LATIN AMERICA (SELECTED COUNTRIES): TERMS OF RESCHEDULING OF THE EXTERNAL DEBT WITH THE PRIVATE BANKS (THIRD ROUND OF RENEGOTIATIONS: 1984/1985)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Period of grace (years)		Commissions[b]	
	R	AC	R	AC	R	AC	R	AC
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Argentina[c]	1.38	1.63	12.0	10.0	3.0	3.0	-	0.63
Ecuador	1.38	1.63	12.0	10.0	3.0	2.0	-	-
Mexico[d]	1.13[e]	-	14.0	-	-	-	-	-
Venezuela[d]	1.13	-	12.5	-	-	-	-	-

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.
[a] Column R refers to rescheduled maturities and column AC refers to terms for additional credits. [b] Calculated as a percentage of the total amount of the transaction and paid on a once-only basis at the time of signing the loan contracts. [c] Refers to the rescheduling negotiations agreed in December 1984. [d] A refinancing agreement was reached without the country having had to sign and agreement with the IMF. [e] In the first four years the average rate applied will be 0.88% over LIBOR; in the next five years, 1.13% over LIBOR, and in the last five years, 1.25% over LIBOR.

Table 16

LATIN AMERICA (SELECTED COUNTRIES): DETERIORATION OF TERMS OF INDEBTEDNESS WITH THE PRIVATE BANKS (THIRD ROUND OF RENEGOTIATIONS: 1984/1985)[a]

Country	Spread over LIBOR (percentage)		Total period (years)		Commissions		Deterioration of terms[b] (percentage)	Real cost of credit[c]		
	1980/1981	R*AC	1980/1981	R*AC	1980/1981	R*AC		1980/1981	R*AC	Increase
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Argentina	0.67	1.44	7.5	11.5	1.09	0.15	16	5.82	6.45	10.8
Ecuador	0.74	1.40	8.0	11.8	0.97	-	10	5.86	6.40	9.2
Mexico	0.65	1.13	7.6	14.0	0.70	-	-17[d]	5.74	6.13	6.8
Venezuela	0.68	1.13	6.9	12.5	1.67	-	-32[d]	5.92	6.13	3.5

Source: ECLAC, on the basis of official data from the countries and information from various national and international sources.
[a] The symbol R*AC represents a weighted average of rescheduled credits and additional credits. [b] Based on an index of the cost-of-credit components that are subject to negotiation. For the formula used, see table 10. [c] A real annual LIBOR of 5% is assumed and C/P + S are added. [d] Improvement of terms.

Table 17

LATIN AMERICA: INDEXES OF MANUFACTURING AND CONSTRUCTION ACTIVITY IN SELECTED COUNTRIES

(1980 = 100)

	Manufacturing			Construction		
	Pre-crisis maximun	1984 level[a]	(1)/(2) (percentage)	Pre-crisis maximum	1984 level[a]	(4)/(5) (percentage)
	(1)	(2)	(3)	(4)	(5)	(6)
Argentina	106[b]	93	13.8	100	53	90.4
Brazil	100	93	7.3	100	75	33.3
Costa Rica	100	97	2.9	102[c]	65	56.5
Chile	100	92	8.3	121[d]	94	29.1
Mexico	107[d]	99	7.8	112[d]	87	28.4
Peru	100	83	20.1	114[e]	89	27.9
Uruguay	100	73	37.3	103[e]	55	88.9
Venezuela	102[e]	100	2.0	100	74	35.8

Source: ECLAC, on the basis of official data.
[a] Preliminary figures. [b] 1977. [c] 1979. [d] 1981. [e] 1982.

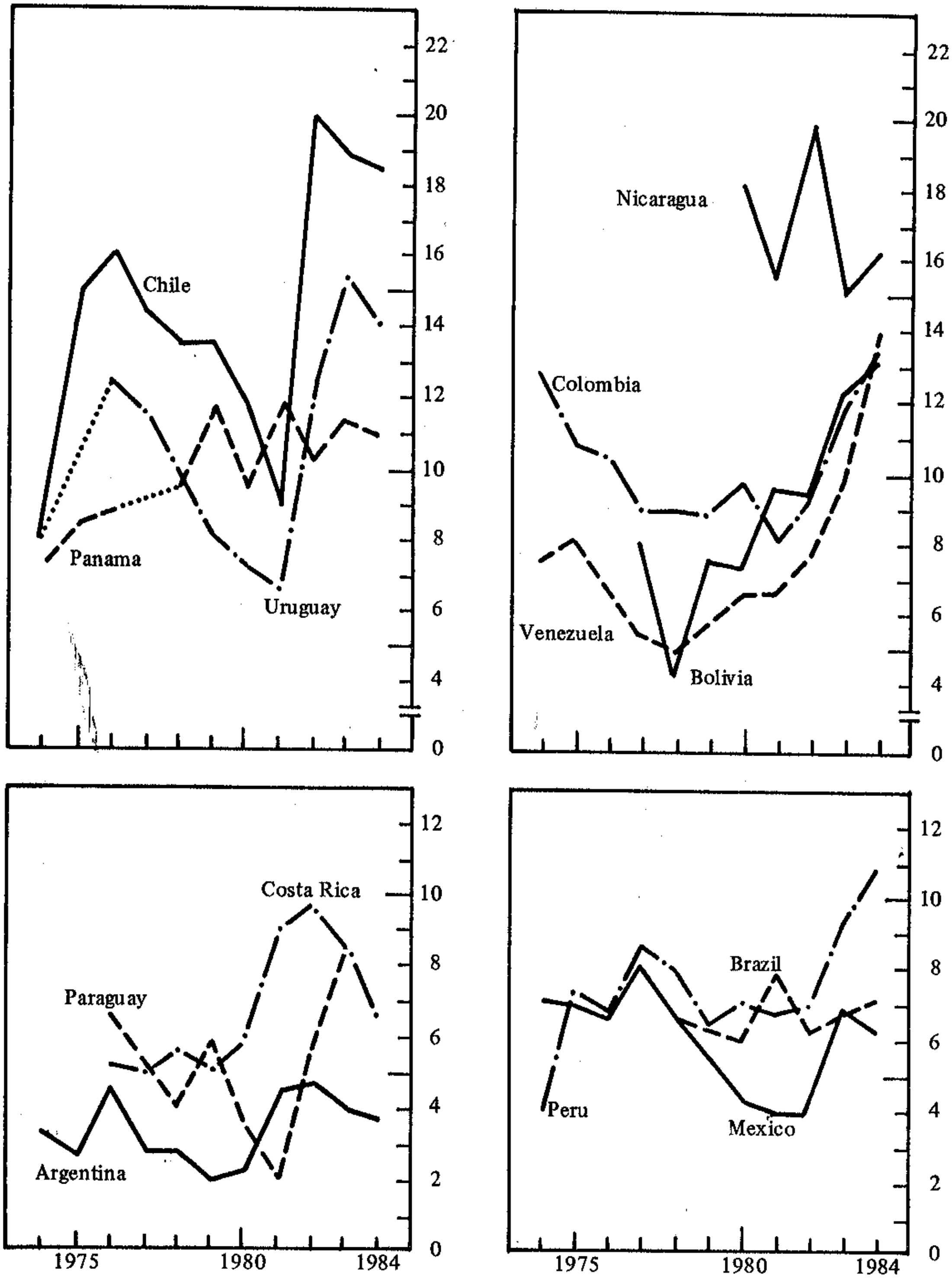
A N N E X

FIGURES

Figure 1

LATIN AMERICA: EVOLUTION OF URBAN UNEMPLOYMENT

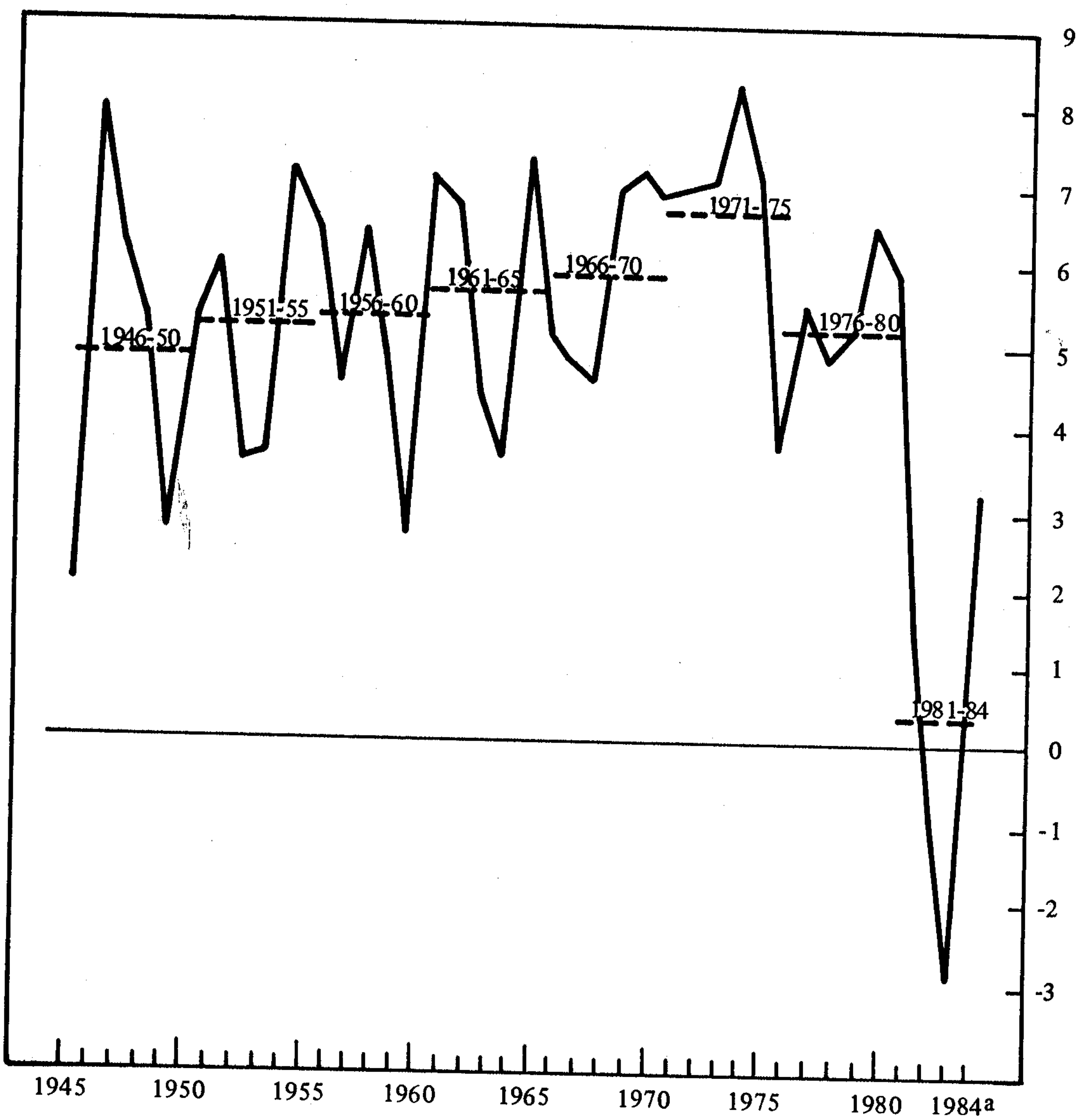
(Annual average rates)



Source: ECLAC, on the basis of official information.

Figure 2

LATIN AMERICA: ANNUAL GROWTH RATES OF GROSS DOMESTIC PRODUCT



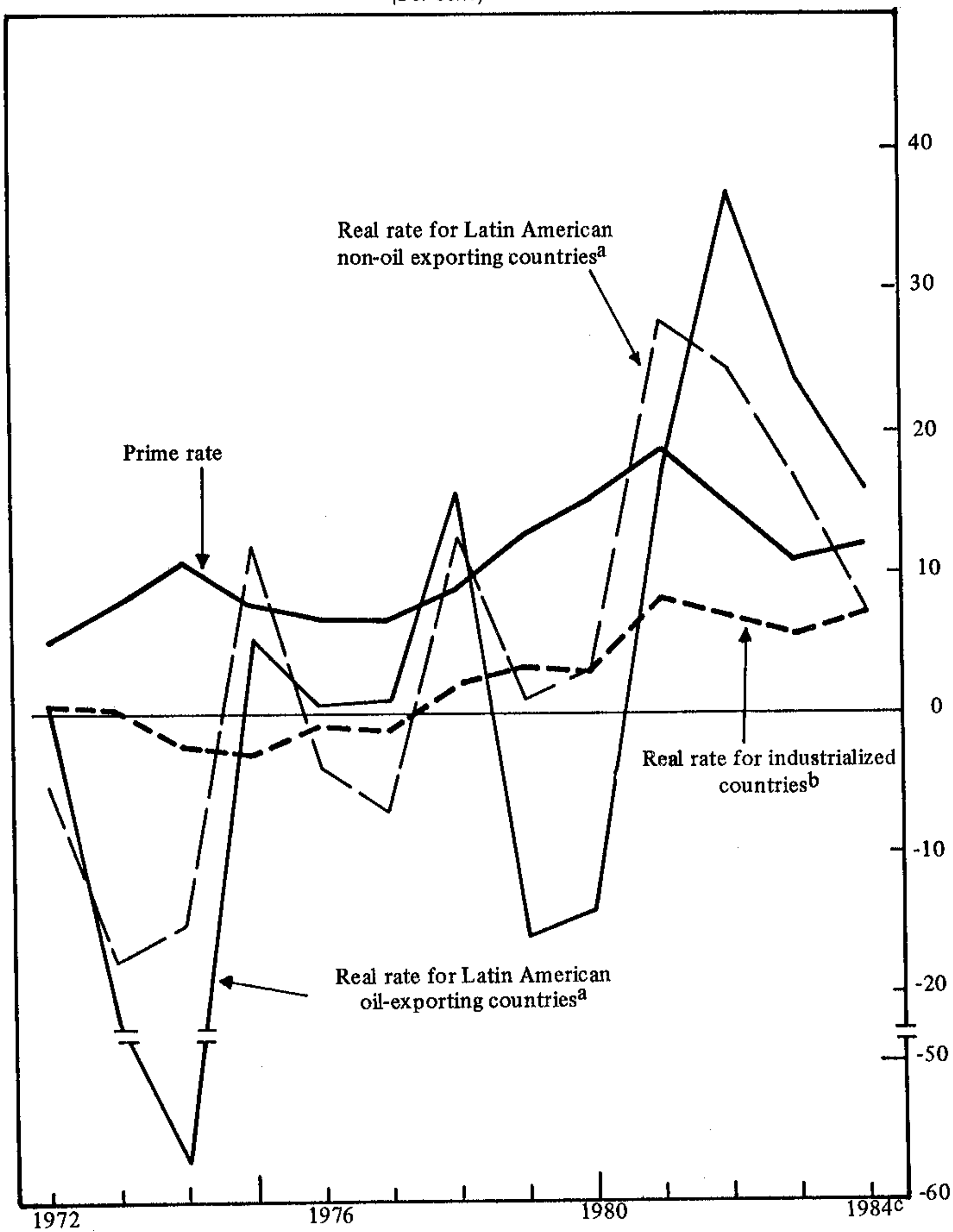
Source: ECLAC, on the basis of official information.

[a]Preliminary estimates.

Figure 3

NOMINAL AND REAL INTERNATIONAL INTEREST RATES

(Per cent)



Source: ECLAC, on the basis of official data from the countries and from *Economic Report of the President*, February 1984.

Note: The nominal interest rate used is the United States prime rate.

[a]Nominal rate deflated by index of unit value of exports.

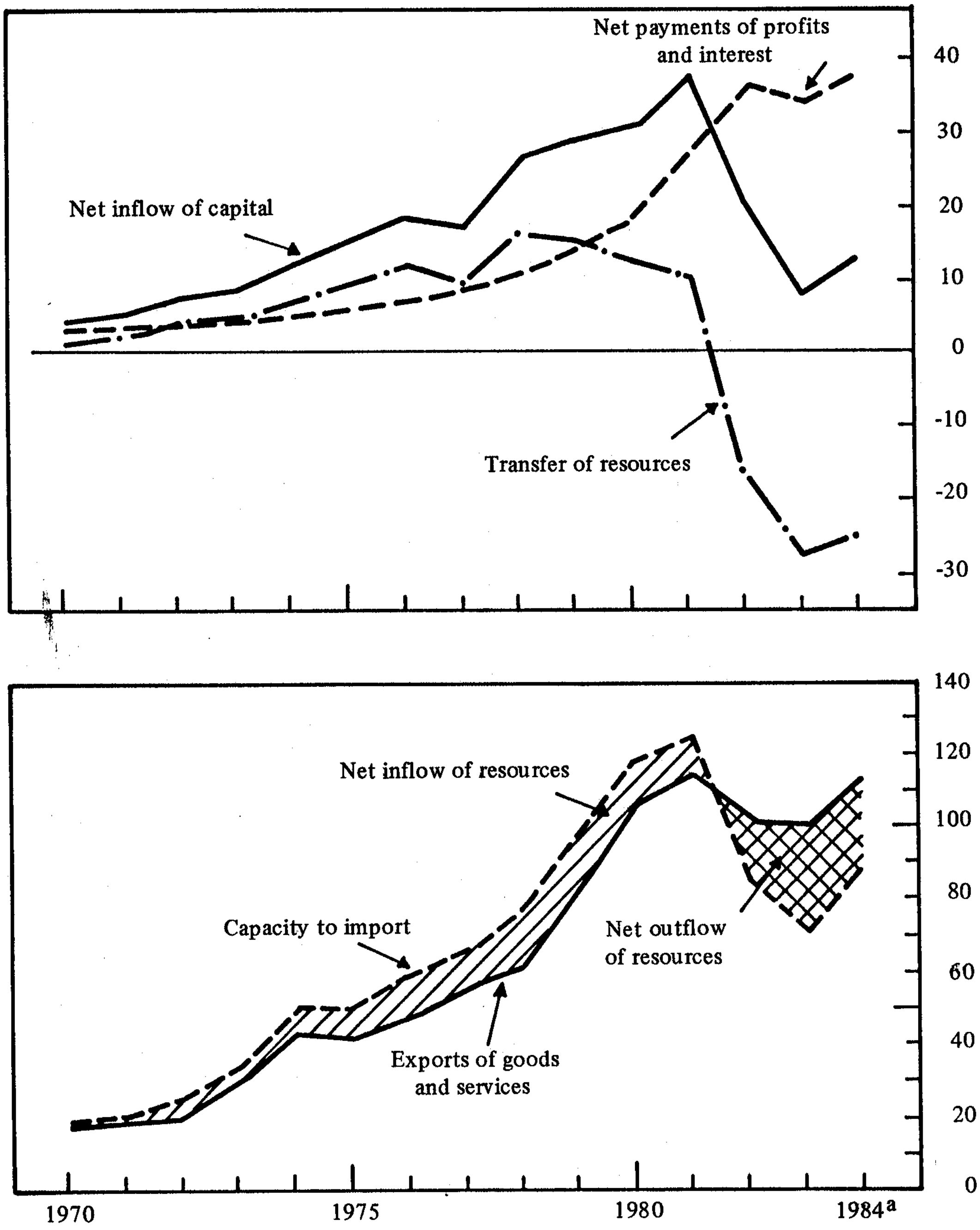
[b]Nominal rate deflated by Consumer Price Index of industrialized countries.

[c]Preliminary estimates.

Figure 4

LATIN AMERICA: NET INFLOW OF CAPITAL AND TRANSFER OF RESOURCES

(Billions of dollars)



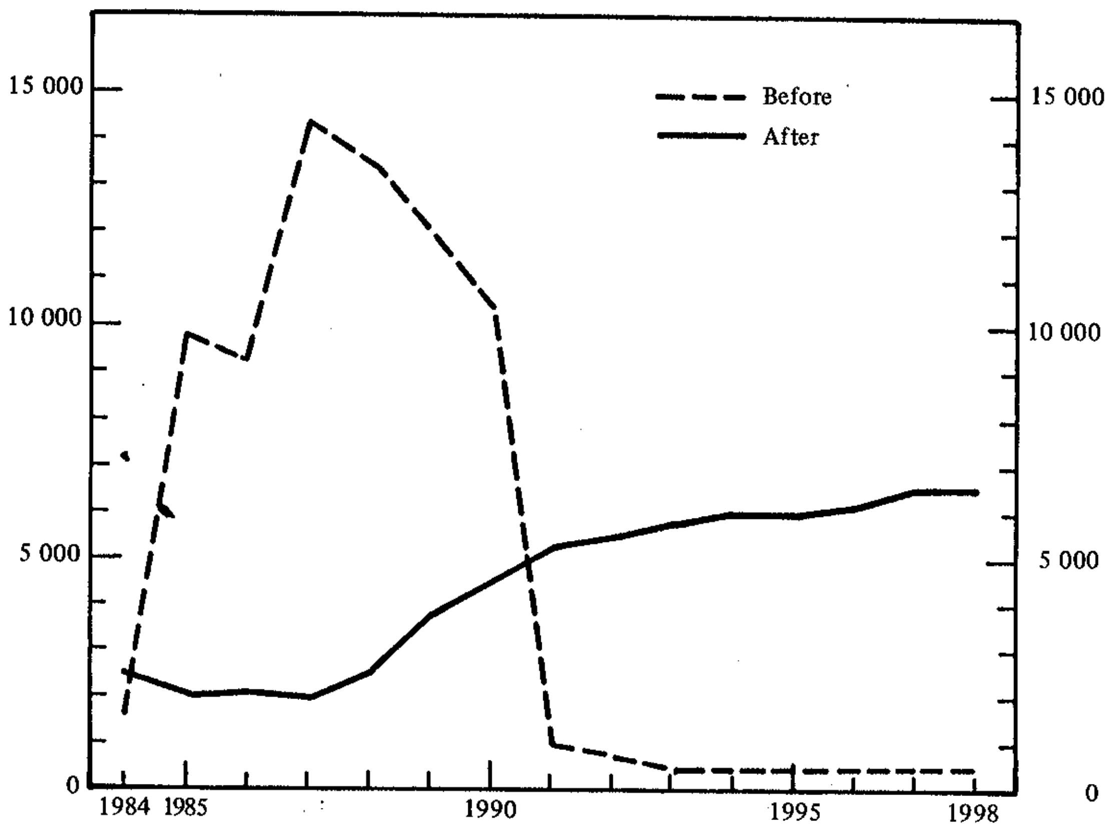
Source: ECLAC, on the basis of official data from the countries and from the International Monetary Fund.

[a]Preliminary estimates.

Figure 5

MEXICO: PROFILE OF EXTERNAL PUBLIC DEBT AMORTIZATION PAYMENTS BEFORE AND AFTER THE NEW DEBT RESTRUCTURING, 1984-1990

(Millions of dollars)



Source: ECLAC, on the basis of the public statement made by Jesús Silva Herzog, Minister of Finance and Public Credit, in *El Mercado de Valores*, 17 September 1984.