Chapter 8

Improving the Financial Outlook

The single most important cooperative measure the United States could take is to correct its own fiscal deficit

Western Hemisphere economies have been seriously burdened during the past decade by capital outflows. Capital deriving from loans, foreign investment, aid, migrant remittances, and export receipts into these countries have generally been outweighed by outflows to pay for loan interest, dividends, imports, or capital flight

The postwar pattern of resources flowing into developing countries from savings generated by richer nations was altered by the mid-1970s. Oil price increases beginning in the early 1970s transferred resources to oil-exporting countries which became the basis for the petrodollars used by commercial banks to underpin much of the debt buildup of Western Hemisphere countries. The United States during the 1980s became the largest single user of foreign savings, thereby reducing its availability and raising its cost to developing countries. In addition, conditions such as overvalued exchange rates and political instability stimulated capital flight in many countries. This has made for a stringency of resources throughout the Hemisphere for domestic investment to increase income. Investment needed to create jobs has lagged and public infrastructure has deteriorated. The need to service internal and external debt has drained public budgets of funds for social services, causing substantial personal hardship.

There is no single comprehensive corrective measure. Responsibilities for action must be shared by the countries of Latin America and the Caribbean on the one hand, and the United States and other developed countries on the other. In this context, U.S. macroeconomic policy, with its effect on capital flows and interest rates, must be regarded as a significant part of the development picture of the Western Hemisphere. The single most important cooperative measure the United States could take is to correct its own fiscal deficit. The Commission has no illusions as to the political difficulties involved, but believes that it must acknowledge this reality. Reducing or eliminating the federal deficit would increase the availability—and lower the cost—of capital for productive investment in the United States and other countries, including migrant-sending countries Although correcting the deficit entails difficult and sensitive choices, they are no more difficult than the adjustments the migrant-sending countries are being called upon to undertake.

In this same shared context, migrant-sending countries are themselves responsible for internal policies to enhance their own development programs. These involve structural issues and the creation of a domestic environment that attracts foreign investors. Only their policies can discourage capital flight or even encourage the return of capital, as has partially occurred in Mexico during the past year.

Some Central American and Caribbean countries have received substantial bilateral assistance, particularly in relation to the size of their economies Mexico is not a recipient of significant U.S. concessional aid, but non-concessional programs have been important, such as loans from the Export-Import Bank to facilitate the purchase of U.S. goods and services, or credit from the U.S. Department of Agriculture to purchase food and fiber.

The international financial institutions in which the United States participates have provided substantial grants and loans to migrant-sending countries. Their programs are generally conditioned on the structural and macroeconomic actions of the recipients Mexico is a major borrower from the World Bank and the Inter-American Development Bank to finance projects, structural adjustment, and import liberalization. Both the International Monetary Fund and the World Bank provided loans that made possible the rescheduling of Mexico's debt to commercial banks, completed early in 1990. These institutions need little urging to continue their programs. The U.S. role is to continue to provide its share of resources to these institutions and to urge them to play activist roles in economic development and employment creation in migrant-sending countries of the Western Hemisphere.

As the Commission looks ahead to the resource needs of sending countries, the debt experience of the 1980s stands out. The difficulties of servicing the borrowing of the previous decade has left commercial bank lenders wary. In the menu of choices available to commercial banks in the Mexican debt rescheduling of 1989-90, only 10 percent of the funds came from new lending. Banks chose in overwhelming numbers to exit from new long-term lending to Mexico, which is the migrant-sending country with the most promising economic future. The Commission must therefore conclude that for the near term, commercial bank lending will not be an important source of external resources for sending countries.

Private foreign direct investment has a large potential role in providing development funds. But conflict in much of Central America, the limited markets of the Caribbean countries and the grinding poverty of Haiti, have limited the prospects for sizeable foreign investments. The investment that is taking place in many of these countries is going into export processing zones, such as the maquiladoras of Mexico. It would be unrealistic for the Commission to recommend to private investors that they direct funds to countries with unpromising prospects. The burden, instead, is on those countries to change investor perceptions.

Servicing External Debt

The burden of servicing external debt, by reducing resources available to migrant-sending countries, has aggravated their economic distress and caused extensive suffering among their people. Governments have been forced to cut essential social programs designed to improve the living conditions of the poor. The degree of debt burden varies by country, but interest payments are typically between 25 and 50 percent of exports of goods and services. (See Figure 8.1, p. 78.)

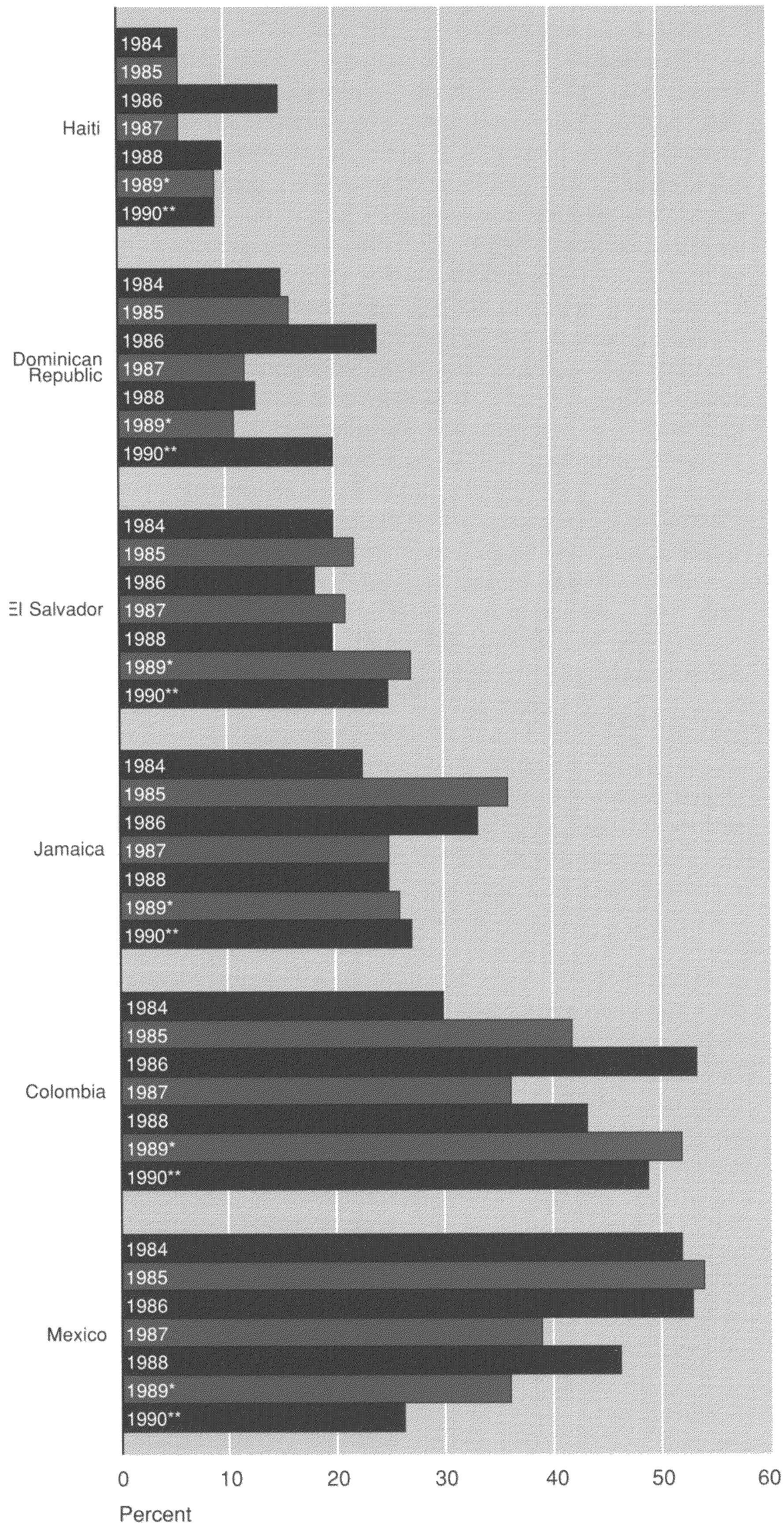
Policy regarding debt restructuring has evolved since the emergence of the global financial crisis in 1982. The problem was first seen as a liquidity shortage, a temporary matter that would soon resolve itself as debtor countries restructured their economies. Debt negotiations at first routinely involved year-by-year arrangements as a way of holding debtors on a short leash to encourage them to change fundamental economic policies It soon became clear, however, that the problem was structural and not just short-term. Debt restructuring was then negotiated on a multi-year basis, but no reductions were granted by commercial banks on interest rates. However, official creditors began to grant some relief on interest costs in the context of the Paris Club (the group of official lenders to developing countries), but the amelioration of overall debt servicing burden was generally modest. (See Box 8.1, p 79.)

The Baker Plan of 1985 recognized the failure of a policy that forced countries to contract their economies in order to pay interest on foreign debt Then Treasury Secretary James A. Baker III essentially proposed increasing lending by official institutions and commercial banks to facilitate economic growth. However, the Plan foundered

FIGURE 8.1
Ratio of Total Debt Service to Exports of Goods and Services for Selected Migrant-Sending Countries, 1984 to 1990

*Estimated

**Projected



Source: World Bank

Box 8.1 - Paris Club

The forum in which debt restructuring negotiations takes place depends primarily on the nature of the creditors. Foreign debt held by official creditors, such as agencies of the U.S government and those of other governments, is generally rescheduled in multilateral negotiations in what is known as the Paris Club The Paris Club is chaired by an official of the French Treasury and it normally reschedules the principal and interest coming due over a specified future period, usually the next twelve months. Put differently, the Paris Club does not reschedule the entire stock of government debt owed to official creditors. Mexico is the biggest debtor among the migrant-sending countries The most recent Paris Club rescheduling of Mexico's debt was in May 1989, and it gave Mexico five years to repay $2.4 billion of obligations coming due over a twelve-month period. The bulk of the external debt of Central American and Caribbean countries is owed to official creditors, and is also subject to Paris Club negotiations.

because of lack of substantial new commercial bank lending. The 1989 plan of Treasury Secretary Nicholas F. Brady recognized this shortcoming and, in effect, proposed a menu of choices for commercial banks that included reductions of principal or interest on old debts, as well as new lending.

The transfer of resources from debtor countries has placed a major burden on their budgets and balance of payments. New investment in public works and expenditures for education, health care, and other services have had to be drastically curtailed to meet external interest costs. The quality of life has been eroded for large segments of the population, particularly the poor and those persons already prone to emigrate.

Because foreign exchange has to be allocated to pay interest on debtor country obligations to U.S. and other foreign creditors, it cannot be used to import the goods and services necessary for the development of national industry. U.S. exports of goods and services to migrant-sending countries have either declined or failed to grow because the debtor countries lacked funds to pay for them. In the event, the U.S. productive sector has thus paid part of the price of debt servicing in order to sustain the U.S. financial sector.

The Commission commends the effort made by Secretary Brady to change the negotiating context for debt restructuring The debt agreement concluded with Mexico is a tangible result of this new strategy However, the Commission doubts that the Brady plan will be sufficient. In the case of Mexico, it has permitted most commercial banks to withdraw from the new lending required for migrant-sending countries to restore adequate rates of economic growth. The United States and other industrial countries should keep the debt issue under constant scrutiny and be prepared to take new initiatives should they be needed. **The key consideration is to assure that the painful efforts of debtor countries to restructure their economies not be frustrated by excessive debt service burdens, which entail a major cost in human suffering and, therefore, increase pressure to emigrate.**