The Foreign Debt Burdens Small Economies

The debt takes on its full role as an impediment to social and economic development in these countries

The issue of the Latin American countries' foreign debt immediately brings to mind Brazil, Mexico and Argentina. There are good reasons for this: the combined debt of these three countries represents 66% of the total regional debt, and when added to the amount owed by four other countries — Venezuela, Chile, Peru and Colombia— it amounts to 88% of the $382.8 billion Latin America owed its foreign creditors by the end of 1986.

A superficial review of these figures might lead to the idea that since the rest of the Latin American countries hold such a small proportion of the debt —$45.73 billion, 12% of the total— the problem doesn't affect them as much as it does the large or medium-size debtors.

This, however, is definitely a rash conclusion. When viewed in relation to the dimension of the smaller Latin American economies, the burden of the foreign debt can be as heavy or heavier than it is on Brazil or Mexico. Unfortunately for the small countries, this situation rarely receives the publicity or understanding needed to change the treatment they receive from their creditors or from the international financial institutions, particularly the International Monetary Fund (IMF).

In these small economies, much more so than in the larger ones in the region, the foreign debt takes on its full role as a deterrent to social and economic growth and development. The debt plays havoc on these economies in many complicated ways. For one, it absorbs an extraordinarily high level of their already precarious monetary reserves and of the foreign exchange obtained through exports. At the same time, they are in a very weak negotiation position *vis a vis* private banks and international financial institutions, and are thus vulnerable to all kinds of external pressure, particularly regarding the application of so-called adjustment policies.

Most of the small Latin American countries house stark contrasts in terms of the internal distribution of wealth, and poverty has reached explosive social and political levels. In this context, the foreign debt becomes an additional burden which subtracts resources from the possibility of reducing what has been termed the "internal social debt."

The Weight of the Debt

Structural factors of these economies such as their basic reliance on a single raw material or crop for export, added to the trend towards declining prices for their main goods, make the weight of the foreign debt much heavier to bear for the smaller Latin American countries. In fact, the pressure is such that some of the small nations — along with their large and medium-size counterparts— have become net capital exporters and can no longer aspire to an effective internal accumulation of capital.

A quick review of how this problem is manifested in three small countries —Costa Rica,

Foreign Debt Indicators for Latin America and Central America

	Latin America +		Central America + +	
	1981	1986	1981	1986
Total disimbursed foreign debt (in millions of dollars)	287.758	382.080	10.410	16.790
Total disimbursed foreign debt per capita (U.S. dollars)	810	941	495	541
Ratio of total interest payed and exports of goods and services (%)	28	35	16	17
Ratio of total disimbursed foreign debt and exports of goods and services (%)	248	401	238	501
Annual growth rates of the total foreign debt (%)	24.6	2.4	17.2	4.7

\+ 19 countries not including Cuba
\+ + Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

SOURCE: United Nations Economic Commission for Latin America (CEPAL).

The figures illustrate how in certain aspects the debt problem is more serious for the smaller economies than for Latin America as a whole. Attention should be called to the fact that while the total disimbursed debt of the entire region amounts to 401% of the value of exports in 1986, the corresponding figure for the five Central American nations is 501%. Taking into account that the price of coffee on the world market fell drastically in 1987, and that this is one of Central America's main exports, it is easy to predict that this index will become even worse. Paradoxically, in order to meet their growing financial needs and to compensate for decreasing prices for their main exports, the Central American nations must resort to more foreign credit. The figures provided show quite clearly that in 1986 the rate of indebtedness in Central America was almost double the rate for Latin America as a whole.

Ecuador and the Dominican Republic— serves to illustrate the point.

At the end of 1986, the total disimbursed foreign debt of the three countries amounted to $4 billion, $7.54 billion and $4.5 billion respectively. If these sums are correlated to the total population, it boils down to a per capita foreign debt of $1,600 in Costa Rica, $800 in Ecuador and $634 in the Dominican Republic. Contrast these figures with the comparable ones for Brazil, where the per capita foreign debt is $727, and you will have a more exact sense of the debt's proportional weight.

These figures are even more revealing when compared to the gross national product (GNP) per capita. For example, in Costa Rica the per capita GNP showed accumulative decrease of 13.1% between 1981 and 1986, while the total disimbursed foreign debt grew by 19% during the same period. In absolute terms, this means that while the per capita GNP in Costa Rica decreased from $932 in 1981 to $885 in 1986, the per capita foreign debt increased from $1,394 to $1,600 during the same period.

The conclusion is the same regardless of what example or index is used: the foreign debt is equally or more onerous for the small Latin American economies than for countries with a relatively higher level of development. This is the case in terms of the economic burden and of political vulnerability, both of which result in an erosion of national sovereignty when dealing with international financial institutions.

In terms of the countries used as examples, it is interesting to recall that in the Dominican-Republic in 1984, adjustment policies suggested by the IMF led to a series of massive protest movements that were as explosive as those which took place during the aborted constitutionalist revolution in 1965.

Costa Rica's internal situation has not reached such explosive proportions. However, there has been a progressive erosion of sovereignty which affects not only economic policy but the course of foreign policy as well. The debt crisis coincided with increasing political and military tension in the Central American region, and it is well known that during Luis Alberto Monge's administration, 1982-1986, the U.S. took advantage of Costa Rica's financial problems to pressure the country into an alignment with its regional strategy.

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Regarding economic policy, the Costa Rican government is at present totally dependent on the negotiation of a letter of intent with the IMF. Subscribing to this letter would facilitate re-scheduling payments to private foreign banks and obtaining a contingency loan for $60.5 million.

In order to obtain IMF and World Bank approval, Costa Rican officials accepted the commitment to reduce the fiscal deficit to 3% of the GNP during the next year, increase direct and indirect taxes, cut back on public sector employment to 1984 levels, and apply a wage-adjustment program which in real terms would mean freezing the wage-earning population's income.

Paraphrazing Saúl Osorio Paz, former rector of the National University of San Carlos of Guatemala, one is forced to conclude that for the large, medium and small Latin American debtors, the debt problem goes hand in hand with the economic crisis of the capitalist world.

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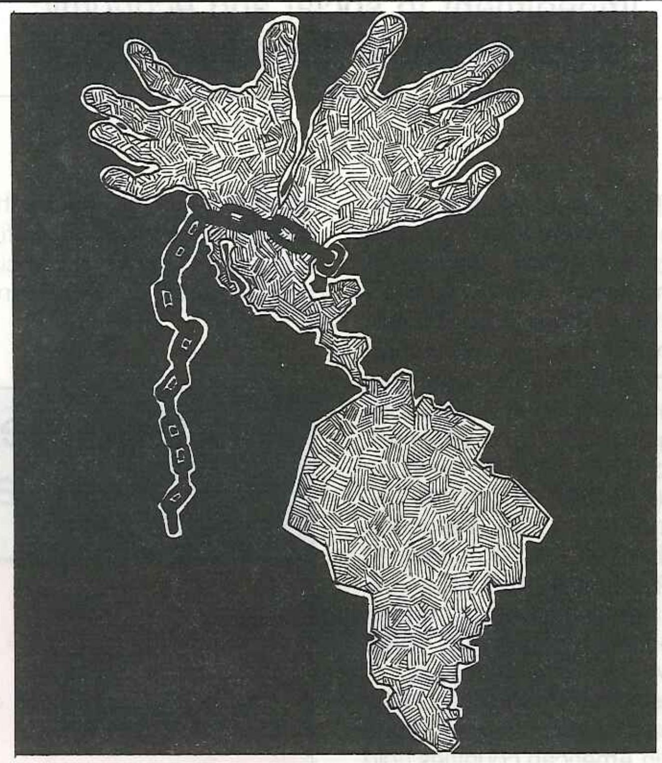

Two Ways of Looking at the Problem

Solutions to the problems the foreign debt poses remain a puzzle. An analysis of the most outstanding proposals leaves us with two basic approaches to the question, and these appear to grow farther apart every day.

On the one hand are the proposals along the lines of the International Monetary Fund's orthodoxy such as the Baker Plan and the more recent Rockefeller Plan, among others. They all share the common goal of guaranteeing payment to the creditors. The adjustment policies these plans recommend emphasize the need to reduce budget deficits at the expense of public services —austerity— freezing wages and increasing exports, and are all based on the idea that these economies need to "grow in order to pay."

On the other hand, from the viewpoint of the Latin American debtors there is a growing coincidence around proposals which initially appeared to be mutually exclusive. Between the radical idea of not paying the debt, the moderate position that insists on renegotiating and seeking new foreign funding with which to revive the national economies in order to service the debt, and the various proposed forms of moratorioum, there are at least three points of growing coincidence. These are a) the co-responsibility creditors share in the origin and development of the problem, and therefore in its solution; b) an unwillingness to place payment of the foreign debt above and beyond the need for economic development in the debtor nations, and c) the need for Latin American solidarity in dealing with the problem.

The latter point is essential for the small Latin American economies to be taken into account in decisive negotiations. Therefore, this is a specific goal in the resolution of their own puzzle.