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LATIN AMÉRICA MAJOR PLAYERS IN THE INTERNATIONAL
FINANCIAL MARKETS: AGONY AND ECSTASY

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**Latin america Major Players in the
International Financial Markets:
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Abstract

This study deals with the complex relationship between the International Financial Markets (IFMs) and the countries of the Latin America Group, emphasizing the entrance and the exit conditions for these countries in the last two indebtedness cycles - 1967/1982 and 1990/1994. Finally, it makes some considerations about the consequences of these Latin America countries of being linking their economic policies to the external financing obtained in the IFMs.

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It has no future — but itself.
It's infinite contain
It's past enlightened to perceive
New periods of pain.

Emily Dickinson

1. Introduction

International Financial Markets (IFMs) are the brainchild of major banks which were internationalized following the overflowing of productive companies since the end of World War II. This internationalization process involving productive and financial capital was led by American companies, albeit having to share markets with new competitors after the recovery of Western Europe and Japan in the late fifties.

The essence of this internationalized economic universe has since then been limited to a relatively small number of countries — basically the USA, Canada, Japan and member countries of the European Union and European Free Trade Association (EFTA). This does not mean other countries had no access to this universe; only that economic ties were stronger among privileged partners.

Latin American countries, although quite distinct from one another, make up a group of “outsiders” whose participation in this internationalized universe may vary in importance and form over time. Specifically vis-à-vis IFMs, the relationship could not be more chaotic: slump periods following others of great ebullience.

It should also be noted that, despite the continuous reference to “Latin America” as a whole, the extremely difficult, even conflicting, access to IFMs has not in fact been granted to all Latin American countries. To emphasize the existing discrimination, the expression “Latin American group” used in this study basically stands for Argentina, Brazil, Chile, Mexico, and Venezuela — and, in certain aspects, just Argentina, Brazil, and Mexico, the major participants in the most important episodes of this complex relationship over the last three decades.

Any analysis of the relationship between the Latin American group and the so-called *international capital* should by definition include items such as foreign trade, direct investments, technology transfer, and foreign financing. History has shown that the international community¹ at large tends to treat these various aspects as a whole during crises. It is enough to mention the painful adjustment process of the eighties.

However, one should not ignore the many different interests that may be at stake at any one time among the many segments of international capital — in other words, positions do not always coincide. Even in the case of very diversified corporations — which is a growing trend nowadays — the decision to expand a plant in a specific country, for example, is not necessarily dictated by the same reasons as for buying or selling bonds issued by a certain company in that country.

It seems, therefore, relevant to analyze separately the Latin American group's relationship with IFMs, especially because one of the objects of this study is to determine the fragility of these relations, as a result of the difficult access of these countries to IFMs and the peculiar characteristics of these markets.

¹Meaning the set of government or multilateral bodies and agencies and also private sector companies and other relevant institutions.

2. Welcome Second-Class Customers!

1967/1981

Latin American countries, mainly Argentina, Mexico, and Brazil, have had considerable access to private international credits since mid-1967. These credits, however, were limited to the short and medium-term segments; access to the new and promising long-term securities segment was not equally granted to these countries.

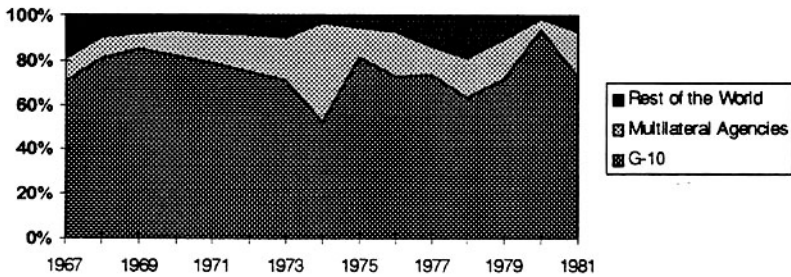
The new method of issuing international bonds through a syndicate of banks and/or other financial institutions² granted access to softer, longer-term loans than alternative sources. Also, the development of an international stock market, mainly through convertibles³, offered good opportunities to obtain credit.

Cheaper and longer-term credits, however, were practically limited to developed countries and international agencies. In Chart 1 there is no breakdown of the *Rest Of The World* item, and therefore it is impossible to calculate what is the Latin American group's share of total IFM long-term credits. At any rate, given the small participation of all of the *Rest Of The World* countries, it is clear that Latin American access to longer-term, softer credit was quite limited. Only top-notch borrowers took part in the then long-term bonds market.

² The international bond issuing procedure through bank syndicates was the following: the leading bank invited several other international banks and/or non-banking financial institutions to take part in the issue and distribution of their clients' securities at face value. A group of underwriters, normally including the managing bank, was also formed and usually took part in the distribution. Not all of them, however, participated in the underwriting and/or distribution of the securities. These functions were clearly assigned, with commissions established for each of them.

³ Bonds that could be converted into common stock. The first international operations of this kind were made in 1965.

Chart 1— International Bond Market— Geographic Distribution— 1967/1981



Source: BIS — Annual Report — various issues

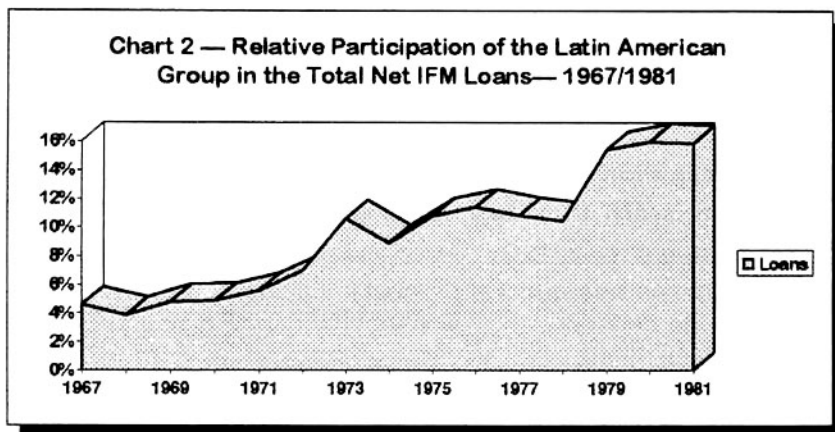
As regards loans, their remarkable growth was followed as of 1968 by an increased participation of the Latin American group. The growth in global international loans is related to the macroeconomic conditions at that time and even the operating characteristics of financial institutions.

In respect to macroeconomics aspects, the increased American external deficits and the slowdown of advanced economies between 1968/1970 followed by stagnation in 1974, led to an increase in the international liquidity. With regard to financial institutions' operating methods, the following aspects should be noted:

- short and medium term operations involving foreign funds and loans had very narrow margins, when compared with similar domestic transactions;
- the lack of rules or regulations governing international operations allowed foreign institutions to operate without having to maintain a fixed proportion between their own capital and their investments, make compulsory deposits, limit the minimum maturity period, establish an interest rate ceiling, and handle non-nominal operations in order to keep clients anonymous;

- the volumes negotiated were never below US\$ 50,000 — a clear sign they were never retail operations, which further contributed to reduced brokerage costs.

The growing availability of short and medium-term foreign credit, coupled with the multinationals' lowering credit demands, explains to a considerable extent the relative expansion in Latin American participation. It should be noted that the access to international loans occurred before the first oil crisis, as shown in Chart 2.



Source: BIS — Annual Report — various issues

The participation of Latin American banks in international markets is also worthy of mention. In fact, the expansion of IFMs granted access not just to second-class clients, but also to smaller financial institutions, including those from developing countries.

Evidently, being able to count on private foreign financing was a significant change for the Latin American group. So far, its only access to foreign funds had been through multilateral and/or government agencies of developed countries. Private international credit afforded a much greater flexibility than that provided by public sector agencies.

The management of the Latin American group's debts in that period is not an object of this study, which does not mean government officials were entirely unaccountable for it. It is true that international liquidity favored the introduction of these countries to the inner circle of international borrowers; but it is also true that domestic governments were free to make decisions involving the obtention and allocation of those funds.

The first years of the seventies were marked by the breach of the Bretton Woods Agreement, the change in prices of the main commodities, especially oil, and by the onset of a full-scale technological revolution after the long cycle of growth of capitalistic economies that had started after World War II came to an end. Regarding IFMs and the Latin American group, the following aspects should be noted.

The breach of the Bretton Woods Agreement marked the end of the economic world order, which had initiated in 1944 and given rise to a long period of economic stability. On the whole, one could say that the economic events which eventually led to the end of the dollar/gold standard in 1971, and consequently of fixed exchange rates in early 1973, also brought higher inflation and marked the beginning of a period of unstable foreign economic relations⁴. The immediate consequence for international financial institutions was that now they had to deal with more volatile exchange and interest rates, which led them to alter many conditions that prevailed until the Latin American group joined in.

The fourfold rise in oil prices in November 1973 brought about a price rise for several processed goods and a reduction in several primary and intermediate product prices. This price alteration caused a marked deterioration in terms of exchange with developing countries, including the Latin American group. As a result, there were significant trade deficits, financed to a great extent by private

⁴The growing deficits in the U.S. balance of payments as of 1968 and the non-intervening policy vis à vis these deficits adopted by the Nixon administration in 1969 resulted in a dollar flooding of European markets, causing enormous monetary instability and widespread inflation.

foreign loans carrying maturity periods of over a year. On the other hand, the boost in oil prices brought significant surpluses to OPEC countries, even considering their increased imports. A significant part of these surpluses was channeled to short-term investments in IFMs, which increased the possibility of mismatched entries of assets and liabilities in the books of international financial institutions.

The technological revolution brought at first a general slowdown in new plant investments which reduced multinational financing demand. Technological changes in the mid-seventies, however, were only starting to shape up. The introduction of what was called an effort to alter the power generation program and streamline productive systems to cut costs did not include any clear guidelines to a productive restructuring.

The process of an increasing economic instability, the recycling through IFMs of the external imbalance caused by sudden price hikes affecting the main commodities traded worldwide, and the technological revolution could be appointed as the main reasons for the acceleration of the financial innovations in the 80's.

Reference is now made to the impact of such changes on the Latin American group. From the point of view of this study, the empty space left by the main players during the first period of the IFMs was more and more being occupied by second-class players — the developing countries. A remarkable change in sources and uses had taken place. If, by 1972, most of the funds came from developed countries, by late 1973 the so-called petrodollars were flooding IFMs. Regarding the use of these funds, when countries such as Germany and Japan adjusted their balance of payments and absorbed the hike in oil prices in 1975, there was a recurrence of the situation prevailing until 1973: dollar surpluses in these countries and deficits in the U.S. The new fact was related to increased deficits in developing countries that did not produce oil and their growing dependence on IFMs to recycle their foreign positions.

Despite the Herstatt crisis in 1974, IFMs resumed their normal pace and operations in 1975 on a definitely modified market. The sluggishness of top-class borrowers coupled with the eagerness of second-ranking customers, prompted international financial institutions to select credit instruments and to carefully consider the profitability and risks involved.

The international financial institutions started to realize the financial deterioration of important Latin American group debtors as early as the mid-seventies — this was obvious from a few measures they implemented such as:

- the introduction of a floating rates system capable of reconciling short-term deposits with medium-term loans in a context of growing uncertainty, the so-called rollover credits. Their repayment included floating interest rates (three or six-months Libor) in addition to a spread that reflected each borrower's risk rating and other fees paid to each participant in the syndicated loan;
- syndicated loans, which existed since 1972, but only became popular from 1976 onwards; joined by a considerable number of institutions, managed by one or more banks, which multiplied the number of participants in the credit operation;
- special clauses that were gradually introduced, such as the so-called "availability clause" which entitled the lending banks to terminate their credit contracts if market resources were insufficient. Another clause that was regularly included in loan contracts was the "Eurodollar catastrophe clause" which provided that the borrower would have to settle his entire debt (principal plus interest) if the Libor could not be fixed in a given three or six-month period due to a crash of the London interbank market. There was also a multicurrency clause providing the right of demanding repayment in several currencies, as previously established in the contract⁵.

⁵ Crawford, F.O. (1978, p. 49/57); Einzing, P. (1975, p. 59); Lima, M.L.L.M.F. (1985, p. 180/190).

International financial institutions introduced new ways of coping with the higher risks that were clearly detected. It is hard to determine to what extent these financial innovations actually reduced those risks, given the impact of the American monetary policy reversal on existing debts and the added difficulties it brought to the Latin American group. One could rightly argue that this blow from the outside was not predictable. But it should also be mentioned that the adoption of those innovations did not work the same way for all international financial institutions.

As to the floating interest rates system, banks could probably have used it as a cushion against variations between paid and received interest rates. Smaller institutions, who continuously had to cover up their positions on the interbank market paying higher interest rates than top banks, had to cope with interest rate fluctuations by cutting back on their operating margins.

The syndicated loan method itself had the advantage of scattering the total credit granted among a wide range of brokers who would then share the risk. However, as institutions were not all the same, this long chain was made up of different links, each standing for a different individual capacity of absorbing losses and accessing the interbank market. If a crisis occurred, the chain would predictably be broken. In fact, during the Herstatt episode, the interbank market shakeout showed how IFMs reacted at crucial moments.

The lack of an institution to act as lender of last resort for the international private financial system and the absence of adequate regulations to preserve the system's credibility made its participants more sensitive to even the slightest threat of a crisis.

Something in the behavior of international financial institutions indicated that they were aware of this IFM fragility. These institutions, of course, sought to develop mechanisms that could afford them greater stability, and experience

has in fact shown how fast they can respond.

This point is emphasized because many analyses made in the wake of events such as the debt crisis of 1982 or the Mexican crisis of 1994, tend to elaborate on the “unpredictability” factor in this sort of accident⁶.

The much more intense and lasting interest rates collapse, coupled with the second oil shock, occurred when the foreign debt of the Latin American group was quite sizable already. The response of international financial institutions’ to these countries’ growing need to finance their unbalanced current accounts was to shorten maturity dates and raise their spreads even further.

⁶ In this respect , this study considers the impossibility of predicting the exact moment when a financial crisis will break out, or the precise point in time when non-performance can be expected. However, the signs of a more serious instability that may deeply affect expectations can usually be detected prior to financial collapse.

3. The “Globe” Gets Smaller for the IFMs

1982/1989

The BIS⁷ report published in June 1982, predicted increasing difficulties for heavily indebted developing countries in obtaining new credits. If in 1981 international financial institutions already limited funds to these countries and raised their spreads, in 1982 they were bound to be even more cautious about East European countries and other heavily indebted developing countries⁸.

Even recognizing the effort made by some of the major debtors in adjusting their balance of payments, it was clear that the degree of exposure of developing countries as a whole led financial institutions to drastically cut down on loans to these countries. The banks' decision to obstruct these countries' access to IFMs seems to be a marked trend detected by BIS.

The immediate effect of Mexico's moratorium in August 1982 was to exclude from IFMs heavily indebted developing countries, specifically major Latin American debtors. These countries' almost simultaneous exclusion was not as thorny to creditors as one could expect thanks to the meekness of these countries and their incapacity of articulating a concerted reaction. Thus, IFMs went back to their main purpose, i.e., dealing almost exclusively with advanced countries.

After the Mexican crisis of August 1982, a new strategy was devised by private international creditors, with the help of multilateral agencies. Its basic principles were that debts should be honored, possible disputes among the numerous creditors settled by building up a single “position”, and that debtors would be treated on a “case-by-case” basis.

⁷ Bank for International Settlements — BIS (1982, p. 117-124).

⁸ Basically the main Latin American debtors.

As soon as the 1982 crisis broke out, private creditors had no institution to support them in their dealings with debtors, as opposed to official creditors who could count on the Paris Club⁹. This was why multilateral and official agencies played a crucial role in these negotiations. In the early stages of the crisis, U.S. Government agencies granted bridge loans to some major debtors to prevent a further deterioration of the situation. The International Monetary Fund (IMF) undertook the consolidation of the main problem countries' private and public-sector debts and set up a detailed economic database on them. Subsequently, it designed and monitored adjustment programs aiming at the settlement of those countries' foreign debts.

The Latin American group had gained access to private international credit primarily through syndicated bank loans. In other words, although the loans had been obtained through major international banks, many other financial institutions had also participated. As a result, an IMF-imposed policy aiming at the adjustment of these countries' balances of payments, covering their high financial deficits, would not by itself secure the result expected by private creditors. A concerted action of the various creditors was also essential. The final decision was to set up Bank Advisory Committees to act on behalf of all private creditors.

Naturally, the existence of such committees strengthened the private creditors' position; but it was nevertheless conflicting¹⁰, since large American banks held most of the posts, and therefore controlled negotiations¹¹. In 1989, when the 1982 debt crisis had already subsided, this kind of solution was, in the words of a creditor, "an imperfect, inefficient, frustrating system. But in the end, it's the best we've been able to devise¹²."

⁹ Negotiations involving credits granted by governments or official agencies are usually conducted at the Paris Club, which has neither a fixed number of participants nor a definite institutional structure. It has, in fact, laid down a number of negotiation rules to which official creditors must adhere in order to gain access to the Club. To initiate a debt-rescheduling process, the country in debt must submit a formal request to the chairman of the Paris Club, who will study it and, if he finds it acceptable, he will call a meeting to work out an agreement between the interested parties.

¹⁰ There was conflict both between American banks — money centers and regional banks — and between American and non-American banks.

¹¹ William Rhodes of Citibank chaired several such committees throughout that period.

¹² LatinFinance, March 1989 — *Rescheduling Fatigue* — p.39

A further remedy was the establishment of a secondary market for foreign debt securities from heavily indebted developing countries. On this secondary market, created by private creditors, problem-country securities were traded at a discount, in one of the following ways:

- debt for cash;
- debt swaps;
- debt for equity;
- debt exchange;
- debt repurchase (buy-back).

The first system — debt for cash — involved the sale of a security for a market price that was lower than its face value, which allowed the seller to write the security off his balance sheet. The second method — debt swaps — involved two financial institutions interested in swapping positions: as there was no settlement, there could be no debt reduction, but this permitted the financial institutions involved in the operation to swap positions.

The next method — debt for equity — involved the purchase of a foreign debt security in the currency of its respective country — for its face value or at a discount — which enabled the buyer to invest in that country. Thus, the investor normally bought the security on the secondary market for P_1 and sold it for P_2 to the central bank of the country to which the debt belonged, $P_1 < P_2$, and acquired stock from companies located in the debtor country. In this case, a debt reduction occurred.

The next instrument — debt exchange — involved the swap of a security for another carrying different rates and maturity date, and with additional debt service guarantees from the debtor. Usually, this type of operation was established by a previous agreement between the debtor and the creditor country or countries¹³.

¹³ The classical example of the use of this instrument is the Mexico-Morgan agreement of February 1988.

The last item — debt repurchase or buy back — involved the purchase of the foreign debt securities by the debtor country at a discount. As in most loan contracts there were clauses that prevented debt repurchasing or prepayment at a discount, this sort of transaction required a prior debt-rescheduling agreement between debtor and creditor.

Despite this secondary market for securities of developing countries consisting of about 30 countries, most transactions involved securities from a very small group of countries including basically major Latin American debtors: Brazil, Mexico, Argentina, Chile, and Venezuela. Being a highly speculative market, its prices are quite volatile and changes in value of one country's securities, for whatever reason, are sure to affect all the others. This market, therefore, typically carries what is called a "contamination risk", meaning that it is highly sensitive, as a whole, to events that may concern just one of the main countries that form it.

In most cases, the degree of exposure of the creditors in relation to large Latin American debtors, mainly the American banks, exceeded these financial institutions' capital. Despite this crisis having at first been considered a temporary liquidity problem of a few borrowers, expected to last no more than two or three years, there was always a possibility of an IFM collapse. However, with the creditors' strategy, implemented during the early stages of the crisis (1982/1984)¹⁴, the major debtors' position, and the development of a secondary market, the risk was reduced.

Although the above strategy did prevent an IFM crash, it did not solve the main problems arising from the crisis, either. In 1985, when some of the heavily indebted countries, led by political changes, started taking a less submissive stance, and thinking of less conventional solutions, the Baker Plan was launched.

¹⁴ The strategy, as mentioned before, was based on the intermediation of multilateral agencies (especially the IMF), the new Bank Advisory Committees, the "case-by-case" treatment of debtors, and the implementation of a secondary market of securities from "problem" countries.

The Baker Plan, launched by the U.S. Treasury Secretary in October 1985, proposed multi-year debt-rescheduling solutions with “problem” countries undertaking to carry out structural reform which would include measures such as free trade, state deregulation, and the enactment of legislation favoring direct investments.

The Baker Plan can be seen as an attempt to strengthen the most relevant aspect of the debt-management strategy so far adopted, i.e., unilaterally-imposed negotiation conditions. It also included a few points designed to stave off any adverse reactions from new governments of heavily indebted Latin American countries.

According to Cline, W. (1990), the atmosphere that preceded the Baker Plan seemed to indicate that “... policymakers in Latin American were increasingly frustrated by the recessionary adjustments their countries had been forced to make, led by sharp cutback in import, and by growing evidence that voluntary bank-lending was not likely to return so soon”¹⁵. It was therefore necessary to offer longer-term alternatives to forestall unconventional initiatives from large debtors.

To Cline, W. (1990), during Baker Plan period, the lower ratio between interest payments and exports of goods and services meant that there had been “progress” in the management of the debt balance (Table 1). The author further mentions the reduced discount in Latin American securities negotiated on secondary markets, an evidence of the aforementioned “progress”.

	(in %)	
	1982	1988
Latin America	41	28
Argentina	58	40
Brazil	57	30
Chile	50	23
Colombia	27	21
Mexico	47	29
Venezuela	31	26

Source: Cline, W. (1990, p.86)

¹⁵ Cline, W. (1990) — *From Baker to Brady: Managing International Debt* — p.85.

However, the annual US\$ 20 billion flow earmarked for loans, which was considered ideal for the 15 countries that took part in the Plan, never materialized. As will be shown, the volume of transactions on the secondary market skyrocketed. As far as structural reforms are concerned, only Mexico, of the three main debtors, “understood” and began implementing the corrective measures prescribed by the Baker Plan, as opposed to Argentina and Brazil.

In the second half of the eighties, anyway, the Latin American group accelerated net remittances to creditor countries, which aggravated the tax crisis, the pressure of inflation, the decline in investments, and the debtors’ economic stagnation. The continuous economic deterioration in these countries coincided with a new period of democratic rule, and governments were less willing to display passive and “cooperative” attitudes towards creditors and their respective multilateral agents.

As a result, the relationship between debtors and creditors became much more tense, leading to situations such as the Brazilian government’s refusal to sign an agreement with the IMF since 1985; Peru’s unilateral decision to limit its medium and long-term debt service to 10% of the country’s exports and rupture its relations with the IMF (1985); and the Brazilian moratorium in February 1987 with a much higher impact, given the size of the country’s debt. The suspension of the Brazilian medium and long-term debt service to commercial banks caused major American banks’ stocks to decrease in value and was a turning point in the negotiation process that dragged on since 1982¹⁶.

After Brazil’s moratorium, Citibank raised its reserves in May 1987 from US\$ 2 billion to US\$ 5 billion for non-performing Latin American debtors. This attitude was followed by other U.S. money centers and considered a watershed

¹⁶ According to William Rhodes, “Brazil’s partial moratorium on interest payments to creditor banks, declared in February 1987, was a milestone in the debt crisis. To many, it signaled a shift in approach from cooperation to confrontation.” *LatinFinance (Evolution, Not Revolution — March, 1989 p.38)*. On the Brazilian moratorium of 1987, see Batista Jr., P.N. (1988).

in the debt crisis¹⁷, since, with larger reserves, the major creditors were in a more comfortable position to manage their Latin American portfolios more aggressively. In fact, portfolios of Latin American group securities were more quickly sold off as of 1987¹⁸.

From the creditors' viewpoint, the 1982 debt crisis was virtually over in late 1988, when they considered themselves cured from the main effects of the crisis and immune to new "problem" country setbacks. The Latin American risk had been reasonably dealt with and could no longer affect the operating results of international financial institutions. The main U.S. banks, particularly Citibank¹⁹, took the opportunity of restructuring their securities through various instruments²⁰ developed to manage "problem" country portfolios, to diversify their investments among the most important Latin American countries.

It was during that period (March 1989) that the then-Secretary of the U.S. Treasury Nicholas Brady proposed a new plan for indebted countries that included the voluntary reduction of the long-term debt (some US\$ 70 billion out of a total US\$ 340 billion) and the granting of new credits jointly financed by private institutions and multilateral agencies, provided these countries adopted economic restructuring programs. Despite some concern about the "free riders"²¹, the plan, following market trends, stood a better chance of success.

¹⁷ See, for example, the LatinFinance article of May 1989, p.16-29 — *Playing it close to the Vest*, and Sachs, J. / Huizinga, H. (1987).

¹⁸ The European banks, for example, exchanged Latin American securities for East European ones.

¹⁹ Citibank's slogan *The Citi never sleeps* appears to faithfully reflect the position adopted by the world's major international financial institutions.

²⁰ The main instruments used to restructure "problem" country debt balances were: debt-equity swaps, debt cash, debt exchange, and charge-off.

²¹ Institutions that would rather stick to the original terms of a contract than adhere to debt or debt service reduction plans.

In May of that year the Brady Plan²² was endorsed by the IMF and the World Bank for countries following the sets of rules laid down by these bodies²³ and made US\$20 billion worth of credits available. Later, the Japanese government announced its intention to participate in the Brady Plan with US\$ 10 billion. In October 1990 Inter-American Development Bank loans were also approved by its executive board for debt or debt service reduction operations.

The first negotiations under the Brady Plan began in 1989 and were completed at the end of 1990. The following countries were contemplated: Mexico, Costa Rica, the Philippines, and Venezuela. As a rule, negotiations under the Brady Plan followed a "case-by-case" principle, from a menu of options proposed by the private creditors and negotiated between a debtor country and a bank advisory committee. Instruments, terms, and other conditions thus varied from country to country.

The following data illustrate the international credit restriction to heavily indebted developing countries and the subsequent balance of payments adjustment conducted by these countries. The Latin American group shows a sharp rise in net transfers as of 1983²⁴, in addition to a significant decrease in net loans (Tables 2 and 3, and Chart 3).

	1980	1983	1984	1985	1986	1987	1988	1989
Total debt balance	242535	360999	377531	389974	409708	445122	427597	422188
Long-term debt	172788	290857	315552	330941	359396	384745	363161	348070
Public sector or endorsed by the publ. sector	129689	221803	249850	275414	309607	341547	332524	324558
Private	43099	69054	65702	55527	49789	43198	30637	23512
Short-term debt	68337	61274	50420	44485	33934	42199	48058	58370
IMF credit	1410	8868	11559	14548	16378	18178	16378	15748
Debt Service	38526	41147	45098	41207	40933	39163	47168	37163

Source: The World Bank — World Debt Tables 1990/1991

²² Data on the Brady Plan were obtained from a World Bank publication (1991).

²³ The rules laid down by the World Bank and the IMF were very similar and included eligibility, availability, forms, and procedures. To become eligible, a country had to adopt an adjustment plan contemplating the following aspects: domestic legislation favoring the entry of venture capital, debt-equity swap incentives, privatization incentive leading to a reduction of the state.

²⁴ Net loans or net flows equal total outlays minus the principal paid. Net transfers equal net loans minus interest payments. World Bank (1990, p.115).

Table 3 — Latin American Net Flows of Loans and Transfers — 1980/1989
(in billions of U.S. dollars)

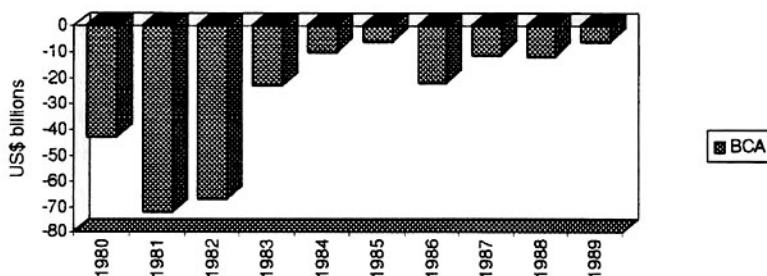
	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Loans-	24,3	28,9	31,6	21,1	18,7	13,8	8,7	10,8	9,7	3,3
Credits from public sector instit.	6,8	7,8	8,5	7	8	7,1	7,5	6,3	6	4,6
Credits from private sector instit.	17,5	21,1	23,1	14,1	10,7	6,7	1,2	4,5	3,7	-1,3
Transfers **	9,1	11,2	10,6	-0,4	-5,4	-12,5	-15,6	-13	-19,1	-19,1
Public Sector Institutions	4,5	5,3	5,6	4	4,5	2,7	2,1	1	-0,3	-2
Private Sector Institutions	4,6	5,9	5	-4,4	-9,9	-15,2	-17,7	-14	-18,8	-17,1

• Net loan= loan - payment of principal

**Net transfer= net loan - interest payment

Source: The World Bank- World Debt Tables (1990/91)

Chart 3 — Balance on Current Account in Latin American Countries — 1980/1989



Source: IMF — World Economic Outlook — various issues

The evolution of secondary market²⁵ operations for debts of developing countries, which furnishes another set of relevant data in that period and is an important market value benchmark for pending debts, can also contribute towards capital gains through transactions on this market. But the use of this kind of information (market value of foreign debt securities from “problem” countries) also affected a great deal the negotiation process between debtors and creditors.

²⁵ Data on the secondary market for highly indebted developing country securities are controversial, as there are several “markets” depending on the kind of securities traded, and data are only collected by the main brokerages on that market. Moreover, the IMF mentions the fact that it is an absolutely deregulated market, with no consensus even about its definition. Therefore, information on this market is extremely inconsistent.

The first secondary market operations were carried out in 1983. But the volume negotiated — US\$ 2 billion — became more expressive as of 1984, and by 1989 totaled US\$ 40 billion. This extremely accelerated growth stemmed from the creditors' decision of getting rid of some securities from heavily indebted developing countries and the capital gain opportunities provided by fluctuations of these securities' market value (Table 4).

	1984	1985	1986	1987	1988	1989
Argentina	31	469	n.a.	35	1330	500
Brasil	731	537	176	1800	9175	4000
Chile	11	313	987	1983	2905	2000
México	n.a.	769	1023	3804	6670	6000
Philippines	n.a.	n.a.	43	287	806	300
Others Countries	0	0	7	279	1467	980
SubTotal*	773	2088	2236	8188	22353	13780
Other Transactions *	1227	1912	4764	3812	27647	26220
Total	2000	4000	7000	12000	50000	40000

*Includes debt for equity, debt swaps and debt repurchases. All transactions involving convertible foreign debt securities.

* Includes all other transactions not previously entered in the books, including interbank operations.

Source: The World Bank - World Bank Debt Tables - 1989/90

The debt-conversion data presented below, although not taking into account options such as buy-backs and debt exchanges that became important after 1989, are relevant to observe the distinct rates of privatization in the main Latin American countries (Table 5).

	1984	1985	1986	1987	1988	1989	1990
Argentina	31	469	699	528	6464
Brazil	731	537	176	336	2095	942	283
Chile	...	324	987	1983	2606	2500	828
Mexico	413	1680	1056	532	344
Other Countries	0	0	22	736	1484	1316	2149
Total	762	1330	1598	4735	7940	5818	10068

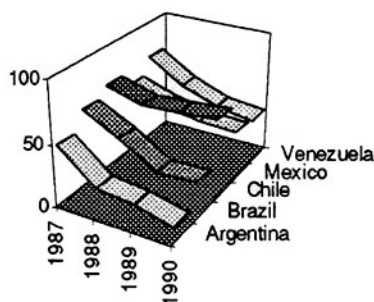
Source: IMF- International Capital Markets- April 1990

Table 6 and Chart 4 show the secondary market price variation between 1986 and 1989. When Brazil came out of the moratorium in 1988²⁶, the face value discount the country's foreign debt securities plummeted, which partly explains the raise in average secondary market prices.

	jun-87	set-88	set-89	fev-90
Argentina	47	21,75	18,25	11,75
Brazil	61	46,25	27,75	28,75
Chile	69	59,5	61	63,5
Mexico	56	46,75	40,75	38,75
Poland	44	40	33	16,5
Venezuela	70	51	40,25	35,25
Yugoslavia	75	47	54	54,59

Source: The World Bank — World Debt Tables — various issues

Chart 4 — Evolution of Discounts in Prices of Securities from the Latin American Group on the Secondary Market — 1987/1990



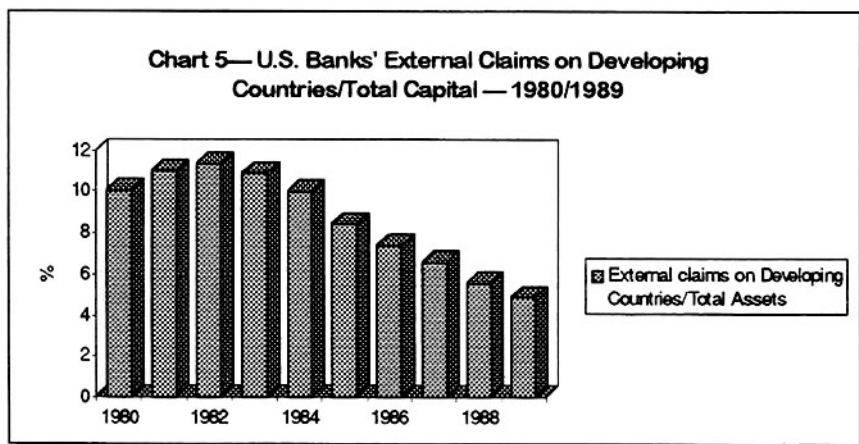
²⁶ Brazil officially ended its 1987 moratorium in September 1988. The moratorium had a very high impact on "problem" countries' foreign debt trading, not only in February 1987 when it was declared, but also when it ended in the following year. The market could never have guessed that Brazil would revert its position so abruptly vis-à-vis its private creditors.

The way private creditors managed the debt crisis reduced their exposure considerably in the late eighties. Table 7, with data from U.S. banks, shows how claims from developing countries were nearly halved by creditor banks — mainly through sales on the secondary market and debt-equity operations — from US\$ 145.2 billion in 1983 to US\$ 84.5 billion in 1989. It should further be noted that these creditors increased their capital base, by reducing their capital ratio to claims from developing countries (Chart 5).

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
External claims on Developing countries*	107,3	127,9	142,8	145,2	140,8	128,8	118,6	108,8	93,2	84,5
Total Assets	1066,3	1164,5	1261	1336	1413	1529	1613	1633	1670,3	1732,5
Capital	56,9	62,7	70,6	79,3	92,2	105,4	116,1	129,2	135,6	144,6

* The data presented in this table are based on exposure; that is, they are adjusted for guarantees and other risk transfers.

Source: IMF- International Capital Markets - April 1990.



Source: IMF— International Capital Markets — various issues

The series of average spreads charged on non-voluntary credits granted to developing countries indicates a significant reduction throughout the period: from about 200 points above the six-month Libor in 1983 to some 80 points

in 1989²⁷ (Table 8). As to spontaneous loans, despite the lower values, the variation was small. However, not many loans of this kind were granted to the Latin American group until 1989. Even after the return of the Latin American group to IFMs, the number of loans obtained was negligible, as will be seen further on.

Table 8 — Loans and Spreads for Latin American Countries — 1983/1989
(loans: in billions of U.S dollars).

	1983	1984	1985	1986	1987	1988	1989
Loans	15,2	16,1	2,4	8,5	2,7	6,4	3,2
Spontaneous lending	1,9	0,6	0,2	0,8	0,4	1,2	1,6
Concerted lending	13,3	15,5	2,2	7,7	2,3	5,2	1,6
Average Spreads -							
Spontaneous lending	80	72	64	61	56	57	72
Concerted lending							
Three main debtors**	225	186	179	81	88	81	81
General	255	185	179	84	89	83	81
Rescheduled debt							
Three main debtor**	193	128	...	85	81	81	81
General	193	131	138	95	80	83	81

* points above Libor

** Argentina, Brazil and Mexico

Source: OECD- Financial Market Trends- various issues

²⁷ For the three biggest debtors — Argentina, Brazil and Mexico — the values are quite close to the total group of developing countries.

4. La Festa è appena Cominciata e già è Finita?

1990/1994

At the beginning of this decade²⁸ the Latin American group recovered their top clearance to international voluntary credits. It should be noted that this return to IFMs did not follow the same pattern as in the seventies, because the markets themselves no longer operated the way they used to before the debt crisis. Thus, most of the financing came from international security markets of stocks and bonds.

There was extensive discussion about the possible return to IFMs of the main players in the 1982 crisis and under what conditions this would take place. For a long time during their absence, most observers considered the access of these countries to spontaneous credits to be “imminent”; the debtor country would just have to adopt a “good” economic policy²⁹. It was argued that, since the debt negotiation took place on a country-by-country basis, credibility would be recovered in the same way. It would, therefore, be entirely up to the country in question to conduct structural economic reform in order to gain access to IFMs³⁰. Despite having originated in the so-called international community, this point of view was quickly adopted by government authorities and analysts from the debtor countries³¹.

²⁸ In 1989 there was already a noticeable trend in the voluntary granting of international private credits to highly indebted developing countries. However, it was only after 1990 that these countries returned to IFMs.

²⁹ A set of economic policies that changes according to international interests. Thus, it can be either the “classic” balance of payments adjustment or the stabilization program with a fixed exchange rate and free foreign trade. The recent Latin American economic history offers examples and establishes what a “correct” economic policy is.

³⁰ Krueger, A. (1989) illustrates this perfectly in her work.

³¹ In Batista Jr., P.N. (1988) there are various examples of the views of Brazilian authorities, who also considered that Brazil’s return to IFMs depended exclusively on adopting a behavior that was deemed adequate by the international community.

On the other hand, there were those that, having criticized the expensive adjustment process in “problem” countries in the eighties, were absolutely skeptical about the chances of a quick reintegration into IFMs. It seemed that private creditors were trying hard to reduce their commitments to the Latin American group and nothing indicated that these countries would so soon recover their share of international voluntary credits. Regardless of the debtor’s attitude, private international creditors still carried on with the penny-pinching. The political and economic changes to the socialist bloc and the consequent excitement of developed countries only confirmed that the exclusion of the Latin American group from the “global financial market” could be even longer than previously expected.

From the viewpoint of this study, considering the agility of international financial institutions in repositioning themselves and the constant search for capital appreciation, the IFM rationale for including or excluding clients follows consistent patterns based on experience, that are not necessarily dictated by mainstream criteria or fatalism. These markets are especially sensitive to macroeconomic variations and are extremely fickle. Therefore, to fully understand the return of the main players in the 1982 crisis, one should consider all the circumstances that eventually led international investors to alter their expectations.

Among the factors that determined the return of heavily indebted developing countries to IFMs, the following stand out:

- the economic position of developed countries;
- IFM changes;
- the restructuring of these countries’ “old” debt balance;
- the reassessment of the East European countries’ potential.

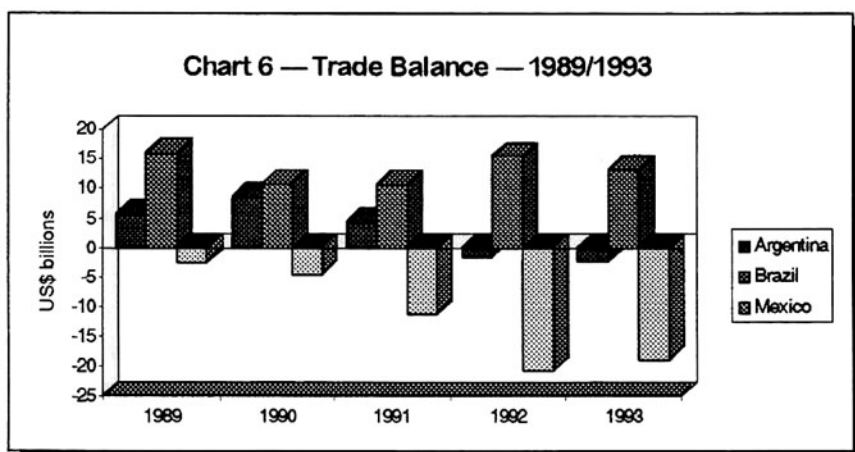
The slump period faced by advanced countries in the early nineties was an essential factor in the return of heavily indebted developing countries to IFMs. As mentioned before, since 1981 these markets were practically the province of developed countries. But after several years of growth with remarkable external imbalances followed by a high demand for credit, the decline in economic activities in advanced countries led financial institutions worldwide to grant new loans to the Latin American group. Other factors to be considered were the reduced interest rates in the U.S. and other countries and the chance of making a bigger profit from securities issued by second-class borrowers, given the shrinkage in the junk bonds segment that occurred in the early nineties.

The deep changes to IFMs also played an important part in the return of non-performing debtors. The notion that international financial institutions had learned a lesson with the 1982 crisis and developed a number of financial instruments to manage risks encouraged the resumption of a spontaneous relationship with partners that had, after all, brought high returns in the past. If the risk issue had been dealt with, why not resume operations that would afford high returns?

At the turn of the eighties, of course, the main world banks had already sorted out debt problems of the past with the Latin American group. The Brady Plan just came to confirm the restructuring of the debt balance process implemented by private financial institutions. From the creditors' viewpoint, the debt cycle that began in the late sixties had now been completed. A new cycle was ready to begin.

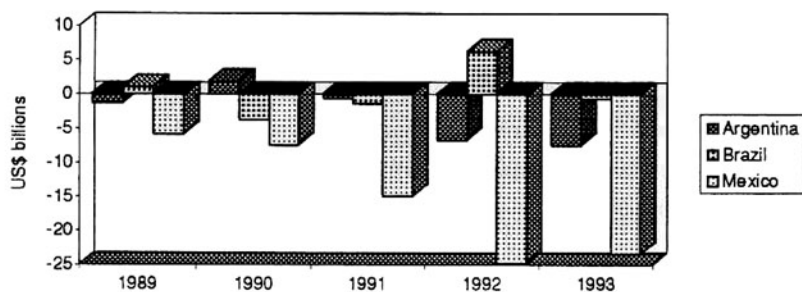
Finally, the belief that Eastern Europe would become a new fertile ground for financial operations was given up. When the true macroeconomic conditions and other institutional aspects of these economies were determined, it turned out many problems had to be solved before any profitable transactions could take place. A few Latin American countries offered better opportunities and lower risks than Eastern Europe as a whole.

Despite claims that the Latin American group was able to restore its credibility and resume its relationship with the international financial community thanks to the economic measures laid down by multilateral agencies, this argument is highly questionable. The diversity of economic policies and performances in the main Latin American countries contradicts this assumption. Although it did bring a lot of business opportunities, economic reform was not a *sine qua non* to gain access to IFMs. Charts 6 and 7 show the disparities in the foreign trade accounts of Argentina, Brazil, and Mexico in the period 1989/1993.



Source: IMF — World Economic Outlook — various issues

Chart 7 — Balance on Current Account — 1989/1993



Source: IMF — World Economic Outlook — various issues

Since their return to IFMs in the early nineties, the main players of the 1982 crisis became part of the so-called emerging markets³². Voluntary credits to the Latin American group were granted basically through issues of bonds, depositary receipt facilities³³ and stock by corporations in these countries, and participation of foreign investors in the local stock markets.

The traditional IFM long-term segment consisting of bond issues and distribution had been completely altered since the seventies, and even more so after the 1982 crisis, in order to comply with a crucial requirement of the unsteady economic environment: liquidity. When the Latin American group resumed their access to external financing through bond issues, they had to face a different reality. Long-term securities had turned into short-term securities and that was the situation of the market. Furthermore, in addition to radically shorter maturity periods, these countries had to live with yields that were significantly higher than those charged for first-class bond issues from advanced countries.

³² According to the International Finance Corporation (IFC), the emerging stock markets concept stood for stock markets that had not been fully developed. It included stock exchanges of industrialized, newly industrialized, and developing countries. About thirty countries are rated as emerging markets. In the early eighties, this concept related to stock markets only, but today it comprises any group of countries that have do not form the "inner circle" of an IFM.

³³ Mainly through American deposit receipt.

The strong decline in international long-term interest rates and the considerable drop in junk bonds issued by companies that had been in this market during the whole of the eighties, brought on a greedy demand for higher risk/higher profit securities. This was exactly what the players in the 1982 crisis were prepared to offer at that moment: high yields. Table 9 compares the average rate of return paid in the period by the main countries in the Latin American group that issued bonds on the international market and a few other selected emerging countries.

	1989	1990	1991	1992	1993-
Public Sector					
Argentina	-	-	-	-	440
Brazil	-	-	548	416	528
China	-	-	67	104	58
India	101	127	140	-	-
Mexico	820	366	264	215	198
South Korea	-	-	-	88	84
Venezuela	-	260	275	256	-
Private Sector					
Argentina	-	-	447	427	533
Brazil	-	-	655	502	578
Hong Kong	-	-	-	180	133
Mexico	800	555	566	427	366
South Korea	-	-	-	121	86
Venezuela	-	496	382	-	450

* Values for the first half-year

Source : IMF— Private Market Financing for Developing Countries — December 1993

It should be noted that the yields paid by financial institutions from these countries were often lower than domestic real interest rates. The suspension of foreign financing and the resulting adjustment in the balance of payments in the eighties had brought a number of important consequences to these economies, namely a sizable internal debt that required the maintenance of extra-high real interest rates. Also, the adoption, toward the end of the decade, of stabilization programs that assumed a continuous inflow of foreign capital,

contributed to the maintenance of domestic real interest rates with highly positive differentials vis-à-vis international rates. Thus, companies had an economic motive for seeking international financing through bond issues, even if it meant paying much higher yields⁵⁴.

In June 1989 the first bond issue (five-year NIFs) was made on IFMs by a company from the Latin American group: Bancomex of Mexico. It totaled US\$ 100 million and carried a yield equivalent to 820 points above U.S. Treasury bonds (USTB) and the same maturity period⁵⁵. Mexican issues in 1989 totaled US\$ 570 million, which, added to the total Venezuelan issues, made up US\$ 833 million, which was the region's global bond issue. In addition to foreign financing through bond issues, a US\$ 230 million loan was made to Chile, which brought the total credit voluntarily granted to the Latin American group to US\$ 1.06 billion in 1989. In the following year, the Latin American group raised about US\$ 2.6 billion through bond issues alone. This segment grew at a remarkable 101% annual average rate between 1989 and 1993 (Table 10 and Chart 8).

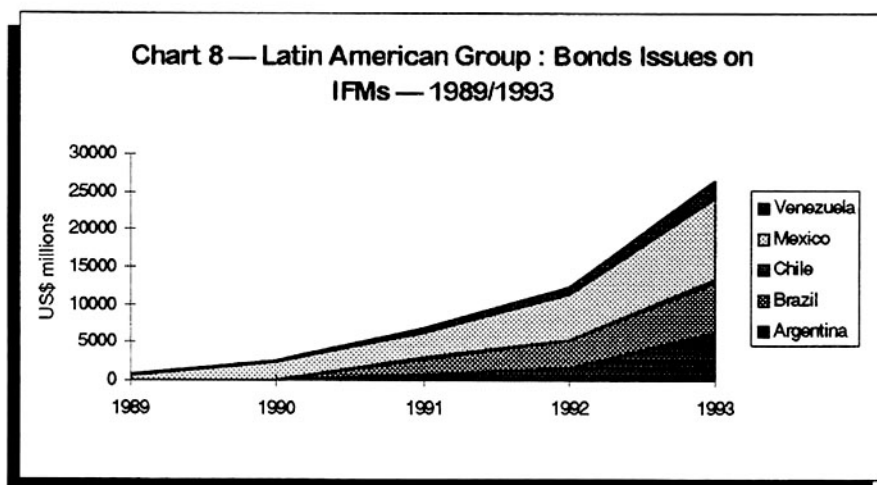
⁵⁴ The yield differential was considered absolutely normal. Peter Clark from J.P. Morgan clearly expresses this view when commenting on yields paid by Argentina's Telecom bonds: "it is a common phenomenon on the junk bond market that spreads should carry such a remarkable differential when compared to the treasuries market... anyway, it was cheap for issuers." *LatinFinance — Out Of Step*— September 1992, p.66.

⁵⁵ Reference is made to the first spread of the issue. Throughout the security's lifetime this value may vary a great deal in further secondary market transactions. Only to have an idea, the average rate of return of junk bonds during the 1990 crisis was 1200 points above the 10-year USTB — considered "astronomical" at the time.

Table 10 — Latin America: Bonds Issues on IFMs — 1989/1993					
(in millions of U.S. dollars)					
	1989	1990	1991	1992	1993
Argentina	0	21	795	1570	6233
Brazil	0	0	1837	3655	6619
Chile	0	0	200	120	433
Mexico	570	2306	3373	5916	10783
Venezuela	263	262	578	932	2348
Latin America	833	2589	6836	12392	27396
Países em Desenvolvimento	5487	6164	12428	23526	59437

*data for the first quarter of 1994

Source: IMF— Private Market Financing for Developing Countries — December 1993
and IMF — International Capital Markets — September 1994



Source: IMF — Private Market Financing For Developing Countries — December 1993

The data referring to bond issues by Asian countries are displayed in Table 11 and Chart 9 to emphasize the fast development of Latin American group issues, compared to those of Asian countries. Since the beginning of this decade both groups of countries totaled more than 70% of all bonds issued by developing countries on IFMs.

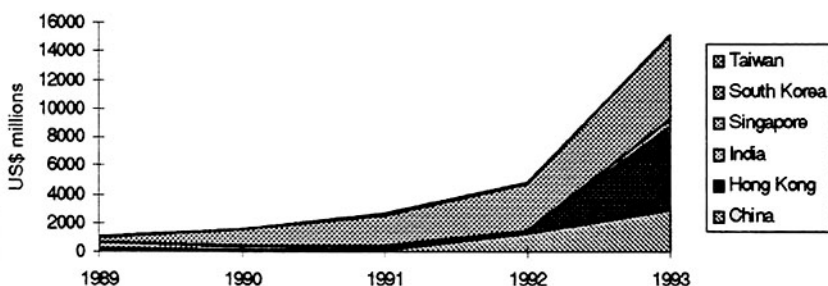
Table 11 — Asia: Bonds Issues on IFMs — 1989/1994
(in millions of U.S. dollars)

	1989	1990	1991	1992	1993	1994-
China	0	0	115	1289	2929	1500
Hong Kong	193	66	100	185	5785	1305
India	450	274	227	0	546	439
Singapore	0	105	0	0	0	0
South Korea	258	1105	2012	3208	5864	1273
Taiwan	100	0	160	60	79	318
Other Countries	600	80	386	1104	4978	2770
Asia	1601	1630	3000	5846	20181	7605
Latin America	833	2589	6836	12392	27396	6313
Developing Countries	5487	6164	12428	23526	59437	17628

-data for the first quarter of 1994

Source: IMF— Private Market Financing for Developing Countries — December 1993
and IMF — International Capital Markets — September 1994

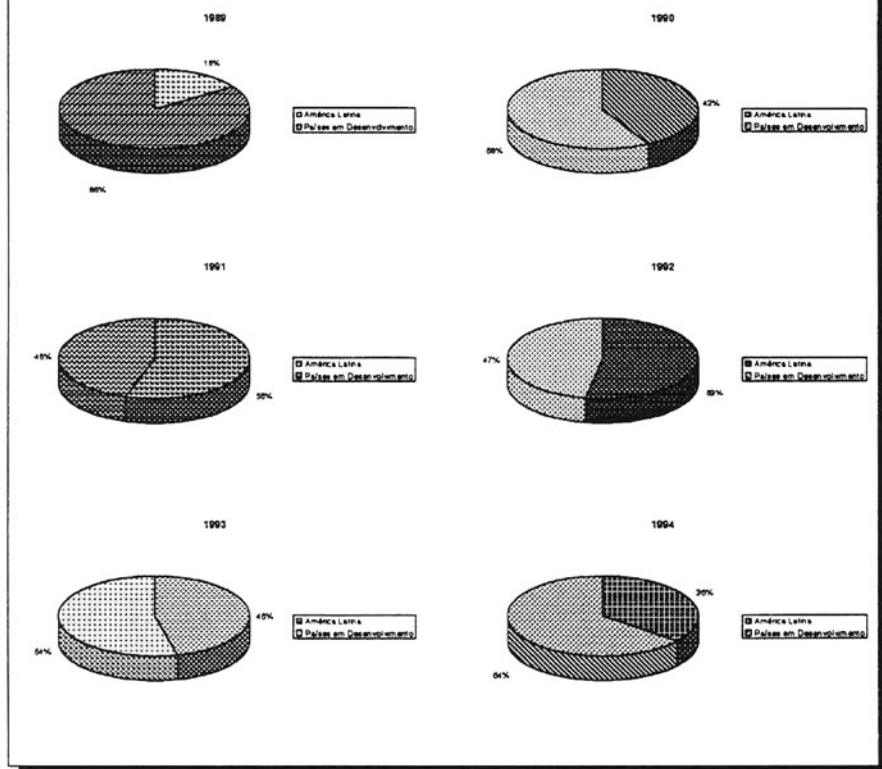
Chart 9 — The Asian Group: Bond Issues on IFMs — 1989/1993



Source: IMF — Private Market Financing for Developing Countries — December 1993

In terms of relative participation, the Latin American group accounted for about 46% of the total bonds issued by developing countries in 1993 and, judging from partial 1994 data, it is possible to detect a reduction in the relative contribution of these countries and a growth of the Asian countries (Chart 10).

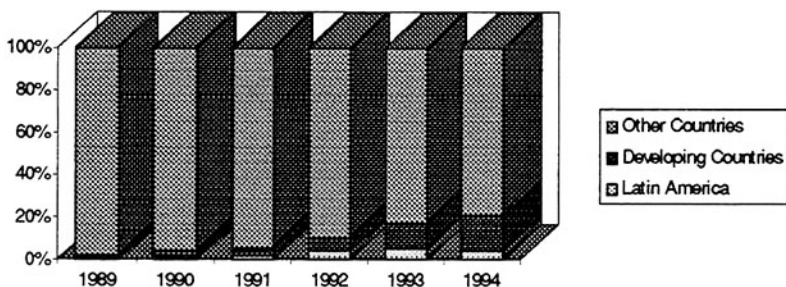
Gráfico 5-10 - Developing Countries: Bond Issues On IFMs: 1989/1994



Source: IMF — Private Market Financing For Developing Countries — various issues

Looking at the total bond issue on IFMs during the mentioned period, one can see that the relative contribution of developing countries jumped from 2.72% in 1990 to around 12.4% in 1993. It is interesting to note that Mexico, Brazil and Argentina issues accounted for 40% of the total issues of developing countries in 1993, which means these three countries accounted for about 4.7% of total bond issues in that year (Chart 11).

Chart 11 — Relative Contribution to Bond Issues on IFMs — 1989/1994



Source: IMF — Private Market Financing For Developing Countries — various issues

The total issued by the Latin American group averaged US\$ 130 million, although a Mexican company (Cemex) and the Argentine government managed to make successful issues of US\$ 1 billion in 1993³⁶. These issues carried much better terms until 1993: reduced yields, higher volumes, and extended maturity periods.

Generally speaking, between 1990 and 1993, Mexico secured the best terms for its bonds issues, having even paid slightly less than 200 points above USTB in 1993³⁷. Brazil, on the other hand, paid the highest spreads of the region in the same period — about 200 to 300 points above Mexican spreads — and had the shortest maturity periods.

It appeared that the market was rewarding Mexico and punishing Brazil: Mexico for having implemented economic reforms that were considered adequate and being the first country back to IFMs, was seen as an example to be followed by

³⁶ IMF (September 1994, p. 82).

³⁷ Considering a very low spread, similar to the one paid by U.S. companies for operations of the same kind.

all other countries in the region; and Brazil — having forestalled the prescribed measures much longer — was the example *not* to be followed. However, with U.S. interest rates climbing since February 1994, there was an increasing deterioration in the negotiation terms of these securities and a “new” reality began for the Latin American bond market.

Another relevant factor in the return of the Latin American group to IFMs was the access to capital markets through the floating of stock from these countries, but more importantly, by taking advantage of the facilities offered by depositary receipts (DRs)³⁸. Tables 12 and 13 show the figures relative to the primary stock issue and the growing importance of DRs, showing both the volume negotiated and their relative participation. As can be seen in Table 15, however, the total stock issue of all Latin American countries did not account for more than 33% of the total credit granted on a voluntary basis to these countries.

	1990	1991	1992	1993	1994*
Argentina	0	356	372	2793	197
Brazil	0	0	133	0	300
Chile	98	0	129	271	96
Mexico	0	3764	3058	2493	583
Venezuela	0	0	283	42	0
Other Countries	0	0	88	126	0
Latin America	98	4120	4063	5725	1176
Developing Countries	1262	5437	9259	11865	4018

*data for the first quarter of 1994

Source: IMF— Private Market Financing for Developing Countries — December 1993 and IMF— International Capital Markets— September 1994

	1990	1991	1992	1993
DRs*	98	2166	1781	5246
Others	0	1954	2282	479
Total	98	4120	4063	5725

* Depository Receipts- ADRs,GDRs and Rule 144 A

Source: IMF - International Capital Markets - September 1994

³⁸ The American depositary receipts (ADRs) issued under Rule 144A of SEC are the most important kind of DRs for the Latin American group. Recently, global depositary receipts (GDRs) were launched. The main difference is the simultaneous trading on several exchanges.

Table 14 displays data on Asian stock issues. The Latin American and Asian groups accounted for almost 100% of the developing country issues traded worldwide.

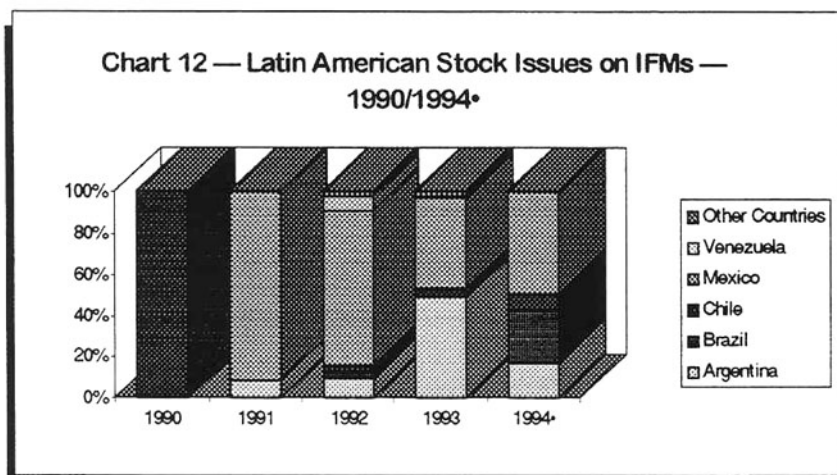
	1990	1991	1992	1993	1994*
China	0	11	1049	1908	351
Hong Kong	0	140	1250	1264	72
India	0	0	240	331	1310
Singapore	214	125	272	613	70
South Korea	40	200	150	328	150
Taiwan	0	0	543	72	0
Other Countries	786	546	1228	1157	555
Asia	1040	1022	4732	5673	2508
Latin America	98	4120	4063	5725	1176
Developing Countries	1262	5437	9259	11865	4018

*data for the first quarter of 1994

Source: IMF— Private Market Financing for Developing Countries — December 1993

and IMF— International Capital Markets — September 1994

The stock issues — basically through DRs — from the Latin American group were linked to the privatization process that occurred in these countries. It can be noted in Chart 12 that Chile was the absolute stock issue leader on IFMs in 1990, having been replaced by Mexico in 1991 and 1992. In 1993, Argentina significantly increased its share of total stock issues negotiated abroad. The partial 1994 data showed Brazil's increasing share in this market segment.



Source: IMF — Private Market Financing For Developing Countries — various issues

Table 15 summarizes the various financing sources obtained on a voluntary basis by the Latin American group between 1990 and the first half of 1994. Charts 13, 14, 15, and 16 illustrate how each of the main countries in this group participates in the various IFMs segments during the period.

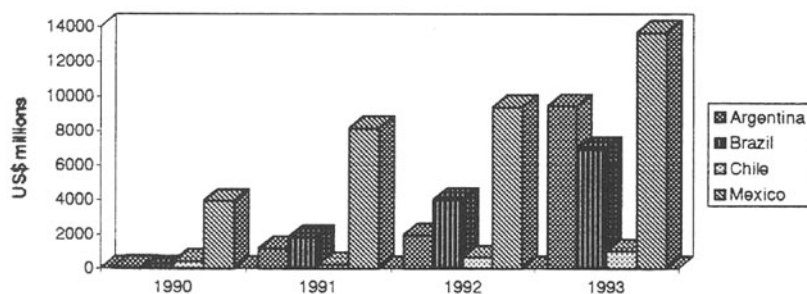
Table 15 — Total Credit Granted to Latin America on a Voluntary Basis — 1990/1994					
(in millions of U.S. dollars)					
	1990	1991	1992	1993	1994-
Argentina	21	1151	1942	9426	1657
Bonds	21	795	1570	6233	1460
Equity	0	356	372	2793	197
Loans	0	0	0	400	N.A.
Brazil	0	1837	3988	6919	1395
Bonds	0	1837	3655	6619	1095
Equity	0	0	133	0	300
Loans	0	0	200	300	N.A.
Chile	398	200	649	1004	96
Bonds	0	200	120	433	0
Equity	98	0	129	271	96
Loans	300	0	400	300	N.A.
Mexico	3906	8146	9358	13676	3890
Bonds	2306	3782	6100	10783	3307
Equity	0	3764	3058	2493	583
Loans	1600	600	200	400	N.A.
Venezuela	1662	578	1415	3190	0
Bonds	262	578	932	2348	0
Equity	0	0	283	42	0
Loans	1400	0	200	800	N.A.
Others	0	450	288	1306	
Bonds	0	50	200	980	451
Equity	0	0	88	126	0
Loans	0	400	0	200	N.A.
Latin America	5987	12362	17640	35521	7489
Bonds	2589	7242	12577	27396	6313
Equity	98	4120	4063	5725	1176
Loans	3300	1000	1000	2400	N.A.
Asia	14670	17622	21078	39257	10113
Bonds	1630	3000	5846	20181	7605
Equity	1040	1022	4732	5676	2508
Loans	12000	13600	10500	13400	N.A.
Developing Countries	28426	44785	50039	90002	21646
Bonds	6164	12438	23780	59437	17628
Equity	1262	5347	9259	11865	4018
Loans	21000	27000	17000	18700	N.A.

-data for the first quarter of 1994 N.A. — NOT AVAILABLE

Source: IMF— International Capital Markets- September 1994

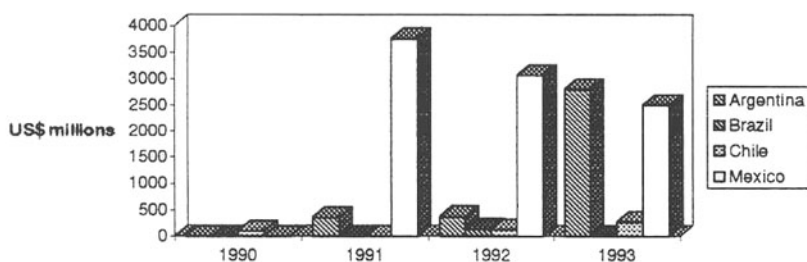
and IMF — Private Market Financing for Developing Countries — December 1993

Chart 13 — Latin America Group: Total Voluntary IFM Credits — 1990/1993



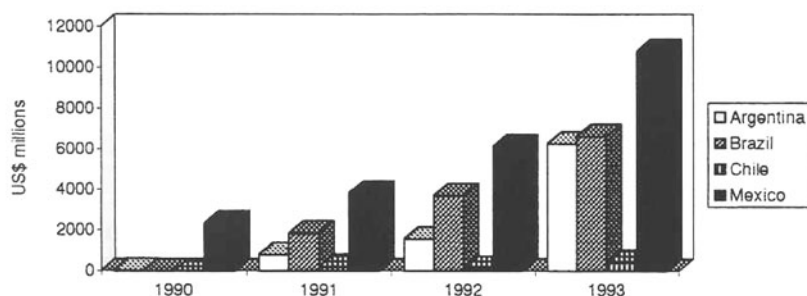
Source: IMF — Private Market Financing For Developing Countries — various issues

Chart 14 — Latin America Group: Equity Issues on IFMs — 1990/1993

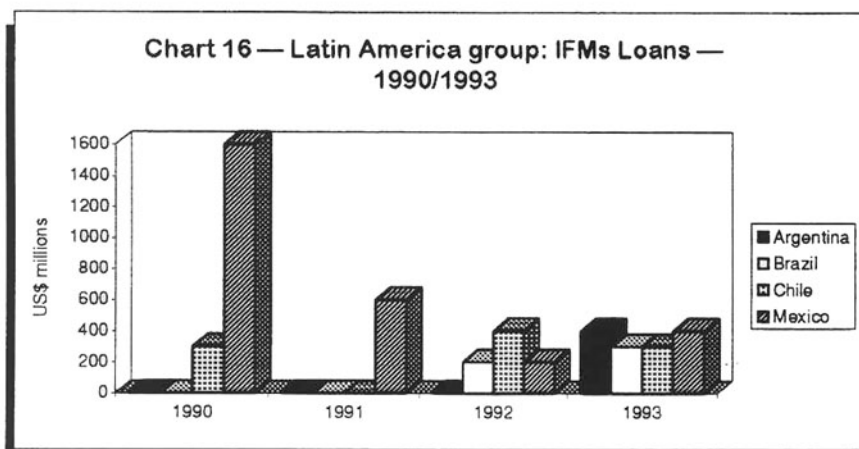


Source: IMF — Private Market Financing For Developing Countries — various issues

Chart 15 — Latin America Group: Bond Issues on IFMs — 1990/1993



Source: IMF — Private Market Financing For Developing Countries — various issues



Source: IMF — Private Market Financing For Developing Countries — various issues

The growing interest of large institutional investors in operations with countries of the region led the main credit risk specialists to analyze and rank securities from the major Latin American countries traded worldwide. Table 16 shows this information.

Table 16 — Credit Ratings of Latin American Countries and Selected Emerging Countries — 1993

	Moody's Investor Service	S&P	
Argentina	B1	BB-	Mainly speculative
Brazil	B2	N.A.	Mainly Speculative
Chile	Baa3	BBB	Average quality
Mexico	Ba2	BB+	Moderately speculative
Venezuela	Ba1	BB	Moderately speculative
China	Baa1	BBB	Average quality
South Korea	A1	A+	Average to high quality
Hong Kong	A3	A	Average to high quality
India	Ba2	BB+	Moderately speculative
Singapore	Aa3	AA+	High quality
Taiwan	N.D.	AA+	High quality

N.A. - not available

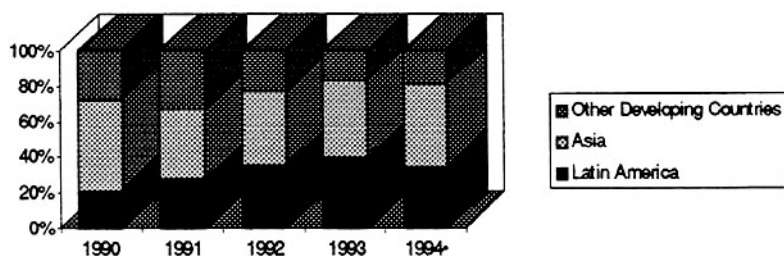
Source: IMF— Private Market Financing for Developing Countries — December 1993

In addition to the presence of companies from these countries at international capital markets, there was also a considerable increase in the number of foreign investors at stock exchanges of the main Latin American countries in the period.

Although there are no consolidated data available on these investments, it is estimated that the Mexican exchange received a US\$ 6 billion equivalent in 1992 and 1993³⁹.

But loans — the main international private credit source in the previous debt cycle — did not receive the same treatment from the international financial community: international banks were very reluctant in granting them, even with the new risk-reducing techniques at their disposal. The loans granted were basically short-term credits to finance foreign trade. Table 15 and Charts 17, 18, 19, and 20 confirm this and also reveal the striking difference of treatment given to Asian countries and to the Latin American group. While the former obtained over 50% of the total loans slated for developing countries, the latter were granted no more than 16% over the period.

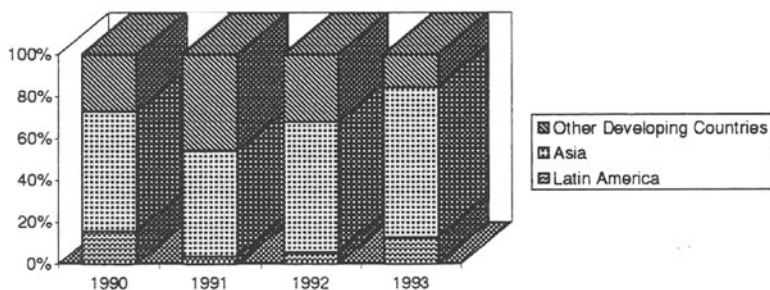
Chart 17 — Distribution of International Private Credit for Developing Countries per Geographical Area — 1990/1994



Source: IMF — Private Market Financing For Developing Countries — December 1993

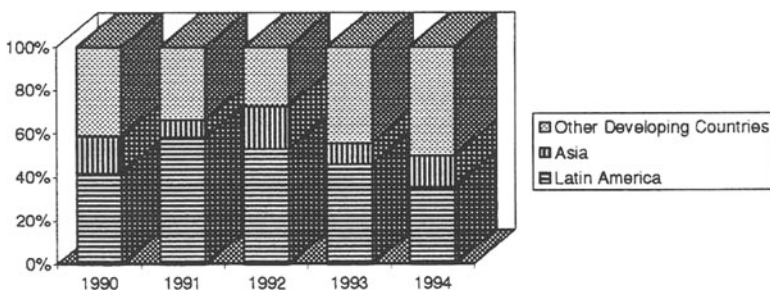
³⁹ Data from the IMF report (September 1994, p.84).

Chart 18 — Geographical Distribution of IFM Loans among Developing — 1990/1993



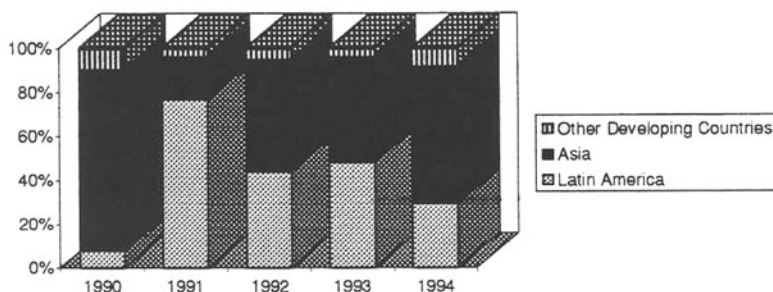
Source: IMF — Private Market Financing For Developing Countries — various issues

Chart 19 — Geographical Distribution of Bond Issues on IFMs among Developing Countries — 1990/1994



Source: IMF — Private Market Financing For Developing Countries — various issues

Chart 20 — Geographical Distribution of Equity Issues on IFMs among Developing Countries — 1990/1994



Source: IMF — Private Market Financing For Developing Countries — various issues

On the secondary market for securities from developing countries, however, most operations (80%) involved securities from the Latin American group⁴⁰. Although there are no precise data available on aggregate transaction values — which include new issues of bonds, “bradies”, and other instruments relative to the restructuring of “old” debts, the outstanding debt balance not yet negotiated — the evolution of this secondary market is shown in Table 17⁴¹.

	1990	1991	1992	1993
Total	100	200	500	750

Includes Brady bonds, securities relating to the “old” debt and “new” debt securities.

Data estimated by IMF

Source: IMF - Private market Financing for Developing Countries - December 1993

If we consider that about US\$ 2 billion was traded on the secondary market in 1984, the volume of business on this market increased almost 400 times in less than ten years. About 75% of the operations refer to transactions involving bank credits granted to the three largest Latin American debtors: Brazil, Mexico and Argentina. Large institutional investors — pension funds, mutual funds, and insurance companies — had now a more active participation in these markets, attracted by gambling possibilities and the high liquidity involved⁴². The inclusion of derivative instruments further bolstered the international investors’ gambling possibilities on the secondary market for securities of “emerging” countries.

⁴⁰ Data from the IMF report — *Private Market Financing For Developing Countries*, December 1993.

⁴¹ Data from the October 1993 report from the Emerging Markets Association, quoted in the IMF report of September 1994.

⁴² According to the IMF report of December 1992, this market’s liquidity was enhanced by a list of Latin American securities in Luxembourg as of 1991. Operations in that country were made on Euroclear and Cedel.

The extraordinary possibilities of making money on this market are due to its deregulation and the special features of the securities traded, which include:

- “old” debt: rescheduling of outstanding balances through risk-reducing collateral and higher yields than other securities;
- unscheduled “old” debt: capital gains from advances on future business;
- new debt: extremely volatile securities with high yields;
- derivatives: over-the-counter operations, with fewer controls than those conducted at exchanges.

Speculation was so intense in recent years, that the Emerging Markets Traders Association (EMTA) published, in June 1993, a code of conduct establishing guidelines for secondary market operators, aiming at the maintenance of market’s liquidity, even in critical situations.

The “old” debt conversion process, after its peak in 1990, began to slow down after the initial phases⁴³ of the privatization process in countries such as Argentina, Mexico, and Chile, and also on account of price hikes on the secondary market of foreign debt securities from the main Latin American countries, and the restrictions imposed by some countries such as Brazil on swaps of debt for stock from companies eligible for privatization (Table 18).

	1990	1991	1992
Argentina	6464	132	3652
Brazil	283	68	95
Chile	1096	828	391
Mexico	221	1956	344
Venezuela	595	343	148

Source: IMF — Private Market Financing for Developing Countries - December 1993

⁴³ Before the December 1994 crisis Mexico and Argentina were getting ready to privatize their financial and social security systems. At that point, Chile was far beyond in its own privatization process and therefore closer to phasing it out.

The higher participation of Latin American countries in IFMs since 1990 was closely related to the expansion of the foreign creditors' base. Side by side with major international banks and financial institutions that traditionally operated on IFMs, other financial institutions — especially large institutional investors such as pension funds, insurance companies, and mutual funds — were now part of the universe of foreign investors in securities from the countries of the region. These institutional investors usually traded on these markets through specific funds from emerging countries. By the end of 1993 there were about 500 funds specializing in emerging countries listed at the main international financial centers, of which 80 were exclusively dedicated to Latin American securities⁴⁴.

The new investors were obviously attracted by the high rates of return offered by these countries' securities. The chance of participating in these markets through specialized funds further aroused their interest. These fast-growing investment funds from emerging markets also attracted smaller investors from advanced countries⁴⁵. The scattering of creditors was certainly one of the most typical aspects of the return of the Latin American group to IFMs.

Excitement took over security markets for the Latin American group until the beginning of 1994 — especially 1993, which had been excellent to its investors. Table 19 bears witness to the extraordinary results obtained by stocks on the main emerging markets, including those from Latin America.

⁴⁴ Data on emerging country funds were obtained from *LatinFinance* (1993, no. 52, p.20 to 31).

⁴⁵ As an example of the development of Latin American funds, mention is made to those managed Barings, which alone grew from US\$ 300 million in 1992 to US\$ 1.3 billion in mid-1994.

Table 19 — Average Yield on Equities from Selected Emerging Markets — 1989/1993

	1989	1990	1991	1992	1993
Argentina	204,4	-42,5	444,9	-25,7	76,7
Brazil	23	-69,5	285,1	1	94,2
Mexico	129,8	27,2	113,9	16,7	54,8
Venezuela	N.A.	N.A.	56,9	-50,7	50,7
Latin America	76,2	9,1	139,2	3,4	60,2
China	N.A.	N.A.	N.A.	N.A.	49,8
India	N.A.	N.A.	N.A.	N.A.	26
Malaysia	47,4	-9,4	10,3	24,1	110
Thailand	105,8	-24,4	20,6	38,5	114
Asia	54,1	-19,2	12,4	18,5	97,6
S&P (USA)	31,6	-3,1	30,4	7,6	7,5

N.A.-not available

Source: IMF— International Capital Markets— September 1994

However, in February 1994, the U.S. monetary authorities started to up interest rates on Treasury bonds, triggering a widespread rise in returns on government bonds from other developed countries. This interest rate increase in the U.S. and other industrialized countries was not so high, but it surely contributed to make financial institutions reassess their expectations, including those on emerging markets.

In June 1994, in articles published by *Latin Finance* (1994, no. 58), some analysts warned investors about the risk of losses on emerging markets due to foreign trade problems. This meant that the flight of foreign investors from these markets, attracted by the higher returns on government bonds from developed countries and the political turmoil in some countries of the Latin American group, could endanger the flow of funds to offset deficits from foreign trade and current accounts of some of the region's main "emerging" countries.

Without foreign financing to offset these deficits, domestic currencies would need to be devalued, with an inevitable slashing of returns on these markets, which would scare foreign investors even more. As the whole idea of restructuring of important Latin American countries was based on expectations of a continuous inflow of capital, a cutback would surely stunt the development of these economies and bring back pressure from the outside⁴⁶.

When on December 20, 1994, the Mexican economic authorities announced a change in foreign trade policy due to the embarrassment caused by the massive loss of the country's reserves, the time was ripe for a financial crisis of international proportions. Apart from the inevitable losses due to the devaluation of peso-denominated securities and the fall of Mexican securities worldwide, the greatest shock came from the realization the fact that an important Latin American country, viewed as a example of market-oriented economic reform, was again on the brink of collapse. And, what was worse, threatening once again IFM stability, the economic beliefs of so many scholars and policymakers, and the analyses of market operators.

When the Mexican crisis broke out in 1994, the financial instruments created in the eighties, despite having "liquefied" the securities market, proved incapable of offering protection against liquidity and credit risks, let alone preventing financial crises. Earlier events⁴⁷ had certainly pointed to the increasing fragility of IFMs. But the excitement about the financial innovations forestalled any serious measures regarding the unstable nature of IFMs.

⁴⁶ Actually, there were other much more optimistic views expressed in several articles published by LatinFinance that year. The events that took place after December 1994, however, seemed to prove that excessive "optimism" under uncertain circumstances tend to hinder good judgement capacity.

⁴⁷ The 1987/1988/1992 crises that were bred within IFMs themselves without any "help" from outsiders.

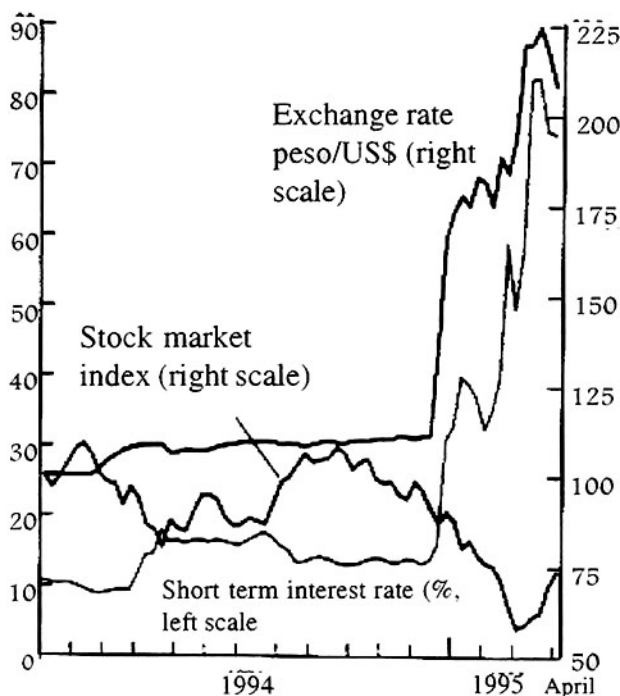
In all these episodes, including the Mexican one, further deterioration was only checked by the quick intervention of “an ultimate lender” — a rather awkward situation, since in point of fact there is no multilateral agency in a position to play this role effectively. Specifically in the Mexican case, the U.S. Government undertook the function by imposing a number of restrictions on the Mexican government. The question here is how capable local monetary authorities are of controlling financial crises of international proportions.

In the recent Mexican episode, of course, the incapacity, inherent in the region’s countries, of complying with a “good” economic policy was blamed — not the intrinsic nature of IFMs. The main charge was that the crisis that shattered the entire region’s credibility had been Mexico’s fault. The slower national product growth in 1993 and the political turmoil following the 1994 political campaign led the local government to lapse into a “populist” behavior and slacken in tax discipline by increasing social policy expenses and reducing revenues through lower taxes.

The excessive optimism of the government as to the inflow of outside capital that would be attracted into the country after the signature of the NAFTA⁴⁸ agreement was also on the list of mistakes that set off the crisis of December 1994. The wrong assessment of the country’s fund-raising capacity led Mexican authorities to guarantee a credit expansion which bolstered internal demand. As expectations did not materialize, this excessive demand resulted in an increased deficit in the country’s current account without the corresponding foreign funds to offset it. Chart 21 depicts the recent performance of a few Mexican economic indicators.

⁴⁸The NAFTA agreement was signed in November 1993.

Chart 21 — Mexico: Financial Indicators

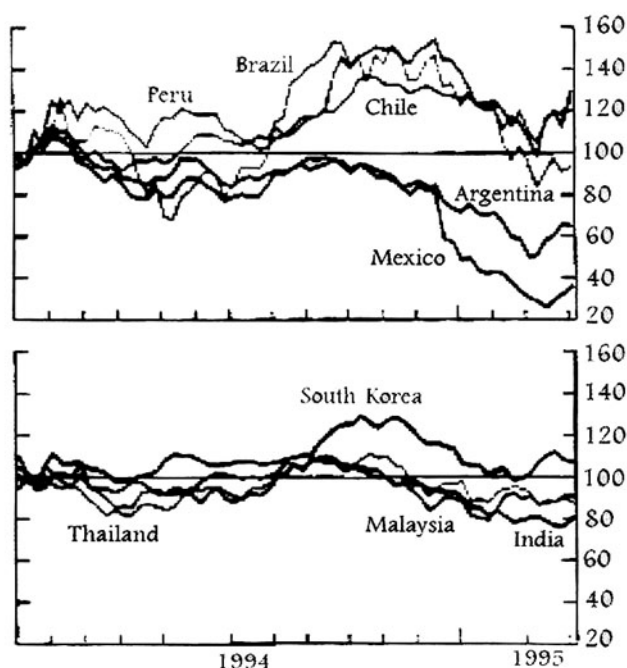


Source: International Finance Corporation, Emerging Markets database in IMF — World Economic Outlook — May 1995.

Economic policy mistakes coupled with the atmosphere of political instability in the country made investors even more suspicious and balky¹⁹. It was only natural for the “marketplace” to impose the applicable “corrective” measures. As expected, the difficulties faced by one country in the region had spread to the others. The risk of contamination led to a reassessment of these countries’ securities and the chances of winning on local markets (Chart 22).

¹⁹ Additionally, an aspect that has not been mentioned, and is worth referring to, is the capital flight and return in these countries. The existing capital mobility encourages residents in countries of the Latin American group to behave like non-residents. Thus, finding out the exact percentage of the total external funds contributed by these residents is entirely irrelevant, as far as this study is concerned. Suffice it to say that these rates are increasingly more attuned with the general activity.

Chart 22 — Select Developing Countries: Equity Prices
(in US dollars, January 1994 equal 100)



Source: International Finance Corporation, Emerging Markets database, in IMF — *World Economic Outlook* — May 1995.

Even before the Mexican crisis broke out in December 1994, “market corrections”⁵⁰ had begun to be felt on emerging Latin American markets. The Latin American group’s privileged access to IFMs was affected many times in 1994, while total Latin American bond issues were down 38% from 1993⁵¹. For markets that were emerging, this was a clear sign that “drowning” might occur even prior to full development.

⁵⁰ A very popular euphemism when crisis is discussed.

⁵¹ As to Mexico, just 20% of total foreign funds came in as direct investment between 1989 and 1994. The other 80% was scattered among security issues abroad and foreign investments in the Mexican money market. IMF — *World Economic Outlook* — May 1995 (p.91).

5. Conclusions

The circumstances governing the Latin American group's access to IFMs and its staying power have been far from stable, durable, or other words to the same effect. On the contrary, throughout two recent cycles of its countries' indebtedness to IFMs — 1967/1982 and 1989/1994 — the funds granted by private international sources were obtained under less favorable circumstances than those granted to first-class clients and always in a more precarious way. The exclusion that occurred between 1982/1989 showed how unstable these relations were.

It should be noted that the conditions under which this external private financing was obtained were altered due to changes that occurred at the IFMs themselves and the continuous reassessment of the participation of Latin American countries. It should also be mentioned that evaluation criteria also changed considerably throughout this period. Just to mention recent events, it is certainly ironic to follow the analyses on Mexico and Brazil as of the return of these countries to IFMs at the beginning of the decade.

Saying that assessments of the Latin American group are mercurial is an understatement. One could argue that it is only natural for capitalistic economies to alternate extreme optimism with deep depression. The greatest concern is the apparent lack of criterion in going from one end to the other. Practical as international financial institutions may seem in so many cases, it is not always possible to find the real reasons for the reversal of expectations, judging from the data on the Latin American group alone.

In the specific case of the Latin American group, the access to private international credits, in this new debt cycle that began in the second half of 1989, has been relatively limited. The very characteristics of the foreign funds available to these countries would not support long-term development strategies based on steady streams of such credits.

Besides, the intrinsic instability of IFMs is more acutely felt by the Latin American group. The movements of inclusion and exclusion of these countries in IFMs over the last three decade show how fragile their relationship with IFMs is. Also, with the increasing liquefaction of these markets since the eighties, the trend has been to shorten the debt cycle: these countries move much faster from a sound financial situation to a fragile position.

The “permissive” credit conditions at IFMs when second-class clients join in eventually lead to an internal economic policy alterations resulting in a change to the financing profile of these economies. This makes them more dependent on steady flows of foreign credit, and therefore more vulnerable to the financial instability of IFMs. When IFM credit terms change and inflows are discontinued, the Latin American group undergoes a serious external imbalance.

This explains why the economic policy “recommendations” made by the international community to the countries of the region in the last thirteen years have ranged from “austerity” to exaggerated “liberalism”. During the period of IFM exclusion — or credit restriction — the instruction, if not imposition, was to generate trade surpluses through a set of economic measures, such as local currency devaluation and strict control of imports and internal credit restriction to create export surpluses. This logic of generating trade surpluses at any cost has been imposed every time the flow of foreign credits drops (or vanishes). To these Latin American countries the maintenance of deficits financed by international private credits seems very unlikely. On the other hand, when IFM liquidity and internal conditions allowed for this group of countries to gain access to these credits, the rhetoric changed so as to praise the qualities of the “liberating” reforms.

Last but not least, considering the manner in which IFMs currently operate and the turn the economies in the Latin American group has taken in the last few years, non-performance of just one of its countries may give rise to a crisis that can be much worse than that of 1982. As discussed, it is obvious that this fragility cannot be attributed solely to the return of second-class clients. In any case, their return has taken place under circumstances that increase the likelihood of an international financial crisis.

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