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# Growth Perspectives for Indebted Latin America: A Note on Major Issues*

Dionísio Dias Carneiro Netto

PUC-Rio – Departamento de Economia
www.econ.puc-rio.br

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## 1. Introduction

The debt crisis of the present decade acted as a shock wave that has affected the whole International Economic System. Latin American economies have been deeply affected when the interruption of voluntary lending required restrictive policies in order to cut imports and domestic absorption. Severe financial problems still persist in spite of the high costs involved in the process of adjustment. As long as the present pattern of financing prevails, the causation between external stabilization and growth prospects is likely to remain one of mutual interdependence.

This paper addresses the question of the determinants of future growth for Latin America. Section 2 reviews some facts concerning the debt crisis, and offers a brief analysis of the adjustments up to 1984 and of the costs suffered by LA countries. Section 3 examines the conditions for future growth of debtor countries and discusses some of the projections and their assumptions. Section 4 reviews the basic uncertainties surrounding the optimistic views which inspire most assumptions, and selects some important issues for discussion.

## 2. The explosion of indebtedness and the costs of adjustment

Since the beginning of the eighties, the debate on growth prospects for developing countries has been centered around the issue of external debt. The evolution of Latin America's external debt has dominated both the figures which illustrate the explosive nature of the developing countries' accumulated debt and the major steps taken to cope with its consequences. As of 1980, the total external debt of Latin America represented a little over 40% of the total debt of the developing countries. The first oil shock (1973-74), the long process of adjustment to the new situation of prices and distribution of reserves following that shock, the mild recession in the central countries in the mid-seventies and, finally, the second oil shock followed by the rise in international lending rates of interest and the depression of 81-82, are the known facts behind the steady growth at 18% average annual rate displayed by total debt of LDC's between 1973 and 1983.

When deflated by non-oil export prices, the average growth rate of the debt comes down to 9%, in line with an average interest cost that been estimated at 10.7% between 1974 and 1980[1]. This growth record reflects both the *difficulties* faced by the debtors in adjusting their external accounts to the post-73 shaky conditions in world trade and the *willingness* of the private banking System to extend credit to these countries.

After the second oil shock (1979-80), which contributed to aggravate the loss in terms of trade

[1] Simonsen (1984b) uses the LIBOR plus 1.5% spread to calculate the average interest cost for what he calls the typical developing country loan.

that was plaguing most countries of the region, Latin American debtors were particularly affected by the rise in International interest rates. The adoption of monetarist policies in the US and the UK – the most important financial centers where private finance was provided for the deficit countries – caused interest rates to rise and exposed the fragility of the whole system. Illustrative figures of that fragility may be analysed by checking the evolution of the fraction of export revenues absorbed by interest payments as shown in table 2. Whereas in 1975 Latin America's interest payments absorbed 16.3% of total merchandise export revenues, in 1981 that figure had climbed to 33.1%. For the major borrowers of the region, the record is still more impressive: 38.1% for Argentina, 39% for Brazil, 48.1% for Chile and 43.2% for Mexico.

Table 1

Comparative Data on External Debt (in current US$ $10^9$ dollars)

| | 1975 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| 1. Latin America**, *** | 75.4 | 229.1 | 279.7 | 314.4 | 336.2 |
| | (25.4) | (42.7) | (47.0) | (50.4) | (53.3) |
| Major L. A. Borrowers | | | | | |
| Argentina | 6.0 | 27.1 | 32.3 | 36.7 | 40.7 |
| | (14.3) | (50.8) | (58.6) | (66.6) | (69.7) |
| Brazil | 23.3 | 64.6 | 74.1 | 83.2 | 91.6 |
| | (22.7) | (33.0) | (35.2) | (37.3) | (40.8) |
| Chile | 4.9 | 11.1 | 15.5 | 17.2 | 17.7 |
| | (41.3) | (62.1) | (75.1) | (91.1) | (88.8) |
| Mexico | 16.9 | 52.7 | 75.5 | 82.5 | 86.5 |
| | (29.2) | (40.3) | (48.9) | (50.4) | (53.0) |
| 2. Total of Developing Countries* | n.a. | 559.9 | 646.5 | 724.8 | 767.6 |
| | | (24.9) | (27.7) | (32.6) | (36.8) |
| 3. Non-oil Developing Countries* | n.a. | 475.2 | 559.6 | 633.3 | 668.6 |
| | | (23.9) | (27.1) | (32.6) | - |
| 4. 25 Major Borrowers* | n.a. | 440.1 | 514.3 | 576.4 | 606.9 |
| | | (27.8) | (30.7) | (36.1) | - |

Figures in parentheses are % of GDP.

Sources: * World Economic Outlook, IMF, Occasional Paper nº 27, April 1984.
** *Economic and Social Progress in Latin America*, IBD, 1983 Report.
*** *La Deuda Externa y El Desarrollo Económico de America Latina*, IDB, 1984.

Table 2

Latin America: Exports+ and Interest Payments for Selected Countries (US$ Millions)*

| | 1975 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| 1. Latin America | | | | | |
| Exports | 36.234 | 92.243 | 98.401 | 88.716 | 89.165 |
| Interest | 5.915 | 24.128 | 32.527 | 38.545 | 39.051 |
| | (16,3%) | (26,2%) | (33,1%) | (43,4%) | (43,8%) |
| 2. Brazil | | | | | |
| Exports | 8.500 | 20.140 | 23.341 | 20.189 | 21.899 |
| Interest | 1.861 | 7.474 | 9.113 | 11.353 | 9.555 |
| | (21,9%) | (37,1%) | (39,0%) | (49,5%) | (43,6%) |
| 3. Argentina | | | | | |
| Exports | 2.961 | 8.020 | 9.169 | 7.572 | 7.950 |
| Interest | 467 | 2.167 | 3.501 | 5.113 | 4.800 |
| | (15,8%) | (27,0%) | (38,2%) | (67,5%) | (60,4%) |
| 4. Chile | | | | | |
| Exports | 1.590 | 4.705 | 3.960 | 3.798 | 3.851 |
| Interest | 284 | 1.152 | 1.906 | 2.454 | 1.620 |
| | (17,9%) | (24,5%) | (48,1%) | (64,6%) | (42,1%) |
| 5. Mexico | | | | | |
| Exports | 3.062 | 15.132 | 19.420 | 21.007 | 21.339 |
| Interest | 1.437 | 5.477 | 8.383 | 10.879 | 9.861 |
| | (46,9%) | (36,2%) | (43,2%) | (51,8%) | (46,7%) |
| 6. Venezuela | | | | | |
| Exports | 8.853 | 19.050 | 19.963 | 16.365 | 14.655 |
| Interest | 400 | 3.424 | 3.877 | 3.383 | 1.100 |
| | (4,5%) | (18,0%) | (19,4%) | (20,7%) | (7,5%) |

+ Commodity exports only.
* Figures in parentheses show interest payments as % of exports.

Sources of Data:

Before 83, see Table 1. For 1983 data:

1. Direction of Trade Statistics Yearbook, IMF, 1984.
2. International Financial Statistics, IMF, May, 1984.
3. Boletim do Banco Central do Brasil.

The growth-cum-debt process of the seventies was criticized all over the world, once the International recession aborted the growth in International trade. Falling commodity prices and contraction in the imports at industrialized countries that resulted from the same monetarist policies, turned that fragility into a virtual disruption of the International credit market. Between 1975 and 1981, total LA exports had increased by an annual average of 15%. in 1982 they went down by 10%. There was no way to reconcile increased debt with decreasing exports. If growth with increasing external indebtedness had looked dangerous in the end of seventies, it became out rightly impossible in the face of the International recession of the early eighties.

At this point, of course, voluntary lending carne to a sudden halt, since as everyone now seems to understand, either the private system is able to provide *all* the credit that is needed to promote smooth roll-over of debt on a voluntary basis or it tends to provide *no new money at all* and the system collapses with generalized defaults. The rules of the game of International finance had to be changed if the International financial links of the Western world were to be maintained.

One should not have to be reminded that at least until 1980 the role of private banks in recycling International reserves and channelling balance of payments surpluses to deficit countries had been hailed by many analysts as a healthy display of vigour of the private International financial system. This was abundantly used as an argument against International monetary reform[2].

Nowadays, when the explosive nature of International indebtedness is again a favourite argument to support the need for generalized austerity, there does seem to be an inconsistency in the view that refers to over-borrowing in the past at the same time that fails to recognize the over lending on the part of commercial banks. On that issue, Simonsen (1984a) has made a useful contribution to our understanding that competitive credit markets are not efficient providers of balance of payments finance.

The fact of the matter is that until the interest shock and the fall in export revenues there seemed to be nothing explosive about the developing countries indebtedness. As long as exports grew consistently above interest rates and import requirements could be maintained under relative control by economic policies directed towards import substitution, the high level of absorption of foreign capital could be economically justified and thus proceed. Foreign private banks did what the governments of industrialized countries did not allow International agencies to do: provide finance for deficit countries, who were the traditional absorbers of foreign capital. Some factors, however, contributed to increase the fragility of their external position.

One dominating characteristic of the growth of foreign debt in the second half of the seventies was its concentrated nature on the borrowing side, when contrasted with the lending side. In December 1982, the ten largest debtors accounted for 50% of total debt. Half of these were Latin American countries, namely, Brazil, Mexico, Argentina, Venezuela and Chile. About 80% of the total debt was the responsibility of 25 countries, seven of which are Latin American. On the lending side, it is enough to observe that when Mexico opened the way to debt rescheduling in August 1982, invitations to participate in the negotiations were sent to not less than 800 banks[3].

If we look inside Latin America alone, we find that in 1980 the five largest borrowers represented 80% of the total regional debt. In spite of the efforts that have been made in 1982/83 to

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[2] Cf. Cline (1983, p. 94) and Diaz-Alejandro (1983).
[3] Kraft (1984).

control current account deficits, compound interest plus sluggish International trade and unfavourable export prices account for an increase in the total debt of these countries of 69% above its 1980 level. In December 1983 the five large debtors were responsible for 92% of the debt of the region. The figures in *Table 1* show the evolution of Latin American debt in the eighties, in comparison with the global figures as well as the debt of the five largest Latin American debtors as compared with the aggregate of the twenty-five largest borrowers in the world.

An additional aspect of the fragility has to do with the absence of a lender of last resort to back the provision of total credit needs set by feasible adjustment of the debtors' balance of payments with minimum depressing effects over world trade. From a technical viewpoint, these issues had been abundantly debated long before the debt crises came to the fore[4]. The available proposals found no response from the governments of the lending countries. Widespread hopes that the proposed increase in IMF quotas would be approved by the U.S. government led only to higher anxiety and generalized frustration after the Toronto meeting. Reliance on private banks, albeit backed by Central banks and the IMF has been the hallmark of the so-called muddling-through strategy of debt restructuring since then.

The costs of adjustment have been high enough thus far. *Table 3* exhibits the record for Latin America, in terms of per capita income performance. For the aggregate of the region, the cumulative growth rate of per capita GDP between 1980 and 1983 is -9.5%. This means essentially that if we ignore intra-regional differences, we entered 1984 with smaller potential welfare than seven years ago. If we consider the seven major L.A. debtors, up until 1983 only Colombia and Mexico managed to obtain a net gain in real per capita GDP in the past seven years. The per capita growth-cum-debt in the three years before 1980 has literally been wiped out by the adjustment-cum-recession of the three years following 1980. Among the countries with the heaviest losses in per capita GDP are those with the lowest per capita income in 1980, showing the dramatic social and political issues involved.

[4] Williamson (1978), for example.

Table 3

Latin America: Per Capita Growth of GDP (1977-80 and 1980-83)

| | Cumulative Growth Rates in Per Capita GDP | | Per Capita GDP in |
|---|---|---|---|
| | 1977/80 | 1980/83 | 1980 |
| 1. Latin America | +9.0 | -9.5 | 1.556 |
| 2. Major L. A. Borrowers | | | |
| Argentina | +0.2 | -13.3 | 1.942 |
| Brazil | +12.0 | -11.9 | 1.652 |
| Chile | +19.1 | -14.3 | 1.628 |
| Colombia | +12.0 | -2.7 | 922 |
| Mexico | +15.7 | -4.8 | 1.863 |
| Peru | +1.0 | -15.2 | 1.100 |
| Venezuela | - 5.4 | -10.5 | 2.649 |
| 3. Countries with Highest Losses | | | |
| Bolivia | - 2.2 | -22.2 | 568 |
| Costa Rica | +4.0 | -20.1 | 1.538 |
| El Salvador | -14.0 | -22.4 | 694 |

Sources of Basic Data:

1. Economic and Social Progress in Latin America, IBD, 1982 and 1983.
2. For 1983, preliminary estimates for sane countries are included.

*Table 4* illustrates the nature of the adjustment that was possible under the auspices of the IMF and the private bankers. For the region as a whole, the usual combination of IMF sponsored recessive policies and exchange devaluation with IMF tolerated direct import Controls led to a decline in import coefficients from 17.4% of GDP in 1980 to less than 9% in 1983. In spite of the fall in GDP and the export promotion measures aided by massive devaluations the export coefficient (merchandise exports divided by GDP) decreased *from 17.4% in 1980 to less than 14% in 1983*, reflecting the difficulties found in adjusting the external accounts in a worldwide recessive environment. Despite the world recession, a substantial improvement in resource balances was made possible by the conversion of a US$1.3 billion trade balance deficit in 1980 to an impressive US$30 billion trade surplus in 1983. According to IDB data total domestic absorption of LA countries decreased from 4.4% above GDP to 0.7% below GDP between 1980 and 1983 as a result of losses of 2.3% in aggregate consumption and of 25% in investment expenditures in real terms. Since 1981, real consumption in Latin America has decreased by 4.5% and real investment by 26.6%. In 1983, around US$30 billion (4.7% of GDP) were transferred abroad and in spite of the large interest payments of about 45% of merchandise exports, corresponding to 6% of GDP, the current account deficit was reduced to a little more than 1% of GDP.

The substantial social costs involved in the adjustment process will require more detailed research to be properly accounted for. Massive relative price changes induced or not by exchange rate devaluations in order to switch domestic expenditures away from traded goods contributed to generalized acceleration of inflation rates. Cuts in domestic absorption coupled with structural rigidities in the production side led to an increase in open unemployment as well as a deterioration in the quality of employment well beyond what is evidenced by the precarious available statistical data.

Table 4

Latin America: Import and Export Coefficients (1975; 1980-83)

| Ano | Imports/GDP | | | | | Exports/GDP | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1975 | 1980 | 1981 | 1982 | 1983 | 1975 | 1980 | 1981 | 1982 | 1983 |
| 1. Latin America | | | | | | | | | | |
| | 14.2 | 17.4 | 16.9 | 13.0 | 8.9 | 12.2 | 17.4 | 16.5 | 14.2 | 13.9 |
| 2. Major Borrowers | | | | | | | | | | |
| Argentina | 8.3 | 17.6 | 15.2 | 8.8 | 8.0 | 7.0 | 15.0 | 16.6 | 13.7 | 13.5 |
| Brazil | 11.7 | 11.7 | 11.1 | 8.7 | 7.5 | 13.6 | 26.4 | 19.1 | 20.1 | 19.3 |
| Chile | 13.0 | 30.7 | 31.7 | 19.0 | 13.0 | 5.3 | 11.5 | 12.6 | 12.8 | 12.9 |
| Mexico | 11.6 | 14.4 | 15.5 | 8.8 | 5.0 | 5.3 | 11.5 | 12.6 | 12.8 | 12.9 |
| Venezuela | 25.1 | 29.4 | 29.9 | 30.4 | 17.5 | 40.8 | 51.6 | 49.2 | 37.8 | 34.8 |

Sources: See Table 2.

## 3. Determinants of future growth prospects

Ever since the collapse of voluntary lending in 1982, the debtor countries' current accounts have substantially improved, in contrast with dismal performance both of activity levels and inflation rates. The challenge now faced by policy-makers and the IMF-supervised International private lenders is to keep the agents involved in the muddling-through strategy, convinced that they are engaged in a fair game with rewarding pay-offs. This challenge requires that current accounts deficits be kept under control – so that bankers may gradually return to voluntary lending – *and* that reasonable growth rates are anticipated for the borrowers – so that governments are able to keep a minimum of internal support to adjustment policies.

The most striking feature of the present situation, however, is that conditions to ensure a stable solution to this new game lie by and large outside the control of the partners involved in the game – debtor countries' governments, private bankers and the IMF. No matter how costly or successful the adjustment so far obtained, the size and the nature of accumulated foreign debt – most of it contracted at floating interest rates – define what seem to be extremely narrow bands for feasible growth paths that are consistent with a sustainable external position.

First, any feasible growth path for most countries in Latin America presupposes at least the continuation of rolling-over principal payments that are becoming due in the next three years. The painful experience of the past two years cannot be worsened; otherwise, strong incentives to major defaults will arise everywhere, fuelled by increasing opposition to good behaviour in the presence of rising unemployment, losses in real wages, untamed inflationary processes and widespread aggravation of social tensions. Rescheduling of maturities seems to be at this time the least controversial point when future growth prospects are discussed, since current account surpluses required to comply with the existing schedule are out of question.

The paramount importance of the debt problem for the stability of International trade and financial relations has been widely recognized and is evidenced by the number of pages dedicated to the subject in every report published by International agencies in the past two years. A common feature of the simulation exercises presented by International agencies, national governments and academic researchers, on both sides of the debt, are the assumptions of resumed growth by OECD countries, lower real dollar interest rates and no further deterioration of terms of trade. The strong recovery of the US economy in 1983 and the first three quarters of 1984 was helpful in at least two ways: it provided badly needed confidence in the reversal of stagnation trends for world trade and guaranteed an immediate (and unexpected) recovery of export revenues for most LA large debtors in the current year. The violent upsurge that occurred in US manufactures imports from the region, was more than sufficient to compensate for the sluggish pattern of imports from the remainder of OECD countries.

For these reasons, in spite of the refusal of dollar real rates to comply with the projected scenarios of generalized stabilization, balance of payments figures will show substantial improvement in the current year thanks to the behaviour of manufactures trade. Primary commodity prices and export quantum are unlikely to contribute to generalize the signs of improvement. For those countries less benefited by the recovery in manufactures exports, better conditions to raise new money will depend more on eventual positive externalities stemming from the large debtors improvement than on traditional stimuli from the developed countries import demand. On the other hand, the fact that some of the major debtors may have been led to depress their economies beyond the need to control debt indicators may leave some room for a mild recovery of intra-regional trade following the upturn in consumption and investment expenditures in some of the large debtors, especially Brazil and México. The relevance of this trickling down of resumed trade for smaller countries should not, however, be overemphasized due to know lack of structural complementarity, but for some specific cases the effect should not be neglected either.

For the rest of the decade and beyond, the available simulation exercises tend to show a somewhat optimistic outlook for growth prospects for debtor countries as a whole, inclusive for Latin America. According to IDB simulations for LA, maintenance of per capita consumption at present levels requires an average annual GDP growth of 2.7% in the period 1986-90, and a corresponding 3.2% average annual growth in real investment (IDB 1984a, pp. 52-53). The IMF (1984c) projects average annual real growth of non-oil developing countries GDP to be between 4.2% and 5.8% for the second half of the eighties under the assumption of normal rescheduling. World Bank (1984) projections for 1985-95 for developing countries lie between 4.7 and 5.5% per year.

Under the most optimistic scenarios, however, real per capita GDP attained in 1980 will not be recovered before the final years of the decade. The striking feature of the recovery scenarios is that all of them assume declining real dollar rates of interest (between 2.5 and 4%), non-deteriorating terms of trade, high growth rates for manufactures exports (between 7.5 and 9.7% per year) and OECD growth above that recorded in the late seventies. Under these assumptions, the debt problem becomes no longer a restriction to largest debtors. For the Brazilian economy, for example, these assumptions would be consistent with a rather vigorous recovery. Feeding these projections for world data into our econometric model for the Brazilian economy we obtained real growth rates averaging 7.8% between 1985 and 1991 (almost 1% above historical trend) with net debt/export ratios declining from the present levels of 3.5 to less than 1.5 in the beginning of the nineties, provided total import coefficient is kept under control via continued import-substitution policies[5].

The important point to be stressed concerning these growth projections is that the actual realization of these assumptions are highly dependent on economic processes, policies, and outcomes some of which not only lie outside the boundaries of our indebted countries but are surrounded by a thick cloud of uncertainties. These uncertainties are too important to be neglected in the setting of major issues to be considered when we take a look on the constraints for future L.A. growth and will be briefly reviewed in the next section.

## 4. A brief look into basic uncertainties

In the second half of 1982 International financial markets were led to the verge of sheer panic. Unbearable signs of uncertainty sprang everywhere as to future behaviour of debtor countries. The worst consequences for the lenders' positions were avoided by an unprecedented display of cooperative behaviour on the credit supply side under the coordination of the IMF with the support of industrialized countries' central bankers. Since then, fears of generalized default that might result from a concerted behaviour by major debtors helped provide the appropriate incentives to concerted behaviour on the part of lenders.

One important reason why debt cartel proposals found no support, besides possible internal

[5] Carneiro and Modiano (1984).

political difficulties for some of the governments involved, was essentially economic. The large debtors had let their external reserves run down beyond the point where the eventual suspension of commercial credit might lead to more severe restrictions on domestic absorption than those implied by IMF conditionality[6]. Since illiquid debtors tend to be well behaved, the muddling-through adjustment seems to be of strategic value to prevent concerted default. In practice, this strategy implies at least a convenient sharing of uncertainties between borrowers and lenders.

At this point, some speeds of adjustment become crucial for at least a moderately happy end. The first one, of course, was the response of trade surpluses to the control of domestic absorption. With the help of US import outburst, this has been achieved satisfactorily from the viewpoint of debt indicators in 1984. Since it became clear that world imports would have to resume in order to sustain the needed export revenues of the borrowers, one important uncertainty that remains is that concerned with the nature of present recovery. A deeper look into this issue would require probing into the structure of US-LA trade. The interested reader will profit Consulting by the review of major aspects in Fritsch (1983).

A second crucial speed comes to the scene. Will the rest of the OECD countries be able to compensate for an unavoidable slowdown of US import growth and thus prevent a new slump in export revenues? The timing of the events is crucial, since the hopes of return of voluntary lending depend on the continuity of performance.

This problem leads to a third crucial speed: the dollar rate of interest has to come down to help the improvement of debt indicators if there is even a mild slowdown in export revenues. Then, how can this be consistent with the present size both of the US fiscal deficit and the US current account deficit? In a world of floating exchange rates, expectations play a dominant role and we know very little about the possible outcomes.

If the International capital market is slow in resuming its role in financing, will it be possible to redefine the role of International institutions in time to prevent a new stalemate in the debt rescheduling process?

In the meantime, what will happen to the dollar *vis-à-vis* other OECD currencies? Everybody seems to believe that it will eventually devaluate, but *when* and *how fast*? While hoping for "soft-landing" everyone seems to fear the behaviour of European central bankers when inflationary pressures start to creep with an eventual sudden decline of the dollar. One should not neglect the risk of a monetarist interpretation of the inflationary consequences of the dollar devaluation for the US economy.

These are some of the facts about which there is a considerable amount of uncertainty

[6] On this issue, see Simonsen (1984a).

nowadays. Some of them depend solely on policy reactions. Market expectations, however, especially exchange markets expectations that tend to be so volatile, are bound to play a dominant role. A great deal of uncertainty also predominates when we try and evaluate to what extent central bankers and conservative governments will wish to take the necessary steps to prevent another interest shock and trade slow-down.

If we look back into the issues belonging to domestic policies in the debtor countries, matters don't seem less uncertain. The outcome of IMF-sponsored policies was, as usual, more favourable in the external accounts adjustment than in internal adjustment. Generalized indexation mechanisms that spread all over inflation-prone economies turned them more inflation-prone and decreased the responsiveness of inflation to demand control. Since the IMF model has no place for structural inflation, continuous control of nominal demand to deal with inflation may lead to a useless prolonged depression that helps feeding internal dissent besides impairing much needed structural adjustment. Exchange devaluations and other important corrections in relative prices tend to aggravate inflation that on its turn attract claims of further austerity. Similarly, induced stagflationary effects over fiscal budgets tend to be misread in the design of macroeconomic policies conceived under the general pressure for austerity, especially in the presence of indexed public debt.

Increasing tensions generated by ill-conceived domestic policies usually have the effect of bringing to the forefront claims for radical changes in domestic policies and tend to increase uncertainty.

These issues of domestic policy, although apparently under the control of national governments cannot be minimized when we try to assess the effective prospects for growth in Latin America. The composition of both sources of uncertainties, external and internal, should be seen as important qualifications that have to be considered in the design of feasible policy strategies for Latin American economies for the remainder of the decade.

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